

19 June 2009

Katherine Maybin Project Administrator International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom

Email: commentletters@iasb.org

Dear Ms Maybin

Comments on IASB Discussion Paper -Preliminary Views on Recognition in Contracts with Customers

The Institute of Actuaries of Australia (the Institute) is the sole professional body for actuaries in Australia. It represents the interests of over 1,500 fellows and 2,000 other members. Our members have had significant involvement in the development of insurance regulation, financial reporting and related practices in Australia over many years.

The Institute welcomes the opportunity to submit comments to the International Accounting Standards Board (IASB) on its Discussion Paper, "Preliminary Views on Recognition in Contracts with Customers". Please do not hesitate to contact the Chief Executive, John Maroney (02 9233 3466; email:john.maroney@actuaries.asn.au) if you wish to discuss any of our comments.

Yours sincerely

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IASB Discussion Paper

"Preliminary Views on Revenue Recognition in Contracts with Customers"

General Comments

The Institute of Actuaries broadly agrees with the proposals in the discussion paper however the current approach for accounting for contracts for goods and service is not appropriate in all cases which would require a a number of exclusions or carve outs to allow for more complex situations. We suggest that it would be preferable to develop an approach that is more generally applicable and yet allows a simpler approach to be adopted for the majority of simpler cases.

We believe that the development of such an approach is already well advanced, as part of the Board's Insurance Contracts Project in relation to liabilities under insurance contracts. Such contracts incorporate most, if not all, of the more complex features that create difficulties, as discussed in paragraphs 5.88 to 5.90 of the Discussion Paper. These include applying the approach proposed in the discussion paper to insurance contracts, take or pay contracts for power and commodities, warranties and guarantees, and long term big ticket construction contracts. Absent these complex features and with appropriate simplifying approximations allowed, the approach that we hope will emerge, for insurance contracts, reduces to the approach in the Discussion Paper that is appropriate for the simpler types of contracts for goods and services.

Purpose

The stated purpose of this project is to develop a suitable accounting approach for contracts with customers for the supply of goods and services that provides clear guidance and simplicity, and results in fewer standards (especially for FASB). Unfortunately, the emphasis on simplicity has resulted in a proposed approach which, while applicable to the majority of simple cases, fails to appropriately handle those with more complex features. It also lacks a framework for dealing with these more complex cases. We believe that the objectives of clear guidance and fewer standards can be better met if the requirement for simplicity in the standard is relaxed, so that simplicity emerges out of the absence of complex features in the contract.

We agree with the proposed approach of basing revenue recognition on changes in the assets and liabilities arising from the contract with the customer. The contracts under consideration provide that, in return for payments by a customer, the supplier will provide goods and/or services to the customer. In order to provide those goods and services, the supplier will incur certain costs. As a result of differences between these two sets of cash flows (customer payments and supplier costs), the supplier's accounts will show a series of gains or losses over time – the profit signature of the contract.

In order to provide information that is useful in making decisions for contracts that extend over time, this profit signature should reflect the supplier's performance of the contract and make economic sense. For this to be the case, the corresponding assets

and liabilities need to reflect the supplier's ability to perform under its contracts, collectively. Neither of these outcomes is possible unless a consistent approach is taken to the measurement (estimation) of these assets and liabilities. This is most easily achieved if both are subject to a single accounting standard.

Proposed General Approach

The general approach that we propose to measuring the liability (or asset) arising from the contract is to make explicit the three main components, set out in paragraph 5.9 of the Discussion Paper quotes as being included in the amount required to meet the performance obligation, namely:

- a) expected costs both direct (e.g. raw materials and labour) and indirect costs (e.g. administrative, plant and service costs);
- b) time value of money
- c) margin because entities price to obtain a return on their provision of goods and services.

Very similar building blocks can be found in IAS 37 Provisions, Contingent Liabilities and Contingent Assets and the Insurance Project.

The first building block, "expected costs", (a) above, is consistent with the fulfilment value approach being proposed in the Insurance Project, and simply needs to be extended to include all expected cash flows arising from the customer contract, be they liabilities – the cost of the goods and services to be provided or assets – the customer payments. This ensures a consistent approach to measuring the net asset/liability position arising from the contract. It is also fully compatible with our understanding of the currently proposed changes to IAS 37.

The second element, "the time value of money" is self evident.

The third element, "the margin" consists of two elements:

- a risk margin relating to the inherent uncertainty in the cash flows and the price (or profit margin) that entities require for accepting that uncertainty, in entering into the contract; and
- a non-negative residual margin to ensure no profit at issue arises. This is essentially the same as that proposed under measurement attribute Option 3 in the Insurance Contracts Project.

This proposed approach is fully compatible with how we would like to see Option 3 implemented for insurance contracts.

The two part approach to the margin may appear complex but, as markets are not always efficient, it is very unwise to assume that the observed margin in a transaction will be sufficient to cover what a rational investor would require, having regard to the uncertainty of outcomes from the transaction. Failure to understand risk and uncertainty, and to price it appropriately, is behind most insurance failures and also plays a significant part in any market failure, including the global financial crisis.

Notwithstanding this, for simple, short-term contracts with no origination costs, the practical implementation of our comprehensive asset/liability approach would reduce to what is proposed in the Discussion Paper. We believe that, for longer-term and more complex contracts, it resolves most, and possibly all, of the concerns likely to arise about the simplified approach adopted in the Discussion Paper. For simple short-term contracts, most of the discussion of implementation issues, in the Discussion Paper, remains relevant and the most appropriate resolution of these issues is largely unaffected.

Origination Costs

Our main concern, beyond the provision of a more general approach, within which to embed the treatment of simple, short-term contracts, lies in the treatment of origination costs. Failure to reflect the fact that these can be a material percentage of customer consideration, can result in a materially misleading presentation of financial results. An ad hoc approach to the deferral of origination costs, which is dependent on whether other standards allow its deferral or on the contract being carved out under another standard (e.g. Insurance or Financial Instruments), is both cumbersome and likely to lead to the artificial distortions associated with accounting arbitrage. We believe that it is important to treat both origination costs and their recoupment consistently, and we address this in more detail further below.

Initial Measurement

In general, the expected present value of customer payments, including a margin for their risk, will differ from the expected present value of cost of goods and services, including a margin for their risk. The initial difference, between these two values, represents a risk adjusted initial estimate of the present value of the profit expected from the contract. This difference, plus the initial margin(s) for risk, as adjusted for differences between actual and expected experience, results in the contract profit signature.

If positive, assuming a no profit at issue constraint, the initial difference is initially held as an additional margin, the residual margin. This residual margin could be divided by the expected present value of cash flows to give a residual loading factor, to be released as these cash flows occur.

Subsequent Measurement

For subsequent measurement, the expected present values of future payments, including the margin for risk, is reassessed on the basis of current information. In addition, if there has been expenditure to create an asset or assets to be transferred to the customer at a future date, the value of those assets is included in the customer liability.

Key Elements

The key elements that need to be reflected are the customer's payments under the contract, the supplier's costs and the transfer of the goods and/or services to the customer.

Customer Payments

In principle, customer payments can be specified as payable at any stage under the contract. The degree to which these payments can be enforced, by the supplier, will depend on a variety of factors, including the terms of the contract, economic conditions and the financial capacity of the customer. Once payments are made, there may be circumstances under which the customer can obtain a full or partial refund. In some cases, the customer may have a degree of freedom as to how much is paid and when. The goods and services that the supplier provides under the contract will then typically depend on the payments actually made. Conversely, some contracts may provide for customer payments that vary according to when or how well the supplier's obligations are performed.

In the general case, once it is decided to recognise a contract, the value of customer payments will be the expected present value of future payments under the contract, minus a risk margin reflecting any uncertainty about those payments. This value is based on current assumptions as to future experience, including assumptions as to customer behaviour in the light of economic and other conditions.

(In some cases, the customer consideration may take forms other than cash payments. How these are allowed for in the expected value of customer is neither central to our

proposed approach nor discussed in the Discussion Paper. We note, that the Board has tentatively expressed a view that they should be measured at Fair Value.)

Supplier Costs

These may be broadly divided into establishment costs and performance costs.

As discussed in the Discussion Paper and elsewhere, it is not immediately obvious which establishment costs should be included in the measurement of a contract. At one extreme, these could be restricted to incremental costs, costs that vary directly with the establishment of a contract. The most obvious of these is sales commission. At the other, establishment costs could be deemed to include a share of all costs incurred in having the ability to enter into such contracts.

While this choice affects the size of the residual margin, it does not affect the structure of what we are proposing. As noted below, however, we believe that establishment costs should, at least, include all direct costs of establishing the contract, including an appropriate share of the cost of marketing and sales activities. To fail to do so would result in inconsistent treatment of otherwise similar businesses selling on commission, through salaried sales staff and direct marketing.

Performance costs can take many forms, including provision of goods from inventory, production of goods to order, construction on the customer's (or third party) premises, direct provision of services, purchase of goods and services and payment of cash. With the exception of cash payments to the customer, the timing of these costs can differ from the timing of the corresponding contract performance *vis-à-vis* the customer. There can also be significant uncertainty about some of these costs, whether as a result of customer actions or extrinsic circumstances. There can also be a need for judgement or conventions in, for example, determining the cash flow equivalent for goods out of inventory or of provision of services, using pre-existing or proprietary techniques. Again, how this need is satisfied is not central to the approach that we propose.

As a general proposition, once it is decided to recognise a contract, the value of supplier costs will be the expected present value of future cash flows in respect of the contract, plus a risk margin reflecting any uncertainty about those cash flows. This value is based on current assumptions as to future experience, including assumptions as to customer behaviour in the light of economic and other conditions.

Transfer of Goods and Services

The issue of when goods and services should be regarded as being transferred from supplier to customer is discussed at some length in the Discussion Paper and is not central to what we propose. What is relevant to our proposal is the treatment of timing mismatches between costs paid by the supplier in respect of goods and services and the transfer of those goods and services to the customer.

Application

The approach outlined above should accommodate all situations, both simple and complex, and does not require a deep and liquid market, as does fair value. For simple contracts, if the time value of money can be ignored on the grounds of materiality, the approach is simplified as well. For many contracts, with simple payment terms and deliverables, it may be appropriate to also ignore the risk margin, on the grounds of materiality.

The main difference, in outcome, from the approach in the Discussion Paper lies in the treatment of origination costs and of preparatory costs that do not result in the creation of a recognisable asset. Under the Discussion Paper approach, that part of customer payments that funds these is not recognised as revenue until delivery of the contracted goods and services. This results in accounting losses that bear no relationship to economic reality.

Under our proposed approach, that part of customer payments needed to fund these costs, offsets these costs as they are paid. As noted in the discussion paper, there is a need to set a boundary between contract origination costs and other costs involved in running a business. Economic reality will be best reflected if this split reflects the approach used for pricing the contract. If this is not explicit, we believe that all direct costs of establishing the contract, including overheads properly attributable to those costs, should be treated as origination costs.

Looking at the outcome from a revenue perspective, customer payments are, in effect, split between cost and profit. The cost component is earned as costs are paid. The profit component is earned as the contracted goods and services are provided.

In principle, if actual origination costs are less than those implied by pricing, a gain or loss can arise when the origination costs are paid. Properly speaking, such a gain is not a profit at inception, since it relates to the payment of costs, rather than to the creation of the contract itself. We would prefer that, for the purposes of spreading the profit component, origination costs are included in the cost of services under the contract.

While, in principle, the liability for future performance costs is fully prospective and should be revisited at each measurement, if the time value of money and risk margins can be ignored, any change in this will, subject to a liability adequacy test, be absorbed in the residual margin and only emerge into profit or loss as the contracted goods and services are provided. This outcome is as proposed under the Discussion Paper approach.

A further desirable simplification is that materiality should be applied to the run-off of the residual margin. If, for example, the expected cost of a warranty is only a small fraction of the cost of the goods provided, re-measurement of the remaining warranty cost could omit the residual margin component.

Answers to Questions

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?

Subject to our view that this needs to be done in a consistent and direct fashion, including all assets and liabilities, yes.

Why or why not?

We agree that consistency is generally desirable and that a single revenue recognition principle assists in achieving this. We also think that consistency is important:

- in the treatment of costs associated with the generation of revenue. We comment further on this in our answer to question 11; and
- where different standards apply to different elements of the contract. We comment further on this in our answer to question 12;

If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

Question 2

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information?

Yes. However, we believe that it is possible to develop a comprehensive asset/liability approach that includes these types of contracts.

Please provide examples and explain why.

<u>Insurance contracts</u>, this arises for a number of reasons.

As is noted in paragraph 5.89 of the discussion paper, insurance contracts have highly variable outcomes, and often cover multiple periods. They also often involve significant acquisition costs and, if appropriately priced, a margin for bearing risk. The revenue recognition approach set out in the discussion paper is unlikely to provide decision useful information for most insurance contracts. This requires a liability measure based on the three building blocks set out in the Insurance Discussion Paper and recently reendorsed by the board in their discussions on the insurance project, namely:

- Explicit current estimates of expected cash flows;
- Discounting for time value of money; and
- Explicit margin for risk.

We note that the recent tentative decision of the Board in the insurance project, to not allow a day one profit, which we support, results in greater alignment of approach with the revenue project and adds, to these three building blocks, a residual margin to exclude day one profit. We regard it as very important that both the discounted cash flows and the explicit risk margin each be subject to current re-measurement and disclosure for insurance liabilities. This gives users critical information about the current exposures and the level of risk. It also means that as experience diverges from that expected in the pricing (and given the high variability in outcomes for insurance this is almost a certainty and the reason that rational markets require a margin for risk in their pricing) this is reflected directly in emerging profit.

The simple approach of allocating premium as earned and only recognising future losses when the expected loss exceed the balance of the premium with no margins for risk results in a poor understanding of risk and the role of uncertainty inherent in insurance outcomes. This tends to over-correction in pricing in response to good experience, which in turn tends to drive the general insurance pricing cycle.

Under the proposed revenue principle the unit of account will be the contract, whereas for insurance contracts the natural unit of account is the portfolio, not the individual contract, as it is only at the portfolio level that expected values make sense and the level of risk is assessed. For example, if the service or "performance obligation" is the payment of a valid claim, then for most contracts the performance obligation will not be satisfied, as a claim will only be paid for the few contracts for which the insured event occurs. For the rest, the premium received will continue to be held as a liability pending the performance obligation being satisfied. Re-characterising the performance obligation as the provision of insurance for the cover period, does not resolve the issue either, as this implies that the premium would be fully released by the end of the cover period. This is only appropriate if the claim has to be notified within the cover period, which is usually not the case. More usually the possibility of a backdated claim slowly fades away and this is normally recognised through the inclusion of reserve for incurred but not reported claims, as part of the insurance liability arising from the contract.

While the approach, that we propose here for Contracts with Customers, is fully compatible with the outcome that we would like to see adopted for pre-claim liabilities under the Insurance Contracts Project, there are sufficient features, specific to insurance contracts, e.g. the need to take a portfolio approach, that we believe that separate treatment remains necessary.

Investment Contracts

The issue here is the potential for accounting mismatch to arise from the interaction between the measurement of the financial instrument liability and the associated management services. Where fair value is available and used (and this is required in Australia where such contracts are issued by life insurers), the financial instrument liability cannot be less the current termination value (deposit floor) of the contract and transaction costs cannot be amortised. This will result in different accounting outcomes:

- In respect of transaction costs, there is no offset if fair value used (assuming no upfront fee charged) or full offset if an amortised cost approach is chosen; depending which measurement option is chosen (or available) in respect of the financial instrument component of the investment contract.
- In respect of ongoing fees, if these give rise to a performance option measured at the expected value of future investment management fees, or if the financial instrument liability can not recognise these as they have not yet been deducted and hence are not reflected in the current termination value

Long-term Contracts

In the current economic climate, in most jurisdictions, for contracts that extend much beyond a year, ignoring the time value of money can result in a significant distortion of economic reality. In an economic climate with high rates of interest and/or inflation, these distortions can be material for even quite short-duration contracts

Product Guarantees and Warranties

The issues are essentially the same as insurance but, when the guarantee provided is only a minor aspect of the contract, the resulting distortions are less likely to be material. There is also much commonality with liabilities generally.

Construction Contracts

Most major construction contracts extend for long enough that the time value of money is highly material. We also understand that there are concerns about the definition of when the contractual obligations under a construction contract are performed.

What alternative principle do you think is more useful in those examples?

We believe that, provided contract performance is suitably defined, our preferred comprehensive asset/liability approach resolves these concerns.

For insurance contracts, we believe that it is important that they continue to be dealt with in the context of the Insurance Contracts Project, where a more appropriate measurement approach is being developed. Our preferred comprehensive asset/liability approach is, however, fully compatible with the outcome that we would like to see in the Insurance Contracts Project.

For investment contracts, it is important that the interaction with financial instrument component is appropriately dealt with in defining the liability arsing from the performance obligation.

As our preferred approach recognises the time value of money, if material, it is more appropriate for long-term contracts

For guarantees, the issue relates to the liability side only. Our preferred approach is similar to that in the proposed changes to IAS 37. If a share of the residual margin is omitted on the grounds of materiality, the result is fully consistent with our understanding of the approach proposed for IAS 37.

Question 3

Do you agree with the boards' definition of a contract?

Yes, provided that the approach to recognising revenue allows all cash flows expected to arise from the contract to be appropriately recognised.

Why or why not?

As noted in our general comments above, once it is decided to recognise a contract, the value of customer payments should be the expected future value of payments under the contract reflecting expected customer behaviour under the contract, without regard to the legal enforceability. Any uncertainty would be reflected in the margin for risk.

Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

Life insurance contracts usually provide for continuation of cover without further underwriting (or ability on the part of the insurer to change the terms of the contract), subject to the payment of the standard premium for such contracts by the customer. Legally this is one contract, and failure to recognise future cash flows expected to arise the exercise the option to continue the contract would give a misleading representation of the nature of the contract.

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?

The proposed definition of a performance obligation works in the context of there being only two parties to the contract.

Why or why not?

It is not clear how it will work if there are other parties involved in the transaction.

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.

For example, if a financial planner provides the client with advice, for which the advisor receives a fee agreed with the client, which is deducted from the client's account by the investment manager (and paid to the advisor) under the terms of the investment management contract then, although a service has been provided by the advisor before the investment management contract, this does not create a performance obligation under the proposed definition for the investment manager, yet the agreed fee for service will be captured as part of the investment manager's remuneration in determining the transaction price to be allocated over his performance obligations.

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?

No.

Why or why not?

This puts too much weight on the form of the transaction, rather than its substance. This is likely to lead to substantial long term contracts being restructured to give some form of continuous transfer, so that profit does not emerge in a lumpy fashion at the end of the contract.

If not, what principle would you specify for separating performance obligations?

We believe that the concept of continuous transfer should be considered.

Ouestion 6

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation?

Yes

Why or why not?

It is very common for legislation to impose cooling off periods, which give the customer the right to unwind the transaction with a set period, with no penalty. For life insurance contracts written in Australia, this is 14 days. If this right is not exercised, then cover is provided from inception of the contract and not the end of the cooling off period, hence we see it as being a more appropriate approach than the alternative of treating the contract as existing only from the end of the cooling off period.

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?

Yes, provided that they meet the definition of a performance obligation.

Why or why not?

If legally enforceable, they represent a liability that should be appropriately recognised.

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?

No.

Why or why not?

We think that the receipt approach is problematic when applied to services and particularly for insurance contracts, as illustrated in our answer to question 2.

If not, please suggest an alternative for determining when a promised good or service is transferred.

We think that an alternative, worth exploring for services, is concept of continuous transfer and the obligation of the customer to pay for the service. This is implicit in our preferred comprehensive asset/liability approach.

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?

Yes

If so, please provide examples.

Contracts that enable substantial acquisition costs to be recovered by way of upfront fees that are not dependant on the contract continuing for their collection. It is very common for investment contracts sold through, retail advisors in Australia, to incorporate upfront fees to recoup some or all of the initial commission paid to the advisor.

It is not decision-useful to represent the transaction as giving rise to an expense that must be recognised immediately but defer recognition of the upfront fee in revenue on the grounds that no service has been provided at inception. This gives rise to a loss and a requirement for capital to finance that loss that is not real, and not reflected in the cash position.

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?

Yes

Why or why not?

It provides an appropriate starting point.

(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?

Yes, if both the time value of money and appropriate risk margins are not material.

Why or why not?

Markets are not perfect and it is important that obligations should be remeasured as soon as it is clear that the margin in the price is inadequate (i.e. appropriate for the remaining risk being borne). We believe that the remeasurement should include an explicit margin consistent with IAS 37 (and as proposed in the Insurance Contracts Project) and not just be based on expected cost. Ignoring risk is particularly inappropriate when outcomes are very uncertain.

It is also highly inappropriate to ignore the time value of money, when it is material.

(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?

Insurance contracts and long-term contracts generally.

Why or why not?

For reasons set out earlier, in particular, our response to question 2.

If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

Refer to our response to Question 2

(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach?

Yes, as discussed in our General Comments.

Why or why not?

See our General Comments.

If so, please provide examples and describe the measurement approach you would use.

See our General Comments.

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?

No

Why or why not?

As noted in our answer to question 9, it is not decision-useful to represent a transaction as giving rise to an expense that must be recognised immediately but defer recognition of the upfront fee received as part of the transaction in revenue, on the grounds that no service has been provided at inception. This gives rise to a loss and requirement for capital to finance a loss that is not real, and not reflected in the cash position.

(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?

The problem does not lie in the recognition of origination coast as expenses as they are incurred. This is entirely appropriate. The issue is not recognising that part of the transaction price recovers this cost. This expenditure should be recognised as reducing any profit margin in the outstanding liability under the contract. Failure to do so, leads reporting of a loss on entering into the contract and a subsequent overstated profit when the performance obligation is meet. This is not a decision useful view of the transaction.

Please provide examples and explain why.

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?

As a general proposition, No. In the case of simple short-term contracts with low origination costs, however, this is a good pragmatic approximation to the more general approach required for longer-term contracts.

Why or why not?

The approach described gives silly answers when there are material origination costs. In such cases, it generates fictitious initial losses.

If not, on what basis would you allocate the transaction price?

As a general proposition, we would apply the comprehensive asset/liability approach described in our general comments. Where there are established stand-alone prices for

the goods and services, and the time value of money is not material, then the contract price, less actual origination costs, should initially be apportioned on the basis of those stand-alone prices. On re-measurement, the latest apportionment should be used for goods and services already delivered and current prices used to re-apportion the balance.

If the time value of money is material, it needs to be considered. Stand-alone prices, if available, may provide a suitable basis for estimating future costs. In principle, estimates of future costs need to be adjusted for inflation.

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?

Yes, if there is no better basis on which to estimate costs.

Why or why not?

The underlying objective, under both the Discussion Paper and our preferred comprehensive asset/liability approach, is to base the allocation on costs.

When, if ever, should the use of estimates be constrained?

Actual costs, if known, should be used if available. This will often not be the case for the future provision of goods and services. If actual costs are not available, fully comparable actual prices should, in principle, be used in preference to estimated prices as a basis for estimating costs.

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