Resource Management Guide No. 112
Identification of general insurance contracts for accounting purposes
This guide contains material that has been prepared to assist Commonwealth entities and companies to apply the principles and requirements of the Public Governance, Performance and Accountability Act 2013 and associated rules, and any applicable policies. In this guide the: mandatory principles or requirements are set out as things entities and officials ‘must’ do; and actions, or practices, that entities and officials are expected to take into account to give effect to those and principles and/or requirements are set out as things entities and officials ‘should consider’ doing.
Audience

This Guide applies to: CFOs and CFO Units in all Commonwealth entities that enter into contracts which transfer insurance risk, irrespective of whether the entity conducts an “insurance business”.

This guide is designed to be read in conjunction with the relevant Australian Accounting Standards.

Key points

- **Purpose**: To provide guidance on applying AASB 1023 *General Insurance Contracts* in the identification of general insurance contracts in relation to agreements entered into by Australian Government entities.

- **Scope**: Only applies in identifying ‘general insurance contracts’ under AASB 1023. Additionally, AASB 1023 applies even if the entity does not conduct an ‘insurance business’ (see “insurer” in ‘Definitions used’ below).

- **Aim**: To provide non-mandatory explanation and examples relating to the interpretation and application of Australian Accounting Standards to the above entities.

- **Reference previous guidance**: This guide replaces Accounting Guidance Note No. 2007/6.

Resources


Applicable accounting pronouncements

- **AASB 1023 General Insurance Contracts**

Contact information

For further information or clarification, please email Budget Estimates and Accounting (BEA) at accountingpolicy@finance.gov.au.

Guidance

1. “General insurance contracts (GICs)” as defined (see ‘Definitions used’ below) are not restricted to a formal insurance policy made by an insurer, but rather, any contract that transfers insurance risk could be considered a GIC. GICs are accounted for under AASB 1023.

**Does a general insurance contract (GIC) exist?**

2. The following six elements **must** all be present before an entity is required to classify a contract as a GIC:

   (a) there is a contract that transfers insurance risk;

   (b) the insurance risk is present regardless of the contract;

   (c) the risk transferred from the policyholder to the insurer is significant;
(d) there is an insured event;
(e) there is an adverse effect on the policyholder resulting from the insured event; and
(f) the insurer provides significant additional benefits should the insured event occur.

Practical guidance: A decision tree has been included in Appendix 1 to assist with this Guide and AASB 1023.

3. The below guidance provides additional assistance to, but does not replicate, AASB 1023’s Appendix: Definition of an Insurance Contract. Therefore, entities MUST refer to this Appendix in AASB 1023 when determining whether there is a GIC.

Note: The references to the Appendix below are minimum references; there may be additional paragraphs relevant in determining whether there is a GIC that entities would need to consider.

A. There is a contract that transfers insurance risk

Refer to AASB 1023’s Appendix paragraphs 7, 9, and 17 – 20 (also, the definition of ‘financial risk’ in AASB 1023.19.1)

4. Insurance risk must be transferred from the policyholder to the insurer.

Practical guidance: Other examples of contracts that transfer no significant insurance risk (in addition to those in AASB 1023) include savings and pension plans.

5. Whether an entity charges the policyholder a premium (fee) is not a determining factor for a contract to be a GIC.

B. The insurance risk is present regardless of the contract

Refer to AASB 1023’s Appendix paragraph 11

6. The insurance risk must be pre-existing. Where the risk is created as a result of a contract, it is not insurance risk.

Practical guidance: An example of a risk created as a result of a contract (thus, is not insurance risk) is an indemnity issued as part of an employment contract to a director.

C. The risk transferred from the policyholder to the insurer is significant

Refer to AASB 1023’s Appendix paragraphs 22 and 24

7. Determination of significance should be performed on a contract by contract basis. It is important to note that risk may be significant even when the insured event is extremely unlikely.

Practical guidance: An example of a risk that may be significant even when the insured event is extremely unlikely is flood/earthquake damage. Although the probability of
these types of catastrophes occurring is small, the risk is considered to be significant.

**D. There is an insured event**

Refer to AASB 1023’s Appendix paragraph 2

8. An insured event is an uncertain future event covered by the contract.

**E. There is an adverse effect on the policyholder resulting from the insured event**

Refer to AASB 1023’s Appendix paragraphs 12 and 13

Practical guidance

Each entity will need to assess what constitutes an adverse effect.

9. Generally, there must be some non-trivial financial impact attaching to the insurance contract. However, the definition is not limited to financial payments to the policyholders. For example, it would cover instances where the entity provides a replacement for the item insured.

**F. The insurer provides significant additional benefits should the insured event occur**

Refer to AASB 1023’s Appendix paragraphs 22 and 23

10. Additional benefits are amounts that exceed those that would be payable if no insured event occurred (excluding scenarios that lack commercial substance).

Practical guidance

This requires that more than the minimal benefit will be paid under a GIC. For example, if the benefit payable under a GIC is similar to earning interest on the same amount that would have been used to acquire an insurance contract then there is no significant additional benefit (there is a lack of commercial substance and transfer of significant insurance risk as per element C above).

**If the contract is not a GIC**

11. Where a contract does not satisfy the definition of a GIC, the entity should consider whether the following Australian Accounting Standards apply:

- AASB 4 *Insurance Contracts* applies to fixed-fee service contracts that meet the definition of an insurance contract such as maintenance contracts or roadside assistance contracts.
- AASB 118 *Revenue* where a contract does not create financial assets or financial liabilities.
- AASB 137 *Provisions, Contingent Liabilities and Contingent Assets* in respect to legal and constructive obligations and contingent liabilities, such as product warranties and refund policies.
• AASB 139 *Financial Instruments: Recognition and Measurement* in respect to financial instruments such as financial guarantees, loans and receivables, and derivatives.

• AASB 1038 *Life Insurance Contracts* in relation to life insurance contracts.

**Disclosure requirements**

12. Entities should consider the disclosure requirements in AASB 1023 where they have GICs.

**Definitions used**

- *General insurance contract* is an ‘insurance contract’ that is not a life insurance contract (AASB 1023.19.1).
- *Insurance contract* is 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 (AASB 1023.19.1).
- *Insurer* is the party that has an obligation under an insurance contract to compensate a policyholder if an insured event occurs (AASB 1023.19.1). The Standard describes any entity that issues an insurance contract as an ‘insurer’, whether or not that entity is regarded as an insurer for legal, regulatory or supervisory purposes (AASB 1023.2.1.3).
A • Is there a contract that transfers insurance risk?
B • Is the insurance risk present regardless of the contract?
C • Is the insurance risk transferred from the policyholder to the insurer significant?
D • Does an insured event exist?
E • Would the insured event have an adverse effect on the policyholder?
F • Would the insurer be required to pay significant additional benefits should the event occur?

If the answer is **YES** to all of these questions:

**General insurance contract**

If the answer is **NO** to any of these questions:

**Not a general insurance contract**
(Exit AASB 1023)
Check against other Australian Accounting Standards