



Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
Collins Street West VIC 8007

via submission portal: <https://www.aasb.gov.au/current-projects/open-for-comment>

27 May 2022

Dear Keith

RE: Exposure Draft 319 *Insurance Contracts in the Public Sector* (“ED 319”) and AASB 2022-X *Amendments to Australian Accounting Standards – Insurance Contracts: Consequential Amendments for Public Sector Entities* (“Fatal-Flaw Review Draft”)

I am responding to your invitation to comment on Exposure Draft 319 and the Fatal-Flaw Review *Draft* on behalf of PwC.

We welcome that the Board is aiming to address some of the unique complexities in applying AASB 17 Insurance Contracts to public sector entities, including the possible need for modifications to facilitate that application. We support the AASB’s proposals. We are of the view that it would be beneficial to have similar public sector arrangements accounted for under a consistent standard, rather than the current approach where some are accounted for under AASB 137 and others AASB 1023. We encourage the AASB to include the heads of treasury and relevant auditor generals, in their deliberations, to ensure the standard can be applied consistently and efficiently within the sector.

Our detailed feedback on the specific questions the Board has raised is provided in the appendix to this letter. We have appreciated the opportunity to discuss our firm views with the AASB team. For further discussion please reach out to Scott Hadfield, Sean Rugers or myself.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Regina Fikkers', written in a cursive style.

PricewaterhouseCoopers, ABN 52 780 433 757
One International Towers Sydney, Watermans Quay, Barangaroo NSW 2000, GPO BOX 2650 Sydney NSW 2001
T: +61 2 8266 0000, F: +61 2 8266 9999, www.pwc.com.au

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Regina Fikkers
Partner

Appendix

Comments on ED 319

Sub-grouping of contracts

- 1) *Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are onerous or non-onerous at initial recognition in a public sector context? Please provide your reasons.*

We agree with the proposed amendments on the basis that many public sector contracts, particularly those where there are no private sector competitors, are not profit orientated entities and determine pricing with the aim to break even over the longer term. We also note that since investment returns will exceed risk free rates on an expected basis, most, if not all, groups of contracts will be onerous.

- 2) *Do you agree with the proposal to not require the sub-grouping of contracts based on whether they are issued more than a year apart in a public sector context? Please provide your reasons.*

Agree with the proposed amendments. The key risks of a public sector entity are ensuring ongoing viability and funding, with less of a focus on an individual product or individual year group profitability.

Initial recognition when contracts are onerous

- 3) *Do you agree with the proposal to amend the AASB 17 initial recognition requirements in a public sector context to not depend on when contracts become onerous? Please provide your reasons.*

We agree with the proposed amendments. Practically it will ensure the standard is easier to apply where onerous contracts are more prevalent and enable recognition over the coverage period rather than “front end loading” many arrangements.

We have talked to the AASB team about the basis for conclusion including information about the difference between significant new policy directions such as the creation of NDIS which may be mentioned in an entity’s disclosures. This type of disclosure is already prompted in requirements for contingent liability disclosures. Versus regular renewal of monthly arrangements which are expected



to be onerous each month, and would be covered by this practicality exemption within AASB 17 for public sector which we support.

Determining contract boundaries, coverage periods and eligibility for the premium allocation approach (PAA)

- 4) *Do you agree with the proposed guidance on coverage periods, which would impact on applying the eligibility criteria for using the premium allocation approach (PAA) in a public sector context? In particular, do you agree with the proposals to provide guidance that:*
- a) *assessing a public sector entity's practical ability to fully price for risks or benefits would include assessing the ability of its controlling government, and any relevant Minister(s), to decide on pricing or benefits;*
 - b) *a public sector entity's monopoly position in providing coverage for risks in a particular community, of itself, would not affect the entity's practical ability to fully price for risks or benefits;*
 - c) *any legislated obligation for a public sector entity to stand-ready to insure future policyholders, of itself, is not an obligation that would affect the practical ability to fully price for risks or benefits;*
 - d) *arrangements would not be regarded as failing to meet the criterion in AASB 17 paragraph 34(b)(ii) simply because premium pricing for coverage up to the date when the risks are reassessed takes into account:*
 - (i) *risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits using a medium to long term view; and/or*
 - (ii) *a broad government policy framework that includes considering general economic circumstances and community needs.*

Please provide your reasons.

We agree with the proposed amendments.

In the absence of the proposed guidance, some contracts may be viewed as having an indefinite term. Measuring such contracts as indefinite may not be practical and could result in misleading or inaccurate information being included in the financial statements.

Additionally, public sector insurers take a longer-term approach to pricing. Determining the contract boundary for public sector insurance contracts, in accordance with AASB 17.34(b)(ii) would require significant judgement and could result in frequent revisions in the original assessment made.

- 5) *Do you agree with the proposals to:*
- a) *require disclosure of information about the nature of the pricing process, including:*
 - (i) *the manner in which pricing/benefits are determined;*
 - (ii) *the timeframes for which they are typically determined; and*



- (iii) *any other relevant constraints under which an entity operates;*

when a public sector entity takes into account risks that relate to periods after the reassessment date based on having a policy of determining prices and benefits over a period longer than a single coverage period; and

- b) *permit the disclosure to be located either:*
 - (i) *in the notes to the financial statements; or*
 - (ii) *by reference to an authoritative source that is available to users of the financial statements on the same terms as the financial statements and at the same time?*

Please provide your reasons.

We agree in principle to the disclosure objectives achieved via disclosing the nature of the pricing processes and being able to refer to other authoritative sources. The basis of conclusions may need to alleviate concerns and clarify the intention is not to require highly sensitive information where there is public versus private entities competing, but rather to have a better understanding of the entity or industry and how it operates.

Risk adjustment

- 6) *The AASB is proposing no modifications to the AASB 17 requirement for a risk adjustment that reflects the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk.*

In contrast, the NZASB is proposing a modification to require a risk adjustment that reflects an amount that is estimated to achieve a 75 per cent confidence level for a liability for incurred claims, which can be rebutted.

- a) *Do you support:*
 - (i) *the AASB approach of not modifying AASB 17 regarding the risk adjustment requirement; or*
 - (ii) *the NZASB approach of specifying a rebuttable presumption that a risk adjustment reflecting an amount that is estimated to achieve a 75 per cent confidence level is included when measuring a liability for incurred claims?*

Please provide your reasons.

- b) *Do you have a suggested alternative approach? If so, please outline the approach and provide supporting reasoning?*



We do not disagree with the AASB proposal for not modifying the AASB 17 requirement for a risk adjustment. There is inherent risk in estimating these future cashflows and a risk adjustment acknowledges this.

While pragmatically we can see how a 75 per cent confidence level can be justified, as this is a principals based standard, we are not of the view a particular per cent should be legislated in the accounting standard. Significant judgement would need to be applied by public sector entities to determine the level of compensation they require for bearing the risk of uncertainty associated with liabilities for incurred claims. In the private sector risk adjustments have trended over time towards consistency. Guidance from APRA as to how they consider risk has also assisted this trend. We would encourage as part of the implementation process for the Heads of Treasury Accounting and Reporting Advisory Committee (HOTORAC) to do the analysis at the HOTORAC level and adopt something like the NZAB approach as part of their implementation process as it would provide for all public sector entities to:

- 1) have a consistent approach based on a common confidence level,
- 2) reduce report preparation costs by removing the need for management and auditors to determine/assess risk adjustments, and
- 3) better illustrate the impacts of any changes in risk adjustments, which provides useful information about changing levels of uncertainty about the amount and timing of cash flows over time.

Insurance contract indicators

- 7) *The Boards propose that the public sector arrangements to which AASB 17 should apply would be identified based on a collective assessment of the following proposed indicators:*
 - a) *similarity of risks covered and benefits provided;*
 - b) *identifiable coverage;*
 - c) *enforceable nature of arrangement;*
 - d) *source and extent of funding;*
 - e) *management practices and assessing financial performance; and*
 - f) *assets held to pay benefits.*

Do you agree with these proposed indicators? If you disagree with the proposed indicators, which of them would you exclude?

We do not disagree with the AASB's approach towards identifying arrangements to which AASB 17 should apply to through a prescribed set of indicators.



Some indicators are more important than others. Indeed, some are necessary to make the application operational - such as having an enforceable arrangement and identifiable coverage, whereas others might rank equally and others such as e) and f) be possible indicators.

We do note that indicators e) and f) may lead to unintended outcomes such as an underfunded entity or one poorly managed not then applying the requirements of the standard.

The indicators do need to be grounded in the definition of insurance risk, to enable new types of insurance to be included over time. More guidance/examples would be valuable for consistent application.

- 8) *Whether or not you agree or disagree with some or all of the indicators, do you have suggested alternatives or additional indicators? If so, please outline those indicators and provide supporting reasoning*

We have not uncovered better alternative indicators.

- 9) *The proposed paragraph AusB16.2 requires that the indicators outlined in paragraphs AusB16.3 to AusB16.25 are considered collectively so that a balanced judgement can be made. The Boards considered that the proposed indicators should not be ranked or be assigned a relative significance because their relative significance is expected to depend on the circumstances. Do you agree with not assigning a relative significance to the indicators or having any other form of ranking approach to indicators? If you disagree:*
- a) *which indicators would you identify as being most significant, or how would you otherwise rank the indicators, and why?*
 - b) *would you identify some indicators as pre-requisites for applying AASB 17 and, if so, which ones, and why?*

In response to 9 (a), we please see the list of indicators arranged in the descending order of importance.

- 1) Enforceable nature,
- 2) Identifiable coverage,
- 3) similarity of risks and benefits
- 4) source and extent of funding
- 5) management practices,
- 6) assets held.

Out of the indicators above, we consider the 'Identifiable coverage period' and the 'enforceable nature' to be pre-requisites for applying AASB 17.



Application date

- 10) *Do you agree with the proposed mandatory application date for public sector entities of annual periods beginning on or after 1 July 2025, with early application permitted? If not, what alternative application date would you suggest? Please provide your reasons.*

We do not disagree with the proposed mandatory application date. However, from our interactions with some of the Public sector insurers, it was evident that the field testing they had performed up to now on the implementation of the new Standard had yielded ambiguous results needing consideration and that the Standard would have a significant impact on their current scope of activities. Much resource is also being utilised in the private sector implementation, reducing capacity available. Given this situation, the Board should continue to monitor the application date over time.

Other modifications

- 11) *Do you consider there should be any further modifications to AASB 17 in respect of public sector arrangements? If so, what modifications would you suggest and on what basis would you justify them? Please provide your reasons.*

Nothing additional to add.

General matters for comment

- 12) *Whether there are any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the proposals, including Government Finance Statistics (GFS) implications?*
- 13) *Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?*
- 14) *Whether, overall, the application of AASB 17, modified as proposed, would result in financial statements that would be useful to users?*
- 15) *Whether the proposals are in the best interests of the Australian economy?*

Nothing further to add.



16) Unless already provided in response to specific matters for comment above, the costs and benefits of the application of AASB 17, modified as proposed, relative to the current requirements, whether quantitative (financial or non-financial) or qualitative?

No further comments.

Other comments on the ED

Drafting/editorial suggestions

We have summarised our editorial and drafting suggestions in the table below. Note that the wording that is subject or relevant to the corresponding comment has emphasis added and is underlined.

Paragraph ref.	Wording involved	Comments/remarks
Aus34.1	a public sector entity's monopoly position in providing coverage for risks in a <u>particular community</u> , of itself, would not affect the entity's practical ability to fully price for risks or benefits; and	Should this wording perhaps explain how a "particular community" is defined?
AusB16.20	The lower is the proportion of a public sector entity's funding to meet benefits that is received in exchange for accepting risks from those who stand to benefit, the less likely is it that those arrangements would be accounted for as insurance contracts. For example, <u>a co-payment</u> that is intended to help ration services and is not intended to fully fund services is unlikely to indicate that arrangements would be accounted for as insurance contracts.	Should this wording be clarified to indicate that this co-payment is specifically from the policyholder?

Matters related to the proposed amendments

We have summarised our comments on the ED that are not covered by any one particular question or areas where further clarification might be needed in the table below. Note that the wording that is subject or relevant to the corresponding comment has emphasis added and is underlined.

Paragraph ref.	Wording involved	Comment
AusB16.10	An insurance contract has an identifiable coverage period – either the period during which insured events occur (losses-occurring coverage) or the period during which claims become known (claims-made coverage). The coverage period might be	Consider discussing to what extent the insurer has to infer a term from a contract. One of the key characteristics of most insurance contracts is a defined term. Even for a product such as an ADC (Adverse

	explicitly stated in the contract or <u>otherwise be determinable from the terms of the contract.</u>	Development Cover) , where the term ends on the occurrence of a specified event in the future.
AusB16.15	<p><i>Enforceable nature of arrangement</i></p> <p>...</p> <p>Conversely, when a public sector entity or its controlling government has the practical ability under existing or substantively enacted legislation to retrospectively deny or change promised benefits or compensation, it indicates that an arrangement is not enforceable. <u>For example, if an entity can retrospectively change the amount of benefits or compensation being paid to a beneficiary in relation to a past event under existing legislation, this is an indicator that the arrangement would not be accounted for as an insurance contract.</u></p>	Consider whether there could be any unforeseen circumstances where insurers may rely on this example to justify scoping certain schemes/contracts out of AASB 17 scope.
AusB16.21	<p>Under most general insurance contracts issued by private sector insurers, in the event that a policyholder cancels its coverage prior to the end of the coverage period, the policyholder would ordinarily receive a pro rata premium refund, possibly adjusted for administrative costs. Although not all contracts issued by private sector insurers allow for refunds, the practice is indicative of insurance contracts. Accordingly, a public sector entity arrangement that allows for a refund of premium when the policyholder terminates the arrangement early is an indicator that an arrangement would be accounted for as an insurance contract.</p>	Consider clarifying why this factor would distinguish insurance contracts from other service oriented contracts that span over an extended period of time.
AusB16.22	<p>An indicator that an arrangement would be accounted for as insurance contracts would be that the public sector entity has <u>objectives, policies and processes for managing risks associated with those arrangements and has its financial performance assessed against those objectives and how successfully it applies those policies and processes.</u></p>	Similar to the point above, consider clarifying why the factors in bold would distinguish insurers from other service providers of similar nature.

	<p>In that context, the entity would be expected to conduct the following activities (either itself or via outsourcing):</p>	
<p>BC31 (c)</p>	<p>All public sector entities should be exempted from AASB 17/PBE IFRS 17.16; however, require disclosure about the nature of the pricing process, <i>including constraints under which an entity operates to cross-subsidise different policyholder cohorts, that can lead to some groups of contracts being onerous.</i> This might provide additional relevant information about the impact of price constraints on each entity. However, it was acknowledged that the additional disclosure could be a burden and may already be readily available from other sources (although the burden might be mitigated by permitting disclosure by cross-reference).</p>	<p>Consider where this disclosure could be practically challenging if one group of policyholders is cross-subsidising another. The challenge will be in the level of detail required and the sensitivity to policy of the information.</p>