From: Brett Story <Brett.Story@auditnz.govt.nz>
Sent: Friday, 7 June 2019 9:15 PM
To: Submissions <submissions@xrb.govt.nz>
Cc: Anthony Heffernan <anthony.heffernan@xrb.govt.nz>; David Bassett <david.bassett@xrb.govt.nz>; Robert Cox <robert.cox@auditnz.govt.nz>
Subject: Audit NZ submission on ED PBE IFRS 17 Insurance Contracts

Dear Warren,

Thank-you for the opportunity to comment on ED PBE IFRS 17 *Insurance Contracts* (the "ED").

We have limited our comments on the ED to the scoping amendments made by the NZASB for insurance type schemes that arise under legislation, and discount rates, risk adjustments, and onerous contracts in relation to these schemes.

The Earthquake Commission (EQC) and Accident Compensation Corporation (ACC), which are consolidated into the Financial Statements of Government (FSG), are the only entities we are aware that would need to consider application of the PBE IFRS 17 scoping amendments.

It is important that the accounting for insurance related liabilities for these statutory based-scheme results in meaningful and useful accounting outcomes.

We provide specific comments below:

1) Meaning of fully funded – ACC

The guidance in AG1.2 discusses that where contributions to a scheme by the entity or other entities relate to specific individuals/households, the contributions are to be considered contributions for the purposes of determining whether a scheme is fully funded.

The ACC operates the non-earners account, whereby the government via an appropriation contributes to the cost of injuries that happen to people not in the workforce. The government contributions to ACC are fully funded for claims from 1 July 2001. Claims before that date are funded on a "pay-as-you-go" (PAYGO) basis from government i.e. cash is provided to ACC as ACC spends cash on those claims. This means the non-earners account has a significant net liability position of $4.9bn at 30 June 2018.

We would welcome clarification on whether this PAYGO funding approach within a scheme is considered a contribution for the purposes of assessing whether a scheme is fully funded.

We consider the most meaningful accounting outcome in this case is that the schemes with PAYGO funding are considered fully funded as the funding is being provided over time as opposed to upfront.

2) Meaning of fully funded – EQC

The guidance in AG1.2 discusses that where a public sector entity makes contributions to fund the deficit on a scheme, these are not considered a contribution for the purposes of determining whether a scheme is intended to be fully funded.

The EQC is presently reporting a substantial net liability position due to significant earthquakes in recent years. EQC expects it will need to call for funding from the government to fund the deficiency associated with its outstanding claims liability.

EQC' legislation provides that the government could either provide a grant or a loan to meet a deficiency in the fund. We are not aware of what may actually occur.

It would be helpful based on this fact pattern if the guidance provided clarity on whether the government funding would be considered a contribution as the government contribution is only occurring due to an infrequent but devastating natural disaster that occurred.

We also note there was guidance on loan funding in paragraph AG1.3 that has been deleted by the NZASB. We recommend this text be re-inserted.

We would be concerned if EQC were viewed as not being within the scope of the standard due to a government's contribution, as the most meaningful accounting for EQC is to follow an insurance standard.

3) Discount rates

We note the XRB's discount rate comments in the Invitation to Comment paragraphs 77 to 79.

We are concerned about the practicability of public sector PBEs preparers making subjective adjustments to discount rates for statutory based liabilities for no apparent benefit.

We are also concerned that making such discount rate liability adjustments creates inconsistent discount rate approaches compared to other illiquid long-term discounted liabilities, such as for pension schemes and provisions.

We urge the NZASB to reconsider the discount rate proposals for insurance arrangements that arise under statute. Our preference would be to retain the current discount rate approach (risk-free rates without a liquidity adjustment) for statutory based insurance schemes until further conceptual work is performed on discount rates for such liabilities.

4) Risk adjustment for non-financial risk

ACC reported a substantial risk margin under PBE IFRS 4 of $4.6bn as at 30 June 2018 on its outstanding claims liability.

We question the appropriateness and relevance of including a risk adjustment in measuring the insurance claims liabilities for ACC and EQC. We also note the Auditor-General raised concerns about risk margins in his 2009 report *The Auditor-General's views on setting financial reporting standards for the public sector.* Refer to pages 44 and 45 of the attached linked.

https://www.oag.govt.nz/2009/financial-reporting-standards/docs/financial-reporting-standards.pdf

5) Onerous contracts

The Invitation to Comment highlights that it is possible contributions or levies charged are determined on a different basis to how the fulfilment cash flows allocated to insurance

contracts are measured under IFRS 17. This could potentially lead to an onerous contract even though the short-fall may be funded by a future year levy or contribution.

We are concerned that such a situation would result in an onerous contract being recognised when it is simply an issue of cash flow timing.

Further, in the FSG those parts of the ACC scheme that are funded from general taxation (e.g. the non-earners account) would appear to meet the requirement to be an onerous contract. This would result in different accounting at the ACC entity level compared to the FSG level. We question whether this difference in reporting would be appropriate or readily understood by readers.

If the NZASB staff would like to discuss any of our comments further, please contact myself on 021 222 6247, or Robert Cox on 021 222 6107.

Kind regards,

Brett Story
Associate Director, Technical

Audit New Zealand |Mana Arotake Aotearoa
P +64 21 222 6247
Level 1, 100 Molesworth Street, Wellington | PO Box 99, Wellington 6140, New Zealand
www.auditnz.govt.nz

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