



Treasury

Contact: Sean Osborn  
Telephone: 02 9228 5932

Dr Keith Kendall  
Chair  
Australian Accounting Standards Board  
PO Box 204  
Collins Street West  
VIC 8007 Australia

Dear Dr Kendall

Keith

### **ED 319 Insurance Contracts in the Public Sector**

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) welcomes the opportunity to respond to ED 319 *Insurance Contracts in the Public Sector* (ED 319). HoTARAC is an intergovernmental committee that advises Australian Heads of Treasuries on accounting and reporting issues. The Committee comprises senior accounting policy representatives from all Australian states and territories and the Australian Government.

HoTARAC acknowledges the proposed indicators are factors relevant in assessing whether an insurance contract exists in the public sector context. However, HoTARAC is of the view that the proposals in ED319 will result in an unnecessarily large number of public sector arrangements subject to the "collective assessment" process, and inconsistency in the conclusions from a "balanced judgment". Therefore, HoTARAC recommends the AASB:

1. clarify the prerequisite/fundamental elements of an insurance contract (i.e. what an insurance contract must have), e.g. enforceability, at least some premiums/levies from those who stand to benefit from the coverage,
2. clarify the relative significance of indicators in the collective assessment, e.g. by classifying them into primary and secondary indicators,
3. clarify the features of "social benefits" and "compensation schemes" or other schemes or sub-groups of those schemes, that are intended to be scoped out of AASB 17, or make it a rebuttable assumption that certain schemes are, or are not insurance contracts,
4. clarify the basis for the "balanced judgment", such as the essence/focus for an insurance contract,
5. provide illustrative examples of applying the proposed indicators in a collective assessment and making a balanced judgment thereon,
6. provide further exemption from the general measurement approach,
7. clarify whether a zero risk adjustment is permitted or possible in relevant circumstances,
8. reduce disclosure requirements in the proposed para Aus34.3,
9. provide optional exemption to captive insurers in GGS that provides insurance services solely, or mainly, to GGS entities

Based on consultation with government agencies, of particular concern to HoTARAC, is the scoping indicators as drafted, will lead to:

- Arrangements being in the scope of AASB 17, where this was not intended, including arrangements that are predominantly social benefits schemes in nature;
- The need to assess multiple non-insurance like schemes, just to determine they are not in the scope of AASB 17; and
- Inconsistent application of the indicators to similar arrangements.

The attachment to this letter sets out HoTARAC's response to the specific and general matters for comment, and the reasons for the above recommendations.

If you have any queries regarding HoTARAC's comments, please contact Sean Osborn from NSW Treasury by email to [sean.osborn@treasury.nsw.gov.au](mailto:sean.osborn@treasury.nsw.gov.au).

Yours sincerely



Stewart Walters

CHAIR

Heads of Treasuries Accounting and Reporting Advisory Committee

8 June 2022

**ENCLOSED:**

HoTARAC Comments to the AASB on ED 319 *Insurance Contracts in the Public Sector*

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## **HoTARAC Comments to the AASB on ED 319 Insurance Contracts in the Public Sector**

### **AASB Specific Matters for Comment**

#### ***Sub-grouping of contracts [paragraphs Aus16.1 and Aus22.1 and paragraphs BC19 to BC45]***

**Question 1:** *Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition in a public sector context? Please provide your reasons.*

HoTARAC members support the proposal to not require the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition in a public sector context, due to the reasons in para BC29, BC30 and BC34.

**Question 2:** *Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are issued more than a year apart in a public sector context? Please provide your reasons.*

HoTARAC members support the proposal to not require the sub-grouping of contracts based on whether they are issued more than a year apart in a public sector context, due to the reasons in para BC45.

#### ***Initial recognition when contracts are onerous [paragraph Aus25.1 and paragraphs BC46 to BC50]***

**Question 3:** *Do you agree with the proposal to amend the AASB 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous? Please provide your reasons.*

HoTARAC members support the proposal to amend the AASB 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous, due to the reasons in para BC50.

#### ***Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (PAA) [paragraphs Aus34.1 to Aus34.3 and AusB64.1 and paragraphs BC51 to BC85]***

**Question 4:** *Do you agree with the proposed guidance on coverage periods, which would impact on applying the eligibility criteria for using the premium allocation approach (PAA) in a public sector context? In particular, do you agree with the proposals to provide guidance that:*

*(a) assessing a public sector entity's practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits;*

*(b) a public sector entity's monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity's practical ability to fully price for risks or benefits;*

*(c) any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits;*

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*(d) arrangements would not be regarded as failing to meet the criterion in AASB 17 paragraph 34(b)(ii) simply because premium pricing for coverage up to the date when the risks are reassessed takes into account:*

- (i) risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits using a medium to long term view; and/or*
- (ii) a broad government policy framework that includes considering general economic circumstances and community needs*

*Please provide your reasons.*

HoTARAC members support the above reliefs from the proposed paras Aus34.1-34.2. However, HoTARAC also notes that there are certain public sector insurance schemes not covered by the proposed relief and that would therefore have to adopt the general measurement model.

AASB17.53 provides for two criteria for an insurance contract to be exempted from the general measurement model. Some public sector insurance contracts have coverage period of more than a year, after taking the proposed para Aus34.1-34.2 into consideration, and therefore would fail the exemption criteria in AASB17.53(b). As acknowledged by para BC55, to demonstrate an insurance contract meets the other exemption criteria in AASB17.53(a), it would involve creating a system to periodically test for material differences that, of itself, could involve significant costs.

Therefore, HoTARAC members recommend a blanket exemption for public sector not-for-profit entities, because the cost of maintaining such a system will outweigh the potential value of the information generated and subsequently reflected in the financial statements.

**Question 5:** *Do you agree with the proposals to:*

*(a) require disclosure of information about the nature of the pricing process, including:*

- (i) the manner in which pricing/benefits are determined;*
- (ii) the timeframes for which they are typically determined; and*
- (iii) any other relevant constraints under which an entity operates;*

*when a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period; and*

*(b) permit the disclosure to be located either:*

- (i) in the notes to the financial statements; or*
- (ii) by reference to an authoritative source that is available to users of the financial statements on the same terms as the financial statements and at the same time?*

*Please provide your reasons.*

HoTARAC members believe the proposed disclosure would be of little value to users of financial statements. Policy restrictions on the pricing process demonstrate that most public sector insurance arrangements do not seek financial profits in their pricing process. Therefore, additional disclosure on the pricing process, is not justified if there is significant extra cost associated with it.

HoTARAC recommends any additional disclosure to be restricted to a statement of the fact that the pricing process is affected by relevant government policies and any other constraints, and a reference to any existing authoritative source that is available to the users of financial statements.

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### **Risk adjustment [paragraphs BC86 to BC122]**

**Question 6:** *The AASB is proposing no modifications to the AASB 17 requirement for a risk adjustment that reflects the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.*

*In contrast, the NZASB is proposing a modification to require a risk adjustment that reflects an amount that is estimated to achieve a 75 per cent confidence level for a liability for incurred claims, which can be rebutted.*

*The proposed paragraph 37.1 in the NZASB's Exposure Draft states:*

*37.1 Notwithstanding paragraph 37, for a public sector entity, there is a rebuttable presumption that the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk is an adjustment to achieve a 75% confidence level (that is, a 75% probability of liabilities for incurred claims being adequate to meet actual claims).*

*(a) do you support:*

*(i) the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or*

*(ii) the NZASB approach of specifying a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75 per cent confidence level is included when measuring a liability for incurred claims?*

*Please provide your reasons.*

*(b) Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning.*

HoTARAC members support the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement.

However, HoTARAC seeks clarification from the AASB on the possible contradiction between para BC114(b) that states public sector entities might determine a zero risk adjustment, and para BC109, 111 and 112 which state that requiring a zero risk adjustment would be inappropriate.

### **Scope [paragraphs AusB16.1 to AusB16.25 and paragraphs BC123 to BC211]**

**Question 7:** *The Boards propose that the public sector arrangements to which AASB 17 should apply would be identified based on a collective assessment of the following proposed indicators [paragraphs AusB16.1 to AusB16.25]:*

*(a) similarity of risks covered and benefits provided;*

*(b) identifiable coverage;*

*(c) enforceable nature of arrangement;*

*(d) source and extent of funding;*

*(e) management practices and assessing financial performance; and*

*(f) assets held to pay benefits.*

*Do you agree with these proposed indicators? If you disagree with the proposed indicators, which of them would you exclude?*

HoTARAC members agree that all of the above factors are relevant when assessing whether an insurance contract exists in the public sector context. However, HoTARAC is of the view that:

- some of the proposed indicators should instead be taken as the prerequisite/defining characteristics. It is important to clarify the fundamental
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elements of an insurance contract (i.e. what an insurance contract must have).

- Some indicators are more relevant than others, and this should be clarified in the proposed amendments to the standard, rather than left to preparers' judgment. Indicating the relevant significance in the assessment, e.g. by classifying them into primary or secondary, will be helpful for implementation.
- If no relative significance can be assigned, the proposed indicators (i.e. no relative significance indicated) would be better included as guidance that does not form part of the standard, rather than in Appendix A that does.
- There is insufficient clarity around social benefits and compensation schemes. Several Aus and BC paras imply that such schemes are distinct from insurance contracts (e.g. AusB16.2, BC136, BC166, BC176, BC178(c)). However, in para BC199 the Board was opposed to excluding them from the scope of AASB 17.
- There is insufficient guidance on how to make a balanced assessment using the indicators. Adding some illustrative examples of applying the proposed indicators for a collective assessment would be useful in clarifying the basis of the balanced judgment required.

HoTARAC believes that the existing proposed approach of a collective assessment using the six indicators, as currently expressed, would create a significant burden for many public sector entities that do not have insurance contracts. Our consultations indicate this would lead to inconsistent outcomes due to an insufficient basis to form a judgment that could be expected to be formed by the majority of the preparers:

- a large number of social benefits schemes and compensation schemes will need to go through the collective assessment, only because they have some or all of the elements in the "definition of an insurance contract" in Appendix A of AASB17. Such schemes are not clearly scoped out of the standard (although several BC paras indicate they are not intended to be included). For example, schemes that are open ended, not subject to premiums/levies, or not enforceable.
- several BC paras suggest that certain indicators are definitive, while other indicators could also be features of non-insurance contracts. Clarifying the relative importance of each indicator in the main text of the standard will be critical to making a balanced judgment, as required by para AusB16.2. Without indicating the relevant significance to each indicator, we expect very different assessment outcomes from applying the six indicators.

HoTARAC's view on each individual proposed indicator is elaborated as follows:

#### Similarity of risks covered and benefits provided

HoTARAC agrees that this is relevant when assessing the existence of a public sector insurance contract. However, applying this indicator in an assessment may only be useful under limited circumstances. This is implied in para AusB16.5.

Public sector schemes often target areas where private sector do not see sufficient financial returns relative to the risks, and therefore do not participate in. In addition to circumstances where public sector entities are monopolies, there are examples where the private sector only provides specific insurance services to cohorts with low risks, while the government decides to provide the same insurance services to cohorts with high risks. Therefore, the practical applicability of this indicator is low.

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Therefore, HoTARAC recommends that the amendments should clarify this is not a primary indicator for the assessment. HoTARAC also recommends removing “have similar characteristics” in para BC127 because it is a very broad term and could cause confusion, or clarify what it means in the context of the proposed indicator.

#### Identifiable coverage period

HoTARAC is of the view that this factor should be clarified as a primary indicator, or a prerequisite for a public sector insurance contract.

HoTARAC notes that para AusB16.12 scopes out open-ended arrangements to provide benefits based on eligibility criteria. This is slightly different from para BC136 which specifies that eligibility criteria “relate to someone’s inherent status”. HoTARAC recommends the AASB clarify the apparent inconsistency, i.e. whether AusB16.12 intends open-ended arrangements for benefits based on eligibility criteria that do not relate to someone’s inherent status, being excluded from AASB 17, for example, accidents or natural disasters.

#### Enforceable nature of arrangement

HoTARAC is of the view that this factor should be a prerequisite, rather than an indicator, for a public sector insurance contract.

According to AASB 17.2, a contract is an agreement between two or more parties that creates enforceable rights and obligations. Therefore, HoTARAC believes that enforceability is an inherent feature for a contract. An arrangement should be outside of the scope of AASB 17 if it is not enforceable.

Stating enforceability as a prerequisite would immediately rule out government schemes where public sector entities retain the capacity to change the benefits payable to scheme participants/eligible beneficiaries, and avoid the need to complete a costly collective assessment process.

HoTARAC believes all the BC paras under the heading of “Enforceable nature of arrangement” will still be valid in their current form, as guidance for public sector entities to make a judgment on the enforceability of an arrangement.

#### Source and extent of funding

HoTARAC is of the view that this factor should be a primary indicator, or a prerequisite for a public sector insurance contract.

HoTARAC notes that para BC166 indicates this indicator would immediately rule out a range of social benefits such as aged pensions, universal healthcare activities and disability support. This implies that this indicator is a prerequisite. The rationale of Medicare falling out of the scope as not being a beneficiary pays model indicates the same.

HoTARAC believes having at least some premiums/levies from the party that stands to benefit from the coverage, should be a prerequisite, if maximum consistency with the GFS manual is to be achieved (please refer to the response to Question 12 below). HoTARAC agrees that the extent (above zero) of funding, from premiums or levies should be a primary indicator in assessing whether an arrangement is insurance in nature, as a “beneficiary-pays” model.

#### Management practices and assessing financial performance

HoTARAC is of the view that this factor should be clarified as a secondary indicator, because it is also a feature of arrangements other than insurance contracts, as stated in para BC178(c).

HoTARAC also notes that the last sentence in para BC178(c) implies that “compensation arrangements” should not be in the scope of insurance contracts. HoTARAC seeks further clarification from the AASB on this point and the essential

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features of compensation arrangements that mean these are not insurance contracts.

#### Assets held to pay benefits

HoTARAC is of the view that this factor should be a secondary indicator, if not completely removed from the list of indicators.

Assets held for a specific purpose is a common feature for many public sector schemes, including but not limited to insurance arrangements. When a public sector insurance contract does demonstrate this feature, it is often because there are premiums or levies collected specifically for the arrangement, which is demonstrated by the other proposed indicator of “source and extent of funding”. In such instances, including “assets held to pay benefits” seems redundant or misleading, and may lead to an unnecessary compliance burden, due to the cost of assessing many government schemes with assets specifically held that are not insurance in nature.

HoTARAC notes para BC185 states that the absence of assets held to pay benefits “may be indicative of arrangements that should not be accounted for as insurance contracts”. HoTARAC acknowledges this will help scope out some non-insurance arrangements (and could be the main reason for keeping it as an indicator). However, the same outcome could be achieved if the public sector amendments clarify the importance of certain indicators over others.

**Question 8:** *Whether or not you agree or disagree with some or all of the indicators, do you have suggested alternatives or additional indicators? If so, please outline those indicators and provide supporting reasoning.*

Please refer to our response to Question 7 above.

**Question 9:** *The proposed paragraph AusB16.2 requires that the indicators outlined in paragraphs AusB16.3 to AusB16.25 are considered collectively so that a balanced judgement can be made. The Boards considered that the proposed indicators should not be ranked or be assigned a relative significance because their relative significance is expected to depend on the circumstances. Do you agree with not assigning a relative significance to the indicators or having any other form of ranking approach to indicators? If you disagree:*

*(a) which indicators would you identify as being most significant, or how would you otherwise rank the indicators, and why?*

*(b) would you identify some indicators as pre-requisites for applying AASB 17 and, if so, which ones, and why?*

Please refer to the response to Question 7 above.

If the balanced approach is retained, it should be made more explicit that:

- Indicators do not necessarily have equal weighting when assessing specific arrangements;
- The presence of one or more indicators, does not necessarily mean an arrangement is insurance in nature.

Without explicit clarification, there is a risk preparers and auditors will apply the indicators in way that leads to inconsistent outcomes.

#### **Application date [paragraph AusC1.1 and paragraphs BC212 to BC215]**

**Question 10:** *Do you agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 July 2025, with early application permitted? If not, what alternative application date would you suggest? Please provide your reasons.*

*Please note that the AASB also issued a Fatal-Flaw Review version of an Amending Standard AASB 2022-X Amendments to Australian Accounting Standards – Insurance Contracts: Consequential Amendments for Public Sector Entities for comment. Since for-*

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*profit public sector entities are currently required to apply AASB 17 for annual periods beginning on or after 1 January 2023, the AASB issued that consultation document to propose amendments to relevant Australian pronouncements so that for-profit public sector entities would be permitted to continue applying AASB 4 and AASB 1023 until a Standard making public sector-specific modifications to AASB 17 is effective or applied.*

HoTARAC notes that

- a large number of public sector arrangements may need to be assessed based on the proposed para AusB16.4-16.25, depending on the volume and complexity of arrangements in each jurisdiction,
- the level of judgment required for a collective assessment may also lead to significant debates among preparers and auditors across jurisdictions,
- a system required for measuring schemes that are not currently accounted for as insurance contracts will take time to be tested and established.

Therefore, HoTARAC proposes delaying the mandatory application date to 1 July 2026 to allow sufficient time for the transition.

### **Other modifications**

**Question 11:** *Do you consider there should be any further modifications to AASB 17 in respect of public sector arrangements? If so, what modifications would you suggest and on what basis would you justify them?*

*Please provide your reasons.*

*Please note that the Boards considered, but rejected, proposing modifications to AASB 17 in respect of public sector arrangements on the following topics:*

*(a) specifically exempting ‘captive’ public sector insurers from applying AASB 17 in their separate general purpose financial statements [paragraphs BC215 to BC223];*

*(b) discounting and inflating requirements applied in measuring insurance liabilities paragraphs BC224 to BC246];*

*(c) the measurement of investments backing insurance liabilities [paragraphs BC247 to BC252]; and*

*(d) classification and presentation of risk mitigation program and other similar costs [paragraphs BC253 to BC260].*

Apart from the suggestions in relation to indicators included in our response to Question 7 above, HoTARAC recommends:

- Adding illustrative examples of collective assessments using the proposed indicators, with different outcome, to allow for comparison. HoTARAC can provide real life examples to assist with illustrative examples if needed. The proposed para AusB16.4 to AusB16.25 provides guidance on what to consider in an assessment, but only limited guidance on applying a significant level of judgment to reach the appropriate conclusions. Without clarifying the substance of an insurance contract in the public sector amendments, it will be challenging for preparers to apply judgments to arrive at consistent conclusions, which will lead to significant diversity in practice.
  - Clarifying whether “social benefits” and “compensation schemes” should be scoped out, including identifying their essential features. This could include providing examples of social benefit or compensation schemes that should be treated as insurance contracts, if appropriate. HoTARAC notes the conclusion to oppose scoping out certain arrangements in para BC200. However, HoTARAC also notes several BC paras (e.g. AusB16.2, BC136, BC166, BC176, BC178(c)) imply that social benefits and compensation schemes are not intended to be treated as insurance contracts. This appears
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to be an inherent contradiction. Our consultation indicates applying the proposed indicators may lead to social benefits and compensation schemes being in the scope of AASB 17, including the examples scoped out in the BC paras above.

- Including a rebuttable assumption that certain schemes are, or are not, insurance contracts, to reduce unnecessary work in scoping assessments.
- Providing an optional exemption to captive insurers within the general government sector (GGS) that provide insurance services solely (or mainly, e.g. 95%) to other entities in the GGS. The costs of preparing individual entity financial statements in accordance with AASB 17, only to eliminate this treatment on consolidation, would exceed the potential benefit.

### **General matters for comment**

The AASB would also particularly value comments on the following general matters, to the extent they have not already been provided in response to specific matters for comment above.

**Question 12:** *Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?*

The proposals in the exposure draft do not appear to have obvious conflicts with GFS requirements. However, HoTARAC notes the *Australian System of Government Finance Statistics: Concepts, Sources and Methods Australia 2015* states (para 13.86): "...under the insurance policy agreement, the policyholder makes payments (known as premiums) to the insurance corporation". This implies the existence of premiums as an essential feature of an insurance policy agreement, while ED 319 proposes to include "source and extent of funding" as one of the 6 indicators of a public sector insurance contract, on which a collective assessment and balanced judgment is required. This could potentially lead to a convergence difference.

**Question 13:** *Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?*

HoTARAC anticipates there may be significant auditing and assurance challenges, because:

- A large number of arrangements may be subject to the collective assessment process based on the proposed indicators. This would require significant audit judgement and resources. Judgment may also be required about which arrangements should be subject to the assessment process.
- Auditors will need to apply significant judgment on application of the "balanced judgment" made by preparers, due to the lack of clarity on the essence/focus of an insurance contract, in the context of the public sector specified in the standard.
- More auditing resources will be incurred in relation to understanding actuarial reports and testing the underlying information system.

**Question 14:** *Whether, overall, the application of AASB 17, modified as proposed, would result in financial statements that would be useful to users?*

HoTARAC members acknowledges that the application of AASB 17 will enhance sector neutrality, and consistency between insurance contracts and insurance-like

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contracts in the public sector. However, the users of most public sector entities, in particular not-for-profit entities, may find the information of limited additional value. This is because:

- Most public sector entities do not compete with the private sector insurers, and therefore the comparability of the information is not relevant
- Not-for-profit sector entities have objectives other than making a financial profit. Therefore, not-for-profit entities may not include this risk in their pricing.

**Question 15:** *Whether the proposals are in the best interests of the Australian economy?*

No comment.

**Question 16:** *Unless already provided in response to specific matters for comment above, the costs and benefits of the application of AASB 17, modified as proposed, relative to the current requirements, whether quantitative (financial or non-financial) or qualitative? In relation to quantitative financial costs, the Boards are particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements (AASB 1023).*

HoTARAC acknowledges that applying AASB 17 will have the benefit of enhancing sector neutrality and consistency. However, HoTARAC expects the implementation of AASB 17 may lead to significant costs for some jurisdictions, dependent on the volume and complexity of government schemes, mainly due to the following reasons:

- The proposed amendments do not definitively scope out social benefits and compensation schemes and therefore a large number of government schemes will need to be assessed;
- Significant judgments are required for the collective assessment of proposed indicators;
- The cost of establishing a system for assessing the exemption criteria in AASB 17.53(a) will be considerable; and
- The cost of establishing a system for measuring new insurance schemes under the general measurement model will be considerable.

As an example, iCare of NSW, anticipates that an implementation cost of \$18m. It is difficult to quantify the costs for other non-insurance government entities, because the indicators in ED319 lack sufficient clarity. Feedback from our consultation suggests a large number of schemes that appear to be non-insurance, including social benefits schemes would need to be assessed.

Public sector schemes are often priced to break even, with future funding adjusted to address claims. Arguably, therefore including a risk adjustment in the liability is less relevant than for the private sector. As drafted, the potential cost of assessing many existing government schemes will likely outweigh the benefit for some jurisdictions. HoTARAC recommends the AASB consider the suggestions included in our responses above, to reduce the implementation costs as far as possible.

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