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Our ref ED 319 Insurance Contracts in
the Public Sector(67385756.1)
Contact Leann Yuen (02) 9335 7649
Will Tipping (02) 9455 9120

15 June 2022

Dear Keith

ED 319 Insurance Contracts in the Public Sector

We are pleased to have the opportunity to comment on Exposure Draft 319 *Insurance Contracts in the Public Sector* (ED 319). In light of the significant differences with respect to the nature and purpose of insurance in the public sector, we appreciate the initiative taken by the respective standard-setting boards in Australia and New Zealand to provide a standard intended to facilitate the appropriate accounting for insurance contracts in the public sector. We believe this is necessary to reduce unnecessary costs for preparers while maintaining relevance for users of the financial statements which would also reduce diversity in practice both across and within the two jurisdictions.

Overall, we support the proposals. In our view, the proposed modifications sufficiently reflect the circumstances specific to the public sector that are largely driven by the need to provide social benefits over a long term rather than profitability. As for the proposed indicators for scope determination we would appreciate further consideration by the AASB. As noted in our response in the Appendix attached below, requiring enforceability and coverage period are consistent with the approach previously taken by the AASB in developing the not-for-profit guidance for identifying contracts within the scope of AASB 15 *Revenue from the Contracts with Customers*.

In addition, we encourage the boards to consider what impact the proposed disclosure requirement may have for auditors as otherwise, the reference to materials outside of financial statements could lead to an unintended consequence of increased audit effort.

Please refer to the Appendix for our detailed comments on the specific and general matters for which feedback was requested.



Australian Accounting Standards Board
ED 319 Insurance Contracts in the Public Sector
15 June 2022

We would be pleased to discuss our comments with members of the AASB or its staff. If you wish to do so, please contact Leann Yuen on (02) 9335 7649 or lyuen@kpmg.com.au , Will Tipping on (03) 8663 8032 or w tipping1@kpmg.com.au , or David Ji on (03) 8663 8467.

Yours sincerely

A handwritten signature in blue ink, appearing to read 'Leann Yuen'.

Leann Yuen
Partner

A handwritten signature in blue ink, appearing to read 'Will Tipping'.

Will Tipping
Partner

Enclosures:

Appendix 1: Specific matters for comment



Appendix

Specific matters for comment

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 proposal for the following reasons:

- Objectives of many public sector arrangements are to manage the financial viability of those arrangements over a long term by way of investment returns or some other source of funding rather than via periodic repricing to issue profitable contracts.
- Identification of non-onerous versus onerous contracts unlikely to affect pricing decisions as these decisions are not usually driven by profitability considerations.
- Allowing the unit of account to be at a portfolio level rather than at the lower level of a group as required by AASB 17 would be more compatible with current practice and therefore less burdensome for entities already applying the Liability Adequacy Test for identifying an unexpired risk liability under AASB 1023 General Insurance Contracts.

For clarity, we recommend revising the draft wording in paragraph Aus16.1 to be consistent with that of AASB 17.16. As drafted in the exposure draft, it is not clear whether paragraph Aus16.1 is intended to provide relief from the requirements in AASB 17.16 (which we understand to be the boards' intent) or if it is requiring to sub-group on another basis, i.e., other than those profitability-based criteria stipulated in AASB 17.16.

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.

We agree with the proposal to not require a group of contracts issued no more than a year apart for a similar reason to that outlined in our response to question 1 above, i.e., profitability is not generally considered to be the main focus in the public sector. For this reason, we do not expect the loss of such information as the development of profitability as noted by the IASB in developing the annual cohort requirement to be a cause of concern in a public sector context.

As per our comment on paragraph Aus16.1, we recommend revising the draft wording in paragraph Aus22.1 to be consistent with AASB 17.22, i.e., an entity is permitted to include contracts issued more than one year apart in the same group.



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 proposal to amend the initial recognition requirements. In addition, based on our experience with general insurers in the private sector is that the time lag between policy inception date and coverage start date was in most cases minimal, with the exception of “retroactive” reinsurance arrangements and extended warranties.

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;

We agree with the above proposal because without this modification those public sector entities that do not possess the direct power to reset a price or benefit level would struggle to apply AASB 17.34(a) or AASB 17.34(b)(i). In our view, taking into account the ability of an entity’s controlling entity does not change the substance of the requirement for the practical ability in AASB 17.34.

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;

We agree that an entity’s monopoly position would not affect its practical ability to change a price or level of benefits for a portfolio of contracts.

In our view, an entity’s inability to withdraw from its market, or its obligation to continue providing insurance services ends when the entity or its controlling entity has the practical ability to reprice. Said another way, although the decision to stop coverage may be subject to a legislative change or similar, this in our view would not have a bearing on the determination of the 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;

We agree with the proposed amendment. Refer to our previous comments for Question 4a and 4b as to why we agree.

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.**

We support this proposal to provide relief from paragraph 34(b)(ii) as otherwise, public sector entities would likely fail the practical ability test and end up having to perform insurance liability valuation over very long contract boundaries.

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?**

We agree with the principle that when a public sector entity takes into account risks that relate to periods after the reassessment date, it is appropriate for disclosure regarding how the pricing/benefits are determined and the timeframes for which they are typically determined.

However, we do not agree that this disclosure should be permitted by reference to an authoritative source available to the users of the financial statements on the same terms. Incorporating disclosure that has already been prepared for another authoritative source does not result in undue cost and effort to the preparer. It also does not enhance comparability between public sector entities for the users of the financial statements.

By referring to an authoritative source outside of the financial statements, we also believe it will create additional work for the user, Directors, and auditors.



- Users will have to go to an additional document to understand the pricing, which may not be written in a way the user will understand or how it relates to the entity.
- Directors declare that the financial statements provide a true and fair view, with the information included outside of the financial statements, the Directors will have to consider how to make this statement when the financial statements refer to sources outside of the financial statement.
- Auditors will have to consider the requirements of *ASA 720 The Auditor's Responsibilities Relating to Other Information* and determine what additional procedures may have to be performed to support the audit opinion. This may create an increase in audit fees due to the additional work involved in obtaining and documenting the audit evidence.

We would like to understand the Auditing and Assurance Standards Board's thoughts on this amendment and what they see as the impact to auditors.

For the reasons above, we believe the disclosure should be included in the notes to the financial statements.

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.

The proposed paragraph 37.1 in the NZASB's Exposure Draft states:

37.1 Notwithstanding paragraph 37, for a public sector entity, there is a rebuttable presumption that the compensation the entity requires for bearing the uncertainty about the amount and timing of the cash flows that arises from non-financial risk is an adjustment to achieve a 75% confidence level (that is, a 75% probability of liabilities for incurred claims being adequate to meet actual claims).

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?**



We support the proposed AASB approach of not modifying the risk adjustment as this is consistent with principle-based standard setting. Although NZASB approach of standardising the probability of sufficiency with a rebuttable presumption would make the requirement relatively straightforward to implement, we note that the risk adjustment for non-financial risk as defined and measured under AASB 17 is entity-specific.

Our view of the risk adjustment is that it is “revenue-like in nature” and therefore its information value for many of the public sector entities will not be the same as that for their private sector counterparts, as the approach to pricing the risk in their contracts is different.

We have also considered the fact that for onerous contracts, the risk adjustment increases the insurance liability whereas for profitable contracts the liability does not increase to the extent the difference between future cash inflows and outflows exceeds the risk adjustment. On the other hand, we have considered that the risk adjustment information would be useful from a claims and claims management perspective, which we understand is where users’ focus lies in the public sector. On balance, we support the proposed unamended application of the risk adjustment by the AASB.

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

No, we do not have an alternative approach to suggest.

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 [paragraphs AusB16.1 to AusB16.25]:

- 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?



Our comments on each of the indicators are as follows:

Similarity of risks covered and benefits provided

It would be helpful to reduce ambiguity that could potentially arise when applying this indicator. For instance, an entity concluding that its risks and benefits are not similar to those in the private sector may not necessarily indicate that its arrangements are not an insurance contract for the reason outlined in paragraph BC131 of this ED, i.e., some arrangements that are clearly insurance contracts may be issued exclusively in the private sector. We recommend including such an exception in the revised wording.

Identifiable coverage period

We agree with this indicator. However, see our response to question 9 as to when this indicator should be considered in the assessment

Enforceable nature of arrangement

We agree with this indicator. However, see our response to question 9 as to when this indicator should be considered in the assessment.

Source and extent of funding

We agree that the determination of who pays (source) and how much of the claims expense is funded by premiums (extent) could be useful in assessing whether the arrangement in question is insurance-like as this would ordinarily be a common feature of insurance contracts issued and sold in the private sector.

However, we envisage there may be inconsistency in how this indicator is applied when the funding is provided by both the policyholder and sources other than policyholders. As proposed, there is not a clear indication of what is the tipping point of being / not being an insurance contract when the funding is from a source other than a policyholder. We can see how different interpretations could be applied in determining what would be considered substantive funding by each public sector entity.

Management practices and assessing financial performance

We agree with this indicator. However, based on the current wording of the proposed paragraphs, it is not clear whether presence or absence of the activities described in AusB16.22 (a)-(c) would be the sole determinant factor in assessing this indicator. This is because in the paragraph preceding AusB16.22(a) an entity is required to have objectives, policies and processes in conjunction with a financial performance assessment based on meeting the objectives and how successfully the policies and processes have been applied. In our view, merely conducting the three activities, i.e.,



underwriting and risk management, managing the entity's capital and ensuring a fair and prudent claims management would not, in itself, meet those requirements described in the paragraph preceding AusB16(a).

We would encourage the boards to provide more clarity as to how conducting the specified activities are expected to satisfy whether an entity has objectives, policies and processes for managing risks associated with those arrangements and for its financial performance to be assessed based on how the entity meets those objectives and how successfully it applies those policies and processes.

Assets held to pay benefits

We agree with this indicator.

Additional comment:

In paragraph BC198-BC200 of the exposure draft we note that the boards considered but rejected the idea of providing an explicit guidance by way of identifying specific entities or activities that should be scoped out of AASB 17. However, application paragraphs B26 and B27 of AASB 17 provide examples of contracts which are an insurance contract and those which are not, respectively.

We would encourage the AASB to provide further guidance with regard to whether and how those paragraphs intended for for-profit private sector entities are to be applied by public sector entities. Further, in our view B26 and B27 provide the AASB with an example approach to help drive consistency in interpretation of the scope requirements given current diversity in practice.

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 agree with the indicators that have been identified for determining whether an arrangement is an insurance contract. See our response to question 9 as to when two of the indicators should be considered in the assessment.

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 our view, an insurance contract cannot exist unless the arrangement is enforceable and the period over which the insurance risk is covered is known. We believe this is consistent with identifying a revenue contract in the scope of AASB 15 *Revenue for Contracts with Customers* for a not-for-profit entity. Therefore, a process should be followed similar to the steps required for a not-for-profit entity in determining whether they have an arrangement in the scope of AASB 15, specifically:

- Identify whether there is an enforceable agreement (AASB 17. AusB16.13 - AusB16.16), which is similar to the requirements in AASB 15.F10 – F18; and then
- Identify whether there is a coverage period (AASB 17.AusB16.10 – AusB16.12), which is similar to identifying the period over which the good or services are transferred in identifying sufficiently specific performance obligations in AASB 15.F20(d) and F24.

Once it has been determined that there is an enforceable agreement and there is a known coverage period (i.e., a period the revenue can be recognised over) then we believe the other indicators should be considered collectively to determine whether an insurance contract exists in the arrangement.

Of the remaining indicators we do not think that one is more significant than the other. We see that the application of the indicators is similar to those in other accounting standards, such as the principal vs agent indicators in AASB 15. None of these indicators outweigh the other and are viewed collectively based on the terms and conditions of the contract that is being assessed.

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 agree with the proposed application date. The proposed modifications intended to provide relief would, in our view, significantly reduce the implementation challenges experienced by private sector entities that were largely driven by the need to account for insurance liabilities at an increased level of granularity. Notwithstanding the data and system challenges, the impact of which will be greater for public sector entities coming into the scope of AASB 17 with little or no experience of applying AASB 1023/NZ IFRS 4, we expect the proposed application date would provide sufficient time for those entities to be ready in time to fully operationalise the new standard by 1 July 2025.



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 note that the Boards considered, but rejected, proposing modifications to AASB 17 in respect of public sector arrangements on the following topics:

- a) specifically exempting ‘captive’ public sector insurers from applying AASB 17 in their separate general purpose financial statements [paragraphs BC215 to BC223];**
- b) discounting and inflating requirements applied in measuring insurance liabilities [paragraphs BC224 to BC246];**
- c) the measurement of investments backing insurance liabilities [paragraphs BC247 to BC252]; and**
- d) classification and presentation of risk mitigation program and other similar costs [paragraphs BC253 to BC260].**

We do not have any further modifications to add.

General matters for comment

The AASB would also particularly value comments on the following general matters, to the extent they have not already been provided in response to specific matters for comment above.

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?

We are not aware of any specific issues.

13. Whether the proposals create any auditing or assurance challenges and, if so, an explanation of those challenges?

We do not expect the proposals to create any auditing or assurance challenges, except as indicated in question 5.



14. Whether, overall, the application of AASB 17, modified as proposed, would result in financial statements that would be useful to users?

In our view, the proposed modifications would benefit users as the relevance of the financial statements is expected to be enhanced.

15. Whether the proposals are in the best interests of the Australian economy?

We do not have any specific comments on whether the proposals are in the best interests of the Australian economy.

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? In relation to quantitative financial costs, the Boards are particularly seeking to know the nature(s) and estimated amount(s) of any expected incremental costs, or cost savings, of the proposals relative to the existing requirements (AASB 1023).

We do not have any specific comments on the costs and benefits of the proposals.