

Compiled Interpretation

Interpretation 1047

Professional Indemnity Claims Liabilities in Medical Defence Organisations

This compiled UIG Interpretation applies to annual reporting periods beginning on or after 1 January 2014. Early application is not permitted. It incorporates relevant amendments made up to and including 20 December 2013.

Prepared on 14 July 2014 by the staff of the Australian Accounting Standards Board.



Australian Government

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COMPILATION DETAILS

UIG Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations* as amended

This compiled Interpretation applies to annual reporting periods beginning on or after 1 January 2014. It takes into account amendments up to and including 20 December 2013 and was prepared on 14 July 2014 by the staff of the Australian Accounting Standards Board (AASB).

This compilation is not a separate Interpretation issued by the AASB. Instead, it is a representation of Interpretation 1047 (November 2004) as amended by other pronouncements, which are listed in the Table below.

Table of Pronouncements

Pronouncement	Month issued	Application date (<i>annual reporting periods ... on or after ...</i>)	Application, saving or transitional provisions
Interpretation 1047	Nov 2004	(<i>beginning</i>) 1 Jan 2005	
AASB 2007-8	Sep 2007	(<i>beginning</i>) 1 Jan 2009	see (a) below
AASB 2007-10	Dec 2007	(<i>beginning</i>) 1 Jan 2009	see (a) below
AASB 2013-9	Dec 2013	Pt B (<i>beginning</i>) 1 Jan 2014	see (b) below

- (a) Entities may elect to apply this Standard to annual reporting periods beginning on or after 1 January 2005 but before 1 January 2009, provided that AASB 101 *Presentation of Financial Statements* (September 2007) is also applied to such periods.
- (b) Early application of Part B of this Standard is not permitted.

Table of Amendments

Paragraph affected	How affected	By ... [paragraph]
5	amended	AASB 2007-10 [118]
6	amended	AASB 2007-10 [118]
10	amended	AASB 2007-8 [7, 8]
13	amended deleted	AASB 2007-8 [8] AASB 2013-9B [37, 38]
22	amended	AASB 2007-8 [6]
25	amended	AASB 2007-8 [6]

Paragraph affected	How affected	By ... [paragraph]
28	amended amended	AASB 2007-8 [6] AASB 2007-10 [118]
30	amended	AASB 2007-10 [118]

INTERPRETATION 1047

UIG Interpretation 1047 was issued in November 2004.

This compiled version of Interpretation 1047 applies to annual reporting periods beginning on or after 1 January 2014. It incorporates relevant amendments contained in other AASB pronouncements up to and including 20 December 2013 (see Compilation Details).

URGENT ISSUES GROUP

INTERPRETATION 1047

PROFESSIONAL INDEMNITY CLAIMS LIABILITIES IN MEDICAL DEFENCE ORGANISATIONS

Interpretation 1047 is set out in paragraphs 1 to 30.

Issue

- 1 Medical Defence Organisations (MDOs) are mutual organisations that accept subscriptions or premiums from their members for professional indemnity cover. The membership rules of MDOs traditionally have included a discretion for the organisation over whether or not to pay claims made by members, which is a key difference from insurance contracts written by registered general insurers. For this reason, MDOs have been considered by the industry to be outside the scope of Accounting Standards dealing with general insurance. However, under legislative changes applying from 1 July 2003, MDOs (or their subsidiaries) are able to offer new or renewal medical indemnity cover only as general insurers, under contracts of insurance. Such contracts are accounted for in accordance with Accounting Standard AASB 1023 *General Insurance Contracts*. Discretionary indemnity still applies to some arrangements entered into prior to 1 July 2003, depending on any revision of the terms offered by an MDO.
- 2 Traditionally, MDOs accepted subscriptions on a claims-incurred basis, which requires the member to have been a member of the MDO at the time the incident (event) occurred in order to be able to report a

claim for indemnity at any time in the future. However, MDOs generally now accept subscriptions or premiums on a claims-made basis, either in addition to or in place of the claims-incurred basis.

- 3 Under the claims-made basis, a member normally is required to report claims for indemnity to the MDO whilst they are a member, in respect of events which have occurred during their claims-made membership period, once the member has become aware of the event. Furthermore, MDOs generally require the member to have also been a member since the period in which the event occurred.
- 4 MDOs may also have offered Extended Reporting Benefits (ERB) indemnity, under which members could pay an exit fee (either upon resignation or over numerous years of membership) and subsequently make claims in relation to incidents that occurred prior to the claimant ceasing to be an active member of the MDO. Similar claims reporting benefits may have been offered by MDOs in relation to the death, disablement or retirement (DDR) of members, with members qualifying for DDR indemnity through death, disablement, purchase upon retirement or satisfying a minimum financial membership period requirement, such as ten or fifteen years' membership. Legislative changes effective 1 July 2004 require MDOs or insurers to provide run-off cover contracts that encompass DDR and similar circumstances, such as not engaging in private medical practice for at least three years and cessation of private medical practice due to maternity. Members' regular premiums include a component to pay for their run-off cover when they become eligible. As the Commonwealth Government will reimburse the claims and costs paid under the run-off cover scheme, a run-off cover support payment is imposed as a tax in relation to the premiums received by the MDO (or insurance subsidiaries) from members.
- 5 There are different views concerning when MDOs should recognise liabilities for claims by members, for example whether claims liabilities should be recognised prior to any formal exercise of discretion to assist a member with a claim (where discretion continues to be relevant) or prior to notification of the claim by the member, as claims incurred but not reported. Concern has been expressed that, in the absence of authoritative guidance, diverse or unacceptable liability recognition practices may continue in the industry. This will undermine the relevance and reliability of general purpose financial statements.
- 6 The issues are:
 - (a) should an MDO recognise a liability for a professional indemnity claim reported to the MDO by a member before, or

only after, the MDO has exercised its discretion (where relevant) in favour of assisting the member with the claim;

- (b) should an MDO recognise a liability for a professional indemnity claim incurred but not yet reported to the MDO (IBNRs) by a member, in relation to each of the following:
 - (i) the claims-incurred basis of indemnity;
 - (ii) extended reporting benefit indemnity, death, disablement or retirement arrangements, and other run-off cover; and
 - (iii) the claims-made basis of indemnity; and
- (c) what disclosures are appropriate in the financial statements?

Consensus

- 7 Subject to paragraph 8, liabilities arising for medical defence organisations in respect of outstanding claims shall be recognised in relation to events that have occurred prior to the end of the reporting period that are alleged to be covered by discretionary medical indemnity arrangements of the entity, in the following cases:**
- (a) **unpaid reported claims;**
 - (b) **incurred but not reported claims arising under claims-incurred indemnity arrangements;**
 - (c) **incurred but not reported claims arising under extended reporting benefit indemnity arrangements, death, disablement or retirement indemnity arrangements, or other run-off cover, in relation to:**
 - (i) **members for whom such arrangements are in effect as at the end of the reporting period; and**
 - (ii) **members expected to qualify in the future for such arrangements as a member of the organisation; and**
 - (d) **incurred but not reported claims arising under claims-made indemnity arrangements which are, in substance, claims-incurred indemnity arrangements.**

- 8** Liabilities arising in respect of outstanding claims shall be recognised when the entity has a present obligation (legal or constructive) as a result of a past event, it is probable that an outflow of resources embodying economic benefits will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.
- 9** The following information shall be disclosed in relation to the determination of the liability for outstanding claims:
- (a) the accounting policies and methods adopted, including the basis of measurement and key assumptions applied; and
 - (b) information about the nature and extent of the underlying indemnity arrangements, including significant terms and conditions that may affect the amount, timing and uncertainty of future cash flows.

Application

- 10** This Interpretation applies to entities that are or include medical defence organisations as follows:
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the *Corporations Act 2001* 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.
- 11** This Interpretation applies to annual reporting periods beginning on or after 1 January 2005.
[Note: For application dates of paragraphs changed or added by an amending pronouncement, see Compilation Details.]
- 12** This Interpretation shall not be applied to annual reporting periods beginning before 1 January 2005.
- 13** [Deleted by the AASB]
- 14** When applicable, this Interpretation supersedes Abstract 47 *Professional Indemnity Claims Liabilities in Medical Defence Organisations*, as issued in June 2002.

- 15 **Abstract 47 remains applicable until superseded by this Interpretation.**

Discussion

- 16 Medical defence organisations (MDOs) previously offered ‘discretionary’ professional indemnity cover to their members, whereas general insurers offer professional indemnity ‘insurance’ cover to policyholders. Both types of entities have issued claims-incurred contracts and claims-made contracts. The view adopted in this Interpretation is that the accounting for these contracts by MDOs and by general insurers should be consistent, since the substance of the contracts is similar. An insurance contract is defined in AASB 1023 as a contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event adversely affects the policyholder. Under the indemnity arrangements addressed in this Interpretation, the MDO formally has the discretion to decide whether to compensate a member if a specified uncertain future event adversely affects the member.
- 17 AASB 1023 addresses the accounting for general insurance contracts, but does not refer in any detail to claims-made insurance policies similar to the claims-made indemnity arrangements of MDOs. AASB 1023 requires the recognition by general insurers of a liability for outstanding claims in relation to unpaid reported claims and claims incurred but not reported. This requirement is reflected in this Interpretation.
- 18 Liabilities arising in respect of outstanding claims are recognised when it is probable that settlement will be required and the liabilities can be measured reliably. Where there are a number of similar claims, the probability that settlement will be required may be determined by considering the class of claims as a whole. Although the probability for any one claim may be small, or unascertainable, it may be probable that an outflow of resources will be required to settle the class of claims as a whole. In that case, a liability (and expense) is recognised in relation to the class of claims where the amount can be measured reliably.
- 19 Claims include requests by members to their MDO for discretionary assistance in relation to adverse events involving them. Claims arise from events alleged to be covered by indemnity arrangements that occur during the period of indemnity, whether or not a formal demand has been made by a party on account of an alleged loss. Some events will occur and give rise to claims that are reported to the MDO 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 MDO, whether or not the member is aware of the event. These claims are termed claims incurred but not reported (claims IBNR). It is necessary to ensure that claims are recognised as liabilities and expenses in the correct reporting period, as discussed in the following paragraphs.

Unpaid Reported Claims

- 20 The view adopted in this Interpretation is that a liability should be recognised by an MDO once a claim has been reported to the MDO by a member. MDOs typically have had a discretion to refuse assistance to a member in relation to a claim, but such action is rare. The members of MDOs have valid expectations that their MDO normally will settle their claims, based either on the terms of the indemnity contracts directly or on the custom or practices of the MDO. Accordingly, any discretion of MDOs to refuse assistance to a member normally is considered not to have substance for financial reporting purposes. Thus, MDOs have at the least a constructive obligation in relation to the claims reported by members. This basis for the identification of liabilities is explained in AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* (paragraph 17). Under this approach, if an MDO subsequently exercises its discretion to reject wholly or partly a reported claim that has been recognised as a liability, then the amount included in the outstanding claims liability for that claim is derecognised to that extent following that decision.

Claims Incurred but not Reported

- 21 The claims IBNR issue is whether an MDO should recognise liabilities for professional indemnity claims that relate to events that have occurred during a member's period of indemnity and prior to the end of the MDO's reporting period, but which have not yet been reported to the MDO by the member. Some of these events will have been reported by injured parties to the MDO's members, whereas other events may not have been reported to the members or even may not yet be apparent to the injured parties. These claims are all referred to as claims incurred but not reported, or claims IBNR.

Claims IBNR under Claims-Incurred Indemnity

- 22 This Interpretation requires MDOs to recognise a liability for claims IBNR arising under claims-incurred indemnity arrangements, based on the view that an MDO has a legal or a constructive obligation to meet

the claims incurred but not reported. This approach is supported on the grounds that the MDO's discretion to refuse assistance to a member (where still relevant) normally is not substantive for financial reporting purposes, as explained in paragraph 20. Furthermore, the identification of the event by the injured party, their reporting the event to the member, and the member's reporting to the MDO, are all independent of the MDO's future actions or conduct of its operations. Therefore, the MDO is presently obliged as at the end of the reporting period to make future claims payments in respect of these claims IBNR as a result of past events, which is an essential characteristic of liabilities.

Claims IBNR under ERB, DDR and Other Run-off Arrangements

- 23 Extended reporting benefits (ERB), death, disablement or retirement (DDR) indemnity arrangements and other run-off cover are not relevant to MDO members who have claims-incurred indemnity, since those members are entitled to report claims relating to events that have occurred during their period of indemnity at any time, including after the end of their membership period. Accordingly, ERB, DDR and other run-off cover are sometimes referred to as a type of claims-made indemnity.
- 24 This Interpretation requires MDOs to recognise a liability for claims IBNR arising under ERB, DDR and other run-off indemnity arrangements where members have qualified for any of those arrangements at some time prior to the end of the reporting period. ERB, DDR and other run-off cover allow a member (or their representative) to report claims arising from events occurring during the indemnity period at any time in the future without further subscription. This is no different from the coverage of claims-incurred indemnity. Accordingly, the same accounting is justified.
- 25 A liability for outstanding claims is also required to be recognised for claims IBNR in relation to members who are expected to qualify in the future for ERB, DDR and other run-off indemnity arrangements as members of the MDO. This approach is based on the view that the obligation to make future claims payments in these circumstances is independent of the MDO's future actions or conduct of its operations. The death or disablement of members is beyond the control of an MDO, and reliable estimates of their incidence may be able to be made. MDOs may also offer continuing reporting benefits upon the resignation or retirement of a member where the member has been a financial member for the minimum qualifying period specified by the MDO, without further subscription. MDOs may have a discretion not to accept membership renewals, however in practice this discretion has been rarely exercised. Accordingly, that discretion is considered not to have substance for financial reporting purposes. Thus, MDOs have a

constructive obligation in these circumstances. Where reliable estimates can be made of members qualifying for ERB, DDR or other run-off cover, a liability is required to be recognised in relation to that cohort of members for events that have occurred to the end of the reporting period and which are expected to result in future claims payments by the MDO.

Claims IBNR under Claims-Made Indemnity

- 26 Under claims-made indemnity, members are required to report claims to an MDO during their membership period. If they cease to be a member of the MDO and have no additional claim reporting rights, then any claims that they report to the MDO after that time are not required to be settled by the MDO, and are not liabilities. AASB 1023 notes that an insurer theoretically cannot have claims IBNR under claims-made insurance contracts.
- 27 However, in some cases, the additional rights of members with claims-made indemnity may be such that the indemnity is effectively the same as claims-incurred indemnity. These additional rights can mean that members are effectively 'locked in' as members of an MDO. This Interpretation requires MDOs to recognise a liability for claims IBNR arising under claims-made indemnity arrangements in such circumstances, because in substance the arrangements represent claims-incurred indemnity. For example, members may have the right to purchase extended reporting benefits upon resignation or retirement (when the member is ineligible for the mandatory run-off cover scheme) for fixed or determinable subscription rates that make it probable that the members will purchase those benefits. However, where a member can only purchase extended reporting benefits upon resignation or retirement from the MDO for fair value at that time, the MDO is not obligated in respect of claims IBNR until the purchase by the member occurs. The determination of fair value would incorporate an assessment of the member's circumstances at that time, including claims history and claims IBNR.

Disclosures

- 28 The purpose of the disclosures required by this Interpretation is to provide users of an MDO's financial statements with information that will enhance their understanding of the basis upon which claims liabilities have been measured and recognised by the MDO. The disclosure requirements are consistent with those in AASB 1023. Various assumptions are required to be made in estimating the future cash flows arising in relation to claims liabilities, such as the incidence of events occurring to the end of the reporting period, the timing of settlement of claims, inflation and discount rates, member retention

rates, and the likelihood of members qualifying for ERB, DDR or other run-off indemnity arrangements. Disclosure of the key assumptions applied by an MDO in measuring its claims liabilities assists users of financial statements in assessing the amount, timing and uncertainty of future cash flows.

- 29 Future cash flows of an MDO are affected by the different types of claims indemnity arrangements offered by the MDO, such as claims-incurred or claims-made indemnity and ERB, DDR and other run-off arrangements. Accordingly, disclosures are required about the nature of the indemnity arrangements, the extent to which they apply in the MDO's business, and their major terms and conditions. For example, where ERB arrangements are material for an MDO, it discloses any membership period requirements and the basis for determining any exit subscription rates (whether at fair value or otherwise) under which members qualify for those arrangements.

Application

- 30 This Interpretation applies to reporting entities that are or include medical defence organisations. It also applies to general purpose financial statements that encompass MDOs. The Interpretation applies to an MDO's own financial statements and to the consolidated financial statements where a group of entities includes an MDO. The Interpretation applies to the discretionary medical indemnity arrangements of the MDO.

REFERENCES

Australia

The Urgent Issues Group discussed Issues Paper 04/3 “Revision of Various UIG Abstracts for 2005” in relation to this Interpretation at meetings on 22 July and 5 October 2004. In developing the superseded Abstract, the UIG discussed Issue Summary 01/11 “Professional Indemnity Claims Liabilities in Medical Defence Organisations” at meetings on 6 December 2001 and 12 February, 19 March, 14 May and 14 June 2002.

Accounting Standard AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*

Accounting Standard AASB 1023 *General Insurance Contracts*

Canada

Accounting Guideline AcG-3 *Financial Reporting by Property and Casualty Insurance Companies*

International Accounting Standards Board

International Financial Reporting Standard IFRS 4 *Insurance Contracts*

United States of America

Statement of Financial Accounting Standards SFAS 60 *Accounting and Reporting by Insurance Enterprises*