PRICEWATERHOUSECOOPERS

AASB 13-14 April 2005
Agenda paper 8.3

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The Chairman
Australian Accounting Standards Board
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4 April 2005

Invitation to comment on "Liability Adequacy Test in AASB 1023 *General Insurance Contracts*" dated March 2005

Dear Chairman,

This letter is in response to invitation to comment on Liability Adequacy Test (LAT) in AASB 1023 *General Insurance Contracts.*

We welcome the AASB's clarification of the Liability Adequacy Test and given the choice of option Option 1 and Option 4 we support the adoption of Option 4 in preference to leaving the LAT component of AASB 1023 unchanged.

Specific matters for comment
We support the decision of the Board to permit LAT to be calculated on an entity basis rather than on a class of business basis.

We support the proposal to permit different probabilities of adequacy (POA) for outstanding claims liability (OCL) and liability for future claims (LFC) where the rationale for a different POA being used has been disclosed in the financial report. We concur with the proposed wording changes in section 9.1.2 however we note that this is not consistent with the wording in section (b) of the Preliminary Conclusions on page 7 of the invitation to comment. Paragraph (b) states that "an entity would often be expected to have the same or similar POA for its OCL and LFC" whereas the wording in paragraph 9.1.2 is "may be the same or similar". The wording in paragraph 9.1.2 is consistent with the description of "Option 4" on page 7 and we suggest that the wording of paragraph (b) be replaced by the following wording "allowing different POA to be adopted in the OCL and LAT, subject to appropriate disclosure."

We welcome the increased clarification in relation to disclosure requirements. We note however that the requirements of paragraph 17.8 (a) are more extensive than the intention of the standard to provide for any deficiency in unearned premium in that disclosure of any surplus is also required.. We support the disclosure requirement to provide details of the calculation of the LAT where it has been determined that the entity has failed the LAT, however, in the circumstance where the entity has passed the LAT we consider that disclosure of the POA used in performing the LAT is sufficient disclosure.

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Disclosure of "surplus" as required by 17.8 (a) (v) is an expansion of the intent of LAT being a provision for unprofitable business and is inconsistent with the requirements of other accounting standards such as AASB 111 Construction Contracts where there is a requirement to recognise expected losses, however there is no requirement to disclose expected future profits. There is also a risk that this disclosure could be misinterpreted by the readers of the financial report as current year profit. The appendix to this letter suggests alternative wording for paragraph 17.8.

We note typographical errors in paragraph 17.1(c) where the references to 17(e)(i) and 17(e)(ii) should refer to 17(b)(i) and 17(b) (ii).

We would be pleased to discuss our views at your convenience. Please contact me directly on 02 8266 7640 if there is any matter you would like me to elaborate further.

Regards

PT Murray

PT Murray
Partner

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APPENDIX

Liability Adequacy Test

17.8 In relation to the liability adequacy test in section 9 the financial report shall disclose:

The probability of adequacy used in performing the calculation and where this probability of adequacy is not the same or similar to the probability of adequacy disclosed in paragraph 17.2(d), the reasons for the difference.

Where, as a result of applying the LAT, the entity recognises a deficiency, the following additional disclosures shall be made::

(a) the amounts underlying the calculation performed, that is:
  (i) unearned premium liability;
  (ii) deferred acquisition costs;
  (iii) intangible assets;
  (iv) present value of expected future cash flows for future claims;
  (v) deficiency ~~***or surplus***~~;

(b) any write-down of deferred acquisition costs under the liability adequacy test;

(c) any write-down of intangible assets under the liability adequacy test;

(d) in relation to the present value of expected future cash flows for future claims:
  (i) the central estimate of the present value of expected future cash flows;
  (ii) the component of present value of expected future cash flows related to the risk margin;
  (iii) the percentage risk margin adopted in determining the present value of expected future cash flows;
  (iv) the probability of adequacy intended to be achieved through adoption of the risk margin; and
  (v) the process used to determine the risk margin, including the way in which diversification of risks has been allowed for.

~~**(e) where the probability of adequacy disclosed in paragraph 17.2(d) is not the same or similar to the probability of adequacy disclosed in paragraph 17.8(d)(iv), the reasons for the difference.**~~