

Accounting Standard

AASB 2005-12

December 2005

Amendments to Australian Accounting Standards

[AASB 1038 & AASB 1023]



Australian Government

**Australian Accounting
Standards Board**

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ISSN 1036-4803

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| Australian Accounting Standard AASB 2005-12 <i>Amendments to Australian Accounting Standards</i> is set out in paragraphs 1 – 15. All the paragraphs have equal authority. |
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PREFACE

Standards Amended by AASB 2005-12

This Standard makes amendments to the following Australian Accounting Standards:

1. AASB 1038 *Life Insurance Contracts*; and
2. AASB 1023 *General Insurance Contracts*.

The ability of entities to claim compliance with IFRSs is not affected by the amendments made by this Standard.

Friendly Societies

AASB 1038, issued in July 2004, applies to life insurance contracts written by friendly societies. The previous version of AASB 1038 (*AASB 1038 Life Insurance Business*) did not apply to friendly societies. Both the current and previous versions of AASB 1038 contemplate that life insurers operating in some overseas markets may have unallocated surplus that is in the nature of “policyholder equity”, because it cannot necessarily be classed as part of shareholder equity or policyholder liability. The Australian Accounting Standards Board (AASB) has concluded that friendly societies face similar issues to those faced by life insurers in some overseas markets.

In November 2005, the AASB issued an Invitation to Comment including a proposal to amend AASB 1038 to acknowledge that friendly societies may have unallocated surplus that is in the nature of “policyholder equity”.

The majority of respondents supported the proposal to amend AASB 1038.

Commentary on Investments

The AASB considered the commentary in AASB 1038 and AASB 1023 *General Insurance Contracts* in relation to the treatment of investments in jointly controlled entities and associates in consolidated financial statements. The AASB agreed that some of the commentary implies a particular treatment that may not be compatible with AASB 127 *Consolidated and Separate Financial Statements*. The AASB concluded that the commentary in paragraphs 10.7.3 of AASB 1038 and 15.5.3 of AASB 1023 should be deleted.

In November 2005, the AASB consulted its Insurance Project Advisory Panel proposing the deletion. The majority of members supported the deletion.

Main Features of this Standard

Application Date

This Standard is applicable to annual reporting periods ending on or after 31 December 2005 with early adoption permitted for annual reporting periods that begin on or after 1 January 2005 and end before 31 December 2005.

Main Requirements

This Standard acknowledges that friendly societies may have unallocated surplus that is in the nature of “policyholder equity”.

ACCOUNTING STANDARD AASB 2005-12

The Australian Accounting Standards Board makes Accounting Standard AASB 2005-12 *Amendments to Australian Accounting Standards* under section 334 of the *Corporations Act 2001*.

Dated 8 December 2005

D.G. Boymal
Chair – AASB

ACCOUNTING STANDARD AASB 2005-12 *AMENDMENTS TO AUSTRALIAN ACCOUNTING STANDARDS*

Objective

1. The objective of this Standard is to make amendments to:
 - (a) AASB 1038 *Life Insurance Contracts*; and
 - (b) AASB 1023 *General Insurance Contracts*.

Application

2. **This Standard applies to:**
 - (a) **each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act;**
 - (b) **general purpose financial reports of each reporting entity; and**
 - (c) **financial reports that are, or are held out to be, general purpose financial reports.**
3. **This Standard applies to annual reporting periods ending on or after 31 December 2005.**
4. **This Standard may be applied to annual reporting periods beginning on or after 1 January 2005 that end before 31 December 2005. An entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act may apply this Standard to such annual reporting periods when an election has been made in accordance with subsection 334(5) of the**

Corporations Act. When an entity applies this Standard to such an annual reporting period, it shall disclose that fact.

Amendments to AASB 1038

5. Paragraph 4.1.2 is amended to read as follows:
 - 4.1.2 Equity in a shareholder-owned life insurer will generally comprise only shareholder equity. Although participants in the industry commonly refer to “policyholder retained profits”, in relation to Australian business such amounts are unvested policyholder benefits liabilities. Under Australian legislation, “policyholder retained profits” relating to Australian *life insurance business* are paid to policyholders, although the timing of the payment is at the discretion of the life insurer. A life insurer may have unallocated surplus that is in the nature of “policyholder equity” if it is a friendly society or has foreign life insurance operations in a jurisdiction that permits retained profits to remain unallocated between policyholders and shareholders, and the policyholders’ component has yet to be determined. A key factor in evaluating the classification as liability or equity of retained profits in a friendly society is the benefit fund rules of each particular benefit fund. If the rules of a benefit fund were such that all retained profits by default are for the benefit of policyholders, such retained profits would be classed as policyholder benefit liabilities.

6. Paragraph 9.2.2 is amended to read as follows:
 - 9.2.2 It is sometimes argued that the discretionary nature of participating benefits means that they should be treated as appropriations of profit in the same way as dividends to shareholders. Because life insurance liabilities relating to all types of policyholders are recognised as liabilities under the *Life Insurance Act* (excluding some contracts issued by friendly societies), it is appropriate for the participating benefits vested in relation to the reporting period, other than transfers from unvested policyholder benefits liabilities, to be recognised as expenses of the reporting period.

7. Paragraph 10.5 is amended to read as follows:

10.5 Investments in associates that:

 - (a) **are defined by AASB 128 *Investments in Associates*;**

...

8. Paragraph 10.6 is amended to read as follows:

10.6 Venturers' interests in jointly controlled entities that:

(a) **are defined by AASB 131 *Interests in Joint Ventures*;**

...

9. Paragraph 10.7.3 is deleted and a note added as follows:

10.7.3 [Deleted by the AASB]

10. Paragraph 17.5.2 is amended to read as follows:

17.5.2 A life insurer that has issued participating business may have "retained profits" generated from that business. In relation to Australian participating policyholders, these "retained profits" are liabilities in accordance with the Life Insurance Act. However, in friendly societies or foreign life insurance operations, "retained profits" may exist which have yet to be allocated between policyholders and shareholders. Such "retained profits" are separately disclosed. It is relevant to note that "retained profits" directly attributable to shareholders may reside in both statutory funds and a shareholder fund.

11. Paragraph 17.5.3 is amended to read as follows:

17.5.3 Where, in friendly societies or foreign life operations, "retained profits" exist, which have yet to be allocated and which are treated as equity then the insurer applies paragraphs 17.5.4 and 17.5.5 to this participating business.

12. Paragraph 17.5.4 is amended to read as follows:

17.5.4 Where a life insurance contract with a discretionary participation feature is issued by a friendly society or foreign life operation, the issuer of such a contract:

- (a) may, but need not, recognise the guaranteed element separately from the discretionary participation feature. If the issuer does not recognise them separately, it classifies the whole contract as a liability. If the issuer classifies them separately, it classifies the guaranteed element as a liability;
- (b) shall, if it recognises the discretionary participation feature separately from the guaranteed element, classify

that feature as either a liability or a separate component of equity. This Standard does not specify how the issuer determines whether that feature is a liability or equity. The issuer may split that feature into liability and equity components and shall use a consistent accounting policy for that split. The issuer shall not classify that feature as an intermediate category that is neither liability nor equity;

- (c) may recognise all premiums received as revenue without separating any portion that relates to the equity component. The resulting changes in the guaranteed element and in the portion of the discretionary participation feature classified as a liability shall be recognised in profit or loss. If part of the entire discretionary participation feature is classified in equity, a portion of profit or loss may be attributable to that feature (in the same way that a portion may be attributable to minority interests). The issuer shall recognise the portion of profit or loss attributable to any equity component of a discretionary participation feature as an allocation of profit or loss, not as expense or income (see AASB 101 *Presentation of Financial Statements*);
- (d) shall, if the contract contains an embedded derivative within the scope of AASB 139, apply AASB 139 to that embedded derivative; and
- (e) shall, in all respects not described in paragraphs 14-20 of AASB 4 and paragraphs 34(a)-(d) of AASB 4, continue its existing accounting policies for such contracts, unless it changes those accounting policies in a way that complies with paragraphs 21-30 of AASB 4.

13. Paragraph 17.5.5 is amended to read as follows:

17.5.5 The requirements in paragraph 17.5.4 also apply to a life investment contract issued by a friendly society or foreign life insurer that contains a discretionary participation feature. In addition:

- (a) if the issuer classifies the entire discretionary participation feature as a liability, it shall apply the liability adequacy test in paragraph 8.6 to the whole contract (i.e. both the guaranteed element and the discretionary participation feature). The issuer need not determine the amount that

would result from applying AASB 139 to the guaranteed element;

- (b) if the issuer classifies part or that entire feature as a separate component of equity, the liability recognised for the whole contract shall not be less than the amount that would result from applying AASB 139 to the guaranteed element. That amount shall include the intrinsic value of an option to surrender the contract, but need not include its time value if paragraph 2.2.2 exempts that option from measurement at fair value. The issuer need not disclose the amount that would result from applying AASB 139 to the guaranteed element, nor need it present that amount separately. Furthermore, the issuer need not determine that amount if the total liability recognised is clearly higher; and
- (c) although these contracts contain financial instruments, the issuer may continue to recognise the premiums for those contracts as revenue and recognise as an expense the resulting increase in the carrying amount of the liability, subject to the requirements of paragraphs 5.1 and 5.2.

Amendments to AASB 1023

14. Paragraph 15.5 is amended to read as follows:

15.5 When preparing separate financial statements, those investments in subsidiaries, jointly controlled entities and associates:

- (a) **that are defined by AASB 127 *Consolidated and Separate Financial Statements*, AASB 128 *Investments in Associates* and AASB 131 *Interests in Joint Ventures*;**

...

15. Paragraph 15.5.3 is deleted and a note added as follows:

15.5.3 [Deleted by the AASB]