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AMERICAN ACADEMY *of* ACTUARIES

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March 13, 2012

Financial Accounting Standards Board (FASB)  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

Re: Comments on *Proposed Accounting Standards Update Revenue Recognition (Topic 605) - Revenue from Contracts with Customers*

On behalf of the American Academy of Actuaries'<sup>1</sup> Financial Reporting Committee, I offer the attached comments on the revised FASB Exposure Draft on Revenue Recognition (ED).

Sincerely,

William C. Hines  
Chairperson, Financial Reporting Committee  
American Academy of Actuaries  
Risk Management and Financial Reporting Council

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<sup>1</sup> The American Academy of Actuaries is 17,000 member professional association whose mission is to serve the public and the U.S. actuarial profession. The Academy assists public policy-makers on all levels by providing leadership, objective expertise and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice and professionalism standards for actuarial in the United States.

## General Comments

Overall, the Financial Reporting Committee (“committee”) supports the FASB’s proposed revenue recognition model. The committee’s primary concern is in insurance contracts, and we note that contracts currently in the scope of ASC Topic 944 are specifically “scoped out” of the proposed standard. However, there are some contracts that are not under the scope of ASC Topic 944 but are likely to be included under the scope of the insurance contracts project (e.g., prepaid health plans reporting under ASC Topic 954), and these contracts would appear to be “scoped into” the proposed revenue recognition standard. Also, we are concerned with the implications of the proposed guidance to insurance companies who offer contracts that fall within the scope of the proposed standard. It is important to have general, high-level consistency between accounting for non-insurance contracts with customers that are covered by this ED and accounting for insurance contracts. Many insurers provide policy administration and claims services under contracts that are likely to fall within the scope of this standard. Some insurance contracts also have significant service elements, which, depending on the eventual guidance arising from the insurance project, could be separated (“unbundled”) and treated as service contracts. We provide specific comments in the following paragraph.

## Effective Date and Transition

It would be desirable for the effective date of this standard and the insurance contract standard to be the same. At the very least, if the effective date of this document precedes the insurance contracts standard, then all contracts to be considered within the scope of the insurance contracts standard should be excluded from the revenue recognition standard in order to prevent an organization from having to make multiple changes to its revenue recognition accounting practices within a short time period.

## Responses to Questions

We provide responses to questions 1, 3 and 4. We have no comment on the other questions posed in the ED.

### Question 1

**“Paragraphs 35 and 36 specify when an entity transfers control of the good or service over time and, hence, when an entity satisfies performance obligation and recognizes 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?”**

Our primary concern with Question 1 relates to whether “service” will be interpreted to include all services in a contract (for example, whether to include in the case of insurance risk coverage) and whether the related term “performance obligation” will be interpreted to include obligations to third parties (such as to governmental and/or quasi-governmental agencies in the case of insurance contracts). We previously highlighted this concern in our June 18, 2009 response<sup>2</sup> to Question 4 of the FASB’s “Preliminary Views on Revenue Recognition in Contracts with Customers”. This response is provided again below:

“We think this definition is appropriate in general, but more specific guidance is needed for insurance contracts. We therefore would propose that the Insurance Contracts Standard (“ICS”) clarify that insurance contracts provide the service of insurance risk coverage over the coverage period. Therefore, revenue for an insurance contract should be recognized over the risk period as that coverage is provided, even if the actual payment of a covered claim is made after the end of the coverage period. Such a pattern of revenue recognition is consistent with defining the performance obligation provided by insurance contracts as risk coverage. As of the end of the coverage period, the insurer estimates its liability both for known and for incurred but as yet unreported claims. Treatment of such post-claim liabilities should be addressed in the ICS.”

“We are concerned that the definition of performance obligation may not encompass at least one component of U.S. insurance contracts that can be material in certain situations. This component involves legal obligations to parties other than the customer that may arise out of insurance contracts, typically in the form of assessments payable to government and/or quasi-governmental agencies. Clarification should be provided in the ICS that such assessments are required as a result of the contract that provides the insurance coverage, and are included within the performance obligation to provide such coverage.”

Although our comments from 2009 above directly addressed the insurance contracts project, we have the same concerns for similar products that may not fall within the scope of the insurance contracts project, or where some contracts may be subject to this standard during the potential interim period between when this standard on revenue recognition becomes effective and when the insurance contract standard that is currently under development becomes effective (e.g., contracts issued by health care entities currently subject to ASC Topic 954).

### 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 recognizes 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**

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<sup>2</sup> [http://www.actuary.org/pdf/finreport/fasb\\_june09.pdf](http://www.actuary.org/pdf/finreport/fasb_june09.pdf)

**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 recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?”**

In our view the restraints in Paragraphs 81 and 82 are too restrictive. Estimates of the future are often affected by the four indicators cited in Paragraph 82: “factors outside the entity’s influence”; “uncertainty”; “experience -- is limited”; “broad range of possible consideration amounts”, yet reliable and reasonable estimates can still be determined by those with the technical expertise. The constraint should only be applied when the entity’s future experience cannot be reasonably estimated.

#### **Question 4**

**“For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time over one year, Paragraph 86 states that the entity should recognize 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?”**

Generally, we agree with the proposed scope of the “onerous test.” However, this test should not be applied solely on a contract-by-contract basis. Aggregation of generally similar contracts would be a more appropriate measurement level. This is particularly true in the case of insurance contracts, where aggregation at some portfolio level is consistent with the manner in which products are priced and managed and with how the existing onerous contract guidance (premium deficiency reserves) in ASC Topic 944 is designed.

We thank you for the opportunity to comment on your proposed revenue recognition model. If you have any questions, please contact Tina Getachew, senior policy analyst, Risk Management and Financial Reporting Council, via email ([getachew@actuary.org](mailto:getachew@actuary.org)) or phone (202/223-8196).