

## Staff Paper

<b>Project</b>	<b>Insurance Activities in the Public Sector</b>	<b>Meeting</b>	AASB (M180)/NZASB April 2021
<b>Topic</b>	<b>Scope of application of AASB 17/NZ IFRS 17 to public sector entities</b>	<b>Agenda item</b>	AASB 10.2 NZASB 5.2
		<b>Date</b>	31 March 2021
<b>Contacts</b>	Angus Thomson athomson@asab.gov.au  Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz  Patricia Au pau@asab.gov.au	<b>Project priority</b>	Medium
		<b>Decision-making</b>	High
		<b>Project status</b>	Addressing specific technical issues for board deliberation

### Objectives of this paper

The objectives of this paper are for the Boards to:

- consider staff's analysis on factors that might be useful, and those that might not be useful, for indicating whether a public sector entity has arrangements that should be accounted for under AASB 17/PBE IFRS 17 *Insurance Contracts* (versus other Standards); and
- provide input to staff on those indicators.

Staff note that, once the Boards have identified the relevant indicators, a subsequent Board discussion would likely be needed to consider the actual impacts of applying those indicators to determine which public sector activities would be within the scope of AASB 17/PBE IFRS 17.

**Abbreviations** used in this paper are referenced in full in [Appendix A](#) to this paper.

### Summary of staff views

#### *Factors likely to be useful indicators*

Staff consider the following factors likely **useful** indicators for determining whether a public sector entity has arrangements that should be accounted for under AASB 17/PBE IFRS 17.

Factors likely to be useful indicators	Reference
1. For-profit private sector insurers cover <b>similar insurance risks</b> as those covered by the public sector entity is a pre-requisite for determining whether AASB 17/PBE IFRS 17 would apply.	<a href="#">Section 4</a>
2. For-profit private sector insurers provide <b>similar benefits</b> as those provided by the public sector entity is a pre-requisite for determining whether AASB 17/PBE IFRS 17 would apply.	



Factors likely to be useful indicators	Reference
3. The extent to which an arrangement is binding on the public sector entity, determined (in part) on whether the public sector entity (or its controlling government) has the practical ability to change a benefit retrospectively.	<a href="#">Section 6</a>
4. The arrangement includes an identifiable coverage period.	<a href="#">Section 7</a>
5. There exists a stand-alone 'contract' that includes substantive terms relating to risks and benefits (that go well beyond the detail in any relevant statute/regulation).	<a href="#">Section 9</a>
6. The arrangement involves a contribution from a scheme participant.	<a href="#">Section 10</a>
7. The absence of any dedicated funding (from participants or government) for an activity would be a useful indicator that AASB 17/PBE IFRS 17 does not apply.	
8. The extent to which claims are assessed to cater for a beneficiary's needs rather than by broadly-determined standardised amounts.	<a href="#">Section 11</a>
9. The focus of cost management of the arrangement is on both income and costs rather than simply cost minimisation.	
10. The entity has liability management practices normally associated with insurance contracts (such as underwriting).	<a href="#">Section 12</a>
11. Assets are held in a separate fund, or assets have been earmarked, and are restricted to being used to provide benefits.	<a href="#">Section 13</a>

### ***Factors unlikely to be useful indicators***

Staff consider the following factors are **unlikely to be useful** indicators for determining whether a public sector entity has arrangements that should be accounted for under AASB 17/PBE IFRS 17.

Factors unlikely to be useful indicators	Reference
12. Classification of an entity as a for-profit entity or a not-for-profit entity.	<a href="#">Section 3</a>
13. The nature of the coverage is fault-based or no-fault-based.	<a href="#">Section 8</a>
14. The arrangement between an entity and a scheme participant arose from a 'contract' or from statute or regulation.	<a href="#">Section 9</a>
15. The entity has a practice of assessing financial performance and financial position on a regular basis.	<a href="#">Section 12</a>

### ***Applying the indicators***

As is normally the case with determining which standard applies to a particular transaction,<sup>1</sup> staff are proposing that judgement would need to be exercised to determine whether, on balance, the indicators establish that an entity's activities are within (or outside) the scope of AASB 17/PBE IFRS 17.

<sup>1</sup> Indicators are used in AASB 136/PBE IAS 36 *Impairment of Assets*



For example, staff are not recommending that an entity's activities would need to meet all the indicators identified above, or even a majority of them, to be judged as falling within the scope of AASB 17/PBE IFRS 17. Different indicators will carry more or less weight, depending on the circumstances.

### ***Specific entities/activities***

In addition, to the indicators, staff consider that it would be useful to specifically identify public sector schemes that are not within the scope of AASB 17/PBE IFRS 17 (this is discussed in [Section 5](#)).

## **1. Context of scope issues**

1.1 The scope issue has two facets – identifying public sector entity activities to which:

- (1) AASB 17/PBE IFRS 17 should apply, rather than a different Standard (refer to Table in paragraph 2.5 in [Section 2](#)); and
- (2) any public sector modifications or guidance to AASB 17/PBE IFRS 17 that might apply.

1.2 The scope issues are the same for both Boards, but the context differs for two reasons:

- (1) the current scopes of the AASB 17 and PBE IFRS 17 differ; and
- (2) there is relatively more consistency in New Zealand public sector reporting of arrangements that are regarded as insurance.

1.3 AASB 1057 *Application of Australian Accounting Standards* (July 2015, as amended by AASB 17 says (emphasis added):

6A AASB 17 *Insurance Contracts* applies to:

- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
- (b) general purpose financial statements of each other reporting entity; and
- (c) financial statements that are, or are held out to be, general purpose financial statements;

**except** when the entity is:

- (d) a superannuation entity applying AASB 1056; or
- (e) **a not-for-profit public sector entity.**<sup>2</sup>

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<sup>2</sup> AASB 136 *Impairment of Assets*, paragraph Aus6.2 says: "A not-for-profit entity is an entity whose principal objective is not the generation of profit. A not-for-profit entity can be a single entity or a group of entities comprising the parent and each of the entities that it controls."



- 1.4 In New Zealand, although Tier 1<sup>3</sup> and Tier 2<sup>4</sup> not-for-profit public benefit entities<sup>5</sup> are already within the scope of PBE IFRS 17, the NZASB decided to undertake further work on public sector issues raised by respondents to NZASB ED 2018-7 [PBE IFRS 17.BC8]. There are currently no differences between the accounting policy requirements of PBE IFRS 17 and NZ IFRS 17, other than might arise because PBE Standards have not yet been issued in respect of IFRS 15 and IFRS 16.
- 1.5 A motivation for developing PBE IFRS 17 was to capture schemes that are **eligible**<sup>6</sup> to apply the insurance approach as permitted under IPSAS 42 *Social Benefits* [PBE IFRS 17.BC7]. (The ‘insurance approach’ would involve applying IFRS 17 [IPSAS 42.AG19].)
- 1.6 It is not yet clear whether the Boards will wish to modify aspects of AASB 17/PBE IFRS 17 for application in the public sector. However, **if there are modifications, staff consider that the Boards should, for the time being, keep an open mind about whether those modifications apply to any public sector entity, not only those classified as not-for-profit / public benefit entities.** Staff acknowledge that this might result in an extension of the AASB’s usual approach, which is to only have modifications from IFRS Standards for not-for-profit entities.<sup>7</sup>

## 2. Overall approach

- 2.1 The general approach to scoping the application of a Standard is to:
- explicitly identify the types of activities that are within the scope, typically based on defined terms;
  - provide supporting application guidance, which sometimes includes indicators; and
  - explicitly identify types of activities that are excluded from the scope.
- 2.2 AASB 17/NZ IFRS 17 defines the following.

insurance contract	A contract under which one party (the issuer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
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3 New Zealand Accounting Standards Framework, paragraph 6: “Tier 1: entities that have “public accountability” (as defined) plus entities that are large (as defined) apply Tier 1 PBE Accounting Requirements. These are the requirements in the accounting standards (referred to as PBE Standards) and applicable authoritative notices”

4 New Zealand Accounting Standards Framework, paragraph 6: “Tier 2: entities that do not have “public accountability” (as defined) and entities that are not large (as defined) and which elect to be in Tier 2 apply Tier 2 PBE Accounting Requirements. These are the requirements in the accounting standards with reduced disclosures (referred to as PBE Standards RDR) and applicable authoritative notices.”

5 New Zealand Accounting Standards Framework, paragraph 9: “A reporting entity whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders”.

6 Staff note that IPSAS 42 is not requiring an entity that meets the criteria to apply the ‘insurance approach’ – only that the entity is **eligible** to apply that approach. This is different from the current project objective of the AASB and NZASB, which is to identify those entities that must apply the insurance Standards.

7 *AASB Not-For-Profit Entity Standard-Setting Framework* (2020), paragraph 24. *New Zealand Accounting Standards Framework* (2015), paragraph 63, has the same focus as the AASB not-for-profit Framework, but New Zealand currently has no for-profit public sector entities with insurance activities.



insurance contract services	The following services that an entity provides to a policyholder of an insurance contract: (a) coverage for an insured event (insurance coverage); (b)* for insurance contracts without direct participation features, the generation of an investment return for the policyholder, if applicable (investment-return service); and (c)* for insurance contracts with direct participation features, the management of underlying items on behalf of the policyholder (investment-related service).  * (b) and (c) are only relevant to entities with investment components in their insurance contracts
Insurance risk	Risk, other than financial risk, transferred from the holder of a contract to the issuer.

2.3 AASB 17/PBE IFRS 17 includes application guidance that explains each aspect of the definition:

- (a) uncertain future event [B3 to B5]
- (b) payment in kind [B6]
- (c) insurance risk versus other risks [B7 to B16]
- (d) significant insurance risk [B17 to B23]
- (e) changes in the level of insurance risk [B24 & B25]
- (f) examples of insurance contracts [B26 to B30].

2.4 The IFRS 17 definitions and guidance have been designed largely to cater for the for-profit private sector, but also in the (not-for-profit) mutual entity context [IFRS 17.B16]. They are not designed to cater for the public sector context. Nonetheless, both Boards are interested in having the most relevant Standards apply in the circumstances and, as supported by current practice, there are activities in the public sector for which it is likely to be most relevant to apply AASB 17/PBE IFRS 17.

2.5 The alternative to applying the insurance Standards is to apply other liability-related requirements, which could include the following.

Australia	New Zealand	Comments
AASB 137 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	PBE IPSAS 19 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	A provision is a liability of uncertain timing or amount
<i>Conceptual Framework for Financial Reporting</i> [permitted per AASB 1057.BC7]	<i>Public Benefit Entities' Conceptual Framework</i> [paragraph 5.14]	Liability definition: A present obligation of the entity for an outflow of resources that results from a past event  Application of 'accrual accounting'

2.6 It is generally accepted that applying AASB 17/PBE IFRS 17 rather than AASB 137/PBE IPSAS 19 would result in higher liabilities for the reasons outlined in [Appendix B](#) to this paper.



### ***International public sector efforts***

- 2.7 The IPSASB is not currently considering the development of an insurance Standard based on IFRS 17. Instead, IPSAS 42 *Social Benefits* sets criteria for identifying schemes that are eligible to apply the 'insurance approach', which involves using IFRS 17.
- 2.8 In the UK, HM Treasury's Financial Reporting Advisory Board is currently considering the application of IFRS 17 to public sector entities.<sup>8</sup> Staff are monitoring the UK's progress, but it is not sufficiently advanced to provide useful guidance for the AASB and NZASB.

### ***Focus of agenda paper***

- 2.9 The focus of the remaining sections of this agenda paper is on assessing possible indicators that could be applied to identify when AASB 17/PBE IFRS 17 should apply in the public sector, including when any public sector modifications or guidance to AASB 17/PBE IFRS 17 might apply (which is **not** to imply that it is necessarily intended there be any modifications or guidance).

- 2.10 The remaining sections in this agenda paper are as follows.

[Section 3](#): For-profit versus not-for-profit public sector entities

[Section 4](#): Transaction neutrality and the nature of the risks covered and similarity of the claims/benefits

[Section 5](#): Scoping out 'social benefits'

[Section 6](#): Binding nature of arrangement

[Section 7](#): Identifiable coverage period

[Section 8](#): Fault-based versus no-fault-based

[Section 9](#): Contract or no contract?

[Section 10](#): Source and extent of funding

[Section 11](#): Claims handling

[Section 12](#): Assessing financial performance/how an entity is managed

[Section 13](#): Assets set aside for benefits

## **3. For-profit versus not-for-profit public sector entities**

- 3.1 This is not an issue in New Zealand at this time as the two most prominent public sector entities applying PBE IFRS 4 *Insurance Contracts* classify themselves as public sector public benefit entities.<sup>9</sup> However, there is a mix of for-profit and not-for-profit classifications among Australian public sector entities applying AASB 4 and AASB 1023 *General Insurance Contracts*.

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<sup>8</sup> FRAB 141(06) – IFRS 17 *Insurance Contracts* – [Implementation update](#).

<sup>9</sup> Public benefit entities (PBEs) are reporting entities whose primary objective is to provide goods or services for community or social benefit and where any equity has been provided with a view to supporting that primary objective rather than for a financial return to equity holders (paragraph 6 of XRB A1 *Application of the Accounting Standards Framework*). PBEs comprise not-for-profit entities and public sector entities.



- 3.2 Staff note that the AASB DP proposed amendments to AASB 17 should apply to both for-profit and not-for-profit public sector entities. Both of the respondents who directly commented on this issue agreed with the AASB's proposal.<sup>10</sup>
- 3.3 Staff also note that, in the recent stakeholder engagement, there was:
- (a) virtually no support for excluding a public sector entity from applying AASB 17/PBE IFRS 17 on the basis that it is a not-for-profit/public benefit entity; and
  - (b) some support for including a public sector entity within the scope of AASB 17 on the basis that it is a for-profit entity.
- 3.4 For some stakeholders, the perspective in paragraph 3.3(b) hinges on a view that a for-profit entity is more likely to be seeking to profit from the service of bearing risk. As a consequence, applying AASB 17/PBE IFRS 17 means including a risk margin in measuring liabilities and recognising revenue from bearing risk in a pattern based on the release from risk. However, two factors mitigate against this view:
- (a) in principle, under AASB 17/PBE IFRS 17, an entity could determine that it does not need to be compensated for bearing risk and, hence have a zero risk adjustment;<sup>11</sup> and
  - (b) some Australian entities are including risk margins in measuring provisions under AASB 137, presumably on the basis that this would be required to 'settle' the liability.
- 3.5 The differing classifications across Australian jurisdictions seem to be driven largely by the funding structure and, for example, whether the entity has been tasked with paying dividends to government in recognition of the cost of government capital deployed to the entity. There are a number of entities deemed by their governments to be for-profit entities that seemingly have highly similar operations to entities that have been deemed not-for-profit.
- 3.6 The IASB did not regard the not-for-profit nature of mutual insurance entities to be a factor that would cause IFRS 17 to be inapplicable. The IASB's Basis for Conclusions makes it clear that IFRS 17 can be applied consistently to for-profit entities and mutual entities [IFRS 17.BC264 to BC269]. For-profit insurance entities and mutual insurance entities often compete for customers in the same markets.
- 3.7 Staff note that government benefits such as the aged pension and unemployment benefits, which are not in dispute as being 'social benefits' are clearly not-for-profit activities. Therefore, it is reasonable to say that the for-profit activities of a public sector entity would not give rise to social benefit liabilities. However, the reverse does not apply – insurance activities could be conducted by either for-profit or not-for-profit entities.

### **Question S1**

- 3.8 Do the Boards agree that:
- (a) activities of a for-profit nature could not be regarded as social benefits; however,
  - (b) the for-profit *versus* not-for-profit distinction should **not** be an **indicator** that AASB 17/PBE IFRS 17 would apply in the public sector?

<sup>10</sup> Australasian Council of Auditors-General, and Heads of Treasuries Accounting and Reporting Advisory Committee.

<sup>11</sup> Risk adjustments are the subject of Agenda Paper AASB 10.3/NZASB 5.3 for discussion at the April 2021 Board meetings.



#### 4. Transaction neutrality and the nature of the risks covered and similarity of the claims/benefits

- 4.1 The AASB DP identified as a suggested criterion for determining whether activities relate to insurance – that the transactions or arrangements entered into have similar characteristics and relate to a similar level of insurance risk as those entered into by for-profit private sector entities that are accounted for as insurance contracts [AASB DP.E14(c)]. This is not a factor explicitly identified in NZ ED 2018-7, although it can be argued that it applies implicitly via other indicators.
- 4.2 In practical terms, staff regard this factor as being inherent in the notion of ‘transaction neutrality’ that needs to be analysed at a more detailed level to be useful in scoping the application of AASB 17/PBE IFRS 17 in the public sector.
- 4.3 The direct approach to determining transaction neutrality is to consider the extent to which the arrangements in the various public sector jurisdictions have direct counterparts among private sector insurers (and to some extent compete with one another). Sections 5 and 6 take this direct approach.
- 4.4 The less direct approach to determining transaction neutrality is to consider indicators of similarities between arrangements in the various public sector jurisdictions and the private sector insurance contracts. Sections 7 to 14 consider potential indicators of when AASB 17/PBE IFRS 17 would apply in the public sector.
- 4.5 Staff note that:
- (a) the existence of a particular indicator would not necessarily mean that AASB 17/PBE IFRS 17 would apply;
  - (a) the absence of a particular indicator would not necessarily mean that AASB 17/PBE IFRS 17 would not apply;
  - (c) the existence of some indicators would mean that it is difficult to refute the relevance of applying AASB 17/PBE IFRS 17.

#### ***Comparing public sector arrangements directly with private sector insurance contracts***

- 4.6 Staff note that Compulsory Third Party (CTP) motor insurance is an example of a similar risk underwritten across sectors. CTP is provided by:
- (a) private sector for-profit insurers in NSW, Queensland, South Australia, the ACT and Northern Territory; and
  - (b) public sector entities in New Zealand, Victoria, Western Australia and Tasmania.
- 4.7 In the context of a transaction neutral approach to accounting standard setting, staff regard this as a strong indicator that some types of arrangements in the public sector should be accounted for by applying AASB 17/PBE IFRS 17.
- 4.8 The AASB would generally need to justify not applying the same requirements in both sectors under the [AASB Not-for-Profit Entity Standard-Setting Framework](#). The NZASB is under a similar obligation in the context of the [New Zealand Accounting Standards Framework](#). Accordingly, given the fundamental place of transaction neutrality in each board’s framework,



staff regard it as a pre-requisite for determining cases when AASB 17/PBE IFRS 17 would apply in the public sector.

- 4.9 In some cases, the risks covered by public sector entities in one jurisdiction are covered separately by both private sector and public sector entities in another jurisdiction.

***Lowest unit of account issue***

- 4.10 Under AASB 17/PBE IFRS 17, there is an underlying presumption that the lowest unit of account is the individual ‘contract’.<sup>12</sup> That is, when an insurance contract covers a range of risks, an insurer would not split the contract into components and account for each risk separately. The presumption could be contested, but the entity would need to justify separating the contract into components for the purposes of applying AASB 17/PBE IFRS 17. There may also be cases when judgement needs to be applied to determine if there is more than one contract within an arrangement.
- 4.11 There are cases in the public sector when some arrangements involve covering a range of risks that in other jurisdictions are the subject of more than one arrangement issued by more than one entity. This can pose a possible complication with relying on a criterion for identifying arrangements that have similar characteristics and a similar level of insurance risk as entered into by a for-profit entity. The following table illustrates the point using CTP as an example.

Jurisdiction	Entity/part of entity	Risk	Comments
New Zealand	Accident Compensation Commission	All accident risks, including CTP	Covers both serious and non-serious personal injury caused by motor accidents
Victoria	Transport Accident Commission	All CTP	
Tasmania	Motor Accidents Insurance Board		
Western Australia	Insurance Commission		
NSW	iCare – CTP Care Fund	Motor accident serious personal injury ONLY	Other aspects of motor accident personal injury covered by private sector contracts
South Australia	Lifetime Support Authority		
Queensland	National Injury Insurance Scheme		
Northern Territory	Motor Accidents Compensation Commission		

- 4.12 Stakeholders in some jurisdictions hold strong views that, on a stand-alone basis, publicly-operated motor accident serious personal injury schemes have the character of compensation schemes that are not insurance activities. In contrast, similar publicly-operated schemes that are provided along with non-serious personal injury coverage are typically regarded as insurance activities.

<sup>12</sup> IFRS 17 Transition Resource Group, [May 2018 Meeting Summary](#), paragraphs 8(a) and 8(b).



### ***Bundling/unbundling***

- 4.13 Staff note that the IASB faced the same issues relating to contracts with multiple components in developing IFRS 17 because many commercially-underwritten contracts include both insurance and non-insurance components (bundled contracts). The most common examples are contracts that provide risk coverage and investment services. (If they were provided on a stand-alone basis, the investment services would be accounted for under IFRS 9.)
- 4.14 IFRS 17 requires a ‘distinct’ investment component of a contract to be separated (unbundled) from a host insurance contract. An investment component is distinct if it is not highly interrelated with the insurance component; and equivalent stand-alone investment components are sold separately [IFRS 17.B31].
- 4.15 An investment component and an insurance component are highly interrelated when the entity is unable to measure one component without considering the other; and the policyholder is unable to benefit from one component unless the other is also present. If the lapse or maturity of one component causes the lapse or maturity of the other, IFRS 17 must be applied to both [IFRS 17.B32].<sup>13</sup>
- 4.16 Hypothetically, in the event it was considered that CTP for non-serious injury is insurance while coverage for serious injury is not insurance, in the cases cited above, it would be consistent with IFRS 17 for:
- (a) the combined (non-serious and serious injury) contracts to be accounted for under AASB 17/PBE IFRS 17; while
  - (b) the stand-alone coverage (serious injury only) is accounted for under AASB 137/PBE IPSAS 19.
- 4.17 Therefore, of itself, the different ways in which risks and services are bundled and provided by different entities in the different jurisdictions is not a barrier to applying AASB 17/PBE IFRS 17.

#### ***Question S2***

- 4.18 Do the Boards agree that:
- (a) the similarity of insurance risks covered with the risks covered by for-profit private sector insurance contracts; and
  - (b) the similarity of benefits provided with the benefits provided by for-profit private sector insurance contracts;
- should be identified as a **pre-requisite** for determining that AASB 17/PBE IFRS 17 would apply in the public sector?

#### ***Question S3***

- 4.19 Do the Boards agree that, in practical terms, transaction neutrality would be determined by reference to whether the same types of ‘contracts’ are issued in both the private and public sectors?

<sup>13</sup> While the lapse of one component causing the lapse of another component under AASB 17.B32/PBE IFRS 17.B32 means that insurance components must remain combined with non-insurance components, the same ‘rule’ does not necessarily apply to multiple insurance components – it is only an indicative factor in this latter context, based on IFRS 17 Transition Resource Group, [February 2018 Meeting Summary](#) paragraph 8(a)(ii).



### **Question S4**

- 4.20 Are the Boards comfortable with the manner in which AASB 17/PBE IFRS 17 would address arrangements in the public sector that are a bundle of services, some of which might be insurance and some of which might not?

## **5. Scoping out ‘social benefits’**

- 5.1 IPSAS 42.5 includes a definition of ‘social risks’, which are intended to be distinct from other forms of aid, such as benefits provided as the result of a disaster [IPSAS 42.AG10]. They are indicative, rather than implying the same risks might not also be the subject of insurance contracts.

Social risks are events or circumstances that:

- (a) Relate to the characteristics of individuals and/or households – for example, age, health, poverty and employment status; and
- (b) May adversely affect the welfare of individuals and/or households, either by imposing additional demands on their resources or by reducing their income.

- 5.2 It seems reasonable to note that most if not all the classes of ‘social risks’ mentioned could be the subject of insurance contracts sold by for-profit private sector entities, including:

- (a) annuities (age-related), which can provide regular income for life;
- (b) health insurance (health-related), which can provide subsidies or free medical care; and
- (b) income protection insurance (potentially related to health, poverty and/or employment status), which can provide regular income for a fixed period, duration of illness, or for life.

- 5.3 Accordingly, staff do not consider defining ‘social risks’ is necessarily a practical way to identify contracts that should be excluded from applying AASB 17/PBE IFRS 17.

### ***IFRS 17 scope issues resolved through ‘practical expedients’***

- 5.4 Staff consider it is important for the Boards to appreciate that, while it would be ideal to address scoping issues solely by applying principles, there may be a need to resort to ‘practical expedients’ that either:

- (a) explicitly rule in, or rule out, applying AASB 17/PBE IFRS 17; or
- (b) provide a specific accounting policy choice of applying AASB 17/PBE IFRS 17 or an alternative Standard.

In both cases, consistent with the Boards’ standard setting frameworks, a justification of any practical expedients would need to be provided by the Boards – probably in a Basis for Conclusions.

- 5.5 IFRS 17 includes a series of practical expedients – please see [Appendix C](#).

- 5.6 Identifying particular schemes as not being ‘insurance contracts’ runs the risk that any scheme not mentioned might automatically be assumed to be within the scope of AASB 17/PBE IFRS 17. However, staff consider that there are many sound precedents for taking



this approach and that it is useful in narrowing the scope of any area for debate. For example, the AASB could specifically identify the following as not being within the scope of AASB 17 in their current form:

- (a) Medicare benefits (Australia)
- (b) National Disability Insurance Authority benefits/programs (Australia).

5.7 Staff appreciate that there may be a need to update the references to specific entities if those arrangements change or evolve. In respect of the AASB, which faces a more substantive scoping issue than the NZASB, any specific schemes could be identified in an AASB Agenda Decision, which could be amended at short notice.

#### **Question S5**

- 5.8 Do the Boards agree that it would be useful to specifically identify public sector schemes that are not within the scope of AASB 17/PBE IFRS 17?

## **6. Binding nature of arrangement**

- 6.1 An indicative criterion in IPSAS 42 for being eligible to apply the insurance approach is that the arrangements between the entity and its participants are binding in a similar manner to an insurer being bound by an insurance contract [IPSAS 42.AG25(a)].
- 6.2 Both the AASB DP [AASB DP.E13(b)] and NZASB ED 2018-7 [ED 2018-7.AG1.6] included a similar proposal. The AASB DP proposal identified as a key criterion that a participant's beneficial rights cannot be altered without a specific change in legislation or relevant governing measures and cannot be retrospectively amended.
- 6.3 In a for-profit private sector setting, an insurer is bound by the terms of the contract with an insured in terms of the types of risks covered and what constitutes insured events and, therefore, could be the subject of a valid claim. The actual amounts of compensation paid in respect of claims are determined by reference to the terms of the contract. Typically, those terms would be based on:
- (a) the extent of loss; and
  - (b) the extent to which the insured or third parties are responsible for the events that led to the loss (that is, which party is at fault), including failure to take reasonable steps to avoid the loss. However, there also exist 'no-fault' arrangements in the for-profit private sector (for example, health insurance accident cover) – accordingly, the fact that 'no-fault' schemes are common in the public sector is probably not a distinguishing feature.
- 6.4 In respect of paragraph 6.3(a), there may be an insured amount (for example, an agreed value for motor vehicle write-off) – however, often the amount is a function of a number of factors and possibly negotiation. Nevertheless, the extent of a claim in a for-profit private sector setting would need to be determined in the context of the insurance contract terms – there would ordinarily not be an opportunity for an insurer to arbitrarily change those terms under an existing contract.
- 6.5 In the public sector, there can be the capacity for governments to change the benefits payable to participants. This is potentially a distinguishing feature of some public sector schemes



(relative to the binding nature of contracts in the for-profit private sector). However, the significance of this capacity may be mitigated by the extent to which benefits could be changed for existing participants under arrangements in place at the reporting date. Three examples can help illustrate the relevance of this capacity. Assume a public sector scheme has a liability for providing income support for permanently disabled motor accident victims based on paying 50% of Average Weekly Earnings (AWE).

**Example A:** The entity has the **power to change** the rate of benefits to **future** scheme participants to less than 50% of AWE. However, the entity has a binding commitment to paying 50% of Average Weekly Earnings (AWE) to existing scheme participants, for example, by way of settlements.

**Example B1:** The entity (or the government that controls the entity) has the **power to change** the rate of benefits to **existing** scheme participants to less than 50% of AWE **but only after obtaining a change to existing legislation**.

**Example B2:** The entity (or the government that controls the entity) has the **unilateral power to change** the rate of benefits to **existing** scheme participants to less than 50% of AWE, for example, based on projected budget priorities.

- 6.6 The terms in Example A are **like** those under most insurance contracts sold in the for-profit private sector.
- 6.7 The terms in Example B1 are **unlike** those under most insurance contracts sold in the for-profit private sector; however, the fact that a legislative change would be needed to change the benefits means it might still be regarded as insurance.
- 6.8 The terms in Example B2 are **unlike** those under all the insurance contracts sold in the for-profit private sector (of which staff are aware). The entity's ability to arbitrarily change benefits seems indicative of a conventional social benefit arrangement that might change over time based on government policy (and is not insurance).
- 6.9 Staff consider that the extent to which the existing benefits under an arrangement are binding on the relevant public sector entity should be a key indicator for determining when that arrangement is regarded as insurance.

### ***Practical ability***

- 6.10 Example B1 presents a dilemma in the sense that, while the entity or government can retrospectively change benefits, the extent to which this might undermine the binding nature of the arrangement is dependent on how difficult it might be to obtain the necessary legislative (or other regulatory) amendments.
- 6.11 AASB 17/PBE IFRS 17 relies on the notion of 'practical ability' for the purposes of:
- (a) determining the boundary of an insurance contract (practical ability to set a new price or new benefits [AASB 17.34(a)/PBE IFRS 17.34(a)])
  - (b) relief from recognising a separate onerous contract group (when contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits [AASB 17.20/PBE IFRS 17.20]).



- 6.12 Staff consider the notion of ‘practical ability’ could be used to help distinguish those cases when a public sector arrangement should be regarded as binding from cases when an arrangement is not binding. That is, an indicator for regarding arrangements as being insurance would be that the entity (or its controlling government) does not have the practical ability to change a benefit retrospectively.
- 6.13 In a public sector context, an assessment of ‘practical ability’ would probably need to take into account a range of factors, including whether the entity (or its controlling government) has sufficient political capital to make a change that reduces a benefit.

### ***Measurement view***

- 6.14 An alternative approach to addressing the impact of an entity’s capacity to change the terms of a scheme’s benefits or the extent of events covered would be to measure the liabilities based on the expected possible changes to benefits and events covered. That is, for example, a measure that factors in a 50% chance that benefits will be reduced by 20% for existing beneficiaries would result in lower liabilities. Accordingly, instead of an entity’s capacity to change the terms of a scheme’s benefits or the extent of events covered would affect the measurement of liabilities, rather than being a factor that indicates whether a scheme provides insurance.
- 6.15 Staff acknowledge that some insurance contracts include a range of options in their original terms about subsequently amending coverage and AASB 17/PBE IFRS 17 requires an insurer to determine the probabilities of those options being exercised in measuring insurance liabilities. When expectations are different from actual events, the insurer recognises ‘experience adjustments and remeasures insurance liabilities based on updated expectations. However, these contract options are at the discretion of the insured and are different from changes to existing contract terms made by an issuer.

### ***Question S6***

- 6.16 Do the Boards agree that the extent to which an arrangement is binding on the public sector entity should be **an indicator** that the arrangements should be within the scope of AASB 17/PBE IFRS 17?

### ***Question S7***

- 6.17 Do the Boards agree with the staff view on identifying the extent to which an arrangement is binding based on whether the public sector entity (or its controlling government) has the **practical ability** to change a benefit retrospectively?

## **7. Identifiable coverage period**

- 7.1 A key feature of an insurance contract in the context of AASB 17/PBE IFRS 17 is the existence of an identifiable coverage period, which is defined as follows:

The period during which the entity provides insurance contract services. This period includes the insurance contract services that relate to all premiums within the boundary of the insurance contract.





- 7.2 The coverage period provides the basis for determining the cash flows to include in measuring insurance contracts.
- (a) Most insurance contracts provide protection for events that occur during the coverage period – for example, coverage for claims that might arise from an incident over a one-year contract period. The claims may not come to light until after the coverage period has ended. These are sometimes referred to as ‘claims incurred’ contracts because the time when the event occurs is crucial to identifying valid claims. These are the most common arrangements in the relevant public sector schemes.
  - (b) Some insurance contracts provide protection for claims that arise during the coverage period, regardless of when the incidents that gave rise to the claims have occurred. These are sometimes referred to as ‘claims made’ contracts because the time when the claim emerges is crucial to identifying valid claims.
- 7.3 Among public sector schemes, one-year coverage periods are the most common. In some cases, public sector schemes ensure that all their arrangements relate to their financial year – from 1 July to 30 June. However, there are cases of longer coverage periods, for example, for domestic builders’ risks.
- 7.4 In contrast, social benefits are typically associated with providing benefits to people that meet eligibility criteria at any given time – there is no identifiable coverage period. IPSAS 42.5 defines ‘social benefit’ as (emphasis added):
- Social benefits are cash transfers provided to:
- (a) Specific individuals and/or households who meet **eligibility criteria**;
  - (b) Mitigate the effect of social risks; and
  - (c) Address the needs of society as a whole.
- Benefits are payable for as long as those people meet the eligibility criteria, which might include, for example, being unemployed, a student, above a certain age.
- 7.5 Staff consider that the existence of an identifiable coverage period would be a useful criterion for determining when AASB 17/PBE IFRS 17 would apply in the public sector. The social benefit eligibility criteria relate to someone’s inherent status, rather than relating to an uncertain future event that occurs within a particular coverage period.
- 7.6 There are likely to be differing views on how this criterion would impact on some of the long-term serious injury and disease schemes, including the lifetime care and industrial diseases schemes.
- (a) One view might be that such schemes generally do not have coverage periods. They are essentially schemes that impose annual levies to fund a long tail of accumulated claims and, over the long term, any relationship between the period(s) during which the harm was caused and the ongoing funding of participant’s needs has become lost. The alternative (to having the scheme) would be to provide support services to this group of participants via the public health system.
  - (b) Another view might be that, while claims development is the most significant aspect of such schemes, the same could be said of some of the workers’ compensation contracts issued by private sector insurers that track each year of development by ‘accident year’. Indeed, AASB 17/PBE IFRS 17 (in common with AASB 1023/PBE IFRS 4) requires



disclosure of claims development by annual cohorts (determined by reference to the issue dates of the contracts) [AASB 17.130/PBE IFRS 17.130].

Nonetheless, staff consider this indicator would be a useful tool in identifying schemes that should apply AASB 17/PBE IFRS 17 versus another Standard.

**Question S8**

7.7 Do the Boards agree that the existence of an identifiable coverage period would be a useful **indicator** for determining when AASB 17/PBE IFRS 17 should apply in the public sector?

**8. Fault-based versus no-fault-based**

8.1 In respect of many classes of risk, for-profit private sector insurers attribute fault in determining whether claims are valid or the amount of those claims. For example, a policyholder that is negligent may receive a lower claim benefit than a policyholder who is not at fault, which is designed to avoid moral hazard issues. Accordingly, it could be argued that no-fault schemes are more likely to not be insurance activities.

8.2 Public sector schemes vary across jurisdictions. For example, some of the CTP for non-serious injury are fault-based, while all the CTP for serious injury are no-fault schemes. Currently, stakeholders have not applied a correlation between whether a scheme involves insurance and its fault status. For example, the Table below shows that some of the no-fault serious injury schemes are regarded as providing insurance and some are not.

Jurisdiction	Entity/part of entity	Fault basis	Insurance?
New Zealand	Accident Compensation Commission	No-fault	Currently regarded as insurance
Victoria	Transport Accident Commission	No-fault	Currently regarded as insurance
Tasmania	Motor Accidents Insurance Board		
Western Australia	Insurance Commission		
NSW	iCare – CTP Care Fund	No-fault	Currently NOT regarded as insurance
South Australia	Lifetime Support Authority		
Queensland	National Injury Insurance Scheme		
Northern Territory	Motor Accidents Compensation Commission		

8.3 In addition, there are many classes of risk covered by for-profit private sector insurers that do not involve attributing fault in determining whether claims are valid or the amount of those



claims. For example, insurance contracts for risks such as health/disease and longevity are typically no-fault contracts.

### Question S9

- 8.4 Do the Boards agree that the fault-based versus no-fault nature of coverage is **not** a useful **indicator** for determining when AASB 17/PBE IFRS 17 would apply in the public sector?

## 9. Contract or no contract?

### 9.1 The AASB DP says:

The AASB's view is that although AASB 17 applies only to contracts, the *Framework for the Preparation and Presentation of Financial Statements* (Conceptual Framework) does not limit liability recognition to that arising from contracts, and specifically indicates that obligations may arise from statute. In applying its principle of transaction neutrality, the AASB considers that public sector entities with insurance risk created by statute, that are in substance similar to public and private sector entities with insurance risk created by contracts, should account for insurance risk in the same way. [page 5]

### 9.2 The respondents to the AASB DP either explicitly or implicitly accepted the view that AASB 17 could apply when there is an insurance arrangement based on statute (and not contracts).

### 9.3 In the recent stakeholder outreach, staff have identified three broad types of response.

- (1) The manner in which the scheme or arrangement has been established (contract versus statute) is a matter of form rather than substance. These stakeholders have observed that:
  - (a) virtually identical forms of coverage are provided under either statutory or private sector (contractual) arrangements (such as comprehensive third-party motor coverage) – accordingly, the insurance Standards would apply by analogy to statutory arrangements under the accounting policy hierarchy<sup>14</sup>
  - (b) the purpose of having a statutory (rather than contractual) arrangement is generally to mandate that people obtain coverage from the one entity (usually a public sector entity)
  - (c) individuals and entities are required by statute to pay for some types of insurance coverage from private sector insurers (such as workers' compensation coverage) and the arrangements are effectively a combination of contractual and statutory terms.
- (2) Literally, the insurance Standards are considered to apply only to 'contracts', and entities' activities in respect of relationships based only on statute are (strictly interpreted) not within the scope of the insurance Standards. These stakeholders have observed that:
  - (a) AASB 15 and AASB 16 provide clear definitions and descriptions of 'contracts' that can be used as a 'bright line'

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<sup>14</sup> AASB 108/PBE IPSAS 3 *Accounting Policies, Changes in Accounting Estimates and Errors* [paragraphs 10 & 11/paragraph 14].



- (b) there are currently cases when the contract versus statute distinction is used to determine the accounting that should be applied – for example, the impairment of tax receivables – refer to the discussion below on ‘Scope of AASB 9/PBE IPSAS 41’.
- (3) For some types of risks (such as workers’ compensation), the existence of a stand-alone contract that includes substantive information about risks and benefits (well beyond the detail in any relevant enabling legislation or regulations), is a strong indication of an insurance contract.
- 9.4 As noted in PBE IFRS 17.BC5, PBE IFRS 4 already applies to insurance activities that arise from statute rather than contracts. In addition, practice in some Australian states is to apply AASB 4 and AASB 1023 to some types of statutory arrangements. Accordingly, the existence of a ‘contract’ has not necessarily been seen as crucial to applying insurance accounting.

### ***Scope of AASB 9/PBE IPSAS 41***

- 9.5 AASB 17/PBE IFRS 17 literally applies to ‘contracts’, which are often distinguished from statutory arrangements. The reference to ‘contract’<sup>15</sup> in the ‘financial instrument’ definition is generally read literally, which has meant that statute-based receivables/payables are not accounted for as financial instruments under AASB 9/PBE IPSAS 41.
- 9.6 AASB 2016-8 amended AASB 9 to specifically scope the initial recognition of statutory receivables into AASB 9 as if it were a (contractual) financial instrument. However, the subsequent accounting for statutory receivables, and the initial and subsequent accounting for statutory payables, is regarded as remaining outside the scope of AASB 9.<sup>16</sup>
- 9.7 For example, for Australian *Commonwealth government entities*, receivables for statutory charges must be assessed for impairment under AASB 136 *Impairment of Assets*.<sup>17</sup>
- 9.8 A possible implication of the view that, without amendment, statutory receivables and payables cannot be regarded as contracts within the scope of AASB 9 is that, without amendment, AASB 17 could not apply to insurance contracts based on statute.
- 9.9 In New Zealand, the initial and subsequent accounting for statutory receivables and payables remains outside the scope of PBE IPSAS 41.<sup>18</sup>

### ***Scope of AASB 17/PBE IFRS 17***

- 9.10 Based on current practice and stakeholder feedback, staff consider that the existence of a contract between an entity and a scheme participant is probably not a useful indicator of the relevance of applying AASB 17/PBE IFRS 17. This is because, while having a contract would help

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15 AASB 132.11 include the following definition (emphasis added): A financial instrument is any **contract** that gives rise to a financial asset of one entity and a financial liability or equity instrument of another entity.

16 AASB 2016-8, paragraphs BC11 to BC13.

17 [Public Governance, Performance and Accountability \(Financial Reporting\) Rule 2015 \(legislation.gov.au\)](https://www.legislation.gov.au) – paragraph 20.

18 This statement is true for PBE IPSAS 41 at present. However, the IPSASB’s recent EDs on revenue and transfer expenses proposed that subsequent measurement of non-contractual receivables and payables be brought within IPSAS 41 *Financial Instruments*. If these proposals are finalised, they would then be considered by the NZASB.



to establish a binding relationship between the entity providing the scheme and the participants, a statute can do the same thing.

- 9.11 This seems consistent with the perspective adopted AASB 17/PBE IFRS 17 in any case. Staff also note that the description of the rights and obligations that should be accounted for under AASB 17/PBE IFRS 17 is broad (and go beyond the contract). AASB 17.2/PBE IFRS 17.2 says (emphasis added):

- 2 **An entity shall consider its substantive rights and obligations, whether they arise from a contract, law or regulation, when applying IFRS 17.** A contract is an agreement between two or more parties that creates enforceable rights and obligations<sup>19</sup>. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). Implied terms in a contract include those imposed by law or regulation. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).

### **Question S10**

- 9.12 Do the Boards agree that the absence of a 'contract' (rather than statute/regulation) should **not** be an **indicator** for determining when AASB 17/PBE IFRS 17 would apply in the public sector?

### **Question S11**

- 9.13 Do the Boards agree that the existence of a stand-alone 'contract' that includes substantive terms relating to risks and benefits (that go well beyond the detail in any relevant statute/regulation) should be an **indicator** for determining when AASB 17/PBE IFRS 17 would apply in the public sector?

### **Question S12**

- 9.14 If the Boards agree to Question S10 in paragraph 9.12, technically, there may or may not be a need to amend, or supplement, AASB 17.2/PBE IFRS 17.2. However, to ensure clarity, do the Boards agree we should specifically note that AASB 17/PBE IFRS 17 applies to statutory arrangements that meet the (other) relevant indicators either in guidance to the Standard or a Basis for Conclusions to the Standard?

## **10. Source and extent of funding**

- 10.1 The source of funding for an arrangement is a matter previously identified by both Boards as potentially differentiating between insurance and other activities. NZASB ED 2018-7 proposed using the 'fully-funded' criterion [ED 2018-7.AG1.1 to AG1.4].

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19 The second sentence of AASB 17.2/PBE IFRS 17.2 is the same as the definition for 'contract' used more generally in IFRS Standards (including: AASB 15 *Revenue from Contracts with Customers*).



### ***Fully funded***

10.2 One of the criteria in IPSAS 42 (and proposed in NZASB ED 2018-7) for being eligible to apply the insurance approach is that a scheme is intended to be **fully funded** from contributions and levies.

10.3 Staff note that the ‘fully funded’ criterion under IPSAS 42.28(a) must be present to permit the insurance approach to be applied. IPSAS 42.AG20 explains ‘fully funded’ as follows:

AG20 A social benefit scheme is intended to be fully funded from contributions when:

- (a) The legislation or other arrangement governing the social benefit scheme provides for the scheme to be funded by contributions or levies paid by or on behalf of either the potential beneficiaries or those whose activities create or exacerbate the social risks which are mitigated by the social benefit scheme, together with investment returns arising from the contributions or levies; and
- (b) One or both of the following indicators (individually or in combination) is satisfied:
  - (i) Contribution rates or levy rates are reviewed (and, where appropriate, adjusted in line with the scheme’s funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the revenue from contributions or levies will be sufficient to fully fund the social benefit scheme; and/or
  - (ii) Social benefit levels are reviewed (and, where appropriate, adjusted in line with the scheme’s funding policy), either on a regular basis or when specified criteria are met, with the aim of ensuring that the levels of social benefits provided will not exceed the level of funding available from contributions or levies.

10.4 Some respondents to NZASB ED 2018-7 commented that the meaning of ‘fully funded’ is not necessarily clear for entities that aim to be self-funded over the long term, but that in any given year might be:

- (a) overpricing to make up for past deficits
- (b) underpricing to use up past surpluses
- (c) underpricing to suit current economic conditions.

### ***Substantially self-funded***

10.5 The AASB was also mindful of the IPSASB’s work on social benefits in preparing the AASB DP, but considered that ‘fully funded’ would be too much of a ‘bright line’ [AASB DP.BC28(b)(ii)].

10.6 Instead, one of the non-mandatory criteria proposed in the AASB DP for determining whether IFRS 17 should apply in the public sector was that the arrangement is **substantially self-funded** [AASB DP.E14(a)]. Under the AASB DP proposal, there are two aspects to ‘self-funding’:

- (a) the source of funding should be those who stand to benefit from the arrangement or those who exacerbate the risks to potential beneficiaries; and
- (b) the revenue being sufficient and/or the benefit levels being managed such that the scheme is self-sustaining.



- 10.7 There was a limited response to the AASB DP proposal of a ‘substantially self-funded’ criterion. Those who did respond gave some support for the criterion.

### ***Dedicated funding***

- 10.8 The responses received by the IPSASB in the process of developing IPSAS 42 identified as a possible criterion the existence of ‘dedicated’ funding for an arrangement where it is funded through government (and not participants) [IPSAS 42.BC124].
- 10.9 Some implications of this feedback received by the IPSASB include that:
- (a) the existence of dedicated funding (whether from government or elsewhere) would be an indicator of insurance activities; and/or
  - (b) the absence of dedicated funding – that is, when funding is from consolidated revenue – would mean activities are not insurance.
- 10.10 Staff observe that all of the public sector entities in either Australia or New Zealand that are currently applying the insurance standards, or have contemplated applying the insurance standards, receive contributions from participants either directly or indirectly via levies. Some of these entities might require top-up funding from consolidated revenue from time-to-time. However, this is the exception rather than the rule (and might be regarded as an ‘equity’ injection in some cases, rather than a source of ongoing funding).
- 10.11 If this criterion was applied, it would at least have the benefit of immediately ruling out the application of the insurance standards to a range ‘social benefits’ such as aged pension or universal healthcare activities. This could be particularly useful for the AASB which has no social benefits standard that might otherwise provide guidance in this respect. The Australian National Disability Insurance Authority, for example, relies on appropriations for all of its ongoing funding and would be scoped out of AASB 17 based on this criterion.
- 10.12 A possible complication is that schemes such as Medicare in Australia, at least notionally, have dedicated funding through the Medicare levy on taxpayers. However, the Medicare levy is probably sufficiently ‘tax-like’ to be regarded as being a levy as intended under this criterion. It might also be helpful to explain that there could be a spectrum of ‘dedicated funding’, under which the criterion is more significant:
- (a) the more closely the levy is related to coverage (for example, a levy on motorists to provide funding for a scheme that relates to motor accidents would be more likely to indicate insurance activities than a levy on all taxpayers above a particular level of income); and
  - (b) the closer the levy is to a ‘user-pays model’.

### ***Staff comment***

- 10.13 Staff consider that:
- (a) some type of funding from a scheme participant is probably a reasonable indicator of the relevance of applying AASB 17/PBE IFRS 17 in the sense that it helps to establish a relationship between the entity providing the coverage and the participants; however,
  - (b) the complete absence of a contribution from a scheme participant might not necessarily mean that AASB 17/PBE IFRS 17 is irrelevant because a payment/contribution to the



insurer is not a part of the ‘insurance contract’ definition in AASB 17/PBE IFRS 17 (identified above).

- 10.14 Staff consider that, although the extent to which a participant in a scheme is responsible for paying a contribution might indicate something about the strength of that relationship. References to ‘fully-funded’ and ‘substantially self-funded’ are probably not useful because they are difficult to interpret.

**Question S13**

- 10.15 Do the Boards agree that the existence of a contribution from a scheme participant should be an **indicator** for determining when AASB 17/PBE IFRS 17 should apply in the public sector?

**Question S14**

- 10.16 Do the Boards agree that the absence of any dedicated funding (from participants or government) for an activity should be an **indicator** that AASB 17/PBE IFRS 17 **does not** apply?

## 11. Claims handling

- 11.1 Under an insurance contract, policyholders make claims that are assessed by the insurer, which is a key part of the risk management process. The following table attempts to compare this process with the process that might be used to assess eligibility for a social benefit.
- 11.2 Staff note that some entities choose to outsource the claims management function to specialists. This does not mean the entity itself is not responsible for claims management. Both private sector insurers and public sector entities sometimes outsource this function.

<i>Insurance contract</i>		<i>Social benefit</i>
<i>Identifying claim events</i>		
1	Determining that the claimed event or loss occurred	As noted in <a href="#">Section 6</a> , social benefits are typically associated with providing benefits to people that meet eligibility criteria at any given time
	Determining whether the relevant event is within the coverage provided by the insurance contract	
<i>Assessing claims</i>		
2	Assessing the extent of the claim (such as the cost to repair damage) The quantity of benefits is usually assessed based on what the insured has lost or on the insured’s needs to recover from an insured event	Social benefits can involve determining the extent of a person’s needs, which would have a bearing on the level of benefits they receive (rent assistance for pensioners who do not own their own homes) However, many social benefits are broadly-applied standardised amounts not tailored to a beneficiary’s needs





<i>Insurance contract</i>		<i>Social benefit</i>
3	Assessing the extent of any contributory negligence on the part of the claimant that might reduce the amount of the claim	Social benefits would not typically be dependent in any way on contributory negligence. However, in <a href="#">Section 7</a> staff suggest that the fault-based versus no-fault nature of coverage is not a useful indicator
4	Contesting the validity and extent of claims through legal and arbitration processes	This may happen, although the process is more likely to be administrative. It might also be a legal process if there is evidence of ineligibility for benefits already paid
<i>Cost management</i>		
5	A key metric for commercial insurers is the 'claims ratio' (claims divided premiums) Particular insureds or groups of insureds with a high claims ratio would be closely monitored and would be the subject of remediation activities aimed at either reducing benefits or increasing premiums.	The main focus is more likely to be on managing costs without regard to any particular source of income Any remediation is more likely to be aimed at discovering why particular beneficiaries are more costly than others and whether their benefits are valid.
6	Managing claims costs through the use of contracted services (for example, arrangements with medical professionals to provide services at agreed prices)	Outsourcing of benefit services through private sector providers is reasonably common – for example, job search services for the unemployed, and aged-care services
<i>Long-term claims management</i>		
7	Long-term management of long-tail claims (such as lifetime disability coverage)	Social benefits can involve long-term management, for example, of those with long-term illnesses through the health system
8	Lump sum payments to settle long-term claims	Probably not relevant to social benefits
<i>Third-party recoveries</i>		
9	Determining whether there are salvage or subrogation recoveries that can be sought	Probably not relevant to social benefits

11.3 There are many similarities between an insurance claims management function and the processes that might be employed to deliver social benefits in an equitable manner and according to government policy. The two features that seem most likely to highlight a distinction between insurance contracts and social benefits are:

- (a) the extent to which claims are assessed to cater specifically for a beneficiary's needs [row 2 of the above Table]; and
- (b) the focus of cost management on both income and costs [row 5 of the above Table].

11.4 Staff consider that each of these features would be useful indicators for determining when AASB 17/PBE IFRS 17 should apply. Staff also acknowledge that (b) is closely associated with underwriting (see [Section 12](#)).



### **Question S15**

- 11.5 Do the Boards agree that useful **indicators** for determining when AASB 17/PBE IFRS 17 would apply in the public sector would be:
- (a) the extent to which claims are assessed to cater specifically for a beneficiary's needs [row 2 of the above Table], rather than being broadly-determined standardised amounts; and
  - (b) the extent to which the focus of cost management is on both income and costs [row 5 of the above Table], rather than simply cost minimisation?

## **12. Assessing financial performance/how an entity is managed**

### ***Assessing financial performance (in general)***

- 12.1 An indicative criterion in IPSAS 42 for being eligible to apply the insurance approach is that the entity assesses its financial performance and financial position of a social benefit scheme on a regular basis where it is required to report internally on the financial performance of the scheme, and, where necessary, to take action to address any under-performance by the scheme [IPSAS 42.AG25(d)].
- 12.2 NZASB ED 2018-7 included a similar proposed indicator [ED 2018-7.AG1.6(d)]. A similar indicator was included in the AASB DP, which put an emphasis on the assessment of claims performance [AASB DP.E14(b)].
- 12.3 There was little feedback on this proposal in response to ED 2018-7. There was a mixed response to the AASB DP proposal, with most respondents saying the criterion was not helpful in distinguishing insurance activities. In general, respondents considered there are accountability and performance mechanisms across the spectrum of social benefit and insurance arrangements in most jurisdictions.
- 12.4 Staff consider that the existence of a practice of an entity assessing financial performance and financial position on a regular basis where it is required to report internally on the financial performance of the scheme, and, where necessary, to take action to address any under-performance by the scheme is not a useful indicator of the relevance of applying AASB 17/PBE IFRS 17. The inference that social benefit schemes versus insurance schemes are less likely to monitor performance in this way is probably not useful or supportable.

### ***Management focus of the entity (more specifically)***

- 12.5 In recent stakeholder interviews, participants were more interested in discussing the ways in which they managed their activities, rather than the more general matter of assessing financial performance. The feedback from those stakeholder interviews has been mixed.
- (a) Most (Australian and New Zealand) stakeholders from entities that are currently applying AASB 1023/PBE IFRS 4 hold the view that they have been established to manage an area of risk and provided with seed capital to operate with a view to not making further calls on government funding. They consider themselves to be operating an insurance business on a long-term sustainable basis. Within the constraints imposed



upon them, they price risk based on commercial principles and manage claims fairly and prudently.

- (b) Most (Australian) stakeholders from entities that are currently applying AASB 137 hold the view that they are operating a compensation scheme based on terms that have largely been dictated to them (for example, through their enabling legislation) and do not have the scope to manage the risks in the manner of a commercial insurer.
- (c) A small number of (Australian) stakeholders indicated that they consider the way their entities are currently managed would be better reflected in a change to their existing accounting – some from AASB 1023 to AASB 137 and some from AASB 137 to AASB 1023/AASB 17.

12.6 This recent feedback might mean that the way a scheme is managed would be a useful indicator for applying AASB 17/PBE IFRS 17. Alternatively, it might simply mean that there are largely entrenched positions based on familiarity with existing practices.

12.7 Staff consider that the manner in which an entity is managed is, in principle, an important indicator of which standards should be applied on the basis that reflecting the ‘business model’ in financial statements is something that standards should aim to achieve. However, this type of indicator is likely to be subject to wide interpretation unless it is associated with specific insurance liability management practices.

12.8 Those insurance liability management practices could include the following.

- (a) Underwriting and pricing specific types of risks. Although few (if any) public sector insurers are completely unconstrained in their ability to differentially price their services, many of them are able to price risk based a participant’s characteristics (for example, industry of employment or type of vehicle or claims experience)
- (b) Use of reinsurance contracts to manage capital. This is not to say that the existence of a reinsurance contract, of itself, indicates that an entity issues insurance contracts. However, it can indicate that the entity is expected to manage its liabilities prudently and protect its own capital base (rather than relying on the taxpayer) for its continuing operation, much like a commercial insurer.

#### **Question S16**

12.9 Do the Boards agree that the existence of a practice of an entity assessing financial performance and financial position on a regular basis (as noted above) is **not** a useful **indicator** for determining when AASB 17/PBE IFRS 17 would apply in the public sector?

#### **Question S17**

12.10 Do the Boards agree that the existence of insurance liability management practices (such as underwriting) would be a useful **indicator** that AASB 17/PBE IFRS 17 should apply?

### **13. Assets set aside for benefits**

13.1 IPSAS 42.AG26(b) identifies the existence of assets being held in a separate fund, or otherwise earmarked, and restricted to being used to provide benefits as being an indicator of insurance contracts, (as opposed to benefits being funded from general taxation).



- 13.2 Similarly, AASB DP.E14(d) identifies that assets and liabilities arising from the arrangements being held in a separate fund, or otherwise specifically identified as used solely to provide benefits to beneficiaries as indicating an insurance arrangement. However, the AASB DP also notes that the absence of separately allocated assets is not necessarily an indicator the arrangement is not insurance.
- 13.3 The implication of this criterion is that a benefit funded from general taxation is more likely to be a social benefit and not insurance. It is related to some extent to the issues around the source and extent of funding ([Section 10](#) above) because funds that are sourced from scheme participants are more likely to be set aside in a scheme fund than would the case for an appropriation of funds from general taxation.
- 13.4 The existence of a separate fund might make it more likely that the scheme is operated and managed as an insurance entity. This is supported by feedback received by staff in recent stakeholder outreach, with many entities having been established to be self-sustaining and to aim for an overall breakeven result from all of their activities, including investment performance. This is a characteristic of private sector for-profit insurers, many of which routinely operate on a long-term sustainable basis by generate underwriting losses that are more than offset by investment returns.
- 13.5 However, staff acknowledge that some non-insurance liabilities might have separate funds earmarked for their settlement – for example funds within the Australian government Future Fund are earmarked to meet the defined benefit superannuation liabilities.<sup>20</sup> Accordingly, the existence of assets set aside to meet benefits does not necessarily mean the related liabilities arise from insurance contracts.

### **Question S18**

- 13.6 Do the Boards agree that the existence of assets being held in a separate fund, or an entity having access to earmarked assets, that are restricted to being used to provide benefits is a useful **indicator** for determining when AASB 17/PBE IFRS 17 would apply in the public sector?

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<sup>20</sup> Superannuation liabilities accruing under the Commonwealth Superannuation Scheme, Defence Force Retirement Benefit Scheme, Military Superannuation and Benefits Scheme, and Public Sector Superannuation Scheme <https://parlinfo.aph.gov.au/parlInfo/search/display/display.w3p;query=Id:%22library/prspub/V/MNF6%22>



## Appendix A – Abbreviations used in this paper

PBE IFRS 4 *Insurance Contracts* [PBE IFRS 4]

PBE IFRS 17 *Insurance Contracts* [PBE IFRS 17]

AASB 4 *Insurance Contracts* [AASB 4]

AASB 1023 *General Insurance Contracts* [AASB 1023]

AASB 17 *Insurance Contracts* [AASB 17]

AASB Discussion Paper [Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities](#) (2017) [AASB DP]

NZASB [ED 2018-7 PBE IFRS 17 Insurance Contracts](#) [ED 2018-7]

IPSAS 42 *Social Benefits* [IPSAS 42]

AASB 7/PBE IFRS 7 *Financial Instruments: Disclosure* [AASB 7/PBE IPSAS 30]

AASB 9/IPSAS 41 *Financial Instruments* [AASB 9/PBE IPSAS 41]

AASB 132/PBE IPSAS 28 *Financial Instruments: Presentation* [AASB 132/PBE IPSAS 28]

AASB 137/PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*  
[AASB 137/PBE IPSAS 19]

AASB 2016-8 *Amendments to Australian Accounting Standards – Australian Implementation Guidance for Not-for-Profit Entities* [AASB 9 & AASB 15] [AASB 2016-8]

AASB 15 *Revenue from Contracts with Customers* [AASB 15].

AASB 16 *Leases* [AASB 16]

## Appendix B – Insurance accounting versus provision accounting in Australia

- B.1 The alternative to applying the insurance Standards is to apply other liability-related requirements, which could include the following.

<i>Australia</i>	<i>Comments</i>
AASB 137 <i>Provisions, Contingent Liabilities and Contingent Assets</i>	A provision is a liability of uncertain timing or amount
<i>Conceptual Framework for Financial Reporting</i> [permitted per AASB 1057.BC7]	Liability definition Application of 'accrual accounting'

- B.2 It is generally accepted that applying AASB 17 rather than AASB 137 would result in higher liabilities for one or more of the following reasons:
- there could be a liability for remaining coverage under AASB 17
  - there is more likely to be a risk adjustment under AASB 17.
- B.3 Some stakeholders also consider that applying AASB 17 rather than AASB 137 would result in higher liabilities because there is potentially more flexibility around determining discount rates under AASB 137 versus AASB 17. However, the reverse could also be true.

### ***Liability for remaining coverage***

- B.4 As noted previously noted, Under AASB 1023 and AASB 17, each insurance contract is considered to potentially give rise to two liabilities:

- a liability for remaining coverage; and
- a liability for incurred claims.

For example, 10 policyholders each pay a premium of \$900 to insure the risk associated with the vehicle they own being involved in an incident in the period from 1 April 20X1 to 31 March 20X2 that causes personal injury to themselves or a third party.

- B.5 In this case, the insurer has:
- a liability for remaining coverage (similar to deferred revenue) – a liability to stand ready to provide coverage for personal injury risks, whether or not any relevant incidents arise – initially measured at \$9,000 (10 x \$900); and
  - in the event that an incident arises and a valid claim is made, a liability to settle that claim (that is, a liability for incurred claims) – measured based on estimated future cash flows.

- B.6 the journal entries under AASB 17:

Debit: Cash \$9,000  
Credit: Liability for remaining coverage \$9,000



B.7 In contrast, cash received that will be used to help fund a provision is (probably) accounted for as follows under AASB 137:

Debit: Cash

Credit: Revenue

### ***Risk adjustment***

B.8 In measuring insurance liabilities, AASB 17 says:

37 An entity shall adjust the estimate of the present value of the future cash flows to reflect the compensation that the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.

B.9 In measuring provisions, AASB 137 says:

36 The amount recognised as a provision shall be the best estimate of the expenditure required to settle the present obligation at the end of the reporting period.

42 The risks and uncertainties that inevitably surround many events and circumstances shall be taken into account in reaching the best estimate of a provision.

B.10 In practice, while some of the public sector entities under consideration for this project that are applying AASB 137 have included risk margins in their liabilities/provisions, most do not include.

### ***Discounting***

B.11 AASB 17 requires fulfilment cash flows to be discounted to reflect the time value of money, the characteristics of the cash flows and the liquidity characteristics of the insurance contracts [AASB 17.36]. This is typically interpreted as meaning a risk-free rate plus an illiquidity premium.

B.12 In measuring provisions, AASB 137 says:

47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted.

B.13 In practice, at least one of the public sector entities under consideration for this project that is applying AASB 137 has applied a discount rate based on long-term rates of return on their investment performance. This has the effect of lowering the liability relative to AASB 17.

B.14 In practice, some of the public sector entities under consideration for this project that are applying AASB 137 have applied largely risk-free discount rates. It is possible that the discount rate under AASB 17 would be higher (and the liabilities lower) due to the addition of an illiquidity premium on top of the risk-free rate.





## Appendix C – IFRS 17 practical expedients

- C.1 IASB's path to developing IFRS 17 has involved using a series of practical expedients. The practical expedients in IFRS 17 include:
- (a) **warranties** provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer
  - (b) **financial guarantees**
  - (c) **fixed-fee service contracts** activities.

### ***Warranties***

- C.2 Although product warranties sold by insurers could be identical to product warranties sold by the makers and sellers of the underlying products, IFRS 17 (and IFRS 4) specifically scopes out warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer [IFRS 17.7(a)].
- C.3 The IASB considered that applying IFRS 15 to warranties provided by a manufacturer, dealer or retailer would probably provide much the same accounting outcomes as applying the premium allocation approach under IFRS 17 [IFRS 17.BC90].

### ***Financial guarantees***

- C.4 Both insurers and banks issue 'financial guarantees' and stakeholders hold widely differing views on the nature of these contracts. The IASB agreed on a 'temporary' compromise when it issued IFRS 4 whereby an entity that previously asserted explicitly that it regards financial guarantees as insurance contracts and has used accounting applicable to insurance contracts can choose on a contract-by-contract basis to apply either IFRS 4 or IAS 32, IFRS 7 and IFRS 9 [IFRS 17.BC93]. Otherwise, IAS 32, IFRS 7 and IFRS 9 automatically apply.
- C.5 The IASB considered that the compromise had functioned in practice and agreed to retain it for IFRS 17 [IFRS 17.7(e) and IFRS 17.BC93].

### ***Fixed-fee service contracts***

- C.6 Responses to the consultative documents that preceded the issue of IFRS 4 included objections from roadside assistance providers to applying insurance accounting to roadside assistance contracts. The IASB agreed to permit "contracts [that] meet the definition of an insurance contract but have as their primary purpose the provision of services for a fixed fee" to be accounted for using either IFRS 4 or IFRS 15.
- C.7 The IASB decided to retain the practical expedient as it considered that applying IFRS 15 would probably provide much the same accounting outcomes as applying the premium allocation approach under IFRS 17 [IFRS 17.8 and IFRS 17.BC96].