Australian Government
Australian Accounting Standards Board



# Summary

## Potential inconsistency between AASB 17 and AASB 110 Events after the Reporting Period

The implementation question addressed in this paper is how AASB 110 Events after the Reporting Period and AASB 17 paragraph B55 interact and whether they are consistent in their requirements or require contradictory approaches on whether the insurance liabilities would/can include allowance for claims development after the reporting date.

AASB 17 describes the fulfilment cashflows as the calculation of the possible outcomes that could occur (scenarios) weighted by the probable likelihood of them occurring. Paragraph B55 sets out that “The probability assigned to each scenario shall reflect the conditions at the end of the reporting period.”. This has been interpreted by some actuaries as setting a central estimate (or mean or probability weighted average) of the distribution of potential outcomes which would not be adjusted for development after the balances date.

AASB 110 allows for adjusting events, where an entity adjusts the insurance liabilities to reflect an adjusting event after the reporting period. The example given of an adjusting event is the settlement of a court case after the reporting date.

Under a probability distribution approach, at the reporting date there will have been a probability associated with each possible outcome of the court case. The actual result would be one of these scenarios.

AASB 110 states that the position should be adjusted, which is effectively giving the actual outcome a 100% probability and the other scenarios 0%. AASB 17 B55 could be read to mean that the scenarios’ probabilities should reflect the probabilities of each scenario occurring at the end of the reporting period only (and not subsequently adjusted).

These two positions potentially contradict each other on the treatment of this event. The event in question (settlement of the claim after the end of the reporting period) would apply to any claims development occurring post the end of the reporting period until the date the financial report is issued.

This issue is a relevant issue as for some time many insurers from the Australian Private Health Insurance (PHI) industry adjust the insurance liabilities for the year-end based on the development of claims in the month (or months) after the end of the financial year. They do this because of the speed with which PHI claims are resolved; a significant share of the outstanding claims at the reporting date will be resolved within 1-2 months and so this information can materially change the insurance liabilities for incurred claims. The adjustments to the outstanding claims are referred to in the industry as ‘hindsight adjustments’.

The Actuaries’ Institute’s taskforce on AASB 17 interpreted B55 as no longer allowing post-reporting date information to be used, as expressed in Q3.20 of their Information Note. Discussions with auditors have identified that their common a view is that “hindsight adjustments” are still permissible based on AASB 110.

This submission is to seek clarification on the interaction of AASB 17 and AASB 110, including an update of industry discussions to date. Although the PHI industry is particularly impacted, this has consequences for both general insurance and life insurance treatment of events.

# AASB Transition Resource Group for AASB 17 *Insurance Contracts*

## Submission form for potential implementation question

In addition to the form, attachments (such as memos) may be included with the submission.

Any public discussion of issues submitted will be without the identification of the submitter's name. Although the submission forms will remain private, please do not include any confidential information in your submission.

Email a PDF of the completed (including any attachments) form to standards@aasb.gov.au.

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|---|---|
| **Submission date** | Click here to enter a date. |
| **Name** | Antony Claughton |
| **Title** | Senior Consultant |
| **Organisation** | Finity Consulting |
| **Address** | 55 Collins Street Melbourne 3000 |
| **Telephone** | 0432 741 820 |
| **Email address** | antony.claughton@finity.com.au |
| **Stakeholder group** | Preparer |
| **Do you wish to present to the TRG?** | I am happy to depending on the date and time |

**Potential implementation question**

Whether the wording of AASB 17 and AASB 110 are contradictory on how adjusting events should be treated.

- AASB 17 sets out that the probability of an event (or scenario) should reflect the probabilities as at the end of the reporting date.
- AASB 110 identifies 'adjusting events' as those events occurring after the reporting date but before the issue of the financial statements that provide evidence of conditions at the end of the reporting period. Adjusting events require adjustment in the financial statements.

The examples given in AASB 110 are examples in the insurance liabilities context of new information occurring about claims incurred.

The question raised is whether these two standards therefore sit in conflict, and, if so what steps are required.

**Paragraphs of AASB standards**

AASB 110 paragraphs 3, 8 and 9.
AASB 17 paragraph B55.

See Attachment A of this document for the key paragraphs from the standard.

**Analysis of the question**
*The analysis of the question should include a detailed description of the different ways the new Standard may be applied, resulting in possible diversity in practice.*

To explain the potential differences, let's consider an example.

At the end of the reporting period (the reporting date) there is an open claim waiting on a court decision. The experts predict that there could be two outcomes: a 40% probability of the insured winning and the claim having no further costs, or a 60% probability of the claim losing for CU1000.

Under AASB 17, paragraph B55 states that "The probability assigned to each scenario shall reflect the conditions at the end of the reporting period. Under this approach, at the reporting date there were two scenarios, with probabilities 40% and 60% and expected costs CU0 and CU1000 respectively. Therefore, the insurance liabilities would be CU600.

The court case is settled after the reporting date but before the issue of the financial statements determining the liability is CU1000.

Applying AASB 110 Events after the Reporting Period, is the court settlement an adjusting event occurring after the end of the reporting period that resolves an uncertainty that existed at the end of the reporting period i.e. does it provide evidence of the conditions that existed at that date?

Applying AASB 17 B55 (refer App A):
One reading of AASB 17 paragraph B55 could be that the court case is a non-adjusting event, and that there are no adjusting events to the AASB 17 insurance liabilities. Under this interpretation, the entity should NOT ADJUST the AASB17 provision for the new information. Therefore, the insurance liability of CU600 would be remain.

However, discussing this issue with industry and accountants an alternative view was raised:

1. Under AASB 17, the court case would ALWAYS BE an adjusting event IF the court case was instituted before year end and related to a claim event that had occurred before year end.

2. Many consider that B55 is only meant to apply to the LRC because the example provided relates to an event (i.e. a storm) occurring after the reporting date and therefore the example provided in B55 is in respect of future claims only.

As B55 does not specify that it is only in respect of the LRC, and Paragraph 40(b) does include it within the paragraphs to be referred to when measuring the LIC, some confusion in application has arisen. Also note, the definition of the fulfilment cashflows and wording in B38 are both consistent with the wording in B55, and apply equally to the LIC and LRC.

AASB 110
In paragraph 9 AASB 110 gives an example of an event which would adjust the financial statements. Paragraph 9 states "the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with AASB 137 Provisions, Contingent Liabilities and Contingent Assets or recognises a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of AASB 137".

Under this interpretation, the entity SHOULD ADJUST the AASB17 provision for the new information. Therefore, the insurance liability of CU600 would be replaced by an insurance liability of CU1000.

NOTE that there is no disagreement that for claims incurred after the reporting date (i.e. arising from future service) that both AASB 110 and AASB 17 agree. AASB 110 treats these as non-adjusting events, and B55 explicitly states the LRC would not be adjusted for information that arises about claims not yet incurred.

**POSSIBLE SOLUTIONS**
View 1
Interpret paragraph B55 as only being intended to refer to events not yet incurred (i.e. the LRC) and that therefore AASB 110 and AASB 17 are in alignment.

View 2
Interpret paragraph B55 as applying to the entire set of scenarios for all uncertain areas of the fulfilment cashflows, and that therefore this applies to both the LIC and LRC. With this interpretation, where material developments occur on incurred claims AASB 110 would require an adjustment. This is either a conflict that needs to be addressed, or the adjustment is made to the financial statements but not the AASB 17 calculated insurance liabilities.

**RECOMMENDED NEXT STEPS BASED ON INDUSTRY DISCUSSION**
In practice, based on industry discussions, B55 has been assumed to apply only to the LRC because the example provided relates to a claim event after the reporting date. Some entities have based their accounting policies on the interpretation in the Actuaries Institutes Information Note and are making no adjustments to claims incurred at the reporting date.

Going forward to avoid uncertainty:

- Option 1: It should be flagged to the IASB that there is an issue of a lack of clarity on the interpretation of B55 and this be recorded as an area for the IASB to review as part of the post-implementation review. Clarity on whether B55 applies only to the LRC, or whether it also applies to claims incurred, would be beneficial.

- Option 2: Alternatively, this could be flagged to the IFRS interpretations committee now.

**Is the question pervasive?**
*Explain whether the question is expected to be relevant to a wide group of stakeholders.*

In Australia many of the PHI entities writing health insurance perform hindsight adjustments for the end-of-financial-year reporting. They do this because of the speed with which PHI claims are resolved; a significant share of the outstanding claims at the reporting date will be resolved within 1-2 months and so this information can materially change the insurance liabilities for incurred claims. The adjustments to the outstanding claims are referred to in the industry as ‘hindsight adjustments’.

Additionally, general insurers and life insurers may adjust the insurance liabilities if there is a material event that occurs. A good example is the one used in AASB 110 paragraph 9, of a settlement of a court case after the end of the reporting period. If that was material to the entity there would be an adjustment made.

# Attachment A – Wording from IFRS Standards (consistent with AASB)

**Wording from IFRS 110**
(areas greyed out are of less relevance)

3 The following terms are used in this Standard with the meanings specified:

Events after the reporting period are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. Two types of events can be identified:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the reporting period); and
(b) those that are indicative of conditions that arose after the reporting period (non-adjusting events after the reporting period).

8 An entity shall adjust the amounts recognised in its financial statements to reflect adjusting events after the reporting period.

9 The following are examples of adjusting events after the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) the settlement after the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised provision related to this court case in accordance with AASB 137 Provisions, Contingent Liabilities and Contingent Assets or recognises a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of AASB 137.
(b) the receipt of information after the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted. For example:
   (i) the bankruptcy of a customer that occurs after the reporting period usually confirms that the customer was credit-impaired at the end of the reporting period;
   (ii) the sale of inventories after the reporting period may give evidence about their net realisable value at the end of the reporting period.
(c) the determination after the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.
(d) the determination after the reporting period of the amount of profit-sharing or bonus payments, if the entity had a present legal or constructive obligation at the end of the reporting period to make such payments as a result of events before that date (see AASB 119 Employee Benefits).
(e) the discovery of fraud or errors that show that the financial statements are incorrect.

**Wording from IFRS 17**
(areas greyed out are of less relevance)

**Estimates of future cash flows (paragraphs B36–B71)**

33 An entity shall include in the measurement of a group of insurance contracts all the future cash flows within the boundary of each contract in the group (see paragraph 34). Applying paragraph 24, an entity may estimate the future cash flows at a higher level of aggregation and then allocate the resulting fulfilment cash flows to individual groups of contracts. The estimates of future cash flows shall:
(a) incorporate, in an unbiased way, all reasonable and supportable information available without undue cost or effort about the amount, timing and uncertainty of those future cash flows (see paragraphs B37–B41). To do this, an entity shall estimate the expected value (ie the probability-weighted mean) of the full range of possible outcomes.
(b) reflect the perspective of the entity, provided that the estimates of any relevant market variables are consistent with observable market prices for those variables (see paragraphs B42–B53).

(c) be current – the estimates shall reflect conditions existing at the measurement date, including assumptions at that date about the future (see paragraphs B54–B60).

40 The carrying amount of a group of insurance contracts at the end of each reporting period shall be the sum of:
(a) the liability for remaining coverage comprising:
(i) the fulfilment cash flows related to future service allocated to the group at that date, measured applying paragraphs 33–37 and B36–B92;
(ii) the contractual service margin of the group at that date, measured applying paragraphs 43–46; and
(b) the liability for incurred claims, comprising the fulfilment cash flows related to past service allocated to the group at that date, measured applying paragraphs 33–37 and B36–B92.

fulfilment cash flows An explicit, unbiased and probability-weighted estimate (ie expected value) of the present value of the future cash outflows minus the present value of the future cash inflows that will arise as the entity fulfils insurance contracts, including a risk adjustment for non-financial risk.

## Measurement (paragraphs 29–71)

### Estimates of future cash flows (paragraphs 33–35)

B36 This section addresses:
(a) unbiased use of all reasonable and supportable information available without undue cost or effort (see paragraphs B37–B41);
(b) market variables and non-market variables (see paragraphs B42–B53);
(c) using current estimates (see paragraphs B54–B60); and
(d) cash flows within the contract boundary (see paragraphs B61–B71).

### Unbiased use of all reasonable and supportable information available without undue cost or effort (paragraph 33(a))

B37 The objective of estimating future cash flows is to determine the expected value, or probability-weighted mean, of the full range of possible outcomes, considering all reasonable and supportable information available at the reporting date without undue cost or effort. Reasonable and supportable information available at the reporting date without undue cost or effort includes information about past events and current conditions, and forecasts of future conditions (see paragraph B41). Information available from an entity's own information systems is considered to be available without undue cost or effort.

B38 The starting point for an estimate of the cash flows is a range of scenarios that reflects the full range of possible outcomes. Each scenario specifies the amount and timing of the cash flows for a particular outcome, and the estimated probability of that outcome. The cash flows from each scenario are discounted and weighted by the estimated probability of that outcome to derive an expected present value. Consequently, the objective is not to develop a most likely outcome, or a more-likely-than-not outcome, for future cash flows.

### Using current estimates (paragraph 33(c))

B54 In estimating each cash flow scenario and its probability, an entity shall use all reasonable and supportable information available without undue cost or effort. An entity shall review the estimates that it made at the end of the previous reporting period and update them. In doing so, an entity shall consider whether:
(a) the updated estimates faithfully represent the conditions at the end of the reporting period.
(b) the changes in estimates faithfully represent the changes in conditions during the period. For example, suppose that estimates were at one end of a reasonable range at the beginning of the period. If the conditions have not changed, shifting the estimates to the other end of the range at the end of the period would not faithfully represent what has happened during the period. If an entity's most recent estimates are different from its previous estimates, but conditions have not changed, it shall assess whether the new probabilities assigned to each scenario are

justified. In updating its estimates of those probabilities, the entity shall consider both the evidence that supported its previous estimates and all newly available evidence, giving more weight to the more persuasive evidence.

B55 The probability assigned to each scenario shall reflect the conditions at the end of the reporting period. Consequently, applying AASB 110 Events after the Reporting Period, an event occurring after the end of the reporting period that resolves an uncertainty that existed at the end of the reporting period does not provide evidence of the conditions that existed at that date. For example, there may be a 20 per cent probability at the end of the reporting period that a major storm will strike during the remaining six months of an insurance contract. After the end of the reporting period but before the financial statements are authorised for issue, a major storm strikes. The fulfilment cash flows under that contract shall not reflect the storm that, with hindsight, is known to have occurred. Instead, the cash flows included in the measurement include the 20 per cent probability apparent at the end of the reporting period (with disclosure applying AASB 110 that a non-adjusting event occurred after the end of the reporting period).