

Investment & Life Assurance Group The Practitioner Voice

IASB 1st Floor 30 Cannon Street London EC4M 6XH

12 March 2012

Dear Sirs,

Response to: ED/2011/6: A revision of ED/2010/6 Revenue from Contracts with Customers

The Investment and Life Assurance Group (ILAG) welcomes the opportunity to comment on the above Exposure Draft (ED).

ILAG is a trade body representing members from the Life Assurance and Wealth Management Industries.

ILAG members share and develop their practical experiences and expertise, applying this practitioner knowledge to the development of their businesses, both individually and collectively, for the benefit of members and their customers.

A list of ILAG members is at the end of this submission.

Overview

Generally we welcome the revised proposals and believe they represent a positive contribution towards the IASB aim of creating a revenue recognition standard that clarifies the principles for recognising revenue that can be applied consistently across various transactions, thereby helping to improve comparability.

As we have explained in our previous responses on the subject of the revenue recognition project, there are compelling reasons why insurance contracts should be scoped out of any new revenue recognition standard. We are pleased that the revised ED maintains the exclusion for insurance contracts within the scope of IFRS 4 *Insurance Contracts* (also for contractual rights or obligations within the scope of IFRS 9 *Financial Instruments*).

We also trust that the exclusion will be extended to insurance contracts within the scope of the new Insurance Contracts Standard that is expected to replace IFRS 4 in due course. In finalising the new Insurance Contracts Standard we would encourage the IASB to try to achieve as much consistency as possible with the principles used in developing this ED.

Our main comments on the original ED related to the treatment of acquisition costs and we were concerned that not allowing the deferment of these where they were expected to be recovered from future margins would make financial statements less useful (losses would be recognised in respect of incurred acquisition costs only to be reversed in future reporting periods), as well as being inconsistent with current practice and the proposals for the new

Insurance Contracts standard. We are pleased that the revised ED appears to have addressed this issue by explicitly providing that 'an entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs'.

In terms of the other changes made from the original ED, we would highlight the following as being the most significant:

Transfer of control of a good or service over time

We strongly support the introduction of a specific list of criteria to assess whether revenue should be recognised over time. The Board's intention seems to be that there should be no significant change to current practice in this area, and this is welcome

Use of the 'most likely amount'

Where the promised amount of consideration is variable, being able to estimate the transaction price using the most likely amount rather than an expected value is a definite improvement. As the ED recognises, this option will be useful if the entity does not have a large number of homogeneous contracts or there are only two possible outcomes eg an entity either achieves a performance bonus, or it does not.

There are some areas where **we do not agree** with the ED and these relate to:

Onerous performance obligations

We do not agree that the 'onerous' test should be conducted at inception at the level of individual performance obligations. It should be conducted for the contract as a whole – the contract is what has been negotiated with the customer and it is the contract, as a whole, that the customer expects to be fulfilled

Disclosure requirements

We are still not persuaded that the detailed disclosures requirements, whether in full or interim financial statements, are relevant or useful. In the absence of any clear guidance as to how to apply the concept of materiality to disclosures in financial statements, these are becoming ever longer, and more unfathomable, to the average user and ever more demanding in cost and time terms for preparers to produce. It is increasingly difficult to isolate, from amid all the prescribed disclosure, what is significant to an assessment of the entity's performance.

Finally, on some occasions reference has to be made to the Basis of Conclusions to understand the underlying accounting consequences of a proposal. The Board should review the Basis of Conclusions and consider whether there is material that could be usefully transferred to the standard itself.

Responses to questions

Our responses to the specific questions are set out in the appendix to this letter. Given the nature of our membership, we have tended to focus on the questions principally affecting publicly accountable entities

If you would like to discuss our response in more detail, please do not hesitate to contact us.

Yours faithfully

Lynda Maynard Administration Team

Appendix

Response to specific Consultation 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?

We agree with the proposal and the criteria to be used to determine whether an entity satisfies a performance obligation and recognises revenue over time. The distinction now made between performance obligations satisfied 'over time' and those satisfied 'at a point in time' is a helpful development and the 'over time' criteria are workable in practice when applied to service arrangements.

The explicit references to recognition 'over time' and the clear articulation of the criterion for satisfaction of an obligation in (b)(iii) ('the entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised') are significant improvements to the proposals. We do not anticipate that the revised ED will result in major changes in practice compared to current accounting treatments under IAS 18 and this is a positive outcome.

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?

We agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations. We do, however, question whether it should be a requirement that the entity should have experience with similar types of performance obligations. An entity may be reasonably assured about the amount of revenue without having experience of similar types of performance obligations. The consideration may be sensitive to a single variable input and the entity may have experience of reliably estimating that input. If the entity has historically entered into contracts with variable revenue, it should not be disqualified, by this fact alone, from recognising revenue on a 'reasonably assured' basis.

We are concerned that this approach would result in inconsistent accounting treatments for the same contract, depending on whether the entity performing it is a market entrant or an established player. The focus should purely be on the nature and level of the assurance.

This section would be clearer if paragraph 83 preceded paragraph 82 as this would better make the point that, even if an indicator exists showing that the entity's experience (or other evidence) may not be predictive of the amount of consideration to which the entity will be entitled, this does not necessarily mean that the entity is not reasonably assured to be entitled to an amount of consideration.

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?

We do not agree with the proposed scope of the onerous test. It does not seem logical to recognise a liability at inception for a performance obligation that is onerous if it is part of a contract which is profitable overall. It is the contract as a whole that has been negotiated and entered into with the client.

If the allocation of the transaction price of the contract to the separate performance obligations leads to identifying a loss at contract inception for at least one performance obligation, the allocation principle described in paragraphs 70 to 71 should be adapted to allocate to the onerous performance obligation(s) an amount of consideration which equals the expected costs to be incurred to satisfy those performance obligations plus an appropriate margin. This margin should either be the percentage margin of the contract as a whole or the margin customarily achieved by the entity on the relevant type of performance obligation.

The residual consideration should then be allocated to the other performance obligations (ie those that were profitable according to the first step allocation) on a relative stand-alone selling price basis. If, following this allocation, another obligation appears to be onerous, there should be another iteration of the previous 'expected cost plus margin' approach and this process should continue until there is onerous performance obligation.

The above should apply only at inception, however. If, during the life of the contract, a performance obligation becomes onerous, then a liability should be recognised in respect of this portion of the contract even though, overall, the remaining performance obligation of the contact is profitable.

The new standard should specify that the stated prices within a contract for its constituent performance obligations should not necessarily be preferred to stand-alone selling prices.

We also disagree with limiting the onerous test to performance obligations that are expected to be satisfied over a period longer than one year. There is no logical justification for excluding shorter duration or 'at a point in time' performance obligations from the scope of the test.

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)

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 fulfil a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

We do not agree that an entity should be required to provide each of the stated disclosures in its interim financial reports. We are not even convinced that the benefit to users of these disclosures in annual financial reports will outweigh the costs to preparers. We doubt whether there is a great demand for any addition to the voluminous and ever increasing body of disclosures required.

Any disclosure requirements in respect of revenue should be driven by the 'chief operating decision maker' approach – what information is actually used in running the business.

On the specific question of interim accounts we consider the routine inclusion of the suggested disclosures to be inconsistent with the principle set out in IAS 34 para 15A: 'A user of an entity's interim financial report will have access to the most recent annual financial report of that entity. Therefore it is unnecessary for the notes to an interim financial report to provide relatively insignificant updates to the information that was reported in the notes in the most recent annual financial report'. Providing revenue in one interim period is in line with that recognised in the comparative period, no detailed disclosures are required.

Ends

ILAG Membership

Members

AXA Wealth Barclays Wealth Barnett Waddingham Canada Life Limited

Capita Life and Pensions Services Co-operative Financial Services

Defaqto Deloitte LLP

Ecclesiastical Insurance Group

Ernst & Young
Family Investments
Fil Life Insurance Limited

Friends Life

General Reinsurance (London Branch)

Grant Thornton

Hannover Life Re (UK) Ltd

HSBC Bank Plc

Just Retirement Limited

HCL Insurance BPO Services Limited

KPMG Logica

London & Colonial Assurance PLC

LV= Milliman Met Life UK

Metropolitan Police Friendly Society Ltd

MGM Advantage

Mazars

Oxford Actuaries and Consultants plc

Pacific Life Re

Partnership Assurance

Phoenix Group Pinsent Masons

PricewaterhouseCoopers

Reliance Mutual

RGA

Royal London Group Sanlam Life & Pensions SCOR Global UK Limited.

Skandia UK Suffolk Life

Sun Life Assurance Company of Canada

Swiss Re Europe SA (UK Branch)

The Children's Mutual Towers Watson

Wesleyan Assurance Society

Zurich

Associate Members

AKG Actuaries and Consultants Ltd Steve Dixon Consultants and Actuaries McCurrach Financial Services Meteor Asset Management NMG Financial Services Consulting Limited State Street Investor Services