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International Accounting Standards Board
First Floor
30 Cannon Street
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MMCK/rw

Dear Sirs

Preliminary Views on Revenue Recognition in Contracts with Customers

We are responding on behalf of the members of our Association to the invitation to comment on the Boards' Discussion Paper. The ABI is the voice of the insurance and investment industry in the United Kingdom. Its members constitute over 90 per cent of the insurance market in the UK and 20 per cent across the EU. They control assets equivalent to a quarter of the UK's capital. They are the risk managers of the UK's economy and society. Through the ABI their voice is heard in Government and in public debate on insurance, savings, and investment matters.

Our comments in this response to the discussion paper reflect particularly matters of relevance or concern to our members as institutional investors and therefore users of accounts. As preparers of insurers' accounts, our views are also being conveyed to you through the joint response of the CEA and the CFO Forum.

We agree with the Boards' focus on achieving a principles-based standard. Reporting on this basis will, though, involve more in terms of management estimates and judgment. This will be a particularly significant issue for US investors and preparers given the current extensive reliance under the FASB standard on industry-specific guidance. We doubt that this guidance has served them any better than the more principles-based IFRS approach. However, an approach entirely based on principles will make it particularly important that key assumptions are clearly disclosed in accounts.

The specification of the revenue recognition standard will have particular significance to those preparers with much of their business accounted for by long-term contracts. For investors focusing on such companies the key point is that consistency should be promoted and that companies should report on a level playing field vis a vis their sectoral peers. Those companies will wish to take the opportunity to convey, for example through their narrative reporting (MD&A), the prospects for crystallisation of revenue and value in future time periods that might not yet be reflected in the current accounting values. However, the interests of all investors will be best served by ensuring as far as possible that recognition of revenue, and of profits, takes place in a way that is reflective of the creation of realisable shareholder value.

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For investors we would emphasise that economic value at stake is closely connected to the concept of risks and rewards. There has been some characterisation of the DP's proposals as moving away from this concept and towards, instead, the concept of control. We are unsure to what extent this is an accurate characterisation. However we would wish to convey our view that a robust standard will be most likely to be secured if it reflects both these concepts such that revenue qualifies for recognition only when both concepts are substantially achieved. Revenue should not be prematurely recognised.

The view of many investors is that the existing percentage of completion approach for long-term construction contracts is opaque and its replacement with a more transparent and robust approach would therefore represent a distinct improvement. There is, however, a danger that a focus on delivery and control may provide too much scope for structuring contracts around the standard, increasing the risk of accounting treatment relating to form rather than substance with users of accounts then needing to spend more time and effort in studying contact clauses; more optimistically there might be an improvement in how contracts are written to more closely reflect economic activity.

We support the Board's aim to replace its current requirements with new ones that reflect a more transparent and robust approach, although we have concerns about how the Board's proposals would deal with long-term contracts with significant uncertainty. One potential drawback of the proposed standard is, however, its reliance on identification of separate components of a contract and the need therefore to identify stand-alone values for what may be elements that are not separately traded and will not therefore have reliable market prices. Where best estimates are made there is the further concern that subsequent changes in assumptions cannot be fully taken into account to better reflect the emerging revenue that should properly be accrued as the different elements of the contract are delivered on. We need a standard that delivers reliable but relevant information to users. We would convey in passing that the idea of applying a fair value approach to the specification of the standard as well being of doubtful appropriateness on point of principle would also have raised greater difficulties in this area and it was right that this approach has been rejected.

Yours sincerely

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