

Basis for Conclusions on AASB 2022-9

This Basis for Conclusions accompanies, but is not part of, AASB 17. The Basis for Conclusions was originally published with AASB 2022-9 Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector.

Introduction

- BC1 This Basis for Conclusions summarises the Australian Accounting Standards Board's and the New Zealand Accounting Standards Board's considerations in reaching the conclusions on public sector modifications to AASB 17 *Insurance Contracts* and PBE IFRS 17 *Insurance Contracts*. It sets out the reasons why the Boards developed the modifications, the approach taken to developing those modifications and the bases for the key decisions made. In making decisions, individual Board members gave greater weight to some factors than to others.

Reasons for making public sector modifications

- BC2 AASB 17 and PBE IFRS 17, as first issued in 2017, have a mandatory application date of annual reporting periods beginning on or after 1 January 2023.
- BC3 IFRS 17 *Insurance Contracts*, which is incorporated into AASB 17/PBE IFRS 17, has been developed largely for the for-profit private sector, and to a relevant extent for a mutual entity context [AASB 17.B16/PBE IFRS 17.AG16]. IFRS 17 has not been designed to cater for the public sector context. Accordingly, the AASB and the NZASB undertook a joint project to consider the need for modifications in AASB 17/PBE IFRS 17 to suit the public sector context in Australia and New Zealand.
- BC4 There are important differences between the public sector and private sector contexts that can affect the manner in which IFRS 17 applies.
- BC5 While mutual entities may be not-for-profit entities in the sense that members share in any surpluses, they nonetheless would typically need to build and maintain reserves to remain in business by generating surpluses. Accordingly, the users of financial statements of private sector entities (including mutual entities) when compared with public sector entities can have very different perspectives on the significance of onerous contracts, compensation needed for bearing risk, and the need to hold capital. Key drivers of these different perspectives in the public sector can include monopoly powers, access to government guarantees and taxpayer funding and a focus on public policy objectives.
- BC6 Accordingly, there is a strong conceptual underpinning for having modifications to AASB 17/PBE IFRS 17 that are applicable only to public sector entities.
- BC7 In addition, there may be existing inconsistencies in Australia in the application of Standards as some Australian public sector entities with similar arrangements have been applying AASB 1023 *General Insurance Contracts* and others have been applying AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*. The project is intended to help achieve a greater level of consistency of reporting across the Australian public sector.

Joint project between the AASB and the NZASB

- BC8 In 2020, the AASB and the NZASB decided to work jointly to progress the project on insurance contracts in the public sector with the following background and objectives.¹
- BC9 Both Boards maintain different tiers of reporting, which, among other things, use the 'public accountability' distinction developed by the IASB. Entities that hold assets in a fiduciary capacity for a broad group of outsiders as one of its primary businesses are identified as having public accountability. Both Boards generally regard entities engaged in insurance activities as having public accountability and needing to prepare Tier 1 general purpose financial statements.
- BC10 Some of the public sector entities in Australia that conduct insurance activities have self-identified as for-profit entities – most have self-identified as not-for-profit entities. In principle, Tier 1 for-profit public sector

¹ At the time of undertaking the public sector modification project, the NZASB had already issued PBE IFRS 17 for not-for-profit public benefit entities. However, this Standard was not regarded as applying to arrangements of public sector public benefit entities.

entities apply Australian Accounting Standards incorporating IFRS Standards without modification. The *AASB Not-for-Profit Entity Standard-Setting Framework* notes the Financial Reporting Council's broad strategic direction that the AASB applies the principle of transaction neutrality (modified as necessary) in setting standards for not-for-profit and public sector entities. This Framework notes (emphasis added):

22 IFRS Standards (including Interpretations) are appropriate as a base for the following reasons: ...

- (d) **IFRS Standards can be modified appropriately for NFP-specific issues**, as demonstrated by the International Public Sector Accounting Standards Board (IPSASB) using IFRS Standards as a base for their corresponding Standards, **departing only to the extent appropriate for public sector issues**.

BC11 The following background applies for the NZASB.

(a) The *New Zealand Accounting Standards Framework* notes (emphasis added):

28. The accounting standards applying to the PBE tiers are as follows: ...

- PBE Tier 1: Tier 1 PBE Accounting Requirements – These are the requirements in the accounting standards (referred to as PBE Standards) and applicable authoritative notices.

They comprise International Public Sector Accounting Standards (IPSAS), **modified as appropriate for New Zealand circumstances** (for either public sector or NFP entities), together with additional standards as necessary and applicable authoritative notices.

- (b) Additional Accounting Standards for PBEs include IFRS Accounting Standards for which there is no equivalent IPSAS (for example, PBE IFRS 4) and domestic Accounting Standards.
- (c) In February 2018, the NZASB considered the application of the *Policy Approach to Developing the Suite of PBE Standards* (PBE Policy Approach) and decided to develop PBE IFRS 17. The trigger in the PBE Policy Approach for developing PBE IFRS 17 is the change to an IFRS Standard (IFRS 4 is superseded by IFRS 17) that has been used as the basis for a PBE Standard.
- (d) A further motivation for developing PBE IFRS 17 was to address arrangements that are eligible to apply the insurance approach as permitted under IPSAS 42 *Social Benefits* [PBE IFRS 17.BC5].² (The insurance approach would involve applying IFRS 17 [IPSAS 42.AG19].)

Consistency in financial reporting – within and between jurisdictions

BC12 The proposals in AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (2017) identified as an objective “to achieve greater consistency of financial reporting across the public sector among entities engaging in insurance activities for the benefit of users of that information” [page 6]. While the NZASB has fewer public sector stakeholders with arrangements that might be accounted for as insurance contracts, consistency remains a key issue.

BC13 Although there is no binding agreement in place regarding public sector entities, to the extent feasible the Boards consider it would be desirable to have the same insurance Accounting Standards applying in Australia and New Zealand. This is because, for example, there can be useful benchmarking of financial position and performance of public sector entities between the two jurisdictions. Accordingly, the Boards consider that it is beneficial to have achieved a consistent outcome in the two jurisdictions such that AASB 17 and PBE IFRS 17 contain the same public sector modifications.

BC14 The public sector modifications to AASB 17/PBE IFRS 17 resulted from a wide-ranging due process that included:

- (a) the AASB and NZASB issuing AASB ED 319 *Insurance Contracts in the Public Sector* and NZASB ED 2022-3 *Insurance Contracts in the Public Sector* in March 2022, which had the same technical content;
- (b) the AASB and NZASB issuing a Draft Standard of the amendments to AASB 17/PBE IFRS 17 (and, in the case of the AASB only, AASB 1050 *Administered Items*) in October 2022 for fatal flaw comment;

² IPSAS 42 does not require an entity that meets the criteria to apply the insurance approach – only that the entity is eligible to apply that approach.

- (c) direct stakeholder outreach, including consulting the Public Sector Focus Group, a sub-group of the Transition Resource Group for AASB 17 *Insurance Contracts*, which includes members from both jurisdictions;
- (d) the AASB issuing Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* in 2017; and
- (e) the NZASB issuing Exposure Draft ED 2018-7 *PBE IFRS 17 Insurance Contracts* in 2018.

Both Boards have considered respondents' feedback from all of the above consultations.

- BC15 The main focus of this Basis for Conclusions is on the most recent due process. The AASB project summary contains a summary of the project history, including the earlier due process stages of the project.
- BC16 At the time of preparing this Basis for Conclusions, the IPSASB was not considering the development of an insurance Accounting Standard based on IFRS 17.

Sub-grouping of contracts (modifications to paragraphs 14, 16 and 22)

Requirements under (superseded) AASB 1023/PBE IFRS 4

- BC17 The Boards observed that, under AASB 1023/PBE IFRS 4, the liability for remaining coverage is measured as the amount of premium received and/or receivable for the contract period that remains unearned. An insurer is required to apply a Liability Adequacy Test to the carrying amount of the liability for remaining coverage (represented by 'unearned premium') when there is an indication that the liability may be inadequate [AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1)]. The Liability Adequacy Test is applied at a portfolio of contracts level. The Boards noted that, in the case of some public sector entities, there is only one portfolio of contracts and, for those entities, the Liability Adequacy Test is effectively conducted at the whole-of-entity level.
- BC18 The Liability Adequacy Test involves comparing:
- (a) the amount of the liability for remaining coverage recognised on the statement of financial position; with
 - (b) current estimates of the present value of the expected future cash flows relating to future claims arising from existing insurance contracts, plus a risk margin that reflects the inherent uncertainty in the central estimate.

There is a deficiency if (a) is less than (b), in which case an additional 'unexpired risk liability' is recognised for the deficiency,³ which is also recognised immediately as a loss.⁴

Requirements in AASB 17/PBE IFRS 17: Sub-grouping of onerous versus non-onerous contracts

- BC19 AASB 17/PBE IFRS 17 has a much greater emphasis (than AASB 1023/PBE IFRS 4) on identifying onerous contracts and their identification has fundamental impacts on a wide range of accounting outcomes. In particular, at initial recognition, insurance contracts within each portfolio of contracts must be sub-grouped as:
- (a) contracts that are onerous at initial recognition, if any;
 - (b) contracts that have no significant possibility of becoming onerous subsequently, if any; and
 - (c) other (non-onerous) contracts [AASB 17/PBE IFRS 17.16].
- BC20 The Boards noted the following:
- (a) In the private for-profit sector,⁵ the presumption is that insurers issue insurance contracts that are intended to be profitable. In practice, the profit component should act as a 'buffer' to any liability inadequacy and private for-profit sector insurers only occasionally need to test for liability

³ Because a deficiency is not represented by 'unearned premium' in the context of AASB 1023/PBE IFRS 4, the deficiency is separately recognised as an 'unexpired risk liability'.

⁴ An entity with deferred acquisition costs and intangible assets related to insurance contracts would write those off before recognising any remaining deficiency [AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1)]; however, public sector entities do not ordinarily have material deferred acquisition costs or intangible assets.

⁵ As noted in paragraphs BC3 and BC5, this is also generally the case for mutual entities in the private sector.

inadequacy and few entities need to recognise an unexpired risk liability under AASB 1023/PBE IFRS 4.

- (b) In contrast, for most public sector entities applying AASB 1023/PBE IFRS 4, the liability for remaining coverage based on unearned premium is routinely inadequate because they price to break even on a best-estimate basis after taking into account projected investment returns.⁶ That is, the amounts collected in levies/premiums are typically inadequate to meet expected claims. Accordingly, many public sector entities routinely recognise unexpired risk liabilities under AASB 1023/PBE IFRS 4.

The Boards highlighted this as a key distinguishing factor among public sector entities compared with private sector for-profit entities.

BC21 The Boards acknowledged that there are no public-sector-specific modifications to AASB 1023/PBE IFRS 4 based on this key distinguishing factor and that the routine recognition of unexpired risk liabilities, which are typically offset by investment income/gains, is an accepted practice. However, the Boards noted that the AASB 17/PBE IFRS 17 requirement to sub-group contracts based on whether they are onerous versus non-onerous raises further potential accounting complications. In particular, the Boards observed that:

- (a) accounting for a whole portfolio that is onerous is likely to be relatively simple compared with having to identify some (possibly) non-onerous contracts from within a largely onerous portfolio of contracts and account for them separately;
- (b) the level of interest among public sector entities and their users in knowing about profitable sub-groups of contracts that might exist within a wider loss-making portfolio, would be lower than the level of interest among private sector insurers and their users in knowing about loss-making sub-groups of contracts that might exist within a wider profitable portfolio; and
- (c) any interest among users of public sector entities' financial statements in knowing about cross-subsidisation among different classes of policyholders would probably be best met through disclosures (rather than disaggregation that affects recognition and measurement).

Analysis on sub-grouping by onerous versus non-onerous contracts

BC22 The Boards noted that:

- (a) there is no impact on the long-run overall results from taking different approaches to onerous contract units of account and annual cohorts of contracts versus a portfolio unit of account; and
- (b) the main impact of AASB 17/PBE IFRS 17 (relative to AASB 1023/PBE IFRS 4) would be to recognise losses up-front that would otherwise have been recognised over the coverage period. The Boards thought that, since most of the coverage periods are typically one year, the timing of loss recognition would typically not be very different as between AASB 17/PBE IFRS 17 and AASB 1023/PBE IFRS 4.

BC23 The Boards observed that the IASB decided on the requirements in AASB 17/PBE IFRS 17.16 to divide each portfolio of contracts into sub-groups because it regards information about onerous contracts to be useful information about an entity's decisions on pricing contracts and about future cash flows, and wants this information to be reported on a timely basis. The IASB does not want this information to be obscured by offsetting onerous contracts in one group with profitable contracts in another group [IFRS 17.BC119].⁷ The Boards acknowledged that the up-front recognition of losses may be particularly useful in a private sector for-profit context.

BC24 The Boards observed that the impact of AASB 17/PBE IFRS 17 would depend on the nature of the arrangements and how they have been priced and they considered the following examples by way of illustration.

- (a) Worker's compensation insurance contracts are typically priced for the expected actual risks by employer and/or industry. At initial recognition, unless a deliberate decision has been taken to under-price for risk on some contracts and over-price others, ordinarily there would not be onerous and non-onerous sub-groups. Typically, in a public sector context (of break-even pricing after taking into account investment earnings), the portfolio would be expected to comprise only one group of onerous contracts.
- (b) Transport accident insurance contracts are typically priced for the expected actual risks over the whole portfolio. However, the public sector entity might have relatively granular information

⁶ The expected investment returns are ordinarily higher than the discount rates (for time value) applied to measure insurance liabilities.

⁷ The IASB chose groups of contracts as a way of striking a compromise between accounting on an individual contract basis (that would be particularly burdensome) and accounting at the portfolio level of aggregation [IFRS 17.BC123 & BC124].

available about policyholders by risk profile. For example, it may be known that drivers living in particular geographic regions are likely, on average, to give rise to fewer claims and are largely profitable. In such a case there may be onerous and non-onerous groups of contracts based on geographic regions.

- BC25 The Boards noted that AASB 17/PBE IFRS 17.20 provides relief from sub-grouping as onerous versus non-onerous contracts when contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity's practical ability to set a different price or level of benefits for policyholders with different characteristics. Accordingly, in the transport accident case noted above, if the pricing constraints on the entity are the cause of overpricing for low-claim geographic regions, they need not be separately accounted for (as a non-onerous contract group). However, the Boards remained concerned that this relief may be difficult to apply in some cases due to possible ambiguity about where price/levy/benefit decision-making power may reside – with the entity itself, or with the government, for example, the relevant Minister(s).
- BC26 The Boards considered feedback received from stakeholders on sub-grouping of contracts in response to consultation that preceded AASB ED 319/NZASB ED 2022-3.
- BC27 NZASB ED 2018-7 proposed no changes to PBE IFRS 17 in respect of onerous contracts; however, it specifically sought feedback from stakeholders on the requirements in PBE IFRS 17.16. The responses to NZASB ED 2018-7 generally argued for public-sector-specific modifications based on a view that the requirements in PBE IFRS 17.16 are not relevant to the circumstances of public sector insurers in New Zealand. The responses included the following:
- (a) pricing decisions and the resulting onerous contracts will often be a consequence of broader policy decisions of government;
 - (b) the level of aggregation should be the same as the level used for setting levies;
 - (c) while for-profit insurers use granular information to improve profitability and avoid adverse selection by policyholders – this is not relevant to public sector entities, which typically deliberately cross-subsidise across communities;
 - (d) public sector entities do not choose their customers or seek to market their services to particular customers, and risks are usually community rated – accordingly, grouping by onerous/non-onerous arrangements is not relevant.
- BC28 The AASB Discussion Paper (2017) did not specifically request input on this topic and there were no comments from stakeholders on onerous contract groups. However, the topic was raised in stakeholder outreach in Australia and New Zealand conducted in 2020-21 and the following matters were raised.
- (a) In any given year, all contracts in a portfolio are likely to be onerous at initial recognition because the entity relies on investment returns to break even. That is, amounts raised from the levies/premiums charged are inadequate relative to expected claims and there will be a negative insurance service result (negative underwriting result). Accordingly, unless there is sound evidence of a non-onerous group of contracts there would be no disaggregation of the portfolio under AASB 17/PBE IFRS 17.
 - (b) Given that some entities do not price differentially based on policyholder-specific risks, they do not monitor (and may not possess) the information necessary to differentiate between onerous versus non-onerous contracts at initial recognition. For example, some entities are not permitted to hold information on gender or age; however, if available, gender and/or age-related information would enable the entity to identify onerous versus non-onerous contracts.
 - (c) Ordinarily, all of a public sector entity's onerous contracts and non-onerous contracts would be the result of regulatory impediments that are covered by the relief in AASB 17/PBE IFRS 17.20; however, there may be exceptions.
 - (d) The entity takes a long-term view to avoid volatility in premiums/levies – periodically, there may be profitable or onerous contracts that depend on whether, for example, there are deficits to be 'rectified' or surpluses to be 'used up'.
- BC29 The Boards considered a number of possible approaches to addressing the sub-grouping of contracts in a public sector context, including the following.
- (a) All public sector entities should be exempted from AASB 17/PBE IFRS 17.16, on the basis that:
 - (i) timely information on profitability is not relevant to most public sector entities; and
 - (ii) whether public sector entities have portfolios of onerous contracts and sub-groups of onerous contracts;

are not relevant. However, it was acknowledged that information on sub-groups of onerous contracts might be useful in helping to inform users about cross-subsidies between different classes of policyholders.

- (b) Only not-for-profit public sector entities (which is the majority of the relevant entities) should be exempted from AASB 17/PBE IFRS 17.16 for the reasons noted in (a) above.
- (c) All public sector entities should be exempted from AASB 17/PBE IFRS 17.16; however, require disclosure about the nature of the pricing process, including constraints under which an entity operates to cross-subsidise different policyholder cohorts, that can lead to some groups of contracts being onerous. This might provide additional relevant information about the impact of price constraints on each entity. However, it was acknowledged that the additional disclosure could be a burden and may already be readily available from other sources (although the burden might be mitigated by permitting disclosure by cross-reference).
- (d) AASB 17/PBE IFRS 17.16 should apply to public sector entities and guidance should be provided for the public sector context on the manner in which AASB 17/PBE IFRS 17.20 would provide relief from the need to sub-group contracts.

Sub-grouping onerous versus non-onerous contracts – proposals for AASB ED 319/NZASB ED 2022-3

BC30 Based on the above deliberations, the Boards decided to propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16. That is, public sector entities would not be required to sub-group contracts based on whether, at initial recognition, they are:

- (a) onerous;
- (b) have no significant possibility of becoming onerous subsequently, or
- (c) are neither (a) nor (b).

BC31 The Boards consider this exemption is justified for the following reasons.

- (a) The motivation behind the AASB 17/PBE IFRS 17 requirements for information about onerous contracts is useful information about an entity's decisions on pricing contracts, which is not as relevant in the public sector context (relative to the private sector). This is particularly the case for not-for-profit entities. However, even public sector entities that are identified as for-profit entities are typically not able to underwrite risks in the manner available to private sector insurers and, therefore, disaggregating onerous versus non-onerous contracts would not provide useful information for assessing a public sector entity's financial position or performance.
- (b) Public sector entities' information systems are often geared to identifying, at a broad level, high-risk groups of policyholders for strategic and government policy decision-making (for example, to conduct safety campaigns), but not necessarily for identifying separate groups of contracts that give rise to accounting profits or losses. The managements of public sector entities (whether for-profit or not-for-profit) typically do not seek to financially remediate groups of onerous contracts or seek to attract more profitable customers in the same manner as private sector insurers. And, unlike private sector insurers, public sector entities do not ordinarily choose the customers to which they market their products. Accordingly, the costs for public sector entities of disaggregating onerous versus non-onerous groups of contracts would exceed any likely benefits.
- (c) If public sector entities are subject to AASB 17/PBE IFRS 17.16, it would be necessary to explain how the relief in AASB 17/PBE IFRS 17.20 could be applied in a public sector context. That would mean explaining whether the constraints identified in AASB 17/PBE IFRS 17.20 would be constraints imposed only on the entity itself or on the entity and its controlling government, including any relevant Minister(s). In the context of AASB 17/PBE IFRS 17, there is the potential for ambiguity in considering whether:
 - (i) a public sector entity's practical ability to fully price for risks or benefits includes the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits in their capacity as managers of the public sector entity; versus
 - (ii) overall pricing constraints relevant to AASB 17/PBE IFRS 17.20 in respect of government policy more broadly.

- BC32 The Boards also considered that the differences (from the private sector) in the accountability/regulatory, governance and financial management frameworks in general among public sector insurers might also justify an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16.⁸
- BC33 The Boards decided to propose requiring additional disclosures about the nature of the pricing process; including information about the manner in which pricing/benefits are determined, the timeframes for which they are typically determined, and any other relevant constraints under which an entity operates that result in, for example, cross-subsidising different classes of policyholders. The Boards noted that this information may already be publicly available from other sources and that the proposed requirement could be met by cross-reference to relevant authoritative sources available to users of the financial statements on the same terms as the financial statements and at the same time.
- BC34 The Boards acknowledged that, in general, Accounting Standards do not require disclosures around pricing decisions and whether they involve cross-subsidisation among customers. However, the Boards considered proposing this additional disclosure is justified due to the likely significance of the manner in which pricing/benefits are determined on the performance and financial position of public sector entities that bear insurance risk.

Sub-grouping of contracts issued no more than a year apart

- BC35 The Boards observed that portfolios of contracts might include contracts entered into over successive years, and that AASB 17/PBE IFRS 17 requires entities to divide each portfolio of contracts into sub-groups of contracts issued no more than a year apart [AASB 17/PBE IFRS 17.22]. The effect of this requirement is to reveal cases of onerous contracts issued in a particular year without them being obscured by profitable contracts issued in other years. This is mainly an issue when there are contracts with multi-year coverage periods.
- BC36 The Boards noted that, given the monopoly position of many public sector entities, they may phase in increases and decreases to levies/premiums and the extent to which arrangements might be onerous or non-onerous for any given annual cohort of contracts is likely to be less relevant than for a private sector for-profit insurer.
- BC37 The Boards noted that some of the responses to NZASB ED 2018-7 argued for a public sector modification based on the view that the requirement in PBE IFRS 17.22 is not relevant to the circumstances of some public sector insurers that take a long view on pricing. That is, for example, grouping by annual cohort is irrelevant when the insured risk is for highly uncertain and infrequent events where the entity is a monopoly provider (and cannot withdraw from the market).

Analysis of sub-grouping of contracts issued no more than a year apart

- BC38 The Boards noted that the IASB decided to require sub-grouping of contracts issued no more than a year apart because it considers annual grouping by the underwriting year to be important to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis [IFRS 17.BC136].
- BC39 In the context of the Australian and New Zealand public sectors, the Boards observed the following.
- (a) Many public sector entities would only issue contracts with one year of coverage and the difference between the portfolio perspective versus sub-grouping by annual cohort would not be particularly relevant. However, some public sector entities issue contracts that provide multi-year coverage – for example, in respect of domestic building risk coverage arrangements, and there may exist onerous versus non-onerous annual cohorts of contracts.
 - (b) When relevant, the requirement in AASB 17/PBE IFRS 17.22 to identify separate groups of contracts by their year of issue is expected to result in insurers identifying their reporting period as the relevant period. Australian and New Zealand public sector entities have 1 July to 30 June reporting periods and, if they were to comply with AASB 17/PBE IFRS 17.22, would be expected to regard all contracts issued between 1 July and 30 June as being within one group of contracts.
- BC40 The Boards noted that the AASB 17/PBE IFRS 17.22 requirement to determine groups of contracts based on the underwriting year as the unit of account for the liability for remaining coverage could have flow-on consequences for the information that needs to be produced to manage the liability for incurred claims (unless insurers operate two parallel systems). This might be the case for the following reasons.

⁸ In that context, the Boards noted: paragraph 30(g) of the *AASB Not-for-Profit Entity Standard-Setting Framework*; and, to some extent, paragraph 62 of the *New Zealand Accounting Standards Framework*.

- (a) Claims are usually monitored in the context of the related levies/premiums ‘earned’, and premium ‘earning’ under AASB 17/PBE IFRS 17 would be based on the underwriting year used for the liability for remaining coverage under AASB 17/PBE IFRS 17.22.
 - (b) Many public sector entities tend to manage claims on an accident year basis because claims management plays such a prominent role for public sector entities, rather than profitability and underwriting performance.⁹ Under an accident year basis, all claims arising from incidents/accidents within a particular annual period are tracked over time and compared year-on-year with levies/premiums earned in that year for the related contracts, regardless of when those contracts were issued/underwritten.
 - (c) For some public sector entities, the underwriting year and the accident year are the same due to most (or all) contracts being issued with coverage that coincides with the annual reporting period. However, for other public sector entities they are different.
- BC41 The Boards also noted that some insurance risks relate to providing coverage for highly uncertain infrequent events. While the coverage period for contracts for these risks are often only one year, the insured events might be expected to occur many years apart. Accordingly, in years when there are no relevant events, the contracts are highly profitable; while in years when a relevant event occurs, the contracts result in large losses. The Boards observed that:
- (a) from the perspective of a private sector insurer that can choose to engage in these contracts or withdraw from the market, sub-grouping contracts by their year of issue (underwriting year) based on AASB 17/PBE IFRS 17.22 might help track this profit or loss volatility; while
 - (b) from the perspective of a public sector entity that is a monopoly and cannot choose to withdraw from the market, sub-grouping contracts by their year of issue (underwriting year) based on AASB 17/PBE IFRS 17.22 seems much less relevant. For these entities, tracking sub-groups of contracts by the year in which the infrequent events occur (accident year) might be more relevant.

Sub-grouping of contracts issued no more than a year apart – proposals for AASB ED 319/NZASB ED 2022-3

- BC42 Based on the above deliberations, the Boards decided to propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22. The Boards consider this exemption is justified for the following reasons:
- (a) The IASB’s reasoning behind the requirements (annual groupings by issue date are important to ensure that trends in the profitability of a portfolio of contracts are reflected in the financial statements on a timely basis) is generally less crucial (or is unimportant) to public sector entities.
 - (b) The main focus of interest among public sector entities is on claims experience rather than profitability or underwriting performance. Some of those entities would track and manage claims on an accident year basis (not an underwriting year). Others use an underwriting year basis. Some entities track claims on both bases. Managements are likely to continue their existing tracking focus (which they have found to be effective) even if the external reporting requirements changed to groups based on the date when contracts are issued. The costs for some entities of operating a parallel tracking system (based on the underwriting year) to facilitate external reporting would not justify any benefits that might arise from applying AASB 17/NZ IFRS 17.22.
 - (c) The requirement in AASB 17/PBE IFRS 17.57 to compare the liability for remaining coverage¹⁰ with the fulfilment cash flows that relate to remaining coverage when facts and circumstances indicate a group of insurance contracts is onerous could be applied at the portfolio level.¹¹ Given that, for most public sector entities, the liability for remaining coverage is routinely inadequate because their price to break even after taking into account projected investment returns, exempting public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22 would rarely (if ever) result in delayed recognition of onerous contracts.

9 The liability for incurred claims is also the focus of management attention for most public sector entities because their liabilities for incurred claims are usually much larger than their liabilities for remaining coverage.

10 Calculated using the premium allocation approach, which public sector entities may choose to apply under AASB 17/PBE IFRS 17.

11 This is the level at which the Liability Adequacy Test is currently applied under AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1).

Sub-grouping contracts – AASB ED 319/NZASB ED 2022-3 feedback and Board conclusions

- BC43 All respondents to AASB ED 319/NZASB ED 2022-3 who commented on the proposal to exempt public sector entities from sub-grouping between onerous and non-onerous contracts were supportive. Their support was based substantively on the reasons outlined in paragraphs BC31 and BC32. Some respondents particularly noted:
- (a) the monopoly and community-wide nature of many public sector arrangements makes them unsuitable for sub-grouping based on profitability;
 - (b) there is no loss-leading in public sector arrangements that users might find interesting in a commercial context;
 - (c) performance at the portfolio level is generally a more relevant benchmark for public sector entities.
- BC44 All respondents to AASB ED 319/NZASB ED 2022-3 who commented on the proposal to exempt public sector entities from sub-grouping contracts issued no more than a year apart were supportive. Their support was largely based on the reasons provided by the Boards in paragraphs BC40 and BC41.
- BC45 Based on the feedback received from stakeholders and the reasoning applied by the Boards in determining their proposals, the Boards concluded that paragraphs 16 and 22 would be modified so that public sector entities would be exempted from the requirements of these two paragraphs.
- BC46 The Boards noted that the practical impact of these exemptions is that public sector entities would be permitted to have a basic unit of account that is a portfolio (also see the discussion above on groups of contracts issued no more than a year apart). Accordingly, their liabilities for remaining coverage and liabilities for incurred claims would be permitted to be measured for each portfolio as a whole (and, for those entities with only one portfolio, effectively at the whole-of-entity level). The Boards concluded that paragraph 14 would be modified to clarify this point.

Terminology

- BC47 The Boards are conscious that most of the requirements in AASB 17/PBE IFRS 17 make reference to ‘group(s) of contracts’, ‘group(s) of insurance contracts’, and ‘same group’ because it has been drafted for private sector entities that would typically have groups of insurance contracts as their main unit of account. However, public sector entities applying the exemption from sub-grouping would read, for example, the reference in AASB 17/PBE IFRS 17.57 to: “If at any time during the coverage period, facts and circumstances indicate that a **group of insurance contracts** is onerous, ...” as requiring: “If at any time during the coverage period, facts and circumstances indicate that a **portfolio of insurance contracts** is onerous, ...”.
- BC48 The Boards also note that entities are generally expected to read the requirements of AASB 17/PBE IFRS 17 based on their own circumstances. For example, when relevant, entities are required to regard references in AASB 17/PBE IFRS 17 to ‘insurance contracts’ as applying to ‘reinsurance contracts held’ in accordance with AASB 17/PBE IFRS 17.4. Therefore, the Boards concluded that public sector entities should be capable of reading AASB 17/PBE IFRS 17, when relevant, as applying to a portfolio unit of account and decided that no public-sector specific terminology modifications are needed regarding the terms ‘group(s)’ and ‘portfolio(s)’.

Initial recognition when contracts are onerous (modification to paragraph 25)

- BC49 In general, the following applies under AASB 1023/PBE IFRS 4.
- (a) An insurance liability is recognised when premium is received or receivable, because the measurement model simply defers unearned premiums received or receivable on the balance sheet. Premiums might be received before coverage begins, on the day coverage begins or after coverage begins.
 - (b) An unexpired risk liability (onerous contract loss) is recognised based on whether unearned premiums are adequate to meet expected future claims and other relevant costs. Accordingly, loss recognition is dependent on when unearned premiums are recognised on the balance sheet.
- BC50 In contrast, AASB 17/PBE IFRS 17.25 requires a group of insurance contracts an entity issues to be recognised from the earliest of the following:
- (a) the beginning of the coverage period of the group of contracts;

- (b) the date when the first payment from a policyholder in the group becomes due; and
 - (c) for a group of onerous contracts, when the group becomes onerous.
- BC51 The Boards observed that, for the onerous contract trigger in AASB 17/PBE IFRS 17.25(c) to be the earliest date, the insurer would have already accepted the insured's risk before coverage commences and before premiums are due and there are facts and circumstances indicating a group of insurance contracts is onerous.¹² Accordingly, there would need to be up-front loss recognition for any onerous contracts that have been entered into as at the balance date, even though the coverage period may only commence in the subsequent reporting period. This reflects the emphasis in AASB 17/PBE IFRS 17 on the early recognition of onerous contract losses.
- BC52 The Boards observed that the differing circumstances of public sector entities compared with their private sector counterparts would potentially mean that applying AASB 17/PBE IFRS 17.25(c) would have unhelpful accounting consequences.

- (a) Private sector for-profit insurers would typically only by exception knowingly issue onerous contracts [see the perspective in IFRS 17.BC135]. However, most public sector entities routinely issue onerous contracts (because levies/premiums charged are inadequate to cover expected claims).
- (b) Private sector insurers will typically have contracts commencing throughout their reporting period and, therefore, only a relatively small portion of contracts that commence in the following year would typically be enforceable on the entity at any given reporting date. However, some public sector entities have a large portion of their contracts covering periods that coincide with their reporting period. Accordingly, for these entities, all or most of next year's contracts could be enforceable on the entity at each reporting date.

The Boards noted that, for an entity that has enforceable arrangements in the weeks before year end for the following 1 July to 30 June coverage period, applying AASB 17/PBE IFRS 17.25(c) would mean all of the onerous contract losses associated with next year's arrangements would need to be included in the current year's results. While this may not have a major impact year-on-year, the Boards thought it would be a counter-intuitive outcome.

Initial recognition when contracts are onerous – proposals for AASB ED 319/NZASB ED 2022-3

- BC53 Based on the above deliberations, the Boards decided to propose an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.25(c). The Boards considered this exemption is justified for the following reasons.
- (a) The consequences of applying AASB 17/PBE IFRS 17.25(c) to some public sector insurers would be potentially burdensome from a practical viewpoint, since their systems are not currently set up to capture this information, and would lead to information that is not useful for users of the financial statements. This is because, for some public sector entities, on an ongoing basis, the results for the current period would include the onerous contract losses of all or most of the following year's contracts.
 - (b) AASB 17/PBE IFRS 17.25(c) was conceived in the context of private sector for-profit insurers for which, in theory, onerous contracts would be the exception and for which enforceable contracts as at the reporting date that relate to the following year of coverage would be a relatively small proportion of total contracts.

Initial recognition when contracts are onerous – AASB ED 319/NZASB ED 2022-3 feedback and Board conclusions

- BC54 All respondents to AASB ED 319/NZASB ED 2022-3 who commented on the proposal to exempt public sector entities from applying the requirements in AASB 17/PBE IFRS 17.25(c) were supportive. Their support was based substantively on the reasons outlined in paragraph BC53. Some respondents particularly noted that, without the exemption, there could be an adverse impact on the usefulness of the information in financial statements to users, in particular for some workers compensation and public indemnity insurers that have coverage periods aligned to annual reporting periods which would result in the recognition of future year onerous contracts late in the current year.

¹² Based on IFRS 17.BC140 to BC144.

- BC55 Based on the feedback received from stakeholders and the reasoning applied by the Boards in determining their proposals, the Boards concluded that paragraph 25 would be modified so that public sector entities would be required to recognise insurance contracts an entity issues from the earliest of:
- (a) the beginning of the coverage period of the group of contracts; and
 - (b) the date when the first payment from a policyholder in the group becomes due.

Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (modifications to paragraph 34)

- BC56 The Boards noted that contract boundaries and coverage periods under AASB 17/PBE IFRS 17 are crucial for two main reasons:
- (a) identifying the cash flows used to measure liabilities for remaining coverage for in-force arrangements; and
 - (b) determining whether liabilities for remaining coverage for in-force arrangements are eligible to be measured by applying the premium allocation approach.

Contract boundaries and coverage periods of public sector arrangements

- BC57 The Boards noted that, of the public sector arrangements that might fall within the scope of AASB 17/PBE IFRS 17:
- (a) most have ‘stated’ coverage periods of one year; however
 - (b) a minority of arrangements have coverage periods longer than a year, including:
 - (i) for example, arrangements issued in respect of construction and home building risks; and
 - (ii) some reinsurance contracts held.
- BC58 Arrangements between public sector entities and their policyholders ordinarily include an identified period that is presumed to be the coverage period for the purposes of applying AASB 1023/PBE IFRS 4. For example, the stated period of cover for arrangements relating to transport accidents or workers’ compensation would usually be one year and the liabilities and revenues are recognised on this basis.
- BC59 The Boards acknowledged that AASB 17/PBE IFRS 17 does not make this same presumption. Under AASB 17/PBE IFRS 17, the coverage period might be different from the stated period in a contract or arrangement because it is determined, in large part, based on identifying the cash flows that are within the contract boundary. In that context, the Boards noted that cash flows are regarded as being within the boundary of an insurance contract to the extent that the entity can compel the policyholder to pay premiums or the entity has a substantive obligation to provide the policyholder with insurance contract services [AASB 17/PBE IFRS 17.34].
- BC60 The Boards further noted that, an entity’s substantive obligation to provide insurance contract services ends when:
- (a) the entity has the practical ability to reassess the risks of the particular policyholder and, as a result, can set a price or level of benefits that fully reflects those risks [AASB 17/PBE IFRS 17.34(a)]; or
 - (b) both of the following criteria are satisfied:
 - (i) the entity has the practical ability to reassess the risks of the portfolio of insurance contracts that contains the contract and, as a result, can set a price or level of benefits that fully reflects the risk of that portfolio; and
 - (ii) the pricing of the premiums up to the date when the risks are reassessed does not take into account the risks that relate to periods after the reassessment date [AASB 17/PBE IFRS 17.34(b)].
- BC61 The Boards observed the following.
- (a) Criterion (a) relating to individual policyholders, would usually only be applicable for large risks that are individually underwritten. This might, for example, be relevant for large construction risk arrangements entered into by some public sector entities.

- (b) The vast majority of the public sector arrangements that might fall within the scope of AASB 17/PBE IFRS 17 would be priced at a level higher than individual contracts and the criteria in AASB 17/PBE IFRS 17.34(b) would be relevant.
- BC62 The Boards acknowledged that these criteria mean a coverage period could be either longer or shorter than the contractually-stated term, and noted the following examples.
- (a) A contract with a stated term of one year and a \$100 premium is accompanied by an option for a second year of coverage for another \$100 premium. The initial contract would be regarded as a contract for two years of coverage because the insurer does not have the practical ability to fully reprice the risk/benefits for the second year.
 - (b) A contract with a stated term of ten years involves ten annual premiums that the insurer can reset each year to reflect current expected risks/benefits as if that contract were a new contract with the same characteristics as the existing contract issued on that date. Although the insurer is obliged to keep accepting premiums and providing coverage for ten years, each year (up to a possible ten years) would be regarded as a separate coverage period because the insurer has the practical ability to reprice risk/benefits each year.
- BC63 The Boards observed that the criteria in AASB 17/PBE IFRS 17.34 are based on the existence of the insurer's practical ability to fully price for risks/benefits, not the manner in which the insurer might choose to use that ability. Accordingly, the fact that an entity might have the practical ability to fully price for risks/benefits but choose not to use that ability, is not relevant to determining the cash flows within the boundary of an insurance arrangement.
- BC64 In relation to the contract boundary criteria, the Boards noted there may be issues specific to the public sector that were not necessarily considered in the development of IFRS 17, which they might need to specifically address in AASB 17/PBE IFRS 17. In particular, those issues include:
- (a) whether a public sector entity (itself) would be regarded as having the practical ability to set prices and benefits, or whether that power lies more broadly with government, including for example, the relevant Minister(s); and
 - (b) assessing the practical ability to set prices and benefits for a monopoly provider that cannot cease insuring risks by withdrawing from the market.

Practical ability

- BC65 The Boards observed that the levy/premium and benefit decision-making power may reside with the public sector entity itself, or more commonly, resides with the government, for example, the relevant Minister(s) or regulatory pricing supervisor.
- BC66 The Boards noted that a typical public sector model involves:
- (a) benefits largely being determined by reference to regulation or legislation, which would be the product of consultation and review; and
 - (b) levies/premiums being set under a process where the public sector entity makes recommendations to a government regulatory pricing supervisor or Minister for approval. The recommendations may be approved with or without alterations.
- BC67 In these circumstances, literally, the public sector entity (itself) does not have the practical ability to set prices/levies and benefits. A strict interpretation of AASB 17/PBE IFRS 17.34 might mean that the public sector entity's arrangements are open-ended and coverage is virtually perpetual. The Boards noted a flow on consequence of this would be that, under AASB 17/PBE IFRS 17, a public sector entity may need to account for arrangements as if they were issuing very long-term multi-year contracts with the need to estimate cash flows over long forecast periods.
- BC68 The Boards considered the main alternative perspective to be that the entity and its controlling government,¹³ including any relevant Minister(s) or regulatory pricing supervisor, would be regarded collectively as having the practical ability to fully price for risks/benefits. The Boards noted a flow on consequence of this perspective is that, under AASB 17/PBE IFRS 17, a public sector entity's arrangements would be regarded as having contract boundaries based on the timing (often annual) of pricing/benefit reviews by government, rather than being open-ended.
- BC69 The Boards also considered whether the practical ability of a government or public sector entity should be affected by constraints imposed by the political and economic environment. However, they noted that:

¹³ Under existing (or substantively enacted) legislation.

- (a) all entities face political and/or economic constraints of some kind; including, for example, competitive pressures facing private sector insurers; and
 - (b) the practical ability benchmark needs to be applied in the context of AASB 17/B64/PBE IFRS 17.AG64, which says (in part): “An entity has that practical ability in the absence of constraints that prevent the entity from setting the same price it would for a new contract with the same characteristics as the existing contract issued on that date ...”.
- BC70 Accordingly, provided the constraints (political or commercial) apply to new (current) arrangements as well as existing arrangements, they are not regarded as constraints that affect an insurer’s practical ability to fully price for risks/benefits in relation to the existing arrangements. The Boards considered that, instead, the focus should be on the constraints operating under existing and substantively enacted legislation.

Practical ability – proposal for AASB ED 319/NZASB ED 2022-3

- BC71 The Boards decided, for the avoidance of doubt, to propose including guidance in AASB 17/PBE IFRS 17 to the effect that an entity’s practical ability to fully price for risks/benefits also includes the ability of its controlling government, including any relevant Minister(s) and/or regulatory pricing supervisor, under existing and/or substantively enacted legislation to decide on pricing and benefits. The Boards considered this guidance to be supportable for the following reasons.
- (a) The approach seems reasonable given that the government owns and controls the public sector entity and users of the financial statements would know, when relevant, that the ultimate decision-making power lies with the government.
 - (b) Without guidance, entities might need to engage in costly analysis in consultation with their auditors to determine how long-run pricing affects the entity’s practical ability; and inconsistent determinations about ‘practical ability’ might be made by different entities in similar circumstances.

Contract boundaries and coverage periods of public sector arrangements – AASB ED 319/NZASB ED 2022-3 feedback and Board conclusions

- BC72 All respondents to AASB ED 319/NZASB ED 2022-3 who commented on the proposed guidance were supportive. Their support was based substantively on the reasons outlined in paragraphs BC69–BC71.
- BC73 Some respondents also sought additional guidance on the following matters.
- (a) In the public sector there can be situations in which there is an established practice of, or regulatory requirement for, periodic pricing reviews, such as every five years, which may appear to give rise to multi-year coverage periods, but do not in fact remove the practical ability to re-price for risk on a more frequent basis.
 - (b) The meaning of coverage may not be clear when public sector arrangements are essentially statutory and are linked to an underlying insurance contract sold by a commercial insurer. There was a concern about possible confusion over whether the coverage would be regarded as: (i) the same as the underlying insurance contract; or (ii) the period over which claims are expected to be settled.
- BC74 Based on the feedback received from stakeholders and the reasoning applied by the Boards in determining their proposals, the Boards concluded that the proposed guidance on coverage periods and practical ability would be included in AASB 17/PBE IFRS 17. They also concluded that additional guidance should be provided along the following lines.
- (a) Public sector entities would need to consider whether multi-year pricing reviews removed the practical ability to reprice more frequently or whether, in substance, it remains feasible for an entity to re-price for risk on a more frequent basis.
 - (b) In some cases, the period over which claims for benefits might arise under a public sector arrangement would be determinable from the period over which coverage is provided under an insurance contract issued by a private sector insurer. This may be the case when, for example, the public sector entity’s arrangements are funded from a levy on the insurance contracts issued by a private sector insurer and the levy is intended to meet claims for benefits arising from events that occur during the private sector insurance contract coverage periods.
 - (c) In other cases, the period over which claims for benefits might arise under a public sector arrangement may not be determinable from the period over which coverage is provided under an

insurance contract issued by a private sector insurer. This may be the case when, for example, the public sector entity's arrangements are funded from a levy on the insurance contracts issued by a private sector insurer in a particular period (say, 1 July to 30 June) and the levy is intended to meet claims for benefits arising from events in that period, rather than from events during the private sector insurance contract coverage periods (which may be for years commencing on any day of the year).

- BC75 The Boards concluded that this additional guidance is particularly important in providing many public sector entities with a basis for determining when they have an identifiable coverage period, being one of the pre-requisites for applying AASB 17/PBE IFRS 17.

Contract boundaries and coverage periods – impact of monopoly and standing ready over the long-run

- BC76 The Boards observed that:
- (a) the IASB presumably developed IFRS 17 largely with competitive markets in mind [IFRS 17.BC167 & BC168(a)]; and
 - (b) most of the public sector entities that are the subject of the joint AASB/NZASB project are monopolies or near monopolies,¹⁴ and are not able to withdraw from the market(s) they serve without a change of legislation.
- BC77 The Boards also observed that, for a public sector entity, a monopoly position can mean:
- (a) the power to charge above-market levies/premiums; but
 - (b) the responsibility to keep providing insurance services to a community of policyholders in perpetuity, or at least until there is legislative change and/or structural changes to the markets served.
- BC78 The Boards considered whether the responsibility to keep providing insurance services to a community of policyholders might have consequences for the contract boundary; and the coverage period of a public sector entity's arrangements and noted the following possible views.
- (a) The responsibility to keep providing insurance services to a community of policyholders means the contract boundary (and coverage period) extends over multiple years, even though the contractually-stated coverage period might be, for example, one year.
 - (b) An alternative view is that this year's policyholders may or may not continue to be policyholders next year and, accordingly, the responsibility to keep providing insurance services to a community of policyholders over the long term is not relevant to determining coverage periods.

Contract boundaries and coverage periods – monopolies and standing ready over the long-run – proposal for AASB ED 319/NZASB ED 2022-3

- BC79 The Boards decided, for the avoidance of doubt, to propose including guidance in AASB 17/PBE IFRS 17 to the effect that an entity's monopoly status (and the possible inference that there is a legislative obligation to stand-ready to insure future policyholders), of itself, does not affect an entity's practical ability to fully price for risks/benefits and, therefore, would not affect the coverage period of an insurance contract. The Boards consider this guidance to be supportable for the following reasons.
- (a) The monopoly or near monopoly status of public sector entities, coupled with their inability to withdraw from the markets they serve without a change of legislation, is a set of circumstances unique to the public sector. The Boards consider that providing some direction to the affected public sector entities could have a cost-beneficial impact on the application of AASB 17/PBE IFRS 17.34(b)(ii). Accordingly, to the extent guidance is provided that these circumstances do not, of themselves affect an entity's practical ability to fully price for risks/benefits is a 'modification' of IFRS 17, it would be justified under the Boards' frameworks for setting standards for public sector entities.
 - (b) If the monopoly status of a public sector entity was to be regarded as leading to multi-year coverage periods, the entity would need to estimate the number of years of coverage. It seems highly likely that the entity's estimates would prove to be different from the actual number of periods over which participants continue their coverage. If the difference between the originally-determined coverage periods and the actual coverage period is significant, this would result in 'a modification of an

¹⁴ The reference to 'near monopolies' relates mainly to arrangements such as the workers' compensation arrangements that operate in most Australian states, from which 'approved' large employers can be excluded on meeting certain conditions.

insurance contract' under AASB 17/PBE IFRS 17.72 and 73. The existing contract would be derecognised and a new (modified) contract would be recognised. This process has the potential to involve complex and costly tracking of information and it seems unlikely this is a scenario that was contemplated in developing IFRS 17.

- (c) The guidance could be regarded as reasonable under the principles in AASB 17/PBE IFRS 17 given that typically there is turnover among policyholders over successive years, even though it may be limited. For example, in respect of compulsory third party (personal injury) insurance, at the margin, some motor vehicles registered and insured in the current year may be deregistered and uninsured in the following year.
- (d) Without guidance, entities might need to engage in costly analysis in consultation with their auditors to determine how monopoly status affects the entity's practical ability to fully price for risks/benefits; and inconsistent determinations about practical ability to fully price for risks/benefits might be made by different entities in similar circumstances.

Contract boundaries and coverage periods – impact of monopoly and long-run pricing

- BC80 The Boards observed that the pricing of levies/premiums for many public sector entities is based on achieving a break even result over the long-term. Accordingly, in some cases, the actual amounts charged in any given period might be regarded as being the result, in part, of taking into account the risks that relate to periods after the current contract period. In these cases, the criterion in AASB 17/PBE IFRS 17.34(b)(ii) would not be met and the arrangements would be regarded as, for example, involving a multi-year coverage period, even though the contractually-stated coverage period might be one year.
- BC81 The Boards noted that the long-run focus of pricing for many public sector entities might be based solely on past experience and not be influenced by projections of risk relating to future periods. This is likely to be the case for entities providing coverage for risks that evolve only slowly over time in their nature and level of severity. For example, typically this might be expected to apply for workers' compensation and transport accident risks. The long-run focus of pricing for other public sector entities might be based, at least in part, on projections of risk relating to future periods. For example, this might be the case for entities providing coverage for risks that are scheduled to change, and possibly when an entity insures for losses arising from infrequent severe events such as earthquakes.
- BC82 The Boards noted the following possible scenarios:
- (a) A legislative change has been made to significantly increase benefits relating to certain types of injuries that occur after July 20X1. Based on government policy, the entity is gradually increasing levies/premiums over the 20X2 to 20X7 financial years in order to establish reserves to help fund the higher benefits. In this case, the current-year pricing is taking into account risks that relate to periods after the current period. Accordingly, the contract boundary (and coverage period) could be determined as extending from 20X2 until 20X7 and possibly beyond.
 - (b) An entity insures against losses from what is projected to be a one-in-20-year event and charges levies/premiums for one-year contracts each year over a 20-year period that are designed to meet the expected benefits that will need to be paid. In a competitive (private sector) market context, the entity would not be regarded as taking into account the risks that relate to periods after the current contract period because the entity would be viewed as considering the risk of loss for each one-year period. Policyholders could obtain the same coverage from a different insurer in a subsequent year. Accordingly, in the private sector context, the contract boundary (and coverage period) would be determined as being one year. In a monopoly public sector context, the current-year pricing could be regarded as taking into account risks that relate to periods after the current period. Accordingly, the contract boundary (and coverage period) could be determined as being 20 years.
- BC83 The Boards observed that applying AASB 17/PBE IFRS 17 unmodified might have a range of related implications. This could include public sector entities having to estimate the average time that a policyholder is expected to keep participating in the arrangement to determine a coverage period for the purposes of AASB 17/PBE IFRS 17. This could have flow-on consequences for uncertainty around the estimated length of coverage periods and the volatility of cash flows.

Contract boundaries and coverage periods – impact of monopoly and long-run pricing – proposal for AASB ED 319/NZASB ED 2022-3

- BC84 The Boards decided, for the avoidance of doubt, to propose including guidance in AASB 17/PBE IFRS 17 that a public sector entity would not fail to meet the criterion that pricing up to the date when the risks are

reassessed does not take into account risks for periods after the reassessment date simply because it has a deliberate policy of setting prices and benefits based on a medium- to long-term view.

- BC85 The Boards considered the guidance is justified on the basis that public sector entities are more likely than their private sector counterparts to have overriding public policy objectives imposed upon them that would necessitate medium- to long-term pricing and benefits approaches. The Boards were also concerned that, without guidance, entities might need to engage in costly analysis in consultation with their auditors to determine how medium- to long-term pricing and benefits would affect their ability to meet the criterion in AASB 17/PBE IFRS 17.34(b)(ii).
- BC86 The Boards also noted that, in principle, such pricing policies are unlikely to mean that the entity has lost its practical ability to price its arrangements based on risks and benefits for the relevant (current) periods of coverage. They simply mean the entity, together with its controlling government, Minister(s) and/or regulatory pricing supervisor, has chosen to take a longer-term perspective.

Contract boundaries and coverage periods – impact of monopoly and standing ready over the long-run – AASB ED 319/NZASB ED 2022-3 feedback and Board conclusions

- BC87 All respondents to AASB ED 319/NZASB ED 2022-3 who commented on the proposed guidance were supportive. Their support was based substantively on the reasons outlined in paragraphs BC84–BC86.
- BC88 Based on the feedback received from stakeholders and the reasoning applied by the Boards in determining their proposals, the Boards concluded, for the avoidance of doubt, to modify paragraph 34 to include guidance in AASB 17/PBE IFRS 17 to the effect that:
- (a) an entity's monopoly status (and the possible inference that there is a legislative obligation to stand-ready to insure future policyholders), of itself, does not affect an entity's practical ability to fully price for risks/benefits and, therefore, would not affect the coverage period of an insurance contract;
 - (b) a public sector entity would not fail to meet the criterion that pricing up to the date when the risks are reassessed does not take into account risks for periods after the reassessment date simply because it has a deliberate policy of setting prices and benefits based on a medium- to long-term view; and
 - (c) any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits.

Disclosure and long-run pricing (modification to paragraph 34)

- BC89 The Boards considered that, given the impact on public sector entities of medium- to long-term pricing and benefits approaches on the application of the requirements of AASB 17/PBE IFRS 17.34, where those approaches exist, they should be the subject of disclosure. This is because the disclosure could provide useful context for users of the financial statements.
- BC90 The Boards observed that the pricing and benefit approaches of public sector entities might be the subject of transparent public processes and, therefore, adequate disclosures might already be made outside the financial statements.

Disclosure and long-run pricing – proposal for AASB ED 319/NZASB ED 2022-3

- BC91 For the reasons noted immediately above, the Boards decided to propose that, when a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period, it should be required to disclose information about the manner in which pricing/benefits are determined and the timeframes for which they are typically determined. The Boards decided to propose that the disclosure could be made either directly in the notes to the financial statements or by reference to an authoritative source, provided that source is available to users of the financial statements on the same terms as the financial statements and at the same time.

Disclosure and long-run pricing – AASB ED 319/NZASB ED 2022-3 feedback and Board conclusions

- BC92 Those respondents to AASB ED 319/NZASB ED 2022-3 who commented on the proposed disclosure requirement expressed concerns about:
- (a) the potential need to disclose commercially sensitive information;
 - (b) the information being of little value to users; and
 - (c) audit and other related cost ramifications of cross-referencing to information in external materials, which may also need to be reviewed.
- BC93 The Boards consider that information about the manner in which a public sector entity sets its prices and benefits is important because it can be driven by a range of regulations and laws. Accordingly, the Board concluded that a form of disclosure should be required.
- BC94 To address the concerns in the feedback received, the Boards concluded that they should simplify the disclosure to require information on the timeframes for which prices are typically determined and identification of the relevant government regulations or laws under which prices and benefits are set, without the need for any further explanation. The Boards noted the simplified disclosure would be required of all public sector entities applying AASB 17/PBE IFRS 17, not only those taking into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period. The Boards considered that requiring the disclosure of all public sector entities applying AASB 17/PBE IFRS 17 avoids entities having to identify whether their pricing policy would be regarded as involving determining prices and benefits over a period longer than a single coverage period. The Boards also noted that the audit of external materials would be expected to be limited to confirming that the references to government regulations or laws are relevant to determining the manner in which a public sector entity sets its prices and benefits.
- BC95 In concluding on the simpler form of disclosure, the Boards noted that they would expect the information provided to be brief and that it would involve naming the relevant authoritative sources from which users can gain a broad understanding of the processes for setting the entity's insurance contract prices and benefits.

Premium allocation approach (modifications to paragraphs 53 and 69)

- BC96 AASB 17/PBE IFRS 17 includes two approaches to measuring liabilities for remaining coverage:
- (a) a general measurement model that involves discounting fulfilment cash flows and, when relevant, recognising a contractual service margin (deferred profit/loss); and
 - (b) the premium allocation approach, which is a simplified approach and typically much less burdensome to apply than the general measurement model.
- BC97 The Boards noted that eligibility for the premium allocation approach is available on a group-of-contracts basis¹⁵ – that is, an entity might apply the general measurement model to some groups of contracts and the premium allocation approach to other (eligible) groups of contracts. However, they further noted that creating an accounting system capable of implementing the general measurement model, of itself, could involve significant costs, even if it only needs to be applied to some of an entity's arrangements.
- BC98 The Boards observed that, for most public sector entities currently applying AASB 1023/PBE IFRS 4, the liability for incurred claims¹⁶ is typically much larger than the liability for remaining coverage.¹⁷ Nonetheless, the liability for remaining coverage would be expected to be a material amount for many public sector entities with arrangements that would be scoped into AASB 17/PBE IFRS 17. Accordingly, eligibility to apply the premium allocation approach is a key issue for public sector stakeholders.
- BC99 The Boards noted the two bases on which arrangements might be eligible for the premium allocation approach under AASB 17/PBE IFRS 17.53 – at inception:
- (a) the entity reasonably expects the premium allocation approach would produce a measurement of the liability for remaining coverage that would not differ materially from the one that would be produced applying the general measurement model: or

¹⁵ Although the Boards proposed that, effectively, the basic unit of account for public sector entities would be portfolios, in which case the test would apply at the portfolio level.

¹⁶ Generally referred to as the 'outstanding claims liability' under AASB 1023/PBE IFRS 4.

¹⁷ Akin to the 'unearned premium liability' referred to in AASB 1023/PBE IFRS 4.

- (b) the coverage period of each contract in the group is one year or less (determined at that date applying AASB 17/PBE IFRS 17.34).

The Boards observed that the same criteria apply in respect of reinsurance contracts held under AASB 17/PBE IFRS 17.69. They also observed that, when there are contracts with coverage periods longer than a year, criterion (a) would involve creating a system to periodically test for material differences that, of itself, could involve significant costs.

- BC100 In general, the Boards expected that, with the proposed guidance on determining coverage periods, most public sector arrangements that would fall within the scope of AASB 17/PBE IFRS 17 seemed likely to be eligible to apply the premium allocation approach. This was on the basis that, in most cases, the coverage periods are expected to be up to a year in duration for insurance contracts issued and one to three years for reinsurance contracts held.
- BC101 The Board noted that, while some public sector arrangements may still not qualify for the premium allocation approach, in principle it would be reasonable for the general measurement model to apply in these cases.

Premium allocation approach – AASB ED 319/NZASB ED 2022-3 feedback and Board conclusions

- BC102 Some respondents expressed concern that there are public sector arrangements which involve multi-year coverage and may not be eligible to measure their liabilities for remaining coverage applying the premium allocation approach. In particular, they noted that domestic building risks and some construction and engineering risks associated with government infrastructure projects would typically have coverage periods of six or more years. These respondents considered the cost of maintaining the relevant systems for applying the general measurement model would outweigh the potential value of the information generated.
- BC103 The Boards redeliberated on:
 - (a) whether having public sector entities applying the premium allocation approach when a strict application of AASB 17/PBE IFRS 17 would otherwise require the entity to apply the general measurement model would deprive users of useful information;
 - (b) whether any benefits a user may enjoy from having an entity apply the general measurement model instead of the premium allocation approach would justify the additional costs; and
 - (c) the possible extent of costs associated with testing for eligibility for the premium allocation approach even when the general measurement model is not eventually applied.
- BC104 The Boards reflected on the factors relevant to determining whether the general measurement model is suitable for application by public sector entities, including the following.
 - (a) The modifications relating to sub-grouping, which mean a portfolio of contracts is expected to be the main unit of account for public sector entities.
 - (b) The key difference between the general measurement model and premium allocation approach is the contractual service margin that represents unearned profit at contract inception – yet most public sector insurance arrangements are break even or loss making. The contractual service margin accretes interest over time based on the initial recognition date discount rate, whereas, other cash flows are discounted at current rates.
 - (c) For public sector arrangements, there would typically be a loss component under the general measurement model, not a contractual service margin. A loss component would need to be tracked so that changes in cash flows can be allocated systematically between the loss component and the liability for remaining coverage excluding the loss component. However, this would be done on a portfolio basis and, unless, the whole portfolio became profitable, all cash flows would be discounted at current rates.
 - (d) Similar losses would typically still be recognised using the premium allocation approach because the deferred premiums received would need to be compared with an up-to-date assessment of expected cash flows, which is essentially the same as the existing accounting under the AASB 1023/PBE IFRS 4 Liability Adequacy Test. There would typically be only a small likelihood of a whole portfolio being profitable and, therefore, a different pattern of profit and loss recognition emerging under the general measurement model compared with the premium allocation approach.
 - (e) In the atypical case that contracts issued by public sector entities would generate a contractual service margin under the general measurement model, the entity would need to determine a pattern of coverage to allocate the margin, which may be different from the pattern of release from risk and two components of revenue (coverage and release of risk) that need to be tracked. It seems unlikely

that the users of the public sector entities' financial statements would place much value on having two separate patterns for revenue recognition. That is, it seems likely that users would be satisfied with all revenue being recognised based on the passage of time or, if significantly different from the passage of time, based on the pattern of risk, which is the basis that applies under the premium allocation approach.

BC105 The Boards acknowledged that some of the same factors might be relevant to private sector not-for-profit entities; however, they noted there are important distinctions between the public and private sectors that provide a conceptual underpinning for a differential approach between the two sectors, including the following.

- (a) Public sector entities typically seek to break even in conducting insurance activities. Not-for-profit entities (outside the public sector) would typically need to rely on their own resources to maintain solvency, which could involve building (and, when necessary, re-building) reserves, by including a profit margin into the pricing of their services. That is, even though these entities may not seek to make a profit from their activities, they would often still generate reserves that are subsequently re-distributed to customers/members. Accordingly, the recognition of a contractual service margin under the general measurement model is likely to be more relevant in a private sector not-for-profit entity context.
- (b) All private sector entities that issue insurance contracts in Australia and/or New Zealand, including for-profit and not-for-profit private sector entities, would need to be registered as insurers and would face prudential regulation and need to hold risk-weighted regulatory capital and maintain the potential to generate profits to remain solvent. Public sector entities may have their own self-imposed prudential measures, but are not typically compelled to consider profits as a source of capital on an ongoing basis.

BC106 The Boards concluded that paragraphs 53 and 69 would be modified to provide public sector entities with an accounting policy choice to always apply the premium allocation approach to measure liabilities/assets for remaining coverage, without the need to consider the eligibility criteria in AASB 17/PBE IFRS 17 paragraphs 53 and 69 on the basis that:

- (a) the practical differences between the accounting outcomes of applying the premium allocation approach or the general measurement model are expected not to be material in a public sector context in most cases;
- (b) the possible difference between the pattern of recognition of any contractual service margin component of the liability for remaining coverage is unlikely to influence users' decision making in a public sector context;
- (c) the costs of establishing and operating a system to produce information that might be needed in applying the general measurement model to every possible scenario that might arise would probably be considerable, and is unlikely to be used by public sector entities for management purposes; and
- (d) few public sector insurance arrangements are likely to be ineligible for the premium allocation approach, yet the process of justifying eligibility for any contracts with coverage period of more than a year can, of itself, be resource intensive and may need to be periodically repeated.

Risk adjustments

Background

BC107 The Boards noted that:

- (a) under AASB 17/PBE IFRS 17, a risk adjustment is: "the compensation an entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils insurance contracts"; while
- (b) under AASB 1023/PBE IFRS 4, a risk margin relates to the inherent uncertainty in the central estimate of the present value of the expected future payments.

BC108 The Boards noted that the notion of a risk adjustment in AASB 17/PBE IFRS 17 is the compensation the entity would require to make it indifferent between fulfilling a liability of fixed amount and a liability of uncertain amount that has a central estimate equivalent to the fixed liability [AASB 17.B87/PBE IFRS 17.AG87]. It is designed to convey information to users of financial statements about the amount charged by the entity for the uncertainty arising from non-financial risk associated with the amount and timing of cash flows.

- BC109 The Boards noted that AASB 1023/PBE IFRS 4 has no equivalent to the AASB 17/PBE IFRS 17 notion of compensation – instead, the risks are regarded as being inherent in the cash flows.
- BC110 The Boards noted that, under AASB 17/PBE IFRS 17:
- (a) there is a presumption that for-profit private sector entities would need to be compensated for bearing risk and, as risk is released, revenue would be recognised; and
 - (b) public sector entities may have a different perspective and not need to be compensated for bearing risk on the basis that:
 - (i) they are often monopolies and there may be the opportunity to increase premiums/levies to meet future claims; and
 - (ii) they have explicit or implicit government guarantees of financial support.

Industry benchmarks and current practices

- BC111 The Boards noted that neither Standard requires a particular technique to be used to measure risk adjustments; however, currently entities typically use a confidence level (probability of adequacy) approach. The Boards also noted that:
- (a) under AASB 1023/PBE IFRS 4, many entities benchmark to a 75% confidence level (indicating the liability for incurred claims would be adequate to meet actual claims three years in four); and
 - (b) under AASB 17/PBE IFRS 17, when an approach other than the confidence level technique is used, an entity must disclose the technique used and the confidence level corresponding to the results of that technique [AASB 17/PBE IFRS 17.119].
- BC112 The Boards observed that the 75% confidence level benchmark originally arose from a minimum prudential reporting benchmark and has become a widely used reference point in Australia and New Zealand and more broadly in other jurisdictions. Additionally, although other methods (such as cost of capital techniques) may be used to measure risk adjustments, they are often only permitted by regulators subject to achieving a minimum confidence level.
- BC113 The Boards observed that most of the public sector entities applying AASB 1023/PBE IFRS 4 recognise risk margins at a 75% confidence level, or some level close to that benchmark. The Boards also observed that some of the Australian public sector entities applying AASB 137 also recognise risk margins at a 75% confidence level, or some level close to that benchmark. In outreach conducted in 2021-21, some stakeholders indicated that information about uncertainties in the cash flows are important to them, even in measuring provisions (under AASB 137).

Previous public sector proposals and stakeholder feedback

- BC114 The Boards noted that the AASB Discussion Paper (2017) and NZASB ED 2018-7 did not propose any modifications in respect of the risk adjustment requirements in AASB 17/PBE IFRS 17. However, they noted that the AASB Discussion Paper Basis for Conclusions [AASB DP.BC8 to BC13] raised the possibility of a risk adjustment of zero based on a case of a public sector entity with a government guarantee and/or a monopoly position in which it can recoup current and past losses from its controlling government or via future contracts. However, the AASB Discussion Paper put the view that, while the risk adjustment might differ from a for-profit private sector entity, it is unlikely to be nil because:
- (a) the uncertainties associated with outstanding claims cash flows in respect of past transactions, that would be reflected in a risk adjustment are a characteristic of the claims liability; and
 - (b) in respect of the current (usually annual coverage) transactions, the entity is bearing risk for that period and an entity's monopoly position is not relevant [AASB DP.BC10].
- BC115 The Boards noted that, in response to the AASB Discussion Paper (2017) proposals:
- (a) some respondents considered that there would be risk adjustments (above zero) and also noted various considerations, including:
 - (i) disclosures around the techniques used to determine risk adjustments should be required to help ensure transparency;
 - (ii) if the AASB expects risk adjustments to be different from those in the private sector, the implication is that they would be lower (compared with the private sector) and guidance would be needed to help entities make those calculations; and

- (iii) whether it is appropriate to imply that risk adjustments in the public and private sectors should be aligned;
 - (b) other respondents considered that there would be circumstances in which a risk adjustment could be zero, such as when:
 - (i) there is absolute certainty around the government backing of the best estimate liability; and
 - (ii) the liability cash flows are so long term that the volatility is mitigated by long-term investment returns.
- BC116 The Boards noted that some respondents to NZASB ED 2018-7 considered that risk adjustments would not be relevant to many public sector entities and, if they were to be required:
- (a) explicit guidance on determining risk adjustments in the public sector would be needed; and/or
 - (b) the Standard should specify that risk adjustments are zero for public sector entities.
- BC117 The Boards noted the comments of respondents to NZASB ED 2018-7, which included the following:
- (a) risk adjustments are predicated on the liability being an estimated amount a third party would likely want to be paid to assume the risk of settling claims, which is akin to an exit price; however, the liabilities will be settled by the entity itself;
 - (b) if the entity seeks to fund a liability that includes a risk adjustment, in order to report a break-even result, the entity would need to set levies and other forms of income at amounts that (on average) would be higher than necessary; and
 - (c) if the entity is funded to meet a best estimate liability, including a risk adjustment in the liability would automatically result in reported losses, which may never eventuate.
- BC118 The Boards also noted the following feedback received from stakeholder outreach conducted in 2020-21.
- (a) AASB 1023/PBE IFRS 4 is regarded as requiring a risk margin to be included in measuring liabilities for outstanding claims, while AASB 137/PBE IPSAS 19 is generally regarded as not requiring a risk margin to be included in measuring provisions, but can be interpreted as permitting a risk/prudential margin to be included.
 - (b) A key reason for some stakeholders choosing to apply AASB 137/PBE IPSAS 19 (rather than AASB 1023/PBE IFRS 4) is that they do not regard risk margins as appropriate to their circumstances.
 - (c) Some stakeholders had assumed that their risk adjustments under AASB 17/PBE IFRS 17 would be the same as their risk margins under AASB 1023/PBE IFRS 4, while others had yet to consider whether they would have a risk adjustment under AASB 17/PBE IFRS 17 and, if they did, whether it would be more or less than any risk margin they currently apply.

Alternative approaches considered by the Boards

- BC119 The Boards considered the following possible approaches regarding the risk adjustments requirement:
- (a) Approach 1: require public sector entities to apply AASB 17/PBE IFRS 17 with no modifications or guidance;
 - (b) Approach 2: require public sector entities to have a zero risk adjustment; and
 - (c) Approach 3: require a particular confidence level for determining risk adjustments for liabilities for incurred claims for all public sector entities.

Approach 1: Apply AASB 17/PBE IFRS 17 with no modifications or guidance

- BC120 The Boards considered the possible advantages of applying AASB 17/PBE IFRS 17 with no modifications or guidance.
- (a) It could be considered consistent with the principle of only making modifications to the IFRS Standards if there is a strong case based on substantive differences in circumstances of public sector entities (compared with the entities for which IFRS Accounting Standards are developed).
 - (b) It would allow for different risk adjustments to be recognised to suit the nature of each entity's claims liabilities, which would be helpful since different public sector entities hold claim liabilities with different characteristics. For example, very long-tail, relatively predictable claims (such as

regular income support payments), would result in a relatively small risk adjustment. In contrast, claims subject to future legal judgements might result in a relatively large risk adjustment.

- (c) Different public sector entities hold different views on whether they should have a risk adjustment above zero in measuring their claim liabilities based on their circumstances. Each entity would be able to determine its position consistent with its own facts and circumstances, including its objectives, management philosophy, and level of risk aversion.
 - (d) A for-profit public sector entity could recognise a risk adjustment on the basis that it expects to profit from bearing risk, while a not-for-profit entity might not recognise a risk adjustment because it does not seek to profit from bearing risk.
- BC121 The Boards considered the possible disadvantages of applying AASB 17/PBE IFRS 17 with no modifications or guidance.
- (a) IFRS 17 was designed to be applied by private sector entities. The public sector context is often different; in particular, due to entities holding a monopoly position and being driven by public policy objectives.
 - (b) Different public sector entities may determine different outcomes even though they have similar operations. Accordingly, their reported financial position and financial performance would not be comparable.
 - (c) Public sector entities might expend a disproportionate amount of time and resources determining the compensation they might notionally require for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk as the entity fulfils its arrangements. There may be little or no additional information value achieved for users of the financial statements through this process.

Approach 2: Require public sector entities to have a zero risk adjustment (confidence level of 50%)

- BC122 The Boards noted that opinions differ about whether, in concept, an entity can have a risk adjustment of zero and still claim to have contracts that transfer insurance risk. For the purposes of discussion, the Boards assumed that, in particular circumstances, a zero risk adjustment is compatible with the transfer of insurance risk and noted the example of a mutual risk-pooling arrangement that involves accepting risk from each policyholder and sharing the risk with other policyholders. Although a public sector entity might be regarded as simply an administrator of such a pooling arrangement, it could nevertheless also be seen as bearing risk for the current in-force arrangements because the risk is typically pooled over a number of coverage periods.
- BC123 The Boards considered the possible advantages of requiring public sector entities to have a zero risk adjustment.
- (a) All public sector entities would have a consistent approach (based on best estimate claim liabilities).
 - (b) Best estimates (with no risk adjustment) are typically relevant to user decision making because they ordinarily provide a basis for determining how much levies or other charges need to be generated to sustain the entity in the long term.
 - (c) Most of the relevant public sector entities are monopolies and/or have the power to adjust future levies and charges to meet any shortfalls in funding the existing claim liabilities. Accordingly, risk adjustments may not be relevant because these entities have no reason to be risk averse.
 - (d) Zero risk adjustments (and, therefore, zero changes from period to period in risk adjustments) would avoid misleading impacts on the income statement, since risk adjustments tend to create short term losses and longer-term gains as actual claims revert to the best estimate over the long term.
 - (e) Zero risk adjustments would reduce report preparation costs by removing the need for management (and auditors) to determine (and assess) risk adjustments and to make disclosures about risk adjustments.
- BC124 The Boards considered the possible disadvantages of requiring public sector entities to have a zero risk adjustment.
- (a) Many public sector entities hold strong views on the need to show their users that claim liabilities carry a level of uncertainty as to timing and amount, and consistency does not necessarily lead to comparability. All entities are risk averse to varying degrees.
 - (b) There would be no changes in risk adjustments to provide useful information about changes in the levels of uncertainty among cash flows over time.

- (c) There are often obstacles to exercising monopoly and other powers. For example, it might not currently be feasible to increase levies in either the short to medium term to meet shortfalls in a timely manner. The risks that exist within in-force arrangements should not be regarded as being able to be offset by possible future transactions.
- (d) It is normal commercial practice to determine risk adjustments and many public sector entities, particularly those with independent boards of management, would wish to have a risk adjustment for financial reporting purposes to match their risk management activities (and management reporting).

Approach 3: Require a particular confidence level (above 50%) for determining risk adjustments for liabilities for incurred claims for all public sector entities

- BC125 The Boards considered the possible advantages of requiring a particular confidence level (above 50%) for determining risk adjustments for liabilities for incurred claims for all public sector entities.
- (a) All public sector entities would have a consistent approach (based on a common confidence level).
 - (b) A common confidence level would reduce report preparation costs by removing the need for management (and auditors) to determine (and assess) risk adjustments. In particular, this requirement would be generally consistent with prevailing current practice (which is long-standing) and be readily understood by all relevant stakeholders.
 - (c) Relative to having a zero risk adjustment, the common confidence level approach would show, from period to period, the impacts of any changes in risk adjustments, which provides useful information about changing levels of uncertainty on the amount and timing of cash flows over time.
- BC126 The Boards considered the possible disadvantages of requiring a particular confidence level for liabilities for incurred claims for determining risk adjustments for all public sector entities.
- (a) It would be inconsistent with principle-based standard setting to set an arbitrary benchmark such as a 75% confidence level.¹⁸
 - (b) The approach prevents entities from determining risk adjustments appropriate to their particular circumstances. Requiring a percentage confidence level also presumes that this is the best technique for determining risk adjustments in all circumstances; however, an entity might consider that another technique (eg a 'cost of capital' technique) is more appropriate.
 - (c) Consistency does not necessarily lead to comparability.
 - (d) If there is a general shift in expectations about the uncertainty surrounding the amount and timing of cash flows, the required confidence level might need to be updated by the Boards.

Disclosures

- BC127 The Boards considered that each of the three approaches outlined above could be supplemented with disclosures such as the following.
- (a) If Approach 1 is adopted (no modifications), the entity could also be required to disclose a risk adjustment for benchmark confidence level (such as 75%) to provide a point of reference for comparison.
 - (b) If Approach 2 is adopted (zero risk adjustment), the entity could also be required to disclose what the risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.
 - (c) If Approach 3 is adopted and each public sector entity recognises a risk adjustment for a standardised confidence level (such as 75%), the entity could also be required to disclose what its risk adjustment would have been if AASB 17/PBE IFRS 17 were applied unmodified.
- BC128 The Boards also considered whether, if Approach 3 were proposed as a rebuttable presumption, disclosure should be proposed of the basis for any rebuttal. However, they observed that this would go beyond counterpart disclosures already required in AASB 17/PBE IFRS 17. For example, they noted that AASB 17/PBE IFRS 17.119 requires that an entity using a technique other than the confidence level technique for determining the risk adjustment need only disclose the technique used and the confidence level corresponding to the results of that technique.

¹⁸ The Boards noted that some Australian public sector entities are required (via regulation imposed in that jurisdiction) to benchmark to Australian Prudential Regulation Authority (APRA) prudential requirements, which include a minimum risk margin.

Analysis of approaches by the Boards

- BC129 The Boards analysed the basis for the IASB's decisions on requiring a risk adjustment and reflected on how each of the benefits the IASB identified might still be met in a public sector context under each of the approaches (no modifications, a mandated zero risk adjustment, or a mandated confidence level such as 75%).
- BC130 The Boards noted that requiring a risk adjustment is intended to provide a clear insight into the insurance contracts and distinguishes them from risk-free liabilities [IFRS 17.BC211(a)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers, but that it does not necessarily suggest that requiring a zero risk adjustment would be inappropriate because a public sector might conceivably be ambivalent between an insurance contract liability with a range of possible outcomes arising from insurance risk and fulfilling a liability that would generate fixed cash flows with the same expected present value.
- BC131 The Boards noted that requiring a risk adjustment results in a profit recognition pattern that reflects both the profit recognised by bearing risk and the profit recognised by providing services [IFRS 17.BC211(b)]. The Boards considered this reasoning would be less relevant in respect of public sector entities that are not seeking to profit from bearing risk. However, on balance, the Boards thought that this reasoning could also be applied to revenue recognition and be relevant to a public sector entity, and would probably best support the view that the risk adjustment requirements of AASB 17/PBE IFRS 17 should be applied unmodified.
- BC132 The Boards noted that requiring a risk adjustment can be necessary to faithfully represent circumstances in which the entity has charged insufficient premiums for bearing the risk that the claims might ultimately exceed expected premiums [IFRS 17.BC211(c)]. The Boards thought this reasoning may not always be as relevant in the public sector as it is for private sector insurers because a public sector entity may have the capacity to aim for a break-even result over the medium to long term while private sector insurers may not.
- BC133 The Boards noted that requiring a risk adjustment should result in changes in estimates of risk being reported promptly and in an understandable way [IFRS 17.BC211(d)]. The Boards thought this reasoning seems as relevant in the public sector as it is for private sector insurers and would suggest that requiring a zero risk adjustment might be inappropriate.
- BC134 The Boards also analysed the following criticisms of risk adjustments considered by the IASB in developing IFRS 17 and reflected on whether they might be more relevant in the public sector and, therefore, justify a different outcome from the requirements in AASB 17/PBE IFRS 17.
- (a) Currently, there is no single well-defined measurement approach to risk adjustments that would necessarily provide consistency and comparability of results [IFRS 17.BC210(a)]. This criticism is no more relevant, in a general sense, in the public sector than it is for private sector insurers.
 - (b) Some measurement techniques for risk adjustments are difficult to explain to users of financial statements [IFRS 17.BC210(b)]. This criticism may be more relevant in the public sector than it is for private sector insurers because the public sector users might be relatively less familiar with actuarial techniques. The NZASB in particular thought that this criticism might imply that mandating a widely-understood basis of measurement (such as a confidence level of 75%) could be useful in a public sector context.
 - (c) It is impossible to assess retrospectively whether a particular adjustment was reasonable, including whether (for example) a decision to set a confidence level at a particular percentile was appropriate [IFRS 17.BC210(c)]. This criticism is no more relevant in the public sector than it is for private sector insurers.
 - (d) Developing systems to determine risk adjustments will involve costs that are not justified by the benefits [IFRS 17.BC210(d)]. This criticism may be more relevant in the public sector than it is for private sector insurers because the public sector entities may not otherwise have to determine risk adjustments for management or prudential reporting purposes and typically do not price arrangements to be compensated for risk. The NZASB in particular, at the time it was preparing and issuing NZASB ED 2022-3, thought that this criticism might imply that it would be inappropriate to simply leave public sector entities to apply the risk adjustment requirements of AASB 17/PBE IFRS 17 unaided.
 - (e) Including a risk adjustment in identifying any loss on initial recognition is inconsistent with IFRS 15 (on revenue) [IFRS 17.BC210(e)]. This criticism is no more relevant (and possibly less relevant given the infrequent application of AASB 15 *Revenue from Contracts with Customers*) in the public sector than it is for private sector insurers.
 - (f) If including a risk adjustment results in a loss, that loss will reverse in later periods as the entity is released from that risk, which may confuse some users of financial statements [IFRS 17.BC210(f)]. This criticism may be more relevant in the public sector than it is for private sector insurers because

many public sector entities would be aiming to break even over the long term, rather than earn profits or incur losses. In contrast, private sector entities would typically aim to profit from bearing risk. However, the Boards also acknowledged that any tendency of risk adjustments to create short term losses and longer-term gains would generally be a ‘once-off’ impact and would not usually affect ongoing reported financial performance unless the volumes of transactions are volatile year-on-year.

- (g) A risk adjustment could be used to introduce bias into the measurement of insurance contracts [IFRS 17.BC210(g)]. This criticism is no more relevant in the public sector than it is for private sector insurers.

Risk adjustment measurement proposal in AASB ED 319

BC135 The AASB observed that:

- (a) most public sector entities do not seek to profit from bearing insurance risk;
- (b) under AASB 17, public sector entities might determine a zero risk adjustment on the basis that they are monopolies and can adjust future prices to make up for higher-than-expected past claims;
- (c) under AASB 17, public sector entities might determine a risk adjustment based on a particular level of adequacy based on their facts and circumstances; and
- (d) providing a benchmark confidence level, even as a rebuttable presumption, is not consistent with principle-based standard setting.

BC136 Accordingly, the AASB decided on Approach 1 and to propose not making public-sector-specific modifications to the requirement to include a risk adjustment in measuring liabilities for incurred claims.

Risk adjustment measurement proposal in NZASB ED 2022-3

BC137 A primary concern for the NZASB was that entities, their advisors and auditors might expend considerable effort to identify and measure a relevant compensation-based risk adjustment for little benefit to users.

BC138 The NZASB observed that existing practice under AASB 1023/PBE IFRS 4 has developed over many years and most public sector entities applying these standards benchmark to a 75% confidence level. The benchmark seems to have become widely accepted (including outside Australia and New Zealand) because it is:

- (a) relatively easy (and low cost) to measure;¹⁹
- (b) relatively easy to understand; and
- (c) financial statement users and entity managements have found it informative.

BC139 The NZASB considered that the 75% benchmark has been an effective and low-cost way for public sector entities to measure risk margins under AASB 1023/PBE IFRS 4. Nevertheless, the NZASB also acknowledged that there may be circumstances in which a benchmark other than a 75% confidence level is more relevant and that entities should be able to rebut the 75% benchmark.

BC140 Accordingly, the NZASB decided on Approach 3 and to propose a public-sector-specific modification of a rebuttable presumption that risk adjustments are measured at an amount that achieves a 75% confidence level in respect of liabilities for incurred claims.

BC141 While acknowledging that providing a benchmark confidence level is not consistent with principle-based standard setting, the NZASB considered it justifiable to propose the modification because:

- (a) the cost-saving benefits of using the benchmark would exceed any loss of information value; and
- (b) the rebuttable presumption would still allow for flexibility in circumstances in which a 75% confidence level may not be appropriate.

Boards’ disclosure proposal for AASB ED 319/NZASB ED 2022-3 about risk adjustments in a public sector context

BC142 The Boards noted that there are comprehensive disclosure requirements in AASB 17/NZ IFRS 17 about risk adjustments, particularly in the requirements for reconciliations of insurance liabilities.

¹⁹ The Boards observed that, of itself, very little additional actuarial effort is likely to be needed to determine a risk adjustment – most of the relevant work is performed to determine the best estimate.

- BC143 Both Boards decided that it would be inappropriate to propose to require more disclosure of public sector entities than is required of other entities applying AASB 17/NZ IFRS 17 about risk adjustments in general.

Feedback on AASB ED 319/NZASB ED 2022-3

- BC144 Some respondents expressed the view that the NZASB's proposed 75% rebuttable presumption would be straightforward to implement and avoid debate about how the risk adjustment requirements should apply. Some respondents also noted the view that it would also help achieve consistency across public sector entities with the rebuttable presumption of a 75% confidence level.
- BC145 Most respondents, however, supported not having an explicit modification to AASB 17/PBE IFRS 17 for the following reasons:
- (a) consistency with principle-based standard setting;
 - (b) many public sector entities would need to rebut the 75% confidence level because it would not be consistent with their existing pricing policies;
 - (c) a rebuttable 75% confidence level could be viewed as more onerous than the requirements for the private sector; and
 - (d) consistency across public sector entities might be able to be achieved without the need for a rebuttable presumption.
- BC146 Some respondents also supported the Boards providing some form of application guidance, including:
- (a) to explain how the risk adjustment requirements differ from the existing risk margin requirements;
 - (b) on the basis that the risk adjustment requirement in AASB 17/PBE IFRS 17 is simply an expression of compensation required due to the uncertainty in fulfilling the liability – additional application guidance should be provided to assist entities that do not require compensation;
 - (c) to explain whether a public sector entity can have a zero risk adjustment and the circumstances when this may be appropriate; and
 - (d) to assist entities to determine when an estimate other than the central estimate would need to be used; that is, when other than a zero risk adjustment would be needed,²⁰ assuming a public sector entity can have a zero risk adjustment.

Boards' redeliberations on risk adjustments

- BC147 The Boards noted the following lines of thinking on the AASB 17/PBE IFRS 17 risk adjustment requirements.
- (a) A strict application of the AASB 17/PBE IFRS 17 definition of 'risk adjustment for non-financial risk' to an entity that does not seek to be compensated for bearing risk would seem to result in a zero risk adjustment. Since almost all public sector entities do not seek to be compensated in their pricing of levies/premiums for bearing risk, it could reasonably be expected (based on the definition alone) that they would determine zero risk adjustments (a liability with a confidence level of 50%);
 - (b) Based on AASB 17.B87/PBE IFRS 17.AG87, some public sector entities that do not price for bearing risk, nonetheless, would not be indifferent between;
 - (i) fulfilling a liability that has a range of possible outcomes arising from non-financial risk; and
 - (ii) fulfilling a liability that will generate fixed cash flows with the same expected present value as the insurance contracts; andwould, therefore, have a risk adjustment above zero. And some stakeholders consulted by the Boards expressed the view that a zero risk adjustment does not seem realistic in respect of insurance liabilities and the uncertainty associated with them.
 - (c) A public sector entity that does not price for risk could validly have no risk adjustment included in its liability for remaining coverage, but have a risk adjustment included in its liability for incurred claims on the basis that it is not indifferent to the variability associated with the expected cash flows estimated to settle claims. Accordingly, it is feasible that the confidence level for measuring a liability for remaining coverage could be different from the confidence level applied to the liability

²⁰ The Boards noted that, in principle, a central estimate is not the same as having a zero risk adjustment because a zero risk adjustment could be re-measured to something above zero; whereas, a central estimate is always a central estimate.

for incurred claims because the actual pricing structure does not necessarily reflect the risk appetite of the entity.

BC148 In respect of the circumstances of a public sector entity, the Boards considered the following.

- (a) Pricing decisions can be based on a range of factors and, for example, complications can arise, when entities include a margin in levies for capital management purposes. By way of illustration, a public sector entity may need to build up its capital in preparation for enhancing future benefits or to make up for previous under-reserving because claims experience has been worse than expected.
- (b) It may be reasonable to distinguish cases of ‘capital management’ and ‘capital repair’ from cases when an entity is pricing with a view to being compensated for risk. That is, there may be cases when entities price above break even for reasons other than seeking to be compensated for risk, which should be acknowledged. An ongoing policy of break-even pricing would be generally indicative of a public sector entity that is not seeking to be compensated for bearing risk.

Boards’ conclusions on risk adjustments

BC149 The Boards concluded that they would not make modifications to the risk adjustment requirements of AASB 17/PBE IFRS 17 for application by public sector entities, that is Approach 1 described in paragraphs BC120 and BC121.

BC150 The Boards consider that the risk adjustment requirements of AASB 17/PBE IFRS 17 were designed to be applied to reflect the circumstances of each entity and public sector entities, by applying the unmodified requirements, would be able to reflect the impacts of their circumstances and their perspectives on insurance risk in their financial reporting. Accordingly, the Boards concluded that the amount of a risk adjustment a particular public sector entity includes in either their liabilities for remaining coverage or liabilities for incurred claims would depend on that entity’s circumstances.

BC151 In forming their conclusions, the Boards noted the following matters.

- (a) For the avoidance of doubt, the ‘compensation’ approach to risk adjustments in AASB 17/PBE IFRS 17 is different from the approach to risk margins under the superseded Standards (AASB 1023 and AASB 4/PBE IFRS 4), which were based on the inherent uncertainty within the estimates of expected cash flows. That is, the risk margins under the superseded Standards needed to be recognised when inherent uncertainty existed, regardless of an entity’s perspective on the extent to which it needed to be compensated for that uncertainty. In contrast, the recognition and measurement of a risk adjustment under AASB 17/PBE IFRS 17 relates to the compensation the entity requires for bearing the uncertainty about the amount and timing of cash flows that arises from non-financial risk. Accordingly, the risk adjustment depends on both the inherent uncertainty within the estimates of expected cash flows and each entity’s own facts and circumstances, including its objectives, management philosophy, and level of risk aversion.
- (b) In the private sector, there would generally be expected to be some, at least broad, connection between the compensation charged for bearing risk included in setting premiums and the extent to which the insurer is indifferent between the two sets of cash flows referenced in AASB 17.B87/PBE IFRS 17.AG87. This broad connection would be expected given that private sector insurers are required to remain solvent from a prudential reporting perspective and endeavour to remain profitable, particularly when they are for-profit entities. However, that same perspective does not necessarily apply to public sector entities.
- (c) There may be public sector entities that have circumstances which would lead them to recognising and measuring their liabilities for remaining coverage and/or their liabilities for incurred claims and those insurance liabilities with a zero risk adjustment.
- (d) There may be public sector entities that have circumstances which would lead them to having a zero risk adjustment in recognising and measuring their liabilities for remaining coverage, but having a risk adjustment above zero in recognising and measuring their liabilities for incurred claims. The Boards observed that this situation might arise, for example, when claims are related to infrequent large-scale events and the uncertainties around the amounts and timing of cash flows from those events are particularly difficult to estimate.
- (e) Break-even pricing may be indicative of public sector entities that do not seek to be compensated for risk and do not include risk adjustments in recognising and measuring their liabilities for remaining coverage and/or their liabilities for incurred claims.
- (f) The availability of risk mitigation factors, such as access to government guarantees and, potentially funding from general taxation, and a monopoly market position, could be significant factors in

determining whether, and to what extent, some public sector entities might need to be compensated for bearing risk. Therefore, those factors may influence public sector entities' level of indifference between fulfilling a liability that has a range of possible outcomes arising from insurance risk and fulfilling a liability that would generate fixed cash flows with the same expected present value. Accordingly, those factors may impact on the amounts of risk adjustments included in recognising and measuring their liabilities for remaining coverage and/or liabilities for incurred claims.

- (g) The extent to which a public sector entity might seek to be compensated for bearing risk, and the significance of the risk mitigation measures such as government guarantees, could depend on the extent to which the entity and its management is treated as operating independently from its controlling government. A relatively independent entity might, for example, be responsible for entering into its own risk mitigation measures, such as a reinsurance program, or maintaining a particular funding-to-liabilities ratio, and may not be expected to rely on measures such as government guarantees.

Identifying public sector arrangements that fall within the scope of AASB 17/PBE IFRS 17 (modifications to paragraph 6 and addition of Appendix E)

- BC152 In developing their proposals for identifying which arrangements in the public sector would be accounted for as insurance contracts, the Boards' general approach was based on:
- (a) considering the definitions and guidance on 'insurance contracts', 'insurance contract services' and 'insurance risk' in AASB 17/PBE IFRS 17; and
 - (b) identifying a range of indicators that would be considered collectively, along with related guidance.
- BC153 The Boards took the view that a collective consideration of the proposed indicators discussed below in paragraphs BC156–BC216 would mean that:
- (a) the existence of a particular indicator would not necessarily result in AASB 17/PBE IFRS 17 being applicable; and
 - (b) the absence of a particular indicator would not necessarily result in AASB 17/PBE IFRS 17 being inapplicable.
- BC154 In developing the proposed indicators, the Boards noted that the main alternative requirements applicable to liabilities of public sector entities are set out in AASB 137/PBE IPSAS 19 *Provisions, Contingent Liabilities and Contingent Assets*. Accordingly, the Boards were mindful of the key differences between the requirements of AASB 17/PBE IFRS 17 and AASB 137/PBE IPSAS 19, which include different discount rate requirements for present valuing cash flows and the specific requirement in AASB 17/PBE IFRS 17 for a risk adjustment.
- BC155 Paragraphs BC156 to BC233 outline the Boards' deliberations in identifying proposed indicators for determining when AASB 17/PBE IFRS 17 would be applied. This includes deliberations on indicators that were considered and rejected, discussed below in paragraphs BC217–BC233.

Similarity of risks covered and benefits provided

- BC156 The AASB Discussion Paper (2017) proposals identified, as a suggested criterion for determining whether activities relate to insurance, that the transactions or arrangements entered into have similar characteristics and relate to a similar level of insurance risk as those entered into by for-profit private sector entities that are accounted for as insurance contracts [AASB DP.E14(c)]. This is not a factor explicitly identified in NZASB ED 2018-7, although it can be argued that it was proposed implicitly via other proposed indicators.
- BC157 The Boards observed that some public sector arrangements have direct counterparts with private sector insurance contracts, including for example, workers' compensation contracts. In the context of a transaction neutral approach to accounting standard setting, the Boards regard this as a useful indicator that some types of arrangements in the public sector would be accounted for by applying AASB 17/PBE IFRS 17.
- BC158 The Boards noted that an arrangement in the public sector might provide a combination of types of coverage and benefits that are not matched by a private sector insurance contract, but that components of the arrangement might be directly comparable to a private sector insurance contract. For example, in Australia, compulsory third-party motor insurance arrangements provided by a public sector entity includes coverage for serious or catastrophic injuries; whereas, the counterpart private sector insurance contracts typically do not. That serious or catastrophic injury coverage is often provided under a separate public sector arrangement.

- BC159 Accordingly, the Boards acknowledge the limitations in some circumstances of using the similarity of risks covered and benefits provided as an indicator of whether AASB 17/PBE IFRS 17 would apply because directly comparable forms of coverage may not be identifiable. However, the Boards note that considering the similarity of risks covered and benefits provided would involve a broader analysis than simply assessing whether directly comparable forms of coverage exist. Also refer to the Boards' conclusions in paragraph BC251 regarding the similarity between the risks and the benefits themselves and not the level of riskiness.
- BC160 The field testing conducted in 2021-22 on the indicators revealed mixed views. Some stakeholders considered 'similarity of risks covered and benefits provided' to be one of the most significant indicators. Other stakeholders considered that it is not a useful indicator either because:
- (a) there are examples of similar risks and benefits being addressed via insurance arrangements and (non-insurance) compensation schemes; or
 - (b) there are some arrangements that are clearly insurance contracts, but are currently exclusively issued in Australia by public sector entities.
- BC161 The field testing also revealed that the perspectives of some stakeholders about what constitutes a similar risk can vary depending on whether the participants/policyholders are third parties or other public sector entities within the same government (see the discussion on 'captive' insurer at paragraphs BC260 to BC275). The Boards noted that the similarity of risks relates to the risks (or the amount and timing of cash flows) transferred and would not depend on the identity of the participants/policyholders. From the perspective of the public sector entity in its stand-alone general purpose financial statements, related-party participants/policyholders are nevertheless third parties.

Boards' proposal on similarity of risks covered and benefits as an indicator in AASB ED 319/NZASB ED 2022-3

- BC162 Based on the above deliberations, the Boards decided to propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the similarity of risks covered and benefits provided due to the fact that the transfer of insurance risk is central to the definition of 'insurance contract'.
- BC163 The Boards considered how widely entities would be expected to search for counterpart insurance contracts and concluded it would be reasonable for entities to consider counterpart contracts both within and outside Australia and New Zealand, using information that is readily available. That is, public sector entities would not need to conduct an exhaustive global search for counterpart contracts.

Identifiable coverage period

- BC164 A key feature of an insurance contract in the context of AASB 17/PBE IFRS 17 is the existence of an identifiable coverage period, which is defined as 'the period during which the entity provides insurance contract services'. The coverage period provides the basis for determining the cash flows to include in measuring insurance contracts.
- (a) Most insurance contracts provide protection for events that occur during the coverage period – for example, coverage for claims that might arise from an incident over a one-year contract period. The claims may not come to light until after the coverage period has ended. These are sometimes referred to as 'claims incurred' contracts because the time when the event occurs is crucial to identifying valid claims.
 - (b) Some insurance contracts provide protection for claims that arise during the coverage period, regardless of when the incidents that gave rise to the claims have occurred. These are sometimes referred to as 'claims made' contracts because the time when the claim emerges is crucial to identifying valid claims.
- BC165 The Boards observed that, instead of having an identifiable coverage period, social benefit type schemes tend to be open-ended and depend on participants continuing to meet eligibility criteria, which might include, for example, being unemployed, being a student, or being above a certain age. In that context, IPSAS 42.5 defines 'social benefit' as:
- cash transfers provided to:
 - (a) specific individuals and/or households who meet eligibility criteria;
 - (b) mitigate the effect of social risks; and
 - (c) address the needs of society as a whole.

The social benefit eligibility criteria relate to someone's inherent status, rather than relating to an uncertain future event that occurs within a particular coverage period.

- BC166 The field testing revealed that some stakeholders consider having an identifiable coverage period is an essential feature for arrangements to be accounted for as insurance contracts on the basis that:
- (a) without a coverage period, an entity would be unable to determine the relevant fulfilment cash flows to include in measuring insurance liabilities; and
 - (b) having an identifiable coverage period contrasts with open-ended compensation schemes that provide benefits based on meeting eligibility criteria (and would not be accounted for as insurance contracts).
- BC167 With the benefit of feedback from field testing the indicators, the Boards noted that there is a distinction between a period being identified for the purposes of raising levies to fund a compensation scheme and the notion that an amount is collected to cover events that occur over a particular coverage period.

Boards' proposal on coverage period as an indicator in AASB ED 319/ NZASB ED 2022-3

- BC168 Based on the above deliberations, the Boards decided to propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the existence of an identifiable coverage period.

Enforceable nature of arrangement

- BC169 The Boards noted that an indicative criterion in IPSAS 42 for being eligible to apply the insurance approach (and apply IFRS 17) is that the arrangements between the entity and its participants are enforceable in a similar manner to an insurer being required to act in accordance with an insurance contract [IPSAS 42.AG25(a)]. Both the AASB Discussion Paper (2017) [AASB DP.E13(b)] and NZASB ED 2018-7 [ED 2018-7.AG1.6] proposed a similar indicator. The AASB Discussion Paper proposal identified as a key criterion that a participant's beneficial rights from an arrangement cannot be altered without a specific change in legislation or relevant governing measures and cannot be retrospectively amended.
- BC170 The Boards observed that, in a for-profit private sector setting, an insurer is required to act in accordance with the terms of the contract with a policyholder in terms of the types of risks covered and what constitutes insured events and, therefore, could be the subject of a valid claim. The actual amounts of compensation paid in respect of claims are determined by reference to the terms of the contract. Typically, those terms would be based on:
- (a) the extent of loss; and
 - (b) the extent to which the policyholder or another party is responsible for the events that led to the loss (that is, which party is at fault), including failure to take reasonable steps to avoid the loss.
- However, in some cases, there is an identified insured amount (for example, an agreed value for motor vehicle write-off) and sometimes the amount is a function of a number of factors and possibly negotiation.
- BC171 Nevertheless, the extent of a claim in a for-profit private sector setting would need to be determined in the context of the insurance contract terms – there would ordinarily not be an opportunity for an insurer to arbitrarily change those terms under an existing contract.
- BC172 This is in contrast with a scheme under which participants are promised a benefit, but the public sector entity retains the capacity to change the benefits payable to scheme participants. This is potentially a distinguishing feature of some public sector schemes (relative to the enforceable nature of contracts in the for-profit private sector). However, the significance of this capacity may be mitigated by the extent to which benefits could be changed for existing participants under arrangements in place at the reporting date.
- BC173 The Boards considered three examples to help illustrate the relevance of this capacity. Assume a public sector arrangement has a liability for providing income support for permanently disabled motor accident victims based on paying 50% of Average Weekly Earnings (AWE).
- (a) Example A: The entity has the power to change the rate of benefits to future participants to less than 50% of AWE. However, the entity has an enforceable commitment to paying 50% of AWE to existing participants, for example, by way of settlements.
 - (b) Example B1: The entity (or the government that controls the entity) has the power to change the rate of benefits to existing participants to less than 50% of AWE but only after obtaining a change to existing legislation.

- (c) Example B2: The entity (or the government that controls the entity) has the unilateral power to change the rate of benefits to existing participants to less than 50% of AWE, for example, based on projected budget priorities.
- BC174 The Boards noted that:
- (a) the terms in Example A are like those under most insurance contracts issued by private sector entities;
 - (b) the terms in Example B1 are unlike those under most insurance contracts issued by private sector entities; however, the fact that a legislative change would be needed to change the benefits is significant; and
 - (c) the terms in Example B2 are unlike insurance contracts issued by private sector entities because these entities would not be able to arbitrarily change benefits.
- BC175 The Boards identified that the enforceable nature of an arrangement is consistent with the basis for the accounting in AASB 17/PBE IFRS 17. Accordingly, the Boards considered that the extent to which the existing benefits under an arrangement are enforceable on the relevant public sector entity is an indicator for determining when that arrangement is accounted for as an insurance contract. Correspondingly, the Boards also considered that cases when an entity would be able to arbitrarily change benefits seems indicative of a conventional social benefit arrangement.
- BC176 The Boards observed that, relative to private sector insurers, governments are in a unique position to be able to legislate, which is relevant to Example B1 above. Having established an arrangement that provides benefits to participants, in theory, the government subsequently has the power to take those benefits away or at least adjust the amount of benefits.
- BC177 The Boards also observed that AASB 17/PBE IFRS 17 relies on the notion of an insurer having a ‘practical ability’ for the purposes of, for example:
- (a) determining the boundary of an insurance contract (practical ability to set a new price or new benefits [AASB 17/PBE IFRS 17.34(a)]); and
 - (b) relief from recognising a separate onerous contract group (when contracts within a portfolio would fall into different groups only because law or regulation specifically constrains the entity’s practical ability to set a different price or level of benefits [AASB 17/PBE IFRS 17.20]).
- BC178 The Boards identified that the notion of ‘practical ability’ could be used to help distinguish those cases when a public sector arrangement should be regarded as enforceable from cases when an arrangement is not enforceable. That is, an indicator that it is relevant to account for public sector arrangements as insurance contracts would be that the entity (or its controlling government) does not have the practical ability to change a benefit retrospectively.
- BC179 The Boards noted that some insurance contracts include features in their original terms that enable policyholders to take actions that change the amount, timing, nature or uncertainty of the amounts they will receive and AASB 17.B62/PBE IFRS 17.AG62 requires an insurer to determine the probabilities of those options being exercised in measuring insurance liabilities. When expectations are different from actual events, the insurer recognises ‘experience adjustments’ and remeasures insurance liabilities based on updated expectations. However, these contract options are at the discretion of the insured and are different from changes to existing contract terms made by an issuer.

Contract versus statute

- BC180 The Boards noted that the AASB Discussion Paper (2017) proposals included the following [page 5].

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

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

- BC181 The Boards also noted PBE IFRS 17.BC5 explains that, when developing NZASB ED 2018-7, the NZASB observed some public sector PBEs were applying the requirements of PBE IFRS 4 for ‘insurance-like’ activities that arose from statute rather than contract.

BC182 The Boards observed that the stakeholder outreach conducted in 2020-21 and the field testing of the indicators conducted in 2021-22 identified three broad types of response from stakeholders.

- (a) The manner in which the arrangement has been established (contract versus statute) is a matter of form rather than substance. These stakeholders have observed that:
 - (i) virtually identical forms of coverage are provided under either statutory or private sector (contractual) arrangements (such as comprehensive third-party motor coverage) – accordingly, the insurance Accounting Standards would apply by analogy to statutory arrangements under the accounting policy hierarchy;²¹
 - (ii) the purpose of having a statutory (rather than contractual) arrangement is generally to mandate that people obtain coverage from the one entity (usually a public sector entity); and
 - (iii) individuals and entities are required by statute to pay for some types of insurance coverage from private sector insurers (such as workers' compensation coverage) and the arrangements are effectively a combination of contractual and statutory terms.
- (b) Literally, the insurance Accounting Standards are considered to apply only to contracts, and entities' activities in respect of relationships based only on statute are (strictly interpreted) not within the scope of the insurance Accounting Standards. These stakeholders have observed that: AASB 15/NZ IFRS 15 and AASB 16/NZ IFRS 16 *Leases* provide clear definitions and descriptions of contracts that can be used as a bright line.
- (c) For some types of risks (such as workers' compensation coverage), the existence of documentation that includes substantive information about risks and benefits (well beyond the detail in any relevant enabling legislation or regulations), is an indication of an insurance contract.

BC183 The Boards noted that, under AASB 17/PBE IFRS 17, the description of the rights and obligations that would be accounted for under insurance contracts is broad (and go beyond the contract). AASB 17/PBE IFRS 17.2 says (emphasis added):

- 2 An entity shall consider its substantive rights and obligations, whether they arise from a **contract, law or regulation**, when applying IFRS 17. A contract is an agreement between two or more parties that creates enforceable rights and obligations^[22]. Enforceability of the rights and obligations in a contract is a matter of law. Contracts can be written, oral or implied by an entity's **customary business practices**. Contractual terms include all terms in a contract, explicit or implied, but an entity shall disregard terms that have no commercial substance (ie no discernible effect on the economics of the contract). **Implied terms in a contract include those imposed by law or regulation**. The practices and processes for establishing contracts with customers vary across legal jurisdictions, industries and entities. In addition, they may vary within an entity (for example, they may depend on the class of customer or the nature of the promised goods or services).

BC184 Stakeholders have requested the Boards to clarify whether an arrangement where a public sector entity is required by statute or other regulation alone, without separate documentation evidencing agreements directly with participants, could indicate a contract exists for the purposes of AASB 17/PBE IFRS 17. The Boards observed, for arrangements that would be accounted for as insurance contracts, it would generally be expected that some form of documentation, in addition to statutory requirements, would exist to evidence rights and obligations of participants and the relevant public sector entity. However, the Boards considered that there may be circumstances in which there is only limited documentation in addition to statutory requirements, and that limited documentation, within the statutory environment, could still be regarded as comprising, in combination with the statutory requirements, a contract.

Boards' proposal on the enforceable nature of arrangement as an indicator in AASB ED 319/NZASB ED 2022-3

BC185 Based on the above deliberations, the Boards decided to propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the absence of a practical ability to retrospectively change coverage or benefits. The Boards also decided to propose the 'practical ability' is linked to existing or substantively enacted legislative powers. The Boards noted that, otherwise, in a public sector context, an assessment of

²¹ AASB 108/PBE IPSAS 3 Accounting Policies, Changes in Accounting Estimates and Errors [paragraphs 10 and 11].

²² The second sentence of AASB 17.2/PBE IFRS 17.2 is the same as the definition for 'contract' used more generally in Accounting Standards (including: AASB 15/NZ IFRS 15 *Revenue from Contracts with Customers*).

‘practical ability’ would probably need to take into account a range of factors, including whether the entity (or its controlling government) has sufficient political capital to make a change that reduces a benefit, which would not be workable.

- BC186 The Boards also decided that the existence or otherwise of ‘contracts’ versus legislative requirements is not, of itself, likely to be a useful indicator of arrangements that would be accounted for as insurance contracts. Instead, the Boards consider the enforceable nature of the arrangements (the absence of a practical ability to retrospectively change coverage or benefits) is the most relevant focus, not the form of the documentation of the arrangements.

Source and extent of funding

Fully funded

- BC187 One of the criteria in IPSAS 42 for being eligible to apply the insurance approach is that an arrangement is intended to be fully funded from contributions and levies. NZASB ED 2018-7 proposed using the ‘fully-funded’ criterion for determining whether PBE IFRS 17 would apply [ED 2018-7.AG1.1 to AG1.4].

- BC188 IPSAS 42.AG20 explains ‘fully funded’ as follows.

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

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

- BC189 Some respondents to NZASB ED 2018-7 commented that the meaning of ‘fully funded’ is not necessarily clear for entities that aim to be self-funded over the long term, but that in any given year might be:

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

Substantially self-funded

- BC190 The AASB was also mindful of the IPSASB’s work on social benefits in preparing its Discussion Paper (2017) proposals, but considered that ‘fully funded’ would be too much of a bright line [AASB DP.BC28(b)(ii)].

- BC191 Instead, one of the non-mandatory criteria proposed in the AASB Discussion Paper for determining whether AASB 17 should apply in the public sector was that the arrangement be ‘substantially self-funded’ [AASB DP.E14(a)]. Under the proposal, there were two aspects to self-funding:

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

- BC192 There was a limited response to the proposal of a ‘substantially self-funded’ criterion. Those who did respond generally supported using the criterion.

Beneficiary pays

- BC193 The Boards observed that all of the public sector entities in Australia and New Zealand that are currently applying the insurance Standards, or have contemplated applying the insurance Standards, receive contributions from arrangement participants either directly or indirectly via premiums or levies. In general, most or all of the funding for these entities is sourced from arrangement participants, who stand to benefit from the coverage.
- BC194 The Boards also observed that some of the public sector entities in Australia that are currently not applying the insurance Standards also source most or all of their funding from those who stand to benefit from the coverage.
- BC195 The Boards noted that, if this indicator were applied, it would at least have the benefit of immediately ruling out the application of the insurance Standards to a range of social benefits such as aged pensions or universal healthcare activities and disability support. The Boards also noted a possible complication is that schemes such as Medicare in Australia, at least notionally, have dedicated funding through the Medicare levy on taxpayers. However, the Boards considered the Medicare levy to probably be sufficiently like a tax to be regarded as not being a beneficiary pays model as intended under this indicator. Accordingly, the Boards considered whether it might also be helpful to explain that the significance of the indicator would be on a spectrum relating to the extent to which premiums or levies represented a beneficiary-pays model.
- BC196 The Boards observed that a payment/contribution to the insurer from a policyholder is not a part of the insurance contract definition in AASB 17/PBE IFRS 17. However, they noted that some type of funding from an arrangement participant is probably a reasonable indicator of the relevance of applying AASB 17/PBE IFRS 17 in the sense that it helps to establish an enforceable contract-like relationship between the entity providing the coverage and the arrangement participants.
- BC197 The Boards observed that the practice of refunding pro rata amounts of payments/contributions in the event that an arrangement participant cancels its coverage prior to the end of the coverage period would be further evidence of an enforceable contract-like relationship between the entity providing the coverage and an arrangement participant. The Boards noted that this is a widespread practice in the private sector general insurance industry.

Capitalising/recapitalising

- BC198 The Boards noted that some public sector entities might need funding sourced from general taxation from time to time to help capitalise or recapitalise a public sector arrangement. These might be regarded as equity injections in some cases, rather than a source of routine funding. Accordingly, the Boards observed that periodic injections of funding from general taxation to capitalise or recapitalise a public sector arrangement would not be in conflict with a self-funding or beneficiary-pays model of funding, for the purpose of determining whether an arrangement should be accounted for under AASB 17/PBE IFRS 17.

Administrative convenience

- BC199 The Boards noted that some public sector arrangements involve sourcing funds by way of levies on transactions between participants and private sector entities (which may be insurers). The Boards noted that, while there may not be a direct cash transaction between the public sector entity and participants in terms of the collection of funds, this is often due to the need for administrative convenience, which would not affect an assessment of the extent to which funds are sourced from participants.

Boards’ proposal on the source and extent of funding as an indicator in AASB ED 319/NZASB ED 2022-3

- BC200 Based on the above considerations, the Boards decided to propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the extent to which an arrangement participant is responsible for paying a contribution. This is on that basis that it provides evidence of a contract-like relationship between an arrangement participant and the public sector entity. The Boards decided that references to ‘fully-funded’ and ‘substantially self-funded’ are probably not useful because they are difficult to interpret, but that relevant contributions would be expected to be more than, for example, a relatively small co-payment.

- BC201 Consistent with this perspective, the Boards also decided that the extent to which a contribution from an arrangement participant is an indicator of public sector arrangements to be accounted for as insurance contracts is dependent on:
- (a) the strength of the association between the contribution and the risks covered – for example, a motor vehicle owner (arrangement participant) contributes in return for being covered for risks associated with road use; and
 - (b) the extent to which the contribution is substantive relative to the risks being transferred.
- BC202 The Boards also noted the level of contributions from arrangement participants that might be sought in any given period could be affected by the extent to which the public sector entity is currently fully funded. That is, contributions might be higher or lower in any given period to either make up for earlier funding shortfalls or use up existing surpluses.²³ Accordingly, a medium-term view (rather than a year-by-year view) might need to be taken when assessing whether contributions from participants are substantive relative to the risks being transferred in any given period.

Management practices and assessing financial performance

Assessing financial performance (in general)

- BC203 The Boards noted that an indicative criterion in IPSAS 42 for being eligible to apply the insurance approach is that the entity assesses its financial performance and financial position of an arrangement on a regular basis where it is required to report internally on the financial performance of the arrangement, and, where necessary, to take action to address any under-performance by the arrangement [IPSAS 42.AG25(d)].
- BC204 The Boards noted that NZASB ED 2018-7 included a proposed indicator similar to this indicative criterion in IPSAS 42 [ED 2018-7.AG1.6(d)]. The Boards also noted that the AASB Discussion Paper (2017) included a proposed indicator similar to this indicative criterion in IPSAS 42, but that the Discussion Paper proposal placed an emphasis on the assessment of claims performance [AASB DP.E14(b)].
- BC205 The Boards observed that there was little feedback on this proposal in response to NZASB ED 2018-7 and a mixed response to the AASB Discussion Paper proposal, with most respondents saying the criterion was not helpful in distinguishing insurance activities from other types of activities. In general, respondents considered there are accountability and performance mechanisms across the spectrum of social benefit and insurance arrangements in most jurisdictions.

Management focus of the entity (more specifically)

- BC206 The Boards noted that, in stakeholder outreach conducted in 2020-21, there was more interest in discussing the ways in which they managed their particular activities, rather than the more general matter of assessing financial performance.
- (a) Most of the stakeholders from entities that are currently applying AASB 1023/PBE IFRS 4 expressed the view that they have been established to manage an area of risk and effectively provided with seed capital and a licence to charge levies/premiums in order to operate with relative financial independence. They are generally expected to be self-funding with a view to not making further calls on government funding and consider themselves to be operating an insurance-like business on a long-term sustainable basis. Within the constraints imposed upon them, they price risk based on commercial principles and manage claims fairly and prudently.
 - (b) Most of the Australian stakeholders from entities that are currently applying AASB 137 expressed the view that they are operating a compensation scheme based on terms that have largely been dictated to them (for example, through their enabling legislation) and do not have the scope to manage the risks in the manner of a private sector insurer.
 - (c) A small number of Australian stakeholders indicated that they consider the way their entities are currently managed would be better reflected in a change to their existing accounting – some from AASB 1023 to AASB 137 and some from AASB 137 to AASB 1023/AASB 17.
- BC207 The Boards considered that, the manner in which an entity is managed is, in principle, an important indicator of which Standards should be applied on the basis that faithfully reflecting the business model in financial statements is something that Standards ordinarily aim to achieve. However, this type of indicator is likely to be subject to wide interpretation unless it is associated with specific insurance liability management practices.

²³ Public sector entities often occupy a monopoly position and are able to raise or lower contributions to either make up for earlier funding shortfalls or use up existing surpluses.

In that context, the Boards considered those insurance liability management practices could include the following.

- (a) *Underwriting and pricing specific types of risks*: although few (if any) public sector entities are completely unconstrained in their ability to differentially price their services, many of them are able to price risk based on an arrangement participant's characteristics (for example, industry of employment, claims experience or type of vehicle).
- (b) *Use of reinsurance contracts to manage capital*: this is not to say that the existence of a reinsurance contract, of itself, is indicative. However, in association with other factors, such as a policy of protecting its own capital base (rather than relying on the taxpayer) for its continuing operation, the existence of a reinsurance contract can indicate that the entity is expected to manage its liabilities prudently in a manner consistent with a private sector insurer.
- (c) *Fair and prudent management of claims and remediation of significant claims risks*: although fair and prudent claims management would typically be a feature of a broad range of compensation schemes, it is a particularly significant feature of managing insurance risk, especially when coupled with possible remediation activities. Remediation will necessarily be different in a monopoly context compared with a typical commercial context. In a commercial context, remediation will often include resetting underwriting terms to exclude certain types of (high-risk) customers; whereas, monopoly public sector entities are not generally able to filter their participant base. Accordingly, for public sector entities, remediation would usually take other forms, such as interventions with risk management education programs or safety campaigns. The Boards acknowledged that, while public sector entities do not have the same imperatives commercial insurers might have on managing claims in a manner that permits them to keep trading, they are required to act fairly and would typically be required to act prudently. Accordingly, while the need to act fairly and prudently might be important in identifying arrangements that would be accounted for as insurance contracts, its presence could also be indicative of a broader range of compensation arrangements.

Boards' proposal on management practices and assessing financial performance as an indicator in AASB ED 319/NZASB ED 2022-3

- BC208 The Boards decided that general practices of assessing an arrangement's financial performance and financial position on a regular basis, reporting internally on financial performance and, where necessary, taking action to address any under-performance is not a potentially useful indicator of public sector arrangements to be accounted for as insurance contracts. The Boards consider the inference that social benefit schemes versus insurance arrangements are less likely to monitor performance in this way is probably not supportable.
- BC209 Instead, the Boards decided to propose as an indicator of public sector arrangements to be accounted for as insurance contracts that the entity has objectives, policies and processes for managing risks associated with those arrangements and for its financial performance to be assessed based on how the entity meets those objectives and how successfully it applies those policies and processes. The Boards decided that, in this context, the public sector entity would be expected to conduct the following activities (either itself or via outsourcing):
- (a) underwriting and risk assessment;
 - (b) the measurement of risks and uncertainties and their impacts; and
 - (c) fair and prudent claims management and, when relevant, engage in remediation work.
- BC210 The Boards decided that the presence of all three of these factors would be an indicator of public sector arrangements to be accounted for as insurance contracts; and, conversely, the fewer of these three factors that are present, the less likely it would be for arrangements to be accounted for as insurance contracts.

Assets held to meet benefits

- BC211 IPSAS 42 identifies the existence of assets being held in a separate fund, or otherwise earmarked, and restricted to being used to provide benefits as being an indicator of insurance contracts [IPSAS 42.AG25(b)]. Similarly, the AASB Discussion Paper (2017) proposals identified that assets and liabilities arising from the arrangements being held in a separate fund, or otherwise specifically identified as used solely to provide benefits to beneficiaries as indicating an insurance arrangement [AASB DP.E14(d)]. However, the AASB Discussion Paper proposals also noted that the absence of separately allocated assets is not necessarily an indicator the arrangement is not insurance.
- BC212 The Boards noted that there is a link between the indicator on 'Source and extent of funding' (discussed above) and 'Assets held to meet benefits' because funds that are sourced from an arrangement's participants

are more likely to be set aside in an arrangement fund than would be the case for funds sourced from general taxation.

- BC213 The Boards also noted that there is a link with the indicator on ‘Management practices and assessing financial performance’ (discussed above) because public sector entities that manage their own assets intended to meet claims would be more likely to have management practices that more generally mirror those of private sector insurers. The Boards observed that this perspective is supported by feedback received in recent stakeholder outreach, with many public sector entities having been established to be self-sustaining and having responsibility for overseeing an area of risk while achieving a breakeven result from all of their activities, including investment performance. This is a characteristic of private sector insurers, some of which routinely operate on a long-term sustainable basis by generating underwriting losses that are more than offset by investment returns.
- BC214 The Boards acknowledged that the existence of assets being held in a separate fund, or otherwise earmarked, and restricted to being used to provide benefits is a feature that can also apply to arrangements which are not in the nature of insurance. For example, a compensation scheme might be established for the victims of a recent disaster and be funded from general taxation, public appeals, or levies on certain suppliers or consumers that are pooled and invested and subsequently applied to help fund recovery efforts. Nonetheless, the Boards considered that this feature is a potentially important indicator because its absence might be indicative of arrangements that should not be accounted for as insurance contracts.
- BC215 The Boards noted that some public sector entities have assets set aside for benefits, but are not actively involved in the management of the underlying investments, which is handled centrally, for example, by a government agency established for this purpose. The public sector entity’s role might be limited to advising that agency about its liquidity needs. The Boards consider the existence of assets set aside to meet benefits to be the crucial factor, and do not regard the extent of a public sector entity’s active involvement in the management of its underlying investments as affecting the validity of this indicator.

Boards’ proposal on assets held to meet benefits as an indicator in AASB ED 319/NZASB ED 2022-3

- BC216 Based on the above considerations, the Boards decided to propose as an indicator of public sector arrangements to be accounted for as insurance contracts, the existence of assets being held in a separate fund, or an entity having access to earmarked assets, that are restricted to being used to provide benefits to an arrangement’s participants.

Profit seeking

Australian entities

- BC217 Most of the Australian public sector entities currently applying AASB 4 and AASB 1023 classify themselves as not-for-profit entities, with some classifying themselves as for-profit entities.
- BC218 The AASB Discussion Paper (2017) proposed that the amendments to AASB 17 for public sector entities should apply to both for-profit and not-for-profit public sector entities and the respondents who directly commented on this issue agreed with the AASB’s proposal.
- BC219 In the stakeholder outreach conducted in 2020–21, there was virtually no support for excluding a public sector entity from applying AASB 17 on the basis that it is a not-for-profit entity. For the few stakeholders who supported automatically including a public sector entity within the scope of AASB 17 on the basis that it is a for-profit entity, their support hinged on a view that a for-profit entity is more likely to be seeking to profit from the service of bearing risk. These stakeholders viewed this as consistent with AASB 17 requiring a risk adjustment in measuring insurance liabilities and recognising revenue from bearing risk in a pattern based on the release from risk.
- BC220 The AASB observed that the differing classifications (for-profit versus not-for-profit) across Australian jurisdictions seem to be driven largely by the funding structure and, for example, whether the entity’s enabling legislation allows for the entity to pay dividends to government in recognition of the cost of government capital deployed to the entity.

New Zealand entities

- BC221 All New Zealand public sector entities currently applying PBE IFRS 4 classify themselves as not seeking to profit from their activities.²⁴
- BC222 NZASB ED 2018-7 did not include any proposals relating to the profit-seeking motive.

Boards' proposal on profit seeking not being an indicator in AASB ED 319/NZASB ED 2022-3

- BC223 The Boards noted that the IASB did not regard the not-for-profit nature of mutual insurance entities to be a factor that would cause IFRS 17 to be inapplicable. The IFRS 17 Basis for Conclusions makes it clear that, in the IASB's view, IFRS 17 can be applied consistently to for-profit entities and mutual entities [IFRS 17.BC264 to BC269]. For-profit insurance entities and mutual insurance entities often compete for customers in the same markets.
- BC224 Based on the above deliberations, the Boards decided to propose that the not-for-profit nature of an entity should not be a barrier to public sector arrangements being accounted for as insurance contracts, and this was not proposed as an indicator. However, the Boards also noted that the classification (as for-profit versus not-for-profit) would be a part of the context in which the proposed indicators are considered and, therefore, could impact on the outcome of a collective assessment of those indicators.

Scoping out social benefits or specific entities

- BC225 The Boards noted that IPSAS 42.5 includes a definition of 'social risks', which mentions events or circumstances that are intended to give rise to distinct benefits from the causes of other forms of aid, such as benefits provided as the result of a disaster [IPSAS 42.AG10]. The IPSAS 42 definition is:

Social risks are events or circumstances that:

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

- BC226 The Boards observed that social risks identified in the definition are indicative, rather than implying that the same risks might not also be the subject of insurance contracts. They further noted that most, if not all, the classes of social risks mentioned in the definition could be the subject of insurance contracts sold by private sector entities, such as: annuities (age-related); health insurance (health-related); and income protection (related to health, poverty and/or employment status). Accordingly, the Boards concluded that it would not be productive to propose scoping out benefits relating to social risks using the definition in IPSAS 42.
- BC227 The Boards also considered whether it might be feasible to identify particular entities or activities that would not fall within the scope of AASB 17/PBE IFRS 17. For example, whether entities such as those closely associated with the hospital/health system, as a way of automatically excluding them and removing the need for an analysis of indicators to determine whether they need to apply AASB 17/PBE IFRS 17. In that context, the Boards noted that AASB 17/PBE IFRS 17 sets a precedent by specifically scoping out particular types of transactions conducted by particular types of entities that would otherwise probably need to be accounted for as insurance contracts. These transactions include, for example, warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer [AASB 17/PBE IFRS 17.7(a)].

Boards' proposal on scoping out social benefits or specific entities not being an indicator in AASB ED 319/NZASB ED 2022-3

- BC228 The Boards decided that, while it would provide certainty for some entities, they are generally opposed to specifically identifying public sector arrangements that are not within the scope of AASB 17/PBE IFRS 17 because it is typically not the role of the Boards to identify specific entities that should, or should not, apply particular Standards.
- BC229 The Boards also decided that while there may be some merit in proposing that specifically identified types of activities are not within the scope of AASB 17/PBE IFRS 17:

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

- (a) this could be problematic due to the potential interface between, for example, the public health system and the medical nature of many claims that might be the subject of arrangements that would be accounted for as insurance contracts; and
- (b) the relevant types of excluded activities should be able to be identified based on applying other proposed indicators.

Fault-based nature of an arrangement

- BC230 In respect of many classes of risk, private sector insurers attribute fault in determining whether claims are valid or the amount of those claims. For example, a policyholder that is negligent may receive a lower claim benefit than a policyholder who is not at fault, which is designed to avoid moral hazard issues. Accordingly, it could be argued that fault-based arrangements are more likely to result in insurance activities.
- BC231 The Boards noted that public sector arrangements vary across jurisdictions. For example, some of the Australian Compulsory Third Party motor insurance arrangements for non-serious injury are fault-based, while all the Compulsory Third Party motor insurance arrangements that include serious injury are no-fault arrangements. Currently, Australian stakeholders' application of either AASB 4 and AASB 1023 or AASB 137 has not reflected the fault status of the arrangements. That is, some public sector entities operating no-fault arrangements are applying AASB 4 and AASB 1023, while others have been applying AASB 137. However, the Boards are not aware of any public sector entities operating fault-based arrangements that are applying AASB 137.
- BC232 The Boards also observed that, while no-fault arrangements are more prevalent in the public sector, many classes of risk covered by for-profit private sector insurers do not involve attributing fault in determining whether claims are valid or the amount of those claims. For example, insurance contracts for risks such as health/disease and longevity are typically no-fault contracts.

Boards' proposal on Fault-based nature of arrangement not being an indicator in AASB ED 319/NZASB ED 2022-3

- BC233 Based on the above deliberations, the Boards decided that the no-fault versus fault-based nature of public sector arrangements would not be helpful in indicating whether the arrangements are to be accounted for as insurance contracts and this distinction was not proposed as an indicator.

Relative significance of the indicators

- BC234 The Boards considered whether some indicators should be:
- (a) separately identified as being pre-requisites for applying AASB 17/PBE IFRS 17 (that is, their absence means AASB 17/PBE IFRS 17 would not apply); or
 - (b) separately identified as being determinative in applying AASB 17/PBE IFRS 17 (that is, their presence means AASB 17/PBE IFRS 17 would apply); or
 - (b) otherwise ranked in some manner based on their significance in determining arrangements that should be accounted for by applying AASB 17/PBE IFRS 17.
- BC235 The field testing conducted in 2021-22 on the proposed indicators revealed a range of views. Some stakeholders noted a preference for ranking the indicators in some manner, although there was no consensus among those stakeholders for a particular ranking of the indicators. However, many of those seeking some form of ranking typically identified the most significant indicators as being:
- (a) an identifiable coverage period – on the basis that it contrasts with an open-ended compensation scheme that provides benefits based on meeting eligibility criteria; and
 - (b) the enforceable nature of the arrangement – on the basis that it means there is a binding arrangement between the public sector entity and a participant similar to that found in an insurance contract issued by a private sector insurer.
- BC236 In contrast, the field testing also revealed that many of those seeking some form of ranking typically identified the least significant indicators as being:
- (a) management practices and assessing financial performance – on the basis that there are many sound management and reporting practices that are routinely practiced both by insurers and by those responsible for compensation schemes; and
 - (b) the existence of a separate fund or earmarked assets held to meet benefits – on the basis that funds are often set aside within compensation schemes.

Boards' proposal on not assigning a relative significance to the indicators in AASB ED 319/NZASB ED 2022-3

- BC237 The Boards decided that they would not propose assigning a relative significance to each of the indicators on the basis that this is generally inconsistent with principle-based standard setting and with the notion of making a collective assessment and applying judgement based on the relevant circumstances. Instead, the Boards responded to the field test feedback by trying to better explain the relevant aspects of the indicators considered by some to be the least significant.
- BC238 The Boards also decided to include a specific question in AASB ED 319/NZASB ED 2022-3 on whether the indicators should be ranked in some manner and, if so, how they should be ranked and the reasons for that ranking.

Identifying public sector arrangements scoped into AASB 17/PBE IFRS 17 – AASB ED 319/NZASB ED 2022-3 feedback

- BC239 Most respondents to AASB ED 319/NZASB ED 2022-3 supported using indicators to determine whether public sector arrangements fall within the scope of AASB 17/PBE IFRS 17.
- BC240 While many respondents considered some indicators to be more relevant than others, most were in favour of retaining all the proposed indicators.
- BC241 Some respondents suggested additional or alternative indicators for arrangements being identified as insurance contracts, and others suggested indicators for arrangements that should not be identified as insurance contracts, including, for example, having a government guarantee to support the arrangements. There were mixed views on whether the fact that some public sector entities fill gaps in the private sector insurance market for the same risks as being insured by private sector insurers is indicative or non-indicative of insurance contracts.
- BC242 Some respondents also suggested amending the 'insurance contract' definition to cater more specifically for public sector circumstances, in particular, in cases when the arrangements depend largely on a regulatory framework rather than separate contracts.
- BC243 Respondents also provided the following feedback on the specific proposed indicators.
- (a) **Similarity of risks covered and benefits provided:** Most respondents considered this to be an important indicator because it is intuitive that a public sector arrangement which addresses similar risks and benefits to insurance contracts in the private sector would be a good candidate to fall within the scope of AASB 17/PBE IFRS 17 and is consistent with the notion of transaction neutrality. Some respondents considered that there could be two elements to this indicator: (i) similarity or comparability between the risks and the benefits themselves; and (ii) similarity with the level of riskiness when compared with private sector insurance contracts, because public sector entities are often filling a gap in the market relating to insuring the more catastrophic risks.
 - (b) **Identifiable coverage period:** All respondents supported this indicator and many considered that it should rank above most of the other indicators, with some suggesting that it should be a pre-requisite for applying AASB 17/PBE IFRS 17. Some of these respondents noted that, without an identifiable coverage period, it would not be feasible to determine the fulfilment cash flows that should be used to measure insurance liabilities and, accordingly, it is an essential feature of an insurance contract both in principle and in practical terms. Some respondents also commented that having an identifiable coverage period can be regarded as the direct opposite of a (non-insurance) compensation scheme under which individuals or entities are eligible for benefits simply because of the inherent characteristics or status they possess at a particular time.
 - (c) **Enforceable nature of arrangement:** All respondents supported this indicator and many considered that it should rank above most of the other indicators, with some suggesting that it should be a pre-requisite for applying AASB 17/PBE IFRS 17. Many of these respondents considered that enforceability is essential to there being a contract, consistent with other AASB Standards applied in the public sector that relate to contracts on revenue recognition and leases.
 - (d) **Source and extent of funding:** All respondents supported this indicator, including that the greater the extent of funding by the insured/beneficiary, the more likely it is an arrangement that would be suitable to be accounted for as giving rise to insurance contracts. Some respondents acknowledged that there is no particular tipping point in respect of the extent of funding. Some respondents considered that it is at least as relevant to focus on how an amount of funding is calculated, rather than only its source being, for example, general taxation and suggested an actuarially calculated appropriation could be indicative of insurance.

- (e) **Management practices and assessing financial performance:** Most respondents supported this indicator, but many considered that it should rank below most of the other indicators. Some respondents did not favour the indicator because they considered that most arrangements operated by government would be expected to possess this attribute to meet relevant governance standards. Some respondents considered that the focus should be on management practices more specific to the insurance industry, including underwriting and risk management.
 - (f) **Assets held to meet benefits:** Most respondents supported this indicator, but many considered that it should rank below most of the other indicators. Some respondents did not favour the indicator because they considered that many compensation schemes operated by government hold assets to meet the expected benefit payments.
- BC244 Some respondents favoured a collective assessment of all the proposed indicators without ranking them. However, most respondents favoured ranking the indicators and/or identifying some indicators as pre-requisites, for a range of reasons, including on the basis that they considered it would:
- (a) tend to result in a greater level of consistency in application and, therefore, in more consistent outcomes;
 - (b) make the assessment easier compared with the potential burden of making a collective assessment of six indicators.
- BC245 Those respondents who favoured ranking the indicators and/or identifying some indicators as pre-requisites had varied views on which of the indicators should be ranked most highly. However, balancing all the feedback received, the Boards noted that:
- (a) having an identifiable coverage period and the enforceable nature of an arrangement were generally regarded as the most crucial of the indicators;
 - (b) the similarity of risks covered and benefits provided and the source and extent of funding from those who stand to benefit from an arrangement were generally regarded as relatively important indicators; and
 - (c) having management practices and assessing financial performance in a manner consistent with insurance industry practices and the existence of assets being held in a separate fund, or an entity having access to earmarked assets, that are restricted to being used to meet benefits to an arrangement's participants were generally regarded as the least important of the indicators.
- BC246 There was no specific feedback from respondents to AASB ED 319/NZASB ED 2022-3 on the Boards' rejecting the following factors in determining whether an arrangement would be within the scope of AASB 17/PBE IFRS 17:
- (a) the for-profit versus not-for-profit status of the entity;
 - (b) scoping out social benefits or specific entities; and
 - (c) the fault-based nature of the arrangement.

Boards' conclusions on identifying public sector arrangements scoped into the AASB 17/PBE IFRS 17

- BC247 The Boards reflected on their reasons for proposing a collective assessment of the six proposed indicators and the feedback received and concluded that, in determining when a public sector arrangement should fall within the scope of AASB 17/PBE IFRS 17:
- (a) the six proposed indicators are all potentially relevant;
 - (b) no other indicators should be applied; and
 - (c) it would be beneficial to provide a more structured approach to applying the indicators, rather than the proposed collective assessment approach.
- BC248 Instead of identifying six indicators, the Board concluded that:
- (a) two of the proposed indicators should instead be pre-requisites for applying AASB 17/PBE IFRS 17;
 - (b) two of the proposed indicators should remain as indicators to be assessed collectively; and
 - (c) two of the proposed indicators should instead be ranked lower than indicators and be 'other considerations' to be assessed collectively.

The Boards considered that this would provide a more rigorous approach to determining public sector arrangements that should fall within the scope of AASB 17/PBE IFRS 17. However, they noted that

judgement would still need to be exercised in applying the pre-requisites, indicators and other considerations based on each entity's circumstances.

BC249 More specifically, the Boards concluded the following.

- (a) The existence of an identifiable coverage period for a public sector arrangement is a pre-requisite for applying AASB 17/PBE IFRS 17 on the basis that the coverage period is crucial for determining the fulfilment cash flows to include when measuring insurance liabilities and for determining the timing of insurance revenues and expenses.
- (b) The enforceable nature of a public sector arrangement is a pre-requisite for applying AASB 17/PBE IFRS 17 on the basis that a key feature of any contract is its enforceability and public sector arrangements that lack enforceability are more in the nature of social benefits.
- (c) The similarity of risks covered and benefits provided with those offered by a relevant counterpart private sector insurer is an indicator to be applied to determine whether arrangements fall within the scope of AASB 17/PBE IFRS 17 on the basis that this is consistent with a transaction neutral approach to standard-setting. The greater the level of similarity between the risks accepted and benefits provided by a public sector entity and those offered by a relevant counterpart private sector insurer, the more likely it would be that the public sector entity's arrangements would be accounted for as insurance contracts.
- (d) The source and extent of funding from those who stand to benefit from an arrangement is an indicator to be applied to determine whether arrangements fall within the scope of AASB 17/PBE IFRS 17 on the basis that a user-pays arrangement is consistent with a commercial arrangement for the transfer of insurance risk. The greater the extent of funding from those who stand to benefit from an arrangement, the more likely it would be that the public sector entity's arrangements would be accounted for as insurance contracts. A user-pays arrangement is typically distinguishable from a social benefit scheme or (non-insurance) compensation scheme.
- (e) In the event that the indicators in paragraphs (c) and (d) are not collectively definitive in determining whether arrangements fall within the scope of AASB 17/PBE IFRS 17, collective consideration is given to whether, in respect of the relevant arrangements:
 - (i) the entity has management practices and assesses financial performance in a manner consistent with insurance industry practices; and
 - (ii) there is a separate fund, or earmarked assets, that are restricted to being used to meet benefits to participants in the arrangement;
 in order to determine whether arrangements fall within the scope of AASB 17/PBE IFRS 17.

BC250 In respect of the pre-requisite for an identifiable coverage period, the Boards concluded that additional guidance would be helpful to explain that a person's inherent status in meeting eligibility criteria for participation in a scheme, stands in contrast to the existence of an identifiable coverage period.

BC251 In relation to the indicator 'similarity of risks covered and benefits provided' with those offered by any relevant counterpart private sector insurer, the Boards concluded that the similarity between the risks and the benefits themselves is the focus, not the level of riskiness. While some 'last resort' risks or 'protection gaps' might be peculiar to the public sector in terms of their level of riskiness, they concluded this would not preclude them from being within the scope of AASB 17/PBE IFRS 17. The Boards observed that, under AASB 17/PBE IFRS 17, insurance contracts are identified on the basis that they involve the transfer insurance risks – there is no limit on the level of insurance risk that might be transferred in an insurance contract or the level of riskiness.

BC252 In relation to the source and extent of funding from those who stand to benefit from an arrangement, the Boards concluded this could still be indicative of an arrangement that would fall within the scope of AASB 17/PBE IFRS 17 even though the relevant public sector entity may receive top-up funding from sources such as general taxation from time to time.

Effective date of the Standard

BC253 The mandatory application date of AASB 17/PBE IFRS 17 for entities other than public sector entities is periods beginning on or after 1 January 2023.

BC254 The Boards noted that they typically provide at least a one-year gap between the time a new or revised Standard is issued and the beginning of the comparative reporting period to which it applies. This is designed to allow stakeholders to adequately prepare for any changes to processes for preparing and auditing financial statements.

- BC255 Accordingly, the AASB decided to propose that public sector entities falling within the scope of AASB 17 be required to apply it for annual reporting periods beginning on or after 1 July 2025 and the NZASB decided it would propose that public sector entities falling within the scope of PBE IFRS 17 apply it to annual periods beginning on or after 1 January 2025. The difference in date reflects different administrative procedures; however, the impact would be the same under both proposed dates because public sector entities typically have July to June reporting periods and would first be required to apply AASB 17/PBE IFRS 17 for the period 1 July 2025 to 30 June 2026, with comparative information for the period 1 July 2024 to 30 June 2025.
- BC256 Consistent with existing practice, the Boards also decided to propose that entities would be permitted to apply AASB 17/PBE IFRS 17 earlier and, if an entity does apply the Standard early, it must disclose this fact.

Effective date of the Standard – AASB ED 319/NZASB ED 2022-3 feedback and Boards' conclusions

- BC257 Most respondents to AASB ED 319/NZASB ED 2022-3 supported the proposed application date, provided the Boards meet the planned timetable of having an Amending Standard issued by the end of December 2022. Entities that had the greatest concerns about the proposed effective date(s) were either currently applying AASB 137²⁵ or were also facing other substantive regulatory changes in the near term.
- BC258 The Boards noted that, in responding to the Draft Standard of the amendments to AASB 17/PBE IFRS 17 issued in October 2022 for fatal-flaw review comment, some stakeholders expressed the view that the effective date should be extended for a further year. In order to gauge views on the effective date, the Boards conducted informal outreach with key constituents in November 2022 on whether the effective date should be extended for a year. While most respondents had no specific preference for either a 2025 or 2026 transition date, some stakeholders considered that the additional time would be of great value to facilitate:
- (a) the update of information systems and data collection processes for arrangements falling within the scope of AASB 17/PBE IFRS 17 that currently classify their liabilities as provisions and, in some cases, when coverage periods need to be determined based on contracts issued by private sector insurers; and
 - (b) the ability to engage with key users of their financial information on the changes to their financial statements from transitioning to AASB 17/PBE IFRS 17, including in terms of budgetary processes.
- BC259 On balance, the AASB concluded that the effective date should be annual reporting periods beginning on or after 1 July 2026 and the NZASB concluded it should be annual periods beginning on or after 1 January 2026, which will result in the Standard being effective for the same annual reporting periods in both jurisdictions. The Boards consider it is appropriate to extend the effective date on the basis that:
- (a) although the 2025 effective date would have provided approximately 18 months between the issue of the Amending Standard and the beginning of the comparative period to which AASB 17/PBE IFRS 17 would apply mandatorily, the transition effort will be much greater for some public sector entities than for others; and
 - (b) although a number of the public sector modifications made to AASB 17/PBE IFRS 17 are expected to help facilitate the transition process, some public sector entities may need the additional time to inform key users of the changes to their financial statements.

The Boards also noted that harmonisation across the two jurisdictions is desirable both in terms of the requirements and the practical effective date.

Captive insurers (Amendments to AASB 1050 *Administered Items*)

- BC260 The Boards noted that large consolidated group entities sometimes establish a 'captive insurer' subsidiary to coordinate risk management for all (or most) entities within the group.²⁶ The subsidiary typically charges premiums to other entities in the group and pays them valid claims in respect of insured events, and ordinarily (re)insures some or all of the risks with one or more third-party (re)insurer(s). Australian or New Zealand-based private sector captive insurers would need to be registered as insurers and, therefore, required to prepare general purpose financial statements and meet relevant regulatory and prudential requirements.

²⁵ AASB 137 only (and not PBE IFRS 19) because the relevant entities are Australian.

²⁶ For a consolidated group that is not an insurer, the captive insurer would typically organise the group's insurance coverage. For a consolidated group that is an insurer, the captive insurer would typically organise the group's reinsurance coverage.

- BC261 The Boards noted that governments also create captive insurers and the key motivations are typically to:
- (a) centralise the administration of insurable risks across a complex group of entities and coordinate risk management policies and processes;
 - (b) charge premiums to other government agencies and, thereby, create incentives for them to manage risks; and
 - (c) in some cases, coordinate in a cost-beneficial manner the acquisition of insurance/reinsurance coverage from an external insurer/reinsurer.
- BC262 The Boards observed that, at the whole-of-government level:
- (a) transactions between the captive insurer and other government agencies are eliminated;
 - (b) any (re)insurance contracts between the captive and third-party insurers are treated as insurance contracts in which the government is a policyholder; and
 - (c) any remaining liabilities to third parties (for example, to government employees for workplace injuries) would be accounted for by applying AASB 137/PBE IPSAS 19.
- BC263 The Boards considered whether they should:
- (a) in the context of the requirements imposed on private sector Australian-based and New Zealand-based captive insurers, explicitly require public sector captive insurers that prepare general purpose financial statements to apply AASB 17/PBE IFRS 17; or
 - (b) given the eliminations at the whole-of-government level, explicitly scope public sector captive insurers out of applying AASB 17/PBE IFRS 17.
- BC264 The Boards noted the following in respect of the AASB Discussion Paper (2017).
- (a) It was proposed that public sector captive insurers should be permitted an optional exemption to not apply AASB 17 on the basis that:
 - (i) some captive public sector entities do not currently apply insurance accounting to their insurance transactions; and
 - (ii) the cost of doing so is likely to be greater than the benefits given the accounting would be reversed on consolidation. (In the consolidated entity, since insurance risk has not been transferred to a party outside the group, any claim liabilities would probably be accounted for as provisions by applying AASB 137).
 - (b) It was also proposed that, in the event there is a public sector entity that accepts insurance risk from both related and unrelated parties, the optional exemption from applying AASB 17 would apply only to transactions with related parties.
 - (c) Respondents expressed mixed views, including:
 - (i) support for captive insurers being scoped out of AASB 17;
 - (ii) support for the optional exemption;
 - (iii) strong disagreement with the proposals based on a view they would create complexity for some entities within a group reporting structure that are required to use two different measurement bases; and
 - (iv) when there are no users dependent upon the financial statements of a captive insurer, it would be at the discretion of the relevant government to exempt the entity from preparing general purpose financial statements.
- BC265 The Boards noted that NZASB ED 2018-7 did not raise the issue of captive insurers and nor did any of the respondents to the ED.
- BC266 The Boards also noted that more recent stakeholder consultation revealed a variety of reasons for different practices among Australian governments in terms of whether separate general purpose financial statements are presented for captive insurers.
- (a) Various accountability mechanisms and reporting requirements apply across the public sector and captive insurers either report separately (or not) based on those general requirements. For example, an entity may be regarded as being primarily engaged in providing claims management services to other areas of government rather than bearing insurance risk, which may lead a jurisdiction to conclude that:
 - (i) separate general purpose financial statements are not needed; or

- (ii) if separate general purpose financial statements are needed, they would be prepared on the basis that the entity is a service provider for managing the claims process, rather than bearing insurance risk, and would not apply insurance contract accounting.
- (b) Historical responsibilities for bearing risks have been allocated to the entity, which were accompanied by particular (usually legislated) 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. Entities with independent boards of directors/management might be particularly keen to demonstrate accountability and prepare separate financial statements. Some stakeholders consider the fact that their customers are related entities makes it all the more important that they prepare separate general purpose financial statements.

Boards' position on captive insurers in AASB ED 319/NZASB ED 2022-3

BC267 The Boards considered that the issues surrounding captive insurers are essentially reporting entity issues, that could affect the application of Accounting Standards more generally, rather than being issues of particular relevance to the insurance project. The Boards observed that governments which regard their captive insurer(s) as needing to prepare general purpose financial statements would have to determine whether they have:

- (a) insurance contracts and need to apply insurance contract accounting; or
- (b) are only service providers, akin to insurance brokers that are intermediaries between policyholders and insurers, that would apply, for example, AASB 15 *Revenue from Contracts with Customers* /PBE IPSAS 9 *Revenue from Exchange Transactions*.

The Boards also observed that governments which regard their captive insurer(s) as not needing to prepare general purpose financial statements, might seek to have them prepare a type of segment information, for example, for management purposes.

BC268 Accordingly, the Boards decided not to propose public sector modifications in respect of captive insurers because wider issues regarding the identification of reporting entities are at stake that are not specific to this project. They noted, if a jurisdiction determines that an entity should prepare general purpose financial statements, provided the entity's activities fall within the scope of AASB 17/PBE IFRS 17, that Standard should be applied. The Boards considered it would be inappropriate, for example, to exempt public sector captive insurers from applying AASB 17/PBE IFRS 17 in their separate financial statements.

Captive insurers – AASB ED 319 feedback and the AASB's conclusions

BC269 Some Australian respondents to AASB ED 319 expressed the following concerns about not providing any specific relief from applying AASB 17 to captive insurers and noted the following issues and perspectives.

- (a) The user of captive insurer financial statements is the controlling government, and the application of AASB 17 would provide no additional information to that user.
- (b) The costs of preparing individual captive entity financial statements in accordance with AASB 17, only to eliminate this treatment on consolidation, would exceed the potential benefit.
- (c) Issues could arise when an entity that does not prepare general purpose financial statements has insurance arrangements which are administered by a government department. Under AASB 1050, the government department may need to apply AASB 17 to prepare its administered items disclosure note in its general purpose financial statements. However, at the Whole of Government level, those arrangements are recognised under AASB 137.
- (d) A similar issue arises for the General Government Sector (GGS) financial statements where AASB 17 accounting would need to be applied in relation to captive insurance activities conducted by Public Financial Corporations (PFC)²⁷ that are eliminated on consolidation in the Whole of Government financial statements.

There were no comments from New Zealand stakeholders on captive insurers.

²⁷ A captive insurer seems most likely to be classified as a PFC, although it's possible there may be captives that are classified as a public non-financial corporation (PNFC).

- BC270 The AASB noted it would be consistent with paragraph 24 of AASB 1050 *Administered Items*, although not the only possible interpretation, for a government department administering an arrangement that falls within the scope of AASB 17 to prepare administered item disclosures based on applying AASB 17. This is because it is not self-insurance from the perspectives of the administered entity or of the administering government department.
- BC271 The AASB also noted that the issue of effectively preparing two sets of financial statements using different accounting policies is not new because there are current instances of reporting AASB 1023 *General Insurance Contracts* information for insurance activities conducted between public sector entities controlled by the same government. Therefore, currently, two sets of financial information are sometimes prepared.
- BC272 The AASB noted that, for the reasons outlined in paragraph BC266, current reporting practices for captive insurance arrangements in the public sector²⁸ vary widely in terms of the type of reporting and the accounting policies applied and the formats include the following:
- (a) separate stand-alone general purpose financial statements, presumably on the basis the arrangements are deemed to be a reporting entity;
 - (b) as a segment of the general purpose financial statements of an entity that also includes other (non-captive) insurance arrangements; and
 - (c) financial information disclosures presented in the notes to the general purpose financial statements of another entity, such as the responsible government department, whether as part of an administered items note or presented in some other way.
- BC273 The AASB considered four possible alternative approaches.
- (a) Approach 1: Allow captive insurers a free choice to apply AASB 17 or AASB 137 regardless of whether the activities would fall within the scope of AASB 17 based on the pre-requisites, indicators and other considerations, which would avoid governments being forced to apply different forms of accounting at the entity and consolidated levels. Entities currently applying AASB 137 would not be at risk of having to change their reporting to applying AASB 17 and some entities currently applying AASB 1023 may change their reporting to apply AASB 137, rather than AASB 17. However, the AASB considered the principle that each entity should apply Standards based on its own perspective and circumstances, not those of its parent, and the free choice might be seen as inconsistent with this principle.
 - (b) Approach 2: Require captive insurers to apply AASB 137, whether controlled or administered, which would avoid governments being forced to apply different forms of accounting at the entity and consolidated levels (unless applying AASB 17 met management reporting needs) and would remove any element of doubt about which Standards to apply. Entities currently applying AASB 1023 would be required to change their reporting to apply AASB 137, rather than AASB 17. It would help achieve consistent reporting of information about self-insurance activities across all forms of reporting. However, the AASB considered this approach may result in a loss of useful information, in particular disclosures about claims, and would be inconsistent with the principle that each entity applies Standards based on its own perspective and circumstances. In addition, it would force some entities to transition from insurance accounting under AASB 1023 to AASB 137, when transitioning to AASB 17 may be preferred for cost-benefit reasons.
 - (c) Approach 3: Require captive insurers to apply AASB 17, whether insurance activities are controlled or administered. This is effectively the position proposed in AASB ED 319/NZASB ED 2022-3, which would avoid governments being forced to apply different forms of accounting at the entity and consolidated levels (unless applying AASB 137 met management reporting needs) and remove doubt about which Standards to apply. Entities currently applying AASB 137 would be required to change their reporting to apply AASB 17, but only when the activities would fall within the scope of AASB 17 based on the pre-requisites, indicators and other considerations. It would help achieve consistent reporting of information about self-insurance activities across all forms of reporting. However, the AASB noted constituent concerns about having some entities transition from accounting under AASB 137 to AASB 17, which would have cost implications.
 - (d) Approach 4: No modifications to the application of AASB 17 when the activities would fall within the scope of AASB 17 based on the pre-requisites, indicators and other considerations when an entity controls the insurance activities and prepares stand-alone general purpose financial statements. However, permit a free choice for government departments to apply either AASB 17 or AASB 137 to prepare administered item information on captive insurers that do not prepare

²⁸ Private sector captive insurers in Australia and New Zealand must prepare stand-alone financial statements because they are registered insurance companies – accordingly, similar debates about the form of reporting generally do not arise.

stand-alone general purpose financial statements. This would avoid governments being forced to apply different forms of accounting at the entity and consolidated levels, but not necessarily when there are stand-alone general purpose financial statements as well. This is consistent with the principle that each entity applies Standards based on its own perspective and circumstances in the context of stand-alone general purpose financial statements, but not in an administered items context.

BC274 The AASB concluded that Approach 4 should be implemented by amending AASB 1050 for the following reasons.

- (a) The AASB considers that the decision of a jurisdiction to require an entity to prepare stand-alone general purpose financial statements when that entity, from a whole of government perspective, conducts self-insurance activities, should trigger the need to apply Accounting Standards based on that entity's perspective. As a stand-alone entity, its insurance activities²⁹ would not be self-insurance and, if the activities fall within the scope of AASB 17 based on the pre-requisites, indicators and other considerations, the captive insurer should apply AASB 17 in its general purpose financial statements.
- (b) It is reasonable from a cost-benefit perspective to avoid the potential for different accounting policies having to be applied in reporting administered item information in Departmental general purpose financial statements and consolidated information in Whole of Government general purpose financial statements.
- (c) Approach 4 seems consistent with the basis on which AASB 1050 was created. AASB 1050 emerged from a restructuring of Accounting Standards applicable to government entities that included withdrawing AAS 29 *Financial Reporting by Government Departments*, which, among other things, addressed administered item disclosure requirements. In this process, the AASB made a limited number of amendments and acknowledged inadequacies in AAS 29 are retained, including the lack of extensive guidance for identifying administered items and the potential inadequate prominence given to administered items in a complete set of financial statements – refer to paragraph BC13 of AASB 1050. The AASB noted that one possible inadequacy appears to be that the basis of accounting for administered items may differ from the basis that would be used in a government department's own financial statements in respect of controlled items – refer to paragraph BC18 of AASB 1050.

The Boards noted that supportive feedback was received for Approach 4, which was included in the Draft Standard of the amendments to AASB 17/PBE IFRS 17 (and, in the case of the AASB only, AASB 1050 *Administered Items*) issued in October 2022 for fatal flaw comment.

BC275 The AASB noted that the decision to take Approach 4 in this project, including permitting a choice of Standard to apply to determine administered item disclosures, should not be viewed as setting a precedent for how any future AASB work on administered item disclosures might evolve.

Other modifications considered but not included

Discounting and inflating

BC276 Based on public sector arrangements that seem likely to fall within the scope of AASB 17/PBE IFRS 17 and the Boards' proposals on contract boundaries and coverage periods (modifications to paragraphs 34 and B64/AG64), the Boards noted that:

- (a) most coverage periods are one year or less; and
- (b) levies/premiums are typically received either shortly before coverage commences or early in the coverage period.

BC277 Accordingly, the Boards observed that the discounting requirements in AASB 17/PBE IFRS 17 (such as in AASB 17/PBE IFRS 17.36 and 56):

- (a) would not be expected to be relevant in measuring levies/premiums and in measuring most liabilities for remaining coverage;
- (b) might be relevant in the unlikely event that the general measurement model would need to be applied to measure liabilities for remaining coverage for arrangements that provide multi-year coverage.

²⁹ This could be all the entity's activities or only a portion of its activities.

- BC278 However, the Boards observed that public sector arrangements which seem likely to fall within the scope of AASB 17/PBE IFRS 17 often involve claims that are settled over long periods – sometimes many decades – and that discounting and inflating is usually an important aspect of measuring liabilities for incurred claims.
- BC279 The Boards noted that, under AASB 1023/PBE IFRS 4, expected future cash flows are:
- (a) discounted for the time value of money at a risk-free rate based on current observable, objective rates that relate to the nature, structure and term of the future obligations;
 - (b) may need to be inflated because the ultimate cost of settlement will be affected by inflationary factors likely to occur during the period to settlement; and
 - (c) not expected to be either discounted or inflated when they are settled within a year.
- BC280 The Boards noted that, under AASB 17/PBE IFRS 17, essentially the same notions of discounting and inflating cash flows apply, but that the discount rate relates to a current time value of money and the liquidity characteristics of the insurance contracts. That is, all other things being equal, the discount rates under AASB 17/PBE IFRS 17 would be expected to be higher than under AASB 1023/PBE IFRS 4 due to the adjustment for illiquidity.
- BC281 The Boards noted the various sources of guidance and requirements (outside the Standards) for determining discount rates and inflation rates, including:
- (a) Australian and New Zealand actuarial guidance on valuation of general insurance claims;
 - (b) Australian Prudential Regulation Authority prudential requirements on insurance liability valuation;
 - (c) the risk-free discount rates and consumer price index (CPI) assumptions published by the New Zealand Treasury that must be used for the purpose of preparing the financial statements of government reporting entities submitting valuations to Treasury for measuring insurance claims liabilities under PBE IFRS 4.
- BC282 The Boards noted that, in respect of discount rates, all the various sources of guidance have a common starting point of sovereign bond yields for durations that match the relevant claims liabilities, with extrapolation when needed.

Illiquidity premium

- BC283 The Boards observed that, in concept, the size of an illiquidity premium would be positively correlated with:
- (a) the length of time over which claims (cash flows) are expected to be paid; and
 - (b) the predictability of the cash flows.
- Accordingly, the longer the time to expected settlement and the more predictable are the cash flows, the less liquid is the liability and the larger is the illiquidity premium.
- BC284 The Boards noted that, in general, private sector insurers have yet to settle on their approach to determining an illiquidity premium under AASB 17/PBE IFRS 17 and that there are, as yet, no readily-available and widely-accepted benchmarks that can be applied. However, the Boards expect that an industry practice will emerge that public sector entities could apply.
- BC285 The Boards considered whether there might be a need for public sector specific guidance on determining an illiquidity premium, but concluded that the issues for public sector entities are no different from those that need to be addressed by other entities applying AASB 17/PBE IFRS 17.

Investment rates of return and discount rate volatility

- BC286 The Boards noted that:
- (a) most public sector entities set premiums/levies with a view to breaking even, after taking into account any relevant projected investment earnings; and
 - (b) the rate of projected investment returns assumed is typically above the time value of money rate applied to measure liabilities for incurred claims.
- Accordingly, public sector entities ordinarily recognise unexpired risk liabilities (onerous contract losses) due, in part, to the gap between the rates.
- BC287 The Boards also noted that, for many public sector entities, the liability for incurred claims is by far the largest liability and small changes in discount rates can create liability changes from period to period that create the largest expense or revenue item in the income statement. Based on consultation with stakeholders when

undertaking this project, yields on government bonds that are typically used to determine risk-free rates had been at historical lows, and small changes in rates have been having a larger than usual impact.

- BC288 The Boards noted that, based on stakeholder outreach conducted in 2020-21, there is a widespread awareness that:
- (a) the gap between discount rates leads to up-front loss recognition;
 - (b) changes in discount rates lead to volatility; and
 - (c) some stakeholders find the up-front loss recognition and volatility potentially misleading.
- BC289 The Boards noted some stakeholders consider that long-run investment rates of return should be applied to discount cash flows in measuring liabilities for incurred claims, which may generally remove the up-front loss recognition and mitigate the volatility in liabilities for incurred claims.
- BC290 The Boards considered whether there might be a need for public sector-specific guidance or modifications in respect of the discount rate requirements in AASB 17/PBE IFRS 17 (such as in AASB 17/PBE IFRS 17.36 and 56) on the basis that:
- (a) for-profit private sector insurers typically have a profit 'buffer' that (in most cases) avoids the need to recognise an up-front loss relating to the impact of the gap between risk-free and investment rates; and
 - (b) the gap between the risk-free and investment rates can be larger for public sector entities relative to their regulated private sector counterparts. This is because regulated private sector insurers typically hold investments with an overall lower risk/return profile than their public sector counterparts, which do not face the same regulatory disincentives to investing in higher risk/return asset classes.

Rates in other Standards

- BC291 The Boards noted that some Australian public sector entities have arrangements that give rise to claims settled over long periods and these arrangements are currently accounted for as provisions by applying AASB 137. They noted that discount rates required for measuring provisions reflect current market assessments of the time value of money and the risks specific to the liability.
- BC292 The Boards noted that, based on stakeholder outreach conducted in 2020-21, there are differing views on the rates required by AASB 137/PBE IPSAS 19.
- (a) Some stakeholders interpret the AASB 137/PBE IPSAS 19 requirements as being the same or similar to the discounting requirements in AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17.
 - (b) Some stakeholders regard the AASB 137/PBE IPSAS 19 requirements as being different from the discounting requirements in AASB 1023/PBE IFRS 4 and AASB 17/PBE IFRS 17. They see a key potential difference being the focus of AASB 1023/PBE IFRS 4 (and AASB 17/PBE IFRS 17) on an entity perspective because an insurer is expected to fulfil its insurance liabilities. In contrast, they see the focus of AASB 137/PBE IPSAS 19 as being on settlement, which could be with a third party and be measured at more or less than face value.

Presentation

- BC293 The Boards observed that:
- (a) under AASB 1023/PBE IFRS 4, both the initial and subsequent impacts of discounting and inflating fulfilment cash flows are presented within the 'underwriting result'; however,
 - (b) under AASB 17/PBE IFRS 17:
 - (i) only the initial impacts of discounting fulfilment cash flows are presented within the 'insurance service result';
 - (ii) the impacts of subsequent discount rate changes are presented in 'insurance finance income or expenses', including the impact on insurance liabilities of the unwinding of the discount as time passes and the impact of discount rate changes under AASB 17/PBE IFRS 17.87; and
 - (iii) some of the subsequent impacts of inflation rate changes are presented in 'insurance service result' and others in 'insurance finance income or expenses' under AASB 17.B128/PBE IFRS 17.AG128.

- BC294 The Boards noted that at least some of the volatility currently presented as a part of the underwriting result would be separately presented under AASB 17/PBE IFRS 17 as insurance finance income or expenses, which may help facilitate explaining the impacts of changing discount rates to users of the financial statements.
- BC295 The Boards also noted that the distinction between the subsequent impacts of inflation rate changes that are presented in 'insurance service result' versus 'insurance finance income or expenses' has yet to be clarified in practice, but the issues are the same for both private and public sector entities. Accordingly, the Boards expect that an industry practice will emerge that public sector entities could apply.

Boards' position on discounting and inflating in AASB ED 319/ NZASB ED 2022-3

- BC296 The Boards considered whether there might be a need for public sector-specific modifications to the discount rate requirements of AASB 17/PBE IFRS 17 to address concerns about up-front loss recognition and volatility.
- BC297 The Boards decided that they would not propose any modifications on discounting fulfilment cash flows for the following reasons.
- (a) The same discounting issues which arise for public sector entities also arise for private sector entities, while acknowledging those issues can have a more significant impact for public sector entities.
 - (b) The issues of volatility of liabilities due to discount rate changes from period to period are also a feature of the discount rate requirements in other Standards (such as AASB 119/PBE IPSAS 39 *Employee Benefits*), and that any efforts to address these issues would need to involve a broad-based project that goes beyond a project on insurance arrangements in the public sector.
 - (c) Any project on discount rates might involve a broader consideration of measurement issues more generally.
- BC298 Specifically in relation to the possible application of long-run investment returns as the basis for discount rates, the Boards noted that, conventionally, assets and liabilities are measured independently. That is, for example, the measurement of a liability is based on the liability's inherent characteristics, not on the characteristics of any assets that might be available to settle the liability. Accordingly, the Boards concluded that any consideration of overturning long-standing conventions of this nature would need to involve a review of principles that go beyond a project on insurance arrangements in the public sector.

Discounting and inflating – AASB ED 319/NZASB ED 2022-3 feedback and Boards' conclusion

- BC299 There was no specific feedback from respondents to AASB ED 319/NZASB ED 2022-3 on discounting and inflating. The Boards concluded that it is not appropriate to have public sector modifications on discounting and/or inflating fulfilment cash flows in the context of AASB 17/PBE IFRS 17.

Measurement of investments backing insurance liabilities

- BC300 When it is feasible under Accounting Standards to measure an investment that backs insurance liabilities at fair value through profit or loss, AASB 1023/PBE IFRS 4 requires an entity to apply fair value through profit or loss accounting. This includes applying accounting policy choices/designations within Accounting Standards to use fair value through profit or loss accounting for: financial instruments; investment property; and, in relation to separate financial statements, investments in subsidiaries, joint ventures and associates.
- BC301 The Boards acknowledged that the AASB 1023/PBE IFRS 4 requirements were based on a view that fair value 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.
- BC302 The Boards noted that, unlike AASB 1023/PBE IFRS 4, IFRS 17 is a global Standard, and asset measurement and reporting practices (other than fair value through profit or loss) may emerge within the insurance industry globally, which Australian and New Zealand insurers should be able to follow.
- BC303 The Boards noted that, in stakeholder consultation conducted for this project in 2020-21, 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 fair value through profit or loss accounting to assets 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. Those funds management entities ordinarily hold assets for trading and apply fair value through profit or loss accounting. Most funds management entities typically only supply fair value information to their unitholders.

Boards' position on measurement of investments backing insurance liabilities in AASB ED 319/NZASB ED 2022-3

- BC304 The Boards considered that:
- (a) in practical terms, there are strong existing incentives for public sector entities to apply fair value through profit or loss accounting;
 - (b) in broad terms, the general application of fair value through profit or loss accounting to investments backing insurance liabilities is probably the most useful approach to meet the needs of public sector users of the financial statements; and
 - (c) all the relevant public sector entities are likely to voluntarily continue applying fair value through profit or loss accounting.
- BC305 The Boards decided that they would not propose carrying forward into AASB 17/PBE IFRS 17 the modifications on investment measurement from AASB 1023/PBE IFRS 4 for public sector entities.

Measurement of investments backing insurance liabilities – AASB ED 319/NZASB ED 2022-3 feedback and Boards' conclusion

- BC306 There was no specific feedback from respondents to AASB ED 319/NZASB ED 2022-3 on measurement of investments backing insurance liabilities. The Boards concluded that it is not appropriate to have public sector modifications on the measurement of investments backing insurance liabilities in the context of AASB 17/PBE IFRS 17.
- BC307 The Boards noted informal feedback suggesting public sector entities with arrangements that might fall within the scope of AASB 17/PBE IFRS 17 would typically be applying a fair value through profit or loss approach to recognise and measure investments, when available under the Accounting Standards. In many cases, this is due to the government-wide accounting policy framework and/or because many entities have their investments in the custody of central agencies that only provide information for financial reporting purposes on a fair value through profit or loss basis.

Risk mitigation program and other similar costs

- BC308 The Boards noted that most entities that conduct insurance business undertake risk mitigation activities, which are not directly related to particular insurance arrangements. They could include, for example:
- (a) risk assessments of a customer's premises that are to be insured; and/or
 - (b) education programs among policyholders regarding safe work practices.
- BC309 The Boards observed that, for private sector for-profit insurers, these activities would be expected to typically be closely associated with underwriting or claims management and to be attributable to particular contracts or groups of contracts.
- BC310 The Boards also observed that the same types of activities are conducted by public sector entities; however, they would often have a broader community focus, including for example:
- (a) road safety campaigns;
 - (b) research into medical practices in public hospitals; and/or
 - (c) research into rehabilitation techniques to improve return to work experience.
- BC311 The Boards noted that, compared with AASB 1023/PBE IFRS 4, AASB 17/PBE IFRS 17 has more specific requirements around the types of costs that are to be accounted for as a part of insurance contract liabilities and more specific presentation requirements around the income statement line items that make up the 'insurance service result'. In particular, they noted that costs which might currently be accounted for as a part of the 'underwriting result' under AASB 1023/PBE IFRS 4 may not be sufficiently attributable to the fulfilment of particular groups of contracts to be accounted for within the 'insurance service result' under AASB 17/PBE IFRS 17.

- BC312 This led the Boards to consider whether there is a need for public-sector-specific modifications in respect of costs associated with risk mitigation activities that might not be attributable to particular groups of contracts. This is particularly since these costs may be more significant in a public sector context (compared with private sector for-profit entities).
- BC313 The Boards noted the following feedback received from stakeholder outreach conducted in 2020-21.
- (a) Some public sector entities that provide risk coverage for policyholders also have a separate (sometimes legislated) objective of educating communities about safety or investing in infrastructure that promotes safe outcomes.
 - (b) Public sector entities are typically separately accountable for costs associated with risk mitigation and they are usually readily identifiable.

Boards' position on risk mitigation program and other similar costs in AASB ED 319/NZASB ED 2022

- BC314 Based on the above considerations, the Boards decided that there is no need to propose any public sector modifications in respect of risk mitigation program and other similar costs.
- BC315 The Boards considered that:
- (a) public sector entities would have little difficulty identifying risk mitigation program costs and classifying them in accordance with AASB 17/PBE IFRS 17; and
 - (b) presenting these costs separately from the insurance service result would be useful in a public sector context since they usually relate to a separate and identifiable organisational objective.

Risk mitigation program and other similar costs – AASB ED 319/ NZASB ED 2022-3 feedback and Boards' conclusion

- BC316 There was no specific feedback from respondents to AASB ED 319/NZASB ED 2022-3 on risk mitigation program and other similar costs. The Boards concluded that it is not appropriate to have public sector modifications on the classification or presentation of risk mitigation program and other similar costs in the context of AASB 17/PBE IFRS 17.

Other matters raised in feedback on AASB ED 319/ NZASB ED 2022-3

- BC317 Respondents to AASB ED 319/NZASB ED 2022-3, either in their formal submissions, or in follow-up discussions, raised the following matters:
- (a) accounting for insurance contracts that provide adverse development coverage; and
 - (b) accounting for non-distinct investment components.

Adverse development coverage

- BC318 In respect of insurance contracts that provide adverse development coverage, the Boards noted that the coverage period relates to the time over which the amount of claims is expected to remain uncertain, which would often be up to the time of settlement, which is potentially a long period. Accordingly, the insurer would recognise any compensation received or receivable for accepting adverse development risk over that potentially long coverage period and may never recognise a liability for incurred claims, even though the liability is managed as a claims liability. The Boards considered whether public sector entities, in particular, might have insurance contracts that provide adverse development coverage and whether there are any public sector specific reasons for modifying AASB 17/PBE IFRS 17 in accounting for such coverage.
- BC319 The Boards concluded that there is no need for public sector modifications in respect of adverse development coverage on the basis that:
- (a) while a public sector entity might have contracts providing adverse development coverage that, for example, might arise from a government restructuring of administrative arrangements, that form of coverage is not expected to be common in the public sector and possibly less common than in the private sector;
 - (b) while there may be concerns that the accounting does not reflect the manner in which the contracts are managed, the same issues arise in the private sector; and

- (c) the potentially long coverage period would not affect eligibility for applying the premium allocation approach given that the Boards concluded public sector entities would have an accounting policy choice to apply that approach.

BC320 However, the Boards also noted that the transition provision in AASB 17.C9A/PBE IFRS 17.132.9A applies to an entity using a modified retrospective approach in accordance with AASB 17.C8/PBE IFRS 17.132.8 and involves classifying as a liability for incurred claims a liability for settlement of claims incurred before an insurance contract was acquired in a transfer of insurance contracts. Such a transfer may not form a business or may be in a business combination within the scope of AASB 3 *Business Combinations* /PBE IPSAS 40 *PBE Combinations*. The Boards observed that there is an additional dimension to such transfers in a public sector context because some liabilities acquired by public sector entities in their claims settlement stage are being accounted for under AASB 137/PBE IPSAS 19. The existing AASB 17/PBE IFRS 17 transition provision requires the continued use of claims liability accounting under AASB 17/PBE IFRS 17, but would not enable the continued use of AASB 137/PBE IPSAS 19.

BC321 Given that the arrangements concerned are in their settlement phase, the Boards considered that any benefit to users of a public sector entity changing its accounting to apply AASB 17/PBE IFRS 17 rather than AASB 137/PBE IPSAS 19 in the event that the relevant arrangement was within the scope of AASB 17/PBE IFRS 17³⁰ would be likely to be outweighed by the costs. Accordingly, the Boards concluded that, on transition to AASB 17/PBE IFRS 17, in respect of an arrangement that constitutes a liability for settlement of claims incurred before the liability was acquired in a transfer, a public sector entity would be required to:

- (a) classify the liability as a liability for incurred claims and apply AASB 17/PBE IFRS 17 when the entity has previously asserted explicitly that it regards the liability as an insurance liability; and
- (b) classify the liability as a provision and apply AASB 137/PBE IPSAS 19 when the entity has not previously asserted explicitly that it regards the liability as an insurance liability.

The Boards noted that supportive feedback was received for the above transition provision, which was included in the Draft Standard of the amendments to AASB 17/PBE IFRS 17 (and, in the case of the AASB only, AASB 1050 *Administered Items*) issued in October 2022 for fatal flaw comment.

Non-distinct investment components

BC322 The Boards noted that non-distinct investment components arise when, in all circumstances, there is a return of premium/levies from the insurer to the policyholder and that this can arise, for example, when the final amount of premiums/levies depends on the extent of claims. They noted that this sometimes arises for Workers' Compensation insurance, which is conducted by both private and public sector entities. The Boards considered whether there are any public sector specific reasons for modifying AASB 17/PBE IFRS 17 in accounting for non-distinct investment components.

BC323 The Boards concluded that there is no need for public sector modifications in respect of non-distinct investment components on the basis that:

- (a) the nature of the non-distinct investment components that arise in the public sector appear to be no different from those that arise in the private sector; and
- (b) based on informal consultation with key stakeholders, the incidence of non-distinct investment components in the public sector is no more prevalent, and possibly less prevalent, than in the private sector.

Regulatory matters, including Government Finance Statistics (GFS) implications, raised in feedback on AASB ED 319

GFS-related matters

BC324 Some respondents to AASB ED 319 raised the following GFS reporting issues:

- (a) possible scope differences between accounting practice and GFS, including that GFS refers to 'premiums' in respect of an 'insurance corporation', implying premiums are an essential feature of insurance, while AASB ED 319 referred to 'source and extent of funding' as one of six indicators; and

30 Although there would be no current coverage, a past coverage period may be determinable in some cases.

- (b) AASB 17 requires investment returns to be recognised, measured and presented separately, while GFS deems the income generated by the investment of reserves as an implicit premium supplement attributed to policyholders.
- BC325 The AASB identified that both the scope issue and investment returns issue can arise under the superseded AASB 1023/AASB 4 and concluded that these matters, at this stage, should be addressed through liaison between the AASB and the Australian Bureau of Statistics, rather than by modifying AASB 17. The AASB noted that a number of other potential issues also need to be discussed with the Australian Bureau of Statistics, including the AASB 17 classification of the impacts of: (i) changes in discount rates and inflation rates; and (ii) the unwinding of discounting and inflating cash flows, as a separate item 'insurance finance income or expenses'.

Audit and assurance matters

- BC326 Some respondents identified a range of audit and assurance challenges under the AASB ED 319 proposals relating to the scope of AASB 17 that could increase audit and client costs including:
- (a) significant audit resources will be required to make judgments about which arrangements should be subject to the assessment process and to make the assessments based on the indicators;
 - (b) a lack of clarity on the essence/focus of an insurance contract will be an audit challenge, including how coverage periods are intended to be determined where there is no contract;
 - (c) any arrangements currently accounted for under AASB 137 that need to migrate to AASB 17 will pose a challenge since the proposals in their current form have not been tested; and
 - (d) applying the notion that risk adjustments are based on compensation sought for bearing risk.
- BC327 The AASB noted that applying any new Accounting Standard would require an entity to incur costs and effort to ensure the new requirements are applied appropriately and concluded that each of the above matters, to some extent, are at least mitigated, based on the following:
- (a) the Boards' decisions to identify two pre-requisites, two indicators and two other considerations and explain how they are applied should help to ease the auditing challenges around determining which arrangements fall within the scope of AASB 17;
 - (b) the range of public sector modifications to AASB 17 should help minimise the costs of transitioning from AASB 1023/AASB 4 and, if relevant, from AASB 137; and
 - (c) further reasoning is included in the Basis for Conclusions on risk adjustments.

Cost-benefit considerations

- BC328 Disparate views were expressed by some respondents in response to AASB ED 319 on the following matters that relate to whether the application of AASB 17 to the public sector is cost-beneficial:
- (a) the usefulness of the information that would be produced by public sector entities applying AASB 17;
 - (b) greater consistency of accounting that could be achieved across entities;
 - (c) costs associated with applying the indicators for determining whether an arrangement falls within the scope of AASB 17;
 - (d) costs associated with liability measurement, including for actuarial services; and
 - (e) costs associated with determining eligibility for the premium allocation approach and/or the costs of applying the general measurement model to determine liabilities for remaining coverage.
- BC329 The AASB concluded that acting on the matters raised would change the objective of the project and that the public sector modifications made to AASB 17 either fully address or substantially mitigate the concerns expressed, based on the following:
- (a) the Boards' decisions on identifying two pre-requisites, two indicators and two other considerations and explaining how they are applied should help to reduce the costs of determining when arrangements fall within the scope of AASB 17, and this would be expected to be a 'one-time' determination; and
 - (b) providing public sector entities with an accounting policy choice to apply the premium allocation approach.

Implications for AASB 4, AASB 1023 and AASB 1038

- BC330 The AASB noted that adopting IFRS 17 would supersede the following Standards and, therefore, change current accounting requirements for insurance contracts:
- (a) AASB 4 *Insurance Contracts*;
 - (b) AASB 1023 *General Insurance Contracts*; and
 - (c) AASB 1038 *Life Insurance Contracts*.
- BC331 The AASB acknowledged that doing so would improve financial reporting in some respects but not in other respects.
- BC332 Regarding the key aspects, the AASB noted that:
- (a) the main improvements include:
 - (i) greater clarity around the accounting for acquisition costs, particularly for general insurance; and
 - (ii) greater alignment with other industries of the basis for revenue recognition for insurance contracts with coverage periods greater than one year; and
 - (b) the main areas of concern include:
 - (i) use of historical (inception-date) discount rates in accounting for the contractual service margin under the general measurement model;
 - (ii) use of ‘coverage period’ (rather than pattern of service provision) as the basis for recognising the contractual service margin in profit over the contract life; and
 - (iii) the level of aggregation of contracts for accounting purposes.
- BC333 In weighing up these issues, the AASB also acknowledged the precedent it established when it decided not to adopt IAS 26 *Accounting and Reporting by Retirement Benefit Plans* in favour of retaining the Australian accounting requirements specified in AAS 25 *Financial Reporting by Superannuation Plans*. This decision was subsequently reconfirmed when the AASB issued AASB 1056 *Superannuation Entities* to supersede AAS 25.
- BC334 In considering the facts and circumstances surrounding the AASB’s decisions not to adopt IAS 26 (and thereby have an exception to its IFRS adoption policy), the AASB concluded that the legislative environment as well as tailored financial reporting requirements for superannuation entities (which were not adequately addressed in IAS 26) justified the need for a specific Australian pronouncement (see paragraphs BC7–BC11 of AASB 1056). In contrast, overall, the AASB concluded that IFRS 17 represents a comprehensive, internationally consistent, set of financial reporting requirements for Australian insurers, despite the issues noted in paragraph BC332(b).
- BC335 On balance, the AASB considered that the benefits arising from international harmonisation in relation to the accounting for insurance contracts, and the greater alignment of the basis for revenue recognition with other industries noted in paragraph BC332(a)(ii), outweighed the drawbacks noted in paragraph BC332(b). Accordingly, the AASB decided to:
- (a) supersede AASB 4 and AASB 1023 for private sector entities when AASB 17 is applied to those entities, that is, for annual periods beginning on or after 1 January 2023;
 - (b) repeal AASB 4 and AASB 1023 for annual periods beginning on or after 1 July 2026 when AASB 17 is applied to all entities, including public sector entities; and
 - (c) repeal AASB 1038 and supersede Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations* (see paragraphs BC337–BC340) for annual periods beginning on or after 1 January 2023, on the basis that AASB 17 applies to those periods in respect of private sector entities and the pronouncements are not relevant to public sector entities.
- BC336 The AASB noted that a consequence of its decision to supersede AASB 1023 and AASB 1038 is that Australian specific disclosures (eg paragraphs 17.8 and 17.10(c) of AASB 1038 relating to regulatory capital disclosures and conformance with the *Life Insurance Act 1995*) are no longer required. The AASB is closely monitoring the response of the Australian Prudential Regulation Authority to the introduction of AASB 17. At this stage there are no plans for the AASB to include similar supplementary disclosures in AASB 17.

Implications for Interpretation 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations*

- BC337 Interpretation 1047 was originally issued in June 2002 to address divergent views as to whether a Medical Defence Organisation (MDO) should recognise a liability for future claims arising from the medical indemnity insurance it offered, given the MDO had discretion as to whether to pay claims made by members. The Interpretation required that a MDO recognise its obligations in a manner consistent with the principles in AASB 1023.
- BC338 After 1 July 2003, the *Medical Indemnity Act 2002* came into effect and regulatory arrangements allowed only authorised general insurers to offer medical indemnity insurance. In August 2016 the AASB noted feedback from staff outreach to industry stakeholders indicating that all medical indemnity insurance had, as of then, been transferred to authorised general insurers (or subsidiaries thereof).
- BC339 Also at its August 2016 meeting, the AASB noted that some business written by MDOs prior to 1 July 2003 could still be in existence, and therefore might still require the guidance of Interpretation 1047. However, on balance, based on the feedback from staff outreach to industry stakeholders, the AASB concluded that any such remaining business would be immaterial to the financial statements of the affected insurers.
- BC340 Accordingly, the AASB concluded that it would supersede Interpretation 1047 upon the adoption of IFRS 17 [as AASB 17] for private sector entities given it was no longer materially relevant, could result in a perceived 'difference' from IFRS Standards if retained and no longer reflected predominant current practice.

Implications for AASB 1056 *Superannuation Entities*

- BC341 The AASB issued Exposure Draft ED 223 *Superannuation Entities* (December 2011) proposing new accounting requirements for superannuation entities as part of the AASB's comprehensive review of AAS 25. ED 223 proposed that superannuation entities must measure any liabilities arising from insurance arrangements provided to members in accordance with the approach in AASB 119 *Employee Benefits* for defined benefit plans.
- BC342 The AASB issued AASB 1056 in June 2014 instead requiring that superannuation entities apply the defined benefit member liability measurement requirements of AASB 1056, as opposed to AASB 119, in response to feedback received on ED 223.
- BC343 When issuing AASB 17 the AASB was aware that a superannuation entity acting in the capacity of an insurer would apply the insurance requirements of AASB 1056 and not those of AASB 17 because AASB 1056 effectively overrides AASB 17 for a superannuation entity acting in the capacity of an insurer. The AASB noted this would mean superannuation entities could not claim compliance with IFRS Standards. However, the AASB noted that superannuation entities could not claim IFRS compliance anyway because AASB 1056 does not incorporate the corresponding IASB Standard. Accordingly, the AASB decided that no amendments were necessary to the insurance requirements of AASB 1056 as IFRS compliance is not an objective in this limited circumstance. For the avoidance of doubt, the AASB also decided to prevent superannuation entities from applying AASB 17 through an amendment to AASB 1057 *Application of Australian Accounting Standards*. Consequently, the AASB deleted a cross-reference to IAS 26 from paragraph 7(b) of AASB 17 instead of replacing it with a cross-reference to AASB 1056.
- BC344 The AASB also considered groups where the consolidated financial statements of a superannuation entity include an insurance subsidiary that applies AASB 17. On this matter the AASB noted that no significant issues were brought to its attention during the development of either AASB 1056 or AASB 17, nor since.
- BC345 Accordingly, the AASB decided to issue AASB 17 without any consequential amendments to the insurance requirements of AASB 1056.