IASB/FASB Meeting
1-2 March 2011

IASB Agenda reference	2G
FASB Agenda reference	59G

Staff Paper

Project	**Insurance contracts**
Topic	**Acquisition costs follow-up**

What is this paper about?

1. The purpose of this paper is to ask the boards to decide in more detail what acquisition costs should be included in the cash flows of insurance contracts, as a follow up to the discussion on 2 February.

Staff recommendation

2. Some staff recommend that:

   (a) The acquisition costs included in the cash flows of insurance contracts should be limited to those costs related to successful acquisition efforts.

   (b) The acquisition costs included in the cash flows of insurance contracts should be limited to direct costs that are related to the acquisition of a portfolio of contracts.

   (c) Implementation guidance should be provided to clarify the types of acquisition costs that should be included in the cash flows of insurance contracts including the functions:

      (i) Sales force contract selling;

      (ii) Underwriting;

      (iii) Medical and inspection;

This paper has been prepared by the technical staff of the IFRS Foundation and the FASB for discussion at a public meeting of the FASB or the IASB.

The views expressed in this paper are those of the staff preparing the paper. They do not purport to represent the views of any individual members of the FASB or the IASB.

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The tentative decisions made by the FASB or the IASB at public meetings are reported in FASB *Action Alert* or in IASB *Update*. Official pronouncements of the FASB or the IASB are published only after each board has completed its full due process, including appropriate public consultation and formal voting procedures.

(iv) Policy issuance and processing.

3. Some staff disagree with this recommendation and have an alternative view, which is set out in appendix D.

Structure of this paper

4. The remainder of this paper is organized as follows:

   (a) Background

   (b) Staff analysis and recommendation

      (i) Successful and unsuccessful acquisition efforts

      (ii) Clarification of direct and indirect, direct, and incremental direct

      (iii) Implementation guidance

   (c) Appendix A – Additional background information

   (d) Appendix B – Decisions relating to acquisition costs in other projects

   (e) Appendix C – Recent FASB guidance in Accounting Standards Update 2010-26 issued for acquisition costs of insurance contracts.

   (f) Appendix D – Alternative staff view and recommendation

Background

5. The IASB's exposure draft *Insurance Contracts* (the ED) and the FASB's discussion paper *Preliminary Views on Insurance Contracts* (the DP) stated that at initial recognition an insurer would include incremental acquisition costs in the present value of the fulfillment cash flows identified at the level of an individual contract only for those contracts that have been issued and that the insurer has incurred because it has issued those particular contracts. Acquisition costs were defined in the ED as the costs of selling underwriting and initiating an

insurance contract and in the DP as the direct and indirect costs of selling, underwriting and initiating an insurance contract.

6. At the boards' joint meeting on 2 February 2011, the boards considered feedback received on the ED and the DP related to the accounting for costs of obtaining insurance contracts (agenda paper 3B/56B). The boards tentatively decided that the cash flows included in the initial measurement of insurance contracts should include some acquisition costs that relate to a portfolio of insurance contracts.

7. The primary reasons supporting the boards' decision to move to determining acquisition costs to be included in the present value of fulfillment cash flows at the portfolio level included:

   (a) All other measurements in the model are at the portfolio level, which is consistent with how insurers price and manage their business;

   (b) To eliminate differences among insurers who have different distribution systems (i.e., whether the entity performs contract acquisition services in-house and incurs internal agent commission and or salaries or sources services externally and pays commissions to third-party agents or uses direct response advertising and incurs related costs);

   (c) To include costs that are not linked to a specific contract such as underwriting, medical and inspection and policy issuance.

8. To stay consistent with the initial intention of the ED and DP and other accounting guidance (see Appendix B) some staff recommended parameters be added regarding which acquisition costs should be included in the initial measurement of the cash flows including:

   (a) Only those acquisition costs associated with successful selling efforts should be included. The FASB tentatively agreed with this recommendation and the IASB did not come to a consensus.

(b) Acquisition costs should be limited to the direct costs that are related to acquiring new and renewal insurance contracts. The boards asked the staff to provide further clarification on how to define incremental costs, direct costs, and direct and incremental costs to better understand the acquisition costs that would be included in the cash flows.

(c) Acquisition costs should be limited to the following acquisition functions:

(i) Sales force contract selling;

(ii) Underwriting;

(iii) Medical and inspection;

(iv) Policy issuance and processing

9. The boards did not discuss this at the 2 February 2011 meeting; however, the FASB tentatively decided to include implementation guidance to clarify which acquisition costs should be included in the initial measurement of an insurance contract. The IASB did not come to a consensus on whether to include implementation guidance.

10. On 18 February, the boards tentatively decided:

(a) to clarify that all costs that an insurer will incur directly in fulfilling a portfolio of insurance contracts should be included in the cash flows used to determine the insurance liability, including:

(i) costs that relate directly to the fulfilment of the contracts in the portfolio, such as payments to policyholders, claims handling, etc (described in paragraph B61 of the ED);

(ii) costs that are directly attributable to contract activity as part of fulfilling that portfolio of contracts and that can be allocated to those portfolios; and

(iii) such other costs as are specifically chargeable to the policyholder under the terms of the contract.

(b) to confirm that costs that do not relate directly to the insurance contracts or contract activities should be recognised as expenses in the period in which they are incurred;

(c) to provide application guidance based on IAS 2 *Inventories* and IAS 11 *Construction Contracts*; and

(d) to eliminate the term 'incremental' from the discussion of fulfilment cash flows that was proposed in the ED / DP (ie paragraph B61 of the ED).

Staff analysis and recommendation

All acquisition efforts or limited to successful acquisition efforts

11. Inherent in the pooling of insurance risk and the creation of portfolios of insurance contracts is a need to underwrite a large number of applications so that they can be appropriately evaluated based on characteristics of the risk and so that sufficient volume is achieved for pooling to work. In that process, it is expected that a portion of the applications will not result in the placement of an insurance contract, either because the insurer will reject the application or the applicant will refuse the final offer made by the insurer.

12. Some believe that a distinction between successful and unsuccessful efforts, while justifiable in a cost-deferral approach to measurement, would not be relevant to an approach based on the cash flows expected to fulfil the contract. The objective of the measurement model is to measure the remaining obligation at inception by reference to what the policyholder paid after excluding what the policyholder implicitly paid for the acquisition effort. At a portfolio level, the amounts paid for the acquisition effort includes costs related to both successful and unsuccessful efforts. Therefore those with this view argue that, if the definition of incremental acquisition costs includes costs incremental at the

portfolio level, all such costs should be included in the present value of fulfilment cash flows.

13. Some believe insurers should include in the fulfilment cash flows only acquisition costs related to the successful acquisition of new or renewal insurance contracts. A *portfolio of insurance contracts* is defined in the ED and the DP as "insurance contracts that are subject to broadly similar risks and managed together as a single pool". Therefore, some believe that definition inherently would limit the costs that would be included to be those costs related to successful acquisition efforts.

14. Including unsuccessful efforts in the contractual cash flows could hinder comparability amongst insurers. For example, if one insurer is more efficient in writing successful contracts than another insurer and obtains 80 percent of efforts as successful contracts while another insurer only obtains 50 percent as successful contracts, assuming the same amount of effort (hours) and that insurance is a competitive market and therefore pricing will be similar, those insurers will not have comparable measurement of insurance contracts at initial recognition and in subsequent periods because of the effect on the residual (or composite) margin of including acquisition costs in the contractual cash flows. In addition, some question the conceptual basis for how costs relating to unsuccessful contract acquisition efforts could be considered to provide a future economic benefit to warrant recognition and can be considered to be recoverable and therefore believe incremental costs should be limited to those only for contracts issued.

15. Some staff do not believe that costs relating to unsuccessful efforts should be included in the measurement of the present value of future cash flows because:

    (a) Unsuccessful efforts do not have a future benefit and although future benefit is a defining characteristic of an asset, the answer should not be different when recorded as part of the cash flows.

(b) This is consistent with the boards' intent in the basis for conclusions in the ED which proposed to limit the acquisition costs to be included in the cash flows to those costs that can be clearly identified as relating specifically to contracts issued.

(c) This is consistent with other projects where acquisition costs are determined at the contract level and therefore are only for successful contracts, although within the context of different measurement approaches.

16. Therefore, some staff recommend that the costs included in the cash flows related to acquisition costs should only be those for successful insurance contracts.

Question 1
Do the boards agree with that the acquisition costs included in the cash flows of insurance contracts should be limited to those costs related to successful acquisition efforts?

17. Some staff disagree with this recommendation and have an alternative view, which is set out in appendix D.

Which costs

18. The alternatives for which acquisition costs should be included in the cash flows of insurance contracts at the portfolio level are as follows and are discussed further below:

(a) Alternative 1—Incremental direct costs.

(b) Alternative 2— Direct costs.

(c) Alternative 3—Incremental costs.

19. As a very high level comparison, the staff believe the alternatives above would result in the following:

Less costs ◄──────────────────► **More costs**

Alt. 1—Incremental Direct   Alt. 2—Direct   Alt. 3—Direct and Indirect

20. Incremental, as that term is used in other projects, refers to those costs an insurer would not have incurred if the insurer had not issued those insurance contracts. The staff note that the incremental costs for insurance contracts may differ from the costs that would be considered incremental in other projects (for example, revenue recognition) because for insurance contracts, incremental costs would be measured at the portfolio level rather than at the individual contract level.

21. One result of including more costs in the measurement of the cash flows is that it would reduce the residual or composite margin. While this is true, the boards decided to recognize the difference between the present value of expected cash inflows less the present value of expected cash outflows as a residual or composite margin to defer day one gains and it was not the intent for the residual or composite margin to include all costs that are priced for in a contract that are not included in the contractual cash flows Other industries that earn/recognize their revenue over time also have a delay between the costs incurred to obtain new business and the recognition of their income.

Alternative 1—Incremental direct costs

22. Incremental direct costs would include acquisition costs that are directly related to the acquisition of a portfolio of insurance contracts and that the insurer would not have incurred if the insurer had not issued that those insurance contracts.

23. Many have viewed these costs, regardless of the unit of account, to be a subset of direct costs and to include only commissions and premium taxes, thus creating different results based on an on an entity's distribution system and sales compensation.

Alternative 2—Direct costs

24. Direct costs would include all acquisition costs that are directly related to the acquisition of a portfolio of insurance contracts. This would include compensation (and compensation related costs) for and costs incurred by the people performing functions directly related to acquiring new or renewal contracts including underwriting, sales force contract selling, medical and inspection, and policy issuance, as well as, other third-party costs related directly to the insurer's acquisition such as medical and inspection fees.

25. Some believe that this is too limiting and that overhead costs allocated to these functions, such as rent for the space needed by these functions and the related costs (i.e., utilities, depreciation or equipment, etc.) that would have to be incurred for individuals to complete these functions should also be included.

26. Others believe that some costs that should be recognized in the period incurred such as base costs to operate a business (e.g., overhead) and obtain potential business / policyholders. Determining whether overhead costs are directly related to the portfolio can be subjective and lead to differences in practice.

Alternative 3—Direct and indirect costs

27. Direct and indirect costs would include all acquisition costs that are related to the acquisition of a portfolio of insurance contracts and therefore, would include the following:

    (a) Incremental direct acquisition costs, such as commissions and premium taxes;

    (b) Other direct acquisition costs, such as compensation for underwriting, medical and inspection, and policy issuance costs;

    (c) Indirect acquisition costs that are associated with performing the acquisition functions, such as rent for the building space occupied by a sales force, administrative costs, depreciation of equipment, and

other general overhead costs related to the acquisition of new and renewal business.

28. Some believe direct and indirect costs related to a portfolio of contracts should be included in the initial measurement of the cash flows of insurance contracts because those costs are included in the pricing of the contracts.

29. Some argue that all insurers incur indirect acquisition costs to operate and their product pricing is such that it recoups all of their costs and make a profit. These costs are not being considered for "deferral" in other projects.

Summary of alternatives

30. The table below identifies typical acquisition costs that may be incurred by an insurer and which of those costs would be included in the contractual cash flows of insurance contracts for each of the three alternatives discussed above. The table assumes acquisition costs are measured at the portfolio level and is not meant to be all-inclusive, but rather an example to give the boards more insight into which types of costs would be included in the contractual cash flows under each alternative.

Costs	Incremental direct	Direct	Direct and indirect
Sales commissions	X	X	X
Premium taxes	X	X	X
Sales and persistency bonuses		X	X
Underwriting, policy issue, and case installation		X	X
Field office management bonuses		X	X
Field office management fixed salaries		X	X
Executive offices and staff			
Product design and development			
Medical and inspection fees		X	X
Direct response advertising		X	X
Corporate image advertising			
Software dedicated to contract acquisition			X
Agent and sales staff recruiting			X

Agent conventions			
Equipment costs			X
Sales training			X
Market research			
Soliciting potential customers			
Administration			X
Recurring commissions			
Commission and agent licensing administration			X
Postage and telephone		X	X
Rent			X
Depreciation			X
Utilities			X
Occupancy			X
Other general overhead			X
Fringe benefits (such as dental and medical insurance, group life insurance, retirement plans, 401(k) plans, stock compensation plans, overtime meal allowances)		X	X
Payroll taxes		X	X
Reimbursement of costs for air travel, hotel accomodations, automobile mileage and tolls, and other similar costs to personnel involved in on-site reviews before the policy is written		X	X

31. The question becomes where the cut-off should be the further the functions and costs are from the direct interaction with the policyholder and the application and written policy.

32. Some staff believe that the acquisition costs included in the cash flows of insurance contracts should be limited to direct costs at the portfolio level.

    (a) Some staff believe that incremental direct costs would be equivalent to determining acquisition costs at the contract level which is too limiting and would not include costs integral to the acquisition of new and renewal business and would result in differences between insurers based on distribution systems.

(b) Some staff believe that direct and indirect costs related to a portfolio of contracts is too broad and do not believe that general allocated costs that are needed to operate a business and obtain potential policyholders, even if those costs are associated with the acquisition functions, should be included in the initial measurement of the cash flows. This is inconsistent with the boards' tentative decision on 18 February to include in the expected cash flows costs (including fixed and variable overheads) that are attributable to contract activity as part of fulfilling that portfolio of contracts and that can be allocated to those portfolios. These staff differentiate acquisition costs as those that have been incurred and therefore are essentially being "deferred" versus those costs to be incurred that are essentially being accrued and therefore do not believe it is necessary to have consistency.

Question 2
Do the boards agree with that the acquisition costs included in the cash flows of insurance contracts should be limited to direct costs that are related to the acquisition of a portfolio of contracts?

33. Some staff disagree with this recommendation and have an alternative view, which is set out in appendix D.

Implementation guidance

34. Direct costs that are related to the acquisition of a portfolio of insurance contracts may be interpreted differently amongst insurers and could result in differences in practices. There is current diversity in practice regarding the types of acquisition costs that insurers defer, especially as it relates to operating costs of an insurance entity that can be allocated to various functions. Also, comments received in the formal comment letter process and during the staff outreach asked for clarification on which acquisition costs could be included in the measurement of the cash flows of an insurance contract.

35. Based on the current diversity in practice, respondents requests and prior board discussions, the staff recommends that implementation guidance should be included to clarify the types of acquisition costs that would be included in the cash flows used to measure an insurance contract.

36. On 18 February 2011, the boards tentatively decided to provide application guidance (Appendix B of Agenda Paper 3F/58F) for the cash flows to be included in the measurement of an insurance contract based on IAS 2 *Inventories* and IAS 11 *Construction Contracts*. IAS 2 explicitly excludes selling costs from the costs of inventories. Similarly, IAS 11 explicitly excludes selling costs from the costs of a construction contract. As such, some staff does not believe the guidance in IAS 2 and IAS 11 is relevant to discussions regarding acquisition costs.

37. As such, some staff recommend that the level of details be consistent with other implementation guidance being proposed, such as in the leases project, and include the following:

    (a) Direct costs of contract acquisition that may be included in the cash flows include:

        (i) Compensation (and compensation related costs) for and costs incurred by (such as travel related activities) the people performing functions directly related to acquiring new or renewal contracts including

            (1) Underwriting,

            (2) Sales force contract selling,

            (3) Medical and inspection, and

            (4) Policy issuance

        (ii) An agent or broker commission or bonus for successful contract acquisition or acquisitions.

        (iii) Medical and inspection fees for successful contract acquisition or acquisitions.

(b) Costs for software dedicated to contract acquisition are not eligible to be included in cash flows. Such costs are not other costs related to those activities that would not have been incurred but for that contract under the definition of that term.

(c) Other costs, some of which entities may consider acquisition-related costs that should be expensed as incurred include:

  (i) Soliciting potential customers
  (ii) Market research
  (iii) Training
  (iv) Administration
  (v) Unsuccessful acquisition or renewal efforts
  (vi) Product development.

(d) An insurer also would expense as incurred any indirect costs. Such costs include all of the following:

  (i) Administrative costs
  (ii) Rent
  (iii) Depreciation
  (iv) Occupancy costs
  (v) Equipment costs (including data processing equipment dedicated to acquiring insurance contracts)
  (vi) Other general overhead.

Question 3
a. Do the boards agree that implementation guidance should be provided to clarify the types of acquisition costs that should be included in the initial measurement of the cash flows of insurance contracts? b. Do the boards agree with the implementation guidance included in the staff recommendation?

Appendix A – Additional background information

Summary of the proposals in the ED and DP

1. The ED and the DP state that, at initial recognition, an insurer would:

    (a) Include incremental acquisition costs in the present value of the fulfilment cash flows

    (b) Recognise all acquisition costs other than those identified in (a) as an expense when incurred.

2. Acquisition costs are defined in the ED as "the costs of selling, underwriting and initiating an insurance contract" and in the DP as "the direct and indirect costs of selling, underwriting and initiating an insurance contract."

3. Acquisition costs would be included in the cash flows used to measure insurance contracts only for those contracts that have been issued and that the insurer has incurred because it has issued those particular contracts (that is, those costs that would not have been incurred if the insurer had not issued those particular contracts).

4. The incremental acquisition costs would be identified at the level of an individual insurance contract. Acquisition costs included in the cash flows of insurance contracts would reduce the residual (or composite) margin at initial recognition of the contract. Accordingly, acquisition costs would not be explicitly amortized, but rather, would affect profit over the coverage period (residual margin) or over the coverage and claims handling periods (composite margin).

Appendix B – Decisions relating to acquisition costs in other projects

Revenue recognition

1. The exposure draft *Revenue from Contracts with Customers* proposed that all costs incurred in obtaining a contract should be expensed as incurred because the asset resulting from the costs of obtaining a contract is primarily the contract asset. The boards did not believe an entity should recognize a contract asset only as a result of satisfying a performance obligation.

2. The boards tentatively decided at the 2 February 2011 joint meeting that an entity should recognize an asset for the incremental costs of obtaining a contract that the entity expects to recover. Incremental costs of obtaining a contract are costs that the entity would not have incurred if the contract had not been obtained. The boards also tentatively decided that the asset recognized for the costs of obtaining a contract should be presented separately on the statement of financial position and subsequently measured on a systematic basis consistent with the pattern of transfer of the goods or services to which the asset relates.

Leases

3. In the exposure draft *Leases*, initial direct costs are capitalized as part of the right-of-use asset (lessee) or the right to receive lease payments (lessor). Initial direct costs are defined as follows:

   > Recoverable costs that are directly attributable to negotiating and arranging a lease that would not have been incurred had the lease transaction not been made.

4. The implementation guidance states that initial direct costs may include:

   (a) Commissions

   (b) Legal fees

   (c) Evaluation of the prospective lessee's financial condition

   (d) Evaluating and recording guarantees, collateral and other security arrangements

(e) Negotiating lease terms

(f) Preparing and processing lease documents

(g) Closing the transaction

(h) Other costs that are incremental and directly attributable to negotiating and arranging the lease.

5. The implementation guidance also states that the following are not initial direct costs:

(a) General overheads, such as rent, depreciation, occupancy and equipment costs, unsuccessful origination efforts and idle time.

(b) Costs related to activities performed by the lessor for advertising, soliciting potential lessees, servicing existing leases or other ancillary activities.

Financial instruments

6. The IASB's exposure draft *Amortised Cost and Impairment* would require deferral of all *transaction costs*, which are defined as follows:

> Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability. An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

7. The FASB's exposure draft *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities* would require deferral of *direct loan origination costs* (net of loan origination fees), which are defined as follows:

> Direct loan origination costs represent costs associated with successfully originating a loan. Direct loan origination costs of a completed loan shall include only the following:
>
> (a) Incremental direct costs of loan origination incurred in transactions with independent third parties for that loan
>
> (b) Certain costs directly related to specified activities performed by the lender for that loan. Those activities include all of the following:
>
> (i) Evaluating the prospective borrower's financial condition

(ii) Evaluating and recording guarantees, collateral, and other security arrangements

(iii)Negotiating loan terms

(iv)Preparing and processing loan documents

(v) Closing the transaction.

The costs directly related to those activities would include only that portion of the employees' total compensation and payroll-related fringe benefits directly related to time spent performing those activities for that loan and other costs related to those activities that would not have been incurred but for that loan. See Section 310-20-55 for examples of items.

8. Paragraph 310-20-55-11, as proposed, provides examples of other direct loan origination costs that may be deferred, which include:

   (a) Reimbursement of costs for air travel, hotel accommodations, automobile mileage, a similar costs incurred by personnel relating to the specified activities

   (b) Costs of itemized long-distance telephone calls related to loan underwriting

   (c) Reimbursement for mileage and tolls to personnel involved in on-site reviews of collateral before the loan is granted

9. Paragraph 310-20-55-12, as proposed, provides examples of payroll related fringe benefits that may be deferred, which include:

   (a) Payroll taxes

   (b) Dental and medical insurance

   (c) Group life insurance

   (d) Retirement plans

   (e) 401(k) plans

   (f) Stock compensation plans, such as stock options and stock appreciation rights

   (g) Overtime meal allowances.

10. Paragraph 310-20-55-13, as proposed, provides further guidance on executive compensation that may be deferred. It states that the amount of executive compensation allocable to time spent by members of a loan approval committee is a component of direct loan origination costs.

11. Paragraph 310-20-55-15, as proposed, provides further examples of specified activities contemplated as direct loan origination costs as follows:

    (a) Loan counselling, such as discussing alternative borrowing arrangements with borrowers, and negotiating terms

    (b) Application processing

    (c) Appraisal

    (d) Initial credit analysis

    (e) Initial credit investigation

    (f) Quality control review performed during the underwriting period

    (g) Direct approval processing

    (h) Loan evaluation and approval committees (all activities involved in origination decisions)

12. Loan closing.

Appendix C – Recent FASB guidance in Update 2010-26 issued for acquisition costs of insurance contracts

13. In October 2010, the FASB issued Update 2010-26, which is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2011. Under Update 2010-26, an insurance entity shall capitalize only the following as acquisition costs related directly to the successful acquisition of new or renewal insurance contracts:

(a) Incremental direct costs of contract acquisition.

(b) The portion of the employee's total compensation (excluding any compensation that is capitalized as incremental direct costs of contract acquisition) and payroll-related fringe benefits related directly to time spent performing any of the following acquisition activities for a contract that actually has been acquired:

(i) Underwriting

(ii) Policy issuance and processing

(iii) Medical and inspection

(iv) Sales force contract selling.

(c) Other costs related directly to the insurer's acquisition activities in (b) that would not have been incurred by the insurance entity had the acquisition contract transaction(s) not occurred.

(d) Advertising costs that meet the capitalization criteria in Subtopic 340-20, Other Assets and Deferred Costs—Capitalized Advertising Costs (that is, the costs of direct-response advertising shall be capitalized if the primary purpose of the advertising is to elicit sales to customers who could be shown to have responded specifically to the advertising and the direct-response advertising results in probable future benefits).

14. Update 2010-26 provides further guidance on the incremental direct costs of contract acquisition that may be deferred:

(a) An agent or broker commission or bonus for successful contract acquisition or acquisitions.

(b) Medical and inspection fees for successful contract acquisition or acquisitions.

15. Update 2010-26 clarifies that payroll-related fringe benefits include any costs incurred for employees as part of the total compensation and benefits program. Examples of such benefits include all of the following:

    (a) Payroll taxes
    (b) Dental and medical insurance
    (c) Group life insurance
    (d) Retirement plans
    (e) 401(k) plans
    (f) Stock compensation plans, such as stock options and stock appreciation rights
    (g) Overtime meal allowances.

16. In addition, Update 2010-26 provides examples of other costs related directly to an insurer's acquisition activities that would not have been incurred by the insurer had the acquisition contract transaction(s) not occurred, including all of the following:

    (a) Reimbursement of costs for air travel, hotel accommodations, automobile mileage, and similar costs incurred by personnel relating to the specified activities
    (b) Costs of itemized long-distance telephone calls related to contract underwriting
    (c) Reimbursement for mileage and tolls to personnel involved in on-site reviews of individuals before the contract is executed.

17. Update 2010-26 clarifies that costs for software dedicated to contract acquisition are not eligible to be included in deferred acquisition. Such costs are not other costs related to those activities that would not have been incurred but for that contract under the definition of that term.

18. Update 2010-26 requires that an insurance entity shall expense as incurred any acquisition-related cost that cannot be capitalized in accordance with that Update. Such costs include costs of all of the following:

    (a) Soliciting potential customers (except direct-response advertising capitalized in accordance with paragraph 944-30-25-1A(d))
    (b) Market research

(c) Training

(d) Administration

(e) Unsuccessful acquisition or renewal efforts (except direct-response advertising capitalized in accordance with paragraph 944-30-25-1A(d))

(f) Product development.

19. In addition, Update 2010-26 clarifies that an insurance entity shall expense as incurred any indirect costs. Such costs include all of the following:

(a) Administrative costs

(b) Rent

(c) Depreciation

(d) Occupancy costs

(e) Equipment costs (including data processing equipment dedicated to acquiring insurance contracts)

(f) Other general overhead.

20. Finally, Update 2010-26 allows an entity to elect not to capitalize costs that the entity had not previously capitalized (if initial application of the amendments in that Update would result in the capitalization of acquisition costs that had not been previously capitalized).

Appendix D: Alternative staff view and recommendation

1. Some staff disagree with the analysis in agenda paper 2G for two reasons:

   (a) In our view, it does not give enough weight to the boards' tentative decision at the February meeting, that all costs that an insurer will incur directly in fulfilling a portfolio of insurance contracts should be included in the cash flows used to measure the insurance liability. Agenda paper 3F from the February meeting / FASB memo 58F discussed which cash flows should be included in contract activity. We believe the arguments in that paper are equally applicable to determining the cash flows to be included in acquisition activity. We further believe that agenda paper 2G does not justify a different basis.

   (b) That analysis relies on notions of recoverability of acquisition costs and future economic benefit arising from acquisition costs. In our view, the measurement model compares the amount paid by the policyholder with the cash flows needed to fulfill the contracts and with the costs incurred in the acquisition effort. The measurement model tests the recoverability of all cash flows at inception through the requirement to recognise a non-negative residual or composite margin. Thus we believe that notions of recoverability of an asset depicting the acquisition costs, or the future economic benefits arising from acquisition costs, are irrelevant.

2. If we were to apply the tentative decision from February to acquisition costs at a portfolio level, we would determine the costs of acquisition activity in the same way as the costs of fulfillment activity. Thus, we would include in the initial measurement of the contracts included in the portfolio of contracts all costs that are necessary for the acquisition of the portfolio of contracts and for acquisition activity. Such costs would include:

   (a) costs that relate directly to the acquisition of the portfolio, such as commissions; and

(b) costs that are directly attributable to acquisition activity in general and that can be allocated to the acquisition of the portfolio.

3. These costs might include indirect costs that are attributable to acquisition activity for the portfolio of contracts and that can be allocated to those portfolios (using guidance similar to the guidance that would be used to determine which costs would arise in fulfilling the portfolio). In addition, this approach would not require an insurer to distinguish costs related to successful, rather than unsuccessful, acquisition efforts: both arise in acquiring the portfolio. We believe that any implementation guidance should be consistent with the guidance based on IAS 2 and IAS 11 that would be provided, in accordance with the boards' tentative decisions in February.

Alternative staff recommendation: Acquisition costs
Do the boards agree that the acquisition costs to be included in the initial measurement of a portfolio of insurance contracts should be all the costs that the insurer will incur in acquiring the portfolio including: (a) costs that relate directly to the acquisition of the portfolio, such as commissions; and (b) costs that are directly attributable to acquisition activity in general and that can be allocated to the acquisition of the portfolio? Do the boards agree that all other acquisition costs should be recognised as expenses when incurred?