

## **The LIAJ's Comments on the IASB Discussion Paper "Preliminary Views on Revenue Recognition in Contracts with Customers"**

1. We, The Life Insurance Association of Japan (LIAJ), would like to extend our sincerest gratitude to the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) for providing us with an opportunity to submit our comments on the discussion paper entitled *Preliminary Views on Revenue Recognition in Contracts with Customers*.
2. The LIAJ is a trade association comprised of all (46) life insurance companies operating in Japan. Its purpose is to promote the sound development of the life insurance industry in Japan and maintain its reliability.

### **General opinions**

3. Regarding revenue recognition, we generally agree to the notion presented in this discussion paper that states that it is preferable to apply a common basic concept for all types of contracts. However, the measurement approach proposed in the discussion paper appears to have been discussed subject to 'short-duration' contracts that may be 'completed with certainty.' We believe that further consideration is necessary to determine whether the approach can provide decision-useful information to users for all types of contracts. In particular, it is not clear whether the current proposal leads to certain measurement results when the approach is applied to insurance contracts with 'long-duration' and/or 'high uncertainty' characteristics.
4. In this context and at this time, we believe that it is premature to determine which of the following stand points regarding measurement approaches for insurance contracts will result in a measurement approach that can provide decision-useful information to users:
  - The inclusion of insurance contracts in the scope of the revenue recognition project, and the development of a second measurement approach that takes into account ongoing discussions in the insurance contract project; or
  - The exclusion of insurance contracts from the scope of the revenue recognition project, and the development of another measurement approach in the insurance contract project that remains consistent with ongoing discussions in the revenue recognition project.
5. Our comments therefore do not state our position on whether the insurance contracts should be included in the scope of the revenue recognition project or not. Our responses to the following questions simply describe the issues that may arise on the assumption that the proposed measurement approach would apply to insurance contracts.
6. Regardless of whether the insurance contracts should be included in the revenue recognition project or not, we believe that, in considering a measurement approach for insurance contracts, it is necessary to keep in mind consistency with the approach proposed in the discussion paper. That is, as the nature of insurance business is to underwrite risks over a long period by diversifying risks into group of insurance contracts, we think that insurers should properly reflect the results of the insurance business - i.e. by recognising profit when an insurer is released from risks and not by recognising future profits at one time. We believe that this notion is consistent with the basic concept of the discussion paper in general.

**Question 1**

Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

<Comments>

7. As mentioned in our general opinions and with regards to revenue recognition, we generally agree to the notion presented in this discussion paper that states that it is preferable to apply a common basic concept for all types of contracts. Meanwhile, we understand the *raison d'être* of current multiple principles underlying the revenue recognition standards and, as a result, we believe that whether it is possible to establish a unique principle should be fully discussed to consider the views of various respondents as well as practical viewpoint.
8. Depending on the outcome of such a discussion, the boards might consider adopting different principles that are not entirely equivalent, but consistent with each other. More specifically, the boards could develop a second measurement approach in a revenue recognition standard that would be suitable for contracts with specific characteristics (i.e. those with highly variable outcomes) as described in paragraphs 5.99 and 5.100 of the discussion paper.

**Question 2**

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

<Comments>

9. Whether users could receive decision-useful information or not depends on the appropriateness of the measurement approaches for contract assets and liabilities. The measurement approach proposed in the discussion paper appears to have been discussed in reference to 'short-duration' contracts that may be 'completed with certainty.' As described in paragraph 5.85, variability in contractual outcomes may arise for contract with 'long-duration' and/or 'high uncertainty' characteristics. Therefore, we think that remeasurement of performance obligations would provide more decision-useful information to users and, in such cases, further treatment to our response to Question 10 (c) should be taken. We believe that such treatment will help ensure consistency with discussions across other projects, including the insurance contract project.
10. In addition, if the performance obligations under a 'long-duration' contract must be accounted for separately on the basis of when the promised assets are transferred to the customer, the revenue received might be recognised after a considerable period. Further examination is needed on whether such treatment provides decision-useful information to users in all cases. We address other specific issues separately in our comments below.

**Question 3**

Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

<Comments>

11. We believe that further discussion is needed in case of complex contracts. Such contracts may include a case where multiple parties involved in one agreement, a situation that may not

formally meet the boards' definition of a contract, which requires that a formal customer to the insurance company be an entity: for instance, when an entity becomes a policyholder of the insurance contract as a part of welfare benefits for its employees (such as in group insurance) and the individual employee must bear the expense (premium), this may be considered a contract because the employer remains the formal customer.

12. In order to make clear the definition of a contract, it is important that the term "on one or both parties" be added after the phrase "creates enforceable obligations." Some contracts create enforceable obligations on one party provided that the other party meets its obligations, while others grant the right of renewal to only one party. We believe that these contracts should also be included in the definition of a contract.

**Question 4**

Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

<Comment>

13. There are some uncertainties in the definition of deliverables in a contract, especially services. We believe that the provision of a service should also include 'provision of goods and services with conditions.' This point needs to be clarified.

**Question 5**

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

<Comments>

14. The discussion paper does not fully explore some issues, including how to determine the timing when the assets concerning services to provide assets in a certain period or services to be provided with certain conditions are transferred. We believe these issues need to be discussed further. There is a concern that the outcome of this discussion, when applied to insurance contracts, might require unbundling of insurance premiums, but this is impractical because it is not possible to unbundle most premiums in insurance contracts.
15. As for the services that provide customers with rights over a certain period, one of our views is to avoid separating those obligations – assuming that the timing of the transfer of services is at the same point in time (i.e. as of the initial point of the period or interim of the fiscal year), and regardless of the timing of such an exercise or whether or not the rights are exercised.

**Question 6**

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

<Comments>

16. We think that the obligation to refund the customer's consideration is a performance obligation: in such a case, the obligation is considered a 'provision of goods and services with conditions.' An estimate (probability of occurrence) in which certain criteria meet future conditions may be

included in this measurement. As for the case of the right of return set forth in paragraph 3.34 of the discussion paper, we believe that a reasonable measurement is possible by estimating the probability to be returned within 90 days and by measuring the performance obligation based on the estimated probability without introducing a new concept of ‘failed-sale’ (please refer to our response to Question 4).

17. We do not think, however, that the refund obligation need always be recognised as revenue separate from other performance obligations. For instance, it is unnecessary to separate the right to cancel services from the services themselves if we assume that the timing of the transfer of the services takes place at the same time (please refer to our response to Question 5).

**Question 7**

Do you think that sales incentives (e.g. discounts on future sales, customer loyalty points and ‘free’ goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

<Comment>

18. Even if sales incentives are provided in a contract with a customer, they do not necessarily lead to (a consideration in) the individual contract. Furthermore, the price may be determined after a customer enters into such a contract. We believe that such incentives should be treated as other performance obligations and recognised separately rather than as revenue for contracts. This, we believe, would constitute more useful financial statements.

**Question 8**

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

<Comment>

19. We prefer that the boards make clear how to treat the timing “when the customer receives the promised service” with regard to services provided as a right to be exercised (please refer to our response to Question 5).

**Question 9**

The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

<Comment>

20. We generally agree that an entity should recognise revenue only when a performance obligation is satisfied. However, as mentioned in our response to Question 2, we believe that some presentation methods – please refer to our response to Appendix C (Presentation) – may not necessarily provide useful information to users to understand the profitability of the entity, particularly long-term contracts.

**Question 10**

In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

- (a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?
- (b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?
- (c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.
- (d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

<Comment>

21. Except in specific cases where a common market is established, it is difficult to measure exit prices, including margins. From this viewpoint, the proposed approach is generally understandable. However, the measurement approach proposed in the discussion paper appears to have been discussed subject to 'short-duration' contracts that may be 'completed with certainty.' Consequently, we believe that further consideration is necessary to determine whether the approach can provide decision-useful information to users for all types of contracts. In particular, it is not clear whether the current proposal leads to certain measurement results when the approach is applied to some insurance contracts, particularly those of 'long-duration' and/or 'high uncertainty.' We address some specific issues as follows.

Regarding 10(a):

22. There is an open discussion as to whether or not to include acquisition costs in the measurement of the performance obligation. Fundamental to this is the need for additional debate about the appropriateness for measuring the performance obligation at the transaction price. This should be deliberated further, and any debate must be intricately linked with the treatment of acquisition costs. (please refer to our response to Question 11 for details).

Regarding 10(b):

23. We agree to the basic concept to remeasure a performance obligation when it is deemed onerous. Concerning insurance contracts (particularly ultralong-term contracts), however, the risk of error in estimation should be taken into account if the specific method is not explicitly shown. The measurement of performance obligations itself is currently under discussion. In addition, we believe that remeasurement in reverse direction where the performance obligation is deemed onerous should also be allowed in some cases when pursuing the relevance of maintaining consistency within the financial instrument measurement approach.

Regarding 10(c):

24. As described in paragraph 5.85, variability in the outcome of a contract may arise from 'long-duration' and/or 'high uncertainty' characteristics. Therefore, we think that remeasuring performance obligations would provide more decision-useful information to users.

25. We believe, however, that the “complexity” and “risk of error in estimation” as described in paragraphs 5.17 through 5.24 are more likely to occur not only at inception, but also in subsequent periods, particularly for contracts with ‘long-duration’ and/or ‘high uncertainty’ characteristics. Thus, in such contracts, the remeasured portion of the performance obligation, which is presented as a portion of ‘another component of comprehensive income’ as described in paragraph 6.16 and concretely as other comprehensive income (OCI), would be consistent with the concept proposed in the discussion paper.

**Question 11**

The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (e.g. selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

- (a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity’s performance obligations? Why or why not?
- (b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity’s financial position and financial performance? Please provide examples and explain why.

<Comment>

26. In paragraph 5.31 of the discussion paper, it states that, “to the extent that an entity incurs any costs in obtaining a contract, those costs are recognised as an expense unless they result in an asset that qualifies for recognition in accordance with other standards.” However, the nature of the insurance business is to underwrite risks over a long period by expending the acquisition costs of the contract and diversifying risks through ‘grouping’ in a certain amount of insurance contracts. Moreover, we understand that, in the insurance contract project meeting held in April 2009, the Board decided tentatively not to include the acquisition costs of the contract in insurance liabilities, but to recognise the same amount as the acquisition costs of the contract as revenue.

**Question 12**

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity’s stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

<Comment>

27. Where selling a set of goods or services creates or adds value to them, or conversely, serves to reduce their costs, there may be a case that it is inappropriate to allocate the total difference in transaction price in proportion to the stand-alone selling price. Reasonable allocation should also be allowed on the basis of any internal allocation rules or pricing standards used for management purposes.

**Question 13**

Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

<Comment>

28. For instance, it is inevitable that an entity will estimate the stand-alone selling price in order to allocate the transaction price where the entity does not sell a good or a service separately. This is the case with a service in which assets are provided within a certain period, as commented in our response to Question 5. Therefore, we agree that the entity should use estimates.

#### **Appendix C (Presentation)**

<Comments>

29. In long-term contracts, we believe that some presentation methods may not necessarily provide useful information to users to understand the profitability of an entity. Strict application of the concept proposed in the discussion paper to a long-term contract, such as single-premium endowment policy, might lead to an entity adapting a method in which most of the revenue is not recognised until the maturity of the contract (see Reference: Example of revenue recognition pattern in a long-term contract).
30. In such cases, we believe that more decision-useful information will be provided to users if we recognise the rights and obligations in the contract (e.g. total insurance premium and insurance liabilities) at contract inception as revenue and expense on a gross basis and at the same time; this would result in the same net outcome. In the example shown in Reference below, the presentation on a gross basis would provide more decision-useful information to users because the total insurance premium has been accepted as a key performance indicator for the insurance industry globally. Thus, case-by-case consideration would be necessary to determine which presentation method should provide useful information to users to understand the profitability of the entity.

Reference: Example of revenue recognition pattern in a long-term contract

31. To illustrate, we have selected a single-premium endowment policy with a maturity of 20 years.
- For simplicity, we neglect the time value of money and loading charged/operating cost.
  - We assume the insured amount of death benefit/matured endowment is equal to 100.
  - Of the total insurance premium (180), we assume that the portion corresponding to the annual premium for death coverage in each year is equal to 4, while the premium corresponding to the matured endowment is equal to 100.
  - If revenue is to be recognised only when the performance obligations are satisfied, the average amount of revenue recognised in the contract will be 4 for the first 20 years and 100 at maturity. Thus, the premium corresponding to the matured endowment, which makes up a major portion of revenue, will not be presented as revenue/expense for 20 years until maturity.
  - In contrast, the total insurance premium (180) will be recognised as gross revenue at inception when the insurance liabilities ( $176 (= 4 \times 19 + 100)$ ) are recognised as gross expense in the first year of the contract and at the same time.

#### **Appendix C (Transition and effective date)**

<Comment>

32. We believe that transitional provisions are inevitable because it is difficult to calculate retrospectively the transaction price at inception in some long-term contracts, including insurance contracts.