

DRAFT AND SUBJECT TO CHANGE

PREPARED FOR PURPOSE OF DISCUSSION ONLY – 25 SEPTEMBER 2017

**AASB Discussion Paper**

XXX 2017

# **Australian specific insurance issues – regulatory disclosures and public sector insurers**

**[AASB 17]**



**Australian Government**

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**Australian Accounting  
Standards Board**

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Australian Accounting Standard AASB 2017-X <i>Amendments to Australian Accounting Standards – Clarifications to AASB 4</i> is set out on pages 5 and 6. All the paragraphs have equal authority.
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## Introduction

### Australian Accounting Standards

The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards.

The AASB is an Australian Government agency under the *Australian Securities and Investment Commission Act 2001*. AASB 1053 *Application of Tiers of Australian Accounting Standards* explains the two tiers of Australian Accounting Standards.

The approach the AASB takes in setting standards, including requirements specific to not-for-profit and public sector entities, is outlined in *AASB Policies and Processes*.

### Discussion Paper

The publication of a Discussion Paper is part of the due process that the AASB follows before making a new Australian Accounting Standard or amending an existing one. Discussion Papers are designed to seek public comment on the AASB's proposals for new Australian Accounting Standards or amendments to existing Standards.

## Why we are making these proposals

The AASB is seeking to address two Australian specific insurance issues in this Discussion Paper:

- application of AASB 17 *Insurance Contracts* to the public sector
- retention of regulatory disclosures for the for-profit private sector

### **Public sector issues**

The issue in applying AASB 17 in the public sector is whether insurance liabilities are being understated. It appears that the unamended scope of AASB 17 will not appropriately capture all schemes with economically similar insurance risk. The issue is whether additional requirements and guidance are required to ensure public sector entities with insurance risk are appropriately reflecting these risks in their financial statements. AASB 17 has been issued, currently limiting the scope to for-profit and not-profit private sector entities.

The AASB has noted that there is inconsistency in how the current insurance Standards AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts* are being applied by public sector entities. It appears that schemes that economically and in substance have similar insurance risk are being treated differently. Some public sector entities are applying AASB 1023 or are applying accounting consistent with AASB 1023, whilst others, with similar activities and risks, are not. Some of those not applying AASB 1023 or accounting consistent with AASB 1023 specifically identify that they are applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*, as the insurance like risk arises from statute rather than a contract. There are different accounting outcomes from AASB 1023/AASB 1038 and AASB 137 (see BC paras 9 to 14 for more detail).

Given that the definitions and scope of AASB 17 are no different from the collective scopes of AASB 4, AASB 1023 and AASB 1038, the Board is concerned that the same issues around inconsistent reporting could remain under AASB 17. Accordingly, there is a risk that public sector insurance liabilities are being understated. 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. Based on this example (which is largely representative of other governments), insurance claims are significant to state and Commonwealth financial statements. Given the size and importance of insurance risk to the public sector, the AASB considers there is justification for modifying AASB 17 for the public sector issues identified above.

Appendix A provides draft amendments to the standard and draft guidance for the public sector, with a draft basis for conclusions.

### **Regulatory disclosures for the for-profit sector**

The issue is whether disclosures currently required in AASB 1023 and AASB 1038 that originate from regulatory oversight purposes should be retained in AASB 1054 *Additional Australian Disclosures*. The AASB is seeking to determine if these disclosures are useful for a broader group of general purpose users, or whether they are no longer necessary.

In finalising AASB 17, the AASB noted that these regulatory type disclosures were not captured in the AASB 17 disclosures and that the IASB had been through extensive due process, including consultation with regulators, in

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finalising the IFRS 17 disclosures. The Board also noted that these disclosures are currently required in NZ IFRS 4 *New Zealand Equivalent to International Financial Reporting Standard 4 Insurance Contracts*, which contains the same requirements as AASB 1023 and ASB 1038.

Appendix B sets out the specific disclosures being considered and an analysis of these disclosures against the criteria in the AASB's draft *For-profit Standard Setting Framework* to assist in determining whether it is appropriate to retain these disclosures.

The AASB's preliminary view is that these disclosures are no longer necessary and should not be carried forward to AASB 1054.

## **What we are proposing**

### ***Public sector issues***

The AASB is proposing that the scope of AASB 17 be expanded to include insurance like arrangements that are created by statute, rather than contractual arrangements. Additional guidance on determining whether an arrangement is insurance like is provided in Appendix A.

The AASB's view is that although AASB 17 applies only to contracts, the Conceptual Framework does not limit liability recognition to that arising from contracts, and specifically indicates that obligations may arise from statute. In applying its principle of transaction neutrality, the AASB considers that public sector entities with insurance risk created by statute, that are in substance similar to public and private sector entities with insurance risk created by contracts, should account for insurance risk in the same way.

In order to ensure that there is a reasonable boundary to what is captured by AASB 17, the AASB has developed the following criteria to identify those arrangements that are 'insurance like'.

The following criteria are mandatory for an 'insurance like' arrangement:

- (a) the terms of the arrangement have commercial substance;
- (b) the key criterion of the arrangements, particularly beneficial rights, cannot be altered without a specific change in legislation or relevant governing measures and cannot be retrospectively amended;
- (c) the arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs;

The following indicators should not be regarded as an exhaustive list and not all factors need to be present for an arrangement to be, in substance, insurance-like:

- (a) Funding: the legislation or other measures governing the arrangements provide for funding by premiums or levies paid by either the potential beneficiaries or those whose activities create or exacerbate the risks, or contributions by the government or other public sector entities. The entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, levies or contributions by the government or other public sector entities) and/or benefit payments on a periodic basis, with the aim that the arrangement is substantially self-funded. The existence of funding determined on this basis is a strong indicator of an insurance like arrangement. However, the absence of funding determined in this way is not necessarily an indicator that an 'insurance like arrangement' does not exist;
- (b) Management of claims: the financial performance and financial position of the scheme are assessed on a regular basis, using data analysis and estimation techniques (eg actuarial analysis), reports internally and/or externally on the financial performance of the scheme occur, and, where necessary, action taken to address any underfunding of the scheme;
- (c) Similar arrangements in the private sector: Transactions or arrangements with similar characteristics and level of insurance risk entered into by for-profit entities and accounted for as insurance contracts; Separate assets and liabilities: The assets and liabilities arising from the arrangements are held in a separate fund, or otherwise specifically identified as used solely to provide benefits to beneficiaries. A separate entity established, which is expected to act like an insurer in relation to the arrangement is a strong indicator of an insurance like arrangement. However, the absence of a separate entity or separately identifiable assets is not necessarily and indicator that an insurance like arrangement does not exist.

The AASB considered a number of alternatives as set out in BC paras BC19 to BC43, including whether to use the anticipated IPSASB guidance on insurance accounting in their social benefits project. However, the AASB was concerned that this would require the inclusion of several new and important definitions such as *social benefit*, which have the potential to create more complexity and judgement. The 'insurance like' criteria have been developed using the proposed IPSASB criterion as a starting point. However, the IPSASB approach relies on full funding of the

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arrangements being provided by the beneficiaries. The AASB notes that the Conceptual Framework definition of a liability does not depend on the source of funding, and accordingly is not proposing to adopt these criteria.

Limited additional guidance on the application of AASB 17 discount rate requirements to the public sector is being proposed. Consistent with IPSASB's recommendations for its forthcoming Exposure Draft on Social Benefits, no additional guidance on the application of AASB 17 requirements for public sector entities is being proposed. The AASB welcomes feedback on whether there are any other areas that warrant public sector specific guidance.

Appendix A provides draft amendments to the standard and draft guidance for the public sector, with a draft basis for conclusions.

## **Who would be affected**

### ***Public sector issues***

All public sector entities, both for-profit and not-for-profit, with arrangements that create insurance risk would be affected by these proposals.

To assist in assessing which public sector entities might come within the scope of AASB 17 under the new proposals, the AASB has prepared a number of examples applying the proposed criteria. These are set out in Appendix E.

### ***Regulatory disclosures for the for-profit sector***

All for-profit entities with insurance contracts would be affected by these proposals. Appendix X sets out the suggested disclosures.

## **What happens next**

The AASB will consider feedback received on this Discussion Paper at future meetings and based on the information received determine whether the proposals should continue to an Exposure Draft or whether they require amendment before proceeding to an Exposure Draft. Exposure Drafts are provided to enable further consultation.

## **We need your feedback**

Comments are invited on any of the proposals in this Discussion Paper by [date]. Submissions play an important role in the decisions that the AASB will make in regard to a Standard. The AASB would prefer that respondents express a clear overall opinion on whether the proposals, as a whole, are supported and that this opinion be supplemented by detailed comments, whether supportive or otherwise, on the major issues. The AASB regards supportive and non-supportive comments as essential to a balanced review of the issues and will consider all submissions, whether they address some or all specific matters, additional issues or only one issue.

## **Specific Matters for Comment**

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The AASB would particularly value comments on the following:

Public sector entities

1. Do you agree with the objective of the proposed Application Guidance to achieve greater consistency of financial reporting across the public sector among entities engaging in insurance activities for the benefit of users of that information? Why or why not?
2. Do you agree with the proposed Application Guidance for determining when public sector entities should be required to apply AASB 17 *Insurance Contracts* and will the Guidance achieve its objective of greater consistency of financial reporting? Why or why not?
3. Are there other forms of Application Guidance that would be more likely to achieve the objective of greater consistency of financial reporting and be beneficial for users?
4. Do you agree the amendments to AASB 17 should apply to both for-profit and not-for-profit public sector entities?

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6. Are there other matters raised by the requirements of AASB 17 that you consider should be addressed in respect of public sector entities?
7. Overall, are the proposals for public sector insurance accounting in the best interests of the Australian economy?

For profit entities

1. AASB 1023 and 1038 required some regulatory disclosures that have not been carried forward into AASB 17. Should these disclosures be included in AASB 1054 *Additional Australian Disclosures*?

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## **Standards amended by AASB 2017-X**

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This Standard makes amendments to AASB 17 *Insurance Contracts* (July 2017).

### **Main features of this Standard**

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#### **Main requirements**

This Standard inserts Australian requirements and authoritative implementation guidance for not-for-profit entities into AASB 17. This guidance assists not-for-profit entities in applying that Standard to particular transactions and other events.

The amendments to AASB 17:

- address the identification of those arrangements that should be regarded as insurance contracts and
- expands its application to include insurance like arrangements that are created by statute, rather than contractual arrangements.

#### **Application date**

This Standard applies to annual periods beginning on or after 1 January 2021. Earlier application is permitted



## Accounting Standard AASB 2017-X

The Australian Accounting Standards Board makes Accounting Standard AASB 2017-X *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* under section 334 of the *Corporations Act 2001*.

Kris Peach

Dated [XX XXX 2017]

Chair – AASB

## Accounting Standard AASB 2017-X *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities*

### Objective

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This Standard amends AASB 17 *Insurance Contracts* to add requirements and authoritative implementation guidance for application by public sector entities.

### Application

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The amendments set out in this Standard apply to entities and financial statements in accordance with the application of the other Standards and Interpretations set out in AASB 1057 *Application of Australian Accounting Standards* (as amended).

This Standard applies to annual periods beginning on or after 1 January 2021.

This Standard may be applied to annual periods beginning before 1 January 2021. When an entity applies this Standard to such an annual period, it shall disclose that fact.

This Standard uses underlining, striking out and other typographical material to identify some of the amendments to a Standard, in order to make the amendments more understandable. However, the amendments made by this Standard do not include that underlining, striking out or other typographical material. Ellipses (...) are used to help provide the context within which amendments are made and also to indicate text that is not amended.

### Amendments to AASB 17

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Paragraph Aus3.1 is added. Appendix E is added
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### Scope

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Aus3.1 Notwithstanding paragraph 3, a public sector entity, shall apply AASB 17 to its non-contractual arrangements that:

- establish a present obligation to accept significant insurance risk, and
- are managed as part of a scheme with ‘insurance-like’ criteria as set out in paragraphs E12 to E15;

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as if they are insurance contracts.

Appendix E *Australian implementation guidance for not-for-profit entities* is added as set out on Pages XX – YY.

## **Commencement of the legislative instrument**

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For legal purposes, this legislative instrument commences on XX XXX 2017.

## Appendix E

### Australian implementation guidance for public sector not-for-profit entities

*This appendix is an integral part of AASB 17 and has the same authority as other parts of the Standard. This appendix applies only to public sector entities.*

#### Introduction

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- E1 AASB 17 *Insurance Contracts* incorporates International Financial Reporting Standard IFRS 17 *Insurance Contracts*, issued by the International Accounting Standards Board. Consequently, the text of AASB 17 is generally expressed from the perspective of for-profit entities in the private sector. The AASB has prepared this appendix to explain the principles in the Standard in relation to arrangements arising from statutory or regulatory requirements that in accordance with paragraph Aus3.1 have the characteristics of insurance transactions ('insurance-like arrangements') from the perspective of public sector entities. This appendix does not apply to private sector not-for-profit entities, or affect their application of AASB 17.
- E2 Public sector entities may enter into arrangements, contractual or statutory in nature, that result in the entity accepting insurance risk and which should be accounted for under this Standard.
- E3 This appendix provides guidance to assist public sector entities to determine whether particular transactions or other events, or components thereof, are within the scope of this Standard. If a transaction is outside the scope of AASB 17, the recognition and measurement of the asset, liability, income and expense arising from the transaction may instead be specified by another Standard, such as AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

#### Insurance risk transferred by statutory or regulatory requirements

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- E4 The scope of AASB 17 depends on the definition of an insurance contract, which is 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. Therefore, AASB 17 specifically addresses insurance assets, liabilities, revenues and expenses that arise from contracts that identify policyholders.
- E5 A contract is defined in AASB 17 paragraph 2 as an agreement between two or more parties that creates enforceable rights and obligations. That paragraph also explains that an entity should consider its substantive rights and obligations, whether they arise from a contract, law or regulation, that contractual terms include all terms in a contract, explicit or implied and that implied terms include those imposed by law or regulation.
- E6 Paragraph 2 states that contracts can be written, oral or implied by an entity's customary business practices. The customary business practices of a not-for-profit entity refer to that entity's customary practice in performing or conducting its activities.
- E7 AASB 17 defines a policyholder as *a party that has the right to compensation under an insurance contract if an insured event occurs* and insurance risk as *risk, other than financial risk, transferred from the holder of a contract to an issuer*.
- E8 Some public sector entities enter into arrangements that are similar to and sometimes indistinguishable from insurance contracts. For example, workers compensation insurance may be provided by a public sector entity that enters into arrangements with employers with insurance premiums determined in a similar way to for-profit private sector entities that enter into insurance contracts with employers in other states and territories. Such arrangements may be regarded as causing the issuance of insurance contracts by the public sector entity. In these cases, the issuer is the public sector entity, the policyholder is the employer, and the insurance risk is the risk that an employer will incur costs<sup>1</sup> in the event an employee is injured.
- E9 Enforceable rights and obligations may also arise from statutory requirements when no contract arises, and may be funded by way of levy or other contribution rather than by way of premiums. For example, motor vehicle accident schemes may provide cover to people who are injured in vehicle accidents and such schemes may be funded by levies added to motor vehicle registration fees. The driver is not made aware of any rights

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<sup>1</sup> Such costs may include medical expenses, weekly and lump sum compensation payments

and obligations under the scheme at the time of payment and there is no ability to ‘go to market’ to choose a service provider. The conditions for a contract to be established are unlikely to be met in these circumstances as there is unlikely to be a reciprocal intention to create legal relations that are voluntarily undertaken. In this example, there is transfer of insurance risk, albeit not through a contract. The public sector entity has taken on the insurance risk (such as the cost of rehabilitation and compensation for loss of earnings) from those injured in motor vehicle accidents that would otherwise be the responsibility of the drivers. For the purpose of this standard, the public sector entity administering the scheme is identified as the issuer as it is the entity that has accepted the insurance risk, and the policyholders are the drivers who have transferred insurance risk to the scheme. To be an arrangement that is recognised and measured under this Standard, the arrangement must also have other insurance-like characteristics as specified in paragraphs E13 to E16.

- E10 Distinguishing between insurance risk created by contract or by statute alone may require significant judgement as to whether there is sufficient “voluntary” and “reciprocal intention” to create a contract, particularly where it may be a voluntary decision to undertake an activity which results in an involuntary fee. Accordingly, the requirements of this Standard focus on whether there is transfer of insurance risk and whether the scheme accepting the insurance risk is managed on an insurance like basis (see paras E12 to E16). A present obligation for insurance risk is recognised regardless of whether it is created by contract or by statute.
- E11 Further guidance on contracts and enforceable agreements is set out in AASB 15 Appendix F8-18.

### **Identifying whether an arrangement is ‘insurance-like’**

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- E12 The substance of an arrangement will determine whether a non-contractual arrangement that transfers significant insurance risk to a public sector not-for-profit entity as set out in para E8 is ‘insurance-like’. In assessing the substance of an arrangement, all relevant material facts and circumstances should be considered. Paragraph E13-E14 provides indicators of insurance-like arrangements. .
- E13 The following criteria are mandatory for an ‘insurance-like’ arrangement:
- (a) the terms of the arrangement have commercial substance. Paragraph 2 defines commercial substance as having a discernible effect on the economics of the arrangement. An arrangement has commercial substance if the risk, timing or amount of the entity’s future cash flows is expected to change as a result of the arrangement<sup>2</sup>. An arrangement may have ‘commercial substance’, even if it is entered into by a public sector not-for-profit entity for purposes that, in everyday language, would be considered ‘non-commercial’ (for example, arrangements to provide insurance to members of the community on a subsidised or cost-recovery basis). This is because arrangements to provide insurance without generating a commercial return may nonetheless cause a change in the risk, timing or amount of the public sector not-for-profit entity’s future cash flows. Accordingly, for the purposes of application of the Standard by not-for-profit entities, ‘commercial substance’ shall be read as a reference to economic substance (ie giving rise to substantive rights and obligations);
  - (b) the key criterion of the arrangements, particularly beneficial rights, cannot be altered without a specific change in legislation or relevant governing measures and cannot be retrospectively amended. For example, there may be evidence that the entity considers that it can amend the terms of its obligations (such as where the entity has previously amended the terms of its obligations; or has proposed retrospective changes to its obligations that do not require legislative change). In such cases, the entity will not be bound in a similar manner to an insurer, and the transaction will not have commercial substance;
  - (c) the arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs. Insurance contracts give such rights to policyholders and similar rights may be provided by legislation or regulation. For example, some legislation may obligate the entity to provide compensation or services to a beneficiary if they are injured in a motor accident. In the event of a dispute as to whether the entity is obligated, the beneficiary may have rights to appeal an entity’s denial of being obligated to provide compensation or other services. Such factors are indicators that beneficiaries have enforceable rights and are effectively policyholders under the arrangement. If the arrangement does not also include such rights, then any benefits provided by the entity will have a discretionary nature and may not be ‘insurance like’;
- E14 The following indicators should not be regarded as an exhaustive list and not all factors need to be present for an arrangement to be, in substance, insurance-like:

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<sup>2</sup> AASB 15 Paragraph 9(d) and Appendix F19

- (a) Funding: the legislation or other measures governing the arrangements provide for funding by premiums or levies paid by either the potential beneficiaries or those whose activities create or exacerbate the risks, or contributions by the government or other public sector entities. Where premiums or levies are determined so that the arrangement is funded by these amounts, even where the amounts are less than the total required to meet the arrangement’s obligations in full<sup>3</sup>, the arrangement is more likely to be insurance-like. An arrangement fully or partially funded by the entity or another public sector entity or government may still be an insurance-like arrangement as there is still a transfer of insurance risk. In these circumstances consideration is given to whether the contributions required by the public sector entity are determined in a similar way as if the public sector entity were a for-profit entity. The entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, levies or contributions by the government or other public sector entities) and/or benefit payments on a periodic basis, with the aim that the arrangement is substantially self-funded. Some arrangements may have identified funding shortfalls that are not addressed promptly due to political, social or other reasons. Arrangements may be insurance-like even when there is a substantial time lag between the identification of a shortfall and changes in revenue or expense or where the entity is funded to meet short term cash requirements rather than regulatory solvency requirements. The identity of the funder of the arrangements is not the sole determinant of whether an insurance like arrangement exists. The existence of funding determined on this basis is a strong indicator of an insurance like arrangement. However, the absence of funding determined in this way is not necessarily an indicator that an ‘insurance like arrangement’ does not exist;
- (b) Management of claims: the financial performance and financial position of the scheme is assessed on a regular basis, using data analysis and estimation techniques (eg actuarial analysis), reporting internally and/or externally on the financial performance of the scheme occurs, and, where necessary, action taken to address any underfunding of the scheme. For example, the legislation establishing the arrangements requires a public annual report to be prepared that must include information about “the extent to which the scheme was fully funded in the financial year, based on actuarial advice”<sup>4</sup>. Importantly, the entity may enter into insurance-like arrangements despite having assets less than its liabilities at a point in time;
- (c) Similar arrangements in the private sector: transactions or arrangements with similar characteristics and level of insurance risk are entered into by for-profit entities and accounted for as insurance contracts. For example, in some states, Compulsory Third Party motor insurance is provided by public sector entities and in other states by private sector entities;
- (d) Separate assets and liabilities: the assets and liabilities arising from the arrangements are held in a separate fund, or otherwise specifically identified as used solely to provide benefits to beneficiaries. If an entity does not separately identify amounts relating to its arrangements, this suggests that the entity considers any contributions made by the beneficiaries as a form of taxation, rather than an insurance-like arrangement. A separate entity has been established by the government, which is expected to act like an insurer in relation to the arrangement. The existence of such an entity provides evidence that the entity enters into the transactions in the same way as an insurer would issue insurance contracts. However, it is not a requirement that a separate entity has been established. This Standard applies to insurance-like arrangements and contracts, regardless of the type of entity assuming the insurance risk. Similarly the separate identification of assets is a strong indicator of an insurance like arrangement. However the absence of separately allocated assets is not necessarily an indicator the arrangement is not insurance like.
- (e)
- E15 The reference in paragraph E13(d) to “those whose activities create or exacerbate the risks” means that arrangements may be insurance-like where they are:
- (a) funded by levies on, for example, motorists or employers in particular industries; and
- (b) providing coverage for insurance risks to a wider population than those paying premiums, levies or contributions. For example, some motor accident schemes will apply even if the accident was caused by a vehicle that is registered in another state and so has not paid a levy to the scheme.
- E16 Co-payments by users of the services, would not of themselves make the schemes receiving the co-payments insurance-like. Co-payment arrangements are usually designed as part of a funding model and/or incentive

<sup>3</sup> A public sector entity may not require premium rates to include an allowance for profit and may be less than the expected cost of the risks assumed where subsidised.

<sup>4</sup> National Injury Insurance Scheme (Queensland) Act 2016, S89(1)(c)

model to manage demand for a service, and are not determined in a manner similar to compensation for insurance risk.

## **Discount rates**

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- E17 Paragraph 36 requires an entity to adjust the estimates of cash flows to reflect the time value of money and describes how the discount rate should reflect the characteristics of the insurance contracts. These requirements apply to insurance-like arrangements.

## **Risk adjustment for non-financial risk**

- E18 Paragraph 37 requires an entity to incorporate a risk adjustment in the measurement of insurance contracts. A public sector entity shall include a risk adjustment when measuring rights and obligations arising from insurance-like arrangements.
- E19 A public sector entity with the benefit of a government guarantee supported by taxing powers and which may also have the benefit of monopoly status might have a less risk averse approach to its activities than entities without these characteristics. In such cases, the compensation that the public sector entity may require for bearing the uncertainty about the amount and timing of cash flows arising from insurance risk may be different to an entity that operates in a competitive environment. For example, in a monopoly situation, the amount that the public sector entity receives for accepting the insurance risk may be increased or decreased, either by the entity or some other party such as regulator or government, and such changes will not be subject to the same competitive pressures that an entity operating in an open market would be. Consequently, public sector entities may have a different risk adjustment to an equivalent private sector entity which did not have such characteristics.
- E20 In relation to the impact of an entity's monopoly status, in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period. Any potential to pass that risk back to external parties relates to possible future transactions that are not the subject of financial reporting for the current period. Accordingly, it is not appropriate for the risk adjustment to be nil.

## BASIS FOR CONCLUSIONS

*This Basis for Conclusions accompanies, but is not part of, AASB 17.*

### Background

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BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in the Exposure Draft (ED). Individual Board members gave greater weight to some factors than to others.

### The need for change

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BC2 Preliminary discussions with key government departments identified the primary factor contributing to a need for public sector specific amendments to AASB 17 and additional guidance is the prevalence and magnitude of 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).

BC3 Some transactions that involve public sector entities bearing insurance risks of an external party are clearly within the scope of the insurance standards. In practice, other similar transactions that may not appear to have all the features of an insurance contract (ie created by statute) are accounted for as insurance in some cases and in other cases are not. Many of the entities with these transactions are regarded as reporting entities and prepare general purpose financial statements. Accordingly, there is inconsistent financial reporting for arrangements that involve public sector entities bearing insurance risks.

BC4 Some public sector entities are applying AASB 1023 *General Insurance Contracts* or are applying accounting consistent with AASB 1023 and others, with similar activities, are not. Some of those not applying AASB 1023 or accounting consistent with AASB 1023 specifically identify that they are applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

BC5 Given that the definitions and scope of AASB 17 are no different from the collective scopes of AASB 4, AASB 1023 and AASB 1038, the Board is concerned that the same issues around inconsistent reporting could remain under AASB 17.

BC6 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. Based on this example (which is largely representative of other governments), insurance claims are significant to state and Commonwealth financial statements.

BC7 Accordingly, the Board considers it timely to address this matter in view of the issue of AASB 17 *Insurance Contracts* that supersedes AASB 4 *Insurance Contracts*, AASB 1023 and AASB 1038 *Life Insurance Contracts*.

### Differences between insurance contract accounting and other standards

BC8 Some of the most significant differences between the accounting required in AASB 1023 and AASB 17 compared with AASB 137 and other relevant standards are noted below.

- (a) AASB 1023 and AASB 17 require outstanding claims liabilities to be measured as the central estimate of the present value of expected future payments with an additional risk adjustment<sup>5</sup> to allow for the

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<sup>5</sup> To help avoid confusion, this Exposure Draft refers consistently to ‘risk adjustment’, which is the term used in AASB 17, even though AASB 1023 refers to ‘risk margin’.

inherent uncertainty in the central estimate.<sup>6</sup> AASB 137 does not require a risk adjustment for inherent uncertainty to be included in the measurement of provisions. AASB 1023 and AASB 17 do not permit the return on insurance assets to be used as the discount rate for measurement of the outstanding claims liabilities.

- (b) The initial measurement of financial liabilities under AASB 9 *Financial Instruments* is at fair value, which would ordinarily be the relevant transaction price. That is consistent with the measurement of the ‘pre-claims’ insurance liability under AASB 1023 and AASB 17’s Premium Allocation Approach described in paragraphs 53 to 59. However, the subsequent measurement of financial liabilities under AASB 9 is either:
  - (i) amortised cost, which is not consistent with the AASB 1023 or AASB 17 measure of outstanding claims liabilities; or
  - (ii) fair value, which as a current value has an element of consistency with the ‘fulfilment value’ measure of outstanding claims liabilities under AASB 1023 and AASB 17, but could be very different based on factors such as the impact on fair value of the insurer’s own credit risk.
- (c) Some of the costs of acquiring insurance contracts can be deferred under AASB 1023 (and AASB 17 where the Premium Allocation Approach is used) while other standards may require immediate recognition as an expense.
- (d) AASB 1023 and AASB 17 include presentation and disclosure requirements designed specifically to cater for insurance activities, such as disclosures around claims development.

BC9 In relation to risk adjustments, the Board acknowledges the view that public sector entities can take a view extending beyond current insurance arrangements and, over the long-term, the best estimate liability is the appropriate total amount to recognise. That is, there is no need for a risk adjustment. This view is often supported on the basis that:

- (a) public sector insurers usually have the benefit of a government guarantee underpinned by taxing powers, which could potentially be called upon for support and sustain them in bad times; and/or
- (b) some public sector entities enjoy monopoly status and have the power to recover cost overruns in any given period by increasing premiums or levies in following years.

BC10 In relation to the support that might be applied by government to a particular entity, the Board considers the uncertainties associated with outstanding claims cash flows in respect of past transactions, that would be reflected in a risk adjustment, to be a characteristic of the claims liability. In relation to the impact of an entity’s monopoly status, the Board considers that, in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period. Any potential to pass that risk back to external parties relates to possible future transactions that are not the subject of financial reporting for the current period. Accordingly, the risk adjustment might differ from a for-profit private sector entity, however, is unlikely to be nil.

BC11 AASB 17 defines ‘risk adjustment’ as:

*The compensation that an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arise as the entity fulfils the insurance contract. [Appendix A]*

BC12 The Application Guidance to AASB 17 comments that:

*Because the measurement of the risk adjustment reflects the compensation that the entity would require for bearing the non-financial risk arising from uncertain amounts and timing of the cash flows, the risk adjustment for non-financial risk also reflects:*

- (a) *the degree of diversification benefit that the entity considers when determining the compensation it requires for bearing that risk; and*
- (b) *both favourable and unfavourable outcomes in a way that reflects the entity’s degree of risk aversion. [paragraph B88]*

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<sup>6</sup> In Australia, risk adjustments are usually based on a particular level of confidence that claims would be no more than the estimated amount. For example, the risk adjustment might be set at an amount providing a 75% level of confidence that actual claims will be no more than the claims liability. AASB 17 does not prescribe a particular technique to determine the risk adjustment.



BC13 The Board notes that public sector entities with the benefit of a government guarantee supported by taxing powers and which may also have the benefit of monopoly status might have a less risk averse approach to its activities than entities without these characteristics. Consequently, public sector entities may have a different risk adjustment to an equivalent private sector entity which did not have such characteristics.

### **Benefits of consistency**

BC14 The Board considers it relevant to apply the accounting in AASB 1023 and its successor, AASB 17, to insurance transactions in both the private sector and public sectors for the following reasons:

- (a) applying insurance contract accounting will result in more useful information than applying other Australian standards. For example, the Board considers risk adjustments included in measuring insurance liabilities convey useful information to users about the amount of risk associated with the insurer's insurance contracts because the management of risk is integral to the insurance business model. The risk adjustment also reflects the insurer's view of the economic burden imposed on it by the presence of that risk; and
- (b) consistently applying insurance contract accounting will facilitate benchmarking between public sector entities in terms of their financial position and financial performance and between public and private sector entities. In some jurisdictions particular types of insurance are sold by public sector entities, while in other jurisdictions the same insurance cover is provided by private sector entities.

BC15 The Board acknowledges that, in order to facilitate consistency, it needs to provide public sector entities with Application Guidance that identifies suitable features of transactions that are in the nature of insurance transactions.

### **Bearing non-financial risks of the external party**

BC16 AASB 17 defines 'insurance risk' as:

*Risk, other than financial risk, transferred from the holder of a contract to the issuer.*

BC17 AASB 17 defines 'financial risk' as:

*The risk of a possible future change in one or more of a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract.*

BC18 Based on the above definitions, many of the risks borne by public sector entities would be classified as insurance risks. For example, accident insurance and workers compensation benefits.

- (a) Compulsory third party motor insurance where a public-sector-entity assumes from motorists the risk of compensating people injured in motor accidents in return for motorists paying a levy that is charged at the time of a vehicle registration.
- (b) Care and support for people that are injured catastrophically by motor accidents, such injuries not being included in the cover provided by private sector compulsory third party insurers. The cost of care is paid for by a public sector entity that assumes risk from motorists and is funded by way of a levy collected from motorists at the time they pay their CTP premium to private sector insurers.
- (c) Workers insurance where the public-sector-entity assumes from employers the risk of employees being injured in the workplace. The employer paying a premium to intermediaries (that may be private sector insurers, agents or brokers) who remit the premium to the public-sector-entity.
- (d) Damage to property owned by the government where a public-sector-entity is used in the same way as a private sector entity may establish a captive insurer. The government agency or department (the insured) that owns or uses the property pays a premium to the public-sector-entity (the insurer) in return for the insurer compensating the insured in the event that the property is damaged or destroyed.

### **Scope**

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BC19 In determining what arrangements should be scoped into AASB 17, the Board noted that the International Public Sector Standards Board (IPSASB) is currently working on a project addressing the accounting for

social benefits, such as the unemployment benefits and pensions. 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.

BC20 Based on discussions as at July 2017, the IPSASB Exposure Draft is expected to recommend that the insurance approach may be applied to social benefit schemes that are intended to be fully funded from contributions, and where there is evidence that public sector entity manages the scheme in the same way as an issuer of an insurance contract. The factors indicative of an insurance like scheme are expected to be:

- (a) The entity considers itself bound by the scheme in a similar manner to an insurer being bound by an insurance contract. For example, there may be evidence that the entity considers that it can amend the terms of the scheme (such as where the entity has previously amended the terms of the scheme; or has proposed retrospective changes to the scheme). In such cases, the entity will not be bound in a similar manner to an insurer, and the social benefit scheme will not have commercial substance or look and feel like an insurance contract.
- (b) Assets relating to the social benefit scheme are held in a separate fund, or otherwise earmarked to provide benefits to participants. If an entity does not separately identify amounts relating to social benefits, this will provide evidence that the entity considers the contributions as a form of taxation. The social benefit scheme will not have commercial substance or look and feel like an insurance contract. There will also be practical difficulties with applying the measurement requirements in the forthcoming IFRS on insurance if the assets associated with a social benefit scheme are not separately identified.
- (c) The legislation that establishes the social benefit gives enforceable rights to participants in the event that the social risk occurs. Insurance contracts give such rights to policyholders. If the social benefit scheme does not also include such rights, then any benefits provided by the entity will have a discretionary nature. The social benefit scheme will not have commercial substance or look and feel like an insurance contract.
- (d) There is a separate entity established by the government, which is expected to act like an insurer in relation to a social benefit. The existence of a separate entity will be an indicator that the insurance approach could be appropriate, however this is not a requirement.

BC21 The IPSASB Exposure Draft is not expected to make any modifications to IFRS 17 for:

- (a) definition of an insurance contract;
- (b) the premium allocation approach required;
- (c) discount rates;
- (d) risk adjustments.

BC22 The Board considered two approaches to distinguishing between other arrangements and insurance-like non-contractual arrangements (the latter to be included within the scope of AASB 17):

- (a) adopting the IPSASB approach – define broader social benefits<sup>7</sup> and specify which of those benefits are to be within the scope of AASB 17 (the ‘indirect approach’); or
- (b) expanding the scope of AASB 17 directly – modify AASB 17 to apply to non-contractual arrangements and limit the extent of its applicability (the ‘direct approach’).

BC23 The Board noted that 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.

## IPSASB ‘indirect’ approach

BC24 The current IPSASB 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

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<sup>7</sup> See Appendix A for the definition of **social benefits** and the definitions of supporting terms.

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- (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.
- BC25 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.
- BC26 The IPSASB exchange/non-exchange proposed distinction to determine the accounting for some social benefits is similar to the way reciprocal/non-reciprocal transactions were previously defined in Australian Accounting Standard AASB 1004 *Contributions*. IPSASB defines a 'non-exchange' transaction as a transaction in which "an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving equal value in exchange.
- BC27 The Board considered that the expected IPSASB criteria sets a reasonable boundary for extending the scope of AASB 17 to capture such insurance-like arrangements as it is expected to require:
- (a) benefits be provided to specific individuals that meet eligibility requirements. This is analogous to the AASB 17 definition of an insurance contract requiring the compensation of a policyholder that is adversely affected (ie eligible) by an uncertain future event;
- (b) arrangements to be fully funded draws a practical distinction between insurance-like schemes and obligations paid out of current revenue as some public sector arrangements are. 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; and
- (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.
- BC28 However, the Board determined for the following reasons that the IPSASB approach was not preferred:
- (a) a number of IPSASB definitions would need to be incorporated (eg. *social benefit*, *social risk* and *universally accessible*) into AASB 17 and the definition of an insurance contract modified. Additional consideration would be needed in respect of what a 'contribution' is and perhaps the scope of 'social risk'. The Board noted 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;
- (b) constituent feedback noted in AASB 1058 *Income of Not-for-Profit Entities*, BC14 indicated challenges in identifying a transaction as a reciprocal/non-reciprocal transaction, and concerns that the consequential accounting did not reflect the true underlying financial performance of the entity. The Board also noted that:
- (i) the exchange/non-exchange distinction could result in arrangements with similar economic substance being accounted for differently purely on the basis of the funding mechanism for the arrangement, as the proposed IPSASB criteria to determine an insurance exchange transaction is that the arrangement is fully funded by contributions from policyholders;
- (ii) the exchange/non-exchange distinction is difficult to determine in practice;
- (iii) AASB 1058 has moved to a performance obligation approach which is more aligned to how constituents think of their liabilities; and
- (iv) Conceptual Framework definition of a liability is not dependent on the way in which the liability is funded.
- BC29 Accordingly, the Board considered that basing its project proposals on the IPSASB approach would not meet its objective in undertaking this project.

### Statutory ‘direct’ approach

BC30 The Board noted the definition of ‘contract’ in AASB 15 *Revenue from Contracts with Customers*:<sup>8</sup>

*An agreement between two or more parties that creates enforceable rights and obligations.*

BC31 The AASB considers this definition to have broad application and, in principle, it captures many statutory arrangements that may not take the legal form of contracts. For example, the Board considers that arrangements with a public sector entity setting out specific risk cover, such as covering employers for medical costs relating to injuries to their workers, would create enforceable rights for those employers and create obligations for the risk bearing entity. This would apply whether or not the arrangement between the public sector entity and employer takes the form of a contract.<sup>9</sup>

BC32 In addition the IASB *Conceptual Framework* defines liabilities as present obligations, and indicates that present obligations might arise from contracts or legislation (paragraph 4.34).

BC33 The Board noted that AASB 1058 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. 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.

BC34 Extending the scope beyond contractual arrangements is consistent with the Board’s recent practice regarding NFP-specific modifications. This addresses the fact 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.

BC35 The Board noted that many of the activities of governments that mitigate risks facing their residents would not be regarded as creating enforceable rights and obligations. Residents might consider themselves entitled to particular services, such as emergency or public hospital services, but the policy of providing them does not grant an enforceable right. Governments might use their best endeavours to provide particular services to those who most need them, but are not obligated to provide them beyond a certain capacity. Furthermore, government has not arranged to make those public services available to any particular parties, but to the public in general.

### Coverage period and boundary of the insurance contract

BC36 AASB 17 defines the coverage period as “The period during which the entity provides coverage for insured events. That period includes the coverage that relates to all premiums within the boundary of the insurance contract.”

BC37 Cash flows are within the boundary of an insurance contract when the entity can compel the policyholder to pay the premiums or has a substantive obligation to provide the policyholder with coverage or other services. A substantive obligation to provide coverage or other services ends when the entity can reassess the risks associated with an insurance contract or portfolio of contracts, and as a result, can set a price or level of benefits that fully reflects those risks.

BC38 The definition of the coverage period and the discussion of the boundary of the insurance contract clearly define which cash flows are to be taken into account in measuring the insurance contract.

BC39 The AASB noted that when extending the scope of the standard to include insurance risk obligations created by statute rather than contract that it is important that there is still a definable coverage period and boundary to enable the basic concepts of AASB 17 to operate. Accordingly, the AASB identified that in addition to creating insurance risk through statute, the arrangement would need to be sufficiently ‘insurance-like’ to enable the coverage period and the boundary of the insurance obligation to be determined.

BC40 The AASB noted that they did not think further guidance on boundary and coverage period would be needed for the public sector. For example most insurance like schemes will relate to a specific period of time (where premiums/levies are charged and are reassessed each year, or the insured event has clear end point such as when an individual dies.

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<sup>8</sup> The insurance standards do not include a definition of ‘contract’.

<sup>9</sup> The wording in this paragraph should be reviewed once AASB 2017-X is finalised.

## Management actions

- BC41 Extending the scope of AASB 17 to include non-contractual arrangements, without limitation 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). The Board determined that the IPSASB's criteria for the management approach to the arrangement could be useful in distinguishing 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'.
- BC42 Although other schemes with transfer of insurance risk could meet liability recognition criteria, the AASB will consider these as part of other standard-setting projects, one of which may be to consider the IPSASB's social benefits project as a whole.
- BC43 Based on the definitions of 'insurance contract' and 'insurance risk' and the introductory text of AASB 17 noted in paragraphs E4-E8, the AASB concluded that a public sector entity's non-contractual arrangements should be accounted for in accordance with AASB 17 when they establish a present obligation to accept significant insurance risk and where the arrangements are managed with insurance-like criteria.

## Insurance-like

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- BC44 Governments stand ready to provide their residents with various services in the event of incidents that adversely affect them. This can include medical services, fire services, policing services and rescue services. These arrangements could be considered to fall into three categories:
- (a) insurance contracts;
  - (b) non-contractual arrangements that create insurance risk and have insurance-like characteristics;
  - (c) community-wide services or safety nets, such as Medicare, that are not the subject of arrangements between particular parties and are not administered like insurance arrangements.
- BC45 Community-wide services or safety nets are not transactions that the Board intends to cover in its proposed Australian Application Guidance. Aspects of such arrangements, such as co-payments by users of the services, would not make them insurance-like. Co-payment arrangements are usually designed as part of a funding model and/or incentive model to manage demand for a service, and are not determined in a manner similar to compensation for insurance risk.
- BC46 Some services may be administered in a way that are similar to insurance arrangements. For example, some Governments fund fire or other emergency services by way of a levy that is collected by private sector insurers on their behalf. Where such arrangements do not result in the transfer of significant insurance risk to the public sector entity, they will not be 'insurance-like'.
- BC47 Service agreements are also not intended to be covered by the proposed Australian Application Guidance and are regarded as a means of facilitating government service delivery. The proposed Australian Application Guidance is designed to capture government arrangements that provide coverage for insurance risks transferred by other parties where those risks are administered in a way that makes the arrangement 'insurance-like'.
- BC48 Some public sector entities deal only with other entities controlled by the parent government – that is, they operate as captive insurers. Some of these entities regard themselves as reporting entities and prepare general purpose financial statements and others do not. The proposed Australian Application Guidance is only concerned with those entities that prepare general purpose financial statements. It is not concerned with identifying which of these captive insurers should prepare general purpose financial statements – that topic is part of a larger issue being addressed within the AASB's project on the Australian Financial Reporting Framework.
- BC49 The Board identified a range of criteria that would be indicative of a non-contractual arrangement in the public sector being in substance an 'insurance-like' arrangement, The Board determined that the presence of certain criteria should be mandatory for an arrangement to be 'insurance-like', and identified other criteria that would be indicators of 'insurance-like' arrangements in consideration with all other relevant material facts and circumstances.
- BC50 The Board considers the following criteria are mandatory for an arrangement to be 'insurance-like':

- (a) the terms of the arrangement have commercial substance;
- (b) the key criterion of the arrangements, particularly beneficial rights, cannot be altered without a specific change in legislation or relevant governing measures and cannot be retrospectively amended.
- (c) the arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs;

BC51 The following indicators should not be regarded as an exhaustive list and not all factors need to be present for an arrangement to be, in substance, insurance-like

- (a) the legislation or other measures governing the arrangements provide for funding by premiums or levies paid by either the potential beneficiaries or those whose activities create or exacerbate the risks, or contributions by the government or other public sector entities.
- (b) the public sector entity assesses the financial performance and financial position of the scheme with the arrangements on a regular basis, uses actuarial assumptions, reports internally and/or externally on the financial performance of the scheme, and, where necessary, takes action to address any underfunding of the scheme;
- (c) the entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, levies or contributions by the government or other public sector entities) and/or benefit payments on a periodic basis, with the aim that the arrangement is substantially self-funded;
- (d) transactions or arrangements with similar characteristics and level of insurance risk are entered into by for-profit entities and accounted for as insurance contracts;
- (e) the assets and liabilities arising from the arrangements are held in a separate fund, or otherwise specifically identified as used solely to provide benefits to beneficiaries and a separate entity has been established by the government, which is expected to act like an insurer in relation to the arrangement.

## **Mandatory criteria**

### ***Commercial Substance***

BC52 AASB 17 Paragraph 2 defines commercial substance as having a discernible effect on the economics of the arrangement<sup>10</sup>. An arrangement has commercial substance if the risk, timing or amount of the entity's future cash flows is expected to change as a result of the arrangement<sup>11</sup>. The Board noted this is consistent with the guidance provided in Appendix F of AASB 15 on how the not-for profit sector should interpret commercial substance.

BC53 AASB17 paragraph B22 explains that the significance of insurance risk is assessed contract by contract and that insurance risk may be significant even if there is minimal probability of significant loss for a portfolio or group of contracts. In public sector arrangements, the entity entering into insurance-like arrangements may not enter into contractual arrangements. In these cases, commercial substance should be assessed by the equivalent unit of account, for example, each vehicle for motor insurance or each employer for workers insurance.

### ***Enforceable rights***

BC54 Consistent with IPSASB and the requirements of AASB 17, the Board noted the importance of the enforceability of the arrangements to create the obligation on the public sector entity. A key component of an insurance contract is that the benefits cannot be retrospectively amended and that a beneficiary has a right of review of the decision of the insurer. Accordingly the Board considered these to be important criteria for an insurance like scheme.

BC55 The Board also noted that consistent with AASB 10 *Consolidated Financial Statements* IG14, a government's sovereign power to change legislation is not a factor to be considered until the legislation is changed.

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<sup>10</sup> AASB 17 Paragraphs B18 to B23 provide application guidance to determine commercial substance.

<sup>11</sup> AASB 15 Paragraph 9(d) and Appendix F19

## **Other Criteria**

### ***Funding***

- BC56 Unlike IPSASB, for the reasons noted above, the Board did not believe arrangements needed to be fully funded by policy holders or beneficiaries. The Board noted where there are premiums or levies paid by policyholders or beneficiaries this is a clear indication that the scheme is insurance-like. The identity of the funder of the arrangements should not be the sole determinant of whether an insurance-like arrangement exists.
- BC57 In some public sector arrangements, a premium or levy that varies with the risk factors of the policy holder or beneficiary is paid to the entity and is intended to be sufficient to fund obligations from risks accepted from the portfolio or group of beneficiaries. In these circumstances, it is almost certain that the arrangement is insurance-like.
- BC58 Other public sector arrangements may result in policy holders or beneficiaries paying similar amounts irrespective of their individual risk factors, an approach commonly referred to as community rating. Community rated arrangements will result in some participants contributing more than their risk profile would require and others contributing too little, so that cross-subsidisation exists. Such funding arrangements indicate an arrangement is insurance-like even if the total amount received by the entity is insufficient to fully fund obligations from risks accepted from the portfolio or group of beneficiaries.
- BC59 Some public sector arrangements are funded so that the obligations are met directly or indirectly from the broader community rather than from the potential beneficiaries or those that create or exacerbate the risk. In such circumstances, the arrangement may still be insurance-like and the other criteria should be evaluated to determine the substance of the arrangement.
- BC60 The Board considers that external party consideration could include, for example, those transactions that involve statutory levies. The fact that an external party pays a levy rather than a premium may be only a matter of form, not substance. Levies might be determined based upon a broad population of external parties, even a whole community regardless of risk factors. However, the pooling of risk is a basic part of the insurance business model. Although the extent of pooling in some public sector arrangements may be broader than in many commercially-driven insurance businesses, the principle is the same.
- BC61 Some parties cite cases in which the levies are simply regarded as a funding mechanism and they note that the funding for a particular scheme might just as well have come from consolidated revenue. However, the Board considers that a decision to have a user-pays basis for funding a scheme is significant in determining the character of the transactions. If a public sector entity undertakes to bear risks in exchange for a compensating levy, those arrangements gives rise to obligations and rights.

### ***Management of claims***

- BC62 The Board noted one of the key aspects of an insurance scheme is the assessment of liabilities and adjustments of premiums to cover the emerging risks in the portfolio of policy holders and/or beneficiaries. Regardless of the source of funding it would be expected that either premiums would be adjusted to reflect the change in risk, whether to be paid by a policy holder or by way of government contribution.
- BC63 The board noted underfunding of the arrangement would be reflected in a similar manner to the way a private sector insurer would reflect its underfunding.
- BC64 Where an arrangement is set up to be self funding this is a clear indication the arrangement is insurance like.
- BC65 The assessment of liabilities does not need to be performed by actuarial specialists or use actuarial methods for the scheme to be insurance-like.

### ***Similar arrangements in the private sector***

- BC66 The Board noted that the public sector has outsourced a number of arrangements with insurance risk transfer to the private sector, in some instances the private sector receives a fee for undertaking the activities, and in other cases undertakes the insurance risk itself. The existence of private sector operators is indicative that these type of arrangements are more likely to be insurance like when performed by the public sector as the risks being undertaken and compensated for are likely to be similar in substance.

### ***Separate assets and liabilities***

BC67 Like the IPSASB, the Board noted that the creation of a separate fund or separate entity would be indicative of an insurance-like arrangement, and this would make assessing the financial performance and position easier. However, the absence of a separate fund or entity would not necessarily preclude the arrangement being insurance-like.

### **Other factors**

BC68 The Board considered a number of other factors in the process of identifying the proposed Applications Guidance, however did not consider these should be specific factors as they were not considered sufficiently discriminatory.

BC69 Arrangements that transfer insurance risk may be established in a variety of forms and not every contract described as an insurance contract transfers insurance risk nor is regulation as insurance necessary for insurance risk to be transferred from one party to another. Other factors may result in preparers applying the form of an arrangement rather than evaluating whether, in substance, the arrangement is 'insurance-like'. This requires the preparer to apply judgement, hence the factors in E13-E14 are not intended to be exhaustive nor must every indicator be present for an arrangement to be 'insurance-like'.

### **Links to public policy objectives**

BC70 Of itself, the Board considers that a close link to a public policy objective would not disqualify a transaction from being regarded as being the same, or having the same economic substance, as an insurance contract. Insurance activities are widely regarded as facilitating economic and social activity, whether they are undertaken by for-profit private sector insurers or public sector entities.



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### **Australian illustrative examples for not-for-profit entities**

*These illustrative examples accompany, but are not part of, AASB 17. They illustrate aspects of AASB 17, but are not intended to provide interpretative guidance.*

IE1 The following examples portray hypothetical situations. They are intended to illustrate how a not-for-profit entity might apply some of the requirements of AASB 17 Insurance Contracts to particular types of transactions, on the basis of the limited facts presented. Although some aspects of the examples might be present in actual fact patterns, all relevant facts and circumstances of a particular fact pattern need to be evaluated when applying AASB 17.

IE2 [to come]