ASSOCIATION ACTUARIELLE INTERNATIONALE
INTERNATIONAL ACTUARIAL ASSOCIATION

October 22, 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir

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

In response to the request for comments on the Exposure Draft *Revenue from Contracts with Customers* (the ED), 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 pursue, please do not hesitate to contact the chairperson of that committee, Sam Gutterman, or any of the other members of the committee. The IAA will be pleased to develop these ideas further with you.

Yours sincerely

Yves Guérard

Yves Guérard
Secretary General

Attachment: IAA comments

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A Commentary on the
EXPOSURE DRAFT ON REVENUE FROM CONTRACTS WITH CUSTOMERS
Released by the International Accounting Standards Board: June 2010

International Actuarial Association and its Due Process

The International Actuarial Association (the "IAA") represents the international actuarial profession. Our sixty-two 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 on the areas of expertise of actuaries.

The IAA is pleased to be given the opportunity to provide input to the IASB on this Exposure Draft. 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

We agree with the Board's rationale for the development of a standard on revenue recognition. We believe that the ED presents an approach to revenue recognition that is both conceptually sound and practical.

We agree that contracts that fall under the insurance contracts standard should be excluded from the scope of the standard on revenue recognition. We note that the existing standard on insurance contracts and the proposed new standard include certain financial instruments in their scope; namely, those with discretionary participation features. In order to make clear that these contracts are not within the scope of the revenue recognition standard, we suggest deleting the word "insurance" from Paragraph 6(b) so that it reads "contracts within the scope of IFRS 4 *Insurance Contracts*".

We are concerned that the ED does not make clear that incremental costs that are directly attributable to securing an investment management contract can be recognized as an asset. We expand upon this comment in our response to Question 8.

In other respects we offer some comments and suggestions that we believe may improve the standard. Our comments suggest ways that the Board can incorporate common actuarial techniques into accounting practices and ways that the standard can be more consistent with other standards. Our specific comments are given in our responses to the questions, which follow.

Responses to Questions

Question 1
Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether to:

(a) combine two or more contracts and account for them as a single contract;
(b) segment a single contract and account for it as two or more contracts; and
(c) account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

IAA Comment: We agree with the principle for price interdependence. However we are concerned with the effects on revenue recognition of the cumulative effect adjustment when a modification results in an interdependent contract. We believe that the modification should be viewed as a renegotiated price for the remaining services and that a "claw back" of revenue does not provide useful information. We also believe that the determination of whether a modification results in an interdependent contract is highly judgmental. We suggest that the Board remove the requirement for a cumulative effect adjustment for contract modifications.

Question 2
The Boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

IAA Comment: We agree with this principle. We note that when payments such as upfront fees are allocated to future performance, there may be deviations from the estimates in the initial allocation. For example, in Example 7, Scenario 1 of B28, the health club may expect to provide services for five years but it may become apparent that customers terminate their memberships on average significantly before five years. We recommend that the Board provide guidance that incorporates grouping of customers and use of expected termination rates when making the initial allocation, and that the Board provide guidance as to how to recognize deviations in experience from that assumed.

Question 3
Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

IAA Comment: We think the guidance is sufficient.

Question 4
The Boards propose that if the amount of consideration is variable, an entity should recognize revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognizing revenue when the transaction price is variable and why?

IAA Comment: We are concerned that this approach may systematically understate revenue in the face of uncertainty. An alternative would be to adapt the approach that the Board has so far developed for uncertain liabilities in the context of IAS 37 and in its insurance contracts project. Under this approach, the transaction price would be estimated at the amount that the entity would rationally accept in lieu of the uncertain amount. In principle, this comprises the expected present value of the contractual amounts, less a margin for risk (noting that the expected present value incorporates allowance for default, whether explicitly in the amounts present valued or in the discount rate).

As it stands, paragraph 38, taken in conjunction with paragraph 41, implies that there are two possible values. Either there is a reasonable estimate, in which case the value is the expected value, or not, in which case the value is whatever can be estimated reliably – in the extreme, the minimum possible value. While this will often produce reasonable results, it will tend to overstate revenue when there is a wide range of possible outcomes with well-understood probabilities and understate it when there is a high degree of uncertainty. We believe that this issue can be accommodated by changing paragraph 38 to read:

> An entity shall recognise revenue from satisfying a performance obligation *to the extent that* the transaction price can be reliably estimated. *For this purpose, the entity shall have regard to both its own experience with similar types of contracts and, to the extent available, the experience of other entities, and shall have regard to the relevance of that experience to the contract.*

and by dropping paragraphs 40 and 41.

This may require some elaboration for those who are not familiar with actuarial credibility theory and similar statistical estimation techniques. The point is that it is always possible both to make an estimate of the expected value of the transaction price and to assess the uncertainty of that estimate. In BC82 the Board has rightly rejected a probability threshold for recognising revenue, on the grounds that such a threshold is arbitrary and creates discontinuity between contracts that almost or just pass that threshold. For the same reason, it should reject a threshold based on the degree of uncertainty.

Rather, what would be appropriate is a value that, looked at one way, discounts the expected value on account of its uncertainty or, looked at the other way, increases the minimum possible value to the extent justified by the credibility of the evidence that it will be greater than the minimum. These two views are equivalent. If there is no credible evidence, the discount for uncertainty will offset the whole of the difference between the (highly uncertain) expected value and the minimum value.

Where this approach differs from one that requires "reliable" estimation is that in principle there is no jump in value as the quality of the evidence passes some threshold and that the value does not immediately jump to the (still rather uncertain) expected value. Instead, the value adopted would increase continually and would only reach the expected value if there is no uncertainty. In practice, of course, materiality comes into play and there will be little point in distinguishing the adopted value from the minimum when the uncertainty is very high, or from the expected value when the uncertainty is very low. The difference in the two approaches comes when there is a moderate level of uncertainty and the range of probable outcomes is wide.

In this context (a wide range of probable outcomes) it can be noted that the discount for uncertainty in assessing revenue is the inverse of the loading that the entity would want on a fixed-price contract. A reasonable rule of thumb is that (on a present value basis) the transaction price for revenue recognition purposes should be as far below the expected value as the fixed price that the entity would require is above the expected value, provided that the transaction price for revenue recognition purposes should not be less than any minimum transaction price.

Question 5
Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect *how much* revenue an entity recognizes when it satisfies a performance obligation rather than *whether* the entity recognizes revenue? If not, why?

IAA Comment: We agree, but note our comment in our response to Question 6 regarding how credit risk is reflected.

Question 6
Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

IAA Comment: We agree that there should be an adjustment, but we do not agree with the requirement in paragraph 45 that, if the time value of money is material, the discount rate *must* incorporate allowance for the customer's credit risk. While reflecting credit risk in the discount rate may often be the most appropriate way of allowing for credit risk, it may sometimes be more appropriate to make an explicit allowance for credit risk, for example by assigning a probability to the collection of the promised consideration. In that regard we note that we have understood the Board's position in prior standards has been that risk should be reflected in the cash flows and not in the discount rate.

Question 7
Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the standalone selling price (estimated if

necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

IAA Comment: We agree.

Question 8
Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, *Intangible Assets*), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why?

IAA Comment: While we agree with the recognition of the costs specified in paragraph 18 as an asset to be amortised on the basis of performance, we believe that the criterion given for this purpose is too narrow. In our view, the criterion should include direct acquisition costs, such as sales commissions, administration costs directly applicable to the sale, tendering costs and contract preparation, similar to the approach that the Board is proposing for short duration insurance contracts.

We are concerned that the ED does not make clear that incremental costs that are directly attributable to securing an investment management contract can be recognized as an asset. Such costs can be significant to many contracts offered by insurers that do not meet the definition of insurance contracts. In order to be consistent with the guidance for insurance contracts we suggest either that the wording in paragraph 14(b)iii of IAS 18 be retained in the new standard for revenue recognition or that the new standard provide guidance for the service component for these contracts that is similar to that used in the guidance for insurance contracts.

Question 9
Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognizing an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognized for an onerous performance obligation. Do you agree with the costs specified? If not, what costs would you include or exclude and why?

IAA Comment: While we would argue that direct origination costs are already included by virtue of the general wording used in (a) to (e), in line with our response to Q8, we suggest that explicit reference to these costs be included.

Question 10
The objective of the Boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

IAA Comment: We are in general agreement with the disclosure requirements. We suggest that paragraph 75 be extended to include a split of outstanding obligations and revenue between those contracts originating in the current and in prior periods.

Question 11
The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

IAA Comment: We agree with this proposal and we suggest that the Board consider also including a split by period of origin in the disclosure of the expected run-off (paragraph 78).

Question 12
Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

IAA Comment: We agree.

Question 13
Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

IAA Comment: We agree.

Question 14
The proposed implementation guidance is intended to assist an entity in applying the principles in the proposed guidance. Do you think that the implementation guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

IAA Comment: We think the implementation guidance is sufficient.

Question 15
The Boards propose that an entity should distinguish between the following types of product warranties:

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

IAA Comment: While we understand the concern implied in the proposal, we believe distinguishing between latent defects and faults arising may often be difficult. We are inclined to believe that both types of warranties should be given the same treatment. We recommend that accounting for product warranties should be consistent with accounting for product warranties provided through insurance contracts.

Questions 16, 17 and 18

IAA Comment: We offer no response to these questions.

Appendix A

Members of the IAA Committee on Insurance Accounting

Sam Gutterman	Chairperson
David Congram	Co-Vice-Chairperson
Francis Ruygt	Co-Vice-Chairperson
Gunn Albertsen	Den Norske Aktuarforening
Victor Hugo Cesar Bagnati	Instituto Brasileiro de Atuária
Daniel N. Barron	Israel Association of Actuaries
Guy Castagnoli	Association Suisse des Actuaires
Antonella Chiricosta	Istituto Italiano degli Attuari
Alexander Dollhopf	Svenska Aktuarieföreningen
David Finnis	Institute of Actuaries of Australia
Mark J Freedman	Society of Actuaries
Kavassery S. Gopalakrishnan	Institute of Actuaries of India
Rokas Gylys	Lietuvos aktuariju draugija
Jozef Hancár	Slovenska Spolocnost Aktuarov
William C. Hines	American Academy of Actuaries
Armand Maurice Ibo	Institut des Actuaires de Côte d'Ivoire
Dragica Jankovic	Udru enje Aktuara Srbije
Burton D Jay	Conference of Consulting Actuaries
Ad Kok	Het Actuarieel Genootschap
Christoph Krischanitz	Aktuarvereinigung Österreichs
Kurt Lambrechts	Association Royale des Actuaires Belges
Yin Lawn	Actuarial Institute of Chinese Taipei
Kristine Lomanovska	Latvijas Aktuaru Asociacija
Ana Maria Martins Pereira	Instituto dos Actuários Portugueses
Brian Morrissey	Society of Actuaries in Ireland
Yoshio Nakamura	Institute of Actuaries of Japan
Marc F Oberholtzer	Casualty Actuarial Society
Manuel Peraita Huerta	Instituto de Actuarios Españoles
Andreja Radic	Hrvatsko Aktuarsko Drustvo
Nithiarani Rajasingham	Singapore Actuarial Society
Ravi Rambarran	Caribbean Actuarial Association
Thomas Ringsted	Den Danske Aktuarforening
Jaanus Sibul	Eesti Aktuaaride Liit
Dieter Silbernagel	Deutsche Aktuarvereinigung e.V.
Mateja Slapar	Slovensko Aktuarsko Drustvo
Pentti Soininen	Suomen Aktuaariyhdistys
Bjarni Thórdarson	Félag Islenskra Tryggingastærðfræðinga
Arseny Timakov	Russian Guild of Actuaries
Charles Vincensini	Institut des Actuaires
Peter Withey	Actuarial Society of South Africa
Derek Wright	Institute of Actuaries
Jana Zelinkova	Ceská Spolecnost Aktuárù
Jesús Zúñiga San Martin	Colegio Nacional de Actuarios A.C.

Appendix B

Full Member Associations of the IAA
Caribbean Actuarial Association
Consejo Profesional de Ciencias Económicas de la Ciudad Autónoma de Buenos Aires (Argentina)
Institute of Actuaries of Australia (Australia)
Aktuarvereinigung Österreichs (AVÖ) (Austria)
Institut des Actuaires en Belgique (Belgique)
Instituto Brasileiro de Atuária (IBA) (Brazil)
Bulgarian Actuarial Society (Bulgaria)
Canadian Institute of Actuaries/Institut Canadien des Actuaires (Canada)
Actuarial Institute of Chinese Taipei (Chinese Taipei)
Institut des Actuaires de Côte d'Ivoire (Côte D`Ivoire)
Hrvatsko Aktuarsko Drustvo (Croatia)
Cyprus Association of Actuaries (Cyprus)
Ceská Spolecnost Aktuárù (Czech Republic)
Den Danske Aktuarforening (Denmark)
Egyptian Society of Actuaries (Egypt)
Eesti Aktuaaride Liit (Estonia)
Suomen Aktuaariyhdistys (Finland)
Institut des Actuaires (France)
Deutsche Aktuarvereinigung e.V. (DAV) (Germany)
Hellenic Actuarial Society (Greece)
Actuarial Society of Hong Kong (Hong Kong)
Magyar Aktuárius Társaság (Hungary)
Félag Islenskra Tryggingastærðfræðinga (Iceland)
Institute of Actuaries of India (India)
Persatuan Aktuaris Indonesia (Indonesia)
Society of Actuaries in Ireland (Ireland)
Israel Association of Actuaries (Israel)
Istituto Italiano degli Attuari (Italy)
Institute of Actuaries of Japan (Japan)
Japanese Society of Certified Pension Actuaries (Japan)
The Actuarial Society of Kenya (Kenya)
Latvijas Aktuaru Asociacija (Latvia)
Lebanese Association of Actuaries (Lebanon)
Lietuvos Aktuariju Draugija (Lithuania)
Persatuan Aktuari Malaysia (Malaysia)
Colegio Nacional de Actuarios A. C. (Mexico)
Association Marocaine des Actuaires (Morocco)
Het Actuarieel Genootschap (Netherlands)
New Zealand Society of Actuaries (New Zealand)
Den Norske Aktuarforening (Norway)
Pakistan Society of Actuaries (Pakistan)
Actuarial Society of the Philippines (Philippines)

Polskie Stowarzyszenie Aktuariuszy (Poland)
Instituto dos Actuários Portugueses (Portugal)
Academia de Actuarios de Puerto Rico (Puerto Rico)
Russian Guild of Actuaries (Russia)
Udruženje Aktuara Srbije (Serbia)
Singapore Actuarial Society (Singapore)
Slovenska Spolocnost Aktuarov (Slovakia)
Slovensko Aktuarsko Drustvo (Slovenia)
Actuarial Society of South Africa (South Africa)
Col.legi d'Actuaris de Catalunya (Spain)
Instituto de Actuarios Españoles (Spain)
Svenska Aktuarieföreningen (Sweden)
Association Suisse des Actuaires (Switzerland)
Society of Actuaries of Thailand (Thailand)
Institute and Faculty of Actuaries (United Kingdom)
American Academy of Actuaries (United States)
American Society of Pension Professionals & Actuaries (United States)
Casualty Actuarial Society (United States)
Conference of Consulting Actuaries (United States)
Society of Actuaries (United States)