



Staff Paper

Project:	Insurance Contracts	Meeting	AASB June 2017 (M158)
Topic:	Public sector scope and modifications	Agenda Item:	3.1
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Introduction and objective of this paper

- 1 The objective of this paper is to obtain Board approval to modify forthcoming AASB [17] *Insurance Contracts* (AASB 17) for not-for-profit (NFP) entities and to seek views on the scope of the resulting exposure draft that will detail how AASB 17 will be applied by NFP entities in the public and private sectors.
- 2 To accomplish the above, this paper first addresses the due-process considerations required by the Board's draft NFP standard-setting framework. That analysis is necessary to establish whether there is sufficient need to make a modification.
- 3 Following that, the paper considers whether public sector 'insurance-like' arrangements that are not expected to meet the IFRS 17 insurance contract definition, still create obligations as defined in the IASB and IPSASB *Conceptual Framework* documents. Before addressing any standards-level requirements, the Board must be satisfied that an obligation does exist and should be accounted for.
- 4 The paper then explores scoping options for including some public sector insurance arrangements within the scope of AASB 17. Here the work of the IPSASB is used as a starting point for consideration.
- 5 Finally, this paper discusses the modification options the Board could make and then lists the next steps.
- 6 This paper is structured as follows:
 - (a) Background and project objectives (paragraphs 8 – 10)
 - (b) Agree transaction-neutrality (paragraphs 11 – 12)
 - (c) Staff analysis – NFP standard-setting framework (paragraphs 13 – 21)

- (d) Staff analysis – IPSASB and IASB conceptual frameworks (paragraphs 22 – 35)
- (e) Staff analysis – Extending scope of AASB 17 for public sector entities (paragraphs 36 – 60)
- (f) Staff analysis – Need for any modifications (i.e. ‘Aus’ paragraphs, application guidance etc) to AASB 17 for public sector entities (paragraphs 61 – 65)
- (g) Next steps (paragraph 66 – **Error! Reference source not found.**)

Summary of staff recommendations

7 The staff recommend that:

- (a) Insurance contracts issued by public sector entities that meet the insurance contract definition under AASB 17 should be accounted for under AASB 17 with no further amendment.
- (b) The scope of AASB 17 be amended to include additional public sector insurance-like arrangements that are managed similarly to insurance arrangements that are within the unmodified scope of AASB 17, such as lifetime care arrangements.
- (c) No modifications be made to recognition, measurement and disclosure requirements.

Background and Project objectives

8 The objectives of the project are to:

- (a) clarify the scope of forthcoming AASB 17 for NFP entities in the public and private sectors to ensure similar activities are treated similarly; and
- (b) consider whether modifications might need to be made to AASB 17 to cater for NFP insurers.

9 In August 2016, the Board accepted the staff recommendation that modifications to IFRS 17 may be required for NFP entities in the public sector for the interaction of contract boundary and onerous contract requirements. The need for such a modification would be reassessed when the wording of IFRS 17 was finalised. No other matters were expected to require NFP modification.

10 IFRS 17 was issued on 18 May 2017.

Existing scope of IFRS 17

- 11 Some NFP entities issue insurance contracts that would meet the definition of insurance contract in AASB 17.¹ In line with the Board's transaction neutrality approach, where a NFP entity issues an insurance contract within the scope of AASB 17, that insurance contract should be accounted for in accordance with AASB 17.
- 12 Staff recommend that insurance contracts where issued by public sector entities should be accounted for under AASB 17 and that no further modification or guidance is required.

Question to the Board

Does the Board agree with the staff recommendation that AASB [17] apply to insurance contracts (as defined in AASB [17]) issued by NFP entities (transaction neutrality)?

Staff analysis – NFP standard-setting framework

- 13 The AASB's draft NFP standard-setting framework² establishes the criteria the Board needs to consider before modifying an IFRS Standard for NFP-specific issues. In this respect transaction neutrality is used as a starting point, and is then modified as necessary to address user needs, prevalence and magnitude of issues specific to the NFP sector, NFP application issues, public interest issues relevant to financial reporting and undue cost or effort considerations.

Why should the Board consider modifications?

- 14 Staff have held preliminary discussions with iCare (NSW), NSW Treasury, the Commonwealth Department of Finance, the Victorian Department of Treasury and Finance and Queensland Treasury about the types of arrangements public sector entities enter into. Based on these discussions, staff identified the primary factor contributing to a need for modification is the prevalence and magnitude of NFP issues affecting reported performance arising from 'insurance-like' arrangements, such as:
- (a) insurance-like arrangements arising from statute and not contract;
 - (b) quantum of insured parties and events; and
 - (c) the nature of the arrangements being similar to for-profit counterparts but different in key respects (e.g. limited qualifying criteria or none at all, extent of funding from policy holders or key beneficiaries of the statute arrangements).
- 15 Notwithstanding the above, NFP issues extend to the general unsuitability of IFRS 17 application guidance to NFP entities. This generally arises from differences in

¹ A contract under which one party (the issuer) accepts significant **insurance risk** from another party (the **policyholder**) by agreeing to compensate the **policyholder** if a specified uncertain future event (the **insured event**) adversely affects the **policyholder**.

² The NFP standard-setting framework is being discussed as part of Agenda Item 10.

terminology and also from the legal form of the insurance-like arrangements public sector NFP entities enter into and the sources of funding, which may or may not be fully funded by those who pay premiums or are beneficiaries.

Are the issues identified sufficiently significant to warrant NFP-specific modification?

- 16 Both federal and state / territory governments enter into arrangements that initially appear to be insurance-like arrangements. Examples include:
- (a) workers compensation insurance;
 - (b) lifetime care insurance; and
 - (c) compulsory third party insurance.
- 17 In Victoria alone, the total provision for insurance claims in FY 2016 was \$29 billion, representing roughly 22% of the State's \$130 billion in total liabilities. Clearly, insurance claims are significant to the financial statements based on this example (which is largely representative of other governments).
- 18 Furthermore, any one transaction or event is similarly significant to the financial statements taken as a whole given the nature of the events insured (for example, WorkSafe Victoria and the Transport Accident Commission).
- 19 Outreach indicates that insurance-like arrangements are accounted for differently across Australian governments, some applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* while others apply AASB 1023 *General Insurance Contracts* to arrangements that are similar in substance. In one example, a state applied different accounting standards to the same arrangement depending on how the liability came to be the responsibility of the state.
- 20 If addressed, any modifications the Board proposes will significantly contribute to increased internal consistency within IFRS Standards as modified for NFP entities. The cost of requiring government to apply AASB [17] to their insurance-like arrangements will vary depending on whether they currently apply AASB 1023 to those arrangements (in which case the cost to those entities from applying any additional NFP guidance is expected to be minimal). On the other hand, entities currently applying AASB 137 would face transition costs that arise primarily from AASB [17], but staff expect that cost to be somewhat offset by the benefits arising from targeted application guidance.

Staff recommendation

- 21 Based on the above analysis, staff consider the NFP issues arising from the issue of AASB [17] to be significant and prevalent enough to warrant NFP-specific modifications to the Standard. Staff are of the view that the benefits arising from the modifications would exceed the cost of applying them.

Question to the Board

Does the Board agree with the staff recommendation to make NFP-specific modifications to AASB [17]?

Staff analysis – IPSASB and IASB *Conceptual Frameworks*

- 22 Previously, insurers recognised both an insurance claims liability and an ‘unearned revenue’ liability for the premiums received for coverage not yet provided. However, IFRS 17 treats both these liabilities as a single liability to be recognised at the beginning of the coverage period of the contract. Accordingly, the analysis below considers the definitions of a liability in both the IASB and IPSASB conceptual frameworks from the perspective of a single IFRS 17 liability.
- 23 As IFRS 17 sets out how to account for liabilities from insurance contracts, the definitions of a liability per the IPSASB and IASB Conceptual Framework have been explored to determine whether insurance-like public sector schemes would adequately satisfy the criteria of a liability. The table below provides a summary of a few public sector schemes that do not meet the IFRS 17 definition of insurance contract, as they are established under statute. However, they exhibit insurance-like characteristics and the applicability of the general definition of a liability to the scheme characteristics is reviewed. Further analysis is performed in the paragraphs below, with specific application to other common insurance-like public sector schemes.

	Lifetime Care Insurance (NSW)	Home Building Compensation Fund Insurance (NSW)	National Disability Insurance Scheme
	Lifetime cover relating to individuals whom have been severely injured in motor vehicle accidents	Provides cover for homeowners who have contracted residential building work and have suffered loss because their builder has been unable to honour commitments under building contract	Supports a better life for Australians with a significant and permanent disability and their families and carers
Liability			
It must be a present obligation	Yes – there is no realistic alternative to avoid providing cover if claimant satisfies eligibility criteria	Yes – there is no realistic alternative to avoid providing cover if claimant satisfies eligibility criteria	Yes – there is no realistic alternative to avoid providing cover if claimant satisfies eligibility criteria
It must involve an outflow of resources from the entity	Yes – outflow of cash to compensate for medical treatments and assistance relating to the return to	Yes – outflow of cash to compensate for losses suffered in the form of defective/incomplete work where the	Yes – outflow of cash to compensate for medical and care treatments

	Lifetime Care Insurance (NSW)	Home Building Compensation Fund Insurance (NSW)	National Disability Insurance Scheme
	Lifetime cover relating to individuals whom have been severely injured in motor vehicle accidents	Provides cover for homeowners who have contracted residential building work and have suffered loss because their builder has been unable to honour commitments under building contract	Supports a better life for Australians with a significant and permanent disability and their families and carers
	work/study	builder has been unable to honour building contract	
It must result from a past event	Yes - Establishment of government legislation to provide cover for individuals who meet eligibility criteria and collection of 'insurance premiums' via levy on CTP insurance fees	Yes – builders are required to obtain a Certificate of Insurance prior to the commencement of a building project > \$20,000	Yes - Establishment of government legislation to provide cover for individuals who meet eligibility criteria
Preliminary Conclusion	Liability	Liability	Liability

The definition of a liability per the IPSASB is analysed in detail below as it underpins the staff analysis for extending the scope of AASB 17 later in this paper and is broadly consistent with the IASB current conceptual framework.

IPSASB (see Appendix B for relevant extracts)

24 *IPSASB Conceptual Framework 5.14* defines a liability as a present obligation of the entity for an outflow of resources that results from a past event. Accordingly, it must satisfy each of the below criteria:

- (a) It must be a present obligation
- (b) It must involve an outflow of resources from the entity

- (c) It must result from a past event

25 Application to insurance-like public sector schemes is analysed in detail below:

Present Obligation

- 26 Paragraph 5.15 defines a present obligation as a legally or non-legally binding obligation where there is little to no realistic alternatives to avoid an outflow of resources. Furthermore, paragraph 5.20 acknowledges that a legally binding obligation may arise from a variety of legal constructs, of which a contract is but one example. **Accordingly, a contract is not necessary to establish a legally binding obligation.**
- 27 Paragraph 5.17 specifically refers to contracts as arrangements with ‘binding’ and ‘legal’ forms, thereby rendering insurers legally bound to terms and conditions agreed per contracts, thus satisfying the definition of a present obligation.
- 28 Paragraph 5.23 lists attributes of non-legally binding obligations that give rise to liabilities. As an example, the Worksafe Victoria workers compensation scheme is analysed below (in italics) to demonstrate how it meets this criteria:
- i) Entity has indicated to other parties that it will accept certain responsibilities – *WorkSafe's mission is to actively work with the community to deliver outstanding workplace safety and return to work, together with insurance protection.*
 - ii) Entity has created a valid expectation that it will discharge those responsibilities – *Policies and guidelines set out the types of eligible claims and the process for making a claim. Worksafe will be liable to provide assistance/cover for eligible claims made in accordance with the guidelines established.*
 - iii) Entity has little or no realistic alternative to avoid settling obligation – *If claimant satisfies eligibility criteria set out and claim process has been appropriately adhered to, Worksafe will be liable to provide assistance/cover to claimant.*

Outflow of resources

- 29 Per the above descriptions of public sector schemes, each of them involve the compensation for loss suffered (ie: medical treatments etc). These would require the outflow of cash (resource) to settle/pay for these claims. For example, under the CTP insurance scheme, it requires an outflow of cash to typically provide for medical treatments and compensation for lost income for the insured. Although there are no specific settlement dates as claims are contingent on an event/condition arising, paragraph 5.19 specifically states ‘*the absence of a settlement date does not preclude an obligation giving rise to a liability*’.

Result from a past event

- 30 Paragraph 5.17 states it is necessary that a present obligation arises as a result of a past transaction/event. In the case of insurance-like public sector schemes, this is

represented by the establishment of government legislation to provide cover for individuals in the case of a future event arising and claims that have occurred.

IASB (see Appendix C for relevant extracts)

31 *IASB conceptual framework 4.24* defines a liability as a present obligation of the entity to transfer an economic resource as a result of past events. Accordingly, it must satisfy each of the below criteria:

- (a) There must be a present obligation to transfer an economic resource
- (b) Present obligation must arise from a past event

32 Application to public sector schemes is analysed in detail below.

Present obligation to transfer an economic resource

33 *Para 4.31* states that for there to be present obligation, an entity must have no practical ability to avoid transfer of economic resource and entity must have received economic benefit or conducted activity to establish extent of obligation. Notably, the IASB *Conceptual Framework* also notes that such obligations might arise from contracts or legislation (paragraph 4.34). In the case of Worksafe Victoria, ‘activities to establish obligation’ arise from the enactment of government legislation and the establishment of eligibility criteria and types of cover set out under terms and conditions of that legislation to provide assistance for injuries/accidents sustained in the course of work. If a claimant meets eligibility criteria set out and the claims process has been followed accordingly, claimant will be entitled to assistance/cover specified under arrangement. This is described as a ‘*constructive obligation*’ under *Para 4.34*.

34 As a present obligation also requires the entity to have no practical ability to avoid the transfer, this is satisfied by the eligibility criteria set out under terms and conditions of legislation which makes the public sector entity liable to individuals whom satisfy this criteria Under the workers compensation scheme, Worksafe Victoria is liable to provide cover for any claims that fall within the scope set out in the legislation, with no realistic alternative but to provide appropriate compensation and assistance to the insured. *Para 4.27* further states that a present obligation need not be certain and may be dependent on an uncertain future event occurring. As insurance arrangements are entered into for the sole purpose of providing for a loss in the event a condition arises, this would satisfy the definition of a present obligation.

Past event

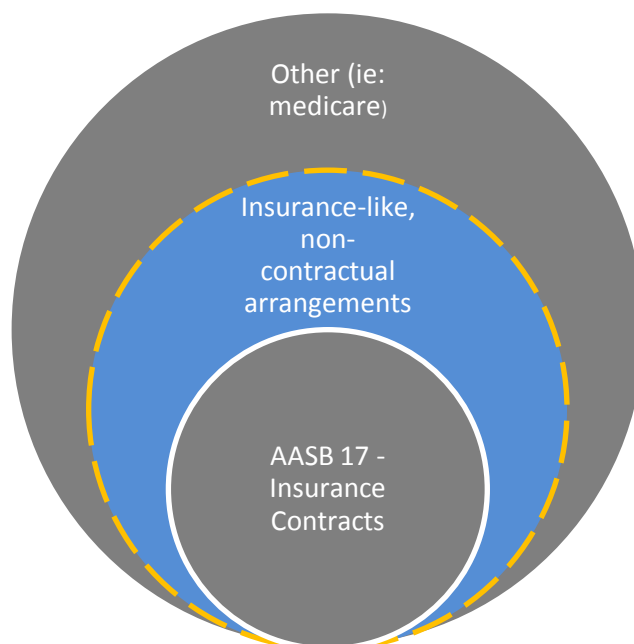
35 *Para 4.36* states that an entity has a present obligation of a past event only if it has already received the economic benefits or conducted the ‘activities’ to establish the extent of the obligation. Public sector insurance arrangements are formed through the establishment of legislation/regulation to implement government policy and premiums /levies to be charged. These satisfy the ‘activities’ as it establishes the insurer’s obligation to provide cover³. The amount paid for CTP insurance through the

³ That is a performance obligation

registration of a vehicle would demonstrate the existence of a performance obligation as it represents an exchange of consideration for motor vehicle cover.

Staff analysis – Extending the scope of AASB 17 for public sector entities

- 36 [Agenda paper 4.3 for the August 2016](#) (M153) meeting described a number of Australian arrangements (also referred to as social benefit schemes) provided by public sector entities that provide ‘insurance-like’ benefits that may, for a range of reasons, not be regarded as resulting in the creation of insurance contracts as defined in AASB 17.



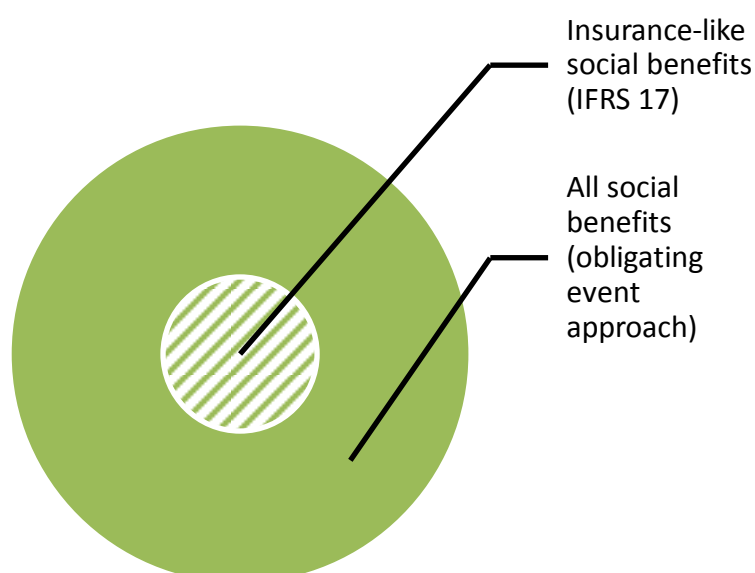
- 37 Staff analysis of various public sector arrangements indicate that some are very similar (sometimes indistinguishable) to private sector insurance contracts (represented by the inner-most circle above), others are unlike private sector arrangements (represented by the outer-most circle above) and there are a wide variety of arrangements in between these extremes. Accordingly, it would be appropriate to account for some of these arrangements in a similar way to insurance contracts (the middle, blue, circle above).
- 38 The Board could define the boundary between other arrangements and insurance-like non-contractual arrangements (the latter to be included within the scope of AASB 17) either by:
- (a) Adopting the IPSASB approach – define broader social benefits⁴ and specify which of those benefits are to be within the scope of AASB 17 (this is the ‘indirect approach’). Or

⁴ See Appendix A for the definition of **social benefits** and the definitions of supporting terms.

- (b) Expanding the scope of AASB 17 directly – modify AASB 17 to apply to non-contractual arrangements and limit the extent of its applicability (this is the ‘direct approach’).
- 39 For those arrangements that are not sufficiently ‘insurance-like’ to be accounted for as insurance, there may be a need to consider whether they should be accounted for under other AASBs such as AASB 137 or AASB 119 *Employee Benefits* or potentially in a further project based on the IPSASB’s broader, non-insurance-like, social benefits project. This is not further considered in this paper.

Adopt IPSASB approach (the ‘indirect approach’)

- 40 The staff have considered how to determine which arrangements are sufficiently ‘insurance-like’ to be accounted for as insurance and which should not be considered insurance-like and so accounted for under other standards. In considering where to draw the boundary between insurance-like and other arrangements, staff have had regard to work done in other environments and, in particular, the work done by the International Public Sector Accounting Standards Board (IPSASB).
- 41 The IPSASB’s Social Benefits project is considering the accounting for social benefit schemes. Some such schemes have the characteristics of insurance and the IPSASB deliberations have developed draft criteria for when such arrangements should be treated as insurance contracts.⁵
- 42 In general, the IPSASB Social Benefits project aims to define social benefits broadly (see Appendix A) and redirect those social benefits that are ‘insurance-like’ to IFRS 17. Those social benefits that remain in the scope of the IPSASB project will apply the ‘obligating event’ approach that is currently in development.



⁵ See also the attached staff commentary on that guidance.

- 43 The current draft criteria for an ‘insurance-like’ arrangement would require entities to apply IFRS 17 where:
- (a) *The social benefit scheme is intended to be fully funded from contributions; and*
 - (b) *There is evidence that the entity manages the scheme in the same way as an issuer of insurance contracts, including assessing the financial performance and financial position of the scheme on a regular basis.*
- 44 In June 2016 the IPSASB tentatively decided that only those insurance-like arrangements that are exchange transactions should be accounted for applying IFRS 17. Critically, any arrangement that is intended to be subsidised through taxation or other general revenues, would be by definition a non-exchange transaction. Accordingly, any public sector scheme that might seek contributions from an insured party in only partial consideration for insurance coverage (for example, a cost contribution arrangement) would not be accounted for in accordance with IFRS 17. Please see attached Agenda Paper 3.2 for further information.
- 45 The Board could expand the definition of an insurance contract for the public sector, and then include appropriate guidance in a new appendix on applying that definition. Under this approach the Board would be able to limit the number of IPSASB definitions necessary to bring into AASB 17.
- 46 As a starting point, the Board could consider the IPSASB’s current draft modifications to the IFRS 17 definition of an insurance contract: (note, IPSASB adjustments are underlined)
- A contract [social benefit scheme] under which one party (the issuer) [a public sector entity] accepts significant insurance risk from another party (the policyholder) [the beneficiaries of the social benefit scheme] by agreeing to compensate the policyholder [the beneficiaries] if a specified uncertain future event (the insured event) [(the social risk)] adversely affects the policyholder [the beneficiaries]*
- 47 Staff envisage that a similar approach to modifying the definition of an insurance contract in AASB 17 would be required to extend its scope. Some terminology (such as *social benefit scheme* as a replacement for *contract*) would need further consideration for their applicability within the Australian legal environment. Furthermore, additional defined terms (noted in Appendix A) may be necessary to explain the modified definition of an insurance contract. This approach would necessitate additional application guidance (adopted from the IPSASB work) to explain what a social benefit is in order to understand the context for the requirement to be a fully funded social benefit scheme as a prerequisite to applying AASB 17.
- 48 Notwithstanding the above, staff consider that the IPSASB criteria, which is further analysed in Appendix A, sets a reasonable boundary for extending the scope of AASB 17 to capture such insurance-like arrangements. This conclusion is based on factors including:
- (a) The IPSASB definition of social benefits requires benefits to be provided to specific individuals that meet eligibility requirements, this is analogous to the

AASB 17 definition of an insurance contract which requires the compensation of a policyholder that is adversely affected (ie eligible) by an uncertain future event.

- (b) The IPSASB requirement that an arrangement be fully funded draws a practical distinction between insurance-like schemes and obligations paid out of current revenue as some public sector arrangements are. This is not to say that obligations paid out of cash flow should not be recognised ‘on balance sheet’ but such arrangements are not sufficiently ‘insurance-like’ to be accounted for as insurance. Note that the IPSASB guidance makes clear that fully funded does not mean that the scheme needs to be fully funded at a point in time nor that funds raised in a particular year have to be sufficient to meet obligations in that year but rather there must be a periodic review of funding with contributions or benefits adjusted to achieve full funding. This is similar to how a private sector insurer would typically respond to premium rates being set at too low a level to fund insurance contract obligations. However, this is not consistent with other accounting standards or the Conceptual Framework, which do not have the ability to fund a liability as the determinant or limiter on whether a liability is recognised.
- (c) The IPSASB requirement that the arrangement be managed in the same way as an insurer provides indicators that an arrangement has the look and feel of insurance. This includes guidance regarding whether the arrangement binds the PSE in the same way that an insurer is bound by an insurance contract and whether the arrangement establishes enforceable rights to eligible participants. By definition an insurance contract in the private sector would have enforceable rights.

- 49 If adopting this approach, the Board would need to incorporate a number of IPSASB definitions (eg. *social benefit*, *social risk* and *universally accessible*, to name a few) into AASB 17 and modify the definition of an insurance contract. Staff envisage that some additional consideration would be needed in respect of what a ‘contribution’ is and perhaps the scope of ‘social risk’. Staff note that the definitions of social benefit and social risk are not intuitive (and are based on IMF definitions used for GFS reporting) and have been controversial with IPSASB stakeholders.

Expand the scope of AASB 17 directly (the ‘direct approach’)

- 50 Alternatively, the Board could consider making minimal modifications to the definition of an insurance contract, for example:

For NFP entities, the definition of an insurance contract includes non-contractual arrangements establishing a present obligation, where a NFP accepts significant insurance risk from another party (the policyholders or other beneficiaries) by agreeing to compensate the policyholder or other beneficiaries if a specified uncertain future event (the insured event) adversely affects the policyholder or other beneficiaries.

- 51 The above definition would then be supported by additional guidance on what a non-contractual insurance arrangement could be and what could be considered ‘compensation’ in the above definition.

- 52 Staff note that the AASB has in its AASB 1058 project extended the accounting for taxation revenue, a non-contractual statutory receivable, to be consistent with AASB 9 (a contract standard) for initial recognition, however, due to lack of consultation prior to issuing AASB 1058, did not extend the application of AASB 9 to subsequent accounting. Staff note that the scope of AASB 15 was not extended to non-contractual arrangements as it was considered additional guidance on what constituted a contract in the NFP sector was sufficient.
- 53 Extending the definition to include non-contractual arrangements that create a present obligation is consistent with the *Conceptual Framework* definition of a liability and is also consistent with AASB 119 *Employee Benefits*, which includes some employee benefits provided under legislative requirements within its scope. Extending the scope beyond contractual arrangements is consistent with the Board's recent practice regarding NFP-specific modifications. This highlights that IASB guidance is set within the context of for-profit arrangements that tend to be contractual. Accordingly, the Board will likely need to make similar considerations in future projects.
- 54 Staff also consider that only extending the definition to include non-contractual arrangements may result in some arrangements being captured that are not insurance-like (ie could capture all social benefits, such as Medicare, unemployment benefits, pension benefits etc), and would need to be limited. Here, staff envisage the IPSASB's criteria for the management approach to the arrangement could be useful in defining a boundary between social benefits generally and insurance-like arrangements. Whilst the way liabilities are managed is not normally a determinant or limiter on liability recognition, in this instance it does provide a mechanism for defining 'insurance like'. Although other schemes could meet liability criteria, these can be considered as part of other standard-setting projects, one of which may be to consider the IPSASB's social benefits project.
- 55 Staff do not think that the IPSASB criteria on funding should be used as a primary limiter on the scope of IFRS 17, as this is based on the notion of exchange/non-exchange. AASB 1058 does not use this distinction given its arbitrary nature and difficulty of applying in practice. Use of this distinction would mean that insurance-like schemes that are not fully funded would not be captured, regardless of the nature of the obligation. In all other standards and conceptual framework, the source of funding is not recognised as a determinant or limiter on liability recognition (eg liability for loans is not reduced because the borrower cannot repay the loan, or employee benefits not recognised because the scheme is unfunded). Staff would prefer to use funding as a sub-criteria of the management approach, for example, if fully funded by premiums then likely being managed similarly to an insurer.

Modifying AASB 17 generally

- 56 Regardless of whether the Board favours the direct or indirect approach, staff consider that a preliminary approach to achieving this in each section of AASB 17 is:

Section	Amendment
Scope	'Aus' para to denote a modified definition of an insurance contract applicable to

Section	Amendment
	NFP entities.
Remainder of main body	None (see next section of this paper)
Appendix A (Defined terms)	Modified definition of an insurance contract applicable to NFP entities similar to that in paragraph 50. Relevant IPSASB definitions to support the above modification.
New Appendix E (Australian implementation guidance for not-for-profit entities)	Relevant IPSASB application guidance (modified where necessary) to support the additional definitions
New Illustrative examples for not-for-profit entities	As required.

Staff recommendation and questions to Board

- 57 Arrangements that are not sufficiently ‘insurance-like’ to be accounted for under AASB 17 (such as Medicare⁶) would need to be assessed for whether they are, or should be, in scope of other standards.
- 58 Staff note that the IPSASB work on key definitions is still quite preliminary, and as noted in Appendix B, are potential sources of diversity in interpretation and consequently might cause diversity in application. Therefore, staff do not recommend that the Board adopt the ‘indirect approach’, which would require the inclusion of various IPSASB definitions in AASB 17.
- 59 In light of the above, staff do recommend the Board adopt the ‘direct approach’ of modifying the definition of an insurance contract for NFP entities using an ‘Aus’ paragraph. Under this approach, staff recommend that the IPSASB’s work on defining the characteristics of an ‘insurance-like’ arrangement be used, albeit modified to refer to funding as a subset of how the arrangement is managed.
- 60 The staff propose to include illustrative examples relevant to Australian public sector entities in the exposure draft. These examples will be provided to the Panel for comment and feedback prior to the exposure draft being finalised.

⁶ Staff analysis of Medicare suggests that scheme does not meet the IPSASB criteria proposed to determine whether AASB 17 should be applied on a number of factors including; (a) it is a universal scheme and so does not have eligibility requirements, (b) it is not a funded scheme, but funded out of revenue and (c) it is not managed like an insurance scheme.

Questions to the Board

- Q1 Does the Board agree to proceed on the basis of the ‘direct approach’ to modifying the definition of an insurance contract for NFP entities?
- Q2 Does the Board agree with the staff recommendation to utilise the IPSASB criteria (funding and management approach), modified as necessary, as criteria for assisting in identifying an ‘insurance-like’ arrangement?

Staff analysis – Need for modifications to AASB 17 recognition and measurement requirements for public sector entities

- 61 The wording of IFRS 17 has been modified since the Board last considered its impact on public sector entities.
- 62 The final wording of IFRS 17 has reduced the potential for the interaction of onerous contracts and contract boundary requirements to result in a public sector entity having to apply both the general and simplified measurement models to the same type of benefits. Where an entity would be required to separate contracts within a portfolio into onerous and other groups only because of legal or regulatory constraints for pricing or provision of benefits, Paragraph 20 of IFRS 17 now permits the entity to include such contracts into one group. In addition, the portfolios to be assessed have been restricted to annual cohorts, identified in 3 separate categories, thus limiting the number of portfolios to be assessed. As a result, the previous concern is not expected to arise but will be tested during outreach activities.
- 63 Accordingly, staff do not believe any modifications to the recognition and measurement requirements of AASB 17 are necessary for public sector entities.
- 64 Staff has also reviewed the other issues considered for modification in Agenda paper 4.3 of the August 2016 (M153) meeting and continue to support the previous recommendations that no modifications be made to the recognition and measurement requirements of AASB 17.
- 65 Therefore, staff recommend that no public sector (or private sector NFP) modification to the recognition and measurement requirements of AASB 17 be made.

Question to the Board

Do Board members agree with the staff recommendation that no recognition and measurement modifications be made to AASB 17 in respect of NFP entities?

Next steps

- 66 If the Board agrees with the staff recommendations, an exposure draft will be completed in June for circulation to Panel members by the end of June with an update to be provided to the Board at its October meeting.

Appendix A

Definition of Social Benefits

- 1 The draft IPSASB definition of social benefits, social risk and universally accessible are as follows:

Social Benefits are benefits that are provided by a public sector entity:

- (a) To address the needs of society as a whole;
- (b) To mitigate the effect of social risks; and
- (c) Directly to specific individuals and/or households who meet eligibility criteria related to the mitigation of the effect of social risks, rather than being universally accessible.

Social risks are events or circumstances that:

- (a) Relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and
- (b) May adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.

Universally accessible services are those that are made available by a government entity for all individuals and/or households to access, and where eligibility criteria (if any) are not related to social risk.

- 2 This definition recognises that social benefits are not delivered by contractual arrangements. The proposed IPSASB application guidance clarifies that a benefit that covers a segment of society as part of a wider system of benefits meets the requirement that it addresses the needs of society as a whole.
- 3 Applying this definition in Australia should mean that a greater number of those Australian NFP ‘insurance-like’ arrangements that are not currently accounted for under existing insurance accounting standards⁷ because a contract does not exist, should fall within the scope of AASB 17.

Guidance on when a scheme is intended to be fully funded

- 4 The draft IPSASB guidance indicates that a social benefit scheme is intended to be fully funded where:
 - (a) A scheme may be funded by contributions or levies paid by, or on behalf of the potential beneficiaries or those whose activities create or exacerbate the risk; and
 - (b) Contribution/levy/benefit levels are reviewed and adjusted on a regular basis with the aim that benefits are fully funded.

⁷ Usually AASB 1023 *General Insurance Contracts*

- 5 The inclusion of arrangements that are funded by some form of levy or contribution should capture those Australian public sector arrangements that are not currently accounted for under existing insurance accounting standards because they are funded by levies or some other form of taxation.
- 6 The need for an arrangement to be subject to regular⁸ review and for contribution or benefits to be adjusted where necessary is similar to practice in the private sector. Such a review may not result in an immediate change to contributions or benefit levels; for example, because of social or political reasons in the public sector or commercial reasons in the private sector. Staff outreach has not identified any Australian public sector arrangements where the presence or absence of such a review has been proposed as a reason for not applying insurance accounting.

Guidance on whether an entity is managing a scheme like an insurer

- 7 The draft IPSASB guidance on whether a scheme is managed like an insurer includes a number of indicators, including:
- (a) Whether the scheme has commercial substance and despite not being a contractual arrangement, has the look and feel of an insurance contract.
 - (b) The extent of obligation to beneficiaries and the ability to retrospectively change those obligations as well as the rights of participants.
 - (c) The extent to which the scheme's assets are separately identified and managed and the scheme's financial performance and position assessed.
- 8 Staff outreach has not identified any Australian arrangements where the way the arrangement is managed has been proposed as a reason for not using insurance accounting. However, this criteria may be important in establishing the limits of where insurance accounting should be applied.
- 9 For example, some schemes that may meet the other criteria but are managed as part of a broader set of activities will not be required to be accounted for as insurance. Staff intend to test this with Panel members before finalising the exposure draft.

⁸ Such a review should reflect the facts and circumstances of the scheme and may be more or less frequent than each year.

Appendix B

Applied examples of IPSASB criteria

- 1 The table below illustrates the application of the IPSASB social benefits criteria to some common Australian NFP arrangements. Please note that the outcomes identified below are based on general information about the arrangements and the outcomes might be different if applied to specific facts and circumstances.

	Lifetime care insurance (NSW)	Home building compensation fund insurance (NSW)	Medicare	National Disability Insurance Scheme
	Lifetime cover relating to individuals whom have been severely injured in motor vehicle accidents	Provides cover for homeowners who have contracted residential building work and suffer losses as a result of defective or incomplete work by their builder.	Medicare provides access to a range of medical services, lower cost prescriptions and free care as a public patient in a public hospital. All eligible Australian residents and certain categories of visitors to Australia can enrol in Medicare and access these services.	Support a better life for hundreds of thousands of Australians with a significant and permanent disability and their families and carers.
Social benefit				
Addresses the needs of society as a whole	Yes	Yes	Yes	Yes
Mitigates the effect of social risk	Uncertain	Uncertain	Yes	Yes
Universally accessible	No (benefits are only to those severely injured as a result of a motor vehicle accident, not to all)	No	Yes (eligibility criteria are not related to mitigates social risk)	No (eligibility criteria are related to the characteristics of the individual)
Exchange arrangement (conditions to apply IFRS 17)				

	Lifetime care insurance (NSW)	Home building compensation fund insurance (NSW)	Medicare	National Disability Insurance Scheme
	Lifetime cover relating to individuals whom have been severely injured in motor vehicle accidents	Provides cover for homeowners who have contracted residential building work and suffer losses as a result of defective or incomplete work by their builder.	Medicare provides access to a range of medical services, lower cost prescriptions and free care as a public patient in a public hospital. All eligible Australian residents and certain categories of visitors to Australia can enrol in Medicare and access these services.	Support a better life for hundreds of thousands of Australians with a significant and permanent disability and their families and carers.
Intended to be fully funded from contributions (not partially subsidised through taxation revenue or general reserves)	Yes ⁹ (funded through levy on CTP insurance premiums)	Yes	No (funded through appropriation)	No (funded through appropriation)
Managed in the same way as an insurance contract	Yes	Yes	No	Yes
Preliminary conclusion	Could be insurance-like	Could be insurance-like¹⁰	Not insurance-like	Not insurance-like

⁹ See sections 49 – 51 of *Motor Accidents (Lifetime Care and Support) Act 2006 No 16 (NSW)*

¹⁰ Note, the scheme, in the case of NSW, operates based on the acquisition of a ‘certificate of insurance’ over works performed. The fee for that certificate of insurance is based on risk factors attributable to the specific project and contractor performing the work. Accordingly, it is more likely that this arrangement meet the definition of an insurance contract issued by the public sector (i.e. under transaction neutrality). The intent of the analysis in this table is to show that despite being very similar to a for-profit insurance arrangement, the potential ambiguity arising from the definition of ‘social risk’ could cause the arrangement to fall outside the scope of AASB 17 in some interpretations.

Appendix C

Extracts of IPSASB conceptual framework definition of a liability

Definition

5.14 A liability is:

A present obligation of the entity for an outflow of resources that results from a past event.

A Present Obligation

5.15 Public sector entities can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

An Outflow of Resources from the Entity

5.16 A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.

Past Event

5.17 To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of a past transaction or other event and requires an outflow of resources from the entity. The complexity of public sector programs and activities means that a number of events in the development, implementation and operation of a particular program may give rise to obligations. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations) are present obligations and satisfy the definition of a liability. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity takes jurisdictional factors into account.

Legal and Non-Legally Binding Obligations

5.18 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.

5.19 Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves an

outflow of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

- 5.20 A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework. For some types of non-exchange transactions, judgement will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.
- 5.21 Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions— or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.
- 5.22 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

Non-Legally Binding Obligations

- 5.23 Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:
- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
 - As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
 - The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.
- 5.24 In the public sector, obligations may arise at a number of points. For example, in implementing a program or service:
- Making a political promise such as an electoral pledge;
 - Announcement of a policy;

- Introduction (and approval) of the budget (which may be two distinct points); and
- The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).

The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.

5.25 The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow of resources include:

- The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;
- The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur; and
- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.26 “Economic coercion”, “political necessity” or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

Appendix D

Extracts of IASB conceptual framework definition of a liability

Definition of a liability

- 4.24 A liability is a present obligation of the entity to transfer an economic resource as a result of past events.
- 4.25 If one party has an obligation to transfer an economic resource (a liability), it follows that another party (or parties) has a right to receive that economic resource (an asset). The party (or parties) could be a specific person or entity, a group of people or entities, or society at large.
- 4.26 A requirement for one party to recognise a liability (or asset) and measure it at a specified amount does not imply that the other party must recognise the corresponding asset (or liability) or measure it at the same amount. Applying different recognition criteria or measurement requirements to the liability (or asset) of one party and the corresponding asset (or liability) of the other party may sometimes be an outcome of decisions intended to meet the objective of financial reporting.

Obligation to transfer an economic resource

- 4.27 An entity's obligation to transfer an economic resource must have the potential to require the entity to transfer an economic resource to another party. It need not be certain, or even probable, that the entity will be required to transfer an economic resource, but the obligation must already exist and there must be at least one circumstance in which it will require the entity to transfer an economic resource. One example of such an obligation is an obligation to stand ready to transfer an economic resource if an uncertain future event occurs.
- 4.28 Obligations to transfer an economic resource include, for example, obligations to:
- (a) pay cash;
 - (b) transfer other assets;
 - (c) exchange economic resources with another party on unfavourable terms (see paragraphs 4.40–4.42);
 - (d) provide services; or
 - (e) issue another obligation that will oblige the entity to transfer an economic resource.
- 4.29 Instead of fulfilling an obligation to transfer an economic resource, entities sometimes:

- (a) settle the obligation by negotiating a release from the obligation;
 - (b) transfer the obligation to a third party; or
 - (c) replace the obligation with another obligation to transfer an economic resource.
- 4.30 An equity claim does not contain an obligation to transfer economic resources. Furthermore, an equity claim is not an economic resource for the issuer. It follows that an obligation of an entity to transfer its own equity claims to another party is not an obligation to transfer an economic resource.

Present obligation

- 4.31 An entity has a present obligation to transfer an economic resource if both:
- (a) the entity has no practical ability to avoid the transfer; and
 - (b) the obligation has arisen from past events; in other words, the entity has received the economic benefits, or conducted the activities, that establish the extent of its obligation.

No practical ability to avoid the transfer

- 4.32 An entity has no practical ability to avoid a transfer if, for example, the transfer is legally enforceable, or any action necessary to avoid the transfer would cause significant business disruption or would have economic consequences significantly more adverse than the transfer itself. It is not sufficient that the management of the entity intends to make the transfer or that the transfer is probable.
- 4.33 If an entity prepares financial statements on a going concern basis, the entity:
- (a) has no practical ability to avoid a transfer that could be avoided only by liquidating the entity or ceasing trading; but
 - (b) has the practical ability to avoid (and hence does not have a liability for) a transfer that would be required only on the liquidation of the entity or on the cessation of trading.
- 4.34 Many obligations are legally enforceable as a consequence of a contract, legislation or similar means. Obligations can also arise, however, from an entity's customary practices, published policies or specific statements that require the transfer of an economic resource. If the entity has no practical ability to act in a manner inconsistent with those practices, policies or statements, the entity has an obligation. The obligation that arises in such situations is often described as a constructive obligation.
- 4.35 In some situations, the requirement for an entity to transfer an economic resource may be expressed as being conditional on a particular future action by the entity,

such as conducting particular activities or exercising particular options within a contract. The entity has an obligation if it has no practical ability to avoid that action.

Past Event

- 4.36 An entity has a present obligation as a result of a past event only if it has already received the economic benefits, or conducted the activities, that establish the extent of its obligation. The economic benefits received could include, for example, goods or services. The activities conducted could include, for example, operating in a particular market. If the economic benefits are received, or the activities are conducted, over time, a present obligation will accumulate over time (if, throughout that time, the entity has no practical ability to avoid the transfer).
- 4.37 An event establishes the extent of an obligation if it specifies either the amount of the future transfer or the basis for determining that amount. For example, an insurer may enter into a contract to provide insurance coverage in return for a single premium. When the insurer receives the premium, it has an obligation to provide insurance coverage because:
- (a) although the amount of any future transfer still depends on whether an insured event occurs, the insurer has no practical ability to avoid transferring an economic resource if an insured event occurs; and
 - (b) the insurer has received the premium that establishes that it must provide coverage to the extent specified by the contract, and this provides the basis for determining the amount of any future transfer.
- 4.38 A present obligation can exist at the end of the reporting period even if the transfer of economic resources cannot be enforced until some point in the future. For example, a financial liability may not require a payment to be made until a future date. The payment cannot be enforced until that future date, but the liability exists now. Similarly, a contractual obligation for the entity to perform work at a future date cannot be enforced by the counterparty until that future date, but the obligation arising from the contract exists now if the counterparty has already paid for the work (see paragraphs 4.40–4.42).
- 4.39 An entity does not have a present obligation for the costs that will arise if it will receive benefits, or conduct activities, in the future (for example, the costs of future operations); the extent of the future transfer will not be determined by reference to benefits that the entity has received, or activities that it has conducted, in the past. If the entity has entered into a contract that is still executory, the entity may have a present right and obligation to exchange economic resources in the future (see paragraphs 4.40–4.42).