

# **Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities**

Comments to the AASB by 28 February 2018



**Australian Government**

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**Australian Accounting  
Standards Board**

## **How to Comment on this AASB Discussion Paper**

Comments on this Discussion Paper are requested by 28 February 2018

### **Formal Submissions**

Submissions should be lodged online via the “Work in Progress – Open for Comment” page of the AASB website ([www.aasb.gov.au/comment](http://www.aasb.gov.au/comment)) as a PDF document and, if possible, a Word document (for internal use only).

### **Other Feedback**

Other feedback is welcomed and may be provided via the following methods:

E-mail: [standard@asb.gov.au](mailto:standard@asb.gov.au)

Phone: (03) 9617 7600

All submissions on possible, proposed or existing financial reporting requirements, or on the standard-setting process, will be placed on the public record unless the Chair of the AASB agrees to submissions being treated as confidential. The latter will occur only if the public interest warrants such treatment.

### **Acknowledgments**

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## Introduction

### Australian Accounting Standards

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The Australian Accounting Standards Board (AASB) develops, issues and maintains Australian Accounting Standards, including Interpretations. The AASB is a Commonwealth entity under the *Australian Securities and Investments Commission Act 2001*.

AASB 1057 *Application of Australian Accounting Standards* identifies the application of Standards to entities and financial statements. AASB 1053 *Application of Tiers of Australian Accounting Standards* establishes a differential reporting framework consisting of two tiers of reporting requirements for preparing general purpose financial statements.

### Discussion Paper

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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

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

- (a) application of AASB 17 *Insurance Contracts* to the public sector; and
- (b) 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 AASB 17 would appropriately capture all schemes with economically similar insurance risk, once it is applicable to not-for-profit public sector entities, ensuring there is no understatement of insurance liabilities. Are additional requirements and guidance necessary to ensure public sector entities with insurance risk are appropriately reflecting these risks in their financial statements? AASB 17 presently applies only to for-profit entities and not-for-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 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 applying AASB 1023/AASB 1038 versus AASB 137 (see paragraphs BC8-BC13 for more detail).

The AASB is concerned that the same issues around inconsistent reporting could remain under AASB 17. Accordingly, there is a risk that public sector insurance liabilities would be understated. In Victoria alone, the total provision for insurance claims in 2015/16 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, Territory 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.

This Discussion Paper presents a draft amending Standard AASB 2018-X *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Public Sector Entities – Insurance*, including Appendix E, which proposes draft guidance for the public sector, and draft illustrative examples of applying the proposed guidance, followed by a draft Basis for Conclusions.

## Regulatory disclosures for the for-profit private sector

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

In finalising AASB 17, the AASB noted that these specific disclosures were not captured in the IFRS 17 *Insurance Contracts* disclosures and that the IASB had been through extensive due process, including consultation with regulators, in finalising the IFRS 17 disclosures. The AASB also noted that these disclosure requirements are currently in NZ IFRS 4 *Insurance Contracts*, which contains the same requirements as AASB 1023 and AASB 1038. The disclosures being considered for retention are set out in the table below.

**Table: Current AASB 1038 disclosures that have not been carried forward**

AASB 1038 paragraph	Disclosure requirements
<b>Regulatory capital information</b>	
17.8	A life insurer shall disclose the regulatory capital position of each statutory fund. In consolidated financial statements a group shall disclose the regulatory capital position of each life insurer in the group.
<b>Managed funds and other fiduciary activities</b>	
17.9	The nature and amount of the life insurer's activities relating to managed funds and trust activities, and whether arrangements exist to ensure that such activities are managed independently from its other activities, shall be disclosed.
<b>Actuarial information</b>	
17.10	The following shall be disclosed in notes: (a) if other than the end of the reporting period, the effective date of the actuarial report on policy liabilities and regulatory capital reserves; (b) the name and qualifications of the actuary; (c) whether the amount of policy liabilities has been determined in accordance with the requirements of the Life Insurance Act; and (d) whether the actuary is satisfied as to the accuracy of the data from which the amount of policy liabilities has been determined.
<b>Other disclosures</b>	
17.12.1	Australian Accounting Standards and the Life Insurance Act differ in their requirements. Accordingly, life insurers are encouraged to disclose a reconciliation between: (a) the profit for the reporting period reported under Australian Accounting Standards and the profit for the reporting period reported under the Life Insurance Act; and (b) the retained earnings at the end of the reporting period in accordance with Australian Accounting Standards and the retained earnings at the end of the reporting period in accordance with the Life Insurance Act.

The AASB considered whether these disclosures would be required elsewhere in AASB 17 or other Australian Accounting Standards, and observed that material disclosures would likely be required by AASB 17 paragraphs 117-120 (significant judgements in applying AASB 17), AASB 17 paragraph 126 (disclosure of the effect of the regulatory frameworks) and AASB 101 *Presentation of Financial Statements* paragraphs 134-136 (capital disclosures). The Board, as well as the AASB's Insurance Project Advisory Panel, agreed with this assessment. In addition, the Australian Prudential Regulation Authority (APRA) confirmed that these disclosures were not required by them, and that it was likely to develop its own set of disclosures for insurance companies in due course.

Consequently, the AASB's preliminary view is that these disclosures are no longer necessary and should not be carried forward to AASB 1054, but would nonetheless like to gather constituents' views on the matter.

## 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 proposed to be added to AASB 17 as Appendix E.

The AASB's view is that although AASB 17 applies only to contracts, the *Framework for the Preparation and Presentation of Financial Statements* (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 some proposed criteria to identify those arrangements that are 'insurance-like'.

The following criteria are necessary, but not sufficient, for an insurance-like arrangement:

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

The following non-mandatory criteria are additional indicators in determining whether an arrangement is insurance-like. These 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 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), internal and/or external reports on the financial performance of the scheme occur, and, where necessary, action is 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; and
- (d) separate entities, 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, 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 an indicator that an insurance-like arrangement does not exist.

The AASB considered a number of alternatives as set out in paragraphs BC24-BC35, 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 has the potential to create more complexity and judgement. The insurance-like criteria have been developed using the proposed IPSASB criteria as a starting point. However, the IPSASB approach relies on full funding of the 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 criteria driven only by funding.

Limited additional guidance on the application of AASB 17 risk adjustments for non-financial risks and contract boundaries for public sector entities are also proposed in this Discussion Paper. No further 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. Draft amending Standard AASB 2018-X includes Appendix E, which proposes draft guidance for the public sector, as well as draft illustrative examples of applying the proposed guidance, followed by a draft Basis for Conclusions.

## Who would be affected

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### 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 proposed in the *Australian illustrative examples of applying the insurance-like criteria by public sector entities*.

## Regulatory disclosures for the for-profit private sector

All for-profit private sector entities with insurance contracts would be affected by these proposals.

### What happens next

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The AASB will consider feedback received on this Discussion Paper at future meetings and based on the information received will determine whether the proposals should form the basis of an Exposure Draft, with or without amendment. Exposure Drafts are published to enable further consultation with stakeholders.

### We need your feedback

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Comments are invited on any of the proposals in this Discussion Paper by 28 February 2018. 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

##### General matters

1. Do you agree with the objective of the proposed Implementation 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 Implementation 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 Implementation Guidance that would be more likely to achieve the objective of greater consistency of financial reporting for the benefit of users?
4. Do you agree the amendments to AASB 17 should apply to both for-profit and not-for-profit public sector entities?

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

5. Do the proposals provide sufficient guidance to determine the risk adjustment factor for non-financial risk? If not, what additional guidance is needed?
6. Are there any situations where there might be a risk adjustment factor of zero (refer paragraph BC11)?

##### Determining the contract boundary

7. When determining the contract boundary, are there any other instances apart from those illustrated in the examples, where there is no premium or the contract boundary is longer than 12 months, but it would still be permitted to apply the simplified approach under AASB 17? If so, do you agree that all public sector entities should be given an exemption to apply the premium allocation approach (the simplified approach) under AASB 17?
8. Do you agree with the following interpretation? If the funding can only be changed with a corresponding change in legislation, then the presumption exists that the simplified approach is not available for

application. However, if the funding can be changed at will, then the presumption that the contract boundary is less than 12 months can be supported and the simplified method will be available for use.

#### **Captive insurance arrangements**

9. Where subsidiaries apply AASB 17 to insurance and insurance-like contracts in the subsidiary's separate financial statements, but at the consolidated group level such contracts are regarded as self-insurance and consequently outside the scope of AASB 17, should such arrangements be scoped out of AASB 17 for the subsidiary's separate financial statements?

#### **Investment contracts with discretionary participation features**

10. Under AASB 17 para 3(c) an entity is required to apply AASB 17 to investment contracts with discretionary participation features, if the entity also issues insurance contracts.
- (a) Do not-for-profit public sector entities regularly issue both insurance contracts as well as investment contracts with discretionary participation features?
  - (b) If so, would the accounting treatment of such investment contracts with discretionary participation features be significantly different under AASB 17 as compared to their current accounting treatment?
  - (c) If the existing accounting treatment is significantly different, would the proposed accounting treatment under AASB 17 impose undue cost or effort on the entity?
  - (d) If the answers to questions (a)-(c) were affirmative, do you propose that all investment contracts with discretionary participation features issued by a not-for-profit public sector entity should be entirely scoped out of AASB 17? If so, what requirements should apply?

#### **Other**

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

#### **For-profit private sector entities**

13. AASB 1023 and AASB 1038 included some regulatory disclosure requirements that have not been carried forward into AASB 17. Do you agree with the AASB's recommendation that these disclosure requirements should not be carried forward to either AASB 17 or AASB 1054 *Australian Additional Disclosures*?

# Contents

PREFACE

**[DRAFT] ACCOUNTING STANDARD**

**AASB 2018-X AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS – AUSTRALIAN IMPLEMENTATION GUIDANCE FOR PUBLIC SECTOR ENTITIES – INSURANCE**

*from paragraph*

<b>OBJECTIVE</b>	<b>1</b>
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<b>AMENDMENTS TO AASB 17</b>	<b>6</b>
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<b>COMMENCEMENT OF THE LEGISLATIVE INSTRUMENT</b>	<b>13</b>

**BASIS FOR CONCLUSIONS**

Australian Accounting Standard AASB 2018-X *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Public Sector Entities – Insurance* is set out in paragraphs 1 – 13. All the paragraphs have equal authority.



## **Preface**

### **Standards amended by AASB 2018-X**

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This Standard makes amendments to AASB 17 *Insurance Contracts* (July 2017) and AASB 1057 *Application of Australian Accounting Standards* (July 2015).

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

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#### **Main requirements**

This Standard inserts Australian requirements and authoritative implementation guidance for public sector entities into AASB 17. This guidance assists such entities in applying that Standard to particular transactions and other events.

The amendments to AASB 17:

- (a) address the identification of those arrangements that should be regarded as insurance contracts; and
- (b) 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.

## **[Draft] Accounting Standard AASB 2018-X**

The Australian Accounting Standards Board makes Accounting Standard AASB 2018-X *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Public Sector Entities – Insurance* under section 334 of the *Corporations Act 2001*.

Kris Peach

Dated ... [date]

Chair – AASB

## **[Draft] Accounting Standard AASB 2018-X Amendments to Australian Accounting Standards – Australian Implementation Guidance for Public Sector Entities – Insurance**

### **Objective**

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- 1 This Standard amends:
- (a) AASB 17 *Insurance Contracts* (July 2017); and
  - (b) AASB 1057 *Application of Australian Accounting Standards* (July 2015);
- to add requirements and authoritative implementation guidance for application by not-for-profit public sector entities.

### **Application**

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- 2 The amendments set out in this Standard apply to entities and financial statements in accordance with the application of the other Standards set out in AASB 1057 *Application of Australian Accounting Standards* (as amended).
- 3 This Standard applies to annual reporting periods beginning on or after 1 January 2021.
- 4 This Standard may be applied to annual reporting periods beginning before 1 January 2021. If an entity applies this Standard to such an annual period, it shall disclose that fact.
- 5 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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- 6 Paragraphs Aus3.1 and Aus3.2 are added.
- Aus3.1 Notwithstanding paragraph 3, a public sector entity shall apply AASB 17 to its non-contractual arrangements that:
- (a) establish a present obligation to accept significant insurance risk; and
  - (b) are managed as part of a scheme with ‘insurance-like’ criteria as set out in paragraphs E12-E16;
- as if they are insurance contracts.

Aus3.2 A wholly-owned public sector entity may elect not to apply AASB 17 in its separate financial statements when it enters into insurance contracts, or insurance-like arrangements, with its parent, subsidiaries or fellow subsidiaries. This exemption shall only be applicable when there is no external insurance risk in the consolidated group (ie self-insurance).

7 Paragraphs AusC34.1 and AusC34.2 and a preceding heading are added.

#### **Withdrawal of AASB pronouncements**

AusC34.1 This Standard repeals:

- (a) AASB 4 *Insurance Contracts*;
- (b) AASB 1023 *General Insurance Contracts*; and
- (c) AASB 1038 *Life Insurance Contracts*.

Despite the repeal, after the time this Standard starts to apply under section 334 of the Corporations Act (either generally or in relation to an individual entity), the repealed Standards continue to apply in relation to any period ending before that time as if the repeal had not occurred.

[Note: When this Standard applies under section 334 of the Corporations Act (either generally or in relation to an individual entity), it supersedes the application of the repealed Standards.]

AusC34.2 When applied or operative, this Standard supersedes Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations*.

8 Appendix E *Australian implementation guidance for public sector entities* is added as set out on pages 13-17.

9 Australian illustrative examples of applying the insurance-like criteria analysis by public sector entities is attached to accompany AASB 17 as set out on pages 17-26.

## **Amendments to AASB 1057**

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10 Paragraph 5 is amended as follows (new text is underlined and deleted text is struck through):

5 Unless otherwise specified in paragraph ~~5A~~6-21, Australian Accounting Standards apply to:

- (a) ...

11 Paragraphs 5A, 11A, 12 and 26 are deleted.

12 Paragraph 6A is amended as follows (new text is underlined and deleted text is struck through):

6A AASB 17 *Insurance Contracts* applies to:

- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
  - (b) general purpose financial statements of each other reporting entity; and
  - (c) financial statements that are, or are held out to be, general purpose financial statements; except when the entity is:
    - ~~(d) a superannuation entity applying AASB 1056, or~~
    - ~~(e) a not for profit public sector entity.~~
- ...

## **Commencement of the legislative instrument**

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13 For legal purposes, this legislative instrument commences on ... [date].

## Appendix E

### Australian implementation guidance for public sector 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.
- 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 of AASB 17 also 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 a 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 the issuer".
- E8 Some public sector entities enter into arrangements that are similar to and sometimes, at least in practice, indistinguishable from insurance contracts. For example, workers compensation insurance may be provided by a public sector entity that enters into arrangements whereby employers with insurance premiums are 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 respect of the employer. 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 that an employee is injured.

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1 Such costs may include medical expenses, and weekly and lump sum compensation payments.

- E9 Enforceable rights and obligations may also arise from statutory requirements when no contractual relationship 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 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 formative elements for a contract to be established are unlikely to be satisfied in these circumstances, on the basis that voluntary and reciprocal intention to create legal relations is lacking. 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, given 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 E12-E16.
- E10 Distinguishing between insurance risk created by contract or by statute alone may require significant analysis as to whether there is sufficient ‘voluntariness’ and ‘reciprocity’ to evidence an intention to create a contract, particularly where a voluntary decision to undertake an activity results in the application of 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 paragraphs E12-E16 of this Standard). 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 F paragraphs F8-F18.

## 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 entity as set out in paragraph E8 is ‘insurance-like’. In assessing the substance of an arrangement, all relevant material facts and circumstances should be considered. Paragraphs E13-E14 provides indicators of insurance-like arrangements. The indicators identified in paragraph E13 are classified as ‘mandatory’ and shall be satisfied for an arrangement to be insurance-like, however this is not sufficient to conclude that an arrangement is insurance-like. Non-mandatory indicators in paragraph E14 must be considered in conjunction with those in paragraph E13 to conclude an arrangement is insurance-like.
- E13 The following criteria are necessary, but not sufficient, for an insurance-like arrangement:
- (a) the terms of the arrangement have commercial substance. Paragraph 2 of this Standard describes 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 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 entity’s future cash flows. Accordingly, for the purposes of application of the Standard by public sector 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;

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2 AASB 15 *Revenue from Contracts with Customers*, paragraphs 9(d) and F19.

- (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 will not be insurance-like;

E14 The following non-mandatory criteria are additional indicators in determining whether an arrangement is insurance-like. These 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. 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) assessment of claims performance – 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. An entity specifically designating its requirements for actuarial expertise that focusses on the assessment of the scheme's performance may be indicative of an arrangement being insurance-like. This indication may be further supported where the governance of the entity is improved by appointing more actuarial experience on, for example, the board. 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 entities, 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. This is further evidenced if a separate entity has been established by the government, which is expected to act like an insurer in relation to the

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3 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.

4 National Injury Insurance Scheme (Queensland) Act 2016, S89(1)(c).

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.

- E15 The reference in paragraph E43(a) 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 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 of this Standard 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 of this Standard 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 The risk adjustment shall reflect the amount that the public sector entity requires for bearing uncertainty about the amount and timing of the cash flows that arises from non-financial risk related to insurance-like arrangements. As for issuers of insurance contracts, a public sector entity will reflect the degree of diversification arising from insurance-like arrangements and the public sector entity’s risk aversion (risk appetite).
- E20 A public sector entity shall consider the extent of diversification in its portfolio, the entity’s risk appetite and required return on capital in determining this amount in the same way as private sector issuers of insurance contracts.

## **Determination of contract boundary by public sector entities**

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- E21 Paragraphs 34 and 35 of this Standard describe how the contract boundary should be determined. For insurance-like arrangements where premiums are charged, the public sector entity will apply paragraphs 34 and 35 to determine the contract boundary. For insurance-like arrangements that are not funded by way of premiums, a public sector entity shall determine the contract boundary as follows:
- (a) where the funding of an arrangement cannot be changed without the need to amend legislation, a public sector entity shall presume that the contract boundary is more than 12 months;
  - (b) where the legislation establishing an arrangement requires a process, usually performed annually, by which the arrangement’s activities are assessed and funding may be changed, the contract boundary shall be presumed to be one year or less; and
  - (c) if the funding of the arrangement may be changed without the requirement for an annual review (ie where the funding can be changed at any time) the public sector entity shall presume the contract boundary to be one year or less.



- E22 The review process is analogous to an insurer of insurance contracts being able to reassess and reprice risks. Accordingly, public sector entities that undertake such annual reviews may conclude that the coverage period is one year or less. AASB 17 permits the use of a simplified measurement model for contracts within the scope of AASB 17 with duration of one year or less. This model is referred to as the premium allocation approach or the simplified approach. This enables a public sector entity, where the other requirements are met, to use the premium allocation approach described in AASB 17 paragraphs 53-59.
- E23 Where a public sector entity is permitted to use the premium allocation approach, it would measure:
- (a) its liability for remaining coverage in accordance with paragraph 55, for example, the amount of funding received, less insurance acquisition cash flows (unless paragraph 59(a) is applied), less the amount of funding that relates to insurance revenue in the period that would usually be determined on the basis of passage of time (paragraph B126 of this Standard); and
  - (b) the liability for incurred claims by applying paragraph 59(b).

## **Captive insurance arrangements**

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- E24 A public sector entity may assume insurance risk in respect of other public sector entities. For example, a State government may own a range of assets such as buildings, vehicles and so on and the risk of damage to these assets may be 'insured' by a related public sector entity (a 'captive' public sector entity). Similarly, workers insurance in respect of public sector employees may be transferred to a related entity. This is the same as some private sector entities that operate captive insurers for a range of reasons.
- E25 In the private sector, captive insurers apply AASB 17 in their standalone accounts but on consolidation, the intra-group transaction is eliminated as there is no insurance contract between the consolidated entity and an external party, commonly referred to as 'self-insurance'. A public sector entity that accepts insurance risk from related public sector entities may choose not to apply AASB 17 to these self-insurance transactions in its standalone accounts where all the relevant parties are consolidated in one set of consolidated financial statements. If the public sector entity chooses not to apply AASB 17, then it will consider which other standards should be applied, including AASB 137.

## Australian illustrative examples of applying the insurance-like criteria analysis by public sector entities

*These illustrative examples accompany, but are not part of, AASB 17. They illustrate aspects of the Australian guidance for public sector entities in AASB 17, but are not intended to provide interpretative guidance.*

- IE1 The following examples portray hypothetical situations. They are intended to illustrate how a public sector entity might analyse the characteristics of a number of public sector arrangements against the criteria in paragraphs E13-E14 of the [draft] Standard, 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 In addition, these examples include an analysis of the eligibility of the hypothetical public sector arrangements to apply the premium allocation approach (or the “simplified approach”) as per paragraphs E22-E23 of the [draft] Standard.

### Example 1: Compulsory third party motor insurance provided by private sector insurers with regulated premiums

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#### Fact pattern

- IE3 This state requires motorists to acquire insurance that will pay for treatment and support services for people injured in transport accidents directly caused by the driving of a car, motorcycle, or other vehicle. Proof of insurance must be provided by motorists when they register their vehicles each year. The scheme operates on a ‘no-fault’ basis, which means that anyone injured in a transport accident within the state (or interstate if the vehicle is registered on the state) is eligible to receive support services, irrespective of who caused the crash.
- IE4 Currently a small number of private sector insurers provide this type of insurance and their premiums are regulated so that each insurer charges a similar amount for policies of similar risks. The state does not have any obligation to fund shortfalls suffered by the private sector insurers.

#### Obligation created by statute versus contract

- IE5 The need for insurance is prescribed under state legislation and the premiums are regulated. There is an element of voluntariness in that motorists can choose whether to drive and register their vehicles in the state (noting it is illegal to not register a vehicle or acquire the third-party insurance).
- IE6 The nature of what motorists receive for purchasing third party insurance is not entirely clear at time of payment. Whilst owners of registered vehicles can research the basis of this insurance and what benefits it provides, this is not apparent at time of payment.
- IE7 The existence of multiple insurers means that motorists can choose which private sector entity that they use. The price of insurance and benefits provided by the private sector insurers are similar but not identical.

#### Conclusion

- IE8 Despite the obligation being created under legislation, the existence of choice for the driver (and by extension, the driver's intention to engage with a particular entity) is likely, in the absence of other relevant circumstances, to mean that a contract is formed between the driver and the private sector insurance company. Accordingly, the arrangements are caught within AASB 17.
- IE9 The contract's coverage period is for one year only; therefore the simplified approach is available for application. The contract is valued as the best estimate of the liability for the remaining coverage period and a liability for the claims incurred during the year.

## Example 2: Compulsory third-party motor insurance provided by the ABC agency

### Fact pattern

- IE10 The ABC agency (ABC) pays for treatment and support services for people injured in transport accidents directly caused by the driving of a car, motorcycle, bus or train. ABC is funded by state motorists when they pay to register their vehicles each year, an amount payable to ABC being incorporated into the registration fee. The scheme operates on a ‘no-fault’ basis, which means that anyone injured in a transport accident within the state (or interstate if the vehicle is registered in the state) is eligible to receive support services, irrespective of who caused the crash.
- IE11 ABC has not received any supplementary funding from the state.

### Obligation created by statute versus contract

- IE12 The following factors are relevant in determining whether ABC’s obligations are contractual or statutory in nature.
- IE13 The activities of ABC and the payment through the annual registration fee are prescribed under state legislation. There is an element of voluntariness in that motorists can choose whether to drive and register their vehicles in the state (noting it is illegal to not register a vehicle).
- IE14 The nature of what motorists receive for paying the ABC charge is not entirely clear at time of payment. Whilst owners of registered vehicles can research the basis of the ABC arrangement and what benefits it provides, this is not fully apparent at time of payment. There is no ability to use any other entity to provide the services.
- IE15 There is a lack of specific intention on behalf of both parties to enter into a contract, a lack of market choice and accordingly voluntariness required to enter a contract. The arrangement’s obligations are statutory in nature.
- IE16 For the purpose of AASB 17:
  - (a) the insurance risk is 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;
  - (b) ABC is identified as the issuer as it is the entity that has accepted the insurance risk;
  - (c) policyholders are the drivers who have transferred insurance risk to the scheme; and
  - (d) premium is the registration charge.

### Insurance-like assessment

- IE17 To be within the scope of AASB 17, statutory arrangements are further assessed to determine if they are ‘insurance-like’:

**Table 1: ABC Agency insurance-like assessment**

Criteria (summary)	Analysis
<b>Mandatory Criteria</b>	
a) The arrangement has commercial substance.	Criteria met – in the event of the insured event occurring, it is possible that ABC will incur a loss on a present value basis in respect of an individual vehicle.
b) The arrangement cannot be altered without a specific change in legislation and cannot be retrospectively amended.	Criteria met – the arrangement is established by state legislation and the benefits are specified in that legislation.
c) The arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs.	Criteria met – ABC provides an injured party with a right to have decisions reviewed.
<b>Funding</b>	
d) The legislation or other measure governing the arrangement provides for the scheme to be funded by premiums, contributions by the government or	Criteria met – ABC requires the owner of each registered vehicle to pay a ‘charge’. The operation of these vehicles is the usual cause of motor accidents and hence the creation of the insurance risk.

<b>Criteria (summary)</b>	<b>Analysis</b>
other public sector entities, or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the risks.	
e) The entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, contributions by the government or other public sector entities, or levies) and/or benefits provided on a periodic basis, with the aim that the arrangement is substantially self-funded.	Criteria partially met – ABC’s financial position is reviewed periodically but the linkage to adjustment to premium where deficits are identified are opaque and subject to economic, political or other imperatives not to increase costs to motorists. However, ABC has the ability to alter the premium each year.
<b>Assessment of claims performance</b>	
f) The entity assesses its financial performance and financial position 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.	Criteria met – ABC undertakes actuarial analysis to estimate claim liabilities and funding levels and has a capital management strategy to achieve its target funding level. ABC prepares annual general purpose financial reports.
<b>Similar arrangements in the public sector</b>	
g) Transactions or arrangements with similar characteristics are entered into by for-profit entities and accounted for as insurance contracts.	Criteria met – similar insurance is provided by private sector insurers in other states.
<b>Separate assets and liabilities</b>	
h) 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 participants.	Criteria met – legislation requires ABC to establish a separate fund to hold monies collected and make payments in accordance with that legislation.
i) A separate entity has been established by the government.	Criteria met – legislation establishes ABC as a statutory corporation.

## Conclusion

- IE18 ABC generates insurance risk as a result of statute requirements and operates an insurance-like arrangement included within the scope of AASB 17.
- IE19 The contract’s coverage period is for one year only, as ABC has the ability to alter the premium annually; therefore the simplified approach is available for application. The contract is valued as the best estimate of the liability for the remaining coverage period and a liability for the claims incurred during the year.

## Example 3

### **Example 3A: Life care scheme operated by the DEF authority**

#### **Fact pattern**

- IE20 The DEF Authority (DEF) provides lifelong treatment, rehabilitation and care services to people catastrophically injured in a motor vehicle accident in the state, regardless of who was at fault. CTP insurance (provided by private sector entities) provides cover for third parties who suffer less serious injuries as a result of motor accidents.
- IE21 DEF is funded by a levy paid by motorists when they purchase CTP insurance. The amount of the levy is determined by a different public sector entity to the entity that accepts insurance risk (DEF). DEF is not obligated to fund any shortfall incurred by the private sector entities for the CTP element.

## Obligation created by statute versus contract

- IE22 DEF is prescribed under state legislation. There is an element of voluntariness in that state residents can choose whether to own and register their vehicle but having decided to register a vehicle, they have no option other than to pay the DEF levy.
- IE23 The nature of what motorists receive for paying DEF levies is somewhat unclear at time of payment (different private sector insurers may have different disclosure of what the scheme does).
- IE24 The CTP element of the transaction is of a contractual nature as there is market choice and voluntariness, on the part of the individual, to enter into the transaction with a CTP provider.
- IE25 However, with regard to the registration fee paid to DEF, there is a lack of specific intention on behalf of both parties to enter into a contract, a lack of market choice and accordingly voluntariness required to enter into a contract. DEF's obligations under the arrangements are statutory in nature.
- IE26 For the purpose of AASB 17:
- the insurance risk is 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;
  - DEF is identified as the issuer as it is the entity that has accepted the insurance risk;
  - policyholders are the drivers who have transferred insurance risk to the scheme; and
  - the premium is the registration charge.

## Insurance-like assessment

- IE27 To be within the scope of AASB 17, statutory arrangements are further assessed to determine if they are insurance-like:

**Table 2: DEF Authority insurance-like assessment**

<b>Criteria (summary)</b>	<b>Analysis</b>
<b>Mandatory criteria</b>	
a) The arrangement has commercial substance.	Criteria met – in the event of the insured event occurring, it is possible that DEF will incur a loss on a present value basis in respect of an individual vehicle.
b) The arrangement cannot be altered without a specific change in legislation and cannot be retrospectively amended.	Criteria met – the arrangement is established by state legislation and the benefits are specified in the legislation.
c) The arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs.	Criteria met – the legislation provides an injured party with right to have decisions reviewed.
<b>Funding</b>	
d) The legislation or other measure governing the arrangement provides for the scheme to be funded by premiums, contributions by the government or other public sector entities, or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the risks.	Criteria met – DEF requires CTP insurers to collect a levy from each CTP policyholder prior to issuing a CTP policy. The amount of the levy is determined by a separate public sector entity that regulates the DEF arrangement. The operation of vehicles is a usual cause of motor accidents and hence the source of the insurance risk.
e) The entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, contributions by the government or other public sector entities, or levies) and/or benefits provided on a periodic basis, with the aim that the arrangement is substantially self-funded.	Criteria met – the legislation requires DEF to determine “the amount required to fully fund” its liabilities and the regulator determines the levy that will result in the collection of an amount that fully funds DEF. The public sector entity regulating the DEF arrangement has the ability to reset the premium annually.
<b>Assessment of claims performance</b>	
f) The entity assesses its financial performance and financial position on a regular basis, uses actuarial assumptions, reports internally and/or externally on the financial performance of the scheme, and, where necessary, takes	Criteria met – DEF undertakes actuarial analysis to estimate liabilities for participants' care and support services and has risk management policies to manage funding levels. DEF prepares annual general purpose financial reports.

Criteria (summary)	Analysis
action to address any underfunding of the scheme.	
<b>Similar arrangements in the public sector</b>	
g) Transactions or arrangements with similar characteristics are entered into by for-profit entities and accounted for as insurance contracts.	Criteria met – cover provided under DEF was previously provided by CTP insurance policies issued by private sector insurers in the state.
<b>Separate assets and liabilities</b>	
h) 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 participants.	Criteria met – the legislation requires DEF to establish a separate fund to hold levies collected and make payments in accordance with it.
i) A separate entity has been established by the government.	Criteria met – the legislation establishes DEF as a statutory body.

## Conclusion

- IE28 DEF generates insurance risk as a result of statute requirements and operates an insurance-like arrangement included within the scope of AASB 17.
- IE29 The contract's coverage period is for one year only, as the premium can be reset annually; therefore the simplified approach is available for application. The contract is valued as the best estimate of the liability for the remaining coverage period and a liability for the claims incurred during the year.

## **Example 3B: Disability services provided by DEF authority**

### Fact pattern

- IE30 In this example, the facts of example 3A apply, except that:
- the lifelong treatment is available under legislation to people permanently disabled, not caused by a motor vehicle accident;
  - the arrangement is completely funded by government contributions (ie levies) under the legislation. These levies are periodically altered.

### Obligation created by statute versus contract

- IE31 DEF operates under federal legislation and receives government funding from consolidated revenue.
- IE32 The only voluntary aspect of the relationship between DEF and the individual is the option to pay for additional private cover to supplement benefits that eligible individuals are entitled to under DEF arrangements. Payment of taxes that fund the arrangement is not voluntary. There is no alternative market provider at the same premium level.
- IE33 There is no voluntary and reciprocal intention to create legal relations. Accordingly, a contract is not formed and the arrangement is statutory in nature.
- IE34 For the purpose of AASB 17:
- the insurance risk is the cost of treating the illness of all those eligible under the legislation;
  - DEF is identified as the issuer as it is the entity that has accepted the insurance risk;
  - policyholders are those eligible under the scheme who have transferred insurance risk to the scheme; and
  - the premium is the levy.

## Insurance-like assessment

IE35 To be within the scope of AASB 17, statutory arrangements are further assessed to determine if they are insurance-like:

**Table 3: DEF Agency insurance-like assessment**

Criteria (summary)	Comments
<b>Mandatory criteria</b>	
a) The arrangement has commercial substance.	Criteria met – The requirement for a person to have a disability in order to be a participant means the arrangement may provide benefits in respect of past events rather than uncertain future events, however, when a disability arises from a future event, it is possible that DEF will incur a loss on a present value basis in respect of an individual.
b) The arrangement cannot be altered without a specific change in legislation and cannot be retrospectively amended.	Criteria met – legislation establishes eligibility to receive support in respect of disabilities.
c) The arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs.	Criteria met – legislation provides an individual with the right to have decisions reviewed.
<b>Funding</b>	
d) The legislation or other measure governing the arrangement provides for the scheme to be funded by premiums, contributions by the government or other public sector entities, or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the risks.	Criteria met –DEF is funded by government contributions. Whilst there is little linkage with the potential beneficiaries or those who create or exacerbate the risks, actuarial assessments as to the funding of the scheme do occur. Inadequate funding of DEF’s future needs to meet existing commitments does not prevent the scheme from being ‘insurance-like’. The availability of support to those with pre-existing conditions may mean that insurance risk is not transferred in every case.
e) The entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, contributions by the government or other public sector entities, or levies) and/or benefits provided on a periodic basis, with the aim that the arrangement is substantially self-funded.	Criteria met –the risks to funding are addressed in the annual report which notes the continued existence of the arrangement is dependent on Government policy and agreements with states and territories. Funding is provided to DEF on a cash needs basis rather than ensuring sufficient assets are held to meet all present obligations to current scheme participants.
<b>Assessment of claims performance</b>	
f) The entity assesses its financial performance and financial position 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.	Criteria met – DEF undertakes actuarial assessments of current and future expenditure to support those with disabilities as well as identifying and managing financial risks and issues relevant to the financial sustainability of DEF from the perspective of having sufficient financial resources to be able to make cash payments as debts fall due. DEF prepares annual general purpose financial reports.
<b>Similar arrangements in the public sector</b>	
g) Transactions or arrangements with similar characteristics are entered into by for-profit entities and accounted for as insurance contracts.	Criteria not met – coverage for people with pre-existing conditions is usually excluded from insurance contracts.
<b>Separate assets and liabilities</b>	
h) 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 participants.	Criteria met – assets and liabilities are held by a dedicated entity.
i) A separate entity has been established by the government.	Criteria met – DEF is delivered by the DEF agency.

## Conclusion

- IE36 DEF generates insurance risk as a result of statute requirements and operates an insurance-like arrangement included within the scope of AASB 17, despite the benefits not being fully funded by the beneficiaries.
- IE37 Usually a contract boundary is when a premium is paid upon contract repricing. This arrangement does not have an explicit premium and, as a result, appears not to have a contract boundary. If there is no premium, it is assumed that the contract can be repriced at any point in time, unless there is a requirement to change legislation to obtain the funding necessary. The public sector entity administering the DEF arrangement periodically reviews and, where necessary, adjusts both the funding and claims components of the arrangement, and is able to do this via regulation changes that it can control. Therefore the simplified method is available for application. The contract is valued as the best estimate of the liability for the remaining coverage period and a liability for the claims incurred during the year.

### Example 4: Universal health care operated by Federal Department GHI

#### Fact pattern

- IE38 GHI provides universal health care that enables those eligible to access cost effective medical, optometry and hospital care and, in some circumstances, other allied health services at no cost.

#### Obligation created by statute versus contract

- IE39 GHI operates under Federal legislation. All taxpayers are charged a levy calculated by reference to a fixed percentage of their taxable personal income.
- IE40 The only voluntary aspect of the relationship between GHI and the individual is the option to opt out of public health services and pay for additional private cover. Payment of taxes that fund the arrangement is not voluntary. There is no alternative market provider at the same premium level.
- IE41 There is no voluntary and reciprocal intention to create legal relations. Accordingly, a contract is not formed and the arrangement is statutory in nature.
- IE42 For the purpose of AASB 17:
- the insurance risk is the cost of treating the illness of all those eligible under the registration;
  - GHI is identified as the issuer as it is the entity that has accepted the insurance risk;
  - policyholders are those eligible under the scheme who have transferred insurance risk to the scheme; and
  - the premium is the levy.

#### Insurance-like assessment

- IE43 To be within the scope of AASB 17, statutory arrangements are further assessed to determine if they are ‘insurance-like’:

**Table 4: Federal department GHI insurance-like assessment**

Criteria (summary)	Analysis
<b>Mandatory criteria</b>	
a) The arrangement has commercial substance.	Criteria met – in the event of the insured event (sickness or injury) occurring, it is possible that GHI will incur a loss on a present value basis in respect of an individual.
b) The arrangement cannot be altered without a specific change in legislation and cannot be retrospectively amended.	Criteria met – Commonwealth legislation establishes eligibility to receive benefits in respect of medical expenses
c) The arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs.	Criteria met – legislation provides an individual with the right to have decisions reviewed.



<b>Criteria (summary)</b>	<b>Analysis</b>
<b>Funding</b>	
d) The legislation or other measure governing the arrangement provides for the scheme to be funded by premiums, contributions by the government or other public sector entities, or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the risks.	Criteria not met – GHI is funded by Government appropriation rather than by those that are the potential beneficiaries or those that create or exacerbate the risk. GHI will provide benefits in respect of pre-existing conditions which is less likely to meet definition of insurance risk <sup>5</sup> .
e) The entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, contributions by the government or other public sector entities, or levies) and/or benefits provided on a periodic basis, with the aim that the arrangement is substantially self-funded.	Criteria not met – GHI funding not addressed in the Department’s annual report and an assessment of liabilities is not performed. The funding is not provided by those that create or exacerbate the risk.
<b>Assessment of claims performance</b>	
f) The entity assesses its financial performance and financial position 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.	Criteria not met – the Department prepares annual general purpose financial reports but GHI transactions are not separately identified. The obligations of the scheme are not valued using analysis of past assumptions as to future experience (such as actuarial analysis), and not reported internally or externally.
<b>Similar arrangements in the public sector</b>	
g) Transactions or arrangements with similar characteristics are entered into by for-profit entities and accounted for as insurance contracts.	Criteria partially met – similar benefits are provided by for-profit entities that issue insurance contracts but not usually in respect of pre-existing conditions.
<b>Separate assets and liabilities</b>	
h) 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 participants.	Criteria not met – GHI is delivered by the Department and the relevant assets and liabilities are not held in a separate fund.
i) A separate entity has been established by the government.	Criteria not met – GHI is delivered by the Department and the relevant assets and liabilities are not held in a separate fund.

## Conclusion

- IE44 GHI is not an insurance-like arrangement. Despite the benefits provided under GHI meeting a number of the criteria, the substance of the arrangement is not similar to insurance and it is not managed on an insurance-like basis with actuarial assessments of the costs of the cover being provided. In addition, GHI activities are mingled with the other activities of the department and the activities are not fully funded.
- IE45 As this arrangement is not insurance-like, it falls outside the scope of AASB 17 and is not subject to the Standard’s measurement requirements.

5 AASB17.B5 notes that some insurance contracts cover events that have already occurred but the financial effect of which is still uncertain, the determination of the ultimate cost being the insured event. In the case of Medicare, it is inappropriate to apply this guidance as the funding does not appear to take account of the expected ultimate cost.

**Example 5: Workers insurance delivered by the MNO agency**

**Fact pattern**

- IE46 The MNO agency accepts insurance risk from state employers by covering the costs associated with supporting an injured worker after a workplace injury or illness. Employers are obliged to obtain workers insurance under state legislation.
- IE47 MNO outsources the distribution, some underwriting and claims management activities to private sector insurers who are paid a fee to deliver these services.

**Obligation created by statute versus contract**

- IE48 MNO operates under state legislation.
- IE49 Employers are required by law to purchase workers insurance.
- IE50 An insurance policy is issued by MNO however employers are compelled to acquire this insurance and, despite the policies being distributed by private sector insurers, employers have no choice as to who underwrites the insurance.
- IE51 The lack of choice available to employers means it is unlikely that there is an insurance contract and the arrangement is statutory in nature.
- IE52 For the purpose of AASB 17:
  - (a) the insurance risk is the employer costs in the event an employee is injured;
  - (b) MNO is identified as the issuer as it is the entity that has accepted the insurance risk;
  - (c) policyholders are those employers eligible under the scheme who have transferred insurance risk to the scheme; and
  - (d) the premium is the levy.

**Insurance-like assessment**

- IE53 To be within the scope of AASB 17, statutory arrangements are further assessed to determine if they are insurance-like:

**Table 5: MNO Agency insurance-like assessment**

Criteria (summary)	Analysis
<b>Mandatory criteria</b>	
a) The arrangement has commercial substance.	Criteria met – in the event of the insured event occurring, it is possible that MNO will incur a loss on a present value basis in respect of an individual employer.
b) The arrangement cannot be altered without a specific change in legislation and cannot be retrospectively amended.	Criteria met – the arrangement is established by state legislation and the benefits are specified in it.
c) The arrangement provides the beneficiaries enforceable rights in the event that the insured event occurs.	Criteria met – legislation provides an injured worker with right to have decisions reviewed.
<b>Funding</b>	
d) The legislation or other measure governing the arrangement provides for the scheme to be funded by premiums, contributions by the government or other public sector entities, or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the risks.	Criteria met – legislation requires each employer to pay a ‘premium’. The employment of people exposes the employees to risk of injury in the workplace and hence the creation of the insurance risk.
e) The entity reviews (and, where necessary, adjusts) revenue (which may be in the form of premium, contributions by the government or other public sector entities, or levies) and/or	Criteria met – MNO undertakes regular (at least annually) actuarial assessments of its funding. Whilst premiums may not respond immediately to the need for change (due to commercial, economic

<b>Criteria (summary)</b>	<b>Analysis</b>
benefits provided on a periodic basis, with the aim that the arrangement is substantially self-funded.	or other factors) the intention is for the scheme to be appropriately funded.
<b>Assessment of claims performance</b>	
f) The entity assesses its financial performance and financial position 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.	Criteria met – MNO undertakes actuarial assessment of claims liabilities as well as ability to influence claim outcomes and future premiums based on applicable industry risk assessments. MNO prepares annual general purpose financial reports.
<b>Similar arrangements in the public sector</b>	
g) Transactions or arrangements with similar characteristics are entered into by for-profit entities and accounted for as insurance contracts.	Criteria met – workers insurance is provided by private sector insurers in other states.
<b>Separate assets and liabilities</b>	
h) 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 participants.	Criteria met – legislation requires MNO to establish a separate fund to hold premiums and make payments in accordance with it.
i) A separate entity has been established by the government.	Criteria met – legislation establishes MNO as a statutory corporation.

## Conclusion

- IE54 MNO generates insurance risk as a result of statute requirements and operates an insurance-like arrangement included within the scope of AASB 17.
- IE55 This arrangement operates like an insurance scheme. The premium is charged as a percentage of the employer's actual payroll costs, and this percentage is based on the industry's current risk assessment. The premium rates are set annually based on actuarial review. Therefore, the contract boundary is one year and the simplified approach is available for application. The contract is valued as the best estimate of the liability for the remaining coverage period and a liability for the claims incurred during the year.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, AASB 2018-X.*

### Background

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BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board’s considerations in reaching the conclusions in the Discussion Paper (DP). 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 (eg 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>6</sup>

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6 To help avoid confusion, this Discussion Paper refers consistently to ‘risk adjustment’, which is the term used in AASB 17, even though AASB 1023 refers to ‘risk margin’.

to allow for the inherent uncertainty in the central estimate.<sup>7</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 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 appendix A 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”.

BC12 AASB 17 paragraph B88 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.”

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<sup>7</sup> In Australia, risk margins required by AASB 1023 are usually based on a particular level of confidence that claims would be no more than the estimated amount. For example, the risk margin 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 which is determined from the perspective of the entity issuing the insurance contract.

- 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 Implementation 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 Appendix A defines 'insurance risk' as "Risk, other than financial risk, transferred from the holder of a contract to the issuer".
- BC17 AASB 17 Appendix A 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:
- (a) accident insurance and workers compensation benefits;
  - (b) 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;
  - (c) 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;
  - (d) 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; and
  - (e) 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; and
  - (e) an entity assesses the financial performance and financial position of a social benefit scheme on a regular basis where it is required to report internally on the financial performance of the scheme, and where necessary, to take action to address any under-performance by the scheme. The assessment is expected to involve the use of actuarial reviews, mathematical modelling, or similar techniques to provide information for internal decision-making on the different possible outcomes that might occur.
- 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; and
  - (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 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
  - (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 by 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. This 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 arrangement be managed in the same way as an insurer. This provides indicators that an arrangement has the look and feel of insurance. This includes guidance regarding whether the arrangement binds the public sector entity 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 observed that the definitions of social benefit and social risk could be difficult to apply, and may require further modification or guidance. The Board also noted that the definitions were based on IMF definitions used for GFS reporting and were controversial with some (but not all) IPSASB stakeholders. The current IPSASB draft ED applies new definitions which have still to be tested with respondents;
  - (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.<sup>8</sup>

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>9</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>10</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.

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8 In making these observations, the AASB acknowledges that the IPSASB’s project on social benefits, while including an insurance-like approach to relevant social benefit schemes, has different aims to the AASB’s project on application of the Insurance Contracts standard to public sector entities.

9 The insurance standards do not include a definition of ‘contract’.

10 The wording in this paragraph should be reviewed once AASB 2018-X is finalised.

- 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 Where insurance-like arrangements are funded by premiums, the AASB decided no further guidance on boundary and coverage period would be needed for the public sector. The AASB noted most insurance-like schemes relate to a specific period of time where premiums/levies are charged and are reassessed each year, or the insured event has a clear end point such as when an individual dies.
- BC41 However, where a public sector entity's funding for insurance-like arrangements arises from levies, contributions or some other means rather than by way of premiums, further guidance on establishing the contract boundary is required. The guidance at paragraphs E21 and E22 uses the way in which funding may be changed to determine the contract boundary.
- BC42 If the legislation establishing a scheme must be changed to revise the amount of funding for the scheme, the contract boundary shall be presumed to be more than one year because there is a presumption that changing the legislation will take a period of greater than one year. This would occur when the legislation specified a fixed amount of money to be paid to the scheme (eg \$X million per annum), or amount of funding for, say a vehicle or individual (eg \$X00 per registered vehicle per annum).
- BC43 In some cases, the legislation may permit the funding of an arrangement to be changed at any time, eg by way of changing regulations. It is also common for the legislation establishing an arrangement to describe a process whereby funding may be revised following a periodic, usually annual, review. As a result of such reviews, the arrangement's funding may or may not be revised. There may be political, social or economic reason why the funding is not revised, but the capacity to make revisions means that the public sector entity has the practical ability to reassess its insurance-like risks and so the contract boundary shall be presumed to be one year or less.
- BC44 This approach clarifies the circumstances when public sector entities may use the Premium Allocation Approach.
- BC45 Where an insurance-like arrangement is not funded by premiums, the public sector entity shall include all insurance-like obligations in the same group in accordance with paragraph 20 and apply paragraphs 57 and 58 to determine whether the obligations arising from an insurance-like arrangement are onerous.

## Management actions

- BC46 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'.
- BC47 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.
- BC48 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.

## Extending the scope to for-profit public sector entities

- BC49 The Board originally agreed in June 2017 that the scope of this Discussion Paper would be limited to not-for-profit public sector entities, given the prevalence and magnitude of the issues outlined in paragraphs BC2-BC18 warranting amendments under *The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities* [draft].
- BC50 At the time of this decision, the AASB were only aware of these issues affecting not-for-profit entities. However, during further consultation and research, the AASB observed that some for-profit public sector entities issue identical arrangements by way of legislation, for example the Transport Accident Commission (TAC) in Victoria. Consequently, the AASB considered expanding the scope of its modifications to include

all public sector entities (ie both for-profit and not-for-profit entities) to avoid issues with identifying whether insurance obligations arise as a result of contracts or statute. In assessing *The AASB's Standard-Setting Frameworks for For-Profit Entities and Not-for-Profit Entities* [draft], the AASB agreed that amendments were also warranted for for-profit entities in the public sector under the following criteria:

- (a) Australian-specific legislation is not adequately addressed by the IFRS Standard and there has been, or is likely to be, diversity in practice warranting specific guidance; and
- (b) issues specific to the public sector are of such prevalence and magnitude that users are likely to make inappropriate decisions based on the financial statements. Consistency across the public sector, and consistency with other FP entities with insurance obligations created by contracts, is more important to users. The NFP Standard Setting Framework provides more details.

BC51 As a result, the AASB expanded its original decision by extending the scope of the proposals to include for-profit public sector entities, in addition to not-for-profit public sector entities.

## **'Insurance-like'**

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BC52 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.

BC53 Community-wide services or safety nets are not transactions that the Board intends to cover in its proposed Australian Implementation 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.

BC54 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'.

BC55 Service agreements are also not intended to be covered by the proposed Australian Implementation Guidance and are regarded as a means of facilitating government service delivery. The proposed Australian Implementation 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'.

BC56 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, but not sufficient, 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.

BC57 The Board considers the following criteria are mandatory, but not sufficient, 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;

BC58 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.
- (b) Assessment of claims performance - 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. Furthermore, 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;
- (c) Similar arrangements to 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;
- (d) Separate entities, 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 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***

- BC59 AASB 17 Paragraph 2 defines commercial substance as having a discernible effect on the economics of the arrangement<sup>11</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>12</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.
- BC60 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***

- BC61 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.
- BC62 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.

## **Other Criteria**

### ***Funding***

- BC63 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.

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11 AASB 17 Paragraphs B18 to B23 provide implementation guidance to determine commercial substance.

12 AASB 15 Paragraph 9(d) and Appendix F19

- BC64 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.
- BC65 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.
- BC66 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.
- BC67 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.
- BC68 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.

### ***Assessment of claims performance***

- BC69 The Board noted one of the key aspects of an insurance arrangement is the regular assessment of the arrangement's financial performance and financial position. This involves the use of actuarial assumptions, internal and/or external reporting on the financial performance of the arrangement, and, where necessary, taking action to address any underfunding of the arrangement by adjusting the level of funding to cover the emerging risks in the portfolio. Regardless of the source of funding it would be expected that either:
- (a) premiums would be adjusted to reflect the change in risk, whether to be paid by a policy holder or by way of government contribution; or
  - (b) the benefits provided by the arrangement would be reduced to reflect the availability of funding.
- BC70 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. That is, the funding ratio of the arrangement would fall until the point at which the obligations arising under the arrangement became onerous.
- BC71 Funding of a public sector entity may not be intended to fully support the liabilities of insurance-like arrangements. For example, funds may be provided to meet the cash outflows arising from the arrangement or to meet liabilities that exclude certain elements of liability for incurred claims (such as the risk adjustment for example). Such circumstances do not indicate that an arrangement is not insurance-like.
- BC72 Where an arrangement is set up to be self-funding this is a clear indication the arrangement is insurance-like.
- BC73 The assessment of liabilities does not need to be performed by actuarial specialists or use actuarial methods for the arrangement to be insurance-like. However, the presence of regular actuarial monitoring and management as part of the governance function of the arrangement, would further indicate that the scheme might be insurance-like.

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

- BC74 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 entities, assets and liabilities**

- BC75 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**

- BC76 The Board considered a number of other factors in the process of identifying the proposed Implementation Guidance, however did not consider these should be specific factors as they were not considered sufficiently discriminatory.
- BC77 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**

- BC78 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.

## **Discount rates**

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

- BC79 Paragraph B89 of AASB 17 explains the purpose of the risk adjustment.
- BC80 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. A public sector entity may also have different cost of capital requirements to private sector entities. 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.
- BC81 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.

## **Captive insurance**

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- BC82 Captive insurers are used by a number of entities in the private and public sectors. A characteristic of a captive insurer is that it assumes insurance risk from related entities within the same consolidated entity. As a result, the consolidated entity has not transferred insurance risk to a party outside the group and liabilities in respect of events that are insured by a captive are accounted for under other standards, such as AASB 137.
- BC83 In the private sector, an Australian captive insurer may be required to prepare standalone financial statements for the Australian Securities and Investment Commission (ASIC) and shall apply AASB 17 to such reports, in the same way as it has been normal to apply AASB 1023 in the past. Additionally, the Australian Prudential Regulation Authority requires reporting forms to be lodged under section 13 of the *Financial Sector (Collection of Data) Act 2001*, and requests insurers to follow the Australian Accounting

Standards as an accounting basis. In the public sector, comparable user demand does not appear to exist at the standalone financial statement level, and consequently the Board has chosen to provide a limited exemption to captive insurers. Where a public sector entity enters into transactions with related entities and all the relevant entities are included within a single consolidated financial report, the public sector entity accepting insurance risk may choose not to apply AASB17 to those transactions in its standalone financial statements.

- BC84 This limited exception has been provided because some captive public sector entities do not currently apply insurance accounting to their insurance transactions and the cost of doing so is likely to be greater than the benefits given the accounting would be reversed on consolidation. A captive insurer that accepts insurance risk from related and unrelated parties shall only apply the exemption to transactions with related parties.

## GAAP/GFS convergence

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- BC85 The Board considered implications of its direction to harmonise Generally Accepted Accounting Principles (GAAP) and Government Finance Statistics (GFS). The Board noted that the *Australian System of Government Finance Statistics: Concepts, Sources and Methods 2015* manual (“ABS GFS Manual”) refers to four types of arrangements related to insurance:
- (a) social protection, which refers to government expenditure on services and transfers provided to individual persons and households and expenditure on services provided on a collective basis. Social protection is further classified into categories including sickness and disability, unemployment, family and children, and housing (ABS GFS Manual paragraph A1C.205-6). Social protection appears akin to ‘social benefits’ referred to elsewhere in this Standard;
  - (b) social insurance, which, in Australia, only relates to workers compensation (*Australian System of National Accounts: Concepts, Sources and Methods 2015* paragraph 13.57-59); and
  - (c) insurance policies, defined as an agreement between an insurer and a policyholder, involving pooling risks. GFS further categorises insurance policies into (ABS GFS Manual paragraph 13.86-87):
    - (i) life insurance, an activity whereby a policyholder makes regular payments to an insurer in return for which the insurer guarantees to provide the policyholder with an agreed sum, or annuity, at a given date or earlier if the policyholder dies beforehand. An important relationship exists between premiums and benefits during the policy period. For policyholders, the benefits receivable are expected to be at least as great as the premiums payable, and this type of insurance can be seen as a form of saving. Essentially, life insurance premiums and benefits are transactions in financial assets and liabilities and not transactions in revenue and expense. GFS also specifies that public sector involvement in life insurance is most often provided in the form of employment-related superannuation schemes, which may fall within the scope of AASB 1056 *Superannuation Entities*; and
    - (ii) non-life insurance, an activity similar to life insurance except that it covers all other risks such as accidents, damage from fire, etc. With non-life insurance, a claim is payable only if a specified contingency occurs and not otherwise. This implies that GFS does not require recognition of a liability for future events that have not yet occurred. This type of insurance arrangement appears that it may fall within the scope of AASB 17.

BC86 The accounting treatment of the different insurance arrangements is not directly discussed in the ABS GFS Manual. Instead, the accounting treatment is deduced from the chart of account classification and the economic type framework, as outlined in the table below:

Social protection	Social insurance (workers compensation)	Insurance policies	
		Non-life insurance schemes	Life insurance schemes
<u>Amounts receivable</u>			
None	Other social contributions (revenue)	Premiums (revenue)	Incurrence of liabilities through actual contributions
<u>Amounts payable</u>			
Social assistance benefits (expense)	Employment-related social benefits (expense)	Claims (expense)	Reduction in liabilities through pensions paid

BC87 The Board noted that key differences between GAAP and GFS exist in relation to the accounting treatment of insurance-like arrangements. The Board also observed that the areas of difference are driven by a difference in the underlying principles. The Board weighed its policy on GAAP/GFS harmonisation against its policy of transaction neutrality and compliance with IFRS. On balance, the Board considered that it was not necessary to amend its decisions reflected in this Standard in order to better achieve GAAP/GFS harmonisation.