INDEPENDENT AUDITOR'S REPORT

TO THE SHAREHOLDERS OF INSURANCE AUSTRALIA GROUP LIMITED

REPORT ON THE AUDIT OF THE FINANCIAL REPORT

Opinion

We have audited the Financial Report of Insurance Australia Group Limited (the Company).

In our opinion, the accompanying Financial Report of the Company is in accordance with the *Corporations Act 2001*, including:

- giving a true and fair view of the Group's financial position as at 30 June 2020 and of its financial performance for the year ended on that date; and
- complying with *Australian Accounting Standards* and the *Corporations Regulations 2001*.

The Financial Report comprises:

- Consolidated balance sheet as at 30 June 2020;
- Consolidated statement of comprehensive income, Consolidated statement of changes in equity, and Consolidated cash flow statement for the year then ended;
- Notes including a summary of significant accounting policies; and
- Directors' Declaration.

The Group consists of the Company and the entities it controlled at the year-end or from time to time during the financial year.

Basis for opinion

We conducted our audit in accordance with *Australian Auditing Standards*. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Our responsibilities under those standards are further described in the *Auditor's responsibilities for the audit of the Financial Report* section of our report.

We are independent of the Group in accordance with the *Corporations Act 2001* and the ethical requirements of the *Accounting Professional and Ethical Standards Board's APES 110 Code of Ethics for Professional Accountants (including Independence Standards)* (the Code) that are relevant to our audit of the Financial Report in Australia. We have fulfilled our other ethical responsibilities in accordance with the Code.

Key Audit Matters

The Key Audit Matters we identified are:

- Valuation of Gross outstanding claims liability
- Valuation of Reinsurance and other recoveries on outstanding claims
- Valuation of Goodwill and Investment in joint venture and associates
- Customer refund provision

Key Audit Matters are those matters that, in our professional judgement, were of most significance in our audit of the Financial Report of the current period.

These matters were addressed in the context of our audit of the Financial Report as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Valuation of Gross outstanding claims liability ($10,584 million)

Refer to Note 2.2 of the Financial Report

The key audit matter

Valuation of Gross outstanding claims liability is a key audit matter due to the following factors:

- judgement is required by us to consider the central estimate of the gross outstanding claims liability. This is a significant estimate as the eventual outcomes of incurred but unsettled claims at the balance sheet date are inherently uncertain;
- there is limited information available and a greater level of uncertainty inherent in assessing the Group's estimations of claims which have been incurred by the balance sheet date but have not yet been reported to the Group;

How the matter was addressed in our audit

We involved our actuarial specialists and senior personnel with deep industry experience. Our key procedures included:

- comparing the Group's actuarial methodologies with the methodologies applied in the industry, prior periods and the requirements of accounting standards;
- obtaining an understanding of the Group's governance processes, including Reserving Committees and actuarial control cycles for the valuation of the outstanding claims liabilities;

- judgement is required when considering the Group's application of historical experience of claims development to determine current estimates, including the greater variability between the original estimation and the ultimate settlement of claims where there is a long time delay between the claim being incurred and the ultimate settlement. Examples include claims arising from Workers' Compensation, Liability, Compulsory Third Party (CTP) and the main Canterbury earthquakes of September 2010 and February 2011;
- claims estimation uses an actuarial modelling process which involves complex and subjective actuarial methodologies, as well as judgements and assumptions about future events and developments, both within and external to the Group. Actuarial assumptions include loss ratios, claim frequency and average size of claims, and allowance for future claims inflation. Changes in methodologies, judgements and assumptions can have significant implications to the quantification of outstanding claims liabilities, as outlined in Note 2.2(E). Specific to the current environment, COVID-19 has caused significant disruption across Australia and New Zealand. As a result claims activity through the period may not be representative of future claims activity and judgement is required when considering the use of recent experience to determine outstanding claims liabilities;
- judgement is required to assess the Group's estimation of the probability of claims arising from circumstances connected with the COVID-19 pandemic. This includes interpretation of policy wordings, estimation of potential losses on a probability-weighted basis and the probable timing of the emergence of such potential claims;
- the Canterbury earthquake claims require judgement and technical actuarial expertise to evaluate the Group's attribution of claims costs between the September 2010 and the February 2011 Canterbury earthquake events;
- judgement is required to assess the Group's estimation of the periods the claims are expected to be settled in;
- the estimation of claims at year end relies on the integrity of the underlying data, including claim payments and individual estimates of unsettled claims, which is gathered from a number of different systems; and
- outstanding claims includes statistically determined risk margins developed by the Group to make allowance for the inherent uncertainty in estimating ultimate claim settlements. The risk margins are included to achieve a specified probability of adequacy for the total outstanding claims reserves. This is an area of significant complexity and judgement for us.

We involved actuarial specialists to supplement our senior audit team members with deep industry experience in assessing this key audit matter.

- evaluating the actuarial methodologies and the assumptions including loss ratios, claim frequency and average size of claims, ultimate claims costs and allowance for future claims inflation applied in the previous reporting period by comparing the actual claims development to the prior year claims liability estimate. We used the information to assess the current year's actuarial assumptions applied in the valuation;
- challenging key actuarial assumptions by comparing these to our expectations based on the Group's historical experience, our industry knowledge and externally observable trends (e.g. APRA and regulatory statistics);
- evaluating the Group's assessment of COVID-19 on insurance liabilities including key judgements in relation to potential claims arising from circumstances connected with the COVID-19 pandemic;
- evaluating the attribution of claims cost to Canterbury earthquake events, by comparing these to our expectations based on the Group's historical experience, our industry knowledge and externally observable trends;
- considering judgements by the Group to estimate the period in which the claims will be settled by analysing historical payment patterns and any significant changes;
- assessing the risk margin parameters for significant portfolios to external sources of data including published statistics (e.g. APRA-published data), prior periods and our industry knowledge;
- critically evaluating the Group's judgment in the execution of the outstanding claims liability calculations by comparing the overall results to our expectations based on the Group's historical experience, our industry knowledge and externally observable trends (e.g. listed competitors);
- for certain classes of business we independently projected the gross outstanding claims liability by applying our own actuarial methodologies and selecting assumptions for those methodologies. We used this re-projection to compare our results to the Group's estimates and challenge any significant differences;
- our procedures for testing key inputs such as claim payments and estimates of unsettled claims into the valuation, financial records and controls included:
  - testing accounting and actuarial controls, such as reconciliations of key data. We involved our IT specialists for testing data integrity risks within the claims process and claims systems;
  - testing key controls (e.g. reconciliations, limits of authority or segregation of duties) within the estimation of claims case estimates and claims payments;
  - testing samples of claims case estimates and paid claims to third party evidence (such as quotes or invoices); and
- assessing the disclosures in the financial report using our understanding obtained from our testing and against the requirements of the accounting standards.

Valuation of Reinsurance and other recoveries on outstanding claims ($6,069 million)
Refer to Note 2.2 of the Financial Report

The key audit matter

The valuation of reinsurance and other recoveries on outstanding claims is a Key Audit Matter as:

- reinsurance and other recoveries are quantified from claims case estimates, paid claims data and estimates of ultimate claims settlement amounts;

How the matter was addressed in our audit

In addition to the audit procedures undertaken to assess the valuation of gross outstanding claims liability above, our procedures included:

- testing a sample of key controls for entering reinsurance arrangements;

- the Group has extensive reinsurance arrangements designed to protect its aggregate exposure to catastrophic claim events; and
- the Group also has a range of significant reinsurance contracts, including the whole-of-account quota share arrangements, the catastrophe excess of loss program, adverse development covers in the form of excess of loss contracts, and other quota share arrangements.

Our consideration of the accounting treatment across multiple contracts, assessment of recoverability in line with the reinsurance agreements (including those pertaining to the claims liabilities connected with the COVID-19 pandemic), the assessment of counterparty credit worthiness and capital strength requires significant effort by our senior personnel.

- evaluating a sample of reinsurance recoveries held to underlying contracts to assess the existence of cover the contracts provide. We selected our sample across different arrangements and contract types. We also tested the appropriateness of the recognition of the reinsurance recoveries held (including those pertaining to the claims liabilities connected with the COVID-19 pandemic) in the financial statements, with reference to accounting standards and our expectations based on past experience and our industry knowledge;
- evaluating a sample of reinsurance recoveries for whole-of-account quota share contracts. We referred to the key terms of the reinsurance contracts, and applied them to the Group's underlying claims estimates and paid claims data as tested above to recalculate the reinsurance and other recoveries due. These independently generated results were compared to the amounts recognised by the Group;
- assessing the recoverability of balances owed by reinsurer counterparties by considering their credit worthiness and capital strength based on external sources of information, payment history of amounts and evaluation of any indicators of disputes with counterparties; and
- assessing the disclosures in the financial report using our understanding obtained from our testing and against the requirements of the accounting standards.

Valuation of Goodwill ($2,862 million) and Investment in joint venture and associates ($351 million)

Refer to Notes 5.1 and 6.5 of the Financial Report

The key audit matter

Valuation of goodwill and investment in joint venture and associates is a Key Audit Matter as:

- judgement is involved by us in assessing the cash-generating units identified by the Group;
- our evaluation of potential impairment involves applying judgement by us in relation to the Group's forecast cash flows and key forward looking assumptions. Instances where judgement is required by us include discount rates, risk premium, growth rates, profit measures and terminal growth rates. We focused specifically on those cash-generating units and associates where there were potential impairment indicators (e.g. performance compared to budget);
- the Group uses complex discounted cash flow models to perform their annual testing of goodwill for impairment. The models use adjusted historical performance, and a range of internal and external sources as inputs to the assumptions. Complex modelling, particularly those containing highly judgemental allocations of corporate costs to cash-generating units, using forward-looking assumptions tends to be prone to greater risk for potential bias, error and inconsistent application. These conditions necessitate additional scrutiny by us, in particular to address the objectivity of sources used for assumptions, and their consistent application; and
- significant judgement was required as a result of the current COVID-19 environment. COVID-19 has caused significant disruption across the countries in which the Group operates. As a result there is increased judgement in forecasting cash flows and assumptions used in the discounted cash flow models.

We involved valuation and IT specialists to supplement our senior audit team members in assessing this key audit matter.

How the matter was addressed in our audit

With the assistance of our valuation specialists, our procedures included:

- evaluating the Group's determination of their cash-generating units based on our knowledge of the business, and understanding of the industries in which the Group operates, against the accounting standard requirements;
- performing sensitivity testing, using the Group's models, to evaluate the impact of varying key assumptions such as growth rates and discount rates within a reasonably possible range. This enabled us to critically challenge the Group's quantification of assumptions and focus our procedures to the most sensitive assumptions;
- assessing the Group's key assumptions used in the discounted cash flow models such as discount rates, risk premium, growth rates, profit measures and terminal growth rates by comparing them to external, observable metrics (e.g. GDP growth and inflation including forecasts provided by Oxford Economics and IBIS World), historical experience, our knowledge of the markets, and current market practice;
- considering the appropriateness of the discounted cash flow methodology applied by the Group to perform the annual test of impairment against the requirements of the accounting standards;
- comparing the forecast cash flows contained in the discounted cash flow models to Board reviewed budgets and business plans; assessing the accuracy of past budgets to actual cash flows in order to challenge the Group's current forecasts;
- considering and challenging the Group's assessment of the impact of COVID-19 on cash flows and assumptions as well as its assessment of a likely recovery period. As part of our sensitivity testing and assessment of model assumptions detailed above, we included specific analysis of reasonably possible impacts of COVID-19 specific to each CGU;
- comparing the valuations for a sample of joint ventures and associates to external and observable valuations for broadly similar enterprises, and investigating significant outliers;

- assessing the Group's allocation of corporate costs to the forecast cash flows contained in the value-in-use model, based on the requirements of the accounting standard and our understanding of the business;
- involving our specialists, we evaluated the internally prepared discounted cash flow model. This included:
  - assessing the valuation approach and methodology against market and industry practices and accounting standards; and
  - assessing the integrity of the models used, including the accuracy of the underlying formulas; and
- assessing the disclosures in the financial report using our understanding obtained from our testing and against the requirements of the accounting standards.

Customer refund provision ($270 million)

Refer to Note 5.3C to the Financial Report

The key audit matter

Customer refund provision is a Key Audit Matter as:

- judgement is involved in determining the existence of a present obligation arising as a result of a past event;
- judgement is involved in determining a reliable estimate of the amounts which may be ultimately paid based on available information arising from investigations, including estimates of related costs; and
- our consideration of the accounting treatment and valuation of the provision requires significant effort by our senior personnel.

How the matter was addressed in our audit

Our procedures included:

- obtaining an understanding of the Group's processes for identifying and assessing the financial impact of customer refund payments and associated project costs to confirm a present obligation exists in accordance with the criteria in the accounting standards;
- inspecting correspondence with relevant regulatory bodies;
- assessing the methodologies applied against both internal and external information available;
- understanding, and challenging the assumptions used based on available information utilised to identify policyholders impacted in order to estimate the provision amounts;
- testing completeness by evaluating where exposures may have arisen based on the Group's documentation including on a sample basis, tracing individual policies back to underlying calculations to determine the appropriateness of its inclusion or exclusion in the provision amount;
- testing a sample of estimated customer refund amounts by independently recalculating them, using the same assumptions and methodologies as management and checking to underlying policy documents;
- assessing the nature and quantum of management's estimation of project costs against expectations and industry ranges;
- enquiry into the status of the Group's ongoing reviews into other pricing system and process matters; and
- assessing the disclosures in the financial report using our understanding obtained from our testing and against the requirements of the accounting standards.

Other Information

Other Information is financial and non-financial information in Insurance Australia Group Limited's annual reporting which is provided in addition to the Financial Report and the Auditor's Report. The Directors are responsible for the Other Information.

Our opinion on the Financial Report does not cover the Other Information and, accordingly, we do not express an audit opinion or any form of assurance conclusion thereon, with the exception of the Remuneration Report and our related assurance opinion.

In connection with our audit of the Financial Report, our responsibility is to read the Other Information. In doing so, we consider whether the Other Information is materially inconsistent with the Financial Report or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

We are required to report if we conclude that there is a material misstatement of this Other Information, and based on the work we have performed on the Other Information that we obtained prior to the date of this Auditor's Report we have nothing to report.

Responsibilities of the Directors for the Financial Report

The Directors are responsible for:

- preparing the Financial Report that gives a true and fair view in accordance with *Australian Accounting Standards* and the *Corporations Act 2001*;
- implementing necessary internal control to enable the preparation of a Financial Report that gives a true and fair view and is free from material misstatement, whether due to fraud or error; and
- assessing the Group and Company's ability to continue as a going concern and whether the use of the going concern basis of accounting is appropriate. This includes disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless they either intend to liquidate the Group and Company or to cease operations, or have no realistic alternative but to do so.

Auditor's responsibilities for the audit of the Financial Report

Our objective is:

- to obtain reasonable assurance about whether the Financial Report as a whole is free from material misstatement, whether due to fraud or error; and
- to issue an Auditor's Report that includes our opinion.

Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with *Australian Auditing Standards* will always detect a material misstatement when it exists.

Misstatements can arise from fraud or error. They are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of this Financial Report.

A further description of our responsibilities for the audit of the Financial Report is located at the *Auditing and Assurance Standards Board* website at http://www.auasb.gov.au/auditors_responsibilities/ar1.pdf. This description forms part of our Auditor's Report.

REPORT ON THE REMUNERATION REPORT

Opinion

In our opinion, the Remuneration Report of Insurance Australia Group Limited for the year ended 30 June 2020, complies with *Section 300A* of the *Corporations Act 2001*.

Directors' responsibilities

The Directors of the Company are responsible for the preparation and presentation of the Remuneration Report in accordance with *Section 300A* of the *Corporations Act 2001*.

Our responsibilities

We have audited the Remuneration Report included in pages 26 to 46 of the Directors' Report for the year ended 30 June 2020.

Our responsibility is to express an opinion on the Remuneration Report, based on our audit conducted in accordance with *Australian Auditing Standards*.

KPMG

KPMG

Andrew Yates
Partner

Ian Moyser
Partner

Sydney
7 August 2020