



Staff Paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M183)/NZASB September 2021
Topic	Captive insurers	Agenda item	AASB 11.6 NZASB 3.6
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		Decision-making	High
		Project status	Board deliberation

Objective of this paper

1. The objective of this paper is for the AASB and the NZASB to decide whether there is a need to provide an exemption to public sector ‘captive insurers’ from applying AASB 17/PBE IFRS 17 *Insurance Contracts* in their separate financial statements.

Structure of this paper

2. This staff paper is set out in four sections:
 - [Section 1](#) sets out the application (scope) of AASB 1023 *General Insurance Contracts*/PBE IFRS 4 *Insurance Contracts* and AASB 17/PBE IFRS 17 and explains the nature of captive insurers
 - [Section 2](#) sets out the reporting entities and the structure of insurance arrangements in the public sector
 - [Section 3](#) sets out previous proposals and stakeholder feedback
 - [Section 4](#) sets out a recommended approach.
3. Key definitions are identified in this paper in [Appendix A](#).

Summary of staff recommendations

4. Staff are recommending there be no public sector modifications to AASB 17/PBE IFRS 17 relating to identifying entities that should prepare general purpose financial statements.
5. That is, the existing practices that generally apply in Australia and New Zealand for identifying:
 - (a) public sector entities that should prepare general purpose financial statements; and
 - (b) the Tier(s) of accounting requirements that should be applied;
should also be applied to public sector entities conducting insurance activities.
6. Staff expect the issues and reasoning for taking no action to be explained in a Basis for Conclusions.

Section 1: Application requirements

AASB 1023/PBE IFRS 4

7. AASB 1023.1.1 states that:
- 1.1 This Standard applies to:
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
 - (b) general purpose financial statements of each other reporting entity; and
 - (c) financial statements that are, or are held out to be, general purpose financial statements.
8. PBE IFRS 4.D2.1 states that:
- D2.1 This Appendix applies to the general purpose financial statements of entities that issue insurance contracts, other than life insurers as defined in paragraph 12.1 of PBE IFRS 4.
9. These are the ‘normal’ application paragraphs and neither Standard has any specific requirements for identifying reporting entities in relation to accounting for insurance contracts.

AASB 17/PBE IFRS 17

10. Other than scoping out not-for-profit public sector entities (for the time being), AASB 17 has the same scope as AASB 1023 in terms of transactions (and entities). AASB 1057 *Application of Australian Accounting Standards* says:
- 6A AASB 17 *Insurance Contracts* applies to:
- (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
 - (b) general purpose financial statements of each other reporting entity; and
 - (c) financial statements that are, or are held out to be, general purpose financial statements;
- except when the entity is:
- (d) a superannuation entity applying AASB 1056; or
 - (e) a not-for-profit public sector entity.
11. Other than scoping out public sector entities (for the time being), PBE IFRS 17 has the same scope as PBE IFRS 4 in terms of transactions (and entities). PBE IFRS 17¹ says:
- 2.1 This Standard applies to Tier 1 and Tier 2 not-for-profit public benefit entities.²

1 NZ IFRS 17 says: “NZ 2.1 This Standard applies to Tier 1 and Tier 2 for-profit entities.”

2 ‘Not-for-profit public benefit entities’ are reporting entities that are public benefit entities but that are not public sector public benefit entities [XRB A1.5].



Section 2: Reporting entities and the structure of ‘self-insurance’ arrangements in the public sector

12. Across the Australian and New Zealand economies, in practical terms, the vast majority of arrangements that would need to be accounted for as ‘general insurance contracts’ (and are not specifically scoped out)³ would be arrangements entered into by entities established for that purpose. That is, entities applying the insurance Standards typically specialise in insurance activities. This is because:
- (a) in the private sector, an entity issuing general insurance contracts in Australia or New Zealand must be a company that is a registered general insurer and comply with a range of financial market requirements (both financial reporting and prudential requirements); and
 - (b) in the public sector, governments usually create separate specialist structures such as a separate corporation, commission or fund to conduct general insurance activities.
13. Each of these entities would ordinarily be a reporting entity required to prepare general purpose financial statements. However, there are exceptions.

Various arrangements in respect of insurance coverage for governments’ own risks

14. Governments typically identify risks associated with their activities or assets and determine those that they:
- (a) retain (self insure) in whole or in part; or
 - (b) externally insure (or reinsure) in whole or in part with a third-party insurer.

Most commonly, government captive insurers retain most of the risks.

15. In relation to risks retained (self-insured), governments might:
- (a) have various formal and informal risk management arrangements that do not involve creating a separate entity; or
 - (b) create a separate entity that manages risk, which may or may not prepare general purpose financial statements.
16. In relation to risks externally insured, governments might:
- (a) have individual departments and other agencies each arranging their own insurance coverage with third-party insurers; or
 - (b) create a separate entity that centralises the task of arranging insurance coverage with third-party insurers, which may or may not prepare general purpose financial statements.

³ In particular: life insurance contracts are scoped out and addressed in AASB 1038 *Life Insurance Contracts* and PBE IFRS 4 Appendix C *Life Insurance Entities* [AASB 1023.2.2(a)/PBE IFRS 4.D2.2(a)]; and product warranties issued directly by a manufacturer, dealer or retailer are scoped out [AASB 1023.2.2(b)/PBE IFRS 4.D2.2(b)]. [Product warranties issued directly by a manufacturer, dealer or retailer are also scoped out of AASB 17/PBE IFRS 17/NZ IFRS 17.]

17. The following table identifies examples of various types of arrangements relating to self-insured risks.

Government entity	Separate reporting entity?	(Re)insures with 3rd party?
Commonwealth ComCare (own employee risks) – agencies pay premiums based on their risks	Yes – ComCare reports as a stand-alone reporting entity	No
Commonwealth ComCover (own asset risks) – agencies pay premiums based on their risks	No – instead, financial information is presented within Department of Finance reports	No
New Zealand government self-insured risks	No – risk management functions are not separately identified in a separate entity or administrative structure that could report on a stand-alone basis	No
NSW Self Insurance Corporation (SiCorp) – in respect of self-insured risks, each year, NSW Treasury funds expected claims for the forthcoming financial year – any excess is returned to Treasury – any shortfall is met by Treasury	Yes, within iCare’s overall financial report – however, SiCorp addresses an amalgam of self-insured (80%) and third-party ⁴ (20%) risks – the self-insurance components do not report separately	Yes, in part
Victorian Managed Insurance Authority – agencies pay premiums based on their risks	Yes – VMIA reports as a stand-alone reporting entity	Yes, in part
Western Australian RiskCover Fund – agencies pay premiums based on their risks	No – financial information presented within the WA Insurance Commission financial statement disclosure notes	Yes, in part

Private sector ‘captive insurers’

18. In the private sector, so-called ‘captive insurers’ are used by some large corporate entities to serve a similar function as the entities identified in the above table. A captive insurer is ordinarily a wholly-owned entity that provides risk-mitigation services for its parent entity or other entities within a group of related entities.⁵ However, typically, captive insurers in the private sector will reinsure 100% of their risks with third-party insurers. A captive insurer can be a useful subsidiary vehicle to:
- (a) centralise the administration of insurable risks across a complex group of entities; and
 - (b) coordinate, and attain in a cost-beneficial manner, the insurance covers required by a group of entities.

4 Such as home builders’ warranty

5 In a private-sector context, a captive insurer would need to be a registered insurer even though its only clients are related parties. For example, BHP Limited has a wholly-owned insurer BHP Marine & General Insurances Pty Ltd that is a registered general insurer in Australia, which accepts risks from companies within the BHP Group and joint ventures in which BHP is a venturer.



Separate and consolidated financial statements

19. Since private sector captive insurers must be registered insurers, they currently prepare separate financial statements in accordance with AASB 1023/NZ IFRS 4. However, at the consolidated level:
- (a) the transactions between the Group entity and the captive are eliminated; and
 - (b) any reinsurance contracts between the captive and third-party insurers are treated as insurance contracts in which the Group entity is a policyholder.
- In relation to (b), the Insurance Standards do not address accounting by policyholders [AASB 1023/NZ IFRS 4.2.2(g); and AASB 17/NZ IFRS 17.7(g)].
20. [Appendix B](#) shows an example of a captive insurance arrangement in the form of a diagram.

Section 3: Stakeholder feedback

21. The [AASB DP \(2017\)](#)⁶ proposed that public sector captive insurers should be permitted an optional exemption to not apply AASB 17 on the basis that:
- (a) some captive public sector entities do not currently apply insurance accounting to their insurance transactions; and
 - (b) the cost of doing so is likely to be greater than the benefits given the accounting would be reversed on consolidation.
- In the event there is a public sector entity that accepts insurance risk from both related and unrelated parties, under the proposal, it would apply the exemption only to transactions with related parties [AASB DP.BC84].
22. The AASB DP noted that, in the consolidated entity, since insurance risk has not been transferred to a party outside the group, any liabilities in respect of events that are insured by a captive entity would be accounted for under other Standards, such as AASB 137.
23. As noted in [Agenda Paper 8.1](#) for the September 2018 AASB meeting, the responses to the AASB DP proposal were mixed. Of the four respondents who commented on this issue:
- (a) Two respondents considered that captive insurers should be scoped out of AASB 17. One of those respondents explained that this is because the government is simply instituting internal cash transfers.
 - (b) One respondent agreed with providing the optional exemption.
 - (c) One respondent strongly disagreed with the proposals based on a view that it would create complexity for some entities within a group reporting structure that are required to use two different measurement bases. This respondent also considered that:
 - (i) if captive insurers are required to prepare general purpose financial statements, they should apply the appropriate standards, which include AASB 17 for insurance-like arrangements, and not AASB 137; and
 - (ii) if the exemption proceeds, it would probably need to apply only when there is no external insurance risk, not when the insured are both related parties and unrelated parties.

⁶ AASB Discussion paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (AASB DP 2017).



24. The respondent expressing disagreement with the proposals also commented that, if there are no users dependent upon the financial statements of a captive insurer, it is up to the appropriate government to exempt the entity from preparing general purpose financial statements.
25. The NZASB ED (2018)⁷ did not raise the issue of captive insurers and nor did any of the respondents to the ED.
26. In recent stakeholder consultation conducted by staff, it is evident that the reasons for some captive insurers of Australian governments reporting separately while others do not is due to a range of factors, including the following.
 - (a) Various accountability mechanisms and reporting requirements apply across the public sector⁸ and captive insurers either report separately (or not) based on those general requirements.
 - (b) Historical responsibilities for bearing risks have been allocated to the entity, which were accompanied by particular accountability mechanisms and reporting requirements.
 - (c) A deliberate policy has been adopted to impose accountability mechanisms and reporting requirements on a captive insurer, consistent with (for example) having an independent board of directors.
27. Some of the entities that have an independent board of directors or board of management are particularly keen to be able to demonstrate their accountability and to explain the constraints they face and, for example, to help show why levies/premiums are at the levels set. Some consider the fact that their customers are related entities makes it all the more important that they have separate financial reporting.

Section 4: Reporting entity approach

Australian circumstances

28. The AASB has on its work program a project on the 'Public Sector Financial Reporting Framework'. The Financial Reporting Council's Public Sector Working Group is leading that project, which includes the following.
 - (a) Reconsidering which entities should prepare financial statements and the content of those financial statements – the overall aim of the project is to clarify and simplify the financial reporting framework, so that objective criteria determine the entities required to prepare general purpose financial statements.
 - (b) Performing a post-implementation review of AASB 1049 *Whole of Government and General Government Sector Financial Reporting*. A report from an independent contractor is expected to be presented to the FRC by the end of 2021.
29. It is expected that the AASB's Reporting Framework project will take many years to complete and not be finalised prior to the insurance project.
30. Currently, the Treasury office of each jurisdiction typically determines the entities required to prepare general purpose financial statements. Therefore, staff agree with the Australian

⁷ NZASB Exposure Draft *Public Benefit Entity International Financial Reporting Standard 17 Insurance Contracts* (NZASB ED [2018])

⁸ For example, the Australian *Public Governance, Performance and Accountability Act 2013* and the NSW *Government Sector Finance Act 2018*.



stakeholder's comment noted in paragraph 24 that it would be up to the Treasury office whether to exempt a public sector entity from preparing financial statements.

New Zealand circumstances

31. In New Zealand, legislation determines which public sector entities are required to prepare general purpose financial statements. For example, the Public Finance Act 1989 (which applies to the Crown and government departments), the Crown Entities Act 2004 and the Local Government Act 2002. Although ACC and EQC are established by legislation (the Accident Compensation Act 2001 and the Earthquake Commission Act 1993 respectively) their financial reporting obligations are set out in the Crown Entities Act 2004. Both entities are required to prepare annual financial statements (s150) in accordance with generally accepted accounting practice (s154).⁹
32. The reporting requirements for public sector entities are set out in External Reporting Board Standard A1 *Application of the Accounting Standards Framework* (XRB A1). The ACC and EQC apply NZ IFRS in accordance with the criteria in XRB A1.

Staff views

33. Staff note that:
 - (a) issues concerning which entities should prepare separate financial statements, and the accounting requirements of those financial statements, are broad-ranging policy issues that relate to user needs and the wider public accountability framework, which are matters that affect all public sector entities;
 - (b) different jurisdictions currently apply different accountability frameworks and the various captive public sector entities each face a different set of circumstances and challenges, including potentially different user groups; and
 - (c) there are mixed views on the issue (based on stakeholder consultation).
34. Accordingly, staff consider that it would be inappropriate to attempt to limit the application of AASB 17/PBE IFRS 17 or provide an optional exemption to particular types of public sector entities based on whether their customers are related or unrelated. It is already within the remit of the appropriate government to determine whether a particular public sector entity, or set of activities within the government, should be the subject of financial reporting requirements.

Question for Board members

- Q1 Do Board members agree that there should be no specific limitations or exemptions in AASB 17/PBE IFRS 17 relating to captive entities?

⁹ 'Generally accepted accounting practice' is defined in s8 of the Financial Reporting Act 2013 as compliance with applicable financial reporting standards and, if there is no applicable financial reporting standard, an authoritative notice.

Appendix A – Definitions

A1 The following definitions are set out in AASB 1057, Appendix A.

general purpose financial statements	Financial statements that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.
reporting entity	<p>An entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial statements for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.</p> <p>This reporting entity definition is not relevant to:</p> <ul style="list-style-type: none"> (a) for-profit private sector entities that have public accountability and are required by legislation to comply with Australian Accounting Standards; and (b) other for-profit entities that elect to apply the <i>Conceptual Framework for Financial Reporting</i> and the consequential amendments to other pronouncements set out in AASB 2019-1 <i>Amendments to Australian Accounting Standards – References to the Conceptual Framework</i>.

A2 The following definitions are included in XRB A1.

general purpose financial reports (GPFR)	are financial reports that are intended to meet the needs of users who are not in a position to require an entity to prepare reports tailored to their particular information needs.
generally accepted accounting practice	<p>The financial statements of various reporting entities are required by legislation to comply with "generally accepted accounting practice" (GAAP). GAAP comprises:</p> <ul style="list-style-type: none"> (a) accounting standards issued by the XRB, or its sub-Board the New Zealand Accounting Standards Board (NZASB), pursuant to section 12(a) of the Financial Reporting Act 2013; and (b) authoritative notices issued by the XRB or the NZASB, pursuant to section 12(c) of the Financial Reporting Act 2013.

A3 Legislation in New Zealand sets out which entities need to report, including the Financial Reporting Act, Charities Act, and Companies Act. The IASB's definition of 'public accountability' and specific (deeming) paragraphs in XRB A1 are used to identify whether entities should comply with Tier 1, Tier 2, Tier 3 or Tier 4 levels of reporting [XRB A1.3].

Appendix B – Diagram of a captive insurer arrangement

