

Staff Paper

Project:	Insurance Activities in the Public Sector	Meeting:	AASB December 2022 (M192) NZASB December 2022 (M105)
Topic:	Consider feedback on Fatal-Flaw Review Draft Standard	Agenda item:	AASB 4.4 NZASB 8.2
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		Project priority	Medium
		Decision-making	High
		Project status	Draft Standard

Objective of this paper

- For the purposes of finalising the proposed public-sector-specific modifications to AASB 17/PBE IFRS 17 *Insurance Contracts*, the objective of this paper is for the AASB and the NZASB to:
 - CONSIDER comments received on the [Fatal-Flaw Review \(FFR\) draft version](#) of proposed amending Standard AASB 2022-Y *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector*;¹ and
 - DECIDE on the actions to take in addressing stakeholder comments.
- Please note that staff recommended changes to the FFR draft for the final Amending Standard, including editorial changes, are marked-up in AASB Agenda Paper 4.5/NZASB Agenda Paper 8.5 for the Boards' consideration.

Responses to Fatal-Flaw Review Draft Standard

- In October 2022 the AASB issued for comment a [Fatal-Flaw Review \(FFR\) draft version](#) of proposed amending Standard AASB 2022-Y *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector*. The consultation period closed on 11 November 2022.
- [Appendix B](#) shows a summary of public sector modifications in the [Fatal-Flaw Review Draft Standard](#) compared with the proposals in AASB ED 319/NZASB ED 2022-3.

¹ The NZASB did not publish a draft Standard for public comment but has consulted with New Zealand stakeholders using the content of AASB 2022-Y.

5. The AASB received the following three formal submissions on the FFR draft:

Respondent	
HoTARAC	The Heads of Treasuries Accounting and Reporting Advisory Committee
icare	icare NSW
ACAG	The Australasian Council of Auditors-General

The formal comment letters to the FFR draft are Attached as AASB Agenda Paper 4.7/NZASB Agenda Paper 8.5.

6. The FFR draft wasn't publicly exposed by the NZASB but it was shared and discussed with the key stakeholders in New Zealand. The issues raised in the New Zealand constituents' discussions were generally consistent with the formal comment letters. The only exception is a comment related to the diagram which is included in the table below.
7. The table below outlines the comments received and the actions recommended by staff.²

Topic	Comment	Staff comment/recommendation
Scope: enforceability	<p>icare: The key principles that should be included in paragraphs E11-E13³ to demonstrate there is no enforceable arrangement (therefore no insurance contract) are the ability to unilaterally:</p> <p>a) <u>change pricing</u> – a public sector arrangement that can unilaterally set the levies it charges is indicative of a social benefit. Where the public sector entity calculates the “pricing” of levies based on cumulative funding requirements as opposed to pricing based on the prospective cover and “risk” being provided demonstrates that there is no insurance risk transferred;</p> <p>b) <u>change eligibility</u>; and</p> <p>c) <u>change benefits</u> - for historical and future events.</p>	<p>Paragraph E12 notes the practical ability under existing or substantively enacted legislation to retrospectively deny or substantively change promised benefits or compensation means the public sector entity does not have enforceable obligations for promised amounts or for amounts based on agreed parameters.</p> <p>Staff consider that the current text adequately addresses point b) and c).</p> <p>Change of pricing for future exposures is not currently identified as a factor relating to enforceability. All or most of the relevant public sector arrangements are monopolies and, in theory, have complete freedom over pricing. In practice, pricing tends to be at break-even levels. Similarly, private sector insurers could, in theory, choose to price at higher or lower than commercial rates, but in practice market forces prevail.</p> <p>Staff do not consider pricing to be a factor impacting on enforceability.</p> <p>Staff recommend no further action.</p>

² Except for some editorial corrections, HoTARAC haven't raised any additional comments to the FFR draft.

³ The references relate to sections in the FFR draft, when using the ballot draft (AASB Agenda Paper 4.5/NZASB Agenda Paper 8.5) “E11 – E13” should be read as “E10 – E12” and so on.



Topic	Comment	Staff comment/recommendation
Scope: identifiable coverage period	<p>icare: identifiable coverage period outlined in paragraphs E14 to E19 results in unintended outcomes. A levy charged via a private insurance contract does not establish a coverage period; it is merely a funding mechanism used for expedience. There is no nexus between the policy issued privately and the levy charged by the public sector. Similarly, the connection to the financial year is an arbitrary period for the schemes and does not establish a coverage period.</p> <p>Should expand the indicators (indicative of an arrangement without an identifiable coverage period) listed in paragraph E18 to include where entry into a scheme is based on eligibility criteria. Schemes such as the Lifetime Care Scheme provide benefits based on criteria rather than the receipt of a levy. This principle is established for Medicare, as the Medicare levy does not create a coverage period for the year it was charged through the taxation system nor is it a requirement for benefits.</p>	<p>Paragraph E16 notes a public sector entity may be able to determine coverage periods for its arrangements based on the coverage periods identified when it sets premiums and benefits. For example, an arrangement may have a coverage period aligned with its financial year on the basis that it sets premiums and benefits with the objective of raising funds from the private sector arrangements in place in that year that are estimated to be sufficient to meet all the benefits, including future benefits, expected to arise from events that occur in that year.</p> <p>This is in contrast with a pay-as-you-go arrangement mentioned in paragraph E18 under which the entity raises only sufficient cash to meet the cash outflows of the period, no matter when the events giving rise to claims have occurred.</p> <p>Staff consider that paragraph E16 is consistent with the principles for identifying coverage periods, which is associating premiums/levies with meeting claims that might arise from events that occur in a particular period.</p> <p>Staff recommend clarifying the meaning of ‘pay-as-you-go’ arrangements in paragraph E18(c) on the basis that this should help readers distinguish pay-as-you-go arrangements from those arrangements with coverage periods. Staff also note that another constituent informally requested this clarification.</p>
Scope: source and extent of funding	<p>ACAG: Some public sector arrangements are funded by levies on insurance contracts, where there is not a direct link between the premium paid and the beneficiary. For example:</p> <ul style="list-style-type: none"> • A person is covered under NIISQ⁴ even if the driver is unlicensed, or the car is not registered. Persons paying the levy may benefit from the scheme (because the damaged parties cannot seek additional compensation from them by other means), however there 	<p>Staff note the draft Standard is clear that judgement will need to be exercised when applying the indicators.</p> <p>Staff consider that when an arrangement involves those who stand to benefit making no funding contribution, this is indicative of an arrangement that does not fall within the scope of AASB 17/PBE IFRS 17, but that the other indicator and other considerations might still mean the arrangement is within scope (assuming the pre-requisites have been met).</p>

4 National Injury Insurance Scheme Queensland



Topic	Comment	Staff comment/recommendation
	<p>will also be persons benefiting from the scheme that have not paid the levy.</p> <ul style="list-style-type: none"> Nominal Defendant schemes can compensate people who are injured as a result of the negligent driving of unidentified and/or uninsured motor vehicles. Therefore, the damaged party has not paid the levy, and the person driving (who is uninsured) has not paid the levy. <p>ACAG supports the guidance on this issue in paragraph E22. However, determining the point at which this link becomes too remote or is too indirect for the arrangement to fall within the scope of AASB 17 will require significant judgment. ACAG has concerns that, even with additional guidance, there may be inconsistencies in accounting for these types of arrangements. ACAG, therefore, strongly supports the development of illustrative examples that demonstrate how these arrangements would be assessed against the scope indicators in AASB 17, including identifying key factors that influence this assessment.</p>	<p>The draft Standard currently contains generic narrative-style examples in explaining each of the pre-requisites, indicators and other considerations. Staff are reluctant to provide definitive ‘whole-of-arrangement’ examples because it is difficult to cater for all types of circumstances and identify the manner in which judgement should be exercised by a particular stakeholder in those circumstances.</p> <p>Staff consider that the Boards should avoid a situation where the examples become the de-facto basis for identifying whether an arrangement is within the scope of AASB 17/PBE IFRS 17.</p> <p>Staff recommend no further action.</p>
<p style="writing-mode: vertical-rl; transform: rotate(180deg);">Scope: source and extent of funding</p>	<p>ACAG: On the assumption that arrangements where the policyholder is not required (directly or indirectly) to pay a premium or levy could be in-scope, ACAG requests that the AASB provide guidance on the revenue recognition by the insurer of the levy (a levy is assumed given the lack of direct benefit).</p> <p>The above situation also raises the issue of whether the premium allocation approach can be used if there is no premium / levy enforceable under the insurance contract (refer to paragraphs BC59 and BC196 of the Fatal Flaw Draft).</p>	<p>Staff note that paragraph [Aus]B121.1 (previously paragraph E19) provides guidance – revenue recognition is based on the coverage period, which must have been identified since it is a pre-requisite for applying AASB 17/PBE IFRS 17.</p> <p>Staff consider that, where no funding is sourced from the parties that benefit from an arrangement, but the arrangement still falls within scope (based on the other indicator and other considerations), any revenue (however sourced) would be used as the basis for recognising and measuring liabilities for remaining coverage under the premium allocation approach. For example, cash inflows may be sourced from consolidated revenue, and that funding would be used for as the basis for recognising and measuring liabilities for remaining coverage.</p>



Topic	Comment	Staff comment/recommendation
		Staff recommend clarifying the above – refer to [draft] paragraph [Aus]B121.1(c).
Scope: similarity of risks and benefits provided	<p>icare: Similarity of risks and benefits is too broad. Where the market is only serviced by public sector arrangements, such as catastrophic injuries, then extending to generic personal injury cover is not appropriate. It is clear these schemes are for social benefit as the risk is uninsurable. This aligns with social benefits such as Medicare.</p>	<p>Paragraph E30 notes public sector entities often fill gaps in a market left by the private sector because they pose the greatest risks and might be generally unprofitable or unsustainable for the private sector to cover. Staff note that the Boards considered this issue at their August 2022 meetings and concluded that similarity between the risks and the benefits themselves is the focus, not the level of riskiness. While some ‘last resort’ risks or ‘protection gaps’ might be peculiar to the public sector in terms of their level of riskiness, this should not preclude them from being in the scope of AASB 17/PBE IFRS 17.</p> <p>Staff note that, under AASB 17/PBE IFRS 17, insurance contracts are identified on the basis that they involve the transfer insurance risks – there is no limit on the level of insurance risk that might be transferred in an insurance contract or the level of riskiness.</p> <p>Staff consider the current position of the Boards to be consistent in principle with AASB 17/PBE IFRS 17.</p> <p>Staff recommend no further action.</p>
Scope: Diagram	<p>Informal feedback from both Australian and New Zealand stakeholders: The Diagram seems to involve a logical inconsistency. An assessment of the indicators and other considerations is a matter of judgement and could lead to an entity concluding it is either within, or outside, the scope of the Standard. However, the final arrow is definitive – that the arrangement is within the scope of the Standard.</p>	<p>Staff recommend changing the questions in each step of the diagram to remove the inconsistency.</p> <p>The ballot draft Standard shows the revised Diagram, which changes the nature of the questions in each step, as follows:</p> <p>Step 1: Is it judged that both pre-requisites are established?</p> <p>Step 2: Do the two indicators considered on a collective basis lead to a judgement that the arrangement gives rise to insurance contracts?</p> <p>Step 3: If Step 2 is not definitive, does a collective assessment of the two other considerations lead to a judgement that the</p>



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		<p>arrangement gives rise to insurance contracts?</p> <p>Accordingly, the diagram now aligns with the narrative implementation guidance in Appendix E and is consistent with the final arrow pointing to a definitive conclusion.</p>
Coverage period	<p>ACAG: Public sector arrangements that relate to issuing building construction warranty insurance often will include a multi-year (e.g., 6-year) warranty period, but the related construction activity will be over a significantly shorter period of time.</p> <p>Additional guidance on how the coverage period is determined for these arrangements would be helpful.</p> <p>For example, does the coverage period extend to the end of the warranty period (the insured event being the identification of the fault) or is it the period of construction (the insured event being the faulty construction of the project which is likely to be less than 12 months)?</p>	<p>Staff note that in some Australian states, private sector insurers issue building construction warranty insurance contracts and reinsure those 100% with a public sector entity and, in other states, the public sector entity issues the contracts directly.</p> <p>Accordingly, the types of contracts for which judgement might need to be exercised about identifying the relevant risks covered is not unique to the public sector.</p> <p>Current practice in the industry is to recognise premium revenue over both the construction period and the subsequent warranty period (e.g., 6 years).</p> <p>While not committing to a view under AASB 17, staff understand that the industry is gravitating to the view that the same coverage period applies in an AASB 17 context. That is, coverage is for both faulty construction and the emergence of claims due to faults.</p> <p>Staff recommend no further action.</p>
Revenue guidance	<p>ACAG: Suggest including in paragraph BC74 an example to help explain revenue recognition over the coverage period.</p>	<p>As staff note above, paragraph [Aus]B121.1 (previously paragraph E19) provides guidance on revenue recognition over the coverage period.</p> <p>Staff recommend also editing paragraph BC74 to include example dates.</p>
Risk adjustment	<p>ACAG: Content from agenda paper 4.3/8.3 from the August 2022 meetings provides useful explanatory material and should form part of the Basis for Conclusions.</p> <p>ACAG notes some material in agenda paper 4.3/8.3 is included in the Basis for Conclusions but some useful explanatory material from the paper has been omitted [paragraphs 22(e), 23(b) and 24 of agenda paper 4.3/8.3].</p>	<p>Appendix A shows relevant extracts from the agenda paper 4.3/8.3.</p> <p>Agenda paper 4.3/8.3, paragraph 22(e) effectively repeats the content of AASB 17.B87/PBE IFRS 17.AG87, that entities which are not indifferent between: (i) fulfilling the claims liability that has a range of possible outcomes arising from non-financial risk; and (ii) fulfilling a liability that would generate fixed cash flows with the same expected present value; would be</p>



Topic	Comment	Staff comment/recommendation
	<p>These paragraphs are particularly relevant as they explain:</p> <ul style="list-style-type: none"> • in simple terms whether a public sector entity is likely to have a zero-risk adjustment or will seek to be compensated for bearing risk • the likely practical outcomes of the explanatory material on risk adjustments for public sector agencies in measuring their liabilities for remaining coverage and liabilities for incurred claims. 	<p>expected to have risk adjustments above zero.</p> <p>Staff recommend no further action in respect of Agenda paper 4.3/8.3, paragraph 22(e).</p> <p>Paragraph BC147(c) reflects the content in Agenda paper 4.3/8.3, paragraph 23(b), which says: an entity might have a zero risk adjustment for the liability for remaining coverage, but have a risk adjustment above zero for the liability for incurred claims.</p> <p>Staff recommend no further action in respect of Agenda paper 4.3/8.3, paragraph 23(b).</p> <p>At their August meetings, in Agenda paper 4.3/8.3, paragraph 24, staff were identifying for the information of the Boards the “likely practical outcomes” of the other suggested guidance, rather than suggesting the text be included in the final Standard’s Basis for Conclusions.</p> <p>The Boards were not specifically asked whether they wished to include the information about those “likely practical outcomes” in the Standard and, based on the meeting discussion, the Boards considered that this information went beyond the type of ‘guidance’ that would ordinarily be included in a Standard.</p> <p>Staff recommend no further action in respect of Agenda paper 4.3/8.3, paragraph 24.</p>
Risk adjustment	<p>ACAG: In the discussion on industry benchmarks (paragraph BC111), private sector benchmarking higher than 75% is relevant. For example, the staff papers presented at Board meetings refer to the private sector using risk margins of between 80% to 95% confidence level (probability of adequacy) (paragraph 1.3 of Agenda paper 10.3/5.3, April 2021) and between 80% and 90% (paragraph 10 of Agenda Paper 5.3, November 2021). These private sector entities include not-for-profit insurers.</p>	<p>Staff note that this comment raises the issue of consolidation of a subsidiary insurance entity into a non-insurance parent entity’s (whole of government’s) consolidated financial statements.</p> <p>Staff understand current practice in both the private and public sectors is to consolidate amounts determined under the Insurance Standard by the insurance subsidiary and make only the necessary consolidation adjustments to remove any inter-entity transactions and balances. The risk adjustment would not typically be changed</p>



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	ACAG suggests the Boards also consider making reference to contrasting risk adjustments for an individual insurance entity, and whole-of-government, as a whole-of-government may be less risk averse than the individual insurance entity.	on consolidation from being based on the subsidiary's level of aversion to being based on the consolidated entity's level of aversion to risk. This would only be expected to happen when the consolidated entity includes more than one insurance subsidiary and there is diversification of risk across the insurance activities of those two subsidiaries. Staff recommend no further action.

Question for Board members

Q1: Do Board members agree with the actions suggested in the table in paragraph 7.

If not, what alternative actions do you suggest and why?



Appendix A: extracts from Agenda paper 4.3/7.3 August 2022 AASB/NZASB meeting

Agenda paper 4.3, paragraph 22(e) suggests providing additional guidance along the following lines:

- (e) Entities that are not indifferent between:
 - (i) fulfilling the claims liability that has a range of possible outcomes arising from non-financial risk; and
 - (ii) fulfilling a liability that would generate fixed cash flows with the same expected present value;would be expected to have risk adjustments above zero [measure its liabilities for incurred claims using a confidence level above 50%].

Agenda paper 4.3, paragraph 23(b) suggests including in the Basis for Conclusions (amended to provide context):

- (b) In the public sector, due to an entity holding a monopoly position and/or implicit or explicit government guarantees, the broad connection (present in the private sector) between the compensation charged for bearing risk included in setting premiums and the extent to which the insurer is indifferent between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87⁵ may not exist.

Accordingly, a public sector entity might use a confidence level of 50% in pricing levies/premiums, which are the basis for measuring its liabilities for remaining coverage (including under the premium allocation approach) while measuring its liabilities for incurred claims applying a confidence level above 50% (and have a risk adjustment above zero).

Agenda paper 4.3, paragraph 24 says:

- 24 Based on the information stakeholders have provided about how public sector arrangements are currently being managed, staff acknowledge that the likely practical outcome of the above explanatory material would be that:

- (a) in measuring their liabilities for remaining coverage:
 - (i) most [possible all] public sector entities would be expected to have zero risk adjustments because risk is not priced into their levies/premiums, which is consistent with current practice;
 - (ii) in the event that risk is priced into a public sector entity's levies/premiums, it would have a risk adjustment above zero;
- (b) in measuring their liabilities for incurred claims:
 - (i) some public sector entities would have zero risk adjustments on the basis that their managements are indifferent between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87;
 - (ii) some public sector entities would have positive risk adjustments on the basis that their managements are not indifferent between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87.

5 AASB 17.B87/PBE IFRS 17.AG87 explains:

The risk adjustment for non-financial risk for insurance contracts measures the compensation that the entity would require to make the entity indifferent between:

- (a) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and
- (b) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts.



Appendix B: Summary of public sector modifications in the Fatal-Flaw Review Draft Standard *Insurance Contracts in the Public Sector* compared with the proposals in AASB ED 319/NZASB ED 2022-3

AASB ED 319/NZASB ED 2022-3 was issued in March 2022 for comment by June 2022. The AASB and NZASB re-deliberated their ED proposals and consulted on a Fatal Flaw Review [Draft] Amending Standard on 26 October 2022 for comment by 11 November 2022.

The table below outlines the AASB ED 319/NZASB ED 2022-3 proposals and the Boards' conclusions in the [Draft] Amending Standard.

Topic	AASB ED 319/NZASB ED 2022-3	FFR [Draft] Standard
Scope Aus6.1 Aus6.2 Appendix E BC152 to BC252	Proposed six indicators to be applied collectively to determine which public sector arrangements are within the scope of AASB 17/PBE IFRS 17: <ul style="list-style-type: none"> enforceability of arrangement identifiable coverage period source and extent of funding from participants similarity of risks covered and benefits provided to insurance to private sector insurance management practices and assessment of financial performance (such as underwriting and risk assessment, managing capital base, fair and prudent claims management) assets held to meet benefits 	<i>Proposed 'indicators' are now ranked as pre-requisites, indicators and other considerations.</i> Apply AASB 17/PBE IFRS 17 only if arrangements meet two pre-requisites: <ul style="list-style-type: none"> are enforceable; have identifiable coverage periods; and are judged to be insurance contracts considering the two indicators and two other considerations. Indicators: <ul style="list-style-type: none"> Source and extent of funding from participants Similarity of risks covered and benefits provided to insurance to private sector insurance Other considerations: <ul style="list-style-type: none"> management practices and assessment of financial performance assets held to meet benefits
Grouping Aus14.1 Aus16.1 Aus22.1 BC17 to BC48	Proposed that public sector entities be exempt from sub-grouping insurance contracts into onerous versus non-onerous groups and groups issued no more than a year apart.	<i>No substantive change to the proposals</i> Public sector entities to be exempt from sub-grouping insurance contracts into onerous versus non-onerous groups and groups issued no more than a year apart.
Initial recognition Aus25.1 BC49 to BC55	Proposed that public sector entities do not initially recognise insurance contracts based on when contracts become onerous.	<i>No substantive change to the proposals</i> Public sector entities not to initially recognise insurance contracts based on when contracts become onerous.
Guidance on coverage periods Aus34.1 to Aus34.3 AusB64.1 BC56 to BC88	Proposed guidance on determining coverage periods in light of the common features of public sector arrangements, including monopoly status, the impacts of public policy objectives, and the basis on which pricing and benefits are set, which may include government regulators and Ministers.	<i>No substantive change to the proposals; however, substantive additions to the proposed guidance in view of the status of "coverage period" as a pre-requisite for applying AASB 17/PBE IFRS 17 in a public sector context.</i>



Topic	AASB ED 319/NZASB ED 2022-3	FFR [Draft] Standard
Pricing and benefits disclosure Aus34.4 BC89 to BC95	Proposed that, when a public sector entity takes into account risks relating to periods after the reassessment date based on a policy of determining prices and benefits over a period longer than a single coverage period, it should be required to disclose information about the manner in which pricing/benefits are determined and the timeframes for which they are typically determined, potentially by cross reference to external information.	<i>Amended the proposal to simplify the disclosure and remove reference to external information</i> All public sector entities would disclose timeframes for which pricing and benefits are typically determined and the titles of the relevant regulations or laws under which prices and benefits are set.
Premium allocation approach Aus53.1 Aus69.1 BC96 to BC106	No proposals made in respect of applying the premium allocation approach.	<i>Substantive change to provide public sector entities with an accounting policy choice</i> Public sector entities can choose to measure liabilities for remaining coverage applying the premium allocation approach, regardless of whether the eligibility criteria are met.
Risk adjustment BC107 to BC151	AASB proposed no public sector modifications NZASB proposed a rebuttable presumption of a risk adjustment measured using a confidence level of 75%	<i>Both Boards concluded on making no public sector modifications in respect of risk adjustments</i>
Effective date AusC1.1 BC253 to BC258	Proposed that AASB 17/PBE IFRS 17 be effective for annual reporting periods beginning on or after 1 July 2025/1 January 2025.	<i>No change to the proposals⁶</i> Public sector entities would be required to apply AASB 17 to annual reporting periods beginning on or after 1 July 2025, and PBE IFRS 17 to annual reporting periods beginning on or after 1 January 2025.
Transition AusC9A.1 BC317 to BC320	No proposals made on the basis of transition to AASB 17/PBE IFRS 17.	<i>Substantive change for public sector entities to continue existing basis of accounting for adverse development covers that pre-date application of AASB 17/PBE IFRS 17</i> Public sector entities would apply AASB 17 if they currently apply AASB 1023 and would apply AASB 137 if they currently apply AASB 137.
Captive insurers AASB 1050.6A and 6B BC268 to BC274	No proposals made in respect of captive insurers.	AASB only: <i>substantive change to provide public sector entities with an accounting policy choice in respect of administered item disclosures</i> Government departments can choose to determine information disclosed about administered captive insurer activities using either AASB 17 or AASB 137.

6 The effective date will be further discussed at the Boards' December meeting.