



Staff Paper

Project:	Insurance Activities in the Public Sector	Meeting:	AASB September 2022 (M190) NZASB October 2022 (M103)
Topic:	Initial recognition when insurance contracts are onerous	Agenda item:	AASB 4.3 NZASB 7.3
Contacts:	Angus Thomson athomson@asb.gov.au Tereza Bublikova tereza.bublikova@xrb.govt.nz Patricia Au pau@asb.gov.au Charis Halliday charis.halliday@xrb.govt.nz	Date:	5 September 2022
		Project priority	Medium
		Decision-making	High
		Project status	Feedback on AASB ED 319 / NZASB ED 2022-3

Objectives of this paper

- 1 In respect of applying the initial recognition requirements in AASB 17/PBE IFRS 17 *Insurance Contracts* to public sector entities, the objectives of this paper are to:
 - (a) CONSIDER comments received on question 3 of AASB ED 319/NZASB ED 2022-3 *Insurance Contracts in the Public Sector*; and
 - (b) CONFIRM whether to proceed with the proposal to amend the Standard so that the timing of initially recognising an insurance contract does not depend on when contracts become onerous.

The proposal in AASB ED 319/NZASB ED 2022-3

- 2 The ED proposed to add paragraph [Aus]25.1,¹ so that, for a public sector entity, the timing of initially recognising an insurance contract does not depend on when contracts become onerous. This paragraph has been reproduced below for the Boards' reference. Paragraph 25 is not amended but is included to provide context.

Recognition	
25	An entity shall recognise a group of insurance contracts it issues from the earliest of the following:
	(a) the beginning of the coverage period of the group of contracts;
	(b) the date when the first payment from a policyholder in the group becomes due; and
	(c) for a group of onerous contracts, when the group becomes onerous.

1 Both Boards have a policy of numbering paragraphs that are added to the IFRS text using the IFRS Standard paragraph number, following by a decimal point and unique consecutive numbering. The AASB also uses an 'Aus' pre-fix, while the NZASB has no prefix.



[Aus]25.1 **Notwithstanding paragraph 25, a public sector entity shall recognise a group of insurance contracts it issues from the earliest of the following:**

(a) **the beginning of the coverage period of the group of contracts; and**

(b) **the date when the first payment from a policyholder in the group becomes due.**

The Boards' considerations when developing the ED

- 3 The Boards observed that the differing circumstances of public sector entities compared with their private sector counterparts would potentially mean that applying AASB 17/PBE IFRS 17.25(c) would have unhelpful accounting consequences in the public sector [AASB ED 319.BC46 to BC49 / NZASB ED 2022-3.BC58 to BC61].
- (a) Private sector for-profit insurers would typically only by exception knowingly issue onerous contracts. However, most public sector entities routinely issue onerous contracts because levies/premiums charged are based on break-even pricing after taking into account projected investment returns. Public sector entity portfolios of insurance contracts are typically onerous as a whole, since the expected investment returns are usually higher than the risk-free discount rate applied to measure the insurance liabilities, and because the onerous contract testing would include any risk adjustment. Accordingly, most public sector entities routinely recognise unexpired risk liabilities (onerous contract losses) under AASB 1023/PBE IFRS 4.
- (b) Private sector insurers will typically have contracts commencing throughout their financial year and, therefore, only a relatively small portion of contracts that commence in the following year would typically be enforceable on the entity at any given reporting date. However, some public sector entities have a large portion of their contracts covering periods that coincide with their financial year. Accordingly, for these entities, all or most of next year's contracts could be enforceable on the entity at each reporting date.
- 4 For an entity that has enforceable arrangements in the weeks before year end for the following 1 July to 30 June coverage period, applying AASB 17/PBE IFRS 17.25(c) would mean all of the onerous contract losses associated with next year's arrangements would need to be included in the current year's results. While this may not have a major impact year-on-year, it would be a counter-intuitive outcome.
- 5 Accordingly, the Boards agreed to propose that a public sector entity be required to recognise a group of insurance contracts it issues from the earliest of:
- (a) the beginning of the coverage period of the group of contracts; and
- (b) the date when the first payment from a policyholder in the group becomes due.
- That is, criterion (c) – recognition when the group becomes onerous – would not apply.
- 6 As noted in ED319.BC50/ED 2022-3.BC62, the Boards consider this exemption is justified because:
- (a) The consequences of applying AASB 17/PBE IFRS 17.25(c) to some public sector insurers would be potentially burdensome from a practical viewpoint, since their systems are not currently set up to capture this information, and would lead to information that is not useful for users of the financial statements. This is because, for some public sector entities, on an ongoing basis, the results for the current period would include the onerous contract losses of all or most of the following year's contracts.



- (b) AASB 17/PBE IFRS 17.25(c) was conceived in the context of private sector for-profit insurers for which, in theory, onerous contracts would be the exception and for which enforceable contracts as at the reporting date that relate to the following year of coverage would be a relatively small proportion of total contracts.

Respondents' feedback

- 7 All respondents who commented on the proposal were supportive. Their support was based on the reasons provided by the Boards. Please refer to [Appendix A](#) for a collation of comments on question 3 of the ED.

Staff recommendations

- 8 Staff recommend that the Boards proceed with the proposals not to require public sector entities to apply criterion (c) of AASB 17/PBE IFRS 17.25 – recognition when the group becomes onerous.

Question for Board members

Q1: Do Board members agree to confirm the AASB/NZASB's proposal to modify AASB 17/PBE IFRS 17.25 for public sector entities so that the timing of initially recognising an insurance contract does not depend on when contracts become onerous?

If not, please provide your alternative view and reasons for that view.

Appendix A: Collation of comments on question 3 in AASB ED 319 / NZASB ED 2022-3

Q3: Do you agree with the proposal to amend the AASB 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous? Please provide your reasons.

Respondent	Summary of comments
PwC	Agree – practical when onerous contracts are more prevalent and would enable recognition over the coverage period rather than ‘front end loading’ many arrangements.
TSY NZ	Agree – follows logically from responses to Q1 and Q2 (on sub-grouping – please see Agenda paper 4.2/7.2 for the September/October 2022 meeting).
iCare	Agree – Not having this exemption can result in future year losses being recognised in the current period.
HoTARAC	Members support the proposal for the reasons in paragraph BC50.
EQC	Agree for the following reasons: <ul style="list-style-type: none"> (a) do not currently have reliable exposure data clarifying coverage periods, nor can we match levy receipts with clients as they are received in bulk from insurers; (b) modelling of catastrophe risk is not an exact science and there is significant room for variation in views of the cost of cover being provided, making determination of “onerous” somewhat fraught; and (c) therefore, there does not appear to be any benefit arising for readers of the accounts for the extra work involved.
ACAG	Agree – initially recognising groups of insurance contracts when they become onerous may: <ul style="list-style-type: none"> • be overly burdensome for some public sector entities where their systems are not set up to capture this information • impact on the usefulness of the information in financial statements to users – some workers compensation and public indemnity insurers have coverage periods aligned to financial years which would result in the recognition of future year onerous contracts late in the current year • public sector entities have more onerous contracts than the private sector as they generally aim to break even and cover their costs over the long term.
ACC	Agree – follows logically from responses to Q1 and Q2 (on sub-grouping – please see Agenda paper 4.2/7.2 for the September/October 2022 meeting).
ICWA	Agree – systems are not currently established to capture this information and the results are unlikely to be useful for users.



Respondent	Summary of comments
KPMG	Agree – We note the time lag between policy inception date and coverage start date for general insurer is in most cases minimal, with the exception of “retroactive” reinsurance arrangements and extended warranties.