Sir David Tweedie
International Accounting Standards Board
30 Cannon Street
London, EC4M 6XH

16 June 2009

Dear Sir David,

We welcome the opportunity to comment on your Discussion Paper – *Preliminary Views on Revenue Recognition in Contracts with Customers* (the "discussion paper"). This letter has been drafted by the European Insurance CFO Forum ("the CFO Forum"), which is a body representing the views of 20 of Europe's largest insurance companies, and the Comité Européen des Assurances ("CEA"), representing 94% of the European insurance market. The letter represents a consensus view on issues specifically impacting the European insurance industry.

The CFO Forum and CEA have considered how your proposals for revenue recognition would apply to the types of contracts entered into by insurers in order to assist the IASB's further deliberation of revenue recognition for more complex contracts. Although the observations in this letter relate to insurance and investment contracts and other insurance-related and investment service agreements, it is recognised that similar observations could be made for many different types of contracts which are long term and/or give rise to rights and obligations that are uncertain in nature.

There is a lack of clarity around the interaction between revenue recognition and insurance contracts phase II proposals

We have closely monitored the development of the Revenue Recognition Project, in light of the potential importance of this project for our members. Our views, expressed in this letter and its appendix, are consistent with the views expressed by the CFO Forum and CEA in relation to the IASB's Insurance Contracts Project. We believe, however, that there are significant inconsistencies between the proposals in the Revenue Recognition discussion paper and those being discussed by the IASB on the Insurance Contracts Project. These include the measurement attribute, initial and subsequent measurement, margins and acquisition costs.

The current proposals cannot be meaningfully applied to contracts such as insurance

We do not consider the proposals could be applied as drafted to complex contracts with inherent uncertainty, such as insurance contracts, for the reasons set out below. We do not believe the principles in the discussion paper are sufficiently robust to enable them to be used to deal with anything other than the simplest types of contract.

In our view the Boards should seek to develop a broader set of principles that would be applicable to all types of contract. This is consistent with the principles based philosophy of IFRS. Many of the proposals in the discussion paper could then be retained as implementation guidance for simple contracts where allocation of consideration represents a suitable proxy for measuring performance and there is no need to remeasure the underlying components of the contract.

The revenue recognition proposals drive liability measurement and hence profit recognition

The discussion paper is unclear with regard to what it is seeking to achieve; revenue recognition or profit recognition. Revenue recognition based on the measurement of the assets and liabilities under the contract results in a direct impact on profit and loss and a measure of the performance obligation rather than providing a pure focus on 'top-line' revenue.

The proposed model focuses on the contract with the customer and the respective rights and obligations that this gives rise to. Revenue is recognised when a performance obligation is satisfied. In measuring the contract the model assumes that both the rights under the contract and performance obligations are measured at the transaction price. The standard is therefore proposing a measurement basis for the performance obligations and hence the corresponding balance sheet liabilities. Hence, de facto, liabilities are calibrated to the transaction price at inception and remeasured only if the performance obligations become onerous. Therefore we consider that the proposals are not just concerned with top line income (premium) but have wider implications for the measurement of liabilities.

The value of the liability at the balance sheet date is a key piece of information for users. By including a basis of valuation of a liability in the revenue recognition standard the Boards are essentially implementing a valuation basis that may differ from that which may be considered appropriate for all contracts. We do not believe it is appropriate that this is determined by reference to the historic transaction price as proposed in this discussion paper, and would consider that contracts with uncertainty should be re-measured. The proposals in this discussion paper do not appear to place sufficient importance on the balance sheet and specifically for insurers the obligations to policyholders as a result of contracts written. Insurance accounting has typically defined profit based on the valuation of the liabilities associated with the contracts written, rather than the revenue generated, and the ongoing insurance contracts project is currently addressing the basis of this valuation. The CFO Forum and CEA have contributed our thoughts on insurance contract valuation to the IASB in this respect.

In summary, the discussion paper goes far beyond simply determining top-line revenue. It both determines profit recognition and the value of the performance obligation and assumes that these are directly linked. For the reasons set out above, we do not believe that this is an appropriate model. In order to provide decision useful information, performance obligations should represent the cost of fulfilling these obligations. A separate profit margin should be recognised in the balance sheet to enable the recognition of profit as obligations are performed. For insurance we believe this should be in line with the release from risk.

Presentation issues must not be forgotten

In this response letter we have focused on measurement and recognition issues. We note, however, that presentation issues must also be carefully considered and addressed in the final standard.

There are a number of specific issues for insurance and other contracts with uncertain cash flows

We have considered whether the generic revenue recognition proposals in the discussion paper would be appropriate for the types of contracts written by insurers, including both insurance and investment contracts. In summary, we do not believe that the proposals as currently drafted could be meaningfully used for such contracts.

The following matters are particularly relevant when considering the discussion paper proposals in relation to insurance and other long term contracts with uncertain cash flows:

- **Acquisition Costs** - Initial acquisition costs are significant to the economics of insurance and investment contracts. The valuation of these contracts, at inception and subsequently, should exclude premium income required to offset initial acquisition costs. Accordingly, such amounts should be recognised as revenue on contract inception.

- **Measurement attribute -** to the extent that the discussion paper is providing a basis to measure the performance obligation and hence the remaining liability, we are not certain of the measurement attribute that the Boards are seeking to apply over the life of the contract. On initial measurement, the objective seems to be to measure the performance obligation by reference to transaction price such that no revenue is recognised on day one. Subsequent measurement is either 'locked in' to the premium and allocated or based on an expected cost if the obligation becomes onerous. It would seem more appropriate to apply a consistent measurement basis across the life of the contract.

- **Initial measurement** - We believe that the most appropriate basis of valuing an insurance contract is the economic value of the contract which, in our letter to the IASB of 25 July 2008, we have termed "market consistent fulfilment value". We do not believe the most appropriate basis of valuing an insurance contract is the original transaction price i.e. premium. The initial profit margin at contract inception should not be included within the contract liability value, as it would be under the discussion paper proposals, but should be shown separately in the liability section of the balance sheet. We define the initial profit margin as the difference between the premium and the "market consistent fulfilment value".

- **Subsequent measurement/Remeasurement** - We have always advocated an active basis of valuation for insurance liabilities; such a basis of valuation requires ongoing remeasurement. Accordingly, subsequent to contract inception, for all contracts, changes in assumptions should be reflected in the contract liability value and either in profit or loss, OCI or through adjustment of the initial profit margin as appropriate. Profit margin should be recognised in line with release from risk. We believe that all performance obligations should be remeasured, however, under the discussion paper, performance obligations are 'locked in' and only re-measured in the event they becomes onerous, which is asymmetrical. When onerous the basis of valuation differs from that on initial measurement and, in our view appears closer to the fulfilment type notion we have advocated for insurance contracts. However, we believe that such a valuation should include a risk margin which is not the case in the discussion paper proposals.

- **Identification and satisfaction of performance obligations and unbundling** - The application of the performance obligation concept for insurance contracts and investment contracts is open to interpretation, which could result in materially different revenue recognition patterns. Annuity contracts illustrate some of these issues. Such contracts may include a single premium at inception or accumulation of funds up to retirement followed by a payout phase, the latter for an uncertain period up to the insured's death. For example, a single premium paid at the inception of such a contract may therefore require recognition over a very long and uncertain period rather than the current practice of full recognition at inception with establishment of an appropriate insurance liability that determines profit recognition. In addition, it would seem inappropriate if, for example, 20 years into such a contract, the value of this contract is not re-measured but the performance obligation is still being calibrated to the original transaction price (unless onerous). This is aside from other complexities including the time value of money and changing risk profiles.

Similar issues are likely to occur across many types of contract written by insurers, for example, property and casualty business where latent claims such as those arising from asbestosis may arise many years after the initial period of coverage or when considering retrospective insurance contracts.

We support the view that revenue should be recognised as the obligations under the contract are performed but consider that the different components of insurance contracts are often interdependent and splitting these out results in arbitrary judgement calls and spurious accuracy in the measurement of those contracts.

- **Unit of Account** – Insurance business is based on pooling and managing a portfolio of risks. Estimating the value of contracts when the rights and obligations are contingent on uncertain events may be impossible at an individual contract level; however estimating values for a portfolio of contracts can achieve reliable estimates suitable as a basis for revenue recognition. In particular, the separate identification of onerous performance obligations is unworkable for individual insurance contracts. We have always argued that unit of account is an important consideration in the measurement of insurance contracts.

Some issues are also relevant to investment contracts
We would like to emphasise that some of the points described above, in particular acquisition costs, are equally applicable to contracts which may not qualify as "insurance contracts" under IFRS 4 and therefore it is not appropriate to argue for a simple "scoping out" of insurance contracts. Insurers write a significant number of investment contracts which are measured in accordance with IAS 39 and where revenue is accounted for in accordance with IAS 18, which currently allows deferral of acquisition costs.

Responses to questions
We have set out responses to specific questions raised in the Discussion Paper in the Appendix to this letter and would be happy to elaborate on any of the matters raised should you require it.

If you have any queries that you would like to raise in relation to the matters raised in this letter, please feel free to contact us.

Yours sincerely

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Chairman
European Insurance CFO Forum

Alberto Corinti
CEA Deputy Director General/
Director Economics & Finance

Appendix: Response 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? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

Response

The discussion paper assumes a direct correlation between revenue recognition and profit recognition. We agree that revenue recognition should be based, in principle, on changes in an entity's contract asset or contract liability, where revenue is defined as the gross inflow of economic benefits arising in the course of the ordinary activities of an entity. For simple contracts profits are the price paid less the cost of the good. For long term contracts the inflow of economic benefits under the contract arises from changes in the economic value of the future rights and obligations.

Transaction prices are not a suitable basis for subsequent measurement of contracts whose rights and obligations are contingent on uncertain events outside of the control of the parties to the contract. An existing contract with five years remaining cover does not necessarily have the same characteristics as a five year contract offering the same coverage that is just commencing. Apart from transaction price the proposals do not state a clear measurement attribute leaving the measurement of contract assets and liabilities open to a wide range of interpretation resulting in inconsistent revenue recognition patterns.

Often the transaction prices for contracts sold by insurers will contain additional margins in excess of the economic value of the transaction to the insurer. Such additional margins relate to the customer's willingness to enter into the transaction rather than the pure cost of providing the contract. We do not consider this is part of the measurement of the obligation to the policyholder and therefore should not be included within the contract liability. These should be recognised over the coverage period defined in the contract or at inception for contracts without a defined coverage period.

A universal revenue recognition standard based on the underlying value of contracts has the potential to achieve consistent measurement of economically similar contracts that would otherwise be subject to different reporting requirements. Whilst in favour of consistent measurement, we acknowledge that the development of a single revenue recognition standard for all contracts that is sufficiently granular for consistent application, may be difficult to achieve. A pragmatic approach might be achieved by developing a standard that is appropriate for more complex contracts whilst permitting short-cuts and proxies for simpler contracts.

Question 2

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

Response

Yes. For insurance and many investment contracts the measurement of the contract assets and contract liabilities depends upon assumptions of future uncertainties: which loss events will occur, when will they occur and how much will it cost to settle the resulting losses. The same applies to other types of long term contracts which are subject to uncertainty. The ultimate cost of claims and benefit payments and, for some contracts, the ultimate premiums received, depends on events outside the control of the issuing entity. Furthermore, the principle as set out in the discussion paper does not extend to subsequent measurement as changes in contract assets and liabilities are not reflected in revenue recognition unless performance obligations are deemed onerous. We have always advocated an active basis of valuation for insurance liabilities; such a basis of valuation requires remeasurement. Accordingly, subsequent to contract inception, for all contracts, changes in assumptions should be reflected in the contract liability value. For long term contracts with uncertainty, a current best estimate of the obligations is essential to provide meaningful information to users, The correlation between revenue and profit recognition highlighted in the response to question 1 above is also significant in this regard. These points are considered further in response to question 9 on satisfaction of performance obligations.

As explained in our covering letter, there are key considerations for insurance and investment contracts that are not currently addressed in the revenue recognition discussion paper. Interpretation of the current proposals would lead to inconsistent accounting practices and financial reporting that is not decision-useful.

Question 3
Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

Response
The discussion paper requires a clear definition of a contract and is currently favouring a definition based on the enforceability of rights and obligations under the contract. Some insurance and investment contracts include rights and obligations that are met at the discretion of one of the parties to the contract but create certain expectations for the other party, which are reflected in the overall transaction price, for example, discretionary participating contracts, contracts offering premium "holidays", Universal Life contracts, contracts which include options and guarantees.

Evaluating these contracts based solely on the enforceable rights and obligations does not reflect the true economics of these transactions. We have deliberated on the boundaries of contracts and concluded that valuation should be based on the expected future cash flows that are expected to fall within the contract's term, including the value of any options or guarantees attaching to those contracts given anticipated wider economic conditions and typical policyholder behaviour in those conditions. The term of a contract is the shorter of the contract's life and the point, if any, at which the policy can be freely re-priced by the insurer.

Question 4
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? Why or why not? 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.

Response
The application of the performance obligation concept for insurance contracts and some investment contracts is open to interpretation which could result in materially different revenue recognition patterns. Consider even a simple home insurance contract. Many would consider that the performance obligation is to bear the risk of a loss event occurring over the contract term. Consistent with the warranty example in the discussion paper, revenue is recognised over the term of the contract as the service is provided.

Whilst for the warranty example most claims will be settled during or very soon after the termination of the contract under a household policy some claims will remain open until several years after the end of the coverage period. For liability insurance policies a material amount of claims may remain outstanding many years after the end of the coverage period and, in addition, loss events that may have been incurred during the coverage period may not even be known at the end of that period. If the performance obligation is to settle the claims with the policyholder then revenue would be recognised over a period of many years with no clear end date as to when the last claim might have been settled.

The Discussion paper is not sufficiently clear on what constitutes a performance obligation, particularly in respect of service contracts and the level of granularity at which these should be separately identified. The model based on passing of control is not as easily applied to service contracts.

We consider that the service provided under an insurance contract is that of bearing risk of a future event so revenue should be recognised over the coverage period, consistent with current accounting bases applying in most territories. As the risk coverage expires a liability accrues for the cost of future claims arising from loss events occurring during the coverage period.

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

Response
Most life insurance contracts provide elements of protection and savings, for example payment of the larger of a guaranteed amount or the policyholder's fund on maturity of the contract or on earlier death. Whilst the contract clearly provides both a mortality benefit and an investment benefit, the overall value of the death benefit also depends on investment performance. Revenue could be recognised in line with the increasing risk of mortality over the term of the contract. Typically for portfolios of such contracts payments at maturity significantly outweigh earlier death benefits; however, recognising all revenue at maturity would fail to recognise the investment management services and risk coverage provided over the term of the contract.

We support the view that revenue should be recognised as the obligations under the contracts are performed but considers that the different components of insurance contracts are often interdependent and splitting these out results in arbitrary judgements and spurious accuracy in the measurement of those contracts. It would be rare to be able to identify transaction prices for individual components of an insurance contract due to the interdependency of the components in the contract.

Performance obligations should not be separately identified for components of insurance and investment contracts unless those components are clearly not interdependent and their value can be estimated reliably.

Question 6
Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

Response
For insurance and investment contracts, the ability for policyholders to cancel or surrender is not a separate performance obligation. The decision to continue with the contract or to cancel is just one uncertainty in an inherently uncertain arrangement and should be dealt with in the measurement of the rights and obligations under the contract.

Question 7
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? Why or why not?

Response
The treatment of sales incentives is not a material issue for the insurance industry.

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

Response
It is difficult to interpret the delivery of a good or service for insurance and the identification and satisfaction of performance objectives for insurance and investment contracts is varied and would result in different revenue recognition patterns depending on the interpretation.

As previously stated we believe that the performance obligation under insurance contracts is standing ready to bear risk. We believe that that service is transferred continuously over the coverage period.

Consider a contract that will provide a lump sum payment at maturity or on earlier death. If most policyholders live to maturity and receive their lump sum payment this could be seen to imply that no revenue could be recognised until the contracts reach maturity. A few policyholders will die prior to maturity and other policyholders may decide to lapse the cover and take a surrender payment. The insurer is providing services over the term of the contract. Accordingly, in our view, revenue should be recognised over the term of the contract consistent with the services provided. It is not clear, however, to what extent bearing risk and managing investments would currently meet the definitions of goods or services under the current proposals.

We believe that the most appropriate basis for recognising revenue from a property and casualty insurance contract is in line with release from risk under the contract. Interpreting that in terms of the current proposals, standing ready to bear risk each day would be seen as a performance obligation. As each day passes the appropriate revenue can be recognised, however, it would be necessary to set up a liability for the cost of settling claims after a loss event, which may not yet be known.

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? If so, please provide examples.

Response
Yes. We have considered these proposals in relation to some of the contracts written by insurers and discuss below our observations in this regard.

Casualty insurance and latent claims: at the end of the contract period some claims will have been notified, other loss events will not have been notified to insurers and, in the case of latent claims, the policyholder or other protected parties may not realise an event has occurred that will entitle them to make a claim at a future date. The pattern of future loss settlements can be estimated but large claims settling a long time after the end of the contract period tend to be highly uncertain leading to variability in assumptions and hence in the resulting revenue recognition patterns. As noted above we favour recognition of revenue over the contract term with a liability being established to meet the cost of settling claims after a loss event.

Life contingent annuity: under these contracts a single premium is received in return for a stream of regular payments up until the death of the policyholder. One interpretation would be to consider each individual benefit payment as a performance objective, such that revenue associated with the payment is recognised as each payment is made. Since the total number of payments is unknown the amount of revenue recognised at each payment date is subjective. The current approach would recognise all revenue at inception of the contract and require a suitable liability to be established to settle future claims. We believe that this basis of accounting is reflective of the economics of the contract and hence would favour such a methodology under any new proposals.

Run-off reinsurance: this type of cover is typically sold after the coverage period of the underlying contracts has expired and provides protection for the ceding party against the total cost of claims from the underlying business exceeding a certain amount. Similar to life contingent annuities there is no fixed term over which claims will be settled hence the revenue recognition pattern will depend on subjective assumptions. We favour a methodology that recognises all revenue at inception but requires a suitable liability to be established to meet the future cost of benefit payments.

Investment contracts and investment management contracts: both these types of contracts provide investment management services; however, the former also bears financial risks on behalf of the policyholder, whilst the latter is a service provision contract. Under the investment management contract, the service is clearly provided over the term of the contract, perhaps increasing or decreasing in line with the volume of funds in management. Some may consider that the performance obligation under an investment contract is to pay the maturity benefit when it falls due. We are concerned that the revenue recognition patterns under these two types of contracts may be materially different when the services provided are broadly similar, namely the management of investments over the term of the contract.

We believe that basing revenue recognition on arbitrarily defined performance obligations, as would be the case for insurance contracts, is not appropriate. We favour revenue recognition based on release from risk of a loss event occurring and a liability, including a margin for bearing risk, established for uncertain future claims payments in respect of expired coverage periods.

Question 10

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? Why or why not?

(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? Why or why not?

(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? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

Response

(a) No. At inception, insurance contracts should be measured at the economic value of the contract which, in our letter to the IASB of 25 July 2008, we have termed "market consistent fulfilment value". At inception the difference between this value and the transaction price is deferred profit which should represent a separate liability in the balance sheet.

(b) We do not believe that remeasurement should be limited to situations where performance obligations are deemed onerous, as this is asymmetrical. This point is discussed further in the response to question 10(c) below. Notwithstanding that point, we do not support the proposed remeasurement basis for onerous performance obligations. The discussion paper introduces a basis of remeasurement of onerous performance obligations that reflects the entity's expected cost of satisfying the performance obligation. This basis of valuation differs from that on initial measurement and, in our view, appears to be closer to the fulfilment style value we have advocated for insurance contracts. However, we believe that such a valuation should include a risk margin which is not the case in the discussion paper proposals. We consider that insurance contracts should be remeasured at “market consistent fulfilment value” at each subsequent financial reporting date. Any separate liability for deferred profit should be recognised over the contract coverage period in line with release from risk.

Overall to the extent that the discussion paper is providing a basis to measure the performance obligation and hence the remaining liability, we are not certain of the measurement attribute that the Boards are seeking to apply over the life of the contract. On initial measurement, the objective seems to be to measure the performance obligation by reference to transaction price such that no revenue is recognised on day one. Subsequent measurement is either ‘locked in’ to the premium and allocated or based on an expected cost if the obligation becomes onerous. It would seem more appropriate to apply a consistent measurement basis across the life of the contract.

(c) Yes, we have already indicated this in our response to question 2. For insurance and many investment contracts the measurement of the contract assets and contract liabilities depends upon assumptions of future uncertainties: which loss events will occur, when will they occur and how much will it cost to settle the resulting losses. The same applies to other types of long term contracts which are subject to uncertainty. The principle as set out in the discussion paper does not extend to subsequent measurement as changes in contract assets and liabilities are not reflected in revenue recognition unless performance obligations are deemed onerous. We have always advocated an active basis of valuation for insurance liabilities; such a basis of valuation requires remeasurement. Accordingly, subsequent to contract inception, for all contracts, changes in assumptions should be reflected in the contract liability value. For long term contracts with uncertainty, a current best estimate of the obligations is essential to provide meaningful information to users.

At subsequent measurement dates the financial information will not be decision-useful unless the contract value is reassessed based on current expectations of the timing, amount and uncertainty of future cash flows and revenue recognition patterns adjusted accordingly on a prospective basis. Revaluation of contacts to reflect updated expectations for future contract performance should not require restatement of past revenue recognition. Variation in contract values resulting from certain types of assumption changes, notably those relating to financial assumptions, and hence changes in revenue recognition patterns should flow directly to profit and loss at each financial reporting date (subject to the treatment of the backing assets). For other assumption changes we believe that the deferred profit component of unrecognised revenue should be adjusted subject to that amount not becoming negative. This would result in valuation changes being spread over the future revenue recognition profile rather than recognised immediately as profit or loss.

For contracts where there is uncertainty as to the goods or services that will be delivered or uncertainty as to the timing of those goods and services, measurement of the value of those contracts after inception cannot be determined from the initial premium paid. Estimating the value of contracts when the rights and obligations are contingent on uncertain events may be impossible for individual contracts, however estimating values for a portfolio of contracts can achieve reliable estimates suitable as a basis for revenue recognition. Unit of account is an important consideration, often a key assumption in the measurement of insurance contracts.

We consider that the recognition of revenue in line with performance obligations is not appropriate for contracts where the performance obligations relate solely to the settlement of claims. All revenue should be recognised over the period of exposure to loss events, or at inception where the loss events occurred prior to inception of the contracts. Settlement of claims is most appropriately measured by establishing a contract liability based on the expected cost of fulfilling the obligations net of any rights under the contact, including a margin for bearing risk.

(d) Whilst we are in favour of consistency of revenue recognition across industries, we acknowledge that the development of a single revenue recognition standard for all contracts that is sufficiently granular for consistent application, may be difficult to achieve. A pragmatic approach would be to develop a broader set of principles that is appropriate for more complex contracts whilst permitting short-cuts and proxies for simpler contracts.

Question 11

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? Why or why not?

(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? Please provide examples and explain why.

Response

The decision as to whether acquisition costs should be expensed when incurred can only be made in the context of the entire valuation model. Where this valuation model is based on a prospective valuation of the future cost of the expected obligations arising under those contracts, no additional allowance for acquisition costs is required. Under the proposals for revenue recognition, however, the transaction price applicable to the future performance obligations should be the premium less revenue to match initial acquisition costs to avoid overstatement of the liabilities for all contracts sold by insurance and reinsurance companies.

(a) No, we do not agree. The transaction price for contracts that give rise to significant acquisition costs includes a margin to cover those costs. Applying the whole transaction price at inception overstates the value of the identified future performance obligations. The Board feel that this error is less of a concern than the potential problems with applying an exit value approach. This may be true for simple contracts with low levels of acquisition costs but for insurance contracts with significant acquisition costs the potential overstatement of the value of the future performance obligations would be material.

It should be noted that this is an issue beyond insurance contracts as defined by IFRS 4. Currently IAS 18 requires that costs directly attributable to securing investment management contracts are recognised as an asset if it is probable they will be recovered. The argument noted above applies equally to contracts for investment management services.

(b) We support recognition of contract origination costs as expenses as they are incurred provided part of the contract revenue is allocated to profit or loss on inception to match those origination costs. We believe that such an approach is reflective of the economics of the transaction.

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

Response

No, the transaction price should not be used to value performance obligations. This response letter has highlighted some of the difficulties of applying a concept of satisfying performance obligations to revenue recognition in insurance. These concerns also extend to the application of stand-alone selling prices to allocate transaction prices across performance obligations.

Due to the inherent uncertainty of loss events and claims costs and the independence of those underlying risks, bundling together of different services does not create a contract with a value that is equivalent to the sum of those individual risks. Consequently, even if it were possible to identify individual transaction prices for separate performance obligations these prices would not be a suitable basis for revenue recognition for the whole contract.

We support the view that revenue should be recognised as the obligations under the contracted are performed but considers that the different components of insurance contracts are often interdependent and splitting these out results in arbitrary judgement calls and spurious accuracy in the measurement of those contracts. Both revenue recognition and performance measurement of insurance contracts should be based on measurement of the combined rights and obligations under insurance contracts unless the individual components are clearly separable and can be measured reliably.

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? Why or why not? When, if ever, should the use of estimates be constrained?

Response
No. As indicated in our response to question 12, both revenue recognition and performance measurement of insurance contracts should be based on measurement of the combined rights and obligations under insurance contracts unless the individual components are clearly separable and can be measured reliably.