Australian Accounting Standard **AAS 26**
November 1996

Financial Reporting of General Insurance Activities

Prepared by the
Public Sector Accounting Standards Board of the
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Australian Accounting Standards Board

Issued by the
Australian Accounting Research Foundation
on behalf of the **Australian Society of Certified Practising Accountants** and **The Institute of Chartered Accountants in Australia**

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211 Hawthorn Road
Caulfield Victoria 3162
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Phone: (03) 9523 8111
Fax: (03) 9523 5499
Email: standard@aarf.asn.au

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Defined words appear in *italics* the first time they appear in a section. The definitions are in Section 14. Standards are printed in **bold** type and commentary in light type.

MAIN FEATURES OF THE STANDARD

Major Requirements

Premiums

Premiums are required to be recognised from the attachment date and to be measured over the period of insurance in a pattern in accordance with the incidence of risk.

Liability for Outstanding Claims

A liability for outstanding claims is required to be recognised for direct and inwards reinsurance business and measured as the present value of expected future payments.

Investments Integral to General Insurance Activities

Investments that are integral to the reporting entity's general insurance activities are required to be measured at net market values and changes in the measured amounts recognised as revenues or expenses in the reporting periods in which the changes occur.

Revised Claims Development Disclosures

The superseded (and original) Standard was issued in 1990. The only difference between the requirements of this Standard and the superseded Standard are revised claims development disclosure requirements.

This Standard is presented in plain English format, which has changed the location of requirements and commentary.

A description of the revised claims development requirements and a table comparing the paragraphs in this Standard with the paragraphs in the superseded Standard is included in the Background to Revision section.

AUSTRALIAN ACCOUNTING STANDARD

AAS 26 "FINANCIAL REPORTING OF GENERAL INSURANCE ACTIVITIES"

1 Application

1.1 This Standard applies to *general purpose financial reports* of:

(a) each private sector *reporting entity*; and

(b) each public sector reporting entity;

to which Accounting Standards operative under the Corporations Law do not apply.

1.2 This Standard applies to financial reports that are held out to be general purpose financial reports by an *entity* which is not a reporting entity, and to which Accounting Standards operative under the Corporations Law do not apply.

1.2.1 Accounting Standards operative under the Corporations Law apply to companies and to other entities required by legislation, ministerial directive or other government authority to apply such Standards. Reporting entities which are not required to apply Accounting Standards operative under the Corporations Law are required to apply this Standard.

1.2.2 The standards specified in this Standard apply to the financial report where information resulting from their application is material, in accordance with Australian Accounting Standard AAS 5 "Materiality".

1.3 This Standard applies to general insurance activities.

1.3.1 There are various types of insurance. This Standard deals with general insurance (including general reinsurance). General insurance provides protection for a specified period against specified losses resulting from the occurrence of specified types of events that may occur. Such events include theft or storms resulting in property loss or damage, work-related and motor vehicle accidents resulting in injury, and fires or floods resulting in interruptions to business. For certain amounts of *premium*, the insurer undertakes to accept, either wholly or in part, from the insured the risks of sustaining specified losses arising from such events within a specified period. For many types of insurance business, such as fire and fire-related risks, the specified period is usually one year. For other types of insurance business the specified period relates specifically to the underlying risk, which may be a period less than one year (for example, marine cargo insurance), or a period of many years (for example, mortgage insurance).

1.4 This Standard does not apply to accounting for life insurance, medical benefits insurance or self-insurance.

1.4.1 This Standard does not deal with accounting for life insurance or medical benefits insurance. Life insurance is normally an assurance that a benefit will be paid on the occurrence of a specified event that will definitely take place, but the timing of which may be uncertain. Medical benefits insurance is provided mainly by mutual provident entities established for the benefit of policyholders rather than equityholders.

1.4.2 This Standard does not deal with accounting for self-insurance. However, the principles adopted in this Standard for measuring the *liability* to external parties in respect of outstanding *claims* are appropriate for measuring liabilities resulting from self-insurance.

2 Operative Date

2.1 This Standard applies to reporting periods ending on or after 31 December 1997.

2.2 This Standard may be applied to reporting periods ending before 31 December 1997.

2.2.1 AAS 26 "Financial Reporting of General Insurance Activities", as issued in December 1990, continues to apply for reporting periods that end before 31 December 1997. However, where an *entity* elects to apply this Standard early in accordance with paragraph 2.2 it will not also be obliged to comply with AAS 26, as issued in December 1990, for the reporting periods to which the election applies.

2.3 When operative, this Standard supersedes Australian Accounting Standard AAS 26 as issued in December 1990.

3 Purpose of Standard

3.1 The purpose of this Standard is to:

(a) specify the manner of accounting for the general insurance activities of a *reporting entity* and for the *investment* activities of the *entity* integral to those general insurance activities; and

(b) require disclosure of information relating to general insurance activities so that users of *general purpose financial reports* are provided with information about the financial position and performance of the reporting entity.

4 Premiums

4.1 *Premium revenue* must be *recognised* from the *attachment date* as soon as the amount of the premium can be reliably measured.

4.1.1 The amount of a premium is determined by a general insurer so as to cover anticipated *claims*, reinsurance premiums, administrative, acquisition and other costs, and a profit component (having regard to expected revenues from the investment of premiums). The amounts collected in respect of these components are revenue of an insurer on the basis that they are collected in consideration for the insurer rendering services by indemnifying those insured against specified losses.

4.1.2 For certain classes of general insurance business, government authorities may require the payment of levies and charges. For example, workers' compensation insurance levies, annual licence fees and fire brigade charges may apply. Such levies and charges are *expenses* of the insurer, rather than government charges directly upon those insured. The insurer is not acting simply as a collector of these levies and charges. Although not compelled to collect these amounts from those insured, the insurer is entitled to include in premiums an amount to cover the estimated amount of the levies and charges. The insurer is usually responsible for paying the levies and charges at a later date. The amount paid by the insurer does not depend on the amounts collected from those insured in relation to the levies and charges. Therefore, the amounts collected to meet levies and charges are revenue of the insurer.

4.1.3 In most States, stamp duty is charged on individual insurance policies and is separately identified by insurers on policy documents. The insurer normally is required to collect and pass on to the government an equivalent amount. Because such stamp duty is a tax collected on behalf of a third party and there is no choice on the part of the insurer but to collect the duty from the insured, it is not revenue of the insurer.

4.1.4 Premium revenue needs to be recognised from the date of the attachment of risk in relation to each policy of insurance because insurers earn premium revenue by assuming risks from that date on behalf of those insured. However, for reasons of practicality, many insurers use bases of recognition that attempt to approximate this date. These bases are predicated on assumptions; for example, a direct insurer may assume that risk attaches to all policies from the middle of the month in which they are written, and a reinsurer may assume, in relation to premiums ceded to it, that risk attaches from the assumed attachment date of the underlying direct insurance policies or of the indemnity periods. Such bases are acceptable provided that they do not result in the recognition of a materially different amount of premium revenue in a particular reporting period than would be the case if recognition occurred from the date of attachment of risk for each policy.

4.2 Over the period of insurance, premium revenue must be recognised in accordance with the pattern of the incidence of risk or, where the result will not be materially different, evenly over the period of the policy (for direct insurance) or period of indemnity (for reinsurance).

4.2.1 Premium revenue is to be recognised in the financial statements only when it has been earned. Therefore, the gross written premium for a reporting period would normally not equate with premium revenue because the gross written premium would normally include amounts which are unearned at the reporting date. These amounts would be earned by the insurer in the subsequent reporting period or periods over the remaining durations of the insurance policies.

4.2.2 Because insurers earn premium revenue by assuming risks on behalf of those insured, the recognition of premium revenue over the period of a policy of insurance needs to be based on the pattern of risk to which the insurer is exposed. An insurer may be able to reliably estimate the pattern of risk for a particular type of insurance business based on past experience.

4.2.3 Most insurers recognise premium revenue on the basis of the passage of time. This is appropriate where the risk of events occurring that will give rise to claims is much the same throughout the policy period. However, there may be policies for which the risk is not evenly spread throughout the policy period.

4.3 In the case of business where the premium is subject to later adjustment, the adjusted premium must be used, where possible, as the basis for recognising premium revenue. Where this is not possible, the *deposit premium* adjusted for any other relevant information must be recognised as the premium revenue provided that it is expected that this amount will not be materially different from the actual amount of premium.

4.3.1 For some classes of insurance it is usual for the premium to be adjusted as a result of events and information that only become known during or after the policy period. For example, marine cargo insurance is a type of "adjustable" business for which a deposit premium is paid at the beginning of the policy period and subsequently adjusted on the basis of a cargo declaration. Some reinsurance arrangements also typically involve the ceding of an amount of deposit premium, which is subject to subsequent adjustment based on the outcome of the covered insurance policies.

4.3.2 Where the precise amount of premium revenue is uncertain, insurers often estimate the amount of the premium using the deposit premium adjusted for any other relevant information that may be available, such as the recent claims experience under adjustable-premium policies. Where such estimates and the actual (adjusted) premiums are not expected to be materially different, this approach provides a reliable basis for measuring premium revenue.

4.4 Premium revenue relating to unclosed business must be recognised in accordance with the standards set out in paragraphs 4.1, 4.2 and 4.3.

4.4.1 Frequently, there is insufficient information available at the end of a reporting period to enable an insurer to accurately identify the business written close to the reporting date for which the date of attachment of risk is prior to the reporting date. This is often referred to as unclosed business. Consistent with the principle stated in paragraph 4.1 that premium revenue is to be recognised from the attachment date, all unclosed business will need to be estimated and the earned portion of premium relating to unclosed business included in premium revenue.

4.4.2 Estimates of the amount of unclosed business can be made using information from prior periods adjusted for the impact of recent trends and events. In addition, information about unclosed business may become available between the reporting date and the date of completion of the financial report that may enable more reliable estimates to be made.

5 Claims

Recognition and Measurement

5.1 A *liability* for outstanding *claims* must be *recognised* in respect of both direct business and inwards reinsurance business and must be measured as the present value of the expected future payments.

5.1.1 The liability for outstanding claims will need to be measured as the present value of expected future payments. This measurement approach is based on the view that the liability for outstanding claims ought to reflect the amount which, if set aside as at the reporting date, would accumulate so as to enable the insurer to pay the amounts of claims as they fall due. The approach requires estimation of the ultimate cost of settling claims and the discounting of those amounts to a present value.

5.1.2 The longer the expected period from the reporting date to settlement, the more likely it is that the ultimate cost of settlement will be affected by inflationary factors likely to occur during the period to settlement. These factors include changes in specific price levels, for example, trends in average periods of incapacity and in the amounts of court awards for successful claims.

5.1.3 For claims expected to be settled within one year of the reporting date, including those arising under *short-tail business*, the impact of events occurring during the period to settlement may not be material. The liability for such claims may be measured as the amount of the expected future payments, provided that the amount of the expected future payments does not differ materially from the present value of those payments.

Expected Future Payments

5.2 The expected future payments must include amounts in relation to unpaid reported claims, claims incurred but not reported, adjustments in the light of the most recently available information for claims development and claims incurred but not enough reported, and costs that the insurer expects to incur in settling these claims.

5.2.1 It is important to identify the components of the ultimate cost to an insurer of settling claims, for the purposes of determining the claims *expense* for the reporting period and determining the liability for outstanding claims as at the reporting date. These components comprise the policy benefit amounts required to be paid to or on behalf of those insured, and claims settlement costs, that is, costs associated with achieving settlements with those insured. Claims settlement costs include costs that can be associated directly with individual claims, such as legal and other professional fees, and costs that can only be indirectly associated with individual claims, such as claims administration costs.

5.2.2 Policy benefit amounts and direct claims settlement costs incurred during the reporting period are expenses of an insurer, representing the consumption or loss of economic benefits. The liability for outstanding claims includes unpaid policy benefits and direct claims settlement costs relating to claims arising during the reporting period, as they are outgoings that an insurer is presently obliged to meet as a result of past events.

5.2.3 Indirect claims settlement costs incurred during the reporting period are also expenses of an insurer, and include a portion of the indirect claims settlement costs to be paid in the future – that which relates to handling claims arising during the reporting period. The liability for outstanding claims includes these unpaid indirect claims settlement costs.

5.2.4 It is important to ensure that claims are recognised as expenses and liabilities in the correct reporting period. Claims arise from events covered by policies of insurance that occur during the period of the policies. Some events will occur and give rise to claims that are reported to the insurer and settled within the same reporting period. Other reported claims may be unsettled at the end of a particular reporting period. In addition, there may be events which give rise to claims which, at the end of a reporting period, have yet to be reported to the insurer. The latter are termed claims incurred but not reported (claims IBNR).

5.2.5 Claims arising from events that occur during a reporting period and which are settled during that same period are expenses of that period. In addition, a liability and corresponding expense will need to be recognised for reported claims arising from events of the reporting period which have yet to be settled. This involves a process of estimation which includes assessment of individual claims and past claims experience.

5.2.6 When, based on knowledge of the business, claims IBNR are expected to exist, an estimate would need to be made of the amount of the successful claims that will arise therefrom. This involves recognition of a liability and corresponding expense for the reporting period. As in the case of reported but unsettled claims, an estimate of the amount of the current claims incurred but not reported needs to be based on past experience and needs to take into account any changes in circumstances, such as recent catastrophic events and changes in the volume or mix of risks underwritten, that may affect the pattern of unreported claims.

5.2.7 The recognition as expenses and liabilities of the components of the ultimate cost of settling claims also depends on whether they can be measured reliably. Some insurers use formulae, related to the amount of outstanding claims and based on the past experience of the insurer and the industry, to arrive at an estimate of direct and indirect settlement costs. Provided that such formulae are based on a reasonable number of years and are appropriately adjusted to take account of recent developments, they would normally provide a reliable estimate of the settlement costs.

5.2.8 Claims expense and the liability for outstanding claims will need to be adjusted on the basis of information, including re-opened claims, that becomes available after the initial recognition of claims, to enable the insurer to make a more accurate estimate of the ultimate cost of settlement. This is often referred to as claims development. As is the case with other liabilities, the effect of the adjustments to the liability for outstanding claims and to claims expense will need to be recognised when the information becomes available.

5.2.9 Where further information becomes available about reported claims and reveals that the ultimate cost of settling claims has been under-estimated, the upwards adjustment to claims expense and to the liability for outstanding claims is often referred to as claims incurred but not enough reported (claims IBNER). Where further information reveals that the ultimate cost of settling claims has been over-estimated, the adjustment is sometimes referred to as negative claims IBNER.

Discount Rate

5.3 The discount rate or rates to be used in measuring the present value of the expected future payments must be the rate or rates of return that the insurer anticipates it could earn if sufficient funds were available to meet claims liabilities as they fall due. The discount rate or rates must be determined by reference to

market-determined risk-adjusted rates of return appropriate to the insurer.

5.3.1 The rates being earned on existing *assets* may be indicative of market-determined risk-adjusted rates of return appropriate to the insurer. Estimated rates of return would need to reflect the *investment* performance expected to be sustainable for the periods to settlement on the amount of funds sufficient to meet claims liabilities.

5.3.2 The portion of the increase in the liability for outstanding claims from the previous reporting date to the current reporting date which is due to discounted claims not yet settled being one period closer to settlement, ought, conceptually, to be recognised as interest expense of the current reporting period. However, it is considered that the costs of distinguishing this component of the increase in the liability for outstanding claims exceed the benefits that may be gained from its disclosure. Thus, such increase will need to be included in claims expense for the current reporting period.

6 Levies and Charges

6.1 A *liability* for levies and charges must be *recognised* on the acceptance of risks that result in the requirement to pay those levies and charges. An *expense* must be recognised for the levies and charges incurred during the reporting period on the same basis as the recognition of *premium revenue*.

6.1.1 The levies and charges imposed by government authorities in respect of certain classes of insurance business are expenses of the insurer, as discussed in paragraph 4.1.2. The amounts of these levies and charges are often calculated as percentages of the insurer's gross written premium for the reporting period. A liability for unpaid levies and charges will need to be recognised by the insurer on the acceptance during the reporting period from those insured of risks that result in the requirement to pay the levies and charges to the authorities. This liability will need to include an estimate for any levies and charges incurred during the reporting period which have not been formally assessed by the authorities.

6.1.2 As the levies and charges represent a cost to the insurer of earning premium revenue, an expense will need to be recognised for the levies and charges incurred during the reporting period on the same basis as the recognition of premium revenue. The portion of the levies and charges incurred that relates to unearned premium therefore will need to be recognised as a prepayment. The levies and charges expense for the reporting period needs to be disclosed in the financial report when considered to be useful to users.

7 Reinsurance Premiums

7.1 *Premium* ceded to reinsurers must be *recognised* by the direct insurer as outwards reinsurance premium *expense* in accordance with the pattern of reinsurance service. Retrocessions must be recognised by the ceding reinsurer as expenses in accordance with the pattern of reinsurance service.

7.1.1 It is common for insurers to reinsure a portion of the risks that they accept. To secure reinsurance cover, the insurer passes on a portion of the premiums received from those insured. This is usually done using reinsurance treaties under which the direct (or ceding) insurer typically agrees to pass on to a reinsurer a specified portion of the risks and premiums for a particular type of business that it underwrites over a specified period. This is known as treaty reinsurance. Reinsurance arrangements are also made in relation to individual risks (rather than whole classes of business) on an ad hoc basis. This is typically known as facultative reinsurance.

7.1.2 Under reinsurance arrangements, the insurer may cede risk and premium to the reinsurer on a proportional basis. Alternatively, the risk and premium may be ceded on a non-proportional basis, such as for excess of loss reinsurance which typically indemnifies the direct insurer against losses above a specified level on a specified range of business.

7.1.3 The direct insurer will need to account for direct insurance and reinsurance transactions on a gross basis, so that the extent and effectiveness of the reinsurance arrangements are apparent to the users of the financial report, and an indication of the insurer's risk management performance is provided to users. Thus, the gross amount of premiums earned during the reporting period by the direct insurer will need to be recognised as *revenue* because it undertakes to indemnify the full amount of the specified losses of those it has insured, regardless of the reinsurance arrangements. Correspondingly, the direct insurer will need to recognise the gross amount of *claims* expense incurred during the reporting period because it is obliged to meet the full cost of successful claims by those it has insured.

7.1.4 Accordingly, premium ceded to reinsurers (outwards reinsurance premium) will need to be recognised as an expense of the direct insurer on the basis that it is an outgoing incurred in undertaking the business of direct insurance underwriting, and is not to be netted against premium revenue. Reinsurance recoveries received or receivable in respect of the reporting period from a reinsurer will need to be recognised by the direct insurer as revenue, and are not to be netted against claims expense or outwards reinsurance premium expense.

7.1.5 Outwards reinsurance premium expense will need to be recognised in the profit and loss or other operating statement in accordance with the pattern of reinsurance service. For proportional reinsurance, this would normally be consistent with the pattern of risk of the underlying direct insurance policies. For non-proportional reinsurance, the expense would normally be recognised over the period of the reinsurance arrangement.

7.1.6 Frequently, a reinsurer will cede a portion of the risk accepted from a direct insurer to another reinsurer. This is generally referred to as retrocession, with the accepting reinsurer referred to as the retrocessionaire and the premiums ceded in these circumstances referred to as retrocessions.

7.1.7 Retrocessions will need to be recognised by the ceding reinsurer in the same way as a direct insurer recognises outwards reinsurance, that is, as an expense, and claims recovered or recoverable from retrocessionaires in respect of the reporting period will need to be recognised as revenue, for the reasons discussed in paragraphs 7.1.3 and 7.1.4.

7.1.8 Similar treatments for premium accepted and reinsured, and claims and claims recoveries would be required for reinsurers further along the reinsurance chain.

7.2 Inwards reinsurance premium revenue and retrocessions revenue must be recognised by the accepting reinsurer in accordance with the standards set out in paragraphs 4.1, 4.2, 4.3 and 4.4.

7.2.1 From the perspective of the reinsurer, reinsurance premiums accepted are akin to premiums accepted by the direct insurer. The reinsurer will need to recognise premiums ceded to it (inwards reinsurance) as revenue in the same way as the direct insurer treats the acceptance of original premiums as revenue. Correspondingly, the reinsurer will need to recognise claims from insurers in the same way as the direct insurer recognises claims from those it has insured, that is, as an expense.

7.2.2 Premiums accepted by the reinsurer under proportional or non-proportional treaty reinsurance arrangements need to be recognised from the *attachment date*, that is, the date from which the reinsurer bears its proportion of the relevant risks underwritten by the direct insurer. Reinsurers usually use bases of recognition that approximate the dates of bearing the risks. For example, the reinsurer may assume that its acceptance of risks occurs from the middle of the period for which the aggregate ceded premiums are advised by the direct insurer. This approach is acceptable provided that the premiums received or receivable in respect of the reporting period are recognised in that period, whether or not the periodic advice from the direct insurer has been received.

7.2.3 The periodic advices from each direct insurer also include aggregate information relating to the *liability* for outstanding claims. The reinsurer will need to measure its liability for outstanding claims on the basis of this information and its past experience of the claims payments made under reinsurance arrangements. As the factors used by the direct insurers in calculating the advised outstanding claims may vary considerably, reinsurers are not required to include proportional treaty reinsurance business in the disclosures of average inflation and discount rates, and average weighted expected term to settlement (refer to paragraph 11.4).

8 Portfolio Transfers

8.1 Where the responsibility in relation to *claims* on transferred insurance business remains with the transferring insurer, the transfer must be accounted for by the transferring insurer and the accepting insurer as reinsurance business.

8.1.1 Portfolio transfer is a term used to describe the process by which *premiums* and claims are transferred from one insurer to another. Transfers may be completed in a number of ways in relation to claims arising from events that occurred before the transfer. The receiving insurer may take responsibility in relation to all claims under the agreement or treaty that have not yet been paid, or it may take responsibility only in relation to those claims arising from events that occur after the date of transfer.

8.1.2 In relation to the transfer of direct insurance business, while the acquiring insurer agrees to meet the claims of those insured from a particular time, the contractual responsibility of the original direct insurer to meet those claims normally remains. However, in relation to the withdrawal of a reinsurer from a reinsurance treaty arrangement, the contractual responsibility of the reinsurer to the direct insurer in relation to outstanding claims may be passed back to the direct insurer with a return of unearned premium, or may be retained by the withdrawing reinsurer. In the former case, the direct insurer may choose to reinsure the outstanding claims with another reinsurer. This assuming reinsurer would be ceded premium for bearing *liability* in relation to existing outstanding claims.

8.1.3 Where the responsibility in relation to claims on transferred insurance business remains with the transferring insurer:

(a) the transferring insurer will need to recognise the transferred premium *revenue* and the relevant outstanding claims in the same way as other outwards reinsurance business; and

(b) the accepting insurer will need to recognise the premium revenue ceded to it and the relevant outstanding claims in the same way as other inwards reinsurance business.

8.2 Where the responsibility in relation to claims on transferred insurance business passes from the transferring insurer to the accepting insurer, the transfer must be accounted for as a portfolio withdrawal by the transferring insurer and as a portfolio assumption by the accepting insurer.

8.3 A portfolio withdrawal must be accounted for by the transferring insurer by eliminating the liabilities and *assets* connected with the risks transferred. A portfolio assumption must be accounted for by the accepting insurer by recognising the relevant amount of unearned premium revenue and the outstanding claims for which the transferring insurer is no longer responsible.

9 Underwriting Pools and Coinsurance

9.1 Insurance business allocated through underwriting pools and coinsurance arrangements by an *entity* acting as agent must be accounted for by the accepting insurer as direct insurance business.

9.1.1 Direct insurers or reinsurers may form underwriting pools or enter coinsurance arrangements as vehicles for jointly insuring particular risks or types of risks. *Premiums*, *claims* and other *expenses* are usually shared in agreed ratios by insurers involved in these arrangements.

9.1.2 Many underwriting pools and coinsurance arrangements involve the acceptance of risks by an entity acting as an agent for pool members or coinsurers. The entity receives premiums and pays claims and expenses, and allocates shares of the business to each pool member or coinsurer in agreed ratios. As the entity acting as agent is effectively not an insurer, the business allocated to pool members and coinsurers is not reinsurance business. Pool members and coinsurers will need to treat such business allocated to them as direct insurance business.

9.2 Business directly underwritten by a member of an underwriting pool or coinsurance arrangement must be accounted for as direct insurance business and the portion of the risk reinsured by other pool members or coinsurers, determined by reference to the extent of the shares in the pool or arrangement of other pool members or coinsurers, must be accounted for as outwards reinsurance. The pool member's or coinsurer's share of insurance business that other insurers place in the pool or arrangement must be accounted for as inwards reinsurance.

9.2.1 Some underwriting pools and coinsurance arrangements involve members of the pool or coinsurers directly underwriting risks and then passing all of those risks into the pool or arrangement. These risks are then shared among pool members or coinsurers. For this type of underwriting pool or arrangement, this Standard requires an insurer to treat its share of the business that other insurers place with the pool or arrangement as inwards reinsurance, and the business that it writes and passes into the pool or arrangement as direct insurance business which it reinsures to the extent of the shares in the pool or arrangement of the other pool members or coinsurers. This approach results in the insurer's financial report properly reflecting its obligations to those it has directly insured and the substance of the transactions with the pool members or coinsurers.

10 Assets

Investments

10.1 *Investments integral to the reporting entity's general insurance activities* must be measured at *net market values* as at the reporting date. Any changes in the amounts at which such *investments* are measured must be *recognised* as *revenues* or *expenses* in the profit and loss or other operating statement in

the reporting period in which the changes occur. Australian Accounting Standards AAS 4 "Depreciation of Non-Current

Assets" and AAS 10 "Accounting for the Revaluation of Non-Current Assets" do not apply to such investments.

10.1.1 The *assets* of general insurers normally comprise the following major types: investments, operating assets such as fixtures and fittings, accounts receivable, and deferred acquisition costs. Investments are primarily held as a means of generating revenues. Operating assets are those assets used in the day-to-day operations of the business, some of which may also directly generate revenues for the insurer. Accounts receivable would include *premiums*, reinsurance recoveries and other recoveries owed at the reporting date by those insured, agents, brokers or reinsurers. The recognition of acquisition costs as assets is discussed below at paragraphs 10.4.1, 10.4.2, 10.4.3 and 10.5.1.

10.1.2 Investments controlled by an *entity* in the conduct of general insurance activities include investments included in solvency assessments pursuant to legislative requirements and investments available to cover possible adverse results or support anticipated growth in the general insurance activities. Investments controlled by *subsidiaries* of an entity conducting general insurance activities are also included in investments integral to the reporting entity's general insurance activities.

10.1.3 Under the historical cost basis, assets are measured at the amount of their original cost (less, where applicable, accumulated depreciation) or, if lower, at their recoverable amount. Reference to market value is normally made only in the initial determination of the carrying amounts of the assets acquired or in subsequent write-downs to recoverable amount. In many cases, the net market values of assets become far removed from their historical cost amounts. This can be of major concern in relation to assets held as investments integral to the reporting entity's general insurance activities because increments in the net market values of such assets may be relied upon by insurers to meet their *liabilities* for outstanding *claims*, particularly where *long-tail business* is concerned.

10.1.4 An insurer's ability to pay claims and to continue to offer insurance cover to its clients normally depends on the extent of its investments and on its investment performance. The use of net market value as the basis for measuring investments integral to the reporting entity's general insurance activities enables users of the financial report of an insurer to more accurately assess the insurer's past performance and future investment cash flows, and thus its ability to remain in business. This net market value approach is also consistent with the present value measurement approach, using market-related discount rates, for the liability for outstanding claims (refer to paragraphs 5.1 and 5.3).

10.1.5 As a consequence of using net market values for measuring all investments integral to the reporting entity's general insurance activities, AAS 4 does not apply to such investments, because depreciation would be inconsistent with the net market value basis.

10.1.6 Using a net market value basis means that revenues from investments integral to the reporting entity's general insurance activities would include:

(a) unrealised amounts relating to the changes during the reporting period in net market values of investments held as at the reporting date; and

(b) in respect of investments realised during the reporting period, the difference between the carrying amounts of the investments as at the beginning of the reporting period (or when acquired, if acquired after the beginning of the reporting period) and the net market value when realised (that is, the net disposal proceeds); and

(c) amounts such as interest, dividends from post-acquisition profits and property rentals.

10.1.7 The requirement to include, for investments integral to the reporting entity's general insurance activities, all changes in net market values of investments realised during the reporting period in revenues, means that no gain or loss would arise on the disposal of such investments. In concept, such investments would be revalued to net market value immediately prior to their disposal (being equal to the net disposal proceeds), the changes in net market value would be included in revenues, and no gain or loss on disposal would result. Therefore, in applying Australian Accounting Standard AAS 15 "Disclosure of Operating Revenue", proceeds from the sale of such investments would not be included in the determination of the operating result/profit or loss.

10.1.8 For general insurers that are subject to income tax, a provision for deferred income tax will arise from, among other sources, the recognition as revenue of unrealised gains on investments integral to the reporting entity's general insurance activities. Such provisions would need to be accounted for in accordance with Australian Accounting Standard AAS 3 "Accounting for Income Tax (Tax-effect Accounting)".

Land and Buildings

10.2 Land and buildings must be accounted for as investments.

10.2.1 This Standard requires all land and buildings to be classified as investments, whether the buildings are partly or wholly owner-occupied or fully leased. The rationale for this is that all property is normally regarded by an insurer as an investment. Owner-occupied property is therefore not to be accounted for as an operating asset.

Other Assets

10.3 Assets other than investments integral to the reporting entity's general insurance activities must be measured at the lower of cost and recoverable amount, subject to the application of AAS 4 and AAS 10.

10.3.1 In relation to operating assets, accounts receivable and deferred acquisition costs, the historical cost basis of measurement is considered to be appropriate (subject to the application of AAS 4 and AAS 10). Insurers do not normally rely on increments in the net market values of these assets to meet their outstanding claims, and the changes in the net market values of such assets are not generally of significance in assessing the performance of a general insurer.

Acquisition Costs

10.4 Acquisition costs incurred in obtaining and recording policies of insurance must be deferred and recognised as assets where they can be reliably measured and it is probable that they will give rise to premium revenue that will be recognised in subsequent reporting periods.

10.4.1 Acquisition costs are incurred in obtaining and recording policies of insurance. They include commission or brokerage paid to agents or brokers for obtaining business for the insurer, selling and underwriting costs such as advertising and risk assessment, the administrative costs of recording policy information and premium collection costs.

10.4.2 Because such costs are usually incurred at acquisition whilst the pattern of earnings occurs throughout the policy periods, which may extend beyond the reporting date, those acquisition costs which lead to the obtaining of future benefits for the insurer will need to be recognised as assets. The amount of acquisition costs recognised as assets will need to be amortised over the reporting periods expected to benefit from the expenditure.

10.4.3 For an asset to be recognised, it must be probable that the future economic benefits will eventuate, and that it possesses a cost or other value that can be measured reliably. Direct acquisition costs such as commission or brokerage are readily measurable. However, it may be difficult to reliably measure indirect costs which give rise to premium revenue, such as administration costs, because it is difficult to associate them with particular policies of insurance.

Amortisation of Acquisition Costs

10.5 Deferred acquisition costs must be amortised systematically over the reporting periods expected to benefit from the acquisition costs incurred. When the recoverable amount of deferred acquisition costs is below cost, that is, when the sum of the deferred acquisition costs and the present value of both expected future claims and settlement costs, in relation to business written to the reporting date, exceeds related unearned premiums, the deferred acquisition costs must be written down to recoverable amount and the write-down must be recognised as an expense.

10.5.1 The carrying amount of deferred acquisition costs will need to be written down to recoverable amount where this is less than the deferred costs, based on an assessment of the aggregate portfolio of insurance business written by the insurer to the reporting date.

Revenues Receivable

10.6 Claims recoveries receivable from reinsurers and other recoveries receivable must be recognised as assets where the amount to be recovered can be reliably measured. Recoveries receivable must be measured as the present value of the expected future receipts.

10.6.1 Reinsurance and other recoveries receivable satisfy the definition of assets and are usually quantifiable under the terms of reinsurance or direct insurance arrangements. The probability of receiving the recoveries would need to be assessed in the light of prevailing circumstances, including the ability of the debtor to meet its obligations.

10.6.2 Consistent with the approach set out in paragraphs 7.1.3 and 7.1.4, this Standard requires recoveries receivable to be recognised as an asset and not offset against the liability for outstanding claims, subject to any right of set-off as defined in Australian Accounting Standard AAS 23 "Set-off and Extinguishment of Debt". There is no right of set-off of claims due to those insured and recoveries receivable from reinsurers.

10.6.3 For some classes of insurance business, recoveries receivable may not be received for a considerable time. In these circumstances, recoveries receivable will need to be inflated and discounted in the same manner as for the liability for outstanding claims. The same factors considered in paragraphs 5.1.1, 5.1.2, 5.1.3 and 5.3.1 in relation to measuring the liability for outstanding claims are relevant in determining the appropriate carrying amount of recoveries receivable. Recoveries receivable may be measured as the amount of the expected future receipts, provided that the amount of the expected future receipts does not differ materially from the present value of those receipts.

10.6.4 Consistent with the treatment of reinsurance by a direct insurer, claims to be recovered by a reinsurer from retrocessionaires will need to be recognised as an asset where they meet the criteria set out in paragraph 10.6 and not offset against the reinsurer's liability for outstanding claims, which needs to be based on the amounts due to other insurers.

11 Disclosures

11.1 In relation to the balance sheet or statement of financial position, the financial report must disclose the following items, classified into current and non-current categories:

(a) ***investments*** **by class of investment; and**

(b) operating ***assets*** **by class of asset; and**

(c) deferred acquisition costs; and

(d) reinsurance and other recoveries receivable; and

(e) ***liability*** **for outstanding** ***claims*****; and**

(f) unearned ***premiums*****.**

11.2 In relation to the profit and loss or other operating statement, the financial report must disclose:

(a) the following items of ***revenue*** **or** ***expense*** **included in the determination of the operating result/profit or loss before income tax for the reporting period:**

(i) direct premium revenue; and

(ii) inwards reinsurance premium revenue (including retrocessions); and

(iii) reinsurance and other recoveries revenue; and

(iv) investment revenue or expense, and its individual components, including the change in *net market value* of investments held as at the reporting date and of investments realised during the period; and

(v) direct claims expense; and

(vi) reinsurance claims expense; and

(vii) outwards reinsurance premium expense (including retrocessions); and

(viii) acquisition costs expense; and

(b) the amount by which deferred acquisition costs have been written down during the reporting period to recoverable amount due to the insurer experiencing an unprofitable aggregate portfolio of insurance business, and the circumstances surrounding that unprofitable business; and

(c) the underwriting result for the reporting period, determined as the amount obtained by deducting the sum of claims expense, outwards reinsurance premium expense and underwriting expenses from the sum of direct and inwards reinsurance premium revenues and recoveries revenue.

11.2.1 This Standard requires the underwriting result for the reporting period to be disclosed. This disclosure gives an indication of an insurer's underwriting performance, including the extent to which underwriting activities rely on investment revenues for the payment of claims.

11.3 Outwards reinsurance premium expense must be disclosed separately as a deduction from total premium revenue, and reinsurance and other recoveries revenue must be disclosed separately as a deduction from total claims expense.

11.4 In relation to the liability for outstanding claims, the financial report must disclose:

(a) **the undiscounted amount of claims, reconciled to the liability for outstanding claims; and**

(b) **average inflation and discount rates applied for the following periods in measuring the liability for outstanding claims:**

(i) **the succeeding year; and**

(ii) **later than one year from the reporting date; and**

(c) **the average weighted expected term to settlement from the reporting date of the claims included in the liability for outstanding claims;**

except that reinsurers may exclude proportional treaty reinsurance business from the disclosures required by paragraphs 11.4(b) and (c).

11.5 **Subject to paragraph 11.7, *net claims incurred* must be disclosed, showing separately the amount relating to risks borne in the current reporting period and the amount relating to a reassessment of risks borne in all previous reporting periods. For each of current period and prior periods net claims incurred, the following components must be separately disclosed:**

(a) **gross claims incurred – undiscounted; and**

(b) **reinsurance and other recoveries – undiscounted; and**

(c) **discount movements shown separately for parts (a) and (b).**

11.6 **Subject to paragraph 11.7, an explanation must be provided where net claims incurred relating to a reassessment of risks borne in previous reporting periods are material.**

11.7 **Paragraphs 11.5 and 11.6 need not be complied with for inwards reinsurance business.**

11.7.1 The information provided by a direct insurer to a reinsurer may be insufficient to allow the reinsurer to make the claims development disclosures required by paragraph 11.5. On this basis, for inwards reinsurance business, the Standard allows an exemption from the claims development disclosure requirements.

11.8 Segment information must be disclosed in the financial report in accordance with Australian Accounting Standard AAS 16 "Financial Reporting by Segments", with the exception that geographical segments must be determined on the basis of the location of risks insured.

11.8.1 General insurers are required by AAS 16 to provide particular information on industry and geographical segments. The geographical segments are required by this Standard to be determined on the basis of the location of the risks insured, rather than the location where the business is written. This approach would enable better assessment of the insurer's exposure to risk.

12 Comparative Information

12.1 Subject to paragraph 12.2, the financial report must disclose information for the preceding corresponding reporting period which corresponds to the disclosures specified for the current reporting period.

12.2 If the disclosure requirements in paragraphs 11.1, 11.2, 11.3, 11.4, 11.5, 11.6, 11.7 and 11.8 have not previously applied to the *entity*, the information required by paragraph 12.1 need not be disclosed.

13 Transitional Provisions

13.1 Where the superseded Standard did not apply to the *entity* and accounting policies required by this Standard are not already being applied as at the beginning of the reporting period to which this Standard is first applied, they must be applied as at that date. Where this gives rise to initial adjustments which would otherwise be *recognised* in the profit and loss or other operating statement, the net amount of those adjustments, including any adjustments to deferred income tax balances, must, in accordance with Australian Accounting Standard AAS 1 "Profit and Loss or other Operating Statements", be adjusted against retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the reporting period to which this Standard is first applied.

13.2 Any asset revaluation reserve as at the beginning of the first reporting period to which this Standard applies which relates to *investments integral to the reporting entity's general insurance*

***activities* must be transferred directly to retained profits (surplus) or accumulated losses (deficiency) as at the beginning of the first reporting period to which this Standard applies.**

14 Definitions

14.1 In this Standard:

***assets* means future economic benefits controlled by the *entity* as a result of past transactions or other past events**

***attachment date* means, for a direct insurer, the date from which the insurer accepts risk from the insured under an insurance policy or endorsement or, for a reinsurer, the date from which the reinsurer accepts risk from the direct insurer or another reinsurer under a reinsurance arrangement**

***claim* means a demand by any party external to the *reporting entity* for payment by the insurer of a policy benefit on account of an alleged loss resulting from an event or events alleged to be covered by a policy of insurance**

***deposit premium* means the *premium* charged by the insurer at the inception of a policy under which the final premium depends on conditions prevailing over the policy period and so is not determined until the expiry of that period**

economic entity* means a group of entities comprising the *parent entity* and each of its *subsidiaries

***entity* means any legal, administrative, or fiduciary arrangement, organisational structure or other party (including a person) having the capacity to deploy scarce resources in order to achieve objectives**

***expenses* means consumptions or losses of future economic benefits in the form of reductions in *assets* or increases in *liabilities* of the entity, other than those relating to distributions to owners, that result in a decrease in equity during the reporting period**

***general purpose financial report* means a financial report intended to meet the information needs common to users who are unable to command the preparation of reports**

tailored so as to satisfy, specifically, all of their information needs

investment **means an asset held by an entity for the accretion of wealth by way of** ***revenues*** **such as interest, royalties, dividends, rentals and capital appreciation, but does not include operating assets**

investments integral to the reporting entity's general insurance activities **means:**

(a) **in relation to an entity which is not an** ***economic entity*** **-** ***investments*** **controlled by the entity in the conduct of its general insurance activities; and**

(b) **in relation to an economic entity - investments controlled by the entities in the economic entity in the conduct of general insurance activities and investments controlled by subsidiaries of those entities**

liabilities **means future sacrifices of economic benefits that the entity is presently obliged to make to other entities as a result of past transactions or other past events**

long-tail business **means general insurance business under which** ***claims*** **are typically not settled within one year of the occurrence of the events giving rise to those claims**

net claims incurred **means direct claims costs net of reinsurance and other recoveries, and indirect claims settlement costs, determined on a discounted basis**

net market value **means the amount which could be expected to be received from the disposal of an asset in an orderly market after deducting costs expected to be incurred in realising the proceeds of such a disposal**

parent entity **means an entity which controls another entity**

premium **means the amount charged in relation to accepting risk from the insured, but does not include amounts collected on behalf of third parties**

recognised **means reported on, or incorporated in amounts reported on, the face of the profit and loss or other operating statement or of the statement of financial position**

(whether or not further disclosure of the item is made in notes thereto)

reporting entity **means an entity (including an economic entity) in respect of which it is reasonable to expect the existence of users dependent on *general purpose financial reports* for information which will be useful to them for making and evaluating decisions about the allocation of scarce resources**

revenues **means inflows or other enhancements, or savings in outflows, of future economic benefits in the form of increases in assets or reductions in liabilities of the entity, other than those relating to contributions by owners, that result in an increase in equity during the reporting period**

short-tail business **means general insurance business under which claims are typically settled within one year of the occurrence of the events giving rise to those claims**

subsidiary **means an entity which is controlled by a parent entity.**

14.1.1 Guidance as to the definitions of assets, liabilities, revenues and *expenses* is contained in Statement of Accounting Concepts SAC 4 "Definition and Recognition of the Elements of Financial Statements".

CONFORMITY WITH INTERNATIONAL AND NEW ZEALAND ACCOUNTING STANDARDS

Conformity with International Accounting Standards

No corresponding accounting standard has been issued by the International Accounting Standards Committee.

Conformity with New Zealand Accounting Standards

No corresponding accounting standard has been issued by the Institute of Chartered Accountants of New Zealand.

APPENDIX

The following Appendix forms part of the commentary and is provided for illustrative purposes only. It does not attempt to illustrate every possible disclosure that may be appropriate to the circumstances of general insurers or that may be required by this and other Australian Accounting Standards. Other methods of presentation may equally comply with the accounting standards set out in this Standard.

EXTRACTS FROM EXAMPLE FINANCIAL REPORT
FOR A GENERAL INSURER

XYZ General Insurance

Operating Statement
for the reporting period ended 30 June 19X8

	Note	19X8 $'000	19X7 $'000
Premium Revenue	2	57,092	55,254
Outwards Reinsurance Expense		(8,613)	(7,952)
		48,479	47,302
Claims Expense		(46,953)	(43,719)
Reinsurance and Other Recoveries Revenue	4	4,972	4,734
Net Claims Incurred	5	(41,981)	(38,985)
Other Underwriting Expenses	6	(9,994)	(8,792)
UNDERWRITING RESULT		(3,496)	(475)
Investment Revenue	7	16,652	8,945
General and Administration Expenses		(1,262)	(1,115)
OPERATING RESULT BEFORE INCOME TAX		11,894	7,355
Income Tax Expense		(5,381)	(3,395)
OPERATING RESULT AFTER INCOME TAX		6,513	3,960
Retained Surplus at the beginning of the reporting period		11,740	9,280
Total Available for Appropriation		18,253	13,240
Dividends Provided for or Paid		(1,500)	(1,500)
Retained Surplus at the end of the reporting period		16,753	11,740

XYZ General Insurance

Statement of Financial Position
as at 30 June 19X8

	Note	19X8 $'000	19X7 $'000
CURRENT ASSETS			
Cash		100	104
Receivables	8	7,711	10,807
Investments	9	15,246	14,396
Other	10	2,577	2,264
TOTAL CURRENT ASSETS		25,634	27,571
NON-CURRENT ASSETS			
Receivables	11	5,353	4,836
Investments	12	91,703	80,023
Operating Assets		2,508	2,827
Future Income Tax Benefit		185	167
TOTAL NON-CURRENT ASSETS		99,749	87,853
TOTAL ASSETS		125,383	115,424
CURRENT LIABILITIES			
Creditors		2,517	4,276
Employee Entitlements		262	218
Outstanding Claims	13	13,945	13,559
Unearned Premiums		22,834	21,992
Income Tax		1,978	2,162
Proposed Dividends		1,500	1,500
TOTAL CURRENT LIABILITIES		43,036	43,707
NON-CURRENT LIABILITIES			
Employee Entitlements		896	805
Outstanding Claims	13	37,592	35,487
Deferred Income Tax		7,106	3,685
TOTAL NON-CURRENT LIABILITIES		45,594	39,977
TOTAL LIABILITIES		88,630	83,684
NET ASSETS		36,753	31,740
EQUITY			
Contributed Capital		20,000	20,000
Retained Surplus		16,753	11,740
		36,753	31,740

XYZ General Insurance

Statement of Cash Flows
for the reporting period ending 30 June 19X8

	Note	19X8 $'000	19X7 $'000
Cash flow from operating activities			
Premiums received			
Direct		44,932	47,608
Inwards reinsurance		15,974	15,927
Reinsurance premiums paid		(8,650)	(7,500)
Claims paid			
Direct		(42,831)	(45,709)
Inward reinsurance		(1,631)	(7,156)
Reinsurance recoveries received		4,578	6,328
Payments to suppliers and employees		(6,746)	(5,400)
Acquisition costs paid		(4,050)	(3,400)
Levies and charges paid		(2,040)	(1,890)
Dividends received		1,611	1,484
Interest received		4,804	4,177
Rentals received		948	799
Income tax paid		(2,162)	(1,370)
Net cash provided by operating activities	3	4,737	3,898
Cash flows from investing activities			
Proceeds from sale of shares		5,642	866
Proceeds from government securities		7,064	—
Proceeds from other fixed interest securities		3,168	—
Purchase of shares		(3,060)	(3,232)
Purchase of government securities		(10,655)	—
Purchase of other fixed interest securities		(5,400)	—
Net cash used by investing activities		(3,241)	(2,366)
Cash flow from financing activities			
Dividends paid		(1,500)	(1,500)
Net cash used by financing activities		(1,500)	(1,500)
Net increase (decrease) in cash held		(4)	32
Cash at the beginning of the period		104	72
Cash at the end of the period	3	100	104

XYZ General Insurance

Notes to the Financial Statements
for the reporting period ended 30 June 19X8

1. Summary of Significant Accounting Policies

(a) Compliance with Accounting Standards and Other Requirements

The financial statements have been drawn up in accordance with Australian Accounting Standards, Statements of Accounting Concepts and other relevant requirements. The accounting policies adopted are consistent with those of the comparative reporting period.

(b) Premium

Direct and inwards reinsurance premium comprises amounts charged to the policyholder or other insurer, excluding amounts collected on behalf of third parties, principally stamp duties. The earned portion of premiums received and receivable, including unclosed business, is recognised as revenue. Premium is treated as earned from the date of attachment of risk.

The pattern of recognition over the policy or indemnity periods is based on time, which is considered to closely approximate the pattern of risks underwritten. Unearned premium is determined for direct business using the pro-rata method and for inward reinsurance based on the 24ths method.

(c) Outwards Reinsurance

Premium ceded to reinsurers is recognised as an expense in accordance with the pattern of reinsurance service received. Accordingly, a portion of outwards reinsurance premium is treated at the reporting date as a prepayment. Reinsurance recoveries are recognised as revenue for claims incurred. Recoveries receivable are measured as the present value of the expected future receipts, calculated on the same basis as the liability for outstanding claims.

(d) Claims

Claims incurred expense and a liability for outstanding claims are recognised in respect of direct and inwards reinsurance business. The liability covers claims incurred but not yet paid, incurred but not reported claims and the anticipated direct and indirect costs of settling those claims. Claims outstanding are assessed by reviewing individual claim files and estimating unnotified claims and settlement costs using statistics based on past experience and trends.

The liability for outstanding claims is measured as the present value of the expected future payments, reflecting the fact that all the claims do not have to be paid out in the immediate future. The expected future payments are estimated on the basis of the ultimate cost of settling claims, which is affected by factors arising during the period to settlement such as normal inflation and "superimposed inflation". Superimposed inflation refers to factors such as trends in court awards, for example increases in the level and period of compensation for injury. The expected future payments are then discounted to a present value at the reporting date using discount rates based on investment opportunities available to the organisation on the amounts of funds sufficient to meet claims as they become payable. The details of rates applied are included in note 13.

(e) Acquisition Costs

A portion of acquisition costs relating to unearned premium revenue is deferred in recognition that it represents future benefits to the organisation. Deferred acquisition costs are measured at the lower of cost and recoverable amount. A write-down to recoverable amount is recognised where the present value of expected future claims (including settlement costs) in relation to business written to the reporting date exceeds related unearned premiums. Deferred acquisition costs are amortised over the reporting periods expected to benefit from the expenditure.

(f) Fire Brigade and Other Charges

Fire service levies and other charges received or receivable from policyholders are included in premiums. A liability for fire brigade and other charges is recognised on business written to the reporting date, regardless of whether assessments have been issued by the appropriate authority. Levies and charges payable by the organisation are expensed on the same basis as the recognition of premium revenue, with the portion relating to unearned premium being recorded as a prepayment.

(g) Investments

Investments are measured at net market value at the reporting date. Investments include properties owned by the organisation, whether wholly or partly owner-occupied or fully leased. Buildings are not depreciated. Differences between the net market values of investments at the reporting date and their net market values at the previous reporting date (or cost of acquisition, if acquired during the reporting period) are recognised as revenue in the Operating Statement.

	19X8	19X7
2. Premium Revenue	$'000	$'000
Direct	42,118	41,346
Inwards Reinsurance	14,974	13,908
	57,092	55,254

3. Notes to the Statement of Cash Flows

(a) For the purposes of the statement of cash flows, cash includes cash on hand as shown in the Statement of Financial Position.

(b) Reconciliation of Net Cash Provided by Operating Activities to Operating Result after Income Tax

	19X8 $000	19X7 $000
Operating result after income tax	6,513	3,960
Investment revenue - changes in net market values	(9,289)	(2,485)
Depreciation	319	210
Decrease (increase) in receivables	2,579	(1,203)
Increase in other current assets	(313)	(179)
Decrease in creditors	(1,759)	(824)
Increase in employment entitlements	135	208
Increase in outstanding claims	2,491	4,273
Increase in unearned premiums	842	525
Decrease in income tax payable	(184)	(167)
Increase in net deferred income tax	3,403	(420)
Net cash provided by operating activities	4,737	3,898

4. Reinsurance and Other Recoveries Revenue

	19X8 $'000	19X7 $'000
Recoveries from:		
Reinsurers	4,326	4,118
Other	646	616
	4,972	4,734

5. Net Claims Incurred

Current period claims relate to risks borne in the current reporting period. Prior period claims relate to a reassessment of the risks borne in all previous reporting periods.

Direct Business	Current Year $'000	19X8 Prior Years $'000	Total $'000	Current Year $'000	19X7 Prior Years $'000	Total $'000
Gross claims incurred and related expenses - undiscounted	37,351	(931)	36,420	40,645	1,608	42,253
Reinsurance and other recoveries - undiscounted	(4,704)	771	(3,933)	(4,780)	(351)	(5,131)
Net claims incurred - undiscounted	32,647	(160)	32,487	35,865	1,257	37,122
Discount and discount movement - gross claims incurred	(4,647)	9,093	4,446	(3,988)	570	(3,418)
Discount and discount movement - reinsurance and other recoveries	585	(1,375)	(790)	469	(164)	305
Net discount movement	(4,062)	7,718	3,656	(3,519)	406	(3,113)
	28,585	7,558	36,143	32,346	1,663	34,009

5. Net Claims Incurred (continued)

Inwards Reinsurance Business	19X8 Total $'000	19X7 Total $'000
Gross claims incurred and related expenses - undiscounted	4,901	5,993
Reinsurance and other recoveries - undiscounted	(233)	(361)
Net claims incurred - undiscounted	4,668	5,632
Discount and discount movement - gross claims incurred	1,186	(732)
Discount and discount movement - reinsurance and other recoveries	(16)	76
Net discount movement	1,170	(656)
	5,838	4,976
Total		
Direct business	36,143	34,009
Inwards Reinsurance Business	5,838	4,976
Net Claims Incurred	41,981	38,985

Exemption for inward reinsurance business
Inwards reinsurance business is exempted from the disclosures for net claims incurred segregated between current and prior years.

Explanation of material variances
The net claims incurred from prior years for direct business is primarily a result of the discount movement on prior year claims.

In 19X8, the impact of the discount expense (the decrease in the discount caused by the passage of time as the claims move one year closer to settlement) has been compounded by the overall decrease of approximately 1% in discount rates and a decrease in the weighted average term to settlement as a result of a re-estimation of payout patterns for workers' compensation claims.

In 19X7, the discount expense was offset to a large extent by a significant increase of 2.5% in overall discount rates.

6.	**Other Underwriting Expenses**	19X8 $'000	19X7 $'000
	Acquisition Costs	3,831	3,349
	Levies and Charges	2,040	1,990
	Administration Expenses	4,123	3,453
		9,994	8,792

7.	**Investment Revenue**		
	Dividends	1,611	1,484
	Interest	4,804	4,177
	Rentals	948	799
	Changes in Net Market Values		
	Investments held at end of the reporting period	7,810	1,676
	Investments realised during the reporting period	1,479	809
		16,652	8,945

8.	**Receivables (Current)**		
	Premiums Receivable	5,784	8,847
	Provision for Doubtful Debts	(320)	(410)
		5,464	8,437
	Reinsurance and Other Recoveries Receivable	2,447	2,570
	Provision for Doubtful Debts	(200)	(200)
		2,247	2,370
		7,711	10,807

9.	**Investments (Current)** At net market value		
	Shares - Quoted	4,683	5,117
	Government Securities		
	Quoted	5,547	4,014
	Unquoted	1,460	2,392
	Other Fixed Interest Securities	3,556	2,873
		15,246	14,396

10. Other Current Assets

	19X8 $'000	19X7 $'000
Prepayments	1,230	1,136
Deferred Acquisition Costs	1,347	1,128
	2,577	2,264

11. Receivables (Non-Current)

	19X8 $'000	19X7 $'000
Reinsurance and Other Recoveries Receivable	5,853	5,626
Provision for Doubtful Debts	(500)	(790)
	5,353	4,836

12. Investments (Non-Current)

At net market value

	19X8 $'000	19X7 $'000
Shares - Quoted	17,522	18,297
Government Securities		
Quoted	24,280	20,250
Unquoted	9,574	6,995
Other Fixed Interest Securities	21,127	17,781
Land and Buildings	19,200	16,700
	91,703	80,023

13. Outstanding Claims

	19X8 $'000	19X7 $'000
Expected future claims payments (undiscounted)	91,458	94,599
Discount to present value	(39,921)	(45,553)
Liability for Outstanding Claims	51,537	49,046
Current	13,945	13,559
Non-current	37,592	35,487
	51,537	49,046

(a) The weighted average expected term to settlement from the reporting date of the outstanding claims is estimated to be 4 years (19X7 - 4 years and 3 months).

(b) The following average inflation (normal and superimposed) rates and discount rates were used in measuring the liability for outstanding claims:

	19X8	19X7
Claims expected to be paid:		
Not later than one year		
Inflation rate	15.0%	13.0%
Discount rate	13.5%	11.0%
Later than one year		
Inflation rate	13.4%	14.6%
Discount rate	11.7%	13.1%

14. Segment Information

The organisation operates in the general insurance industry, underwriting risks predominantly in Australia. Most classes of general insurance business are written by the organisation, with an emphasis on long-tail classes, both as a direct insurer and as a reinsurer. Policies written are predominantly for one-year terms.

BACKGROUND TO REVISION

This section does not form part of the Standard. It is a summary of the reasons for revising the Standard.

Some general insurers and users of their financial reports considered that the former ten-year net claims development table was too complex and not particularly useful for analysing the financial position and performance of general insurers.

The general insurance industry proposed that the ten-year net claims development table be replaced by requirements to disclose separately the amount of claims incurred relating to risks borne in the current reporting period and risks borne in all previous reporting periods.

The reissue of the Standard follows consideration of responses received on Exposure Draft ED 69 "Financial Reporting of General Insurance Activities: Amendments to the Claims Development Disclosure Requirements of AAS 26/AASB 1023", which was prepared by the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation and by the Australian Accounting Standards Board and released in December 1995.

Responses to ED 69 were basically supportive of the proposals, however a number of key respondents suggested further refinements. These further refinements were selectively exposed in August 1996 to all those who responded to ED 69. There was widespread support for the disclosures proposed in ED 69A "Financial Reporting of General Insurance Activities: Further Proposals to Amend the Claims Development Disclosure Requirements of AAS 26/AASB 1023 following the Issue of ED 69 in December 1995" and this document formed the basis for the revised AAS 26 and AASB 1023. There was little support from respondents for application of the disclosures to proportional inwards reinsurance business and this led to the introduction of an exemption from the claims development disclosures for all types of inwards reinsurance business.

The following table shows the effect of the changed requirements (shown in italics) and the change in presentation to a plain English format.

Table of Comparative Paragraphs

Superseded	New	Comments
1		Citation paragraph deleted
2		Commentary on accounting standards deleted
3	Sections 1 - 2	Application and operative date
4		Standard on general purpose financial reports deleted
5	3.1	
6	1.3.1	
7 - 8	1.4.1 - 1.4.2	
9 - 12		Commentary on users of financial reports of general insurers deleted
13 - 14	1.2.2	
15	14.1	Definitions. Definition of assets transferred from para. 84 *Definitions of liabilities, revenues and expenses added* *Definition of "net claims incurred" added*
	14.1.1	Guidance on definitions of assets, liabilities, revenues and expenses added
16 - 17		Commentary on reporting entity deleted
18 - 21	4.1 - 4.4	Premiums
22 - 24	4.1.1 - 4.1.3	
25	4.2.1	
26		Deleted
27	4.1.4	
28 - 29	4.4.1 - 4.4.2	
30 - 31	4.2.2 - 4.2.3	
32 - 33	4.3.1 - 4.3.2	
34 - 36	5.1 - 5.3	Claims
37 - 45	5.2.1 - 5.2.9	
46 - 48	5.1.1 - 5.1.3	
49 - 50	5.3.1 - 5.3.2	
51	6.1	Levies and Charges
52 - 53	6.1.1 - 6.1.2	
54 - 55	7.1 - 7.2	Reinsurance Premiums
56 - 60	7.1.1 - 7.1.5	
61 - 63	7.2.1 - 7.2.3	
64 - 66	7.1.6 - 7.1.8	
67 - 69	8.1 - 8.3	Portfolio Transfers

70 - 72	8.1.1 - 8.1.3	
Superseded	**New**	**Comments**
73 - 74	9.1 - 9.2	Underwriting Pools and Coinsurance
75 - 76	9.1.1 - 9.1.2	
77	9.2.1	
78 - 83	10.1 - 10.6	Assets
84		Definition of assets included in 14.1. Commentary on assets deleted
85	10.1.1	
86	10.2.1	
87 - 93	10.1.2 - 10.1.8	
94	10.3.1	
95 - 97	10.4.1 - 10.4.3	
98	10.5.1	
99 - 102	10.6.1 - 10.6.4	
103 - 106	11.1 - 11.4	Disclosures *11.4 amended to delete requirement for ten-year Net Claims Development Table*
107	11.5 - 11.7	*Amended to include a requirement for current and prior period claims development disclosures*
	11.7.1	*Commentary on reinsurers added*
108	11.8	
109		*Commentary on ten-year net claims development table deleted*
110	11.2.1	
111	11.8.1	
112	12.1 - 12.2	*Comparative Information amended. Reference to net claims development table deleted*
113	13.1	*Transitional Provisions amended*
114	13.2	
115		Transitional provision deleted
Appendix	Appendix	Statement of Sources and Applications of Funds replaced by Statement of Cash Flows
Note 3	Note 3	Note to Statement of Sources and Applications of Funds replaced by Note to Statement of Cash Flows
Note 4	Note 5	*Claims Expense disclosures replaced by Net Claims Incurred disclosures*
Note 5	Note 4	
Note 14		*Net Claims Development Table deleted*

Note 15	Note 14	