Australian Government
Australian Accounting Standards Board

AASB Transition Resource Group for AASB 17 *Insurance Contracts*

PHI focus group – consideration of Australian Government Rebates

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Stakeholder group	Industry Group

Potential implementation question

The purpose of this paper is to discuss the treatment of the Australian Government Rebate (AGR) operating in the Australian Private Health Insurance Industry under AASB 17 Insurance Contracts.

Paragraph of IFRS 17 *Insurance Contracts*

AASB 17 – refer to Appendix A for various references.

Analysis of the question

The analysis of the question should include a detailed description of the different ways the new Standard may be applied, resulting in possible diversity in practice.

Refer to Appendix A for paper drafted and discussed by the PHI industry

Is the question pervasive?

Explain whether the question is expected to be relevant to a wide group of stakeholders.

The question is relevant for all PHI's and may also impact others in similarly regulated insurance industries in Australia.

Appendix A – Australian Government Rebate (AGR) considerations for Australian PHI

A1. Background

To encourage people to take out, and continue to hold, private health insurance in Australia, the Federal Government provides a rebate known as the Australian Government Rebate on Private Health Insurance (AGR) which reduces the premiums that policyholders pay.

The AGR reduces the amount payable by policyholders for resident hospital and extras policies by a percentage of their premium, with the rebate determined by the insured's age and income (policyholders who earn an income of $140,000 or less as a single, or $280,000 or less as a family are eligible for the rebate in 2021). Policyholders can elect to receive the rebate as a future refundable tax offset or as a reduction in the premium paid (which most policyholders elect). Where the rebate is received as a reduction in the premium paid, the policyholder pays the premium net of the rebate and the Federal Government pays the rebate directly to the insurer. The insurer can only claim the rebate from the government once the policyholder has paid their share (therefore there is a lag between policyholder payment and the receipt of the rebate).

The AGR percentages are set annually by the Government on 1 April, and the rebate is not claimable on the Lifetime Health Cover (LHC) loading component of a premium.

A2. Accounting Analysis

Current Accounting

If a policyholder elects to claim the AGR as a reduction in the amount of premium that they pay, then PHI's currently apply the following accounting treatment:

- Recognise AGR within premium revenue; and
- Recognise a receivable for the AGR due from the government (but not received) in the month in which the premium is received from the policyholder.

AASB 17 Accounting

The following areas are considered to determine the appropriate accounting treatment of the AGR under AASB 17:

P&L treatment:

> AASB 17 para32-34 requires an entity to include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group. AASB 17.B65 goes on to state that cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including cash flows for which the entity has discretion over the amount or timing, and include:
>
> (a) premiums (including premium adjustments and instalment premiums) from a policyholder and **any additional cash flows that result from those premiums**
>
> AASB 17.B126 states that when an entity applies the premium allocation approach, **insurance revenue** for the period is the **amount of expected premium receipts allocated to the period**.

Under AASB 17.B65a, cashflows within the boundary of an insurance contract include premiums from a policyholder and any additional cash flows that result from those premiums. Fulfilment cash flows within the scope of AASB 17 are not restricted to cash flows from policyholders. As the AGR arises from an insurer's obligations to provide health insurance cover and the insurer is entitled to the total premium, regardless of what share of the premium is paid by the policyholder or the government, it remains part of premium revenue under AASB 17.

> ***Summary of discussions***:
> The PHI focus group noted that as premium revenue for PAA is recognised based on expected premium receipts, the AGR will continue to be recognised within premium revenue.

Balance Sheet recognition

AASB 17.55(a) requires the Liability for Remaining Coverage (LFRC) under the PAA approach to initially include the premiums, if any, received at initial recognition. AASB 17.55(b) requires that this is then **subsequently adjusted** for any **premiums received** in the period, and any amounts recognised as insurance revenue for the period based on the expected premiums receipts (AASB 17.B126).

AASB 17 Appendix A defines the **liability for remaining coverage** as an entity's obligation to

(a) investigate and pay valid claims under existing insurance contracts for insured events that have not yet occurred (ie the obligation that relates to the unexpired portion of the insurance coverage); and
(b) pay amounts under existing insurance contracts that are not included in (a) and that relate to:
    i. **insurance contract services not yet provided** (ie the obligations that relate to future provision of insurance contract services); or
    ii. any investment components or other amounts that are not related to the provision of insurance contract services and that have not been transferred to the liability for incurred claims.

AASB 17 Appendix A defines the **liability for incurred claims** as to

(c) investigate and pay valid claims for insured events that have already occurred, including events that have occurred but for which claims have not been reported, and other incurred insurance expenses; and
(d) pay amounts that are not included in (a) and that relate to:
    i. **insurance contract services that have already been provided**; or
    ii. any investment components or other amounts that are not related to the provision of insurance contract services and that are not in the liability for remaining coverage.

Under AASB 17.55 only the premiums received (not receivable) is recognised in LFRC. Therefore, the AGR would only be allocated to the LFRC as follows:

- the LFRC is increased when payment for the AGR is received (AASB 17.55(b)(i); and
- the LFRC is decreased as insurance revenue relating to the AGR is earned (AASB 17.55(b)(v) based on the expected premium receipts (AASB 17.B126).

As noted above, AGR is only received after the policyholder has paid their share of the premium. Therefore depending on the policyholder payment profile, the AGR receipt may be post the period of coverage.

<u>Liability for Incurred Claims (LIC) vs LFRC</u>

A potential view is that the definition of LFRC and LIC noted above in AASB 17 may mean that once insurance services have been provided, any related future cash flows should be recognised in the LIC. Based on this view, all expected premium cash inflows would initially be included in measuring the LFRC and as coverage is provided and premiums remain outstanding (as may be the case for any AGR amounts that are received in arrears), the expected premium cash inflows would be then be recognised in LIC.

In contrast to this though, AASB 17.55 requires the PAA LFRC to be measured based on premiums that are received in the period even if that occurs after the coverage has expired. Furthermore, the definition of LIC and LFRC refers to the insurer having to "pay amounts…" suggesting that it is referring to and intending to capture claims or premium refunds, rather than premiums receivable.

Whilst PHI preparers appear to be aligned to date on recognising AGR within the LFRC, there is still a view across some of the accounting firms that premiums receivable after coverage has ended should be recognised in LIC. Therefore PHI's should ensure that they discuss this with their advisors and auditors as necessary as this continues to be an area of interpretation and there may be differing views.

<u>IFRS 9 application</u>

Consideration was also given to whether IFRS 9 applied to the AGR given that it is a premium due from a third party. However, given that the amount essentially arises from the policyholder's insurance contract and no separate contract exists between the insurer and the government, there was clear consensus from PHI preparers that IFRS 9 would not apply to the AGR receivable. However, this is a further topic where interpretations are continuing to emerge so PHI's should ensure that they discuss with their advisors and auditors as needed.

Summary of discussions:
The PHI focus group general consensus of preparers was that the receivable for the AGR due from the government (but not received) in the month in which the premium is received from the policyholder would be recognised in the LFRC, however, it was acknowledged that the interpretation of Appendix A could imply that where coverage has ended a receivable may need to be transferred to LIC.

A3. Summary of discussions
The treatment of the AGR is expected to be largely unchanged from current practice.