Australian Government
Australian Accounting Standards Board

XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Staff Paper

Project	**Insurance Activities in the Public Sector**	**Meeting**	AASB (M183)/NZASB September 2021
Topic	Risk mitigation program costs and other similar costs	**Agenda item**	AASB 11.5 NZASB 3.5
		Date	23 August 2021
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Objective of this paper

1. The objective of this paper is for the AASB and the NZASB to decide whether public-sector-specific modifications or guidance in AASB 17/PBE IFRS 17 *Insurance Contracts* is needed in respect of the classification and presentation of risk mitigation program and other similar costs, which are not directly related to particular insurance arrangements.

Structure of this paper

2. This staff paper is set out in three sections:
   - Section 1 discusses risk mitigation costs
   - Section 2 discusses insurance contract costs under Accounting Standards
   - Section 3 analyses whether any modifications are needed in respect of accounting for risk mitigation costs by public sector entities.

Summary of staff recommendations

3. Staff are recommending there be no public sector modifications or guidance on the classification and presentation of risk mitigation program and other similar costs. However, staff expect the issues and reasoning for taking no action to be explained in a Basis for Conclusions.

Section 1: Risk mitigation costs

4. Most insurers undertake risk mitigation activities – for example:
   (a) risk assessments of a customer's premises that are to be insured; and/or
   (b) education programs among policyholders regarding safe work practices.
5. For a private sector for-profit insurer, these activities would be expected to typically be closely associated with underwriting or claims management and to be attributable to particular contracts or groups of contracts. The same types of activities are conducted by public sector entities.

6. However, some public sector entities sometimes also engage in activities that have a broader community focus, including for example:

   (a) road safety campaigns;

   (b) research into medical practices in public hospitals; and/or

   (c) rehabilitation techniques to improve return to work experience.

Section 2: Requirements in Standards

AASB 1023/PBE IFRS 4

7. AASB 1023 *General Insurance Contracts*, paragraphs 17.6.2 and 17.6.3/PBE IFRS 4 *Insurance Contracts* Appendix D.17.6.2 and 17.6.3 outline a range of income and costs that are recognised within assets and liabilities and income and expenses that would normally arise from insurance contracts. Appendix A, paragraph A1, quotes these paragraphs.

8. There is no specific reference to costs associated with risk mitigation, such as safety programs, research into claims prevention, and other similar costs. The general practice among public sector entities applying AASB 1023/PBE IFRS 4 is mixed.

Practice	***Comments***[1]
Include the costs in determining the underwriting result	Usually presented as a separate income statement line item within the underwriting result. The costs are often considered to be relatable to insurance contracts and, in particular, can impact on the long-term amounts of claims. (For example, more efficient injury treatments may lead to lower incurred claims costs, which relate to existing incurred claims or future claims.)
Present the costs below the underwriting result	Sometimes presented as a separate income statement line item below the underwriting result. Sometimes presented within a broader income statement line item of 'other' costs below the underwriting result. The costs are often considered insufficiently relatable to existing insurance contracts and most likely to affect either: (i) claims under future contracts; or (ii) the public in general, rather than participants/policyholders. The entity has two separate mandates, for example, in the entity's enabling legislation: (i) to provide risk coverage; and (ii) to provide safety/risk management/education programs.

1 Based on: (a) stakeholder feedback from interviews conducted by staff in late 2020 and early 2021; and (b) staff reviews of published financial statements.

AASB 17/PBE IFRS 17

9. It is expected that, under AASB 17/PBE IFRS 17, the following income statement lines items that make up the net profit or loss will be presented by insurers:

   (a) insurance service result, comprising insurance revenue and insurance service expenses [AASB 17/PBE IFRS 17.80(a)];

   (b) insurance finance income or expenses [AASB 17/PBE IFRS 17.80(b)];

   (c) investment income/expenses; and

   (d) other items – for example, general administration costs, restructuring costs, share of net gain/loss of associates, and amortisation/impairment of intangibles.

10. Items identified in AASB 17/PBE IFRS 17.B65 would affect the 'insurance service result because they fall within the boundary of insurance contracts. AASB 17/PBE IFRS 17.B65 says, in part (**emphasis added**):

> B65 Cash flows within the boundary of an insurance contract are those that **relate directly to the fulfilment of the contract**, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include: …
>
> (l) an **allocation of fixed and variable overheads** (such as the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities) **directly attributable to fulfilling insurance contracts**. Such overheads are allocated to groups of contracts using methods that are systematic and rational, and are consistently applied to all costs that have similar characteristics. …

AASB 17/PBE IFRS 17.B65 is quoted in full in Appendix A, paragraph A2.

11. AASB 17/PBE IFRS 17.B66 sets out the types of cash flows that do not fall within the boundary of insurance contracts. AASB 17/PBE IFRS 17.B66 says (in part):

> B66 The following cash flows shall not be included when estimating the cash flows that will arise as the entity fulfils an existing insurance contract: …
>
> (d) cash flows relating to **costs that cannot be directly attributed to the portfolio of insurance contracts that contain the contract**, such as some **product development and training costs**. Such costs are recognised in profit or loss when incurred.

Section 3: Analysis of insurance contract costs under AASB 17/PBE IFRS 17

12. In applying AASB 17/PBE IFRS 17, an assessment would need to be made by each insurer to determine whether the risk mitigation costs are sufficiently attributable to existing contracts or a portfolio of contracts to be accounted for within the insurance service result. If they cannot be directly attributed to contracts or a portfolio of contracts, they would be immediately recognised as expenses and presented below the insurance service result.

13. The following perspectives may be relevant in determining whether any public-sector specific guidance is needed.

Perspectives against specific guidance	***Perspectives supporting specific guidance***
Although the nature of some of the risk mitigation program and other similar costs incurred by public sector entities might be	The risk mitigation program and other similar costs incurred by public sector entities usually have a broader public policy purpose than those

Perspectives against specific guidance	***Perspectives supporting specific guidance***
different from those conducted in the private sector, the decision making around whether those costs are 'directly attributable' to insurance contracts would be no different.	conducted in the private sector and may be the subject of a specific public benefit mandate.
Although practice is currently mixed and this may continue under AASB 17/PBE IFRS 17, that may be due to the fact that the costs differ in nature from entity to entity.	Practice is currently mixed and this may continue under AASB 17/PBE IFRS 17 in the absence of guidance.
Similar decisions about the attribution of costs will need to be made in respect of organisational overheads (more broadly).	
The amounts relating to risk mitigation program and other similar costs are usually not material.	Although the amounts relating to risk mitigation program and other similar costs, are usually not material, they can be in the multiple millions of dollars, which might be significant in a public policy context.

Staff views

14. Staff note that, if guidance were to be provided, staff consider that there is no compelling reason to require risk mitigation program and other similar costs to be:

    (a) included in determining the insurance service result; or

    (b) included below the insurance service result;

    That is, there does not appear to be any 'inherently right' or 'wrong' presentation for public sector entities for these types of costs.

15. Based on staff research and the outreach, the topic is not sufficiently significant to stakeholders to warrant a public sector modification or guidance in regard to the classification and presentation of risk mitigation program and other similar costs.

Question for Board members

Q1 Do Board members agree that there is no need for a public sector modification or guidance on the classification and presentation of risk mitigation program and other similar costs?

Appendix A – Extracts from AASB 1023.17/PBE IFRS 4

A1 AASB 1023.17.6.1(b)/PBE IFRS 4 Appendix D.17.6.1(b) addresses the disclosure of recognised assets, liabilities, income, expense and cash flows arising from insurance contracts. AASB 1023.17.6.2 and 17.6.3/PBE IFRS 4 Appendix D.17.6.2 and 17.6.3 say:

17.6.2 In applying paragraph 17.6.1(b), the recognised assets and liabilities arising from insurance contracts would normally include:

(a) gross outstanding claims liability;

(b) reinsurance recoveries receivable arising from the outstanding claims liability;

(c) gross unearned premium liability;

(d) reinsurance recoveries receivable arising from the unearned premium liability;

(e) unexpired risk liability;

(f) other reinsurance recoveries receivable;

(g) other recoveries receivable;

(h) outwards reinsurance expense asset or liability;

(i) direct premium revenue receivable;

(j) inwards reinsurance premium revenue receivable;

(k) deferred acquisition cost asset; and

(l) intangible assets relating to acquired insurance contracts.

17.6.3 In applying paragraph 17.6.1(b), the recognised income and expenses arising from insurance contracts would normally include:

(a) direct premium revenue;

(b) inwards reinsurance premium revenue (including retrocessions);

(c) reinsurance and other recoveries revenue;

(d) direct claims expense;

(e) reinsurance claims expense;

(f) outwards reinsurance premium expense (including retrocessions);

(g) acquisition costs expense; and

(h) other underwriting expenses, including claims handling expenses.

A2 AASB 17/PBE IFRS 17.B65 says:

B65 Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include:

(a) premiums (including premium adjustments and instalment premiums) from a policyholder and any additional cash flows that result from those premiums.

(b) payments to (or on behalf of) a policyholder, including claims that have already been reported but have not yet been paid (ie reported claims), incurred claims for events that have occurred but for which claims have not been reported and all future claims for which the entity has a substantive obligation (see paragraph 34).

(c) payments to (or on behalf of) a policyholder that vary depending on returns on underlying items.

(d) payments to (or on behalf of) a policyholder resulting from derivatives, for example, options and guarantees embedded in the contract, to the extent that those options and guarantees are not separated from the insurance contract (see paragraph 11(a)).

(e) an allocation of insurance acquisition cash flows attributable to the portfolio to which the contract belongs.

(f) claim handling costs (ie the costs the entity will incur in investigating, processing and resolving claims under existing insurance contracts, including legal and loss-adjusters' fees and internal costs of investigating claims and processing claim payments).

(g) costs the entity will incur in providing contractual benefits paid in kind.

(h) policy administration and maintenance costs, such as costs of premium billing and handling policy changes (for example, conversions and reinstatements). Such costs also include recurring commissions that are expected to be paid to intermediaries if a particular policyholder continues to pay the premiums within the boundary of the insurance contract.

(i) transaction-based taxes (such as premium taxes, value added taxes and goods and services taxes) and levies (such as fire service levies and guarantee fund assessments) that arise directly from existing insurance contracts, or that can be attributed to them on a reasonable and consistent basis.

(j) payments by the insurer in a fiduciary capacity to meet tax obligations incurred by the policyholder, and related receipts.

(k) potential cash inflows from recoveries (such as salvage and subrogation) on future claims covered by existing insurance contracts and, to the extent that they do not qualify for recognition as separate assets, potential cash inflows from recoveries on past claims.

(ka) costs the entity will incur:

  (i) performing investment activity, to the extent the entity performs that activity to enhance benefits from insurance coverage for policyholders. Investment activities enhance benefits from insurance coverage if the entity performs those activities expecting to generate an investment return from which policyholders will benefit if an insured event occurs.

  (ii) providing investment-return service to policyholders of insurance contracts without direct participation features (see paragraph B119B).

  (iii) providing investment-related service to policyholders of insurance contracts with direct participation features.

(l) an allocation of fixed and variable overheads (such as the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities) directly attributable to fulfilling insurance contracts. Such overheads are allocated to groups of contracts using methods that are systematic and rational, and are consistently applied to all costs that have similar characteristics.

(m) any other costs specifically chargeable to the policyholder under the terms of the contract.