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 September 2022 (M190) NZASB October 2022 (M103)
Topic:	Regulatory and other matters	**Agenda item:**	AASB 4.8 NZASB 7.8
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Objectives of this paper

1. The objective of this paper is to DECIDE whether any actions are needed from the Boards in respect of responses received on AASB ED 319/NZASB ED 2022-3 *Insurance Contracts in the Public Sector* that have not been addressed elsewhere in the agenda papers for the August and September/October 2022 meetings.

2. **Appendix A summarises responses to questions 12 to 16 asked by the AASB in ED 319.[1] Those questions were not included in NZASB ED 2022-3.**

3. **However, the NZASB may wish to note the issues raised by Australian constituents.**

Both Boards asked about other possible modifications

4. Both Boards noted that they had considered, but rejected, proposing modifications to AASB 17/PBE IFRS 17 *Insurance Contracts* in respect of public sector arrangements on the following topics:

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

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

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

5. Respondents raised issues on adverse development coverage and investment components, which the Boards addressed at their August 2022 meetings.

6. The only response to question 11 [other modifications] which haven't been addressed in other agenda papers relates to liaison with staff on catastrophe reinsurance arrangements [EQC]. The staff is in touch with EQC and will bring this matter back to the Boards if necessary.

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1 These are matters on which the AASB typically seeks comment in any consultation document that might affect public sector entities.

However, at this stage, staff expect this to give rise to application issues, rather than accounting policy issues.

Respondents' feedback on the AASB [only] questions in ED 319

Regulatory matters (general matter for comment 12)

7. ED 319 asked 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[?]

Scope

8. Two stakeholders commented that a scope difference between accounting practice and GFS might arise, since GFS refers to 'premiums' in respect of an 'insurance corporation', implying premiums are an essential feature of insurance, while ED 319 refers to 'source and extent of funding' as one of six indicators [HoTARAC, ACAG].

9. Staff note the Boards decided in August that 'source and extent of funding' would be ranked as a significant indicator for public sector arrangements being identified as insurance contracts. The AASB staff will liaise with Australian Bureau of Statistics [ABS] staff to determine how rigidly the GFS 'insurance policy' definition is applied and bring this matter back to the Boards if necessary.

Treatment of investment returns

10. One stakeholder commented that AASB 17 requires investment returns to be recognised, measured and presented separately, while the GFS deem the income generated by the investment of reserves as an implicit premium supplement attributed to policyholders [ACAG].

11. Staff note that the same issue arises under AASB 4 *Insurance Contracts*, and AASB 1023 *General Insurance Contracts* [and PBE IFRS 4 *Insurance Contracts*] and we will discuss the matter with the ABS to determine how this issue is handled under existing GAAP and whether any further issues need to be addressed.

Auditing and assurance (general matter for comment 13)

12. Two stakeholders identified a range of auditing and assurance challenges under the ED 319 proposals relating to the scope of AASB 17 [HoTARAC, ACAG], including:

- significant audit resources will be required to make judgments about which arrangements should be subject to the assessment process and to make the assessments based on the indicators; and
- a lack of clarity on the essence/focus of an insurance contract will be an audit challenge, including how coverage periods are intended to be determined where there is no contract.

13. Staff note that applying any new Accounting Standards would require an entity to incur costs and effort to ensure the new requirements are applied appropriately. Staff consider that the Boards' decisions on ranking the indicators, including identifying some as pre-requisites, and the inclusion of examples relating to particular indicators should help to ease the auditing challenges.

14. Three stakeholders identified a range of other auditing and assurance challenges under the ED 319 proposals, including:

- any arrangements currently accounted for under AASB 137 that need to migrate to AASB 17 will pose a challenge – the proposed standard in its current form has not been tested [ACAG];
- determining risk adjustments since not-for-profit entities generally don't seek compensation from bearing risk [HoTARAC, ACAG]
- the reference to materials outside of financial statements could lead to an unintended consequence of increased audit effort [KPMG].

15. Staff note that the further commentary in the Basis for Conclusions on risk adjustments (discussed in Agenda paper 4.6/7.6) should help to ease these auditing challenges, and that the staff plan to continue to engage with key stakeholders, including actuaries via the AASB 17 Transition Resource Group and other forums.

16. Staff also note that the recommended amendments in Agenda paper 4.4/7.4 remove the reference to materials outside of financial statements and require disclosure in the notes to the financial statements instead.

Usefulness to users (general matter for comment 14)

17. One stakeholder considered the application of AASB 17 by public sector entities would produce useful information [KPMG]. Four other stakeholders, while expressing some scepticism about the usefulness of the information that would be produced by public sector entities applying AASB 17, noted that greater consistency of accounting could be achieved across entities [HoTARAC, ACAG, ICWA, iCare].

Costs versus benefits (general matters for comment 15 and 16)

18. One stakeholder considered the application of AASB 17 by public sector entities would not be materially more costly than applying AASB 1023 [ICWA].

19. One stakeholder considered the application of AASB 17 by public sector entities may lead to significant costs for some jurisdictions, dependent on the volume and complexity of the schemes, mainly due to:

- significant judgments required to apply the indicators;
- the cost of establishing a system for assessing eligibility for the premium allocation approach; and
- cost for any schemes that might need to apply the general measurement model [HoTARAC].

20. One stakeholder considered it unlikely that the additional benefit from the new standard would exceed the cost of implementation [iCare].

21. Staff note that the Boards' decisions on ranking the indicators, including identifying some as pre-requisites, and the inclusion of examples relating to particular indicators should help to ease the cost burdens.

22. Agenda paper 4.4 for this meeting discusses potentially providing public sector entities with an accounting policy choice to always apply the premium allocation approach to measure liabilities for remaining coverage, which would overcome the concerns about eligibility testing and possibly having to apply the general measurement model in some cases.

Staff recommendation

23. Staff consider that the issues raised by stakeholders in respect of regulatory and other matters are addressed to extent feasible in:

- other topics considered by the Boards in August 2022;
- other topics being considered by the Boards in September/October 2022; and
- ongoing staff liaison with stakeholders;

and do not recommend any further Board actions.

Question for Board members

Q1: Do you agree with the staff recommendation noted in paragraph 23? If not, what other alternatives would you suggest?

Appendix A: Collation of comments on questions 12 to 16 in AASB ED 319

This Appendix summarises the key comments received from respondents on questions 12 to 16 in AASB ED 319 relating to general matters on which the AASB routinely seeks comments in respect of most projects.

Regulatory issues

Q12: 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?

	Q12 – GFS implications
HoTARAC	No 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.
ACAG	**GFS scope issue** The International Monetary Fund Government Financial Statistics Manual 2014 (IMF GFSM) and the Australian Government Financial Statistics Manual (AGFSM) defines insurance policy as: 'an agreement between an insurer and another institutional unit, the policyholder. Under the agreement, the policyholder makes a payment (premium) to the insurance corporation, which makes a payment (claim) to the policyholder if or when a specified event occurs. The policyholder protects itself against certain forms of risk' (paragraph A4.66 of the IMF GSFM and paragraph 13.86 of AGFSM). This is different from ED 319, where the 'source and extent of funding' is only one of 6 indicators for applying AASB 17. Some public sector arrangements may be accounted for as an insurance contract within the scope of AASB 17, but not captured as an insurance policy under GFS. **GFS investment revenue issue** ACAG notes the following possible convergence difference between AASB 17 and GFS. • A general government sector (GGS) unit operating an insurance scheme and maintaining separate reserves must record transactions in the same way as other insurers (paragraph A4.79, IMF GFSM). • AASB 17 requires investment returns to be recognised, measured and presented separately, while the IMF GSFM and AGFSM deem the income generated by the investment of reserves as an implicit premium supplement attributed to policyholders.

	Q12 – GFS implications
	• A public sector insurer attributes the investment returns by recording an expense (Property, expense for investment income disbursements) and an increase in liabilities in non-life insurance technical reserves (consists of prepayments of net non-life insurance premiums and reserves to meet outstanding claims (paragraph A1A.327 of AGFSM)). • When the liability is extinguished, the insurer records the premium supplement [which reduces the cash payment that would otherwise be required from the policyholder] as revenue (classified as premiums, fees and current claims related to non-life insurance and standardised guarantee schemes) and a decrease in insurance technical reserves (A4.79 of IMFGFSM and Box 13.1(i) of AGFSM). The extent of the convergence difference will depend on whether a GGS unit or the PFC operates insurance schemes including whether they are eliminated at the whole of government level. It is not clear whether these changes can be dealt with as changes to liability estimates or will create a GFS difference.

Auditing and assurance

Q13: Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?

	Q13 – auditing and assurance challenges
HoTARAC	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.
ACAG	The proposals would create the following key auditing and assurance challenges • Determining whether a public sector entity is within the scope of AASB 17 – see comments on Q9 [ranking of indicators – August 2022 Agenda paper 4.2/8.2]. • Applying AASB 17 to arrangements currently accounted for under AASB 137 – the proposed standard in its current form has not been tested, in particular, how contract boundary and coverage periods are intended to be determined where there is no contract – see comments on Q4 [guidance on coverage periods – September/October 2022 Agenda paper 4.4/7.4].

	Q13 – auditing and assurance challenges
	• Determining the risk adjustment – especially since not-for-profit entities generally don't seek compensation from bearing risk, the possibility of government backing of claims liabilities and the long-term nature of the claims. Adding to the complexity, is whether it is appropriate for public sector entities to have a zero risk adjustment – see comments on Q6 [risk adjustment – August 2022 Agenda paper 4.3/8.3].
KPMG	Do not expect the proposals to create auditing or assurance challenges, except as indicated in Q5.

Usefulness to users

Q14: Whether, overall, the application of AASB 17, modified as proposed, would result in financial statements that would be useful to users?

	Q14 – usefulness to users
HoTARAC	Applying AASB 17 will enhance sector neutrality, and consistency between insurance contracts and insurance-like 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-for profit entities may not include this risk in their pricing.
ACAG	AASB 17 modified as proposed would result in financial statements that are useful for users as they will help promote consistency in the accounting for insurance-like arrangements by public sector entities, particularly in relation to the calculation of liabilities. In most cases, it is the liability calculation, not the income stream, that drives government decision-making and is the focus of users of the financial statements.
ICWA	Unlikely that AASB 17 information will be any more useful to users than the existing AASB 1023 information. However, it may ensure greater consistency of accounting treatment (and therefore increased comparability) among public sector entities across Australia
KPMG	The proposed modifications would benefit users as the relevance of the financial statements is expected to be enhanced.

Best interests

Q15: Whether the proposals are in the best interests of the Australian economy?

Costs and benefits

Q16: 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).

	Q16 – costs and benefits
HoTARAC	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 ED 319 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.
ICWA	As the ICWA applies AASB 1023 for the majority of its Funds, the cost of implementing AASB 17 is considered to be immaterial.

<table>
<tr><th></th><th>Q16 – costs and benefits</th></tr>
<tr><td>iCare</td><td>
The introduction of a risk margin for schemes currently accounted for under AASB 137 would require funding to be increased to account for the higher level of assets that are required to be held. These requirements are indicatively:
<table>
<tr><th>Scheme</th><th>Impact</th></tr>
<tr><td>Lifetime Care and Support Authority</td><td>$1.7 billion at a PoA of 75%</td></tr>
<tr><td>Treasury Managed Fund</td><td>$1.7 billion at a PoA of 75%</td></tr>
<tr><td>Workers Compensation Dust Diseases Authority</td><td>$0.1 billion at a PoA of 75%</td></tr>
<tr><td>Motor Accident Benefits Fund</td><td>$0.14 billion at a PoA of 75%</td></tr>
</table>
The inclusion of a risk margin will have an adverse impact on the funding required by the schemes which will result in either Government funding redirected that could be used for the betterment of the NSW economy or an increase in the levies imposed on motorists or employers being held in deposit to meet the requirements of the new accounting standard.
This $3.64 billion could be used for essential services necessary for the ongoing running and development of the State, such as building more schools and hospitals. Locking this away to comply with an accounting standard could not reasonably be considered in the public interest or in the best interests of the Australian economy.
Our initial estimates suggest that CTP Insurers in NSW will have to increase the annual CTP levy by approximately $425 per car to fund the risk margin should Lifetime Care have to comply with the requirements of AASB 17.
The directors may not be able to sign the accounts on a going concern basis if we introduce an increase in the liability by $3.64 billion without appropriate asset backing.
In addition, the cost of implementing a AASB 17 compliant reporting solution for the schemes we believe should be within scope of the new standard is approximately $18 million.
NSW Treasury are the primary users of our financial statements. It is unlikely that the additional benefit from the new standard will exceed the cost of implementation.
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