AASB 1023 GENERAL INSURANCE CONTRACTS

FACT SHEET

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This fact sheet is based on existing requirements as at 31 December 2015 and it does not take into account recent standards and interpretations that have been issued but are not yet effective.

IMPORTANT NOTE

This Standard is an Australian specific standard with no international equivalent. The application date included below is the effective date of the initial version of the Standard.

AASB APPLICATION DATE

AASB 1023 is applicable for annual reporting periods commencing on or after 1 January 2005.

OBJECTIVE

The objective of AASB 1023 is to:

a. specify the manner of accounting for general insurance contracts consistent with AASB 4;

b. specify certain aspects of accounting for assets backing general insurance liabilities;

c. specify certain aspects of accounting for non-insurance contracts; and

d. require disclosure of information relating to general insurance contracts.

SCOPE

AASB 1023 applies to:

a. general insurance contracts (including general reinsurance contracts) that a general insurer issues and to general reinsurance contracts that it holds;

b. certain assets backing general insurance liabilities;

c. financial liabilities and financial assets that arise under non-insurance contracts; and

d. certain assets backing financial liabilities that arise under non-insurance contracts.

AASB 1023 does not apply to:

a. Life insurance contracts – refer AASB 1038 *Life Insurance Contracts*.

b. Product warranties issued directly by a manufacturer, dealer or retailer – refer AASB 118 *Revenue* and AASB 137 *Provisions, Contingent Liabilities and Contingent Assets*.

c. Employers' assets and liabilities under employee benefit plans (refer AASB 2 Share based Payment and AASB 119 *Employee Benefits)* and retirement benefit obligations reported by defined benefit retirement plans (refer AAS 25 *Financial Reporting by Superannuation Plans*).

d. Contingent consideration payable or receivable in a business combination – refer AASB 3 *Business Combinations*.

e. Contractual rights or contractual obligations that are contingent on the future use of, or right to use, a non-financial item (e.g. licence fees, royalties, contingent lease payments and similar items), as well as a lessee's residual value guarantee embedded in a finance lease – refer AASB 117 *Leases*, AASB 118 and AASB 138 *Intangible Assets*.

f. Financial guarantee contracts unless the issuer has previously asserted explicitly that it regards such contracts as insurance contracts and has used accounting applicable to insurance contracts, in which case the insurer may elect to apply either AASB 139 *Financial Instruments: Recognition and Measurement*, AASB 132 *Financial Instruments: Presentation* and AASB 7 *Financial Instruments: Disclosures* or AASB 1023 to such financial guarantee contracts.

g. Direct insurance contracts that the entity holds; however a cedant applies AASB 1023 to reinsurance contracts it holds.

h. Fixed-fee service contracts, that meet the definition of an insurance contract, if the level of service depends on an uncertain event, e.g. maintenance contracts or roadside assistance contracts – refer AASB 4 *Insurance Contracts*.

RECOGNITION AND MEASUREMENT

Premium revenue – classification, recognition and measurement

Premium revenue comprises of premiums from direct business and premiums from reinsurance business. Direct business arises from contracts when a policyholder transfers significant insurance risk to an insurer. Reinsurance business arises from contracts when an insurer or reinsurer transfers significant insurance risk to another reinsurer.

Premium revenue shall be recognised from the attachment date as soon as there is a basis on which it can be reliably estimated.

Premium revenue shall be recognised in the statement of comprehensive income from the attachment date:

a. over the period of the general insurance contract for direct business; or

b. over the period of indemnity for reinsurance business;

c. in accordance with the pattern of the incidence of risk expected under the general insurance contract.

In the case of business where the premium is subject to a later adjustment, the adjusted premium shall be used where possible, as the basis for recognising premium revenue. If this is not possible, the deposit premium, adjusted for any other relevant information, shall be recognised as the premium revenue, provided that it is expected that this amount will not be materially different from the actual premium amount.

Measuring premium revenue involves the following:

a. estimating the total amount of premium revenue expected under the contract;

b. estimating the total amount of claims expenses expected under the contract and estimating when the claims are expected to arise;

c. estimating the pattern of the incidence of risk as a result of (b); and

d. recognising the premium revenue under the contract identified in (a) when it will be earned, that is, in accordance with the pattern of the incidence of risk determined in (c).

Premium revenue relating to unclosed business is recognised on the same basis.

Outstanding claims liability – recognition and measurement

An outstanding claims liability shall be recognised in respect of direct business and reinsurance business and shall be measured as the central estimate of the present value of the expected future payments for claims incurred with an additional risk margin to allow for the inherent uncertainty in the central estimate.

In estimating the outstanding claims liability, a central estimate is adopted. If all the possible values of the outstanding claims liability are expressed as a statistical distribution, the central estimate is the mean of that distribution.

The additional risk margin reflects the inherent uncertainty in the central estimate of the present value of the expected future payments. In business terms, risk margins are determined on a basis that reflects the insurer's business.

The recognition and measurement approach requires estimation of the probability-weighted expected cost (discounted to a present value) of settling claims incurred and the addition of a risk margin to reflect inherent uncertainty in the central estimate. The measurement approach recognises the inflationary factors. However, where the claims are expected to be settled within one year of the reporting date, and the amount of the expected future payments does not differ materially from the present value of the payments, insurers would not need to discount the expected future payments.

Expected future payments

The expected future payments shall include:

a. amounts in relation to unpaid reported claims;

b. claims incurred but not reported (IBNR);

c. claims incurred but not enough reported (IBNER); and

d. costs, including claims handling costs, which the insurer expects to incur in settling these incurred claims.

Claims handling costs include costs that can be associated directly with individual claims, such as legal and other professional fees, and costs that can only be indirectly associated with individual claims, such as claims administration costs.

Discount rates

The outstanding claims liability shall be discounted for the time value of money using risk-free discount rates that are based on current observable, objective rates that relate to the nature, structure and term of the future obligations.

Government bond rates may be appropriate discount rates or they may be appropriate starting point in determining such discount rates.

Unearned premium liability

Premium that has not been recognised in the statement of comprehensive income is premium that is unearned and is recognised in the statement of financial position as an unearned premium liability.

The unearned premium liability is to meet the costs, including the claims handling costs, of future claims that will arise under current general insurance contracts and the deferred acquisition costs will be recognised as an expense in the statement of comprehensive income in future reporting periods.

Acquisition costs

Acquisition costs shall be deferred and recognised as assets where they can be reliably measured and where it is probable that they will give rise to premium revenue that will be recognised in the statement of comprehensive income in subsequent reporting periods.

The deferred acquisition costs shall be amortised systematically in accordance with the expected pattern of the incidence of risk under the related general insurance contract.

Examples of acquisition costs are:

a. commission/brokerage paid to agents or brokers for obtaining business for the insurer;

b. selling and underwriting costs (i.e. advertising, risk assessment);

c. the administrative costs of recording policy information; and

d. premium collection costs.

Liability Adequacy Test

The adequacy of the unearned premium liability shall be assessed by considering current estimates of the present value of the expected future cash flows relating to future claims arising from the rights and obligations under current general insurance contracts.

This test for unearned premium liability shall be performed at the level of a portfolio of contracts that are subject to broadly similar risks and are managed as a single portfolio.

IF			THEN
Present value of expected future cash flows relating to future claims plus risk margin	EXCEEDS	Unearned premium liability less related intangible assets and related deferred acquisition costs	Unearned premium liability is deficient. Recognise entire deficiency in statement of comprehensive income. Firstly, write-down any related intangible assets and then deferred acquisition costs. If additional liability is required, this shall be recognised in the statement of financial position as an unexpired risk liability.

Outwards reinsurance expense

Premiums ceded to reinsurers shall be recognised by the cedant as outwards reinsurance expense in the statement of comprehensive income from the attachment date over the period of indemnity stipulated in the reinsurance contract in accordance with the expected pattern of the incidence of risk.

Reinsurance recoveries and non-reinsurance recoveries

Reinsurance recoveries received or receivable in relation to the outstanding claims liability and non-reinsurance recoveries received or receivable are recognised as income of the cedant and are not netted off against the claims expense or outwards reinsurance expense in the statement of comprehensive income, or the outstanding claims liability or unearned premium liability in the statement of financial position.

Impairment of reinsurance assets

A reinsurance asset is impaired if and only if:

a. there is objective evidence, as a result of an event that occurred after initial recognition of the reinsurance asset, that the cedant may not receive amounts due to it under the terms of the contract; and

b. that event has a reliably measureable impact on the amounts that the cedant will receive from the reinsurer.

If the cedant's reinsurance asset is impaired, the cedant shall reduce its carrying amount accordingly and recognise that impairment in the statement of comprehensive income.

Portfolio transfers and business combinations

Where the responsibility in relation to claims on transferred insurance business:

- remains with the transferring insurer, the transfer is treated by the transferring insurer and the accepting insurer as reinsurance business.
- passes to the accepting insurer, the transfer is accounted for as a portfolio withdrawal by the transferring insurer and as a portfolio assumption by the accepting insurer.

A portfolio withdrawal is accounted for by the transferring insurer by eliminating the liabilities and assets connected with the risks transferred.

A portfolio assumption is accounted for by the accepting insurer by recognising the relevant amount of unexpired premium revenue and the outstanding claims for which the transferring insurer is no longer responsible.

Underwriting pools and coinsurance

Insurance business allocated through underwriting pools and coinsurance arrangements, by an entity acting as agent, shall be accounted for by the accepting insurer as direct insurance business.

Assets backing general insurance liabilities

The fair value approach to the measurement of assets backing general insurance liabilities or financial liabilities that arise under non-insurance contracts is consistent with the present value measurement approach for general insurance liabilities and the fair value measurement of financial liabilities that arise under non-insurance contract, required by AASB 1023.

Where the assets are not backing general insurance liabilities or financial liabilities that arise under non-insurance contracts, general insurers apply the applicable accounting standards making use of any measurement choices available.

Measurement

Financial assets that:

a. are within the scope of AASB 139;

b. back general insurance liabilities; and

c. are permitted to be designated as 'at fair value through profit or loss' under AASB 139;

d. shall be designated as 'at fair value through profit or loss' under AASB 139 on first application of AASB 1023, or on initial recognition.

Investment property within the scope of AASB 140 *Investment Property* and that backs general insurance liabilities are measured using the fair value model under AASB 140 and AASB 13 *Fair Value Measurement*.

Property, plant and equipment that is within the scope of AASB 116 *Property, Plant and Equipment* and that backs general insurance liabilities shall be measured using the revaluation model under AASB 116.

When preparing separate financial statements, those investments in subsidiaries, joint ventures and associates that:

a. are defined by AASB 10 *Consolidated Financial Statements*, AASB 11 *Joint Arrangements* and AASB 128 *Investments in Associates and Joint Ventures*;

b. back general insurance liabilities; and

c. are permitted to be designated as "at fair value through profit or loss" under AASB 139;

d. shall be designated as "at fair value through profit or loss" under AASB 139, on first application of AASB 1023 or on initial recognition.

Non-insurance contracts regulated under the Insurance Act 1973

Non-insurance contracts regulated under the *Insurance Act 1973* are treated under AASB 139 to the extent that they give rise to financial assets and financial liabilities. However, the financial assets and the financial liabilities that arise under these contracts shall be designated as "at fair value through profit or loss", on first application of AASB 1023, or on initial recognition of the financial assets or financial liabilities, where this is permitted under AASB 139.

DISCLOSURES

Refer to Appendix 1 for a checklist to assist with AASB 1023 disclosure requirements.

REDUCED DISCLOSURE REQUIREMENTS (RDR)

On 30 June 2010, the Australian Accounting Standards Board published AASB 1053 *Application of Tiers of Australian Accounting Standards* (and AASB 2010-2 *Amendments to Australian Accounting Standards arising from Reduced Disclosure Requirements*) which established a differential reporting framework, consisting of two Tiers of reporting requirements for preparing general purpose financial statements:

a. Tier 1: Australian Accounting Standards; and

b. Tier 2: Australian Accounting Standards – Reduced Disclosure Requirements.

Tier 2 comprises the recognition, measurement and presentation requirements of Tier 1 and substantially reduced disclosures corresponding to those requirements.

A Tier 2 entity is a 'reporting entity' as defined in SAC 1 *Definition of the Reporting Entity* that does not have 'public accountability' as defined in AASB 1053 and is not otherwise deemed to be a Tier 1 entity by AASB 1053.

RDR is applicable to annual periods beginning on or after 1 July 2013.

When developing AASB 1053, the AASB concluded that the Australian Government and state, territory and local governments should be subject to Tier 1 requirements. The AASB also decided that General Government Sectors of the Australian Government and state and territory governments should continue to apply AASB 1049 *Whole of Government and General Government Sector Financial Reporting*, without the reduction in disclosures provided by Tier 2. Other public sector entities are able to apply Tier 2 reporting requirements.

Disclosure requirements under Tier 2 are the same as those under Tier 1 for this standard.

DEFINITIONS

Attachment date	For a direct insurer, the date as from which the insurer accepts risk from the insured under an insurance contract or endorsement or, for a reinsurer, the date from which the reinsurer accepts risk from the direct insurer or another reinsurer under a reinsurance arrangement.
Cedant	Means the *policyholder* under a *reinsurance contract*.
Claim	A demand by any party external to the entity for payment by the insurer on account of an alleged loss resulting from an insured event or events, that have occurred, alleged to be covered by an insurance contract.
Claims expense	The charge to the statement of comprehensive income for the reporting period and represents the sum of claims settled and claims management expenses relating to claims incurred in the period and the movement in the gross outstanding claims liability in the period.
Claims incurred	Claims that have occurred prior to the end of the reporting date, whether reported or unreported at the end of the reporting date.
Deposit premium	The premium charged by the insurer at the inception of a contract under which the final premium depends on conditions prevailing over the contract period and so is not determined until the expiry of that period.
Direct insurance contract	An insurance contract that is not a reinsurance contract.
Future claims	Claims in respect of insured events that are expected to occur in future reporting periods under policies where the attachment date is prior to the end of the reporting period.
General insurance contract	An insurance contract that is not a life insurance contract.
General insurer	An insurer that writes general insurance contracts.
Insurance asset	An insurer's net contractual rights under an insurance contract.
Insurance contract	A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.
Insurer	The party that has an obligation under an insurance contract to compensate a policyholder if an insured event occurs.
Liability adequacy test	An assessment of whether the carrying amount of an insurance liability needs to be increased (or the carrying amount of the related deferred acquisition costs or related intangible assets decreased) based on a review of future cash flows.
Life insurance contract	An insurance contract, or a financial instrument with a discretionary participation feature, regulated under the Life Insurance Act 1995, and similar contracts issued by entities operating outside Australia.
Life reinsurance contract	A life insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.
Net claims incurred	Direct claims costs net of reinsurance and other recoveries, and indirect claims handling costs, determined on a discounted basis.

Non-insurance contract	A contract regulated under the Insurance Act 1973, and similar contracts issued by entities operating outside Australia, which fails to meet the definition of an insurance contract under AASB 1023.
Outstanding claims liability	All unpaid claims and related claims handling expenses relating to claims incurred prior to the end of the reporting date.
Policyholder	A party that has a right to compensation under an insurance contract if an insured event occurs.
Premium	The amount charged in relation to accepting risk from the insured, but does not include amounts collected on behalf of third parties.
Reinsurance assets	A cedant's net contractual rights under a reinsurance contract.
Reinsurance contract	An insurance contract issued by one insurer (the reinsurer) to compensate another insurer (the cedant) for losses on one or more contracts issued by the cedant.
Reinsurer	The party that has an obligation under a reinsurance contract to compensate a cedant if an insured event occurs.
Unbundle	To treat the components of a contract as if they were separate contracts.
Weather derivative	A contract that requires payment based on climatic, geological or other physical variables.

RELATED INTERPRETATION

- AASB 1047 *Professional Indemnity Claims Liabilities in Medical Defence Organisations*

APPENDIX 1 – DISCLOSURE CHECKLIST

This checklist can be used to review your financial statements. You should complete the "Yes / No / N/A" column about whether the requirement is included. To ensure the completeness of disclosures, provide an explanation for "No" answers.

CODE		YES / NO / N/A	EXPLANATION (*If required*)
AASB 1023.17.1	In relation to the statement of comprehensive income, has the entity disclosed: a. the underwriting result for the reporting period, determined as the amount obtained by deducting the sum of claims expense, outwards reinsurance premium expense and underwriting expenses from the sum of direct and inwards reinsurance premium revenues and recoveries revenue; b. net claims incurred, showing separately: i. The amount relating to risks borne in the current reporting period; and ii. The amount relating to a reassessment of risks borne in all previous reporting periods. Has an explanation been provided where net claims incurred relating to a reassessment of risks borne in previous reporting periods are material; and c. in respect of paragraphs 17.1(b)(i) and 17.1(b)(ii), have the following components been separately disclosed: i. gross claims incurred – undiscounted ii. reinsurance and other recoveries – undiscounted; and iii. discount movements shown separately for (i) and (ii)?		
AASB 1023.17.2	Have the financial statements disclosed, in relation to the outstanding claims liability: a. the central estimate of the expected present value of future payments for claims incurred; b. the component related to the risk margin; c. the percentage risk margin adopted in determining the outstanding claims liability (determined from (a) and (b) above); d. the probability of adequacy intended to be achieved through adoption of the risk margin; and e. the process used to determine the risk margin, including the way in which diversification of risks has been allowed for?		
AASB 1023.17.3	Has the insurer disclosed the process used to determine which assets back general insurance liabilities and which assets back financial liabilities arising under non-insurance contracts?		

CODE		YES / NO / N/A	EXPLANATION (*If required*)
AASB 1023.17.4	Where a general insurer has issued a non-insurance contract or holds a non-insurance contract as a cedant, and that non-insurance contract has a material financial impact on the statement of comprehensive income, statement of financial position or cash flows; has the general insurer disclosed: a. the nature of the non-insurance contracts; b. the recognised assets, liabilities, income, expenses and cash flows arising from the non-insurance contract; and c. information that helps users to understand the amount, timing and uncertainty of future cash flows from the non-insurance contract?		
AASB 1023.17.6	Has an insurer disclosed information that identifies and explains the amounts in its financial statements arising from insurance contracts?		
AASB 1023.17.6.1	Has an insurer disclosed: a. its accounting policies for insurance contracts and related asses, liabilities, income and expenses; b. the recognised assets, liabilities, income, expense and cash flows arising from insurance contracts. Furthermore, if the insurer is a cedant, has it disclosed: i. gains and losses recognised in the statement of comprehensive income on buying reinsurance; and ii. if the cedant defers and amortises gains and losses arising on buying reinsurance, the amortisation for the period and the amounts remaining unamortised at the beginning and end of the period; c. the process used to determine the assumptions that have the greatest effect on the measurement of the recognised amounts described in (b). When practicable, has the insurer also given quantified disclosure of those assumptions? d. the effect of changes in assumptions used to measure insurance assets and insurance liabilities, showing separately the effect of each change that has a material effect of each change that has a material effect on the financial statements; and e. reconciliations of changes in insurance liabilities, reinsurance assets and, if any, related deferred acquisition costs?		

CODE		YES / NO / N/A	EXPLANATION (*If required*)
AASB 1023.17.7	Has the insurer disclosed information that enables users of its financial statements to evaluate the nature and extent of risks arising from insurance contracts?		
AASB 1023.17.7.1/ 17.7.5	To comply with paragraph 17.7, has the insurer disclosed: a. its objectives, policies and processes for managing risks arising from insurance contracts and the methods used to manage those risks; b. information about insurance risk (both before and after risk mitigation by reinsurance), including information about: i. sensitivity to insurance risk by disclosing either: – sensitivity analysis that shows how profit or loss and equity would have been affected had changes in the relevant risk variable that were reasonably possible at the end of the reporting period occurred; the methods and assumptions used in preparing the sensitivity analysis; and any changes from the previous period in the methods and assumptions used. However, if an insurer uses an alternative method to manage sensitivity to market conditions, such as an embedded value analysis, it may meet this requirement by disclosing that alternative sensitivity analysis and the disclosures required by paragraph 41 of AASB 7; or – qualitative information about sensitivity, and information about those terms and conditions of insurance contracts that have a material effect on the amount, timing and uncertainty of the insurer's future cash flows. ii. concentrations of insurance risk, including a description of how management determines concentrations and a description of the shared characteristic that identifies each concentration and iii. actual claims compared with previous estimates.		

CODE		YES / NO / N/A	EXPLANATION (*If required*)
AASB 1023.17.7.1/ 17.7.5	c. information about credit risk, liquidity risk and market risk that paragraphs 31 – 42 of AASB 7 would require if the insurance contracts were within the scope of AASB 7. However: i. the maturity analysis required by paragraphs 39(a) and (b) of AASB 7 is not required if the insurer discloses information about the estimated timing of the net cash outflows resulting from recognised insurance liabilities instead. ii. if an insurer uses an alternative method to manage sensitivity to market conditions, it may use that sensitivity analysis to meet the requirement in paragraph 40(a) of AASB 7. Such an insurer shall also provide the disclosures required by paragraph 41 of AASB 7; and d. information about exposures to market risk arising from embedded derivatives contained in a host insurance contract if the insurer is not required to, and does not, measure the embedded derivatives at fair value?		
AASB 1023.17.8	In relation to the liability adequacy test in section 9, have the financial statements disclosed: a. where a deficiency has been identified, the amounts underlying the calculation performed, that is: i. unearned premium liability; ii. related reinsurance asset; iii. deferred acquisition costs; iv. intangible assets; v. present value of expected future cash flows for future claims, showing expected reinsurance recoveries separately; and vi. deficiency. b. any write-down of deferred acquisition costs under the liability adequacy test; c. any write-down of intangible assets under the liability adequacy test;		

CODE		YES / NO / N/A	EXPLANATION (*If required*)
AASB 1023.17.8	d. in relation to the present value of expected future cash flows for future claims: i. the central estimate of the present value of expected future cash flows; ii. the component of present value of expected future cash flows related to the risk margin; iii. the percentage risk margin adopted in determining the present value of expected future cash flows (determined from (i) and (ii) above; iv. the probability of adequacy intended to be achieved through adoption of the risk margin; and v. the process used to determine the risk margin, including the way in which diversification of risks has been allowed for. e. where the probability of adequacy disclosed under paragraph 17.2(d) is not the same or similar to the probability of adequacy disclosed under paragraph 17.8(d)(iv), the reason for the difference; and f. where a surplus has been identified, the fact that the liability adequacy test identified a surplus?		

OTHER MATTERS

LEGAL NOTICE

DISCLAIMER

LIMITATION OF LIABILITY

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