ACAG
AUSTRALASIAN COUNCIL
OF AUDITORS GENERAL

9 November 2022

Dr Keith Kendall
Chair
Australian Accounting Standards Board
PO Box 204
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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