

Board Meeting Agenda

Virtual Meeting (half-day) — Tuesday, 21 September 2021

Est Time	Item	Topic	Objective		Page
NON-PUBLIC SESSION					
PUBLIC SESSION					
9.05 am	2	Tier 3 and Tier 4 PIR	(JC/NH)		
	2.1	Cover memo – Tier 4 Standard simplifications	Consider	Paper	
	2.1.1	Draft amended Tier 4 Standard	Consider	Paper	
	2.1.2	Current Tier 4 Standard <i>Public Benefit Entity Simple Format Reporting – Cash (Not-for-profit)</i>	Note	Supp paper	Link to XRB website
	2.2	Cover memo – Tier 3 recognition of donation and grant revenue	Consider	Paper	
10.35 am	Morning tea break				
10.45 am	3	Public Sector Insurance	(VSF/AT)		
	3.1	Cover memo	Consider	Paper	
	3.2	Identifying and accounting for onerous contracts and related unit of account issues	Consider	Paper	
	3.3	Redeliberation of scope and risk adjustments topics	Consider	Paper	
	3.4	Measurement of investments backing insurance liabilities	Consider	Paper	
	3.5	Risk mitigation program costs and other similar costs	Consider	Paper	
	3.6	Captive insurers	Consider	Paper	
12.45 pm	<i>Finish</i>				

Next NZASB meeting: Tuesday 19 October 2021 (virtual)

Date: 13 September 2021

To: NZASB Members

From: Jamie Cattell and Nicola Hankinson

Subject: Tier 4 Standard Simplifications

Purpose and introduction¹

1. The purpose of this session is to seek Board FEEDBACK on proposed amendments to the Tier 4 Standard.
2. Many respondents to the Post-implementation Review of the Simple Format Reporting Standards (PIR) highlighted concerns about the length and complexity of the Tier 4 Standard. Respondents noted the Standard required simplification to promote increased adoption and consistent application by non-accountants
3. In response to these concerns, staff have drafted an amended Tier 4 Standard. Through a process of shortening and simplifying the language used to explain the Tier 4 reporting requirements the Tier 4 Standard has been reduced by 31 pages to 16 pages.
4. This memo highlights the key amendments made to the Tier 4 Standard. Given the significant re-write of the Standard, we encourage the Board to review draft amended Tier 4 Standard in full (agenda item 2.1.1).

Background

5. At the June meeting we provided the Board with a detailed analysis on each of the issues we received feedback on as part of the PIR and agreed that proposed standard-setting activity would be undertaken in simplifying the Tier 4 Standard.

Structure of this memo

6. The remaining sections in this memo are:
 - (a) Summary of feedback; and
 - (b) Proposed amendments.

Summary of feedback

7. As noted in the Feedback Statement, respondents noted that many Tier 4 not-for-profit entities were finding it difficult to comply with the Tier 4 Standard. Reasons provided for this included the following.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

- The Tier 4 Standard and guidance is considered too long and complex for many Tier 4 not-for-profit entities.
 - The language used in the Tier 4 standard is considered too technical to be understood by non-accountants.
 - Many not-for-profit entity’s view preparing their performance report as a compliance exercise, rather than as an important part of managing their organisation.
 - Small not-for-profit entities are often under-resourced and find it difficult to attract and retain volunteers or staff who understand the reporting requirements.
 - There is a general lack of financial capability in the not-for-profit sector.
8. These respondents generally considered that our primary focus should be to reduce the length and complexity of the Tier 4 Standard and to simplify the language used. They considered this could be achieved without compromising transparency and accountability, provided that the Standard focuses on the key information required by users.

Proposed amendments

9. In response to this, we have prepared a simplified Tier 4 Standard (agenda item 2.1.1). It is important to note that the final wording for inclusion in the Exposure Draft will depend on the decisions the Board makes at future meetings on other issues (i.e. consideration of specific issues that relate to both Tier 3 and 4 Standards such as service performance reporting).
10. The proposed amendments to the Tier 4 Standard are summarised below.

Name of the Tier 4 Standards

11. One respondent considered that use of the word ‘cash’ in the title of the Tier 4 Standards was confusing and that many charities do not think the Standard applies to them because they do not operate using physical cash.
12. We also note the name of the Tier 4 Standard is rather long and the short-form name is not useful when encouraging adoption by non-accountants. The current Tier 4 names are:
- (a) Public Benefit Entity Simple Format Reporting — Cash (Not-for-Profit) (PBE SFR-C (NFP)); and
 - (b) Public Benefit Entity Simple Format Reporting — Cash (Public Sector) (PBE SFR-C (PS)).
13. We agree that use of the word ‘cash’ in the name of the Standards may not be useful. Because of this, and to assist in simplifying the language used, we recommend renaming the two Tier 4 Standards as:
- (a) Tier 4 Standard (Not-for-Profit) – (Tier 4 NFP)
 - (b) Tier 4 Standard (Public Sector) – (Tier 4 PS)

Question for the Board

- Q1. Does the Board agree with the staff recommendation to rename the Tier 4 Standards?

Statement of Resources and Commitments

14. We noted mixed views from respondents on the usefulness and purpose of the Statement of Resources and Commitments in the Tier 4 Standard. It appears there is some confusion over whether this Statement was intended to be some form of simplified balance sheet. Many respondents considered that it was not appropriate to force accrual concepts onto preparers that are applying a cash-based standard.
15. At the June 2021 meeting, the Board agreed in principle to remove the requirement to a Statement of Resources and Commitments from the Tier 4 Standard. Instead, the Board agreed to require the disclosure of any significant assets and/or significant liabilities in the notes.
16. On balance we consider it important that the Tier 4 Standard continues to require the reporting of an entity's significant assets and liabilities to enable the reader to understand the significant assets available to deliver future services and the entity's ability to continue operating in the future. However, this information should be kept at a minimum to recognise the cash-basis of the standard and the need to keep the requirements simple.
17. Given the Tier 4 Standard is cash-based we considered the arguments for removing the information concerning assets/resources and liabilities/commitments completely. However, we considered its retention was important to assist smaller entities to transition to Tier 3 when and if/when they exceed the Tier 4 size threshold in the future.
18. The current Tier 4 Standard contains over 30 paragraphs of requirements relating to the Statement of Resources and Commitments (A72 – A103). The proposed amendments (agenda item 2.1.1) reduce these requirements down to 12 paragraphs, including example disclosures of significant assets and liabilities.
19. The proposed amendments to the Tier 4 Standard in agenda item 2.2.1 include:
 - (a) requiring disclosure of assets and liabilities in the notes to the Performance Report rather than as a separate Resources and Commitment Statement; and
 - (b) restricting disclosure to significant assets (such as land, buildings, and vehicles) and significant liabilities (primarily borrowings from external parties).

Question for the Board

- Q2. Does the Board agree with the staff recommendation relating to the Statement of Resources and Commitments?

Entity Information

20. The Tier 4 Standard currently includes an *Entity Information* section to be presented within the Performance Report. The Tier 4 requirements relating to Entity Information were intended to provide context to help readers understand the Performance Report, in particular the service performance information.
21. Two respondents commented that the requirements relating to Entity Information duplicates information required to be provided in other parts of the Performance Report and the Annual Report filed with Charities Services.
22. One respondent also noted that the requirements for Entity Information in the Tier 4 Standard are more onerous than those which apply to Tier 2 entities.
23. Staff recently discussed the current Tier 4 Entity Information with Charities Services, who agreed that there was some duplication of information reported and there was scope for reducing the extent of entity information disclosed in the Tier 4 Performance Report.
24. Staff propose amending the Tier 4 Entity Information as set out in the table on the next page.

Question for the Board

- Q3. Does the Board agree with the staff recommendation relating to Entity Information?

Existing Tier 4 Entity Information requirements	Proposed Tier 4 Entity Information requirements	Basis for proposed amendment
The entity information shall provide general descriptive information about the entity and its activities. This information shall comprise:	The purpose of the Entity Information section is to provide general information about the entity.	Removed reference to “activities” because this is covered by the Statement of Service Performance
(a) The entity’s name, type of entity and legal basis (if any)	(a) the entity’s name, type of entity and legal basis (if any);	No change
(b) The entity’s purpose or mission (the key difference the entity is trying to make)	Removed from Entity Information	Removing duplication – this information should be captured by the Statement of Service Performance
(c) A description of the structure of the entity’s operations (including governance arrangements);	(b) the entity structure if it is not a stand-alone entity (i.e. whether it includes separate operating units, divisions or branches);	No significant change
	(c) the names of any entities controlled by your charity for financial reporting purposes;	Considered useful information <u>if</u> the entity prepares a consolidated Tier 4 performance report
	(d) the entity’s governance arrangements (i.e. the governing body that makes the key operating, investing and financing decisions);	No significant change, split from existing requirements
(d) The main sources of the entity’s cash and resources;	Removed from Entity Information	Removing duplication – information on the entity’s source of cash and other significant assets/resource is provided in other sections of the Performance Report
(e) The main methods used by the entity to raise funds;	Removed from Entity Information	
(f) The entity’s reliance on volunteers and donated goods or services; and	(e) the entity’s reliance on volunteers and donated goods or services;	No significant change
(g) Any additional information that is considered essential to users’ overall understanding of the entity.	Removed from Entity Information	General information about the entity’s objectives and activities is captured by the Statement of Service Performance

Size thresholds

25. One respondent considered that more clarity is needed about when and how entities are required to transition between tiers. They recommended including guidance on determining whether an entity has exceeded the size threshold for Tier 3 or Tier 4 within the standards themselves (rather than in XRB A1 Application of the Accounting Standards Framework).
26. Staff agree that it would be useful to include guidance on determining whether an entity has exceeded the size threshold within the standards themselves, given the majority of preparers would not be familiar with XRB A1. We also considered it is useful for the Tier 4 Standard to stand alone, as was intended when these Standards were developed.
27. As such, staff recommend that some simple information on the Tier 4 size threshold be included in the Tier 4 Standard.

Question for the Board

- Q4. Does the Board agree with the staff recommendation to include some information about the Tier 4 size threshold in the introductory section of the Tier 4 Standard?

Use of the terms Cash and Receipts

28. We received feedback that the use (and definition) of the terms ‘cash’ and ‘receipts’ in the Tier 4 Standard was resulting in interpretation issues. Often, preparers and users think these terms refer to physical cash and receipts rather than all funds held or received by the entity during the period. One respondent also commented that some items may be inappropriately treated as receipts, where funds are being held on behalf of others.
29. The existing definition of ‘cash’ in the Tier 4 Standard is:

Bank Accounts and Cash

A69. *Bank accounts and cash comprises petty cash, any other cash on hand at balance date, cheque accounts, deposits held at call with banks and other financial institutions, bank overdrafts and term deposits.*

Required Information

A70. *Bank accounts and cash shall be recorded at the amount actually held. However, bank account balances shall be adjusted to reflect amounts deposited but not yet shown on the bank statement, or cheques that have been issued but not yet presented to the bank (commonly referred to as unpresented cheques).*

A71. *As a minimum, the following aggregated categories shall be separately reported:*

- (a) *Bank accounts;*
- (b) *Term deposits; and*
- (c) *Cash on hand.*

30. While this definition confirms that cash, for the purposes of applying the Standard, is not restricted to physical currency, we propose including the following phrase on the first page of the Tier 4 Standard to make it clear that cash has a broader meaning than just physical notes and coins:

Under the Tier 4 Standard, an entity is required to report the cash received and cash paid in the reporting period, being the transactions recorded in an entity's bank account(s) that relate to their entity.

31. We also propose renaming the 'Statement of Receipts and Payments' in the Tier 4 Standard, the 'Statement of Cash Received and Cash Paid' to help preparers understand that the statement should include all funds received, not just those for which receipts have been issued.

Question for the Board

- Q5. Does the Board agree with the staff recommendation relating to the use of the terms 'cash' and 'receipts' in the Tier 4 Standard?

Removal of sections

32. In the draft amended Tier 4 Standard (agenda Item 2.1.1) we have removed the following sections:
- (a) Transitional arrangements;
 - (b) Basis for Conclusions; and
 - (c) History of Amendments.
33. We have included external links to this information on the Contents page of the amended Tier 4 Standard. The external link will be to separate documents where this information will be provided on the XRB website
34. In addition, we have also removed the Illustrative Examples section as provided for in the current Tier 4 Standard. These examples will instead be included in the accompanying Tier 4 Explanatory Guide.

Question for the Board

- Q6. Does the Board agree that these sections should be removed from the Tier 4 Standard (with links provided to where this information can be found on the XRB website)?

Required components of the Tier 4 Performance Report

35. The core components of the Tier 4 Standard have been amended as follows:

Existing Tier 4 Standard	Amended Tier 4 Standard
Entity Information	Entity Information
Statement of Service Performance	Statement of Service Performance
Statement of Receipts and Payments	Statement of Cash Received and Cash Paid
Statement of Resources and Commitments	Removed (as discussed above)
Notes	Notes

36. The change from ‘Statement of Receipts and Payments’ to Statement of Cash Received and Cash paid’ has been discussed above.

37. The ‘Statement of Resources and Commitments’ has been removed as separate Statement within the Tier 4 Performance, and the requirement to disclose information about any significant assets or liabilities held has been moved to the Notes section.

Minimum receipt and payment categories

38. The minimum Tier 4 categories of receipts and payments have been amended as follows:

Existing Tier 4 Standard	Amended Tier 4 Standard
Minimum categories	
<i>Operating receipts</i>	<i>Cash received from operating activities</i>
Donations, fundraising and other similar receipts	General donations/koha and fundraising
	Grants received – government
	Grant received – non-government
Fees, subscriptions and other receipts from members	Membership fees or subscriptions
Receipts from providing goods or services	Sale of goods or services to members
	Sale of goods or services to non-members
Interest, dividends and other investment income receipts	Cash from Interest or dividends received
<i>Capital receipts</i>	<i>Cash received from other activities</i>
Receipts from the sale of resources	Sale of assets
	Sale of investments
Receipts from borrowings	Cash received from loans and borrowings
<i>Operating payments</i>	<i>Cash paid for operating activities</i>
Payments related to public fundraising	Fundraising costs
Volunteer and employee related payments	Employee remuneration costs
Payments related to providing goods or services	Costs related to sale of goods or services
Grants and donations paid	Grants and donations paid
	Interest paid
	Property lease and rental costs
	Other administration and overhead costs
<i>Capital payments</i>	<i>Cash paid for other activities</i>
Purchase of resources	Purchase of assets
	Purchase of investments
Repayment of borrowings	Repayment of loans and borrowings

39. The current Tier 4 Standard provides for additional categories of receipts and payments which are described as “optional information” a Tier 4 entity may choose to present. In the amended Tier 4 Standard the “optional information” has been removed and instead the Standard focuses only on the minimum information required by the Standard. The “optional information” will be retained in the template Tier 4 Performance Reports for those users that choose to present their financial information under additional categories.
40. The optional information concerning additional categories of receipts and payments is currently provided as follows.

Operating receipts:²

- (a) Donations or koha from the public;
- (b) Fundraising receipts;
- (c) Grants not directly related to service delivery;
- (d) Fees and subscriptions from members;
- (e) Donations, koha or offerings from members;
- (f) Receipts from grants or contracts for service with central or local government;
- (g) Receipts from grants or contracts for service with non-governmental agencies;
- (h) Receipts from sales to the public;
- (i) Receipts from sales to members;
- (j) Receipts from commercial activities;
- (k) Lease or rental receipts;
- (l) Interest and dividend income receipts; and
- (m) Other operating receipts

Operating payments:³

- (a) Administration and overhead payments;
- (b) Lease and rental payments;
- (c) Affiliation fees;
- (d) Interest payments; and
- (e) Other operating payments.

Question for the Board

- Q7. Does the Board agree with the proposed changes to the minimum receipt and payment categories and the removal of the related optional information from the Tier 4 Standard?

² Tier 4 Standard, paragraph A50

³ Tier 4 Standard, paragraph A63

Tier 4 Notes section

41. The components of the Notes section of the Tier 4 Standard have been amended as follows:

Existing Tier 4 Standard	Amended Tier 4 Standard
Basis of Preparation	Basis of Preparation
Goods and Services Tax (GST)	Goods and Services Tax (GST)
	Significant Assets
	Significant Liabilities
	Grants or Donations with Restrictions over Use
Related Party Transactions	Related Party Transactions
Events After the Balance Date	Events After the Reporting Period
Additional Information	Additional Information
Correction of Errors	Correction of Errors

42. The addition of the ‘significant assets’ and ‘significant liabilities’ disclosure requirements within the Notes sections has been discussed above.

43. The addition of the ‘Grants or Donations with Restrictions over Use’ disclosure requirements is provided for in the existing Tier 4 Standard under the “Statement of Resources and Commitments’. These disclosure requirements are now treated as separate component within the Notes section.

Question for the Board

Q8. Does the Board agree with the amended components of the Notes section of the Tier 4 Standard?

Prior period errors

44. One respondent advised that they did not consider that the Tier 4 Standard was clear enough about how to handle prior period errors as:

- (a) the Standard says not to restate comparatives; and
- (b) due to the cash-based nature of the Standard, it is not really possible to make prior period adjustments in the financial statements.

45. The existing requirement for accounting for prior period errors in the Tier 4 Standard is:

Correction of Errors

A24. *Significant errors shall be corrected as soon as practicable. Errors arising during the reporting period shall be corrected before the performance report is finalised. Errors relating to past periods shall be corrected in the current performance report before the report is finalised. No adjustments to past periods are required (see paragraph A84).*

...

A84. *The notes to the performance report shall disclose significant errors relating to past periods that have been corrected in the current performance report.*

46. The proposed requirement for accounting for *Correcting Errors* in the amended Tier 4 Standard (agenda item 2.1.1) is shown below.

Correcting Errors

25. Significant errors identified that relate to prior periods should be disclosed in the notes in the period in which the errors were identified. There is no requirement to restate prior year figures. An example of a significant error would include the reporting of the wrong bank balance.
- ...
76. The notes to the Performance Report shall include information about any significant errors relating to past periods that have been corrected in the current Performance Report. The note shall state what the error was, how the error arose, and how the error has been corrected in the current period.

47. The intention is to make it clearer that there is no requirement to adjust the prior period Performance Report to correct prior period errors and that note disclosure will be sufficient to let readers know about the error.

Question for the Board

- Q9. Does the Board agree with the staff recommendation relating to prior period errors?

Other amendments

48. In response to overall feedback regarding the length of the Standard, we have reduced the Standard down from 31 pages to 16 pages by shortening and simplifying the language used to explain the Tier 4 reporting requirements. This has resulted in a general re-write of the Standard.
49. To improve the accessibility of the Standard, staff propose changing the font of the Tier 4 Standard from Times New Roman to Arial to make it appear more user-friendly.

Question for the Board

- Q10. Does the Board have any other comments on the draft amended Tier 4 Standard (agenda item 2.1.1)?

Attachments

Agenda item 2.1.1: Draft amended Tier 4 Standard

Agenda item 2.1.2: Current Tier 4 Standard Public Benefit Entity Simple Format Reporting – Cash (Not-for-profit) (in supporting papers)

Agenda item 2.2: Cover memo – Tier 3 recognition of donation and grant revenue

TIER 4 STANDARD (NOT FOR PROFIT) — (TIER 4 NFP)

This Standard sets out the annual reporting requirements for not-for-profit (NFP) entities (which includes registered charities and other NFP entities) who are permitted to prepare financial statements in accordance with Tier 4 reporting requirements for Public Benefit Entities as issued by the XRB.

The Standard provides for simple format cash-based reporting requirements. Under the Tier 4 Standard, an entity is required to report the cash received and cash paid during the reporting period (i.e. the transactions as recorded in an entity's bank account(s) or other cash transactions).

If you want to report all the assets owned and all the liabilities owed by the reporting entity using a traditional balance sheet, we recommend you consider reporting under the Tier 3 Standard (Not For Profit), which provides simple format accrual-based reporting requirements.

Effective Date

This Standard is effective for reporting periods beginning on or after **1 April XXXX**

Issued December 2013 and incorporates amendments to **12 July 2018**

This Standard was issued by the New Zealand Accounting Standards Board of the External Reporting Board pursuant to section 12(a) of the Financial Reporting Act 2013. It is a non-GAAP Standard for the purposes of section 12 and section 18 of that Act.

This Standard applies for the purposes of the following enactments:

- Section 42A of the Charities Act 2005;
- Section 63 of the Friendly Societies and Credit Unions Act 1982; and
- Section 12 of the Agricultural and Pastoral Societies Act 1908.

This Standard is a disallowable instrument for the purposes of the Legislation Act 2012.

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TIER 4 STANDARD (NOT FOR PROFIT)

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Links to additional information:

- [Transitional Provision \(first-time use of the Standard\)](#)
- [History of Amendments](#)
- [Basis for Conclusions](#)

Introduction

1. This Standard sets the minimum reporting requirements for smaller NFP entities that are eligible, and elect, to apply the Tier 4 Standard (Not for Profit). This will include registered charities and other NFP entities that are permitted by legislation to apply this Standard.
2. The Charities Act 2005 requires registered charities to complete annual reporting to Charities Services. This includes completing an Annual Return accompanied by a copy of the financial statements for the most recently completed reporting period. This Standard sets out the minimum information that must be included in the financial statements to meet this requirement for entities that are eligible to apply this Standard.
3. This Standard requires entities to provide cash-based financial information (referred to as the “Statement of Cash Received and Cash Paid”) and information about what the entity has done during the reporting period (referred to as the “Statement of Service Performance”). These statements, and the corresponding Notes, are collectively known as the “Performance Report”.
4. The Performance Report aims to provide people reading the reports (such as members, funders, and the general public) with useful and relevant information about an entity’s performance for the reporting period and its ability to continue operating in the future.
5. Optional [reporting templates](#) and [guidance material](#) have also been developed to help you apply the requirements of this Standard. In addition, terms used throughout the Standard have been included in the [Glossary](#).

Who should use this Standard?

6. This Standard applies to NFP entities that are eligible, and elect, to apply this Standard.
7. Entities need to first consider whether they are subject to statutory reporting requirements (the most common requirement being set in the Charities Act 2005 as outlined above).
8. NFP Entities can choose to report using this Standard if:
 - (a) They have [annual operating payments](#) under \$125,000;
 - (b) They do not have [public accountability](#) for financial reporting purposes; and
 - (c) Meet the definition of a [Public Benefit Entity](#) (PBE) for financial reporting purposes.

Please refer to the [Glossary](#) for further information on the underlined terms.

9. [XRB A1 Application of the Accounting Standards Framework](#) provides further information on how to work out if you are eligible to apply this Standard.

The Tier 4 Performance Report

10. The Performance Report is required to include the following parts:
 - (a) **Entity Information** which explains your entity and why it exists;
 - (b) A **Statement of Service Performance** which explains the key activities your entity carried out in the period;
 - (c) A **Statement of Cash Received and Cash Paid**; and
 - (d) **Notes** to provide other useful information.

General Requirements

Period of reporting

11. The Performance Report is usually prepared for a twelve-month period which ends on the entity's "balance date" (sometimes referred to as an entity's 'year-end').¹ If an entity has a 31 December balance date, the reporting period covered by the Performance Report prepared in accordance with this Standard will be 1 January to 31 December. The Performance Report only includes information about the cash received, the cash paid, and the service performance activities delivered during the reporting period (including comparative information).

Reporting entity

12. The Performance Report needs to include information on all the entity's activities, including any branches or other operating units. This is done by collating information from all the branches and operating units and excluding any internal transactions between these units.²

Accounting for other entities

13. Where an entity controls³ one or more entities and the total combined operating payments⁴ of the entity and all its controlled entities are less than the legislative size threshold (i.e. annual operating payments of \$125,000), the reporting entity is required to prepare a consolidated Performance Report.
14. A consolidated Performance Report involves presenting the information required by this Standard for all the entities that are controlled (including the controlling entity) as if the group of entities was one reporting entity.

The Tier 4 Performance Report

15. The following information needs to be included at the top of each page of the Performance Report:
 - (a) The name of your reporting entity; and
 - (b) The reporting period which the Performance Report covers.
16. This Standard sets out the minimum information to be included in the Performance Report. Additional information can be included if you consider this would be useful to readers.
17. The Performance Report should be reported in amounts rounded to the dollar (i.e. the rounding of any cents). All amounts shall be reported in New Zealand dollars, unless the entity's bank account is denominated in a foreign currency.

¹ The Performance Report may be prepared for a part year, but this is unusual and occurs only when an entity is first established or ceases to exist during a year, or changes its balance date

² [Explanatory Guide A8 Tier 1, 2, 3 & 4: Financial reporting by not-for-profit entities: The Reporting Entity](#) provides guidance on identifying the reporting entity.

³ [Explanatory Guide A9 Financial Reporting by Not-for-profit Entities: Identifying Relationships for Financial Reporting Purposes](#) provides guidance for not-for-profit entities in determining whether they have control over another entity.

⁴ The combined operating payments of the entity and all its controlled entities excludes any payments between the entity and the controlled entities and/or between the controlled entities.

Comparatives

- 18. Comparative information for the previous year/period should be included for each balance or transaction and performance measure included in the Performance Report.
- 19. Budgets, or other forecast information, is not required to be included in the Performance Report.

Accounting for GST

- 20. Generally, the Performance Report should be prepared by reporting cash received and cash paid on a GST inclusive basis (i.e. the total amount of a transaction including any GST) because this will match the cash transaction recorded in the entity's bank account. The total balance of GST paid or refunded by the IRD for the reporting period should be reported separately in the Statement of Cash Received and Cash Paid.
- 21. You may choose to report on a GST exclusive basis so long as a consistent approach is taken.

Consistency of presentation

- 22. The way the information is presented in the Performance Report should be consistent from one period to the next, unless the entity's operations have significantly changed or you consider a different format would be more useful to readers.

No offsetting of amounts

- 23. Cash received and cash paid should not be netted off against each other, even if these relate to a similar activity (except for GST paid or refunded in the period). For example, the net proceeds from a school fair should not be reported as one balance, instead the Statement of Cash Received and Cash Paid should include separate amounts for the total cash received and the total cash paid for running the fair.

Prior period errors

- 24. Significant errors identified that relate to prior periods should be disclosed in the notes in the period in which the errors were identified. There is no requirement to restate prior year figures. An example of a significant error would include the reporting of the wrong bank balance.

Signing the Performance Report

- 25. When the Performance Report is completed the governing body of the entity will review and approve the document for publication. It is important that users can identify when, and by whom, the Performance Report was authorised, as the Performance Report does not reflect any events after this date. The Performance Report is approved when it is signed and dated by the entity's governing body.

Required Information

- 26. Entities should include in the Performance Report the date the Performance Report was approved, who gave that authorisation and the relevant signature(s).

The Tier 4 Performance Report

Section 1: Entity Information

Purpose

27. The purpose of the Entity Information section is to provide general information about the entity.

Required Information

28. The following information should be included:
- (a) the entity's name, type of entity and legal basis (if any);
 - (b) the entity structure if it is not a stand-alone entity (i.e. whether it includes separate operating units, divisions or branches);
 - (c) the names of any entities controlled by your entity for financial reporting purposes;
 - (d) the entity's governance arrangements (i.e. the governing body that makes the key operating, investing and financing decisions); and
 - (e) the entity's reliance on volunteers and donated goods or services.

Section 2: Statement of Service Performance

Purpose

29. The purpose of the Statement of Service Performance is to provide information about the entity's key activities during the reporting period – what did the entity do during the period to achieve its objectives?

Required Information

30. The entity should provide information about the entity's key activities for the period. This information should include:
- (a) general information about the entity's objectives (what it is seeking to achieve – this should be aligned with the entity's purpose, mission or vision);
 - (b) the key activities conducted by the entity during the year to achieve its objectives; and
 - (c) any additional information that is considered important for the readers overall understanding of the entity's objectives and key activities for the period.

31. When reporting on the key activities, entities:
- (a) should describe and quantify (to the extent practicable) the key activities undertaken during the current reporting period; and
 - (b) are only required to report the key activities the entity has undertaken during the period. A detailed account of everything the entity has done is not required.
32. Entities can choose how to report the information provided in the Statement of Service Performance. The Tier 4 template provides a simple example. An image or table showing your entity's activities and achievements during the reporting period can be another useful way to report your entity's service performance.

Section 3: Statement of Cash Received and Cash Paid

Purpose

33. The purpose of the Statement of Cash Received and Cash Paid is to report all the cash received and paid by the entity during the reporting period (i.e. through its bank account(s) and any cash on-hand).
34. The Statement of Cash Received and Cash Paid should group transactions into two main categories: operating activities and other activities, as shown in Table 1.

Required Information

35. The Statement of Cash Received and Cash Paid should be presented using the **applicable** line items as shown in [Table 1](#).
36. The Statement of Cash Received and Cash Paid should include additional information to help readers understand:
 - (a) the source and amount of funding (or any other cash inflows) in the period; and
 - (b) the nature and amount of costs incurred (or any other cash outflows) in the period.

Table 1: Statement of Cash Received and Cash Paid

	Previous period	Current period
	\$	\$
Opening balance in bank account(s) — at the start of reporting period/year⁵		
Plus cash received from operating activities		
General donations/koha and fundraising		
Grants received – government		
Grant received – non-government		
Membership fees or subscriptions		
Sale of goods or services		
Interest or dividends received		
Total		
Less cash paid for operating activities		
Fundraising costs		
Grants and donations paid		
Costs related to sale of goods or services		
Employee remuneration costs		
Property lease and other rental costs		
Other administration and overhead costs		

⁵ This balance will also include any undeposited cash on-hand at the start of the reporting period.

Total		
Total GST paid or refunded in period ⁶		
Cash surplus or (deficit) from operating activities		
Plus cash received from other activities		
Sale of investments		
Sale of other assets		
Cash received from loans and borrowings		
Total		
Less cash paid for other activities		
Purchase of investments		
Purchase of other assets		
Repayment of loans and borrowings		
Total		
Cash surplus or (deficit) from other activities		
Income tax paid or refunded (if applicable)		
Increase or (decrease) in cash for the period		
Closing balance in bank account(s) — at the end of the reporting period/year		
Represented by:		
Closing balance of bank account(s)		
Balance invested in term deposit(s)		
Cash on hand		
Total cash balances held		

Guidance

37. The **opening and closing balance in bank account(s)** should include all bank account balances (cheque or savings accounts), any term deposit balances held, and any undeposited cash on-hand.
38. **Cash received** should include all transactions that resulted in an increase in the bank account(s) balance during the reporting period, including any deposited cash held at the end of the reporting period (and any cash on-hand).
39. **Cash paid** should include all transactions that resulted in a decrease in the bank account(s) balance during the reporting period (and any cash on-hand).
40. Transfers between bank accounts and/or term deposits held by the entity should not be recorded in the Statement of Cash Received and Cash Paid because this does not change the total balance of cash held by the entity.

⁶ If the Performance Report is prepared on a GST inclusive basis.

41. **Operating activities** are the day-to-day activities of your entity and include all transactions that are not classified as other activities.
42. **Other activities** include:
- (a) cash paid to purchase assets or cash received from the sale of assets. Assets are items of property, plant, or equipment with an expected life greater than twelve months (such as computer equipment) which is owned by your entity and used to support the delivery of its objectives;
 - (b) cash paid to purchase investment or cash received from sale of investments (investments may include such things as shares or government bonds); and
 - (c) cash received from loans or borrowings and cash paid to repay loans or borrowings (loans and borrowings include any cash owing to an external party as a result of a financing arrangement).
43. If you are not sure whether a transaction relates to an operating activity consider how frequently such a transaction occurs. If it occurs frequently, say at least monthly, it is likely to relate to one of your operating activities.

Other considerations

44. Headings (such as other activities) and line items (such as purchase of assets) do not need to be included if your entity does not have any transactions that relate to these in the current or previous period. The operating and other activity headings should be retained when these are applicable. However, you can use different wording for the line items if these are more appropriate for your entity.
45. Additional headings and line items may be included to help users better understand the cash received and the cash paid in the period. You can also include further breakdowns in the Notes if you wish, although this is not required. For example, you may include a list of donors and grant providers and a summary of their contributions if you think this would be useful to those reading your Performance Report.

Section 4: Notes

Purpose

46. The purpose of the Notes to the Performance Report is to provide additional information that is relevant to readers understanding of your entity's performance for the reporting period.

Basis of Preparation

Required Information

Basis of Preparation

47. The Notes to the Performance Report should include the following information about the basis for preparing the Performance Report:
- (a) The entity has prepared the Performance Report in accordance with the Tier 4 Standard (NFP) issued by the External Reporting Board (XRB);
 - (b) Where applicable, the entity is permitted by its governing legislation and has elected to meet its statutory reporting requirements by applying the Tier 4 Standard (NFP); and
 - (c) All transactions included in the Statement of Cash Received and Cash Paid and related Notes to the Performance Report have been reported on a cash basis.

48. Example Note disclosure:

Basis of preparation

ABC Charity is permitted by law to apply the Tier 4 Standard (NFP) issued by the External Reporting Board (XRB) and the Board has elected to use the Standard. All transactions included in the Statement of Cash Received and Cash Paid and related notes to the Performance Report have been reported on a cash basis.

GST

Required Information

Goods and Services Tax (GST)

49. The Notes to the Performance Report should include information about whether:
- (a) the entity is registered for GST; and
 - (b) the Performance Report is prepared on a GST inclusive or GST exclusive basis.

50. Example Note disclosure:

GST

All amounts recorded in the Performance Report are inclusive of GST (if any). The entity is GST registered and any GST is recognised when paid to the Inland Revenue (or when a refund is received from the Inland Revenue).

Or

All amounts recorded in the Performance Report are exclusive of GST (if any). The entity is GST registered and any GST is recognised when paid to the Inland Revenue (or when a refund is received from the Inland Revenue).

Significant assets

51. The purpose of this note is to provide information about any significant assets owned by the entity. These assets may have been purchased or donated. The note is not expected to list all assets owned by the entity, just those assets that would be considered significant by readers of the Performance Report.
52. The assessment of significance will at times require judgement and should be based on the information that readers of the Performance Report will find useful when considering the entity's ability to continue operating in the future.⁷
53. The total balance of bank accounts held at the end of the reporting period is one type of asset. This note is focused on providing information about other significant assets an entity owns.
54. Significant assets held by the entity may include:
- (a) Physical assets owned by the entity and available for the entity to use in future periods, such as buildings, computers, or vehicles; and
 - (b) Investments.

⁷ The assessment of significance requires judgement and will be based on several factors including the monetary value of the asset, the entity's ability to replace the asset, and whether the entity could continue operating without the asset. For example, the entity may hold items such as furniture or office equipment, but in many cases due to their low value and short useful lives these will not be considered significant.

Required information	
55.	The notes to the Performance Report should include information about significant assets held at the end of the reporting period. Table 2 below provides an example disclosure. Entities are not required to provide information about all assets owned.
56.	For each significant type of asset owned, the entity should include, if easily available, either: <ul style="list-style-type: none"> (a) the amount paid to purchase the asset; or (b) the assets current value (i.e. an estimate of the assets replacement cost, rateable value or market value) particularly if the asset was donated and the cost of the asset is unknown. Where an estimated value is provided, the source of this estimate shall be disclosed.

Table 2: Example Note — Significant assets	Previous period	Current period
<i>Physical assets owned</i>		
Land and buildings		
Motor vehicles		
Computers		
<i>Investments</i>		
Shares		
Bonds		
Other		

57. The significant assets note is not intended to list all assets owned by the entity, as this would not be practical when recording transactions on a cash-basis. If you wish to fully account for all assets owned by the entity, we recommend considering reporting under the Tier 3 Accrual Reporting Standard (NFP).

Significant liabilities

58. The purpose of this note is to provide information about any significant liabilities, being amounts owed to external parties where a future outflow of cash cannot be avoided. Liabilities are obligations to transfer cash to individuals or other organisations at a future date, as well as any significant funds the entity is holding on behalf of others (i.e. cash received that belongs to another party).

59. The note is not expected to list all amounts owed by the entity, just those liabilities that would be considered significant by readers of the Performance Report.

60. The assessment of significance will at times require judgement and should be based on the information that readers of the Performance Report will find useful when considering the entity's ability to continue operating in the future.

Required Information	
61.	The notes to the Performance Report should include information about any significant liabilities held at the end of the reporting period. Table 3 below provides an example disclosure. Entities are not required to provide information about all liabilities owed.

Table 3: Example Note — Significant liabilities	Previous period	Current period
<i>Borrowings</i>		
Loans payable		
Money held on behalf of others		

62. The information in Table 3 is not intended to list all the entity’s liabilities, as this would not be practical when recording transactions on a cash basis. If you wish to fully account for all your entity’s commitments, we recommend considering reporting under the Tier 3 Accrual Reporting Standard (NFP).

Grants or donations with restrictions over use

63. Many grants are given with restrictions on what they can be used for. It is important that readers are made aware of these restrictions.

Required Information

64. If the entity has received any significant grants or donations with an expectation that the grant or donation be used for a specific purpose or in a particular way, and those expectations have not been fully met at balance date, it should report information about:
- (a) The amount of significant grants or donations received which are expected to be used in future periods (i.e. the balance of grants or donations which have not been spent at the balance date); and
 - (b) The nature of the expectations over use, including whether the grant/donation provider can require the unspent funding to be returned.

Related Party Transactions

65. The purpose of this note is to provide readers with information about any significant related party transactions in the reporting period.
66. The reporting of related party transactions provides important information to readers of the Performance Report because:
- (a) Related party relationships can influence the way in which an entity operates;
 - (b) Related party relationships might expose an entity to risks, or provide opportunities, that would not have otherwise existed; and
 - (c) Related parties may enter into transactions on different terms and conditions than would normally be available to unrelated parties.
67. A related party transaction is a transfer of money, goods or services between an entity and those who are closely associated, and have the ability to influence, the entity.
68. Related parties comprise:
- (a) People that have significant influence over the decisions of the reporting entity (such as officeholders, committee members, or others that are involved in the strategic management of the entity – including employees and volunteers); and
 - (b) Close family members of those people described above (such as a parent, partner, sibling, or child).

Required Information

69. The notes to the Performance Report should include information about any significant transactions with related parties that have occurred during the reporting period. For each significant related party transaction, the following information should be reported:
- (a) A description of the related party relationship;
 - (b) A description of the transaction and the amount of any cash received or cash paid, and the value of any free goods or services provided by or to the related party; and
 - (c) Any significant amounts due from, or to, related parties at end of the reporting period.

70. Examples of transactions with a related party that would be disclosed are:
- (a) the sale of a significant asset (such as a building or vehicle) to the spouse of a board member;
 - (b) the provision of free services to the child of the board chair;
 - (c) loaning cash at below-market rates to a related party; and
 - (d) a member of the board/trust providing professional services (e.g. accounting or legal services) to the entity at no cost.

Events after the reporting period

71. Events after the reporting period are those significant events, both favourable and unfavourable, that occur between the end of the reporting period and the date when the Performance Report is signed as approved by the governing body.

Required Information

72. An entity should report the following for each significant event after the reporting period:
- (a) The nature of the event;
 - (b) An estimate of any associated cash expected to be received, or cash paid; and
 - (c) How, if at all, the event is likely to affect the entity's ability to continuing operating over the subsequent 12 months.

73. An example of an event requiring disclosure is a fire which destroys the premises of a charity a week after the end of the reporting period. The notes to the Performance Report would report the fact that the fire occurred, the extent of the damage, the extent to which the damage is covered by insurance, and the likely impact on the charity's ability to continuing operating over the short and long term.

Additional Information

Required Information

74. The notes to the Performance Report should include any additional information considered necessary for readers to understand the overall performance of the entity.

Correcting Errors

Required Information

75. The notes to the Performance Report should include information about any significant errors relating to past periods that have been corrected in the current Performance Report. The note should state what the error was, how the error arose, and how the error has been corrected in the current period.

Glossary

This Glossary contains terms used in this Standard.

Annual operating payments	<p>Means the total amount of any payments (including grant payments, other than a capital payment), made by the entity during the reporting period.</p> <p>A capital payment is a payment during the reporting period for the purchase of a resource (commonly referred to as an asset) with an expected life greater than twelve months.</p>
Assets	<p>Assets are resources owned by the entity at the balance date that will be used in future periods to help satisfy the entity's objectives.</p>
Balance date	<p>The date to which the Performance Report is prepared. It is usually an end of month date, for example, 31 March 202X.</p>
Cash paid	<p>Payments comprise all money paid during the financial year by cash, cheque, bank transfer or other method. Payments can be either operating payments (relating to day-to-day activities) or relate to the purchase of assets or the repayment of borrowings.</p>
Cash received	<p>Cash received comprise all money received during the financial year. This includes all funds deposited into the entity's bank accounts. Most cash received will relate to the normal operating activities of the entity (for example, cash received from a fundraising event). However, some cash received might result from other transactions, such as receipts from the sale of assets or proceeds from borrowings).</p>
Entity	<p>An organisation which may take any of a number of forms, including but not limited to, registered charity, company, incorporated association, unincorporated association or trust. Depending on organisational structure, this may be a legal entity, a unit within a wider organisation, or it may comprise one or more units.</p>
Investments	<p>Any other financial asset held by the entity in addition to money held in bank accounts or term deposits. This would include investments in fixed interest bonds or shares.</p>
Loans and borrowings	<p>Funds owing to an external party as a result of a financing arrangement (such as a bank or finance company).</p>
Performance Report	<p>Information which collectively tell the story of the reporting entity over the reporting period. This includes the entity information, statement of service performance, statement of cash received and cash paid and notes to the Performance Report.</p>
Public accountability	<p>While NFP entities are generally considered to be publicly accountable, "public accountability" has a specific meaning in the accounting standards issued by the XRB.</p> <p>Entities are considered to have public accountability for financial reporting purposes when they have issued debt or equity instruments through a public offering or their main activity is holding cash or other assets on behalf of others (e.g. a superannuation scheme).</p> <p>The full definition of "Public Accountability" is included in XRB A1.</p>
Public benefit entity (PBE)	<p>A reporting entity 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.</p>

Related party	People or entities that have significant influence over the entity, such as officeholders, committee members, or others that are involved in the strategic management of the entity (whether employed or volunteer) and close members of their families.
Reporting entity	An entity preparing a Performance Report in accordance with this Standard. In the New Zealand reporting environment it is an organisation that is required by law, or elects to apply, standards issued by the External Reporting Board (XRB). For the purposes of applying this Standard, the entity is required to be a not-for-profit entity and a PBE.
Reporting period	A period usually of twelve months ending on the entity's balance date.
Significant	An item is significant if disclosure of the particular item, whether financial or non-financial, could influence a reader's understanding of the entity's overall performance.
Statement of cash received and cash paid	A summary of all the cash received, and all the cash paid out, by the entity during the reporting period.
Statement of service performance	A statement that provides information on what the entity has delivered during the reporting period. These are particularly useful in the not-for-profit sector when the focus is on achieving broader societal outcomes, rather than making a profit.

Date: 13 September 2021

To: NZASB Members

From: Nicola Hankinson

Subject: **Donation and grant revenue recognition in the Tier 3 Standard**

Recommendations¹

1. The Board is asked to:
 - (a) NOTE the feedback received on the Simple Format Reporting Standards Post-implementation Review (PIR) concerning the recognition of donation and grant revenue in the Tier 3 Standard;
 - (b) CONSIDER staff recommendations to address the issues highlighted in the feedback received; and
 - (c) Provide DIRECTION on the development proposed amendments to the Tier 3 Standard in response to issues highlighted.

Introduction

2. At the June 2021 meeting the Board agreed on the high-level approach in response to issues raised through the PIR. One of the issues the Board agreed to consider standard-setting activity for was the recognition requirements for donation and grant revenue in the Tier 3 Standard.
3. The Board noted the PIR feedback received highlighted concerns that the ability to recognise donation and grant revenue over time (as the resources received were used in the delivery of agreed NFP activities) was too restrictive. These concerns centre around the deferral of revenue for donations and grants only being permitted by the Tier 3 Standard when there are “use or return” conditions attached.
4. Many charities rely on multi-year funding arrangements to give them the confidence to operate as a going concern. Concerns were expressed that the accounting requirements, as currently provided for in the Tier 3 Standard, were resulting in a short-term focus in the way funding arrangements are structured. As a result of the current Tier 3 revenue recognition requirements requiring immediate recognition of donations and grant revenue (for funding arrangements that have no explicit “use or return” conditions), some funders are no longer offering multi-year funding arrangements.

¹ This memo refers to the work of the International Accounting Standards Board (IASB) and uses registered trademarks of the IFRS Foundation (for example, IFRS® Standards, IFRIC® Interpretations and IASB® papers).

5. The “use or return” condition is also used in IPSAS 23 *Revenue from Non-Exchange Transactions (Transfers and Taxes)* (and PBE IPSAS 23 *Revenue from Non-Exchange Transactions*) as a key criterion for determining when present obligations arise from revenue transactions that result in the recognition of a liability (i.e. deferred revenue). Under IPSAS 23, when a transfer of funds is recognised (typically when the cash is received) revenue is not recognised until any “use or return” conditions are satisfied, because until this point the reporting entity has an obligation to return the funds.
6. The IPSASB has received feedback from a number of stakeholders that the current “use or return” revenue recognition approach in IPSAS 23 is too restrictive. Stakeholders have requested amendments to IPSAS 23 to allow for increased flexibility to recognise revenue over the period in which obligations to use funding received in a particular way are satisfied. We have also received similar feedback from Tier 1 and Tier 2 PBEs in New Zealand who highlight the current requirement results in the recognition of “lumpy grants” when resources from donations and grants received upfront are expected to be used over multiple accounting periods.
7. In response to IPSAS 23 concerns raised by New Zealand constituents when the PBE Standards were first introduced for NFP over the 2014-2015 period, the NZASB made a strategic decision to support the IPSASB *Revenue* project, rather than developing a domestic solution.
8. The current IPSASB *Revenue* project will likely result in two new revenue standards:²
 - (a) a revenue standard that will be aligned with IFRS 15 *Revenue from Contracts with Customers* for revenue transactions with performance obligations;³ and
 - (b) a new revenue standard to replace IPSAS 23 for revenue transactions without performance obligations.⁴

After the IPSASB issues final *Revenue* pronouncements, we will consider whether to propose changes to the revenue recognition requirements for Tier 1 and 2 PBEs.

9. The Board noted in June 2021 that full alignment between the Tier 3 and 4 PBE Standards and IPSAS requirements was not essential, as the Tier 3 and 4 Standards were intended to contain simpler requirements to enable them to meet the needs of users in a cost-effective manner. However, staff also acknowledge the desire to maintain alignment of the broad recognition and measurement principles between all four tiers to the extent possible.
10. When deciding on whether to amend the Tier 3 revenue recognition requirements for donations and grants at this time, a key consideration is whether to depart from existing Tier 1

² Final standards are expected to be approved by the IPSASB in June 2022.

³ A performance obligation (as defined by ED 70 *Revenue with Performance Obligations*) is a promise in a binding arrangement with a purchaser to transfer to the purchaser or third-party beneficiary either:

- (a) A good or service (or a bundle of goods or services) that is distinct; or
- (b) A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the purchaser or third-party beneficiary.

⁴ The new revenue standard will provide requirements for accounting for revenue transactions with no present obligation and revenue transactions with present obligations but no performance obligations. Present obligations are enforceable obligations in a binding arrangement that requires a resource recipient to act or perform in certain way.

and Tier 2 principles in PBE Standards ahead of the IPSASB *Revenue* project. This question is considered within the content of this memo.

Structure of this memo

11. This memo is structured as follows:
 - (a) Current requirements in the Tier 3 Standard;
 - (b) The basis for current revenue recognition requirements in the Tier 3 Standard;
 - (c) Post-implementation review feedback;
 - (d) Analysis of post-implementation review feedback;
 - (e) Review of other approaches to revenue recognition;
 - (f) Update on IPSAS 23 *Revenue* project; and
 - (g) Staff recommendations in responding to concerns raised.

Current requirements in the Tier 3 Standard

12. The public sector and not-for-profit versions of the Tier 3 Standard⁵ are virtually identical in relation to revenue recognition, including recognition of donation and grant revenue.
13. The donation and grant revenue recognition principles in the Tier 3 Standard are generally consistent with IPSAS 23. Donations and grants received with “use or return” conditions are recognised as revenue as the conditions over use are satisfied. Donations and grants received with no “use or return” conditions are required to be recognised as revenue immediately when the donations and grants are received.⁶
14. The Tier 3 requirements result in donation and grant revenue being recognised immediately unless there are “use or return” conditions. These requirements are consistent with the principle underpinning IPSAS 23 that revenue recognition can only be deferred when the definition of a liability is met. IPSAS 23 (issued in December 2006) takes the view that a liability only arises for non-exchange transactions when there are “use-or return” conditions — in these circumstances the resource recipient is unable to avoid an outflow of resources, as it is required to consume the resources received in a particular way, or else to return the resources.⁷
15. Paragraph A62 of the Tier 3 Standard outlines the general principle for revenue recognition:

Revenue shall be recorded on the occurrence of a recognition event. This is when there is a legal right to receive cash either now or sometime in the future.

⁵ Tier 3 Standards: *Public Benefit Entity Simple Format Reporting – Accrual (Public Sector)* and *Public Benefit Entity Simple Format Reporting – Accrual (Not-For-Profit)*.

⁶ IPSAS 23 requires donations and grants to be recognised when receivable, this difference is discussed later in the memo.

⁷ The IPSASB is currently seeking to broaden the notion of a present obligation (resulting in the recognition of a liability – deferred revenue) so that it is wider than only when there are “use or return” conditions.

16. Table 1 following paragraph A62 provides guidance on when to record revenue for common types of revenue transactions reported by Tier 3 PBEs, which includes specific guidance on the recognition of revenue from donations and grants (including capital grants).

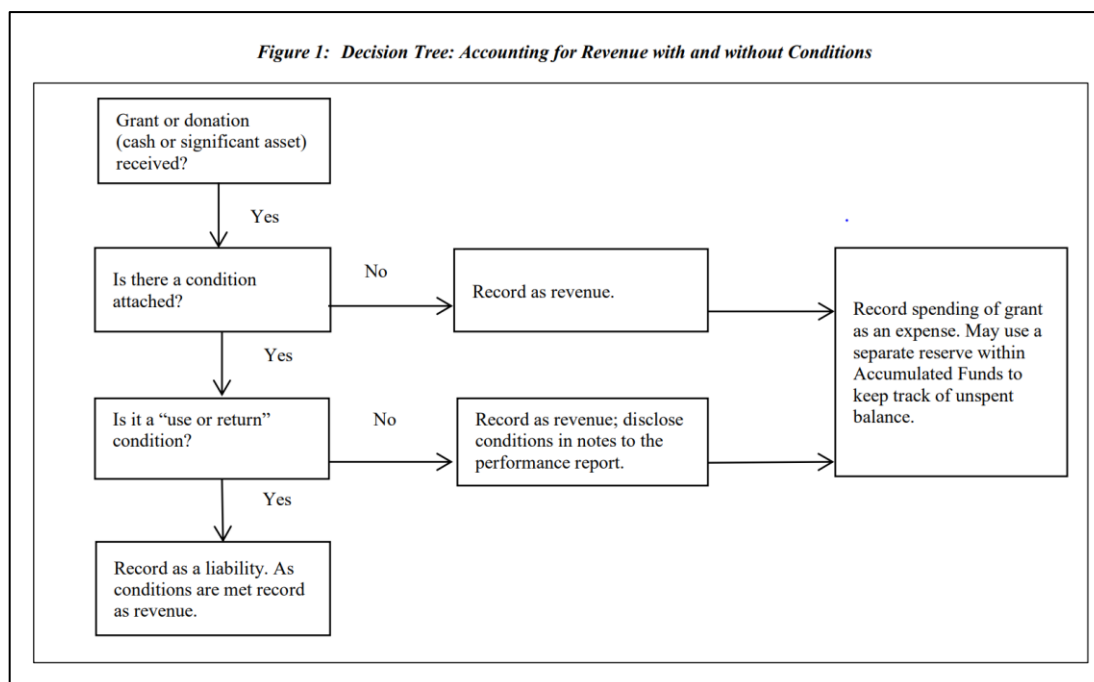
Table 1 of Tier 3 Standard

Donations, fundraising and other similar revenue		
...
Donations and grants with no “use or return” condition attached	Record as revenue when cash received.	Recording as revenue shall not be deferred even if the resources are received in advance of any expense on the activity funded by the donation or grant.
Grants for current operations with no “use or return” condition attached	Record as revenue on receipt.	A grant for current operations might be to help staff a drop-in centre for new mothers, whereas a grant for capital purposes might be to contribute to a new building.
Grants for capital purposes with no “use or return” condition attached	Record as revenue on receipt.	
Grants and donations that have a “use or return” condition attached	On receipt of grant record asset received (generally cash) and a liability. As the conditions are met the liability is reduced and revenue is recorded.	The liability as at balance date reflects the extent to which conditions have not been satisfied.

17. Paragraphs A63 to A66 of the Standard provide further guidance on applying the recognition requirements to revenue with or without “use or return” conditions.

<i>Revenue with and Without Conditions</i>	
A63.	Revenue from donations, grants and fundraising without “use or return” conditions attached is recorded when the cash or significant assets are received.
A64.	Some donations and grants have conditions attached. Sometimes these can be of a general nature, for example to be used for specific purposes by the entity, and the entity is not legally required to return the money if it is not used for that purpose. Other donations and grants can be received on a “use or return” basis, for example when the entity is required to either use the donation/grant as specified by the donor/grantor or return the donation/grant to the donor/grantor.
A65.	Where revenue has conditions attached, it is necessary to determine whether those conditions lead to a liability. Revenue that has a “use or return” condition, shall initially be recorded as a liability until the condition has been met, at which point the revenue shall then be recorded.
A66.	For the purposes of this Standard donations or grants with conditions attached, but which are not “use or return” conditions, shall be accounted for in the same way as revenue without conditions (see paragraph A63). In these circumstances entities may elect to keep track of these unconditional but “tagged” donations or grants by establishing a designated reserve within accumulated funds (see paragraph A143). Note, however, that under this approach the donation/grant received is still recorded as revenue and any subsequent spending is recorded as an expense of the entity; the reserve fund is just a vehicle to keep track of the amount of the unused donation/grant.

18. Paragraphs A67 provides a decision tree for accounting for revenue with and without conditions. The decision tree again highlights the principle that donation or grant revenue can only be deferred (by recognising a liability) when there is a “use or return” condition.



The basis for current revenue recognition requirements in the Tier 3 Standard

19. The Basis for Conclusions in the Tier 3 Standard provides the following explanation for why the Board decided to require donations, grants and other fundraising revenue to be recorded as revenue when received unless there is a “use or return” condition attached.

Extract from Tier 3 Standard Basis for Conclusions

Simplifications

BC8. The major simplifications in this Standard compared to the Tier 1 and Tier 2 PBE Accounting Standards are as follows:

- (a) *Whether grants or donations are recorded:* Goods or services (and other non-cash assets) received in kind are not required to be recorded;
- (b) *Timing of recognition:* Bequests of cash or significant assets are recorded on receipt rather than when the definition of an asset is met (which might be earlier than receipt); and
- (c) *Treatment of donation/grant revenue:* Donations and grants (and other fundraising revenue) are recorded as revenue when received unless there is a “use or return” condition attached to the revenue. In this Standard the key element that drives recognition of a liability relating to the donation/grant received is the “use or return” condition.

BC11. In relation to the simplification set out in BC8(c) the NZASB chose not to fully apply to grants and donations the principles in PBE IPSAS 23 *Revenue from Non-Exchange Transactions*. The NZASB considered the requirements of PBE IPSAS 23 to be too costly and complex for entities likely to apply PBE SFR-A (NFP) without a corresponding increase in the usefulness of the information that would be provided to users. The NZASB decided to simplify the principles to require a “use or return” condition before a liability is recorded.

20. As outlined above, the basis for the decision reached by the Board when developing the Tier 3 Standard centred around the importance of keeping the requirements simple to apply. As

such it was decided that revenue from donations and grants should be recognised on a cash basis (i.e. when received) unless there was a “use or return” condition.

Feedback received when developing the Tier 3 Standard

21. The Tier 3 accounting treatment for recognition of donations, grants and other fundraising revenue was considered by the Board when developing the Tier 3 NFP ED issued in December 2012 and when developing the final pronouncement issued in November 2013.

22. The following revenue recognition approach was proposed in the ED:

Treatment of donations/grant income: donation and grants (and other fund-raising revenue) are recorded as revenue when received, even when there are conditions attached to the donation/grant. Unmet conditions attached to grants or donations are to be disclosed in the notes to the financial statements.

23. Responses to the specific question on this topic in the ED are summarised in the table below. Only 2 of the 23 respondents agreed that all grants, donations and fundraising revenue should be recorded as an asset and revenue immediately when the cash is received, although a further 6 respondents partially agreed. 10 respondents disagreed with this approach and the remaining 5 respondents indicated they were in favour of matching such revenue with the corresponding expenditure.

NOT-FOR-PROFIT TIER 3 - ED PBE SFR-A (NFP) – Summary of submissions received by question	
Question 3 [Recognition and Measurement Simplifications]	
Do you agree that grants, donations and fundraising revenue should be recorded as an asset and revenue when the cash (or other significant asset) is received (even when there are conditions attached to the donation or grant)? If not, how would you propose that grants, donations and fundraising revenue are recorded?	
Category (C#)	Total
A - Agree	2
B - Partially agree	6
C - Disagree	10
M - Want matching	5
	Sub-total of those providing comments 23

24. Respondents that did not support immediate recognition of all donations and grants when received noted:

Grant or fundraising revenue should not be immediately recognised as revenue when there are conditions attaching to the grant or fundraising revenue. The conditions that attach to a grant or fundraising revenue reflect obligations that the NFP entity has agreed with the grantor, or made with the contributor of fundraising revenue, to deliver certain agreed services, purchase capital items, or for other matters. The nature of the obligation can vary in strength from a requirement to repay a grant to a grantor if the conditions are not met, to a moral obligation to utilise the funds in accordance with an understanding between the NFP entity and the contributor of fundraising revenue.

25. In response to the feedback received, the Board agreed to introduce the concept of the “use or return” condition into the Tier 3 Standard for donations and grants. As a result, when applying the Tier 3 Standard revenue from donation and grants can only be recognised over the period in which conditions over use are satisfied, when there is an explicit return obligation. In all other circumstances, donation and grant revenue is recognised immediately.

Post-implementation Review feedback

26. Many respondents to the PIR commented on a desire/need for the deferral of donation and grant revenue to be more widely permitted, as they considered the current Tier 3 Standard “use or return” condition to be too restrictive. For many respondents, grant and donation revenue recognition was the only issue raised in their submission, which highlights the extent to which this issue is causing concerns in practice.
27. 20 of the 65 PIR respondents who provided feedback on the Tier 3 Standard raised comments concerning revenue recognition. These comments included the following:
- *There appears to be scope for an inconsistency of deferral between funders and recipients where grants have a “use or return” condition. The standard does not appear to allow for deferral of expenditure by the funder.*
 - *Some of the examples provided in the standard for revenue recognition appear to be inconsistent with the accrual principles. For example, grant income seems to be considered under the assumption that all revenue will be on a cash basis. That is, revenue is recognised when the grant is received rather than when it becomes receivable. They also seem to imply a different treatment in terms of deferral of revenue depending on the source of the revenue.*
 - *It is often a difficult assessment for revenue with reporting conditions to state how money is spent but no visible return clause where trustees can use funds in years they wish - why income couldn't be deferred i.e. what is the rationale?*
 - *Agree with the principle but do not agree with the effect. Impractical to assess.*
 - *Many charities are reporting conditional grants and contract income as a liability.*
 - *General concern about inability to defer income where Koha given for capital projects or to be used over multiple periods.*
 - *Use or return conditions/deferral of grant revenue - the requirements about this are poorly understood. Could be addressed by more guidance.*
 - *Timing can present some specific issues for entities because of the way they receive funding. Grants are usually paid in instalments with an upfront amount and the remainder paid in one or more instalments upon receipt of an accountability/progress report.*
 - *Grants for capital purposes causing significant surpluses:*
 - *Not a true reflection of operations for the year.*
 - *A number of entities are affected.*

28. One of the respondents to the PIR expressed the view that the “use or return” condition is an *arbitrary distinction which is impractical to apply given the large number of philanthropic grants available*. They explained that the “use or return” condition introduces a requirement to check in each individual case whether the organisation has signed an agreement that could potentially allow a funder to enforce the return of the funds (let alone the probability that such enforcement would be executed). The respondent considered that, even if there is no legal obligation to use or return funds, there is generally a moral obligation in relation to use of the funds. In addition, substantial specific-purpose grants that are made without a formal “use or return” requirement may lead to a large distortion of an organisation’s accrual-based financial statements if no liability is recognised. The respondent therefore recommended that the “use or return” condition is modified to include all grants for which there is a clear expectation that they are to be used to cover specific expenditure, regardless of whether the donor asks for return.
29. Another respondent raised concerns that the examples in the revenue recognition table relating to general funding for government grants with no “use or return” conditions, are not consistent with the principle in paragraph A62 to recognise revenue upon the occurrence of a recognition event. They also noted that some of the examples in the Standard state that revenue is recorded when the funding is received, implying cash accounting and that this is inconsistent with the accrual-based nature of the Standard. Their view was that all revenue types should be accounted for based on accrual accounting concepts to be consistent with the fact that the Standard is an accruals-based standard.

Analysis of Post-implementation Review feedback

30. The PIR feedback highlights two key issues regarding the Tier 3 revenue recognition requirements for donations and grants.

Issue 1: Should the inflow of resources from donations or grants (either in the form of cash or other significant assets donated) be recognised as an asset when received (i.e. cash accounting) or when receivable (accrual accounting)? — the DR side of the transaction.

Issue 2: When the inflow of resources from donations and grants are recognised as assets, when should the corresponding revenue be recognised – immediately or deferred and recognised as any associated obligations over their use are satisfied? — the CR side of the transaction.

31. For issue 1, we agree there is an inconsistency in the Tier 3 Standard between the:
- general asset recognition requirements — paragraph A94 requires the recognition of debtors (receivables) for amounts owed to the entity by third parties; and
 - recognition of the inflow of resources from donations and grants — paragraph A63 requires the initial inflow of resources to be recognised when received (i.e. on receipt).

32. For issue 2, we note the PIR feedback highlights similar concerns to those received in response to the 2013 Tier 3 Standard ED. There is a consistent message from respondents that the “use or return” condition for deferral of revenue recognition does not provide appropriate accounting outcomes in practice.
- Some respondents would like the flexibility to recognise revenue in the same period as the corresponding expenditure is incurred (i.e. matching).
 - Other respondents would like the conditions for deferring revenue recognition to be relaxed (i.e. replacing the strict “use or return” condition with an ability to defer revenue recognition when there is an “expectation” that the grants or donations received will be used in a particular way or to achieve a particular purpose).

Review of other approaches to revenue recognition

33. In addition to reviewing the feedback received from respondents, we also considered the requirements relating to the recognition revenue contained in comparable frameworks where the objective is to provide simplified requirements for smaller entities and/or not-for-profit focused reporting requirements — *IFRS for SMEs* Standard, the Charities SORP⁸ (applicable to charities in the UK and Republic of Ireland), and CA ANZ *Special Purpose Reporting Framework*.
34. We found that similar approaches have been taken in each of these frameworks to allow grant revenue to be deferred where specified future obligations, including specified time periods in which funding is to be consumed, have been agreed upon between the resource recipient and resource provider. The recognition and measurement requirements of each framework have been summarised in [Appendix A](#) to this memo.

IFR4NPO Project and IAS 20

35. We also considered the four non-exchange revenue recognition alternatives outlined in the Consultation Paper (CP)⁹ released in early 2021 by the *International Financial Reporting for Non-Profit Organisations* (IFR4NPO) project. This project aims to develop internationally recognised financial reporting guidance for non-profit organisations (NPOs) to improve the transparency, consistency, comparability, credibility and reliability of NPO financial statements. The four alternatives included within the CP have been developed based on the requirements contained within the *IFRS for SMEs* Standard, IFRS and IPSAS. Detail on each alternative has been included in [Appendix B](#) of this memo.
36. The IFR4NPO CP considers the approach to non-exchange revenue recognition as well as the approach to recognising donated goods and services received in-kind. The approach to recognition of donated goods and services received in-kind was not a significant issue raised as part of the PIR and as such it has not been considered in this memo.

⁸ *Accounting and Reporting by Charities: Statement of Recommended Practices* applicable to charities preparing their accounts in accordance with the Financial Reporting Standard applicable in the UK and Republic of Ireland (FRS 102).

⁹ *IFR4NPO Consultation Paper* released January 2021 is available here: [IFR4NPO_consultation_paper.pdf](#).

37. While staff considered all the alternatives included within the CP, alternative two is considered to best address the feedback received in relation to the Tier 3 Standard. Alternative two requires non-exchange revenue to be recognised using the principles in IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*.

38. The key revenue recognition requirement in IAS 20 is set out in paragraph 12:

Government grants shall be recognised in profit or loss on a systematic basis over the periods in which the entity recognises as expenses the related costs for which the grants are intended to compensate.

39. It is important to note that for government grants within the scope of IAS 20, there is a presumption that the reporting entity will comply with the conditions attached to the government grant¹⁰ – based on the understanding the Government has the ability to enforce the consumption of the grant on the specified expenditure.

40. The CP notes the advantages and disadvantages of the IAS 20-based approach as follows:

Advantages

- Follows the *IFRS for SMEs* standard
- The options available in IAS 20 may be easier to implement
- Provides a framework for recognising revenue and guidance that might aid consistency

Disadvantages

- Not consistent with IPSAS 23
- NFPs will need to identify the period in which related expenses are recognised and track consumption of the grant
- Comparability and transparency may be reduced if different entities take different approaches to non-exchange guidelines.

41. We also note that IAS 20 is an old Standard (the standard has not been substantially updated since 2001) and does not fully reflect the principles in the current conceptual frameworks of the IASB and/or the IPSASB.

AASB 1058 Income for Not-for-Profit Entities

42. Closer to home, the AASB is about to embark on a post-implementation review of their NFP revenue recognition standard, AASB 1058 *Income for Not-for-Profit Entities* (AASB 1058). The requirements in AASB 1058 are based largely on the requirements of the for-profit standard, AASB 15 *Revenue from Contracts with Customers*. A number of issues have been experienced as a result of applying this approach, including the difficulty in applying the for-profit concept of “sufficiently specific performance obligations” to government grants and the significant mismatch that often occurs between timing of the recognition of income and the recognition of the related expense. This is thought to result in a presentation of financial performance which is inconsistent with user expectations.

¹⁰ Paragraph 8 of IAS 20

43. We will monitor the AASB post-implementation review closely and update the Board as this review progresses.

Update on IPSASB Revenue project

ED 71 Revenue Without Performance Obligations

44. ED 71 issued by the IPSASB in February 2020 included proposals for the recognition and measurement of revenue transactions with no performance obligations.
45. Transactions with performance obligations are arrangements that involve promises to transfer control of distinct goods or services to the resource provider or agreed third-party beneficiaries in exchange for consideration. Transactions without performance obligations therefore involve arrangements where there are no obligations to transfer control of distinct goods or services, but there may be obligations for the resource provider to act or perform in a particular way in exchange for the transfer of resources.
46. ED 71 recognises that although revenue transactions without performance obligations include no obligations to transfer control of distinct goods or services to an external party, they may include obligations requiring the resource provider to act or perform in a particular way – either in the form of conducting specified activities or incurring specified costs. The ED proposed that when these obligations arise from binding arrangements (an arrangement that confers enforceable rights and obligations on both parties to the arrangement) they should be treated as *present obligations*.¹¹ Any resources transferred with present obligations should be recognised as revenue over the period in which the present obligations are satisfied.
47. IPSAS 23 and the current Tier 3 Standard requirements only allow for the deferral of revenue when there are “use or return” conditions – perceived by some to be a rules-based approach. In contrast, ED 71 allows for the deferral of revenue when the resource provider in principle can enforce/compel the entity to use the transferred resources in a particular way. Enforceability requires the obligations to be specific enough to allow for monitoring of performance and remedies for non-performance.
48. Respondents to ED 71 proposals had mixed views both in New Zealand and internationally.
- Many respondents supported ED 71 based on the accounting outcomes, because the proposals would allow for the increased deferral of revenue for transactions of this nature – they feel this will provide a better performance story about the use of unspent public funding.
 - Others highlighted conceptual concerns that the definition of a liability was not met unless the revenue transaction involved the satisfaction of performance obligations (an obligation to transfers control of distinct goods or services to a third-party). They considered that revenue transactions with no performance obligations do not result in an outflow of resources and any resources received were instead consumed by the

¹¹ Paragraph 5.15 of IPSASB Conceptual Framework: Public sector entities can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

resource recipient in meeting its own service objectives – therefore regardless of any enforceable obligations to use the resources received in a particular way, revenue should be recognised immediately.

Revenue recognition principles subsequently agreed by IPSASB

49. ED 71 closed for comment in September 2020. The IPSASB, after deliberating on the feedback received, agreed to the following revenue recognition principles for revenue without performance obligations.
- For revenue transactions without performance obligation, obligations may still exist which require the resource recipient to use the resources received in a particular way. When the transfer provider can enforce how the resources transferred are used by the resource recipient and can hold the resource recipient accountable for the satisfaction of those expectations over use, a binding arrangement and present obligation exist.
 - A revenue transaction without performance obligations, which arises from a binding arrangement, will by definition give rise to at least one present obligation. Therefore:
 - Revenue transactions not arising from a binding arrangement will be recognised immediately when an asset is recognised for the inflow of resources; and
 - Revenue transactions arising from a binding arrangement will be recognised as the enforceable obligations associated with the arrangement are satisfied by the resource recipient.
 - When accounting for an inflow of resources arising from a revenue transaction without performance obligations, the transfer recipient shall recognise an asset when receivable and recognise revenue over the period in which any present obligations associated with the transaction are satisfied.
 - The concept and enforceability of binding arrangements in revenue accounting.
 - Can arise from various mechanisms, created through legal or equivalent means;
 - Requires consideration of all relevant factors to determine whether any mechanism(s) provide(s) the entity with the ability to hold the other parties in the binding arrangement accountable (therefore the agreed obligations need to be sufficiently specific); and
 - Provides the resource provider with the ability to impose consequences on parties that do not fulfil their agreed-upon obligations in the binding arrangement.
 - Although revenue transactions without performance obligations do not include obligations to transfer specific goods or services to an external party, the satisfaction of the stated objectives in a binding arrangement will ultimately require an outflow of resources (in the form of payments to suppliers to acquire goods or services (including employee services) to satisfy the agreed obligations over use.
50. The IPSASB has reached the preliminary view that, if a resource provider can enforce/compel an entity to use transferred resources in a particular way, then the resource recipient should recognise revenue over the period in which the obligations over use are satisfied. The key

principle is enforceability, which requires an ability for the resource provider to monitor performance and to have remedies available to address non-performance.

51. The IPSASB is currently in the process of drafting a new standard based on ED 71 and the subsequent principles agreed on above. A final pronouncement is expected to be approved in June 2022.

September 2021 IPSASB papers

52. A key conceptual issue being discussed by the IPSASB at its September meeting¹² is whether a liability exists in a binding arrangement without performance obligations (when a resource recipient recognises an asset for transferred resources which are required to be use in a particular way). Some constituents had indicated that ED 71 is not clear on what gave rise to a liability in a binding arrangement. A few respondents considered the liability to only arise when there are return obligations (consistent with IPSAS 23).
53. IPSASB staff have recommended the following to clarify when a liability would arise from a binding arrangement for revenue transactions without performance obligations

- (a) An entity (i.e., transfer recipient) in a binding arrangement recognizes a liability (i.e., deferred revenue) when both criteria are met:
- (i) (The transfer recipient receives resources associated with its unfulfilled or partially unfulfilled obligation in a binding arrangement; and
 - (ii) If the transfer recipient does not fulfil its obligations associated with the resources received, the terms of the binding arrangement require it to transfer resources to another party, such as right of return or something economically similar (i.e., directly associated with a consequence of non-completion).
- (b) This liability (deferred revenue) is extinguished as the transfer recipient fulfils its obligations to earn revenue.

54. The IPSASB papers are not clear by what was meant by “economically similar”. The paper highlights the IPSASB staff view that revenue should not be deferred unless the resource provider had the ability to impose some form of penalty on the resource recipient for non-fulfilment of agreed obligations.

Staff recommendations in response to concerns raised

Issue 1: Recognition of inflow of resources from donations and grants

55. The Tier 3 Standard currently requires the inflow of resources from donations and grants to be recognised upon receipt (i.e. when the cash is received), to keep the Standard simple.
56. PIR feedback highlighted concerns that this cash recognition approach is inconsistent with the general accrual principles of the Tier 3 Standard. When reporting under the Tier 3 Standard we

¹² The IPSASB meeting is being held 13 – 17 September. We will provide a verbal update on the meeting outcomes at the NZASB meeting on 21 September.

consider it is reasonable to expect the preparer to recognise the inflow of resources from grants or donations on an accrual basis.

57. Paragraph A94 of the Tier 3 Standard requires the recognition of debtors (receivables) for amounts owed to the entity by third parties. If the inflow of resources from grants or donations are required to be recorded when receivable, the preparer would be required to consider the Tier 3 definition of an asset:

Tier 3 Glossary

Asset: Resources controlled by the entity as a result of past events (which would usually be transactions), from which future economic benefits are expected to flow to the entity (such as investments producing interest revenue).

Staff recommendation

58. Staff recommend the Tier 3 Standard be amended to require the inflow of resources from donations and grants to be recognised when receivable.
59. Under the proposed amendment, an inflow of resources would be recognised as an asset when the resources are controlled by the entity. If there is any doubt over whether an amount is receivable, the Standard would guide the preparer to defer recognition until the donation or grant is received.

Question for the Board

- Q1. Do you agree with the staff recommendation to propose amendments to the Tier 3 Standard to recognise the inflow of resources from grants and donations when receivable?

Issue 2: Recognition of revenue from donations and grants

60. The Tier 3 Standard currently requires receipts from donations and grants to be recognised immediately unless there are “use or return” conditions attached to the arrangement. We appreciate this simple approach was intended to help Tier 3 PBEs understand when the recognition of donations or grants can be deferred and when they cannot.
61. PIR feedback highlighted the request from many respondents for an increased ability to recognise donation and grant revenue over the period in which associated obligations over the use of the donation and grant funding was satisfied. This would help align the accounting outcomes with how they managed the use of grant and donation funding received for specific purposes.
62. The concerns with current Tier 3 revenue recognition requirements centre around donations and grants that are expected to be used by a PBE over multiple accounting periods. A funder may provide a grant or donation with a clear expectation that the resources transferred be used for a specific purpose or used in a particular way (including using the resources over a specified time period), but unless the arrangement has a “use or return” condition the resources transferred will be recognised as revenue immediately. Constituents have raised

concerns that this outcome results in the recognition of “lumpy grants” and financial surpluses which do not fairly represent the entity’s financial performance

Options to address issue 2

63. Staff have identified the following options in response to issue 2.

Option	Advantages	Disadvantages
<p>1. No change – the recognition of donation and grant revenue can only be deferred after receipt of funding when there are “use or return” conditions</p>	<ul style="list-style-type: none"> • Retains current accounting practice – any change in accounting requirements will incur implementation costs. • The current requirements are simple to apply and reduce the level of judgement required. • In principle, the simple requirements are consistent with existing Tier 1 and Tier 2 PBE Standards. • This approach supports the argument that we should wait for this issue to be resolved by the IPSASB, before seeking to provide a simplified solution in the Tier 3 Standard. 	<ul style="list-style-type: none"> • Does not address concerns that the inflow of resources from grants and donations when provided for a specific purpose (but no return obligations) are required to be recognised as revenue immediately – resulting in ‘lumpy grants’.
<p>2. Introduce a requirement to recognise donation and grant revenue in the same accounting period in which any associated obligations over use are satisfied – when the obligations over use are <u>enforceable</u> by an external party. A “use or return” condition would be a strong indication of enforceability, but not the only indicator.</p>	<ul style="list-style-type: none"> • Responds to PIR feedback calling for increased flexibility to recognise donation and grant revenue over time – <u>but</u> only when certain criteria are met. • Consistent with the current direction of the IPSASB <i>Revenue</i> project. 	<ul style="list-style-type: none"> • Introduces a change to the existing requirements that will need to be explained and applied. • This approach means introducing a change that may not be consistent with the final outcomes of the IPSASB <i>Revenue</i> project, or may not be supported by Tier 1 and 2 PBEs when a future IPSAS-based Revenue standard is proposed in New Zealand.

Option	Advantages	Disadvantages
		<ul style="list-style-type: none"> • Tier 3 entities will be required to apply increased judgement when determining whether conditions over the use of donation or grant obligations are enforceable.
<p>3. Introduce a requirement to recognise donation and grant revenue in the same accounting period in which any associated obligations over use are satisfied – when there are <u>expectations</u> over how the transferred resources will be used (but no requirement to assess enforceability).</p>	<ul style="list-style-type: none"> • Responds to PIR feedback calling for increased flexibility to recognise donation and grant revenue over time. • Simple principle to explain to Tier 3 preparers 	<ul style="list-style-type: none"> • Introduces a change to the existing requirements that will need to be explained and applied. • Is not consistent with the current direction of the recognition principles in the IPSASB <i>Revenue</i> project. • Recognising donation and grant revenue based on expectations alone (sometimes referred to a “moral obligations”) is not conceptually supported – because the deferred revenue would not meet the definition of a liability. • Introduces too much flexibility and increased risk of financial performance manipulation.

Option	Advantages	Disadvantages
<p>4. Introduce a requirement to recognise donation and grant revenue over the period in which the inflow of resources is used in the delivery of the entity’s NFP objectives – i.e., revenue is recognised when <u>matching expenditure</u> is incurred (aka, the “matching principle”).</p>	<ul style="list-style-type: none"> • Responds to PIR feedback calling for increased flexibility to recognise donation and grant revenue over time. • There is strong support for the “matching principle” among certain groups of Tier 3 PBEs. • Simple principle to explain to Tier 3 prepares – the matching principle inherently makes sense to many non-accountants (and also many accountants). 	<ul style="list-style-type: none"> • Introduces a change to the existing requirements that will need to be explained and applied. • The “matching principle” is not conceptually supported, and many argue it provides too much flexibility for financial results to be manipulated. • Matching revenue to related expenditure requires an increased level of professional judgement. • Is not consistent with the current direction of the recognition principles in the IPSASB <i>Revenue</i> project.

Staff recommendation

Preferred option to address donation and grant revenue recognition concerns

64. In response to concerns raised by respondents, we support developing amendments to the Tier 3 Standard based on Option 2. This option would broaden the ability for Tier 3 NFPs to defer revenue recognition over the period in which donations and grants are used for their intended purpose – but the ability to defer revenue recognition would be limited to when specific conditions are met (rather than only when there are “use or return” conditions).
65. The amendments would be developed with the objective of providing Tier 3 NFPs with increased flexibility to recognise donations and grants over the period(s) in which any enforceable obligations over use are satisfied. Staff consider that this increased flexibility will be appropriate when donations and grants are provided with:
 - (a) specific obligations over their use;
 - (b) the performance of the agreed obligations is monitored by the resource provider; and
 - (c) the resource provider has mechanisms available to enforce/compel the resource provider to use the resources as agreed or has remedies available for non-performance.
66. The challenge will be drafting these conditions in a simple format standard. One option could be reducing the criterion down to only requiring evidence of monitoring by the resource

provider. If there is no monitoring of performance, then the donation or grant is recognised as revenue immediately when received/receivable.¹³

67. Another way of explaining the principle in the Tier 3 Standard, could be asking the preparer questions such as:
 - (a) Could you choose to use the grant or donation funding received on other activities without the risk of facing any consequences from the funder?
 - (b) Are you required to report back to the funder on how the donation and grant funding received has been used?
68. If the Board supports exploring this option further drafting of proposed Tier 3 amendments (together with examples) would be considered at a future meeting.
69. A draft flow chart of how Option 2 would be applied is provided in [Appendix C](#).

Moving ahead of the IPSASB Revenue Project

70. Applying Option 2 would require moving ahead of IPSASB final pronouncements resulting from its *Revenue* project. We support developing amendments to the Tier 3 Standard ahead of the *IPSASB Revenue* project (which is considering similar revenue recognition issues) because:
 - (a) it is considered important that the proposed amendments to the Tier 3 Standard (planned for exposure the Q1 2022), address all the significant issues raised through the PIR process; and
 - (b) the proposed option is consistent with the current direction of the *IPSASB Revenue* project.
71. The IPSASB has agreed with the broad revenue recognition principle that “*revenue shall be recognised to the extent the reporting entity has satisfied any present obligations associated with the transaction*”. Present obligations arise when the resource provider has the ability to enforce/compel the resource provider to use the resources transferred in a particular way and has remedies available for non-performance.
72. We expect that we will be in a position to expose for comment new Tier 1 and Tier 2 PBE *Revenue* Standards based on final IPSASB pronouncements in Q1 2023 (dependent on the extent of New Zealand amendments to the final IPSAS pronouncements).
73. We are conscious of the risks associated with seeking to develop amendments to the revenue recognition principles in the Tier 3 Standard ahead of the *IPSASB Revenue* project. The alternative (and arguably safer option) is to wait – and to propose amendments to the revenue recognition requirements across the New Zealand PBE Standards (Tiers 1 to 3) after the IPSASB has issued final *Revenue* pronouncements. This approach would result in the Tier 3 Standard being amended twice over 12 months:

¹³ We note that when drafting any proposed amendments to the Tier 3 Standard we will avoid using the terms ‘resource provider’ and ‘resource recipient’. The term ‘resource’ in general is confusing.

- Q1 2022 – we expect to issue a Tier 3 amendments ED, in response to PIR feedback.
- Q1 2023 – we expect to issue new *PBE Revenue Standard(s)* based on IPSASB final pronouncements (under the ‘wait’ approach the Tier 3 Standard could be updated at the same time for revenue recognition).

Questions for the Board

- Q2. Should the Tier 3 Standard be amended for concerns over donation and grant revenue recognition at the same time as considering other PIR feedback, or should consideration of these amendments be deferred until after the IPSASB has completed its *Revenue* project?
- Q3. **If** the Board supports moving ahead of IPSASB final pronouncements on this matter to address Tier 3 PBE concerns does the Board support the staff recommendation to develop amendments to the Tier 3 Standard based on Option 2 (see below)?
- Option 2: Recognising donation and grant revenue over the period in which any associated obligations over use are satisfied, when the fulfilment of the agreed obligations is enforceable by the resource provider?
- If not, is there another option you would prefer?
- Q4. Does the Board have any other feedback on responding to PIR concerns over the recognition of donation and grant revenue?

Next steps

74. Based on Board FEEDBACK and DIRECTION staff will develop amendments to the Tier 3 Standard and examples for consideration at a future meeting.

Appendix A – Review of some comparable reporting frameworks

	Recognition and Measurement	Presentation and Disclosure
IFRS for SMEs	<p>24.4 An entity shall recognise government grants as follows:</p> <ul style="list-style-type: none"> (a) a grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable; (b) a grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met; and (c) grants received before the revenue recognition criteria are satisfied are recognised as a liability. <p>24.5 An entity shall measure grants at the fair value of the asset received or receivable. [The term ‘specified future performance conditions’ is not defined or described in this section or in the Glossary of Terms to <i>IFRS for SMEs</i>]</p>	<p>An entity shall disclose the following:</p> <ul style="list-style-type: none"> (a) the nature and amounts of government grants recognised in the financial statements; (b) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income; and (c) an indication of other forms of government assistance from which the entity has directly benefited.
Charities SORP	<p>Recognition of income, including legacies, grants and contract income is addressed by section 5 of the SORP.</p> <p>Section 5.3 distinguishes between income from exchange transactions (contract income) and income from non-exchange transactions (gifts) in a similar way to the Tier 1 and Tier 2 PBE Standards.</p> <p>Section 5.7 notes that transactions must be accounted for and presented in accordance with their substance and not simply their legal form.</p> <p>Section 5.10 notes that income from donations or grants is recognised when there is evidence of entitlement to the gift, receipt is probable and its amount can be measured reliably.</p> <p>Section 5.21 notes that donor-imposed conditions may also specify the time period over which the expenditure of resources on a service can take place. Specification of a time period may amount to a pre-condition for use that limits the charity’s ability to spend a grant or donation until it has performed the activity related to the specified time period. For example, a condition might specify the provision of a number of training weeks or the completion of a number of work placements in a particular period.</p> <p>Section 5.22 notes that time-related conditions may be implied. For example, when a multi-period grant is approved and is to be paid on</p>	<p>Section 5.58 and section 5.59 outline the disclosure requirements that apply to government grants and the deferral of income as follows:</p> <p>A charity in receipt of government grants must also disclose:</p> <ul style="list-style-type: none"> • The nature and amounts of government grants recognised in the accounts; • Unfulfilled conditions and other contingencies attaching to grants that have been recognised in income; and • An indication of other forms of government assistance from which the charity has directly benefited. <p>When a charity has deferred income, the notes to the accounts must explain the reasons why income is deferred and should analyse the movement on the deferred income account, identifying income deferred in the current year and the amounts released from previous reporting periods.</p>

	Recognition and Measurement	Presentation and Disclosure
	the basis of agreed annual budgets, the charity may not be entitled to spend part or all of that income in advance of its budgeted year(s) without the further prior approval of the grant-maker.	
CA ANZ Special Purpose Reporting Framework ¹⁴	<p>Recognition of revenue from government grants</p> <p>9.31 An entity shall recognise government grants as follows:</p> <ul style="list-style-type: none"> (a) a grant that does not impose specified future performance obligations on the recipient is recognised as revenue when the grant proceeds are receivable; (b) a grant that imposes specified future performance obligations on the recipient is recognised as revenue only when the performance obligations are met; and (c) a grant received before the revenue recognition criteria are satisfied is recognised as a liability. 	<p>9.33 An entity shall disclose the following about government grants:</p> <ul style="list-style-type: none"> (a) the nature of the amount of government grants in the financial statements; and (b) unfulfilled performance obligations and other contingencies in relation to government grants that have not been recognised in revenue.

¹⁴ Note: This framework deals with revenue from sale of goods and services and government grants — it does not deal with other donations and grants because it was not designed for use by NFPs.

Appendix B – IFR4NPO Consultation Paper: Non-Exchange Revenue Alternatives

The IFR4NPO CP considered four alternative approaches to account for non-exchange revenue.¹⁵ The CP explores the advantages and disadvantages of each approach, but the CP does not settle on a preferred approach – instead respondents were asked to identify the alternative treatment they favoured.

Alternative 1: Requires all non-exchange revenue to be recognised in accordance with the IFRS for SMEs Standard. This would mean for non-exchange revenue other than government grants, that the broad principles of the *IFRS for SMEs Standard* would apply. Alternatively, the government grants requirements (refer to [Appendix A](#)) could be applied to non-exchange revenue transactions. Additional NPO-specific guidance would be provided. [We note that the IFRS for SMEs Standard has no specific requirements on how to account for donations and grants, other than government grants.]

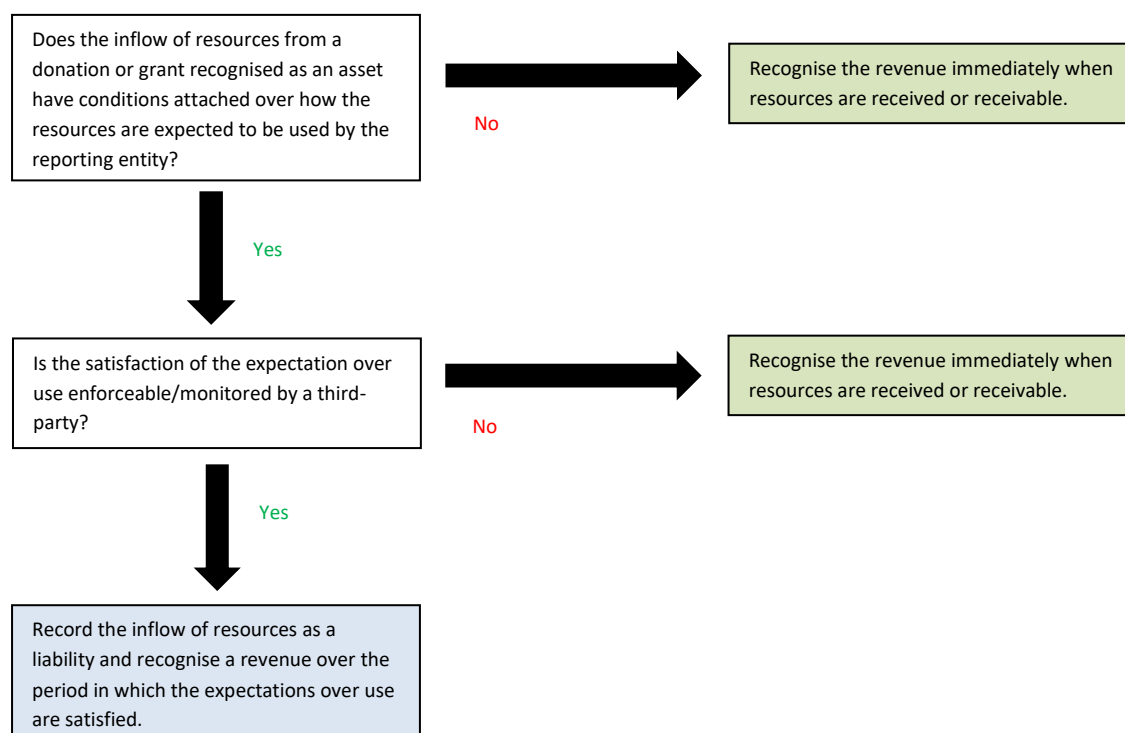
Alternative 2: Requires non-exchange revenue to be recognised using the principles in IAS 20 to extend the treatment of government grants to other non-exchange revenue (i.e. to recognise revenue on a systematic basis over the periods that the entity recognises as expenses the related costs). Additional NPO-specific guidance would be provided to enable the consistent treatment of all non-exchange revenue.

Alternative 3: Requires non-exchange revenue to be accounted for using the principles in IPSAS 23 (i.e. revenue is usually recognised when an NPO controls the assets and revenue recognition will depend on whether any stipulations over use are defined as having conditions (use or return requirements) or stipulations (no use or return conditions). Additional NPO-specific guidance would be provided.

Alternative 4: Requires non-exchange revenue to be accounted for using the principles in IPSAS 23 with specific NFP amendments drawn from national standards concerning the accounting for donated assets and inventory.

¹⁵ Non-exchange revenue as defined by the CP includes donations, grants and volunteer services. These transactions are characterised by situations where the provider of the resources does not themselves directly receive goods and/or services of approximately equal value in return for the resource they provided.

Appendix C – Option 2: Draft Revenue Recognition Flowchart





Cover Memo

Project	Insurance Activities in the Public Sector	Meeting	AASB (M183)/ NZASB September 2021
Topic	Applying AASB 17/NZ IFRS 17 in public sector entities	Agenda item	AASB 11.1 NZASB 3.1
		Date	23 August 2021
Contacts	Angus Thomson athomson@asb.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asb.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

Objectives of this agenda item

1. The objectives of this agenda item are for the AASB and the NZASB to:
 - (a) **decide** whether public-sector-specific modifications or guidance is needed in AASB 17/PBE IFRS 17 in respect of:
 - (i) Onerous contracts;
 - (ii) Measurement of investments backing insurance liabilities;
 - (iii) Classification and presentation of risk mitigation program costs and other similar costs;
 - (iv) Captive insurers;
 - (b) **redeliberate** some of the decisions the Boards made on:
 - (i) scope of application of AASB 17/PBE IFRS 17 to public sector entities;
 - (ii) risk adjustments for non-financial risk in respect of public sector entities; and
 - (c) **decide** whether to defer the mandatory application date of AASB 17/PBE IFRS 17 for public sector entities.
2. The papers in this agenda item are being presented to the September 2021 AASB and NZASB meetings.

Reasons for bringing this agenda item to the Boards

3. The AASB and the NZASB decided at their February 2021 meetings the key issues to be deliberated in this project.¹ The following table outlines the issues:
 - (a) the Board meetings at which topics have been, and are expected to be, considered; and

¹ The AASB project summary is available [here](#).



(b) other activities needed to progress the project;
with comments on progress against the timetable identified in February 2021.

4. There have been no changes to the timetable since the June 2021 meetings.

Activity / Topic	AASB	NZASB	Comment
Scope: public sector activities to which AASB 17/PBE IFRS 17 should apply	April 2021	April 2021	
Risk adjustment: relevance and measurement	April 2021	May 2021	
Discounting/inflating: used to measure insurance liabilities	June 2021	June 2021	
PAA eligibility: criteria for using 'simplified' measure of liabilities for remaining coverage	June 2021	June 2021	
Reporting entities: identifying 'insurance entities' that should prepare financial statements	Sept 2021	Sept 2021	
Non-contract costs: classification	Sept 2021	Sept 2021	
Onerous contracts: recognition basis	Sept 2021	Sept 2021	
Investments: measurement for those backing insurance liabilities	Sept 2021	Sept 2021	
Targeted redeliberation on scope and risk adjustment	Sept 2021	Sept 2021	
Agree on Consultation document	Planned Nov 2021	Planned Dec 2021	Originally Sept 2021
Issue Consultation document	Planned Feb 2022	Planned Feb 2022	Originally Oct 2021
Consider feedback on Consultation document and proposals for addressing issues raised	Planned April 2022	Planned April 2022	Originally Feb 2022
Address any sweep issues and agree on revised Standards	Planned May-July 2022	Planned May-July 2022	Originally April 2022
Issue revised Standards	Planned Sept 2022	Planned Sept 2022	Originally May 2022

Communicating the timeframe to stakeholders

- The mandatory application date of AASB 17/PBE IFRS 17 is annual periods beginning on or after 1 January 2023. As noted at the Boards' previous meetings, there may be a need to defer the mandatory application date for public sector entities.
- The NZASB's policy is to decide on an effective date depending on the complexity of the relevant Standard, and the Board has a history of allowing a reasonable period between issuing a Standard and its mandatory application date to facilitate the transition to new requirements.



7. Paragraph 7.9.2 of the *AASB Due Process Framework for Setting Standards* (September 2019) states (emphasis added):
- 7.9.2 When determining the effective date of Standards, the AASB seeks to ensure that stakeholders have adequate time to prepare for their implementation. Typically, the AASB will issue a Standard with at least 2 years before its effective date (eg a year before the beginning of the comparative reporting period) and generally permits entities to apply those requirements early should they wish to do so.
8. Based on this benchmark, for public sector entities with July to June financial years, periods beginning on or after 1 January 2023 effectively means 1 July 2023, with a comparative period beginning 1 July 2022. Using the timetable outlined above, the earliest date the Boards expect to finalise any amendments to AASB 17/PBE IFRS 17 is September 2022, which is two months after the beginning of the benchmark comparative reporting period.
9. If the revised AASB 17/PBE IFRS 17 is issued in September 2022, providing a window of at least one year before the beginning of the comparative reporting period would mean a mandatory application date of 1 July 2025 with a comparative year beginning 1 July 2024.
10. Although a decision about the mandatory application date of a Standard is not required to be made until the finalisation of the Standard, staff consider appropriate to communicate with public sector stakeholders that the mandatory date for applying AASB 17/PBE IFRS 17 will be extended at least until 1 July 2025. This is because some public sector stakeholders have informed staff that they would like some certainty about when AASB 17/PBE IFRS 17 is expected to become mandatory for their entities, to assist their planning of the implementation of the Standard.

Question for Board members

- Q1 Do Board members agree with the staff view in paragraph 10 to provide certainty to stakeholders that the mandatory date for applying AASB 17/PBE IFRS 17 for public sector entities will be extended at least until 1 July 2025?

Papers for this agenda item

Agenda Paper AASB 11.2/NZASB 3.2: Identifying and accounting for onerous contracts and related unit of account issues

Agenda Paper AASB 11.3/NZASB 3.3: Redeliberation of Scope and Risk Adjustments topics

Agenda Paper AASB 11.4/NZASB 3.4: Measurement of investments backing insurance liabilities

Agenda Paper AASB 11.5/NZASB 3.5: Risk mitigation program costs and other similar costs

Agenda Paper AASB 11.6/NZASB 3.6: Captive insurers



Staff Paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M183)/NZASB September 2021
Topic	Identifying and accounting for onerous contracts and related unit of account issues	Agenda item	AASB 11.2 NZASB 3.2
		Date	23 August 2021
Contacts	Angus Thomson athomson@asab.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asab.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

Objective of this paper

1. The objective of this paper is for the AASB and the NZASB to decide whether public-sector-specific modifications or guidance is needed in AASB 17/PBE IFRS 17 *Insurance Contracts* in respect of identifying and accounting for onerous contracts.

Structure of this paper

2. This staff paper is set out in five sections:
 - [Section 1](#) sets out the basis for identifying and recognising onerous contracts under AASB 1023/PBE IFRS 4
 - [Section 2](#) sets out the basis for identifying and recognising onerous contracts under AASB 17/PBE IFRS 17
 - [Section 3](#) sets out possible approaches on onerous versus non-onerous groups of contracts
 - [Section 4](#) sets out possible approaches on annual groups of contracts
 - [Section 5](#) sets out possible approaches on initial recognition of insurance contracts.

Summary of staff recommendations

3. Staff are recommending a number of public sector modifications to AASB 17/PBE IFRS 17 relating to the grouping of contracts. Staff expect that the issues and reasoning in respect of these modifications will be included as part of a Basis for Conclusions to AASB 17/PBE IFRS 17.

Background

4. Under both AASB 1023 *General Insurance Contracts*/PBE IFRS 4 *Insurance Contracts* and AASB 17/PBE IFRS 17 *Insurance Contracts*, because the liability for incurred claims is measured using current estimates of cash flows, there is no need to separately consider whether the amount provided is adequate. That is, there is no need for an onerous contract testing and recognition process in respect of liability for incurred claims. Accordingly, the identification of



onerous contracts and the subsequent accounting is only relevant to liabilities for remaining coverage, and these are the focus of this paper.

Terminology

5. The equivalent of the AASB 17/PBE IFRS 17 term ‘liability for remaining coverage’ under AASB 1023/PBE IFRS 4 is ‘unearned premium liability’ – although the two liabilities are calculated differently (depending on the circumstances) as explained below.
6. Selected terms relating to contract recognition are outlined in [Appendix A](#).
7. The language used in AASB 1023/PBE IFRS 4 differs from the language used in AASB 17/PBE IFRS 17 – for example an ‘unearned premium liability’ under AASB 1023/PBE IFRS 4 is effectively a ‘liability for remaining coverage’ under AASB 17/PBE IFRS 17. To simplify the discussion, this paper generally uses the AASB 17/PBE IFRS 17 term unless specified.

Section 1: Identifying and recognising onerous contracts under AASB 1023/PBE IFRS 4

8. 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 (LAT) to the carrying amount of the liability for remaining coverage (UEP) when there is an indication that the liability may be inadequate [AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1)]. The LAT is applied at the **portfolio level**. **In the case of some public sector entities, there is only one portfolio of contracts**. For those entities, the LAT is effectively conducted at the **whole-of-entity** level.
9. The LAT involves comparing:
 - (a) the balance of the liability for remaining coverage recognised on the balance sheet; 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) < (b). An additional ‘unexpired risk liability’ is recognised for the deficiency,¹ which is also recognised immediately as a loss.²

10. An indication that the liability for remaining coverage is inadequate and needs a LAT could include, for example, recent claims that are materially higher than expected when premiums were originally priced.

1 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’.

2 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.



Example		
A portfolio consists of 1,000 contracts each with a premium of \$100 for a year's coverage, commencing on 1 April 20X1	Total premium	\$100,000
At 30 June 20X1, 25% of premiums have been earned (i.e. 75% of unearned premium) (assumes a straight-line basis for earning)	Unearned premium liability at 30 June	\$75,000
Estimated cost of claims incurred in the period 1 April to 30 June 20X1 is \$30,000 and this experience is expected to continue for the remainder of the coverage period	Estimated future claims from existing contracts	\$90,000
The unearned premium liability is inadequate [\$75,000 less \$90,000]	Unexpired risk liability	\$15,000

11. In the private for-profit sector, the presumption is that insurers issue insurance contracts that are intended to be profitable. The profit component should act as a 'buffer' to any liability inadequacy. In practice, private for-profit sector insurers only occasionally need to test for liability inadequacy and few entities need to recognise an unexpired risk liability.
12. For most public sector insurers, the liability for remaining coverage calculated based on unearned premium is routinely inadequate because they price to break even after taking into account projected investment returns.³ That is, on a stand-alone basis, levies/premiums charged are inadequate to meet expected claims. Accordingly, many public sector entities routinely recognise unexpired risk liabilities under AASB 1023/PBE IFRS 4. **This is a key distinguishing factor among public sector entities compared with private sector for-profit entities.**
13. There are no public sector specific modifications to AASB 1023/PBE IFRS 4 based on this key distinguishing factor – the routine recognition of unexpired risk liabilities, which are typically offset by investment income/gains, is an accepted practice. However, the more granular levels of disaggregation required for assessing and recognising onerous contracts under AASB 17/PBE IFRS 17 might complicate the accounting for some public sector entities and lead to them presenting less relevant information – these matters are considered below.

Section 2: Identifying and recognising onerous contracts under AASB 17/PBE IFRS 17

Premium allocation approach (PAA)

14. When liabilities for remaining coverage are measured using the PAA,⁴ the onerous contract test in AASB 17/PBE IFRS 17.57 applies (based on the sub-groupings identified below). It is equivalent to the LAT in AASB 1023/PBE IFRS 4.9.1 in that it applies after initial recognition of contracts and involves comparing the PAA balance to an amount based on the present value of fulfilment cash flows when facts and circumstances indicate that a group of insurance contracts is onerous.

³ The expected investment returns are ordinarily higher than the discount rates (for time value) applied to measure insurance liabilities

⁴ Refer to June 2021 [AASB Agenda Paper 14.3](#) and [NZASB Agenda Paper 8.3](#).

Sub-grouping at initial recognition – onerous versus non-onerous

15. One of the key differences between:
- existing insurance accounting practices in Australia and New Zealand (and most other jurisdictions); and
 - IFRS 17 requirements;
- is the need to sub-group contracts within a portfolio from initial recognition. In general, AASB 17/PBE IFRS 17 will result in contracts being recognised as onerous earlier and more often because AASB 17/PBE IFRS 17 applies a more granular unit of account for testing.
16. AASB 17/PBE IFRS 17.16 requires insurers to divide each portfolio of contracts into sub-groups:
- contracts that are onerous at initial recognition, if any; and
 - other (non-onerous) contracts.⁵

Example for illustrative purposes			
AASB 1023/PBE IFRS 4		AASB 17/PBE IFRS 17	
(a) Portfolio unearned premium	\$1,000,000	(a1) Non-onerous sub-group PAA	\$500,000
		(a2) Onerous sub-group PAA	\$500,000
(b) Portfolio PV of future claims on existing contracts	\$950,000	(b1) Non-onerous sub-group PV of future claims on existing contracts	\$350,000
		(b2) Onerous sub-group PV of future claims on existing contracts	\$600,000
Portfolio onerous contract loss [because (a) > (b)]	0	Onerous contract loss (a2) – (b2)	\$100,000

17. The sub-groups under AASB 17/PBE IFRS 17.16 are established at initial recognition and are not subsequently changed, although new contracts would be added⁶ to each group over an underwriting year. That is, the discovery that contracts initially thought to be non-onerous are actually onerous based on subsequent experience does not give rise to a new sub-grouping.

Sub-grouping at initial recognition – by issue date within one year period

18. AASB 17/PBE IFRS 17.22 requires insurers to divide each portfolio of contracts into sub-groups of contracts issued no more than a year apart. These sub-groups are a key unit of account used in applying AASB 17/PBE IFRS 17. This contrasts with AASB 1023/PBE IFRS 4 under which successive generations of contracts are included in a single portfolio, which is the key unit of account used in applying AASB 1023/PBE IFRS 4. This has an impact on the potential for early recognition of onerous contracts with multi-year coverage periods.

⁵ In practical terms, there are two sub-groups: (a) onerous; and (b) non-onerous. However, in theory, the actual requirement is more complex – there are three sub-groupings: (a) a group of contracts that is onerous at initial recognition; (b) a group of contracts that at initial recognition have no significant possibility of becoming onerous subsequently, if any; (c) other contracts. However, early indications are that most insurers consider that (c) would rarely, if ever, arise; or insurers are unable to distinguish between (b) and (c).

⁶ Except in the cases of public sector entities with a single fixed contract period for all contracts – such as 1 July to 30 June each year.



19. Under AASB 1023/PBE IFRS 4, a profitable annual cohort of contracts can offset a loss-making annual cohort of contracts; whereas the loss-making annual cohort would be accounted for on a stand-alone basis and regarded as onerous under AASB 17/PBE IFRS 17.

Example for illustrative purposes			
AASB 1023/PBE IFRS 4		AASB 17/PBE IFRS 17	
(a) Portfolio (20X1 and 20X2 cohorts) unearned premium	\$2,000,000	(a1) Non-onerous 20X1 cohort PAA	\$1,100,000
		(a2) Onerous 20X2 cohort PAA	\$900,000
(b) Portfolio (20X1 and 20X2 cohorts) PV of future claims on existing contracts	\$1,900,000	(b1) Non-onerous 20X1 cohort PV of future claims on existing contracts	\$950,000
		(b2) Onerous 20X2 cohort PV of future claims on existing contracts	\$950,000
Portfolio (20X1 and 20X2 cohorts) onerous contract loss [because (a) > (b)]	0	Onerous 20X2 cohort contract loss [(a2) – (b2)]	\$50,000

20. There is no impact on the long-run overall results from taking different approaches to onerous contract units of account. The main impact of AASB 17/PBE IFRS 17 (relative to AASB 1023/PBE IFRS 4) will be to front-end losses that would otherwise have been recognised over the life of the contracts.

How might public sector entities be affected by AASB 17/PBE IFRS 17.16?

21. The impact of AASB 17/PBE IFRS 17.16 will depend on the nature of the contracts and how they have been priced. The following examples help to illustrate the impact in different circumstances.
- (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 underprice for risk on some contracts and overprice others, ordinarily there would not be onerous and non-onerous sub-groups. Typically, as noted in paragraph 8(above), there will often be only one group of contracts and, as noted in paragraph 12, that will typically be an onerous group of contracts.
 - (b) Transport accident insurance contracts are typically priced for the expected actual risks over the whole portfolio. However, the public sector entity would typically have relatively granular information 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.
22. AASB 17/PBE IFRS 17.20 provides relief from sub-grouping under AASB 17/PBE IFRS 17.16 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 insurance contract case, 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).



23. As discussed by the Boards in June 2021 (in respect of PAA eligibility), the price/levy decision-making power may reside with the entity itself, or it might reside with the government (for example, the relevant Minister). At their June meetings, the Boards decided it should be clarified that assessing a public sector entity's practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits. This would be on the basis that, for the purposes of determining pricing and benefits, the controlling government, including any relevant Minister(s), are acting in their capacity as managers of the public sector entity.
24. There are two ways in which this decision about a controlling government, including any relevant Minister(s) might be interpreted for the purposes of AASB 17/PBE IFRS 17.20.
- (1) It would mean that a pricing constraint imposed on an entity by its controlling government (or any relevant Minister) would not provide the entity with access to relief from sub-grouping because it would be deemed to be self-imposed.
 - (2) While a public sector entity's practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits, this is only in respect of their capacity as managers of the public sector entity. The overall pricing constraints relevant to AASB 17/PBE IFRS 17.20 are in respect of government policy more broadly, which is possibly set out in legislation (rather than being within a government's or Minister's management capacity). This broader framework of constraints would mean the entity has access to relief from sub-grouping because it would be deemed to be an externally-imposed constraint.

How might public sector entities be affected by AASB 17/PBE IFRS 17.20 (annual cohorts)?

25. Many public sector entities would only issue contracts with one year of coverage and the above difference [paragraph 16] between the portfolio perspective versus sub-grouping by annual cohort would not arise. However, some public sector entities issue contracts that provide multi-year coverage – for example, in respect of domestic building risk coverage arrangements, which may result in a greater frequency of early onerous contract recognition.

Stakeholder feedback

26. NZASB ED 2018-7⁷ 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.
27. The responses to NZASB ED 2018-7 generally concluded that a PBE modification is needed 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 PBEs, which typically deliberately cross-subsidise across communities.

⁷ NZASB Exposure Draft ED 2018-7 PBE IFRS 17 *Insurance Contracts* [ED 2018-7].



- (d) PBEs 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.
28. Some responses to NZASB ED 2018-7 also concluded that a PBE modification is needed because 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, 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 exit the market).
29. The AASB DP (2017)⁸ did not specifically flag this issue and there were no comments from respondents to the AASB DP on onerous contract groups. The issue was raised in interviews between Australian stakeholders and AASB and NZASB staff conducted in late 2020 and early 2021 and feedback included the following.
- (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, on a stand-alone basis, 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 17.16.
- (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 17.20.
- (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'.

Section 3: Possible approaches on onerous versus non-onerous groups of contracts

30. 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].⁹

⁸ AASB Discussion Paper *Australian-specific Insurance Issues – Regulatory Disclosures and Public Sector Entities* (2017) [AASB DP (2017)].

⁹ 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].



31. In respect of AASB 17/PBE IFRS 17.16 and 20, the Table below outlines approaches available to the Boards. Other approaches or combinations of approaches might also be available.

Reasons for and against each approach to AASB 17/PBE IFRS 17.16 & 20		
Possible approach	Arguments for	Arguments against
A1 Exempt all public sector entities from AASB 17/PBE IFRS 17.16	[1a] The basis for these requirements is timely information on profitability, which is not relevant to most public sector entities	[2a] Timely information on sub-groups of onerous contracts might be useful because it might help inform users about cross-subsidies between participants / policyholders
	[1b] Most public sector entities have portfolios of onerous contracts – sub-groups of onerous contracts are not relevant	
A2 As above, but only exempt not-for-profit public sector entities (which is the majority of the relevant entities)	[1c] Information on profitability remains relevant to for-profit public sector entities	[2b] For-profit public sector entities also have portfolios of onerous contracts ¹⁰ – sub-groups of onerous contracts are not relevant
B1 Exempt all public sector entities 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	As per [1a, 1b & 2a] [3] Provides additional relevant information about the impact of price constraints on each entity (the information could be provided by cross-reference)	[4] The additional disclosure would be a burden and may already be readily available from other sources (although the burden might be mitigated by permitting disclosure by cross-reference)
B2 As above, but only exempt not-for-profit public sector entities	As per [1c]	As per [4] As per [2b]
C No amendments/guidance on applying the requirements in AASB 17/PBE IFRS 17.16 & 20 (That is, no exemption for public sector entities.)	[5] Public sector entities should be able to identify the constraints relevant to their pricing decisions	As per [1a, 1b, 2a & 2b] [6] Public sector entities may struggle to identify constraints relevant to their pricing decisions, resulting in inconsistent reporting outcomes
D Keep AASB 17/PBE IFRS 17.16 and provide guidance to the effect that the constraints identified in AASB 17/PBE IFRS 17.20 would be constraints imposed on the entity itself and its controlling government (Ministers) in their managerial capacities	As per [6] [7] Consistent with the Boards' decision on PAA eligibility	As per [5] [8] Despite the guidance, public sector entities may struggle to identify the relevant constraints, resulting in inconsistent reporting outcomes
E Keep AASB 17/PBE IFRS 17.16 and provide guidance to the effect that the constraints identified in AASB 17/PBE IFRS 17.20 would be constraints imposed on the entity in respect of government policy broadly, which is possibly set out in legislation [and not in the controlling government's (Ministers') managerial capacities]	As per [6] [9] The context of price constraints for contract boundary purposes is different from the relief provided by AASB 17/PBE IFRS 17.20 ¹¹	As per [5 & 8] [10] Might be viewed as inconsistent with the Boards' decision on PAA eligibility

10 The entity itself might aim to be 'profitable' after taking into account investment earnings, but the contracts themselves are typically onerous prior to taking into account the investment earnings.

11 Price constraints for contract boundary purposes [AASB 17/PBE IFRS 17.34] are constraints that operate between the insurer and policyholder(s) and affect coverage periods; whereas, the regulatory constraints for the purposes of AASB 17/PBE IFRS 17.20 are imposed on both the insurer and the policyholder(s) and affect aggregation/disaggregation.



Staff views

32. Staff consider that the Boards should exempt all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16. That is, Approach A1 in the Table immediately above.
33. Staff consider the exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16 is justified for the following reasons.
- (a) The IASB's thinking about why the requirements for information about onerous contracts is useful information about an entity's decisions on pricing contracts 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 the 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, pricing decisions are not a useful basis for disaggregation.
 - (b) Public sector entities' information systems are typically geared to identifying, at a broad level, high-risk groups of participants/policyholders for strategic and government policy decision-making (for example, to conduct safety campaigns), but not necessarily for identifying separate groups of contracts for accounting purposes. 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 AASB 17/PBE IFRS 17.20 would 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 (Minister). However, it would be potentially confusing if the explanation was anything other than an explanation that is perceived as being consistent with the decision in respect of PAA eligibility. It might be feasible to argue a distinction between:
 - (i) a public sector entity's practical ability to fully price for risks or benefits including 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.However, any such distinction could be a source of confusion.
34. Staff also note that the differences (from the private sector) in the accountability/regulatory, governance and financial management frameworks in general among public sector insurers could justify an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16.¹²

12 In particular, paragraph 30(g) of the [AASB Not-for-Profit Entity Standard Setting Framework](#); and, to some extent, paragraph 60 of the [New Zealand Accounting Standards Framework](#).



35. Staff consider that additional disclosures about the nature of the pricing process, including constraints under which an entity operates that result in cross-subsidising different groups of policyholders, is not justified for the following reasons.
- (a) (There is no equivalent disclosure in AASB 17/PBE IFRS 17.
 - (b) In general, accounting standards (on other topics) do not require disclosures around pricing decisions and whether they involve cross-subsidisation among customers.
 - (c) In practice, a wide variety of disclosures of varying usefulness might result from requiring this type of disclosure. Some entities might provide pages of explanation or multiple cross-references to a range of possible sources, while others may provide a 'boilerplate' disclosure. Staff consider that users who are interested in this aspect of an entity's activities would probably be able to obtain this type of information from other sources, which might (for example) include the entity's management commentary, actuarial reports, deliberations of supervisory bodies, budget papers, and enabling legislation.

Question for Board members

- Q1 Do Board members agree with the staff view that it would be appropriate to:
- (a) exempt all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16; and
 - (b) not require any additional disclosure?

Section 4: Possible approaches on annual groups of contracts

36. 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. The year of issue is often referred to as the 'underwriting year'. For example, an entity with a 1 July to 30 June financial year would be expected to regard all contracts issued between 1 July and 30 June as being within one group of contracts for the purposes of complying with AASB 17/PBE IFRS 17.22.
37. The IASB decided on the requirements in IFRS 17.22 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].

Underwriting year versus accident year

38. 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 systems consequences for the ways in which the liability for incurred claims would also be managed (unless insurers operate two parallel systems). This is because:
- (a) claims are usually compared with premium/levies earned, and premium earning under AASB 17/PBE IFRS 17 would be based on the underwriting year groups used for the liability for remaining coverage under AASB 17/PBE IFRS 17.22; and



- (b) many general insurers (including some public sector entities) tend to manage claims on an ‘accident year’ basis.¹³ That is, 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.

39. For some public sector entities, the underwriting year and the accident year are the same.¹⁴ However, for other public sector entities they are different. The following table is intended to help explain the approach implied by AASB 17/PBE IFRS 17.22 versus the accident year approach. The table is based on contracts that have a one-year coverage period.

Basis of groups	<i>Underwriting year basis</i>	<i>Accident year basis</i>
		Contracts issued between 1 July to 30 June 20X2 [AASB 17/PBE IFRS 17.22]
Observations	Accidents related to these contracts could occur between 1 July 20X2 to 29 June 20X3	Contracts related to these accidents could have been issued from 2 July 20X1 to 30 June 20X2
	The focus is on tracking and reporting underwriting performance year-on-year	The focus is on tracking and reporting claims year-on-year

40. Given that there is less focus on profitability and underwriting performance for public sector entities (relative to their private sector for-profit counterparts) claims management plays a more prominent role for public sector entities. Liabilities for incurred claims are relative more significance to public sector entities versus liabilities for remaining coverage when compared with the private sector (as identified in the Boards’ previous meeting papers on this project¹⁵).

Other factors – coverage for highly uncertain infrequent events

- 41. Some insurance risks relate to providing coverage for highly uncertain infrequent events. The coverage period for contracts for these risks are often only one year and:
 - (a) in years when there are no relevant events, the business is highly profitable; while
 - (b) in years when a relevant event occurs, the business results in large losses.
- 42. 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.
- 43. From the perspective of a public sector insurer 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.

13 Lloyd’s business is a major exception because the syndicates (whose members’ relative interests in the syndicates may change over time) are based on underwriting years.

14 For example, Comcare and iCare’s Workers’ Compensation business (except for ‘new’ employers).

15 For example, June 2021 [Agenda Paper AASB 14.3/NZASB 8.3](#).



Staff views

44. Staff consider that the Boards should exempt all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22. Staff consider the exemption for all public sector entities is justified for the following reasons.
- (a) The focus of interest among some 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.
 - (b) 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 unimportant) to public sector entities.
 - (c) The requirement in AASB 17/PBE IFRS 17.57 to compare the PAA liability for remaining coverage 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. [This is the level at which the LAT is currently applied under AASB 1023.9.1/PBE IFRS 4 (Appendix D.9.1).] Given that, for most public sector entities, the liability for remaining coverage is routinely inadequate because they 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.
 - (d) The differences (from the private sector) in the accountability/regulatory, governance and financial management frameworks in general among public sector insurers help justify an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.16.¹⁶

Question for Board members

- Q2 Do Board members agree with the staff view that it would be appropriate to exempt all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.22?

Section 5: Initial recognition of insurance contracts

45. 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.

¹⁶ In particular, paragraph 30(g) of the [AASB Not-for-Profit Entity Standard Setting Framework](#); and, to some extent, paragraph 60 of the [New Zealand Accounting Standards Framework](#).



- (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 – see (a) above.
46. In contrast, AASB 17/PBE IFRS 17.25 says:
- 25 An entity shall recognise a group of insurance contracts it issues 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.
47. IFRS 17.BC140 to BC144 indicate 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.¹⁷ Staff interpret this to mean that there are onerous contracts which are ‘bound but not incepted’ (BBNI).¹⁸
48. 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 financial year.

Private sector versus public sector circumstances

<i>Circumstances</i>	<i>Private sector for-profit insurers</i>	<i>Public sector entities</i>
Prevalence of onerous contracts	An insurer would only by exception knowingly issue onerous contracts [see IASB’s perspective in IFRS 17.BC135]. In practice, as at the reporting date, insurers will need to consider all of their BBNI contracts and identify those which are onerous based on facts and circumstances.	As noted in paragraph 12, most public sector entities routinely issue onerous contracts (because levies/premiums charged are inadequate to cover expected claims).
Prevalence of BBNI contracts	An insurer will typically have contracts commencing throughout their financial year and, therefore, only a relatively small portion of contracts would typically be within the BBNI category as at any given reporting date.	Some public sector entities have a large portion of their contracts covering periods that coincide with their financial year. Accordingly, for these entities, all or most of next year’s contracts could be BBNI at financial year end.

17 The IASB reasoned that it would be too burdensome to require all contracts (rather than just onerous contract) to be recognised on the acceptance of risk due to the need to track each group of contracts prior to coverage commencing [IFRS 17.BC141]. However, an entity would need to know the population of those contracts in order to determine which are onerous.

18 ‘Bound But Not Incepted’ (BBNI) or ‘Written But Not Incepted’ (WBNI) is a widely accepted notion in the general insurance industry. For example, in relation to capital adequacy, refer to: APRA [Discussion Paper Integrating AASB 17 into the capital and reporting frameworks for insurers and updates to the LAGIC framework](#) [page 43].



49. The differences in circumstances between private sector for-profit insurers versus many public sector entities with insurance arrangements mean that AASB 17/PBE IFRS 17.25(c) might have a much more significant impact in the public sector.

Example public sector entity

Coverage for all contracts runs from 1 July to 30 June. All contracts are known to be onerous [refer paragraph 12]. As at balance date, all of the entity’s policyholders/participants have entered into arrangements that commence on 1 July of the subsequent financial year (that is, they are all BBNI contracts). The losses (before investment earnings) for the next year’s arrangements are estimated to be \$50m. All of next year’s arrangements would be initially recognised in this year’s financial statements, including the \$50m onerous contract loss.

50. The Table below shows a range of possible circumstances for an entity that is reporting for the year ending 30 June 20X1 and:
- coverage for all (existing) contracts expire on 30 June 20X1
 - there is one (new) contract with a single premium of \$100 for a coverage period from 1 July 20X1 to 30 June 20X2, which is arranged on 15 June 20X1 and premium is due and paid on 1 August 20X1.

The Table illustrates when the accounting under AASB 17/PBE IFRS 17.25(c) will be different from the accounting under AASB 1023/PBE IFRS 4.

Circumstances	AASB 1023/PBE IFRS 4	AASB 17/PBE IFRS 17	Comment
Premium due & paid: 15 June 20X1 Contract is not onerous	20X1 balance sheet Debit: Cash \$100 Credit: UEP liability \$100 20X1 income statement No impact	20X1 balance sheet Debit: Cash \$100 Credit: PAA liability \$100 20X1 income statement No impact	Same outcome
Premium due & paid: 1 August 20X1 Contract is not onerous	20X1 balance sheet No impact 20X1 income statement No impact	20X1 balance sheet No impact 20X1 income statement No impact	Same outcome
Premium due & paid: 15 June 20X1 Contract is onerous (\$10)	20X1 balance sheet Debit: Cash \$100 Credit: Liability \$100 20X1 income statement No impact	20X1 balance sheet Debit: Cash \$100 Credit: PAA liability \$110 20X1 income statement Debit: Onerous contract loss \$10	Different outcome <i>AASB 17/PBE IFRS 17 requires loss recognition for BBNI while losses under AASB 1023/PBE IFRS 4 arise only once coverage has commenced</i>
Premium due & paid: 1 August 20X1 Contract is onerous (\$10)	20X1 balance sheet No impact 20X1 income statement No impact	20X1 balance sheet Credit: PAA liability \$10 20X1 income statement Debit: Onerous contract loss \$10	



IASB's deliberations

51. The IASB considered, but rejected, requiring all insurance contracts to be recognised from the time an insurer accepts risk, which is potentially before coverage begins. The IASB agreed with stakeholders who were concerned that this would require system changes whose high costs outweigh the benefits of doing so [IFRS 17.BC141]. However, as a compromise, the IASB decided to impose recognition from the time an insurer accepts risk for onerous contracts [IFRS 17.BC142]. This reflects the IASB's emphasis on the early recognition of onerous contract losses.

Staff views

52. Staff consider that the consequences of applying AASB 17/PBE IFRS 17.25(c) to some public sector insurers would:
- (a) be potentially burdensome from a practical systems viewpoint; and
 - (b) lead to information that is not useful for users of the financial statements because, for some public sector entities on an ongoing basis, the results for the current period would include the onerous contract losses of the following year's contracts.
53. 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 BBNI contracts as at the reporting date would be a relatively small proportion of total contracts. Given that:
- (a) for most public sector insurers, onerous contracts are typical; and
 - (b) for some public sector insurers, BBNI arrangements as at the reporting date would be all, or a relatively significant proportion of total arrangements;
- staff consider that public sector insurers should be exempted from applying AASB 17/PBE IFRS 17.25(c) to ensure that current period's result would not include losses of following year's onerous contracts.
54. In addition, staff note that the differences (from the private sector) in the accountability/regulatory, governance and financial management frameworks in general among public sector insurers could justify an exemption for all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.25(c).¹⁹

Question for Board members

- Q3 Do Board members agree with the staff view that it would be appropriate to exempt all public sector entities from applying the requirements in AASB 17/PBE IFRS 17.25(c) to ensure that current period's result would not include losses of following year's onerous contracts?

¹⁹ In particular, paragraph 30(g) of the [AASB Not-for-Profit Entity Standard Setting Framework](#); and, to some extent, paragraph 60 of the [New Zealand Accounting Standards Framework](#).

Appendix A – Selected terms relating to contract recognition

A1 For information – the following Table outlines the terminology used in the Standards.

Terminology	AASB 1023/PBE IFRS 4	AASB 17/PBE IFRS 17	Comment
Inception date	Occasionally used to indicate when a coverage period begins [AASB 1023/PBE IFRS 4.2, 3 & 27]	Appears to mean when contract terms are agreed, which could be prior to when coverage begins [IFRS 17.BC80 & BC135]	Different meanings attached to the same term
Attachment date	The date from which the insurer accepts risk from the insured under an insurance contract [AASB 1023/PBE IFRS 4.19.1]	Not used	Appears to mean the same as inception date under AASB 17/PBE IFRS 17
Initial recognition	Not used (in respect of insurance contract recognition)	Earlier of when coverage begins, first payment is due from insured, or the contract has inception and is onerous [IFRS 17.25]	



Staff Paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M183)/NZASB September 2021
Topic	Redeliberation of Scope and Risk adjustment topics	Agenda item	AASB 11.3 NZASB 3.3
		Date	23 August 2021
Contacts	Angus Thomson athomson@asb.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asb.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

Objective of this paper

- The objective of this paper is for the AASB and the NZASB to redeliberate some of the decisions taken at the April 2021 AASB meeting and April and May 2021 NZASB meeting on:
 - scope of application of AASB 17/PBE IFRS 17 *Insurance Contracts* to public sector entities
 - risk adjustments for non-financial risk in respect of public sector entities.
- Most of the tentative decisions on these topics made by the respective Boards are either the same or are likely to be reconcilable when the Boards consider a draft consultative document. However, there are some differences that, to be resolved, require redeliberation.
- There is no imperative for the Boards to arrive at the same conclusions, and the circumstances in each jurisdiction are different.
- However, the Boards agreed to use their best endeavours to achieve a consistent outcome and there are benefits in leveraging from the efforts of both Boards.

Structure of this paper

- This staff paper is set out in four sections:
 - [Section 1](#) notes the difference between the decisions of both Boards on the use of the indicator ‘binding nature of the arrangement’ for determining the **scope** of application of AASB 17/PBE IFRS 17 to public sector entities, and provides a staff suggestion for resolving the difference.
 - [Section 2](#) notes the difference between the decisions of both Boards on the use of the indicators ‘claims handling’ and ‘financial management’ for determining the **scope** of application of AASB 17/PBE IFRS 17 to public sector entities, and provides a staff suggestion for resolving the difference.



- [Section 3](#) compares the differences between the decisions of both Boards on **risk adjustments** in respect of public sector entities and provides staff suggestions on resolving the differences. A table of the decisions of both Boards on risk adjustments are presented in [Appendix C](#).
- [Section 4](#) seeks to confirm the decisions on **scope** that were virtually the same across both Boards. These decisions are outlined in [Appendix B](#).

Section 1: Boards’ decisions on ‘binding nature of arrangement’ in respect of determining the scope of application of AASB 17/PBE IFRS 17 to public sector entities

6. The table below outlines different perspectives of the Boards on the indicators: S6 & S7 – binding nature of arrangement.

S6 & S7	Binding nature of arrangement		
<p>Brief background: The notion of ‘practical ability’ can be used to help distinguish those cases when a public sector arrangement should be regarded as binding from cases when an arrangement is not binding. That is, an indicator for regarding arrangements as being insurance transactions would be that the entity (or its controlling government) does not have the practical ability to change a benefit retrospectively.</p> <p>The Boards discussed whether an assessment of ‘practical ability’ should take into account whether the entity (or its controlling government) has sufficient political capital to make a change that reduces a benefit.</p> <p>An alternative approach to addressing the impact of an entity’s capacity to change the terms of a scheme’s benefits or the extent of events covered would be to measure the liabilities based on the expected possible changes to benefits and events covered. That is, for example, if it expected that governments will reduce benefits, the entity’s liabilities would be measured at lower amounts relative to existing benefit levels.</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that the extent to which an arrangement is binding on the public sector entity should be:</p> <p>(a) an indicator that the arrangement is within the scope of AASB 17 [Question S6]; and</p> <p>(b) determined based on whether the public sector entity (or its controlling government) has the practical ability to change a benefit retrospectively using an existing power, or power that is substantively enacted [Question S7].</p> <p>The Board did not support using ‘practical ability’ in a broader sense, based on an entity’s, or government’s, practical power to obtain legislative/regulatory</p>	<p>The Board agreed that:</p> <p>(a) the extent to which an arrangement is binding on the public sector entity should be an indicator that the arrangement is within the scope of PBE IFRS 17 [Question S6]; and</p> <p>(b) the extent to which an arrangement is binding should be based on whether the public sector entity (or its controlling government) has the practical ability to change a benefit retrospectively [Question S7].</p>	<p>Yes/but</p>	<p>Staff consider the NZASB and AASB decisions are effectively consistent, but staff suggest the Boards should specifically redeliberate whether they favour proceeding on the basis that:</p> <p>(a) entities don’t need to look at ‘political’ issues to determine ‘practical ability’; and</p> <p>(b) ‘practical ability’ is determined by reference to existing or substantively enacted regulation.</p> <p>Alternatively, unless members have further comments on these indicators, the Boards redeliberate this matter when they have a (staff-prepared)</p>



S6 & S7	Binding nature of arrangement		
change in order to retrospectively change benefits.			draft consultative document to review.

Question for Board members
<p>Q1 Do Board members agree with proceeding on the basis that:</p> <p>(a) entities do not need to look at ‘political’ issues to determine ‘practical ability’; and</p> <p>(b) ‘practical ability’ is determined by reference to existing or substantively enacted regulation?</p>

Section 2: Boards’ decisions on ‘claims handling’ and ‘financial management’ in respect of determining the scope of application of AASB 17/PBE IFRS 17 to public sector entities

7. The table below outlines different perspectives of the Boards on the indicators: S15, S16 & S17 – claims handling and financial management.

S15	Claims handling		
<p>Brief background: The Boards discussed the features of claims handling and the management of other types of benefits, including:</p> <p>(a) there are many similarities between an insurance claims management function and the processes that might be employed to deliver social or other benefits in an equitable manner and according to government policy;</p> <p>(b) insurance contract claims might be more likely to be handled in a manner that caters specifically for a beneficiary’s needs relating to a specified loss, relative to other benefits, which are more likely to be standardised (however, standardised benefits also apply under some forms of insurance, such as private health insurance medical expense reimbursements based on a schedule);</p> <p>(c) the focus of insurance contract claims handling is on both income and costs, whereas other benefits are more likely to be managed only from the cost side.</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that:</p> <p>(a) the extent to which claims are assessed to cater specifically for a beneficiary’s losses, rather than being broadly-determined standardised amounts is unlikely to be a useful indicator for applying AASB 17 because insurance contracts often provide only standardised benefits (such</p>	<p>The Board agreed that:</p> <p>(a) the extent to which claims are assessed to cater specifically for a beneficiary’s losses, rather than being broadly-determined standardised amounts; and</p> <p>(b) the extent to which the focus of cost management is on both income and costs,</p>	No	<p>It would useful to attempt to reconcile the Boards’ views for the purposes of preparing a draft consultative document.</p> <p>Staff suggest blending claims handling as an indicator into the broader indicator on on ‘Assessing financial performance/how an</p>



S15	Claims handling		
<p>as many private health insurance contracts); and</p> <p>(b) the extent to which the focus of cost management is on both income and costs, rather than simply cost minimisation would, at best, be a weak indicator for applying AASB 17 – please refer to the Board deliberation on ‘Assessing financial performance/how an entity is managed’ [Question S15].</p> <p>Please see S16 & S17 immediately below.</p>	<p>rather than simply cost minimisation;</p> <p>are potentially useful indicators for determining when PBE IFRS 17 would apply in the public sector [Question S15].</p>		<p>entity is managed’ – please see S16 & S17.</p> <p>Alternative suggestions are most welcome.</p>

S16 & S17	Assessing financial performance/how an entity is managed		
<p>Brief background: The Boards discussed the following:</p> <p>(a) 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 a social benefit scheme on a regular basis where it is required to report internally on the financial performance of the scheme, and, where necessary, to take action to address any under-performance.</p> <p>(b) Stakeholders generally consider there are accountability and performance mechanisms across the spectrum of social benefit and insurance arrangements in most jurisdictions.</p> <p>(c) The inference that social benefit schemes versus insurance schemes are less likely to monitor performance in this way is probably not supportable.</p> <p>(d) Stakeholders seem more interested in discussing the ways in which they managed their activities, rather than the more general matter of assessing financial performance.</p> <p>(e) Many stakeholders from entities currently applying AASB 1023/PBE IFRS 4 hold the view that they have been established to manage an area of risk and provided with seed capital to operate with a view to not making further calls on government funding. They consider themselves to be operating an insurance 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.</p> <p>(f) Many (Australian) stakeholders from entities currently applying AASB 137 hold 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 commercial insurer.</p> <p>(g) 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.</p>			



S16 & S17	Assessing financial performance/how an entity is managed		
<p>(h) Staff consider 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 reflecting the ‘business model’ in financial statements is something that standards should aim to achieve. However, this type of indicator can be subject to wide interpretation unless it is associated with specific insurance liability management practices.</p> <p>(i) Insurance liability management practices can include underwriting and pricing specific types of risks. Although few (if any) public sector insurers are completely unconstrained in their ability to differentially price their services, many of them are able to price risk based a participant’s characteristics (for example, industry of employment or type of vehicle or claims experience).</p> <p>(j) Use of reinsurance contracts to manage capital. This is not to say that the existence of a reinsurance contract, of itself, indicates that an entity issues insurance contracts. However, it can indicate that the entity is expected to manage its liabilities prudently and protect its own capital base (rather than relying on the taxpayer) for its continuing operation, much like a commercial insurer.</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that:</p> <p>(a) the existence of a practice of an entity generally assessing financial performance and financial position on a regular basis is not a useful indicator for determining when AASB 17 would apply in the public sector [Question S16]; however,</p> <p>(b) the existence of insurance liability management practices (such as underwriting and reinsurance of risks accepted from participants) would be a useful indicator that AASB 17 should apply [Question S17].</p>	<p>The Board agreed that:</p> <p>(a) the existence of a practice of an entity generally assessing financial performance and financial position on a regular basis is not a useful indicator for determining when PBE IFRS 17 would apply in the public sector [Question S16]; however,</p> <p>(b) the existence of insurance liability management practices (such as underwriting) would be a useful indicator that PBE IFRS 17 should apply [Question S17].</p>	<p>Yes</p>	<p>The Board’s decisions are effectively the same.</p> <p>The AASB gave more weight (than the NZASB) to reinsurance as a relevant capital management practice in an insurance context. A noted above in respect of ‘Claims handling’, staff suggest blending the indicator S15 into the broader indicator on on ‘Assessing financial performance/how an entity is managed’ (S16 & S17).</p>

Question for Board members

Q2 Do Board members agree with proceeding on the basis that claims handling is blended as an indicator into the broader indicator on ‘Assessing financial performance/how an entity is managed’ – please see S16 & S17 immediately below?



Section 3: Boards' decisions on risk adjustments

8. The table in Appendix C to this paper outlines the decisions of the AASB and the NZASB at their April and May 2021 meetings on accounting for risk adjustments by public sector entities under AASB 17/PBE IFRS 17.
9. 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.
10. The NZASB was particularly concerned 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.
11. 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% probability of adequacy. That benchmark originated in minimum solvency requirements issued by the Australian Prudential Regulation Authority. It seems to have become widely accepted (including outside Australia and New Zealand) because it is:
 - (a) relatively easy to measure;
 - (b) relatively easy to understand; and
 - (c) financial statement users and entity managements have found it informative.
12. The 75% benchmark has effectively alleviated the need for entities to expend resources on measuring risk margins under AASB 1023/PBE IFRS 4. Another practice (which is equally inexpensive to implement) that has gained general acceptance is to measure risk margins under AASB 1023/PBE IFRS 4 at a probability of adequacy that matches the amount of the available (earmarked) funding, typically subject to there being a minimum 75% probability of adequacy.
13. At their April and May 2021 Board meetings, a number of Approaches were considered. In addition, a number of possible supplementary disclosure requirements were considered in conjunction the three Approaches, as outlined in the Table below.

Approaches	Possible supplementary disclosures
Approach 1: Require each public sector entity to apply AASB 17/PBE IFRS 17 with no modifications or guidance	If each public sector entity applies AASB 17/PBE IFRS 17 with no modifications or guidance, the entity could also be required to disclose a risk adjustment for a benchmark probability of adequacy (such as 75%) to provide a point of reference for comparison.
Approach 2: Require public sector entities to have a zero risk adjustment	If each public sector entity recognises a zero risk adjustment, the entity could also be required to disclose what the risk adjustment would have been if AASB 17/PBE IFRS 17 had been applied unmodified.
Approach 3: Require a particular probability of adequacy for determining risk adjustments for all public sector entities	If each public sector entity recognises a risk adjustment for a particular probability of adequacy, the entity could also be required to disclose what its risk adjustment would have been if AASB 17/PBE IFRS 17 had been applied unmodified.

14. Table 3-1 (below) outlines the objectives that the IASB had in mind when they concluded on the need for a risk adjustment in measuring insurance contact liabilities. Table 3-1 also includes staff remarks on the IASB's reasoning in a public sector context, plus a staff assessment about how each of the three Approaches might achieve the relevant objectives. The first two columns are an extract from the April/May 2021 meeting agenda paper on risk adjustments, with some additional commentary.

Table 3-1		Staff assessment of how Approaches might achieve risk adjustment objectives		
Objectives of requiring risk adjustments under IFRS 17		1: No modifications	2: Zero risk adjustment	3: Risk adjustment based on standardised PoA (eg: 75%)
Basis for Conclusions	Staff comments			
Requiring a risk adjustment provides a clear insight into the insurance contracts and distinguishes them from risk-free liabilities [BC211(a)].	This reasoning seems as relevant in the public sector as it is for private sector insurers.	Approach 1 would achieve this objective to the same extent for all entities in all sectors.	Approach 2 would not achieve this objective.	Approach 3 would substantially (and possibly fully) achieve this objective.
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 [BC211(b)].	This reasoning would be less relevant in respect of public sector entities that are not seeking to profit from bearing risk (although, as previously discussed with the Boards, IFRS 17 specifically applies to not-for-profit mutual entities).		Approach 2 would not achieve this objective.	Approach 3 would achieve this objective to the extent the risk adjustment based on a standardised PoA faithfully reflects the insurance risks.
Requiring a risk adjustment faithfully represents circumstances in which the entity has charged insufficient premiums for bearing the risk that the claims might ultimately exceed expected premiums [BC211(c)].	This reasoning seems relevant in the public sector. However, probably not as relevant as for private sector insurers because not-for-profit public sector entities are less likely to be seeking to remediate loss-making arrangements.		Approach 2 would not achieve this objective in respect of the risk adjustment itself; however, insufficiency of premiums would still be revealed by any underwriting shortfall.	Approach 3 would achieve this objective to the extent the risk adjustment based on a standardised PoA faithfully reflects the insurance risks.
Requiring a risk adjustment results in reporting changes in estimates of risk promptly and in an understandable way [BC211(d)].	This reasoning seems as relevant in the public sector as it is for private sector insurers.		Approach 2 would not achieve this objective.	Approach 3 would substantially (and possibly fully) achieve this objective – while the PoA is fixed, the risk adjustment amount would change with changed estimates of the level of risk.



Staff analysis

15. There was a general view among both Boards that it would be inappropriate to require more of public sector entities than is required of other entities applying AASB 17/NZ IFRS 17. Accordingly, in general, there was little support for requiring supplementary disclosure requirements in conjunction with any of the above three recognition Approaches.
16. Staff note that recognition Approach 1 (no modifications) would be consistent with 'sector neutrality', but it could be argued that it is not necessarily consistent with 'transaction neutrality' on the basis that there is economic substance to the differences between the circumstances of public sector entities versus private sector insurers in respect of risk adjustments.
17. Staff note that recognition Approach 2 (zero risk adjustment) would satisfy the concerns of those who consider that bearing risk is not relevant to the purposes of public sector arrangements that might fall within the scope of AASB 17/PBE IFRS 17. However, some types of risk adjustment would seem relevant for any entity that has transactions which fall within the scope of AASB 17/PBE IFRS 17 because the whole basis for identifying 'insurance contracts' is the transfer of risk.
18. Staff note that recognition Approach 3 would:
 - (a) involve the Boards in having to identify the relevant benchmark probability of adequacy, which may suit some entities but not others; and
 - (b) not be consistent with a principle-based approach to standard setting.However, staff also note that these concerns might be mitigated by making the benchmark probability of adequacy a rebuttable presumption.
19. On balance, staff favour recognition Approach 3 (probably as a rebuttable presumption) because it achieves most of the objectives of recognising a risk adjustment, as identified in the IFRS 17 Basis for Conclusions, and:
 - (a) the 75% probability of adequacy benchmark is a widely entrenched benchmark that the Board could identify;
 - (b) concerns about the use of a standardised benchmark, such as the 75% probability of adequacy, could be (at least partially) overcome by identifying it as a 'rebuttable presumption' – that is, entities could recognise a different risk adjustment if it is justified in the entity's particular circumstances;¹ and
 - (c) Accounting Standards already include a number of practical expedients.²

1 Accounting Standards use a number of rebuttable presumptions – please refer to [Appendix A](#).

2 Accounting Standards use a number practical expedients – please refer to [Appendix A](#).



Questions for Board members

- Q3 Do Board members agree not to propose requiring additional disclosures for public sector entities in respect of risk adjustments? If you disagree, which disclosure(s) do you wish to propose?
- Q4 Do Board members agree to propose requiring public sector entities to recognise a risk adjustment based on a standardised probability of adequacy (recognition Approach 3)? If not, which recognition approach would you propose?
- Q5 If you agree with the proposition in Question 4, do Board members agree that a reasonable benchmark for a standardised probability of adequacy would be a 75% benchmark probability of adequacy? If not, what alternative benchmark would you propose?
- Q6 If you agree with the proposition in Question 5, do Board members agree to propose requiring a 75% benchmark probability of adequacy as a rebuttable presumption?

Section 4: Boards' decisions on scope that were virtually the same

20. The issues relating to the scope of application of AASB 17/PBE IFRS 17 on which the Boards indicated the same perspectives are presented in a table in [Appendix B](#).

Questions for Board members

- Q7 Do Board members agree that, for all the indicators noted in [Appendix B](#), **there is no need for additional Board discussion** until the Boards have a (staff-prepared) draft consultative document to review?



Appendix A: Standards with rebuttable presumptions and practical expedients

- A1 Accounting Standards use a number of rebuttable presumptions, including:
- (a) AASB 2/NZ IFRS 2 *Share-based Payment* [paragraph 13];
 - (b) AASB 9/NZ IFRS 9 *Financial Instruments* [paragraphs 5.5.11 & B6.3.13];
 - (c) AASB 15 *Revenue from Contracts with Customers* – Australian implementation guidance for not-for-profit entities [paragraph F28];
 - (d) AASB 16/NZ IFRS 16 *Leases* [paragraph 53];
 - (e) AASB 101/NZ IAS 1 *Presentation of Financial Statements* [paragraph 24];
 - (f) AASB 138/NZ IAS 38 *Intangible Assets* [paragraph 98A];
 - (g) AASB 140/NZ IAS 40 *Investment Property* [paragraph 53]; and
 - (h) AASB 141/NZ IAS 41 *Agriculture* [paragraph 30].
- A2 Accounting Standards use a number of practical expedients, including:
- (a) AASB 102 *Inventories* for not-for-profit entities acquiring inventories for significantly less than fair value [Aus10.2];
 - (b) AASB 9/NZ IFRS 9 *Financial Instruments* on using mid-market pricing [paragraph 71]; and alternative Level 1 pricing mechanisms [paragraph 79(a)];
 - (c) AASB 15/NZ IFRS 15 *Revenue from Contracts with Customers* relating to significant financing components [paragraph 63]; recognising incremental contract costs as an expense as incurred [paragraph 94]; recognising the amount the entity has the right to invoice in measuring revenue [paragraph B16]; and
 - (d) AASB 16/NZ IFRS 16 *Leases* on short-term and low-value leases [paragraph 5] and non-separation of non-lease components [paragraph 15]; rent concessions not being modifications [paragraph 46A].



Appendix B: Decisions of the Boards at their April/May 2021 meetings on scope of application of AASB 17/PBE IFRS 17 on which the Boards indicated the same perspectives

B1 The table below outlines the decisions of the AASB and the NZASB at their April and May 2021 meetings on scope of application of AASB 17/PBE IFRS 17 on which the Boards indicated the same perspectives. Extracts along the lines of the meeting minutes are quoted in the table.

S1	For profit versus not-for-profit public sector entities		
<p>Brief background: 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 IASB’s Basis for Conclusions makes it clear that 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.</p> <p>IPSAS 42 distinguishes ‘social benefits’ from ‘insurance’; however, most of the ‘social risks’ mentioned in the IPSAS 42 definition could be the subject of insurance contracts sold by for-profit private sector entities, including: (a) annuities (age-related risks); (b) health insurance (health-related risks); and (c) income protection insurance (potentially related to health, poverty and/or employment status risks). Also refer to S16 & S17 in Section 1.</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that:</p> <p>(a) although it is highly unlikely that activities of a for-profit nature could be ‘social benefits’, it would not necessarily be a useful indicator for determining the entities that should apply AASB 17;</p> <p>(b) the not-for-profit nature of an entity should not be a barrier to applying AASB 17; however,</p> <p>(c) the for-profit nature of an entity might be an indicator that AASB 17 would apply in the public sector, depending on other indicators [Question S1].</p>	<p>The Board agreed that:</p> <p>(a) activities of a for-profit nature should not be regarded as social benefits;</p> <p>(b) the not-for-profit nature of an entity should not be a barrier to applying PBE IFRS 17; however,</p> <p>(c) the for-profit nature of an entity might be an indicator that PBE IFRS 17 would apply in the public sector, depending on other factors [Question S1].</p>	<p>Yes</p>	<p>The Board’s decisions are effectively the same.</p> <p>Compared with the NZASB, the AASB thought (a) would be relatively less useful.</p> <p>However, unless members have further comments on these indicators, staff suggest there is no need for additional Board discussion about them until the Boards have a (staff-prepared) draft consultative document to review.</p>



S2, S3 & S4		Transaction neutrality, nature of risks covered and similarity of claims/benefits	
<p>Brief background: The Boards discussed whether the transactions or arrangements entered into by public sector entities having similar characteristics and relating to a similar level of insurance risk as those entered into by for-profit private sector entities that are accounted for as insurance contracts should be a criterion for applying AASB 17/PBE IFRS 17.</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that:</p> <p>(a) the similarity of insurance risks covered and the similarity of benefits provided relative to for-profit private sector insurance contracts should be identified as a pre-requisite for determining that AASB 17 would apply in the public sector [Question S2];</p> <p>(b) depending on the circumstances, transaction neutrality would generally be determined by reference to whether the same types of ‘contracts’ are issued in both the private and public sectors [Question S3]; and</p> <p>(c) it is suitable to apply the AASB 17 approach to addressing arrangements in the public sector that are a bundle of services, some of which might be insurance and some of which might not (and no specific additional guidance should be needed) [Question S4].</p> <p>In relation to (b), members decided it would be reasonable for entities to consider counterpart contracts 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.</p>	<p>The Board agreed that:</p> <p>(a) the similarity of insurance risks covered and the similarity of benefits provided relative to for-profit private sector insurance contracts should be identified as a pre-requisite for determining that PBE IFRS 17 would apply in the public sector [Question S2];</p> <p>(b) in practical terms, transaction neutrality would be determined by reference to whether the same types of ‘contracts’ are issued in both the private and public sectors [Question S3]; and</p> <p>(c) it is suitable to apply the PBE IFRS 17 approach to addressing arrangements in the public sector that are a bundle of services, some of which might be insurance and some of which might not [Question S4].</p> <p>The Board indicated that the global private sector context is most relevant for benchmarking to similarity of insurance risks covered and benefits provided on the basis that the nature of the risks and benefits in general are relevant and the benchmarking should not be dependent on the existing state of the New Zealand insurance market.</p>	<p>Yes</p>	<p>The Board’s decisions are effectively the same.</p> <p>The AASB wants to emphasise that public sector entities would only need to consider ‘readily available’ information in identifying counterpart arrangements in the commercial sector at a global level.</p> <p>Staff consider the NZASB and AASB decisions are effectively consistent.</p> <p>Unless members have further comments on these indicators, staff suggest there is no need for additional Board discussion about these factors until the Boards have a (staff-prepared) draft consultative document to review.</p>



S5	Scoping out specific public sector schemes		
<p>Brief background: AASB 17/PBE IFRS 17 uses a range of practical expedients, including specifically identifying certain types of transactions that are excluded from its scope (rather than relying on principles to determine the scope). For example, AASB 17/PBE IFRS 17 excludes: (a) warranties provided by a manufacturer, dealer or retailer in connection with the sale of its goods or services to a customer; (b) financial guarantees; and (c) fixed fee contracts.</p> <p>At the Boards' June 2021 meetings, staff suggested using practical expedients such as (in an Australian context) specifically identifying the following as not being within scope in their current form: (a) Medicare benefits (Australia); and (b) National Disability Insurance Authority benefits/programs (Australia).</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that:</p> <p>(a) while it would provide certainty for some entities, it is generally opposed to specifically identifying particular public sector schemes that are not within the scope of AASB 17 because it is not the role of the Board to identify specific entities that should (or should not) apply Standards; and</p> <p>(b) there may be some merit in specifically identifying particular types of transactions that are not within the scope of AASB 17, but that this should be addressed by applying other indicators [Question S5].</p>	<p>The Board agreed that:</p> <p>(a) it should not be necessary to resort to specifically identifying particular public sector schemes that are not within the scope of PBE IFRS 17; and</p> <p>(b) there may be some merit in specifically identifying particular types of transactions that are not within the scope of PBE IFRS 17, but that this should be addressed by applying other indicators [Question S5].</p>	Yes	<p>The Board's decisions are effectively the same.</p> <p>Unless members have further comments on these indicators, staff suggest there is no need for additional Board discussion about scoping out specific public sector schemes.</p>

S8	Identifiable coverage period		
<p>Brief background: The Boards discussed the fact that 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. This period includes the insurance contract services that relate to all premiums within the boundary of the insurance contract".</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that the existence of an identifiable coverage period would be a useful indicator for determining when AASB 17 should apply in the public sector [Question S8].</p>	<p>The Board agreed that the existence of an identifiable coverage period would be a useful indicator for determining when PBE IFRS 17 should apply in the public sector [Question S8].</p>	Yes	<p>The Board's decisions are effectively the same.</p> <p>Unless members have further comments on this indicator, staff suggest there is no need for additional Board</p>



S8	Identifiable coverage period		
			<p>discussion about it until the Boards have a (staff-prepared) draft consultative document to review.</p>

S9	Fault-based versus no-fault-based			
<p>Brief background: The Boards noted that, in respect of many classes of risk, for-profit 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 no-fault schemes are more likely to not be insurance activities. However, while public sector entities are generally more likely to operate no-fault schemes, for-profit private sector insurers are also involved in no fault insurance schemes.</p>				
AASB	NZASB	Same?	Staff comments/suggestions	
<p>The Board decided that the fault-based versus no-fault nature of coverage is not a useful indicator for determining when AASB 17 would apply in the public sector [Question S9].</p>	<p>The Board agreed that the fault-based versus no-fault nature of coverage is not a useful indicator for determining when PBE IFRS 17 would apply in the public sector [Question S9].</p>	<p>Yes</p>	<p>The Board’s decisions are effectively the same.</p> <p>Unless members have further comments on this indicator, staff suggest there is no need for additional Board discussion on this topic.</p>	



S10, S11 & S12	Contract or no contract		
<p>Brief background: The Boards discussed a range of perspectives, including:</p> <ul style="list-style-type: none"> (a) the principle of transaction neutrality would imply 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 be accounted for in the same way; (b) under some Standards, such as AASB 9/PBE IPSAS 41, there is a ‘bright line’ between ‘contracts’ and statutory arrangements; (c) virtually identical forms of some types of coverage are provided under either statutory or private sector (contractual) arrangements and, accordingly, the insurance Standards would apply by analogy to statutory arrangements under the accounting policy hierarchy; (d) 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); (e) 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; (f) for some types of risks, the existence of a stand-alone contract that includes substantive information about risks and benefits (well beyond the detail in any relevant enabling legislation or regulations), is a strong indication of an insurance contract. 			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that:</p> <ul style="list-style-type: none"> (a) the focus should be on whether there is a ‘binding arrangement’ (described in the Conceptual Framework) and not on whether there is a ‘contract’ (rather than statute/regulation) [Question S10]; (b) the existence of a stand-alone ‘binding arrangement’ that includes substantive terms relating to risks and benefits should be an indicator for determining when AASB 17 would apply in the public sector, while acknowledging that arrangement might incorporate elements contained in statutes/regulation related to the public sector entity’s activities [Question S11]; (c) commentary might usefully be included in guidance or the Basis for Conclusions, to 	<p>The Board agreed that:</p> <ul style="list-style-type: none"> (a) the focus should be on whether there is a ‘binding arrangement’ (described in the Conceptual Framework) and not on whether there is a ‘contract’ (rather than statute/regulation) [Question S10]; (b) the existence of a stand-alone ‘binding arrangement’ that includes substantive terms relating to risks and benefits should be an indicator for determining when PBE IFRS 17 would apply in the public sector [Question S11]; (c) potentially include specific references to binding arrangements in guidance or the Basis for Conclusions, to help ensure clarity about PBE IFRS 17 applying to binding arrangements that are statutory in nature (and meet the other relevant indicators determined by the Board for inclusion in PBE IFRS 17) [Question S12]. 	<p>Yes</p>	<p>The Board’s decisions are effectively the same.</p> <p>Unless members have further comments on the significance of the existence of a ‘contract’ as an indicator, staff suggest there is no need for additional Board discussion about it until the Boards have a (staff-prepared) draft consultative document to review.</p>



<p>help ensure clarity about what could constitute binding arrangements that are statutory in nature [Question S12].</p>			
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S13 & S14	Source and extent of funding		
<p>Brief background: The Boards discussed a range of perspectives, including:</p> <ul style="list-style-type: none"> (a) there are two aspects to funding; (i) the source of funding and whether this is those who stand to benefit from the arrangement or those who exacerbate the risks to potential beneficiaries; and (ii) the revenue being sufficient and/or the benefit levels being managed such that the scheme is self-sustaining; (b) the criteria in IPSAS 42 for being eligible to apply the ‘insurance approach’ is that a scheme is intended to be ‘fully funded’ from contributions and levies; (c) 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: overpricing to make up for past deficits; underpricing to use up past surpluses; or underpricing to suit current economic conditions; (d) ‘substantially self-funded’ and/or ‘dedicated funding’ are possible criteria; (e) references to ‘fully-funded’ and ‘substantially self-funded’ can be difficult to interpret; (f) all of the public sector entities in either Australia or New Zealand that are currently applying the insurance standards receive contributions from participants either directly or indirectly via levies, while some of these entities might require top-up funding from consolidated revenue from time-to-time; (g) receipt of contributions as a criterion would rule out the application of the insurance standards to a range ‘social benefits’ such as aged pension or universal healthcare activities, but possibly not schemes such as Medicare in Australia, which at least notionally has dedicated levy funding; (h) the extent to which a participant in a scheme is responsible for paying a contribution might indicate something about the strength of that relationship and its likeness to a policyholder/insurer relationship. 			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that:</p> <ul style="list-style-type: none"> (a) the existence of a contribution from a scheme participant should be an indicator for determining when AASB 17 should apply in the public sector [Question S13] and that contribution should be: <ul style="list-style-type: none"> (i) associated with the risks covered – for example, a motor vehicle owner contributes in return for being registered to use roads; and (ii) substantive relative to the risks being transferred; 	<p>The Board agreed that:</p> <ul style="list-style-type: none"> (a) the existence of a contribution from a scheme participant should be an indicator for determining when PBE IFRS 17 should apply in the public sector [Question S13]; (b) the absence of any dedicated funding (from participants or government) for an activity should be an indicator that PBE IFRS 17 	<p>Yes</p>	<p>The Board’s decisions are effectively the same.</p> <p>The AASB sought more detail on the association between the funding and risk.</p> <p>The AASB mentioned the case of a government-capitalised ‘closed fund’ scheme, which should probably be excluded from applying the insurance standards. This could include a fund established to meet compensation claims from a specific past</p>



S13 & S14	Source and extent of funding		
<p>(b) the absence of any dedicated funding (from participants or government) for an activity should be an indicator that AASB 17 does not apply [Question S14]; and</p> <p>(c) references to ‘fully-funded’ and ‘substantially self-funded’ are probably not useful because they are difficult to interpret.</p> <p>The Board also noted that a scheme might be fully or largely funded from government contributions and effectively be self-sustaining and not need substantive contributions from participants – please refer to the Board deliberation on ‘Assets set aside for benefits’.</p>	<p>does not apply [Question S14]; and</p> <p>(c) references to ‘fully-funded’ and ‘substantially self-funded’ are probably not useful because they are difficult to interpret.</p>		<p>or future type of event, such as emergency assistance in response to natural disasters or the recovery of credit losses from financial crime.</p> <p>Unless members have further comments on these indicators, staff suggest there is no need for additional Board discussion about them until the Boards have a (staff-prepared) draft consultative document to review.</p>

S18	Assets set aside for benefits		
<p>Brief background: The Boards discussed the following:</p> <p>(a) 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, (as opposed to benefits being funded from general taxation).</p> <p>(b) The implication of this criterion is that a benefit funded from general taxation is more likely to be a social benefit and not insurance. It is related to some extent to the issues around the source and extent of funding (S13 & S14 above) because funds that are sourced from scheme participants are more likely to be set aside in a scheme fund than would the case for an appropriation of funds from general taxation.</p> <p>(c) The existence of a separate fund might make it more likely that the scheme is operated and managed as an insurance entity. This is supported by feedback received by staff in recent stakeholder outreach, with many entities having been established to be self-sustaining and to aim for an overall breakeven result from all of their activities, including investment performance. This is a characteristic of private sector for-profit insurers, many of which routinely operate on a long-term sustainable basis by generating underwriting losses that are more than offset by investment returns.</p> <p>(d) It was acknowledged that some non-insurance liabilities might have separate funds earmarked for their settlement – for example funds within the Australian Government Future Fund are earmarked to meet the defined benefit superannuation liabilities.</p>			
AASB	NZASB	Same?	Staff comments/suggestions
<p>The Board decided that 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 is a useful indicator for determining when</p>	<p>The Board agreed that 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 is a useful indicator for determining when</p>	<p>Yes</p>	<p>The Board’s decisions are effectively the same.</p> <p>Unless members have further comments on this indicator, staff suggest there is no need for additional Board discussion on this topic until</p>



S18	Assets set aside for benefits		
AASB 17 would apply in the public sector [Question S18].	PBE IFRS 17 would apply in the public sector [Question S18].		the Boards have a (staff-prepared) draft consultative document to review.



Appendix C: Decisions of the Boards at their April/May 2021 meetings on risk adjustments

C1 The table below outlines the decisions of the AASB and the NZASB at their April and May 2021 meetings on accounting for risk adjustments by public sector entities under AASB 17/PBE IFRS 17. Extracts along the lines of the meeting minutes are quoted in the table.

R1	Overall approach to risk adjustments
	<p>Brief background: The Boards were presented with three possible approaches to recognising and measuring risk adjustments (which represent the compensation the entity requires for bearing insurance risk):</p> <ol style="list-style-type: none"> (1) apply AASB 17/PBE IFRS 17 unmodified; (2) prohibit recognition of a risk adjustments (that is, risk adjustment = zero); (3) require risk adjustments to be measure at a specified level, such as 75% probability of adequacy (PoA). <p>In relation to risk adjustments in general, the Boards noted that they can reveal useful information about the relative riskiness associated with insurance liabilities.</p> <p>In respect of approach (1), the Boards noted:</p> <ol style="list-style-type: none"> (a) applying AASB 17/PBE IFRS 17 unmodified could facilitate benchmarking with private sector insurers; (b) different public sector entities hold different views on whether they should include a risk adjustment in measuring their claim liabilities and approach (1) would allow each entity to determine its position consistent with its own objectives, management philosophy, level of risk aversion, and nature of their claim liabilities; (c) 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; (d) public sector entities might incur considerable costs in trying to determine whether they should be compensated for bearing risk and, if so, the extent of that compensation. <p>In respect of approach (2), the Boards noted:</p> <ol style="list-style-type: none"> (a) it can be argued public sector entities in a monopoly position don't bear insurance risk as they can adjust future premiums/levies in light of past losses/profits; (b) zero risk adjustments would avoid the effect of (routinely) creating short term losses and longer-term profits (as risk adjustments unwind); (c) it would remove the burden of having to determine the risk adjustment; (d) some public sector entities are keen to recognise risk adjustments because they see risk management as central to their role; <p>In respect of approach (3), the Boards noted:</p> <ol style="list-style-type: none"> (a) existing practice is largely to apply a 75% PoA in measuring risk margins, which is relatively easy to calculate; (b) a 75% PoA across all entities would still (b) reveal the relative riskiness of different entities' claims liabilities.



R1	Overall approach to risk adjustments		
AASB	NZASB	Same?	Staff comments
<p>The Board decided that public sector entities applying AASB 17 should be required to apply the risk adjustment requirements with no specific public sector modifications, with the Board noting that judgement would need to be applied by public sector entities to determine the level of compensation they require for bearing the risk of uncertainty associated with liabilities for incurred claims – that is, Approach (1) [Question R1].</p>	<p>The Board noted that Agenda paper 5.3 includes some information on the benefits of measuring and recognising and/or disclosing risk adjustments outlined in the IFRS 17 Basis for Conclusions. However, the Board agreed that, before it could make decisions on the questions posed in Agenda paper 5.3, more information is needed on the likely costs and benefits to public sector entities of applying the PBE IFRS 17 approach, to be considered at a future Board meeting [Question R1].</p>	<p>No</p>	<p>The NZASB was more concerned than the AASB about the costs to public sector entities of applying IFRS 17 without modifications.</p> <p>Please refer to paragraphs 10–19 above.</p> <p>While NZASB ED 2018-7 proposed no additional PBE modifications in respect of risk adjustments, there was a strong theme among respondents that risk adjustments may not be relevant to many public sector entities; or that, if risk adjustments were required, explicit guidance on determining ‘compensation’ in a public sector context would be needed. Their reasons included:</p> <ul style="list-style-type: none"> (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. <p>To some extent, many Australian stakeholders are also concerned about (b) and (c).</p>



R2	Guidance on measuring risk adjustments		
<p>Brief background: The Boards noted that IFRS 17 contains little guidance on determining risk adjustments and subsequent IFRS 17 Transition Resource Group meetings have agreed to provide only limited guidance on selected issues (such as, that risk adjustments might differ within the one Group of entities depending on whether the Group or subsidiary perspective is taken).</p> <p>The Boards also noted that there are features of public sector entities that differ from private sector entities and affect the context in which risk adjustments might be determined, including:</p> <ul style="list-style-type: none"> (a) implicit or explicit government guarantees; (b) monopoly position in a particular jurisdiction and the potential to adjust future premiums/levies in light of past losses/profits; (c) compulsory for participants/policyholders; and (d) in most cases, no intention of making profits from bearing insurance risks and, therefore, no concept of needing to be compensated for risk in any given period. 			
AASB	NZASB	Same?	Staff comments
The Board decided that there should be no need for public-sector-specific guidance on how such risk adjustments would be accounted for by a Group that consolidates an entity applying AASB 17 [Question R2];	As above – more information is needed on the likely costs and benefits to public sector entities of applying the PBE IFRS 17 approach [Question R2].	No	Please refer to comments above on R1
R3	Disclosure requirements		
<p>Brief background: The Boards noted that AASB 17/PBE IFRS 17 contains the following disclosure requirements relating to risk adjustments:</p> <ul style="list-style-type: none"> (a) all claim liability reconciliations must separately show movements for risk adjustments [100(c)(ii)] – the Boards observed that substantially the same requirement applies under the existing insurance standards; (b) change in risk adjustment due to current service (recognised in the period) [104(b)(ii)] – the Boards observed that there is no similar disclosure under the existing insurance standards; (c) the approach used to determine the risk adjustment [117(c)(ii)] – the Boards observed that substantially the same requirement applies under the existing insurance standards; and (d) the confidence level used to determine the risk adjustment. If the entity uses a technique other than the confidence level technique, disclose the technique used and the confidence level corresponding to the results of that technique [119] . The Boards observed that the existing insurance standards require disclosure of the probability of adequacy. 			
AASB	NZASB	Same?	Staff comments
The Board decided that public sector entities applying AASB 17 should apply the disclosure requirements relating to risk adjustment with no specific public sector modifications [Question R3].	As above – more information is needed on the likely costs and benefits to public sector entities of applying the PBE IFRS 17 approach [Question R3].	No	Please refer to comments above on R1



Staff Paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M183)/NZASB September 2021
Topic	Measurement of investments backing insurance liabilities	Agenda item	AASB 11.4 NZASB 3.4
		Date	23 August 2021
Contacts	Angus Thomson athomson@asab.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asab.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

Objective of this paper

- The objective of this paper is for the AASB and the NZASB to decide whether public-sector-specific modifications or guidance is needed in AASB 17/PBE IFRS 17 *Insurance Contracts* in respect of the measurement of investments backing insurance liabilities.

Structure of this paper

- This staff paper is set out in three sections:
 - [Section 1](#) sets out the basis for accounting for investments backing insurance liabilities under AASB 1023 *General Insurance Contracts*/PBE IFRS 4 *Insurance Contracts*
 - [Section 2](#) sets out stakeholder feedback on accounting for investments backing insurance liabilities
 - [Section 3](#) analyses whether any modifications are needed in respect of accounting for investments backing insurance liabilities.

Summary of staff recommendations

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

Section 1: Accounting for investments backing insurance liabilities

AASB 1023/PBE IFRS 4

- When it is feasible under accounting standards to measure an investment that backs insurance liabilities at fair value through profit or loss (FVPL), AASB 1023/PBE IFRS 4 requires an entity to apply FVPL accounting. This includes applying accounting policy choices/designations within accounting standards to use FVPL for:
 - financial instruments [AASB 1023/PBE IFRS 4.D.15.2];
 - investment property [AASB 1023/PBE IFRS 4.D.15.3]; and



- (c) in relation to separate financial statements, investments in subsidiaries, joint ventures and associates [AASB 1023/PBE IFRS 4.D.15.5].
- 5. The Boards reasoned that FVPL accounting for investments would provide the greatest level of balance sheet and income statement consistency with the measurement of insurance liabilities, which is largely a current value basis.
- 6. A FVPL approach to measuring investments that back insurance liabilities has been in place since the early 2000s in both jurisdictions,¹ and was carried forward to the extent feasible when IFRS Standards were adopted. The approach has applied in both the private and public sectors.

AASB 17/PBE IFRS 17

- 7. In respect of private sector entities, the Boards decided that AASB 17/PBE IFRS 17 should not mandate FVPL accounting for investments backing insurance liabilities. This is because, unlike AASB 1023/PBE IFRS 4, IFRS 17 is a global Standard, and asset measurement practices (other than FVPL) may emerge within the insurance industry globally, which Australian and New Zealand insurers should be able to follow.
- 8. The extent to which private sector Australian and New Zealand insurers might account for investments backing insurance liabilities using a measurement basis other than FVPL is not yet clear. There are a number of contextual factors that might mitigate against any change from current practice. For example:
 - (a) many investments would be 'held for trading' financial assets and require FVPL accounting in any case;
 - (b) insurers typically manage investments primarily on a fair value basis;
 - (c) prudential regulators² require fair value information about investments; and
 - (d) much of the information about investments provided to insurers by custodians and investment managers is readily available in respect of fair values, but not other bases of measurement.

Section 2: Stakeholder feedback

- 9. In the stakeholder consultation conducted for this project by staff late in 2020 and early in 2021, the following themes emerged.
 - (a) Most public sector entities do not determine their own accounting policies, particularly in relation to policies for transactions that are common across the public sector – those policies are determined by the Treasury office of their jurisdiction.
 - (b) The established practice is to apply FVPL accounting when feasible and this shows no sign of changing.
 - (c) Many public sector entity investments are managed separately by a specialist public sector funds management entity. That funds management entity ordinarily holds assets for trading and applies FVPL accounting. Those funds management entities typically only

1 In Australia, since the 1990s.

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



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

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

Section 3: Assessment of the need for modifications

11. There is an Australian precedent for mandating the application of policy options to apply fair value measurement for certain public sector entities. AASB 1049 *Whole of Government and General Government Sector Financial Reporting* requires the Whole of Government and the General Government Sector for each State, Territory and the Commonwealth to use the fair value options allowed under Australian Accounting Standards to align with the Australian Bureau of Statistics Government Finance Statistics (GFS) manual [AASB 1049.13 to 14]. Because of this requirement to align with GFS, the Treasury office of each State, Territory and the Commonwealth have issued mandates to its public sector entities to also elect the fair value options under Australian Accounting Standards where possible.
12. However, the context is different for the Whole of Government and the General Government Sector, which do not have private sector counterparts. This contrasts with the situation among public sector entities that might be subject to the insurance Standards, many of which have private sector counterparts.
13. Most of the entities that are the subject of this project are not-for-profit entities. The [AASB Not-for-Profit Entity Standard-Setting Framework](#) sets out factors that might justify not-for-profit-specific Standards, amendments, guidance or examples. Factors drawn from paragraph 30 of that *Framework* that might be relevant to the topic of this paper include:
 - (a) Australian-specific legislation is not adequately addressed by the IFRS Standard and there has been, or is likely to be, diversity in practice warranting specific guidance;
 - (b) an existing optional treatment in the IFRS Standard is not consistent with Australian-specific legislation, not relevant or inappropriate and should therefore be eliminated;
 - (c) differences in the accountability or regulatory framework, governance or financial management differences or alignment with other financial frameworks;
 - (d) the IASB's considerations of undue cost or effort for for-profit entities not being valid for entities in the not-for-profit sector; and
 - (e) IFRS Standards are not compatible with existing not-for-profit-specific Standards.
14. In practical terms, the existing incentives for public sector entities to apply FVPL accounting are already strong, which might lead the Boards to conclude that:
 - (a) there is no need to include a modification in AASB 17/PBE IFRS 17 mandating FVPL accounting; or
 - (b) a modification should be included in AASB 17/PBE IFRS 17 mandating FVPL accounting to formalise the practice.
15. The New Zealand entities that are the subject of this project are public benefit entities. The NZASB approach is to commence with any relevant IPSAS under its *Policy Approach to Developing the Suite of PBE Standards*, rather than to modify IFRS Standards. However, this is not relevant to accounting for insurance contracts, with the IPSASB indicating it will not be developing an IPSAS on this topic and will, instead, rely on IFRS 17 when relevant.



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

Question for Board members

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

Staff Paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M183)/NZASB September 2021
Topic	Risk mitigation program costs and other similar costs	Agenda item	AASB 11.5 NZASB 3.5
		Date	23 August 2021
Contacts	Angus Thomson athomson@asab.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asab.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

Objective of this paper

- The objective of this paper is for the AASB and the NZASB to decide whether public-sector-specific modifications or guidance in AASB 17/PBE IFRS 17 *Insurance Contracts* is needed in respect of the classification and presentation of risk mitigation program and other similar costs, which are not directly related to particular insurance arrangements.

Structure of this paper

- This staff paper is set out in three sections:
 - [Section 1](#) discusses risk mitigation costs
 - [Section 2](#) discusses insurance contract costs under Accounting Standards
 - [Section 3](#) analyses whether any modifications are needed in respect of accounting for risk mitigation costs by public sector entities.

Summary of staff recommendations

- Staff are recommending there be no public sector modifications or guidance on the classification and presentation of risk mitigation program and other similar costs. However, staff expect the issues and reasoning for taking no action to be explained in a Basis for Conclusions.

Section 1: Risk mitigation costs

- Most insurers undertake risk mitigation activities – for example:
 - risk assessments of a customer’s premises that are to be insured; and/or
 - education programs among policyholders regarding safe work practices.
- For a private sector for-profit insurer, 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. The same types of activities are conducted by public sector entities.

6. However, some public sector entities sometimes also engage in activities that have a broader community focus, including for example:
- road safety campaigns;
 - research into medical practices in public hospitals; and/or
 - rehabilitation techniques to improve return to work experience.

Section 2: Requirements in Standards

AASB 1023/PBE IFRS 4

7. AASB 1023 *General Insurance Contracts*, paragraphs 17.6.2 and 17.6.3/PBE IFRS 4 *Insurance Contracts* Appendix D.17.6.2 and 17.6.3 outline a range of income and costs that are recognised within assets and liabilities and income and expenses that would normally arise from insurance contracts. [Appendix A](#), paragraph A1, quotes these paragraphs.
8. There is no specific reference to costs associated with risk mitigation, such as safety programs, research into claims prevention, and other similar costs. The general practice among public sector entities applying AASB 1023/PBE IFRS 4 is mixed.

<i>Practice</i>	<i>Comments¹</i>
Include the costs in determining the underwriting result	Usually presented as a separate income statement line item within the underwriting result. The costs are often considered to be relatable to insurance contracts and, in particular, can impact on the long-term amounts of claims. (For example, more efficient injury treatments may lead to lower incurred claims costs, which relate to existing incurred claims or future claims.)
Present the costs below the underwriting result	Sometimes presented as a separate income statement line item below the underwriting result. Sometimes presented within a broader income statement line item of 'other' costs below the underwriting result. The costs are often considered insufficiently relatable to existing insurance contracts and most likely to affect either: (i) claims under future contracts; or (ii) the public in general, rather than participants/policyholders. The entity has two separate mandates, for example, in the entity's enabling legislation: (i) to provide risk coverage; and (ii) to provide safety/risk management/education programs.

1 Based on: (a) stakeholder feedback from interviews conducted by staff in late 2020 and early 2021; and (b) staff reviews of published financial statements.



AASB 17/PBE IFRS 17

9. It is expected that, under AASB 17/PBE IFRS 17, the following income statement lines items that make up the net profit or loss will be presented by insurers:
 - (a) insurance service result, comprising insurance revenue and insurance service expenses [AASB 17/PBE IFRS 17.80(a)];
 - (b) insurance finance income or expenses [AASB 17/PBE IFRS 17.80(b)];
 - (c) investment income/expenses; and
 - (d) other items – for example, general administration costs, restructuring costs, share of net gain/loss of associates, and amortisation/impairment of intangibles.
10. Items identified in AASB 17/PBE IFRS 17.B65 would affect the ‘insurance service result because they fall within the boundary of insurance contracts. AASB 17/PBE IFRS 17.B65 says, in part (**emphasis added**):
 - B65 Cash flows within the boundary of an insurance contract are those that **relate directly to the fulfilment of the contract**, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include: ...
 - (l) an **allocation of fixed and variable overheads** (such as the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities) **directly attributable to fulfilling insurance contracts**. Such overheads are allocated to groups of contracts using methods that are systematic and rational, and are consistently applied to all costs that have similar characteristics. ...

AASB 17/PBE IFRS 17.B65 is quoted in full in [Appendix A](#), paragraph A2.

11. AASB 17/PBE IFRS 17.B66 sets out the types of cash flows that do not fall within the boundary of insurance contracts. AASB 17/PBE IFRS 17.B66 says (in part):
 - B66 The following cash flows shall not be included when estimating the cash flows that will arise as the entity fulfils an existing insurance contract: ...
 - (d) cash flows relating to **costs that cannot be directly attributed to the portfolio of insurance contracts that contain the contract**, such as some **product development and training costs**. Such costs are recognised in profit or loss when incurred.

Section 3: Analysis of insurance contract costs under AASB 17/PBE IFRS 17

12. In applying AASB 17/PBE IFRS 17, an assessment would need to be made by each insurer to determine whether the risk mitigation costs are sufficiently attributable to existing contracts or a portfolio of contracts to be accounted for within the insurance service result. If they cannot be directly attributed to contracts or a portfolio of contracts, they would be immediately recognised as expenses and presented below the insurance service result.
13. The following perspectives may be relevant in determining whether any public-sector specific guidance is needed.

<i>Perspectives against specific guidance</i>	<i>Perspectives supporting specific guidance</i>
Although the nature of some of the risk mitigation program and other similar costs incurred by public sector entities might be	The risk mitigation program and other similar costs incurred by public sector entities usually have a broader public policy purpose than those



<i>Perspectives against specific guidance</i>	<i>Perspectives supporting specific guidance</i>
different from those conducted in the private sector, the decision making around whether those costs are 'directly attributable' to insurance contracts would be no different.	conducted in the private sector and may be the subject of a specific public benefit mandate.
Although practice is currently mixed and this may continue under AASB 17/PBE IFRS 17, that may be due to the fact that the costs differ in nature from entity to entity.	Practice is currently mixed and this may continue under AASB 17/PBE IFRS 17 in the absence of guidance.
Similar decisions about the attribution of costs will need to be made in respect of organisational overheads (more broadly).	
The amounts relating to risk mitigation program and other similar costs are usually not material.	Although the amounts relating to risk mitigation program and other similar costs, are usually not material, they can be in the multiple millions of dollars, which might be significant in a public policy context.

Staff views

14. Staff note that, if guidance were to be provided, staff consider that there is no compelling reason to require risk mitigation program and other similar costs to be:

- (a) included in determining the insurance service result; or
- (b) included below the insurance service result;

That is, there does not appear to be any 'inherently right' or 'wrong' presentation for public sector entities for these types of costs.

15. Based on staff research and the outreach, the topic is not sufficiently significant to stakeholders to warrant a public sector modification or guidance in regard to the classification and presentation of risk mitigation program and other similar costs.

Question for Board members

Q1 Do Board members agree that there is no need for a public sector modification or guidance on the classification and presentation of risk mitigation program and other similar costs?



Appendix A – Extracts from AASB 1023.17/PBE IFRS 4

A1 AASB 1023.17.6.1(b)/PBE IFRS 4 Appendix D.17.6.1(b) addresses the disclosure of recognised assets, liabilities, income, expense and cash flows arising from insurance contracts.

AASB 1023.17.6.2 and 17.6.3/PBE IFRS 4 Appendix D.17.6.2 and 17.6.3 say:

17.6.2 In applying paragraph 17.6.1(b), the recognised assets and liabilities arising from insurance contracts would normally include:

- (a) gross outstanding claims liability;
- (b) reinsurance recoveries receivable arising from the outstanding claims liability;
- (c) gross unearned premium liability;
- (d) reinsurance recoveries receivable arising from the unearned premium liability;
- (e) unexpired risk liability;
- (f) other reinsurance recoveries receivable;
- (g) other recoveries receivable;
- (h) outwards reinsurance expense asset or liability;
- (i) direct premium revenue receivable;
- (j) inwards reinsurance premium revenue receivable;
- (k) deferred acquisition cost asset; and
- (l) intangible assets relating to acquired insurance contracts.

17.6.3 In applying paragraph 17.6.1(b), the recognised income and expenses arising from insurance contracts would normally include:

- (a) direct premium revenue;
- (b) inwards reinsurance premium revenue (including retrocessions);
- (c) reinsurance and other recoveries revenue;
- (d) direct claims expense;
- (e) reinsurance claims expense;
- (f) outwards reinsurance premium expense (including retrocessions);
- (g) acquisition costs expense; and
- (h) other underwriting expenses, including claims handling expenses.

A2 AASB 17/PBE IFRS 17.B65 says:

B65 Cash flows within the boundary of an insurance contract are those that relate directly to the fulfilment of the contract, including cash flows for which the entity has discretion over the amount or timing. The cash flows within the boundary include:

- (a) premiums (including premium adjustments and instalment premiums) from a policyholder and any additional cash flows that result from those premiums.
- (b) payments to (or on behalf of) a policyholder, including claims that have already been reported but have not yet been paid (ie reported claims), incurred claims for events that have occurred but for which claims have not been reported and all future claims for which the entity has a substantive obligation (see paragraph 34).
- (c) payments to (or on behalf of) a policyholder that vary depending on returns on underlying items.



- (d) payments to (or on behalf of) a policyholder resulting from derivatives, for example, options and guarantees embedded in the contract, to the extent that those options and guarantees are not separated from the insurance contract (see paragraph 11(a)).
- (e) an allocation of insurance acquisition cash flows attributable to the portfolio to which the contract belongs.
- (f) claim handling costs (ie the costs the entity will incur in investigating, processing and resolving claims under existing insurance contracts, including legal and loss-adjusters' fees and internal costs of investigating claims and processing claim payments).
- (g) costs the entity will incur in providing contractual benefits paid in kind.
- (h) policy administration and maintenance costs, such as costs of premium billing and handling policy changes (for example, conversions and reinstatements). Such costs also include recurring commissions that are expected to be paid to intermediaries if a particular policyholder continues to pay the premiums within the boundary of the insurance contract.
- (i) transaction-based taxes (such as premium taxes, value added taxes and goods and services taxes) and levies (such as fire service levies and guarantee fund assessments) that arise directly from existing insurance contracts, or that can be attributed to them on a reasonable and consistent basis.
- (j) payments by the insurer in a fiduciary capacity to meet tax obligations incurred by the policyholder, and related receipts.
- (k) potential cash inflows from recoveries (such as salvage and subrogation) on future claims covered by existing insurance contracts and, to the extent that they do not qualify for recognition as separate assets, potential cash inflows from recoveries on past claims.
- (ka) costs the entity will incur:
 - (i) performing investment activity, to the extent the entity performs that activity to enhance benefits from insurance coverage for policyholders. Investment activities enhance benefits from insurance coverage if the entity performs those activities expecting to generate an investment return from which policyholders will benefit if an insured event occurs.
 - (ii) providing investment-return service to policyholders of insurance contracts without direct participation features (see paragraph B119B).
 - (iii) providing investment-related service to policyholders of insurance contracts with direct participation features.
- (l) an allocation of fixed and variable overheads (such as the costs of accounting, human resources, information technology and support, building depreciation, rent, and maintenance and utilities) directly attributable to fulfilling insurance contracts. Such overheads are allocated to groups of contracts using methods that are systematic and rational, and are consistently applied to all costs that have similar characteristics.
- (m) any other costs specifically chargeable to the policyholder under the terms of the contract.



Staff Paper

Project	Insurance Activities in the Public Sector	Meeting	AASB (M183)/NZASB September 2021
Topic	Captive insurers	Agenda item	AASB 11.6 NZASB 3.6
		Date	23 August 2021
Contacts	Angus Thomson athomson@asab.gov.au Vanessa Sealy-Fisher vanessa.sealy-fisher@xrb.govt.nz Patricia Au pau@asab.gov.au	Project priority	Medium
		Decision-making	High
		Project status	Board deliberation

Objective of this paper

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

Structure of this paper

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

Summary of staff recommendations

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



Section 1: Application requirements

AASB 1023/PBE IFRS 4

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

AASB 17/PBE IFRS 17

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

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

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



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

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

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

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

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

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

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



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

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

Private sector ‘captive insurers’

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

4 Such as home builders’ warranty

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



Separate and consolidated financial statements

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

Section 3: Stakeholder feedback

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

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



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

Section 4: Reporting entity approach

Australian circumstances

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

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

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



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

New Zealand circumstances

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

Staff views

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

Question for Board members

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

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

Appendix A – Definitions

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

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

A2 The following definitions are included in XRB A1.

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

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

Appendix B – Diagram of a captive insurer arrangement

