



**ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION**

March 13, 2012

Mr. Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Mr. Hoogervorst

Re: IAA comments on the Exposure Draft *Revenue from Contracts with Customers*

In response to the request for comments on the Request for Views – the IASB Agenda Consultation 2011, I am pleased to transmit, on behalf of the International Actuarial Association (IAA), our comments and recommendations.

These comments have been prepared by the Insurance Accounting Committee of the IAA. If, upon reading these comments, you identify any points that you wish to discuss or obtain further insight regarding them, please do not hesitate to contact Francis Ruygt, chairperson of the Insurance Accounting Committee, care of the IAA Secretariat. The IAA will be pleased to develop these ideas further with you.

Yours sincerely

Desmond K. Smith
President

[Attachment](#): IAA comments

A Commentary on the Exposure Draft
REVENUE FROM CONTRACTS WITH CUSTOMERS
Released by the International Accounting Standards Board: November 2011

International Actuarial Association and its Due Process

The International Actuarial Association (the “IAA”) represents the international actuarial profession. Our sixty-four Full Member actuarial associations, listed in an Appendix to this statement, represent more than 95% of all actuaries practicing around the world. The IAA promotes high standards of actuarial professionalism across the globe and serves as the voice of the actuarial profession when dealing with other international bodies on matters falling within or likely to have an impact upon the areas of expertise of actuaries.

The IAA is pleased to have been given the opportunity to provide input to the IASB on this important Exposure Draft (the “ED”). These comments have been prepared by its Insurance Accounting Committee, the members of which are listed in an Appendix to this statement. It has also been subject to the due process required for it to constitute a formal view of the IAA, and will be posted to the IAA’s official web site.

General Comments

Overall, the IAA supports the model proposed in the Exposure Draft and is pleased to see the project on revenue recognition nearing completion.

Our interest in the ED stems mainly from the implications of the proposed guidance to insurers who offer contracts that fall within the scope of the standard and from our desire to see general, high level consistency between accounting for contracts with customers and accounting for insurance contracts. For example, many insurers provide policy administrative and claims services to customers outside of an insurance contract. In addition, insurance contracts also have significant service elements, which, depending on the eventual guidance arising from the insurance contracts project, for some contracts may be separated (“unbundled”) and treated as service contracts. There are broad similarities between accounting for contracts with customers and for insurance contracts and there is a direct similarity where the premium allocation approach is applied. There are also similar considerations for contract costs, use of expected values to make estimates and consideration of collective effects. We provide our thoughts on these topics and our response to the questions in ED in the paragraphs that follow.

Portfolio as the Unit of Account

Paragraph 6 states:

This [draft] IFRS specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this [draft] IFRS to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the result of doing so would not differ materially from the result of applying this [draft] IFRS to the individual contracts (or performance obligations).

Certain fixed-fee contracts such as those providing road-side assistance are specifically excluded from the scope of the insurance standard. For such contracts the use of a statistical measurement based on a group of contracts with similar features, i.e. using expected values (mean values), may be necessary to reflect the economics of the business. The results of using such a statistical approach may differ significantly from the results of applying this draft guidance to single contracts. This is most evident where variable consideration exists and the estimate of this consideration is based on the “most likely” option provided in paragraph 55(b), since the sum of individual “most likely” estimates may be significantly less than the “most likely” aggregate result.¹ We recommend that any guidance encourages, to the extent practical, the use of statistical approaches similar to that provided in IAS37.39 when it is more representationally faithful than the use of single contracts, regardless of whether the results are materially the same. We believe that permitting and encouraging such use of a statistical approach, when appropriate, will make the insurance and revenue standards more consistent.

In particular, we support the greater use of expected values by entities when estimating transaction prices for contracts with variable consideration. We believe that entities that use expected values will in most cases observe smaller differences between estimated and actual consideration than those that use the most likely amount and, hence, that the use of expected values will provide more reliable financial information. Most likely values commonly result in a biased aggregate estimate where the contract cash flows contain uncertainty² and should only be used where such uncertainty is not material or sufficient data to support a reliable expected value estimate do not exist.

Contract costs

The ED proposes that certain costs associated with acquiring and with fulfilling contracts can be recognized as assets and amortized into expenses over time. The proposed guidance calls for consideration of incremental acquisition costs. We believe that the approach to acquisition costs would be better if it is, at least conceptually, consistent with the currently proposed treatment for insurance costs, which is to consider direct costs related to the unit of account. At the same time we acknowledge that it may be preferable to allow entities to consider only incremental costs when other, non-incremental direct costs are not significant or when the determination of these amounts is not practical.

Of course, it would be desirable if the definition of cost would be consistent across accounting standards. Nevertheless, we understand that this is a proposed standard relating to revenue and not cost. We believe it appropriate to deal with costs in a cross-cutting manner or within the Conceptual Framework. For example as the Board knows, the proposed approach in this ED is to use incremental cost, rather than directly attributable costs included in the current version of

¹ The “most likely” value is, in statistical terms, the mode of the probability distribution that describes the uncertainty. This is typically different from the mean, which is the probability-weighted average of all possible outcomes. For a single contract, this difference can be substantial. In many cases, the most likely value is also the minimum, possibly even zero, whereas the most likely outcome for the portfolio is that a few contracts will be above the minimum. In mathematical terms, modes are not generally additive, that is: the sum of the modes is not equal to the mode of the sums. In contrast, means are additive.

² Insurance provides a particularly striking example of this. For many classes of insurance, the most likely outcome for a single contract is that there will be no claim. Measuring pre-claim liabilities on this basis would be a gross distortion of the economic reality.

the insurance contracts. We note the difficulty in allocating costs within the same entity and in some cases the same department that will arise if an insurer offers both insurance and service contracts, either separately or in bundled or unbundled contracts. We believe that it would be desirable if these costs are referred to in a consistent manner, and prefer the use of the directly attributable cost approach. We note that certain costs, such as the variable component of the wages of sales managers and CEOs would be included if directly proportional to sales efforts.

We also believe that it is preferable for the amounts deferred to be presented as a reduction of the liability, since this presentation provides a more realistic measure of the net obligation. We note that this treatment would be consistent with the proposed treatment for insurance contracts that use the building block approach. Since the appropriateness of the recognition of an asset is somewhat dubious and the purpose of the deferral of costs is to match costs to revenue, we believe the presentation of the deferred amount as an asset to be inappropriate.

We believe that the credibility of the treatment is dependent on the proper disclosures. The deferral of costs should not be allowed to cause the amount of costs incurred to be obfuscated. Hence, the face of the statement of profit and loss should show how the recognized expense comprises costs incurred, costs deferred and netted against the liability, and amortization of the deferred cost or release from the liability.

We concur with the proposed guidance for capitalizing certain costs that are associated with fulfilling contracts. We see the conceptual considerations to be similar to those for acquisition costs, namely a desire to provide a better matching of costs and revenue as an important element in measurement of an accounting value. As already noted, we prefer the presentation proposed for insurance contracts, namely a reduction in the liability, although we do not object strongly to a deferred expense asset. There are practical reasons to present those deferred cost as an asset since we see there are similarities to, for example, costing of inventories. However, we see it merely as a practical way of dealing with those costs, rather than a conceptually appropriate way to defer costs incurred and, at the same time, to defer the recognition of the associated consideration as revenue. Conceptually, fulfillment costs should be recognized when incurred and deferred consideration should be released to revenue as obligations are fulfilled.

We note the lack of guidance with respect to trailing commissions, although as indicated it may not be appropriate to include cost guidance in the resultant IFRS.

We agree that amortization of costs should be consistent with the pattern of transfer of goods or services. However, we note that in certain cases, particularly in short-term contracts, current practice is to use a straight-line approach. In these cases, the use of a straight-line approach may be reasonable for practical reasons.

Responses to Questions

Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

IAA Comment

We agree with the proposal. We believe that the proposal reflects the principles and concepts which are also the proposed basis of accounting for insurance contracts.

Question 2: Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

IAA Comment

We agree with the presentation, but we believe that an expected loss model is preferable to an incurred loss model.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

IAA Comment

We do not agree with this constraint since it may lead to confusion about how to make a most likely estimate or an expected value estimate. As stated above, we prefer an expected value model. This proposed guidance is redundant for an expected value, since the probabilities assigned to collection amounts would reflect the reasonability of assuming that amounts are collectible and the entitlement of the entity. It also seems to presume that a most likely estimate would, by definition, not exceed an amount that the entity is reasonably entitled to receive. We recommend that this guidance be deleted.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

IAA Comment

Yes, we agree with the guidance for onerous contracts and we agree, as a practical expedient, with not testing contracts that the entity expects to satisfy within one year.

We believe that it would be appropriate to reflect present values in any onerous contract test, regardless of whether an insurance or service contract is involved.

Question 5: The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.* The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
 - A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
 - An analysis of the entity’s remaining performance obligations (paragraphs 119–121)
- * In the IASB exposure draft, see paragraph D19 in Appendix D.
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
 - A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfill a contract with a customer (paragraph 128).

IAA Comment

We have no response to this question other than provided in our general comments above.

Question 6: For the transfer of a non-financial asset that is not an output of an entity’s ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset.* Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity’s ordinary activities? If not, what alternative do you recommend and why?

IAA Comment

We have no response to this question.

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