

28 February 2018

Ms. Kris Peach
Chair
Australian Accounting Standards Board
PO Box 204
Collins St West Victoria 8007
AUSTRALIA

By email: standard@asb.gov.au

Dear Kris

**Discussion Paper – Australian-specific Insurance Issues -
Regulatory Disclosures and Public Sector Entities**

The Australasian Council of Auditors-General (ACAG) welcomes the opportunity to comment on the discussion paper. The views expressed in this submission represent those of all Australian members of ACAG.

ACAG's comments are primarily in the context of the public sector, which reflects ACAG's significant experience and involvement in the sector.

If the amendments proposed in this discussion paper were to be made to AASB 17, ACAG believes that they would appropriately require all current not-for-profit public sector 'insurance-like' arrangements with economically similar insurance risk to be accounted for on a consistent basis with comparable for-profit insurance contracts. This would ensure there is no understatement of these arrangements' insurance liabilities. ACAG therefore supports the proposed amendments.

ACAG appreciates the opportunity to comment and trust that you will find the attached comments useful.

Yours sincerely



Andrew Greaves
Chairman
ACAG Financial Reporting and Accounting Committee

Specific Matters for Comment

General matters

1. **Do you agree with the objective of the proposed Implementation Guidance to achieve greater consistency of financial reporting across the public sector among entities engaging in insurance activities for the benefit of users of that information? Why or why not?**

Yes, ACAG agrees with the objective and believes consistency of financial reporting for comparable insurance activities is important.

2. **Do you agree with the proposed Implementation Guidance for determining when public sector entities should be required to apply AASB 17 *Insurance Contracts* and will the Guidance achieve its objective of greater consistency of financial reporting? Why or why not?**

Yes, ACAG agrees with the proposals in the implementation guidance that attempt to remove current reporting inconsistencies. The proposal to withdraw current standards' AASB 4 *Insurance Contracts*, AASB 1023 *General Insurance Contracts* and AASB 1038 *Life Insurance Contracts* should ensure a single framework (AASB 17) is achieved to account for all types of insurance contracts.

ACAG has the following comments on certain aspects of the proposed Implementation Guidance:

Funding (Paragraph E14(a), Basis for conclusions BC63 to BC68, Illustrative Examples)

ACAG agrees that AASB 17 should be applied to insurance-like activities, even if the arrangement is not intended to be fully-funded from premiums and levies received. Specifically, ACAG agrees AASB 17 is appropriate when the arrangement is substantially self-funded from premiums and levies.

However, ACAG finds the proposed guidance confusing when the criteria is applied to arrangements that are substantially (or indeed fully) funded through contributions by government. ACAG found the criteria difficult to distinguish from social benefits that are recognised on a 'pay-as-you-go' basis and found that other indicators provided at E14 (e.g. assessment of claims performance) did not help clarify the confusion in the guidance.

ACAG also question how the criteria for an 'insurance-like' arrangement can move from 'necessary' to 'sufficient' as outlined in paragraph E13.

Assessment of claims performance (Paragraph E14(b), Basis for conclusions BC69 to BC73, Illustrative Examples)

ACAG did not consider this criteria useful in distinguishing social benefit type arrangements with insurance-like arrangements. In particular, ACAG felt it could be argued that “regular” reviews, such as for budget forward estimates and for inter-generational reports, that used actuarial assumptions such as population growth, met this criteria. Similarly, it could be argued that such reviews are not frequent enough to meet this criteria.

While the criteria refers to taking action to address any underfunding, this guidance is difficult to apply in circumstances described above, when substantially all the funding is through government contributions.

Similar arrangements in the private sector (Paragraph E14(c), Basis for conclusions BC74, Illustrative Examples)

Example 2

Paragraph IE13 refers to the annual registration fee being prescribed under state legislation. ACAG considers this seems to imply that the simplified approach would be prohibited by paragraph E21(a). This contradicts paragraph IE19 that states the simplified approach is available for application.

General comments on proposed examples

ACAG considers the analysis for each of the examples should not introduce facts that are not in the stated fact pattern. The fact pattern for example 2 should make it clear that the amount of registration fee can be changed.

The analysis in examples 3A and 3B also introduces some facts that are not in the fact pattern. The analysis states that the public sector regulating the DEF arrangement has the ability to reset the premium annually. The fact pattern only states that the amount of the levy is determined by a different public sector entity to the entity that accepts the insurance risk.

3. Are there other forms of Implementation Guidance that would be more likely to achieve the objective of greater consistency of financial reporting for the benefit of users?

No, ACAG is not aware of other forms of implementation guidance that would better achieve the objective of greater consistency.

4. Do you agree the amendments to AASB 17 should apply to both for-profit and not-for-profit public sector entities?

Yes, ACAG supports the amendments to AASB 17 applying to both for-profit and not-for-profit public sector entities.

ACAG requests that the AASB clarify whether or not it believes that the requirements in paragraph E21 are intended to modify AASB 17, as this may result in a for-profit entity not being able to claim compliance with IFRSs. ACAG's view is that paragraph E21 does not override AASB 17 for insurance contracts with premiums. Further, ACAG's view is that other insurance-like arrangements, not being insurance contracts under AASB 17, can be accounted for on a simplified basis and still comply with AASB 17.

Risk adjustment for non-financial risk

5. Do the proposals provide sufficient guidance to determine the risk adjustment factor for non-financial risk? If not, what additional guidance is needed?

No, ACAG suggests further guidance is required to assist in determining the appropriate risk adjustment factor for non-financial risk as the proposals' guidance in this area are limited.

The discussion paper suggests that public sector entities may have different risk adjustment factors to those of the private sector due to the benefits of government guarantees in respect of insurance arrangements (i.e. benefits achieved through taxing powers and monopoly provider status in respect of providing certain insurance/insurance-like arrangements). These benefit characteristics may result in lower risk adjustment factors. ACAG suggests the proposals consider this and provide further guidance on how to determine the risk adjustment factor (also known as 'risk margin') in such circumstances. ACAG also consider it would be useful to include a definition of 'non-financial risk'.

ACAG notes that there currently appears to be significant variation as to how public sector insurance arrangements adjust for the risk margin compared to private sector arrangements. In particular, public sector arrangements often measure claims liabilities at a provision for adequacy at 75% (per APRA capital adequacy requirements) and private sector arrangements use a provision for adequacy at 90% and higher. It is not clear whether these differences are due to factors included in the Discussion Paper, or differences in understanding between the public and private sectors in how to apply the requirement. ACAG suggest the AASB consider whether the public and private sector margins could be aligned.

6. Are there any situations where there might be a risk adjustment factor of zero (refer paragraph BC11)?

ACAG believes the basis for conclusions should be updated to reflect that if there is absolute certainty around the government backing of the best estimate liability then the risk adjustment would be nil. Refer to the State Insurance Regulatory Authority (SIRA) example provided below.

The scenario described in paragraph BC9 is (a) public sector entities have the support of the government in “bad times”, and (b) entities can recover cost overruns in future periods. This arguably in substance describes what happens with some Australian statutory schemes.

The last two sentences in para BC10 seems to be saying that even if paragraph BC9 (b) above applies, a zero risk adjustment would not be appropriate, as the focus is on the current reporting period. Future levies would be the subject of future reporting periods.

From a risk perspective however, paragraphs (a) and (b) mean that any uncertainty related to outstanding claims cash flows from past transactions is effectively passed on to the external parties, even if it does relate to a future period. If this is the case – and the risk adjustment factor is aimed at reflecting uncertainty – it seems incorrect to disregard the impact of being able to adjust levies and benefits in future periods, and to state that a zero risk adjustment would not be appropriate. Note that any decision to change levy rates, would ordinarily be outside the authority of the individual entity (e.g. set by another entity e.g. State Insurance Regulatory Authority (SIRA) – the independent regulator. with SIRA setting rates so that individual schemes are self-funded.)

ACAG believe that in a public sector context, it is important that the circumstances in which a risk margin should be applied, and its size (i.e., a small or large margin) are clear. The guidance should be clear how the ability to change levy rates (or benefits) in the future impacts risk margins under different scenarios. For example, levies can be changed through:

- (i) legislative change,
- (ii) through an independent regulator, without direct legislative change (e.g. in response to an annual independent review which is required by legislation, but which aims for schemes to be fully funded) or
- (iii) at the discretion of the entity.

Determining the contract boundary

- 7. When determining the contract boundary, are there any other instances apart from those illustrated in the examples, where there is no premium or the contract boundary is longer than 12 months, but it would still be permitted to apply the simplified approach under AASB 17? If so, do you agree that all public sector entities should be given an exemption to apply the premium allocation approach (the simplified approach) under AASB 17?**

ACAG has the following comments in relation to determining the contract boundary:

Clarification of premiums vs levies

ACAG recommends that the AASB makes more explicit in paragraph E21 the distinction between premiums and levies. Throughout the Discussion Paper, premiums and levies are discussed together, as being similar in nature. However, for this paragraph, premiums are treated differently to levies. For premiums, reference is made to AASB 17 paragraphs 34 and

35 (therefore enabling ongoing compliance with IFRSs), while levies have modified requirements. ACAG would prefer the proposals use a single term - 'premiums' and include further discussion/guidance on when other funding arrangements would be considered to be premiums.

Using the terms 'premiums' and 'levies' interchangeably is confusing and implies that there is no distinction. In the Commonwealth context, there is a very important distinction. A levy is considered to be a tax for the purposes of the Constitution and under s55 of the Constitution, it must have its own Act, whilst a premium is considered to be a fee for a service.

While it is common for entities to subsequently receive appropriation funding for a purpose related to the levy and for that funding to be based substantially on levy receipts, the funding is subject to the normal budget/appropriation process and there is no obligation for the government to pass on the levy amount. This means there is a disconnect between the levy as taxation legislation and parliamentary appropriations provided to fund government activities.

Premiums on the other hand are considered to be a fee for a service arrangement and would be retained by the entity. Premiums can generally be varied by the entity (occasionally subject to ministerial oversight or legislative constraints e.g. means testing). Changes to levies would be subject to specific consideration of the particular levy Act.

Residential builders' insurance

ACAG recommends that the AASB clarify the application of the contract boundary provisions related to residential builders' insurance. For example, the Queensland Building and Construction Commission (QBCC) provides the Queensland Home Warranty Scheme and states that structural defects are covered for six and a half years' duration for a single premium payment. For this situation, it appears that rather than the contract covering risk for over six years, the risk relates to a claims incurred approach for defects in the construction or alterations undertaken within a short period of time.

Simplifications for levies

ACAG agrees with the proposed simplifications in paragraphs E21(b) and (c).

- 8. Do you agree with the following interpretation? If the funding can only be changed with a corresponding change in legislation, then the presumption exists that the simplified approach is not available for application. However, if the funding can be changed at will, then the presumption that the contract boundary is less than 12 months can be supported and the simplified method will be available for use.**

No. ACAG believes that the proposed restriction about legislative approvals preventing the use of the simplification approach is not appropriate, and that paragraph E21(a) should be removed or if not removed, modified.

Paragraph E22 expresses the view that annual reviews would generally result in the simplified approach similar to that permitted under paragraphs 34 and 35. ACAG believes that annual reviews of levies can be undertaken even when legislative amendment is required for changes. For example, for private health insurance premiums, these need approval by an external entity (Commonwealth Minister for Health). While not specifically requiring legislative amendment, the approval is similarly not within the control of the insurer.

The restrictions proposed in paragraph E21(a) may cause unnecessary prohibition on the use of the simplified approach for:

- arrangements where an external party is required to approve levy changes, even when that party is within the same consolidated entity as the affected entity (e.g. whole of government)
- arrangements that are partially funded by government contributions, given it can be argued that budget appropriations require annual legislative approval.

Captive insurance arrangements

- 9. Where subsidiaries apply AASB 17 to insurance and insurance-like contracts in the subsidiary's separate financial statements, but at the consolidated group level such contracts are regarded as self-insurance and consequently outside the scope of AASB 17, should such arrangements be scoped out of AASB 17 for the subsidiary's separate financial statements?**

No. ACAG strongly disagrees with the proposals to exempt captive insurers. ACAG believes that it will create complexity for some entities within a group reporting structure that are required to use two different measurement bases, where one entity meets the captive insurance definition and another does not. ACAG believes that if captive insurers are required to prepare general purpose financial reports (GPFRs) then they should follow the appropriate standards, which include AASB 17 for insurance-like arrangements. ACAG does not agree that other standards, like AASB 137, would be appropriate for GPFRs of entities with insurance-like arrangements.

If there are no users dependent upon the financial reports of the captive insurer, then it is up to the appropriate government to exempt the body from preparing GPFRs.

If the AASB pursues the exemption, ACAG notes that while paragraph Aus3.2 restricts the exemption to situations when there is no external insurance risk, paragraph BC84 requires AASB 17 to be applied to such entities with external insurance risk which is inconsistent.

Investment contracts with discretionary participation features

- 10. Under AASB 17 para 3(c) an entity is required to apply AASB 17 to investment contracts with discretionary participation features, if the entity also issues insurance contracts.**

(a) Do not-for-profit public sector entities regularly issue both insurance contracts as well as investment contracts with discretionary participation features?

No, ACAG is not aware of any not-for-profit public sector entities that issue both insurance contracts as well as investment contracts with discretionary participation features.

(b) If so, would the accounting treatment of such investment contracts with discretionary participation features be significantly different under AASB 17 as compared to their current accounting treatment?

N/A – Given ACAG’s answer to (a) above, ACAG provides no comment to this question.

(c) If the existing accounting treatment is significantly different, would the proposed accounting treatment under AASB 17 impose undue cost or effort on the entity?

N/A – Given ACAG’s answer to (a) above, ACAG provides no comment to this question.

(d) If the answers to questions (a)-(c) were affirmative, do you propose that all investment contracts with discretionary participation features issued by a not-for-profit public sector entity should be entirely scoped out of AASB 17? If so, what requirements should apply?

N/A – Given ACAG’s answer to (a) above, ACAG provides no comment to this question.

Other

11. Are there other matters raised by the requirements of AASB 17 that you consider should be addressed in respect of public sector entities?

Yes ACAG raises the following additional matters below.

Premium allocation approach

AASB 17 paragraph’s 55(a)(i) and 55(b)(i) refer to amounts received which could be construed as ‘cash accounting’. ACAG suggests the AASB consider also including amounts ‘receivable’ in these sub-paragraphs as this better aligns with existing principles and requirements in AASB 9 *Financial Instruments* and AASB 15 *Revenue from Contracts with Customers*. If the AASB agrees, the remainder of paragraph 55 should be revised, in particular, the recognition of expenses (which currently refers to cash flows only).

However, ACAG notes that modifying AASB 17 as proposed above may cause complications. If the requirements for public sector entities are changed, for-profit public sector entities may not be able to claim IFRSs compliance. If the change is made for not-for-profit public sector entities only then there will be different accounting for for-profit and not-for-profit entities with insurance like arrangements.

Coverage period

ACAG suggests further guidance be provided on the 'coverage period' to answer the following questions:

- (a) Where an insurance policy is cancelled due to a payment being missed, would this indicate an insurance liability should only be recognised and exist until the next payment is due?
- (b) When a premium is not paid, does the insurer have an obligation to provide ongoing coverage or would the policy be cancelled? ACAG notes that the specific terms and conditions of the insurance contract, including those relating to the rights for parties to cancel the policy, would need to be assessed in determining the contract boundary.

Definitions

ACAG suggests the definitions contained within AASB 17 could be further enhanced by expanding the term 'risk adjustment / risk margin' to take account for public sector nuances as explained above. In addition, ACAG suggests definitions for 'risk appetite', 'risk aversion' and 'degree of diversification' be included as they would be useful in the application of the revised standard.

12. Overall, are the proposals for public sector insurance accounting in the best interests of the Australian economy?

ACAG is not in a position to comment on whether these proposals are in the best interests of the Australian economy. ACAG does consider that the proposals provided will ensure consistency of recognition, measurement, presentation and disclosure financial reporting for insurance contracts and insurance-like arrangements regardless of whether such arrangements are conducted in the public or private sectors.

For-profit private sector entities

13. AASB 1023 and AASB 1038 included some regulatory disclosure requirements that have not been carried forward into AASB 17. Do you agree with the AASB's recommendation that these disclosure requirements should not be carried forward to either AASB 17 or AASB 1054 Australian Additional Disclosures?

Yes, ACAG agrees with the AASB's recommendation. ACAG considers some of the disclosures not carried forward may be captured by AASB 17's 'significant judgements' requirements in paragraphs 117-120