Australian Government
Australian Accounting Standards Board

Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Staff paper

Project:	**Insurance Activities in the Public Sector**	**Meeting:**	AASB September 2022 (M190) NZASB October 2022 (M103)
Topic:	Captive insurance arrangements	**Agenda item:**	AASB 4.7 NZASB 7.7
Contacts:	Angus Thomson athomson@aasb.gov.au	**Date:**	5 September 2022
	Tereza Bublikova tereza.bublikova@xrb.govt.nz	**Project priority**	Medium
	Patricia Au pau@aasb.gov.au	**Decision-making**	High
	Charis Halliday charis.halliday@xrb.govt.nz	**Project status**	Consider feedback on Exposure Draft

Objectives of this paper

1. The objective of this paper is to for the Boards to CONSIDER stakeholders' feedback and DECIDE whether to include any specific requirements or practical expedients in the Standard to address the issue.

2. As noted in the Board's August 2022 meeting papers, the status of 'captive insurers' within the scope of AASB 17/PBE IFRS 17 *Insurance Contracts* has been raised as an issue by a number of Australian respondents. Appendix C shows a diagram of a captive insurance arrangement.

3. **This issue is generally only relevant for AASB** due to the existence of captive insurance arrangements and administered item requirements [in AASB 1050 *Administered Items*]. Accordingly, the references to Standards are largely to AASB Standards. However, the issue **may become relevant to the NZASB** if the New Zealand government were to establish a captive insurer that prepares general purpose financial statements.

Background on captive insurance

4. The Basis for Conclusions to AASB ED 319/NZASB ED 2022-3 *Insurance Contracts in the Public Sector* includes the following [a longer extract is included in Appendix B to this paper].

BC223/BC235 The Boards considered that the issues surrounding captive insurers are essentially reporting entity issues, that could affect the application of accounting standards more generally, rather than being issues of particular relevance to the insurance project. The Boards observed that governments which regard their captive insurer(s) as needing to prepare general purpose financial statements would have to determine whether they have:

(a) insurance contracts and need to apply insurance contract accounting; or

(b) are only service providers, akin to insurance brokers that are intermediaries between policyholders and insurers, that would apply, for example, AASB 15/PBE IPSAS 9 *Revenue from Exchange Transactions*.

The Boards also observed that governments which regard their captive insurer(s) as not needing to prepare general purpose financial statements, might seek to have them prepare a type of segment information, for example, for management purposes.

BC224/BC236 Accordingly, the Boards concluded that wider issues regarding the identification of reporting entities are at stake and are not specifically relevant in this project as a way of exempting public sector captive insurers from applying AASB 17/PBE IFRS 17 in their separate financial statements. They noted that, if a jurisdiction determines that an entity should prepare general purpose financial statements, provided the entity's activities fall within the scope of AASB 17/PBE IFRS 17, that Standard should be applied.

5. Appendix A summarises comments from three respondents on Question 11 in AASB ED 319 / NZASB ED 2022-3 regarding captive insurance arrangements and can be summarised as follows.

- The user of captive insurer financial statements is the controlling government, and the application of AASB 17 would provide no additional information to that user [iCare].
- The costs of preparing individual captive entity financial statements in accordance with AASB 17, only to eliminate this treatment on consolidation, would exceed the potential benefit [HoTARAC, iCare].
- Issues could arise when an entity that does not prepare general purpose financial statements (GPFS) has insurance arrangements which are administered by a Department. Under AASB 1050, the Department may need to apply AASB 17 to prepare its administered items disclosure note in its GPFS. At the Whole of Government level, those arrangements are recognised under AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* [ACAG].

  A similar issue arises for the General Government Sector (GGS) financial statements where AASB 17 accounting would need to be applied in relation to 'captive' insurance activities conducted by public financial corporations (PFC)[1] that are eliminated on consolidation in the Whole of Government financial statements [ACAG].

Staff analysis

Administered items

6. In respect of ACAG's comment, staff note that AASB 1050 *Administered Items* says:

> 24 To facilitate the assessment of the costs incurred and the cost recoveries generated as a result of the government department's activities, administered income, expenses, assets and liabilities are reported on the same basis adopted for the recognition of the elements of the financial statements.

7. Staff consider, if the entity administering the insurance activities determined that (based on the indicators) the arrangement falls within the scope of AASB 17, it would be consistent with AASB 1050.24 for the Department's administered item disclosures to be prepared in accordance with AASB 17. This is because it is not self-insurance from the perspectives of the administering entity and of the Department. Staff also acknowledge that this may not be the only basis on which AASB 1050.24 might be met because "the same basis adopted for the recognition of the elements of the financial statements" could be read more broadly.

1 A captive insurer seems most likely to be classified as a PFC, although it's possible there may be captives that are classified as a public non-financial corporation (PNFC).

8. The issue of effectively preparing two sets of financial statements using different accounting policies is not new because there are current instances of reporting AASB 1023 *General Insurance Contracts* information for insurance activities conducted between public sector entities controlled by the same government. Therefore, currently, two sets of financial information are sometimes prepared:

   (a) one set determined by applying AASB 1023 [either in a captive entity's stand-alone GPFS or in administered information disclosed in a Department's GPFS]; and

   (b) another set determined by applying AASB 137 at the Whole of Government level.

9. The main concern with the ED 319 proposals seems to be that more insurance activities will be scoped into AASB 17 [than are currently scoped into AASB 1023] and there will be a larger number of activities for which two sets of financial information would need to be prepared.

Current practice in Australia

10. Current reporting practices for captive insurance arrangements in the public sector[2] vary widely in two respects:

   - the form of reporting; and
   - the accounting policies applied.

11. The formats applied to captive insurance arrangements include the following:

   (a) separate stand-alone GPFS, presumably on the basis the arrangements are deemed to be a reporting entity;

   (b) as a segment of the GPFS of an entity that also includes other [non-captive] insurance arrangements; and

   (c) financial information disclosures presented in the notes to the GPFS of another entity, such as the responsible Department, whether as part of an administered items note or presented in some other way.

12. As noted in ED 319.BC222 (see Appendix B below), the various formats appear to have arisen as result of:

   - different governance arrangements, usually reflected in enabling legislation; and
   - historical factors, including the origin of the claims and whether there might be new claims or only claims run off.

13. The table below is a summary of current practices in respect of the form of reporting (column 3) and accounting policies applied (column 4), prepared using publicly available information and does not address all jurisdictions or necessarily all the self-insurance activities within a jurisdiction. *Please note the different practices can arise from the different circumstances in each case.*

2 Private sector captive insurers in Australia and New Zealand must prepare stand-alone financial statements because they are registered insurance companies – accordingly, similar debates about the form of reporting do not arise.

	Entity	Reporting format	Liability[3]
Commonwealth	**Comcare**[4] Worker's Compensation risks for government employees	GPFS as a stand-alone reporting entity	AASB 137
	Comcover Liability, Property, Motor Vehicle, Accident and Travel risks for GGS entities	Information in Notes to the Department of Finance GPFS [not included in administered balance sheet or income statement]	AASB 1023
NSW	**SICorp**[5] [Insurance for NSW]	GPFS as a stand-alone reporting entity	
	Treasury Managed Fund: Asset, Liability, and Workers' Compensation risks for government entities	Line-by-line financial statement information in columnar format	AASB 137
	Construction Risk Insurance Fund: Construction risks for government entities	Line-by-line financial statement information in columnar format	AASB 1023
	Supplementary Sporting Injuries Fund: Personal Injury risks for participants in school and other government-sanctioned sporting activities	Line-by-line financial statement information in columnar format	AASB 137
VIC	**VMIA**[6] [Victorian Managed Insurance Authority] Liability, Medical Indemnity, Property and Other risks for government entities	Presented in VMIA GPFS as a stand-alone reporting entity	AASB 1023
QLD	**QGIF** [Queensland Gov't Insurance Fund] Public Liability, Property, Medical Indemnity risks for gov't entities	Claims liability and associated investments reported in annual Report on State Finances Claims expense disclosed in Notes to the Qld Treasury GPFS [not included in administered balance sheet or income statement]	AASB 137
WA	**RiskCover** Workers' Compensation, Property, Motor Vehicle, Liability risks for gov't entities	RiskCover assets, liabilities, revenues and expenses are consolidated into the WA Insurance Commission's GPFS	AASB 137
SA	**SAFA**[7] (Insurance Division) [South Australian Financing Authority] Liability, Property, and Medical Malpractice risks for government entities	Assets, liabilities, revenues and expenses relating to insurance activities are consolidated into SAFA's GPFS	AASB 1023

3 Main liabilities accounted for using AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* or AASB 1023 *General Insurance Contracts*.

4 Comcare conducts other activities, including secretariate services for Seacare, Common law asbestos-related claims against the Commonwealth and Self-insured licencees' employee risks for registered national employers.

5 SICorp conducts other activities, including the Home Building Compensation Fund, managing claims run off for a range of now-closed government schemes and for other ongoing schemes for emergency workers.

6 VMIA conducts other activities, including Domestic Building Insurance, managing claims run off for a range of now-closed government schemes [Dust Diseases and a former Workers' Compensation scheme].

7 SAFA's four Divisions are: Treasury Services, Insurance and Fleet, Risk and Commercial Advisory, and Finance.

14. The example of Workers' Compensation insurance for government employees helps to illustrate the diversity. Practices vary from:

- a jurisdiction with a separate entity that only conducts Workers' Compensation insurance activities for government employees and reports on those activities in stand-alone GPFS [Comcare] and applies AASB 1023;
- jurisdictions with a separate entity that conducts many different activities, which include Workers' Compensation insurance activities for government employees, and consolidates those activities within the financial statements of another entity that prepares GPFS [part of Treasury Managed Fund within SICorp NSW, and RiskCover within the WA Insurance Commission] applying AASB 137;
- jurisdictions in which the separate entity that conducts Workers' Compensation insurance activities for government employees also conducts those activities for non-government employers reports on those activities on a consolidated basis in stand-alone GPFS [WorkSafe Victoria and WorkCover Queensland] applying AASB 1023. [These entities are not included in the table above because they are not primarily 'captive insurers'.]

Possible alternative courses of action for the Board

15. Staff have identified a number of possible alternative courses of action for the Board and the possible impacts of them and other factors that might be relevant.

Course of action	Impacts	Other factors
Approach 1: Allow entities a free choice to apply AASB 17 or AASB 137 regardless of the indicators	Would avoid governments being forced to apply two different forms of accounting Entities currently applying AASB 137 would not be 'at risk' of having to change their reporting to applying AASB 17 Some entities currently applying AASB 1023 may change their reporting to apply AASB 137, rather than AASB 17	It is a well-established principle that each entity applies Standards based on its own perspective and circumstances, not those of its parent – the free choice might be seen as inconsistent with this principle
Approach 2: Require entities to apply AASB 137, whether controlled or administered	Would avoid governments being forced to apply two different forms of accounting [unless applying AASB 17 met management reporting needs] Entities currently applying AASB 1023 would be required to change their reporting to apply AASB 137, rather than AASB 17 Would remove any element of doubt about which Standards to apply Would achieve consistent reporting of information about self-insurance activities across all forms of reporting May result in a loss of useful information, in particular disclosures about claims	Inconsistent with the principle that each entity applies Standards based on its own perspective and circumstances Would force some entities to transition from insurance accounting under AASB 1023 to AASB 137, when transitioning to AASB 17 may be preferred for cost-benefit reasons

Course of action	Impacts	Other factors
Approach 3: Require entities to apply AASB 17, whether insurance activities are controlled or administered ***This is effectively the position under ED 319/ED 2022-3***	Would avoid governments being forced to apply two different forms of accounting [unless applying AASB 137 met management reporting needs] Entities currently applying AASB 137 would be required to change their reporting to apply AASB 17, but only when the indicators are met Would help remove doubt about which Standards to apply Would help achieve consistent reporting of information about self-insurance activities across all forms of reporting	Inconsistent with the principle that each entity applies Standards based on its own perspective and circumstances Might force some entities to transition from accounting under AASB 137 to AASB 17, which would have cost implications
Approach 4: No modifications when an entity controls the insurance activities and prepares stand-alone GPFS. That is, apply AASB 17 if the activities fall within scope based on the indicators BUT, allow a free choice for Departments to apply either AASB 17 or AASB 137 to prepare administered item information on captive insurers that do not prepare stand-alone GPFS	Would avoid governments being forced to apply two different forms of accounting in respect of administered activities, BUT not necessarily when there are stand-alone GPFS	Consistent with the principle that each entity applies Standards based on its own perspective and circumstances in the context of stand-alone GPFS, but not from an administered items perspective

Staff comments and recommendations

16. Staff maintain that the decision of a jurisdiction to prepare GPFS for an entity conducting activities[8] that, from a whole of government perspective, are self-insurance activities, should trigger the need to apply accounting standards based on that entity's perspective. As a stand-alone entity, the insurance activities would not be self-insurance and, if the relevant factors are present [see Agenda paper 4.5/7.5], the entity should apply AASB 17.

17. Staff recommend that the AASB make no modification to the scope of AASB 17 in respect of reporting by 'captive insurers' in their stand-alone GPFS, consistent with the existing reasoning in the ED 319/ED 2022-3 Basis for Conclusions.

18. To avoid the potential for different accounting policies having to be applied in Departmental GPFS and Whole of Government GPFS, staff recommend allowing a free choice to apply either AASB 17 or AASB 137 to administered items or other information presented that is not consolidated, regardless of whether activities would fall within the scope of AASB 17 based on applying the relevant factors [see Agenda paper 4.5/7.5].

8 This could be all the entity's activities or only a portion of its activities.

19. Staff note that this position seems consistent with the basis on which AASB 1050 was created. AASB 1050 emerged from a restructuring of accounting standards applicable to government entities that included withdrawing AAS 29 *Financial Reporting by Government Departments*, which, among other things, addressed administered item disclosure requirements. In this process, the AASB made a limited number of amendments.

20. AASB 1050.BC13 says:

> BC13 The Board noted that some of the acknowledged inadequacies in AAS 29 are retained, including the lack of extensive guidance for identifying administered items and the potential inadequate prominence given to administered items in a complete set of financial statements The Board decided that this is justified on the basis that this Standard is a short-term measure until such time as the Board undertakes a longer-term project on administered items as part of a broader review

21. One possible 'inadequacy' appears to be that the basis of accounting for administered items may differ from the basis that would be used in a Department's own financial statements in respect of controlled items, as indicated in AASB 1050.BC18.

22. AASB 1050.BC18 says:

> BC18 The Board decided to delete the following sentence in paragraph 12.9.6 of AAS 29: "In some jurisdictions, this may mean that the basis adopted by a government department for reporting administered items may differ from the basis adopted by the government itself". The Board considers this sentence to be redundant, given that government departments are typically directed to adopt particular policies by their controlling government.

23. Staff consider that the Board took a pragmatic view when it first issued AASB 1050 and it is not the role of this project to attempt to address any shortcomings related to the reporting of administered items more generally.

24. Accordingly, **staff recommend** taking a pragmatic view – Approach 4 above:

    (a) require entities to apply either AASB 17 or AASB 137 based on the indicators for their stand-alone GPFS; but

    (b) allow entities to make a free choice to apply AASB 17 or AASB 137 for reporting information about administered activities on cost-benefit grounds; and

    (c) explain the Board's position in the Basis for Conclusions, including that the decision in this project to permit a choice is not intended to set a precedent for how future work on administered items disclosures might evolve.

Questions for Board members

Q1 Do Board members agree with not modifying the scope of AASB 17 in respect of reporting by 'captive insurers' in their stand-alone GPFS?

Q2 Do Board members agree with modifying the scope of AASB 17 to allow a free choice to apply AASB 17 or AASB 137 to administered items, regardless of the outcome that might be achieved by applying the factors for determining whether an activity is within the scope of AASB 17?

Q3 If you disagree with Q1 or Q2, what alternative approach(es) do you wish to take?

Appendix A: Collation of comments on question 11 in AASB ED 319/NZASB ED 2022-3 regarding captive insurance arrangements

	Q11 – other modifications
iCare	Governments create agencies to perform claims management on behalf of the state typically only providing services to other government sector agencies – these would be considered captive insurer arrangements. Requiring captive insurers to apply AASB 17 without considering their enabling legislation would require a risk margin applied to the accounts of the agency, increasing the need for funding. The users of the accounts of the captive insurer are the controlling government, and the application of the standard would provide no addition information to the users. The AASB should revisit the requirement for captive insurers to apply AASB 17.
HoTARAC	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.
ACAG	ACAG has identified anomalies in the proposal that 'captive' public sector entities preparing general purpose financial statements (GPFS) apply AASB 17, but captives not preparing GPFS need not apply AASB 17. The anomalies arise when the insurance arrangements are administered by an agency that does not have GPFS on behalf of the state. AASB 17 may need to be applied for disclosures in the Treasury administered financial statements, while AASB 137 [provisions] is applied in the Whole of Government (WoG) financial statements. A similar anomaly arises in AASB 1049 for the general government sector (GGS) financial statements where AASB 17 accounting would need to be applied by PFC and PNFC entities that are eliminated on consolidation in the WoG financial statements.

Appendix B – extracts from ED 319 Basis for Conclusions

Captive insurers

BC216 The Boards noted that large consolidated group entities sometimes establish a 'captive insurer' subsidiary to coordinate risk management for all (or most) entities within the group.[1] The subsidiary typically charges premiums to other entities in the group and pays them valid claims in respect of insured events, and ordinarily (re)insures some or all of the risks with one or more third-party (re)insurer(s). Australian or New Zealand-based captive insurers would need to be registered as insurers and, therefore, required to prepare general purpose financial statements and meet relevant regulatory and prudential requirements.

BC217 The Boards noted that governments also create captive insurers and the key motivations are typically to:

(a) centralise the administration of insurable risks across a complex group of entities and coordinate risk management policies and processes;

(b) charge premiums to other government agencies and, thereby, create incentives for them to manage risks; and

(c) in some cases, coordinate in a cost-beneficial manner the acquisition of insurance/reinsurance coverage from an external insurer/reinsurer.

BC218 The Boards observed that, at the whole-of-government level:

(a) transactions between the captive insurer and other government agencies are eliminated;

(b) any (re)insurance contracts between the captive and third-party insurers are treated as insurance contracts in which the government is a policyholder; and

(c) any remaining liabilities to third parties (for example, to government employees for workplace injuries) would be accounted for by applying AASB 137/PBE IPSAS 19.

BC219 The Boards considered whether they should:

(a) in the context of the requirements imposed on private sector Australian-based and New Zealand-based captive insurers, explicitly require public sector captive insurers to prepare general purpose financial statements, including applying AASB 17/PBE IFRS 17; or

(b) given the eliminations at the whole-of-government level, explicitly scope public sector captive insurers out of applying AASB 17/PBE IFRS 17.

BC220 The Boards noted the following in respect of the AASB Discussion Paper (2017).

(a) It was proposed that public sector captive insurers should be permitted an optional exemption to not apply AASB 17 on the basis that:

(i) some captive public sector entities do not currently apply insurance accounting to their insurance transactions; and

(ii) the cost of doing so is likely to be greater than the benefits given the accounting would be reversed on consolidation. (In the consolidated entity, since insurance risk has not been transferred to a party outside the group, any claim liabilities would probably be accounted for as provisions).

(b) It was also proposed that, in the event there is a public sector entity that accepts insurance risk from both related and unrelated parties, the optional exemption from applying AASB 17 would apply only to transactions with related parties.

(c) Respondents expressed mixed views, including:

(i) support for captive insurers being scoped out of AASB 17;

---

1 For a consolidated group that is not an insurer, the captive insurer would typically organise the group's insurance coverage. For a consolidated group that is an insurer, the captive insurer would typically organise the group's reinsurance coverage.

(ii) support for the optional exemption;

(iii) strong disagreement with the proposals based on a view they would create complexity for some entities within a group reporting structure that are required to use two different measurement bases; and

(iv) when there are no users dependent upon the financial statements of a captive insurer, it would be at the discretion of the relevant government to exempt the entity from preparing general purpose financial statements.

BC221 The Boards noted that NZASB ED 2018-7 did not raise the issue of captive insurers and nor did any of the respondents to the ED.

BC222 The Boards also noted that more recent stakeholder consultation revealed a variety of reasons for different practices among Australian governments in terms of whether separate general purpose financial statements are presented for captive insurers.

(a) Various accountability mechanisms and reporting requirements apply across the public sector and captive insurers either report separately (or not) based on those general requirements. For example, an entity may be regarded as being primarily engaged in providing claims management services to other areas of government rather than bearing insurance risk, which may lead a jurisdiction to conclude that:

(i) separate general purpose financial statements are not needed; or

(ii) if separate general purpose financial statements are needed, they would be prepared on the basis that the entity is a service provider for managing the claims process, rather than bearing insurance risk, and would not apply insurance contract accounting.

(b) Historical responsibilities for bearing risks have been allocated to the entity, which were accompanied by particular (usually legislated) accountability mechanisms and reporting requirements.

(c) A deliberate policy has been adopted to impose accountability mechanisms and reporting requirements on a captive insurer, consistent with (for example) having an independent board of directors. Entities with independent boards of directors/management might be particularly keen to demonstrate accountability and prepare separate financial statements. Some stakeholders consider the fact that their customers are related entities makes it all the more important that they prepare separate general purpose financial statements.

Conclusion

BC223 The Boards considered that the issues surrounding captive insurers are essentially reporting entity issues, that could affect the application of accounting standards more generally, rather than being issues of particular relevance to the insurance project. The Boards observed that governments which regard their captive insurer(s) as needing to prepare general purpose financial statements would have to determine whether they have:

(a) insurance contracts and need to apply insurance contract accounting; or

(b) are only service providers, akin to insurance brokers that are intermediaries between policyholders and insurers, that would apply, for example, AASB 15/PBE IPSAS 9 *Revenue from Exchange Transactions*.

The Boards also observed that governments which regard their captive insurer(s) as not needing to prepare general purpose financial statements, might seek to have them prepare a type of segment information, for example, for management purposes.

BC224 Accordingly, the Boards concluded that wider issues regarding the identification of reporting entities are at stake and are not specifically relevant in this project as a way of exempting public sector captive insurers from applying AASB 17/PBE IFRS 17 in their separate financial statements. They noted that, if a jurisdiction determines that an entity should prepare general purpose financial statements, provided the entity's activities fall within the scope of AASB 17/PBE IFRS 17, that Standard should be applied.

Appendix C – Diagram illustrating a captive insurance arrangement