Australian Government
Australian Accounting Standards Board

XRB | Te Kāwai Ārahi Pūrongo Mōwaho
EXTERNAL REPORTING BOARD

Staff Paper

Project	**Insurance Activities in the Public Sector**	**Meeting**	AASB (M183)/NZASB September 2021
Topic	Measurement of investments backing insurance liabilities	**Agenda item**	AASB 11.4 NZASB 3.4
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Contacts	Angus Thomson athomson@aasb.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@aasb.gov.au	**Project priority**	Medium
		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 public-sector-specific modifications or guidance is needed in AASB 17/PBE IFRS 17 *Insurance Contracts* in respect of the measurement of investments backing insurance liabilities.

Structure of this paper

2. This staff paper is set out in three sections:

   - Section 1 sets out the basis for accounting for investments backing insurance liabilities under AASB 1023 *General Insurance Contracts*/PBE IFRS 4 *Insurance Contracts*
   - Section 2 sets out stakeholder feedback on accounting for investments backing insurance liabilities
   - Section 3 analyses whether any modifications are needed in respect of accounting for investments backing insurance liabilities.

Summary of staff recommendations

3. Staff are recommending there be no public sector modifications to AASB 17/PBE IFRS 17 relating to the measurement of investments backing insurance liabilities. However, staff expect the issues and reasoning for taking no action to be explained in a Basis for Conclusions.

Section 1: Accounting for investments backing insurance liabilities

AASB 1023/PBE IFRS 4

4. When it is feasible under accounting standards to measure an investment that backs insurance liabilities at fair value through profit or loss (FVPL), AASB 1023/PBE IFRS 4 requires an entity to apply FVPL accounting. This includes applying accounting policy choices/designations within accounting standards to use FVPL for:

   (a) financial instruments [AASB 1023/PBE IFRS 4.D.15.2];

   (b) investment property [AASB 1023/PBE IFRS 4.D.15.3]; and

(c) in relation to separate financial statements, investments in subsidiaries, joint ventures and associates [AASB 1023/PBE IFRS 4.D.15.5].

5. The Boards reasoned that FVPL accounting for investments would provide the greatest level of balance sheet and income statement consistency with the measurement of insurance liabilities, which is largely a current value basis.

6. A FVPL approach to measuring investments that back insurance liabilities has been in place since the early 2000s in both jurisdictions,[1] and was carried forward to the extent feasible when IFRS Standards were adopted. The approach has applied in both the private and public sectors.

AASB 17/PBE IFRS 17

7. In respect of private sector entities, the Boards decided that AASB 17/PBE IFRS 17 should not mandate FVPL accounting for investments backing insurance liabilities. This is because, unlike AASB 1023/PBE IFRS 4, IFRS 17 is a global Standard, and asset measurement practices (other than FVPL) may emerge within the insurance industry globally, which Australian and New Zealand insurers should be able to follow.

8. The extent to which private sector Australian and New Zealand insurers might account for investments backing insurance liabilities using a measurement basis other than FVPL is not yet clear. There are a number of contextual factors that might mitigate against any change from current practice. For example:

   (a) many investments would be ‘held for trading’ financial assets and require FVPL accounting in any case;

   (b) insurers typically manage investments primarily on a fair value basis;

   (c) prudential regulators[2] require fair value information about investments; and

   (d) much of the information about investments provided to insurers by custodians and investment managers is readily available in respect of fair values, but not other bases of measurement.

Section 2: Stakeholder feedback

9. In the stakeholder consultation conducted for this project by staff late in 2020 and early in 2021, the following themes emerged.

   (a) Most public sector entities do not determine their own accounting policies, particularly in relation to policies for transactions that are common across the public sector – those policies are determined by the Treasury office of their jurisdiction.

   (b) The established practice is to apply FVPL accounting when feasible and this shows no sign of changing.

   (c) Many public sector entity investments are managed separately by a specialist public sector funds management entity. That funds management entity ordinarily holds assets for trading and applies FVPL accounting. Those funds management entities typically only

1 In Australia, since the 1990s.

2 The Australian Prudential Regulation Authority (APRA) has indicted that this will continue to be the case – in its Discussion Paper *Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework* (November 2020), APRA proposes to clarify its prudential requirements to reflect the expectation that general insurers measure all assets at fair value for the capital base determination [Section 4.7].

supply FVPL information to their unitholders, (regardless of whether the assets are held for trading).

10. Some entities (among those that manage their own investments directly) would prefer that the Boards mandate FVPL accounting to avoid any possible debate over their use of FVPL accounting for investments backing insurance liabilities.

Section 3: Assessment of the need for modifications

11. There is an Australian precedent for mandating the application of policy options to apply fair value measurement for certain public sector entities. AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires the Whole of Government and the General Government Sector for each State, Territory and the Commonwealth to use the fair value options allowed under Australian Accounting Standards to align with the Australian Bureau of Statistics Government Finance Statistics (GFS) manual [AASB 1049.13 to 14]. Because of this requirement to align with GFS, the Treasury office of each State, Territory and the Commonwealth have issued mandates to its public sector entities to also elect the fair value options under Australian Accounting Standards where possible.

12. However, the context is different for the Whole of Government and the General Government Sector, which do not have private sector counterparts. This contrasts with the situation among public sector entities that might be subject to the insurance Standards, many of which have private sector counterparts.

13. Most of the entities that are the subject of this project are not-for-profit entities. The *AASB Not-for-Profit Entity Standard-Setting Framework* sets out factors that might justify not-for-profit-specific Standards, amendments, guidance or examples. Factors drawn from paragraph 30 of that *Framework* that might be relevant to the topic of this paper include:

    (a) Australian-specific legislation is not adequately addressed by the IFRS Standard and there has been, or is likely to be, diversity in practice warranting specific guidance;

    (b) an existing optional treatment in the IFRS Standard is not consistent with Australian-specific legislation, not relevant or inappropriate and should therefore be eliminated;

    (c) differences in the accountability or regulatory framework, governance or financial management differences or alignment with other financial frameworks;

    (d) the IASB's considerations of undue cost or effort for for-profit entities not being valid for entities in the not-for-profit sector; and

    (e) IFRS Standards are not compatible with existing not-for-profit-specific Standards.

14. In practical terms, the existing incentives for public sector entities to apply FVPL accounting are already strong, which might lead the Boards to conclude that:

    (a) there is no need to include a modification in AASB 17/PBE IFRS 17 mandating FVPL accounting; or

    (b) a modification should be included in AASB 17/PBE IFRS 17 mandating FVPL accounting to formalise the practice.

15. The New Zealand entities that are the subject of this project are public benefit entities. The NZASB approach is to commence with any relevant IPSAS under its *Policy Approach to Developing the Suite of PBE Standards*, rather than to modify IFRS Standards. However, this is not relevant to accounting for insurance contracts, with the IPSASB indicating it will not be developing an IPSAS on this topic and will, instead, rely on IFRS 17 when relevant.

16. In broad terms, the general application of FVPL accounting to investments backing insurance liabilities is probably the most useful approach for public sector users of the financial statements. Staff consider that all the relevant entities are likely to voluntarily continue this practice in any case. Accordingly, there is no need for the Boards to carry forward into AASB 17/PBE IFRS 17 the modifications on investment measurement in AASB 1023/PBE IFRS 4.

Question for Board members

Q1 Do Board members agree that there should be no public sector modifications to AASB 17/PBE IFRS 17 relating to the measurement of investments backing insurance liabilities?