



Treasury

AASB2022-Y Sub 1

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Dr Keith Kendall
Australian Accounting Standards Board
PO Box 204
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VICTORIA 8007

Dear Keith,

Comments on Fatal-Flaw Review Version AASB 2022-Y Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector [AASB17 & AASB 1050]

The Heads of Treasuries Accounting and Reporting Advisory Committee (HoTARAC) thanks you for the opportunity to respond to the *Fatal-Flaw Review Version AASB 2022-Y Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector [AASB17 & AASB 1050]*. The provision of additional guidance to the public sector is beneficial to a consistent and conceptually sound approach to financial reporting for all sectors.

This represents an important milestone in what has been an extensive consultation process by the AASB. HoTARAC acknowledges the extensive work of AASB and its staff in considering the feedback from HoTARAC and its members over the course of the project.

We do not have any additional comments to make on this Fatal-Flaw Review, except for a couple of minor typos in para E33 and E37 (references should be made to “paragraph E8” instead of “paragraph E7”).

If you require any further information or explanations, please contact Anna Tong from NSW Treasury by email to anna.tong@treasury.nsw.gov.au in the first instance.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Stewart Walters'.

Stewart Walters
Chair
Heads of Treasuries Accounting and Reporting Advisory Committee
11 November 2022

**Response
AASB17 Fatal-
Flaw Review**

November 2022



Commercial in Confidence

Executive Summary

This paper is in response to the Australian Accounting Standards Board’s (AASB) request for comments on the Fatal-Flaw Review in respect of amendments to AASB 17 *Insurance Contracts* and AASB 1050 *Administered Items* for the public sector.

Background

The AASB introduced the Australian Accounting Standard 17 Insurance Contracts (AASB17) in May 2017 with an effective date of 1 January 2023. It is not currently applicable for the public sector.

The Australian Accounting Standards Board (AASB) issued a Fatal- Flaw Review for amendments to AASB 17 *Insurance Contracts* and AASB 1050 *Administered Items* 11 November 2022 (Appendix A). The intent of the proposed amendments appears to be the uniform application of AASB 17 on all insurance and ‘insurance like’ public sector schemes.

The principle of the AASB17 is to ensure that insurance and insurance like arrangements are accounted for as insurance contracts. The purpose of an insurance contract is the indemnification for a loss resulting from a specified event.

Compensation Schemes established and managed by icare are not designed for the indemnification of loss, they are social benefit structures designed to ensure that the people of New South Wales are supported as a result of disability or injury resulting from either exposure to Dust or injury from a motor vehicle.

These schemes are social benefit schemes akin to the NDIS and Medicare not insurance arrangements.

The fatal flaw version of the standard continues to put at risk social benefit schemes that are akin to Medicare and NDIS which are currently accounted for under AASB137. The consequence of the introduction of a risk adjustment for these arrangements would require funding to be increased to account for the higher level of assets that are required to be held. These requirements are indicatively: -

Scheme	Impact
Lifetime Care and Support Fund	\$1.7 billion at a PoA of 75%
Motor Accident Benefits Fund	\$0.14 billion at a PoA of 75%

The inclusion of the risk adjustment will have an adverse impact on the funding required by the schemes which will result in either Government funding redirected that could be used for the

betterment of the NSW economy or an increase in the levies imposed on motorists or employers being held in deposit to meet the requirements of the new accounting standard.

This \$1.84 billion could be used for essential services necessary for the ongoing running and development of the State, such as building more schools and hospitals. Locking this away to comply with an accounting standard could not reasonably be considered in the public interest or in the best interests of the Australian economy.

Our initial estimates suggest that CTP Insurers in NSW will have to increase the annual CTP levy by approximately \$425 per car to fund the risk adjustments should Lifetime Care have to comply with the requirements of AASB 17. The above cost increase will put significant pressure on household budgets, particularly in an environment where inflation and interest rates are increasing relative to real wages. This will also significantly impact NSW community's ability to recover from the economic impacts of COVID.

Scope

The amendments provide the factors to consider for identifying arrangements that fall within the scope of AASB 17 in a public sector context.

Enforceability of the arrangement

An insurance contract is defined as one party accepting significant insurance risk from another party by agreeing to compensation for a specified future event. Where an arrangement is not enforceable then there is no agreement to accept any risk.

Within the public sector there are arrangements that should not be defined as an insurance contract. The key principles that should be included in sections E11-E13 to demonstrate that there is no enforceable arrangement, and therefore no insurance contract, are the ability: -

- Unilaterally change pricing
- Unilaterally change eligibility
- Unilaterally change benefits

Change of Pricing

A public sector arrangement that can unilaterally set the pricing of the levies that it charges are indicative of a social benefit. Where the public sector entity calculates the "pricing" of levies based on cumulative funding requirements as opposed to pricing based on the prospective cover and "risk" being provided demonstrates that there is no insurance risk transferred.

Change of Eligibility

Eligibility criteria that can be changed in a public sector arrangement is indicative that there is no transfer of insurance risk and therefore no enforceable arrangement. Eligibility criteria is a critical principle as it demonstrates that there no agreement, or enforceability, for transferring the risk for a specified future event. For example, where eligibility criteria are extended or reduced through the issuing of the criteria it is indicative that the public sector entity has unilateral discretion on what is covered under the scheme. This is akin to the Medicare scheme arrangements where benefits are extended or reduced at the government's discretion.

Change of Benefits

Where a public sector arrangement can alter the benefits provided under the arrangement for historical and future events there is no enforceable agreement and no insurance contract. This can be demonstrated through the issuance of guidelines that are able to be revised and reissued by the public sector arrangement. This ability to deny/change benefits provides should be clear that there is no enforceable arrangement.

Identifiable Coverage Period

The identifiable coverage period paragraphs included in E14 to E19 results in unintended outcomes for arrangements that do not have coverage periods.

A levy that is changed via a private insurance contract does not establish a coverage period; it is merely a funding mechanism used for expedience. There is not a nexus between the policy issued privately and the levy charged by the public sector.

Similarly, the connection to the financial year is an arbitrary period for the schemes and does not establish a coverage period.

More appropriately, the standard should expand the indicators listed in E18 that where entry into the scheme is based on eligibility criteria. Schemes such as the Lifetime Care Scheme provide benefits based on criteria rather than the receipt of a levy. This principle is established for Medicare, as the Medicare levy does not create a coverage period for the year it was charged through the taxation system nor is it a requirement for benefits.

E18 should be extended to include arrangements where eligibility criteria are the critical factor, especially where the receipt of a levy is not a factor in acceptance.

Similarity of Risks and benefits provided

Similarity of risks and benefits is too broad. Where the market is only serviced by public sector arrangements, such as catastrophic injuries, then the extending to generic personal injury cover is not appropriate. It is clear these schemes are for social benefit as the risk is uninsurable. This aligns with social benefits such as Medicare.

Other items

Accounting Policy Choice

The amendments that allow public sector arrangements to have an accounting policy choice to measure liabilities for remaining coverage applying the premium allocation approach.

Icare supports the accounting policy choice.

Onerous Contracts

The amendments relating to the exemption from sub-grouping onerous versus non-onerous contracts at initial recognition.

Icare supports the relief from sub-grouping for onerous and non-onerous contracts.

Annual Cohorts

The amendments relating to the exemption from sub-grouping contracts issued no more than a year apart.

Icare supports the relief for the subgrouping of annual contracts.

Initial Recognition of onerous contracts

The amendment to the initial recognition requirements so that they do not depend on when contracts become onerous.

Icare supports the relief from initial recognition requirements when contracts become onerous.

Guidance on coverage periods

Guidance on coverage periods in a public sector context, which has consequences for determining the cash flows used to measure insurance liabilities and the pattern of revenue recognition.

Icare comments on coverage periods are included in the identifiable coverage period response above.

Effective Date

The deferral of the effective date of AASB 17 to annual reporting periods beginning on or after 1 July 2025.

Icare supports the effective date to annual reporting periods beginning on or after 1st July 2025.

AASB1050

Amendments to permitting a choice of Standard for administered items.

Icare supports the choice of standard for administered items.



9 November 2022

Dr Keith Kendall
 Chair
 Australian Accounting Standards Board
 PO Box 204
 Collins St West Victoria 8007
 AUSTRALIA

Dear Dr Kendall

Fatal Flaw Review Version – AASB 2022-Y – Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on Fatal Flaw Review Version – AASB 2022-Y – *Amendments to Australian Accounting Standards – Insurance Contracts in the Public Sector*. The views expressed in this submission represent those of all Australian members of ACAG.

ACAG appreciates the Australian and New Zealand Accounting Standards Boards' efforts to propose public sector-specific modifications to AASB 17 *Insurance Contracts* to facilitate the application of this standard by public sector entities with insurance and insurance-like arrangements.

ACAG supports the Fatal Flaw Draft and has raised important matters below which we believe should be included in the final standard to help ensure consistency and comparability of financial statements across like public sector entities.

Illustrative examples

ACAG has reviewed the 21 September 2022 Board papers and notes the Board's intention (for example staff paper 4.5) to develop education material to support implementation of the amending standard.

ACAG would like to express support for developing illustrative examples that accompany the amending standard to help provide greater clarity and consistency in the accounting treatment across like public sector insurance arrangements.

Arrangements where the premium is not paid directly by the policy holder

Some public sector arrangements are funded by levies on insurance contracts, where there is not a direct link between the premium paid and the beneficiary. These include lifetime care and nominal defendant schemes that support people that sustain serious and substantial injuries. For example:

- National Injury Insurance Scheme, Queensland (NIISQ) – a person is covered under this scheme even if the driver is unlicensed, or the car is not registered. Persons paying the levy may benefit from the scheme (because the damaged parties cannot seek additional compensation from them by other means), however there will also be persons benefiting from the scheme that have not paid the levy.
- Nominal Defendant (Queensland) – this scheme is set up to compensate people who are injured as a result of the negligent driving of unidentified and/or uninsured motor vehicles. Therefore, the damaged party has not paid the levy, and the person driving (who is uninsured) has not paid the levy.

ACAG supports the AASB's efforts to provide guidance on this issue through the inclusion of paragraph E22 in the Fatal Flaw Draft. However, ACAG believes that this guidance alone will not fully clarify this matter. While the guidance in paragraph E22 refers to an indirect link between the person paying the levy and the person receiving the benefit, there is still a link to the person paying the levy. Determining the point at which this link becomes too remote or is too indirect for the arrangement to fall within the scope of AASB 17 will require significant judgment. ACAG has concerns that, even with additional guidance, there may be inconsistencies in accounting for these types of arrangements. ACAG, therefore, strongly supports the development of illustrative examples that demonstrate how these arrangements would be assessed against the scope indicators in AASB 17, including identifying key factors that influence this assessment.

On the assumption that arrangements where the policyholder is not required (directly or indirectly) to pay a premium or levy could be in-scope, ACAG requests that the AASB provide guidance on the revenue recognition by the insurer of the levy (a levy is assumed given the lack of direct benefit). In particular, it appears that the insurer entity cannot compel the policyholder (defined under AASB 17 as a party that has a right to compensation under an insurance contract if an insured event occurs) to pay the levy, and therefore the levy is not within the contract boundary (AASB 17 paragraph 34).

The above situation also raises the issue of whether the premium allocation approach can be used if there is no premium / levy enforceable under the insurance contract (refer to paragraphs BC59 and BC196 of the Fatal Flaw Draft).

Building construction warranties

Public sector arrangements that relate to issuing building construction warranty insurance often will include a multi-year (e.g., 6 year) warranty period, but the related construction activity will be over a significantly shorter period of time. An illustrative example that clarifies how the coverage period is determined for these arrangements would help to clarify the impact. For example, does the coverage period (of the insured event) extend to the end of the warranty period (the insured event being the identification of the fault) or is it the period of construction (the insured event being the faulty construction of the project which is likely to be less than 12 months)?

For example, under the Queensland Home Warranty Scheme (run by the Queensland Building and Construction Commission (QBCC)) notices of cover are issued for individual work projects and premiums are linked to the value of the individual work projects. Coverage is provided to protect against contractor failure to complete a given contract for residential work or failure to rectify defective work arising from the individual work project. There are certain limitations and restrictions, for example limitations to the notification of defects – non-structural defects of six months and structural defects of six years and six months. Under these arrangements, it appears that the insured event relates to the construction period for both the failure of the contract to complete the work, and the contractor completing work that contains structural or non-structural defects. Policyholders cannot cancel the insurance contract (say after 2 years) and obtain coverage from another insurer for defects identified for another 4 years.

Risk adjustments

ACAG notes that agenda paper 4.3 from the 3 August 2022 meeting explored risk adjustments in measuring insurance liabilities and believes that this is useful explanatory material and should form part of the Basis for Conclusions accompanying the amending standard.

ACAG acknowledges that some of the material in agenda paper 4.3 is included in the Basis for Conclusions of the Fatal Flaw draft although in less detail than in agenda paper 4.3. We also note that it does not include the content in paragraphs 22(e), 23(b) and 24 of agenda paper 4.3. ACAG believes these paragraphs are particularly relevant as they explain:

- in simple terms whether a public sector entity is likely to have a zero-risk adjustment or will seek to be compensated for bearing risk
- the likely practical outcomes of the explanatory material on risk adjustments for public sector agencies in measuring their liabilities for remaining coverage and liabilities for incurred claims.

In the discussion on industry benchmarks (paragraph BC111 of the Fatal Flaw Draft), ACAG believes that private sector benchmarking higher than 75% is relevant. For example, the staff papers presented at the AASB Board meetings refer to the private sector using risk margins of between 80% to 95% confidence level (probability of adequacy) (paragraph 1.3 of Agenda paper 10.3, April 2021) and between 80% and 90% (paragraph 10 of Agenda Paper 5.3, November 2021). These private sector entities include not-for-profit insurers.

ACAG also suggests that the AASB consider whether a specific reference should be made between risk adjustments for the individual insurance entity, and whole-of-government, as a whole-of-government may be less risk adverse than the individual insurance entity.

Editorial

ACAG suggests that paragraph BC74 could be improved by including an example. For example, an insurance policy is issued in March X1 to cover private sector insurance entity March X1 to following February X2, but to cover public sector entity costs July X0 to June X1. ACAG has previously included a request to provide guidance on the recognition of revenue by the public sector entity.

ACAG appreciates the opportunity to comment and trusts you find our comments useful.

Yours sincerely



Margaret Crawford
Chair
ACAG Financial Reporting and Accounting Committee