STAFF PAPER

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FASB | IASB Meeting

Project	**Insurance Contracts**		
Paper topic	Transition Requirements		

CONTACT(S)	Akwasi Ampofo	aaampofo@fasb.org	+1 203 956 3421
	Robert Barton	rdbarton@fasb.org	+1 203 956 3442
	Jennifer Weiner	jmweiner@fasb.org	+1 203 956 5305

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What is this paper about?

1. This is the first paper in a series of papers that addresses the transitional requirements for the boards' tentative decisions to date in the insurance contracts project.
2. This paper asks the boards to decide on:
   a. The measurement of the insurance contract fulfilment cash flows including the measurement of the acquisition costs.
   b. The method to determine the single or residual margin (hereinafter referred to as the margin) at date of transition.
   c. Disclosures regarding transition.
3. Agenda Paper 2C/89C asks the boards to consider a practical expedient to determine the locked-in discount rate to be applied and the cumulative changes in the discount rate to be included in other comprehensive income for contracts written prior to the transition date.
4. ~~Agenda Paper 2D/89D asks the boards to decide on whether insurers should be allowed to re-designate financial assets at the transition date.~~
5. This paper does not discuss the following items, all of which will be discussed at a future meeting:
   a. Intangible assets on insurance contracts recognized in a business combination

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The Financial Accounting Standards Board (FASB), is the national standard-setter of the United States, responsible for establishing standards of financial accounting that govern the preparation of financial reports by nongovernmental entities. For more information visit www.fasb.org

b. The effective date of the new insurance contract guidance

c. Any additional considerations for an unlocked residual margin (IASB only)

d. Whether to provide exemptions from disclosing comparatives in the first year

6.e. Agenda Paper 2D/89D asks the boards to decide on whether insurers should be allowed to re-designate financial assets at the transition date.

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6. This paper also does not discuss additional transition guidance that may be needed depending on the boards' tentative decisions on the pattern for recognition of premium.

7. However, the staff do not believe those decisions would impact the topics discussed in this paper.

Summary of staff recommendations

8. The staff recommends as follows:
   a. At the beginning of the earliest period presented, an insurer shall:
      i. Measure the present value of the fulfillment cash flows[1] in accordance with the board's existing tentative decisions for measuring insurance contract liabilities.
      ii. Account for the acquisition costs in accordance with the board's existing tentative decisions for acquisition costs and derecognize any existing balances of deferred acquisition costs.
   iii. Determine the margin through *retrospective application* of the new accounting policy to all prior periods, unless it is impracticable[2] to do so. However,

[1] The expected present value of the future cash outflows less future cash inflows that will arise as the insurer fulfils the insurance contract, (for the IASB, adjusted for the effects of uncertainty about the amount and timing of those future cash flows).

[2] IAS 8 defines states that "applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:
(a) the effects of the retrospective application or retrospective restatement are not determinable;
(b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or

1. If it is impracticable to determine the cumulative effect of applying that change in accounting principle retrospectively to all prior periods, the insurer is required to apply the new policy prospectively from the start of the earliest period for which retrospective application is practicable (i.e., apply retrospectively as far back as is practicable)
2. For earlier periods for which retrospective application would normally be considered impracticable because it would require significant estimates that are not based solely on objective information, an insurer shall determine the margin through retrospective application of the new accounting principle. In such cases, an insurer need not undertake exhaustive efforts to obtain objective information, but shall take into account all objective information that is reasonably available.
3. if it is impracticable to apply the new accounting policies retrospectively for other reasons, an insurer shall apply the general requirements of ASC Topic 250-10/ IAS 8 relevant to situations in which there are limitations on retrospective application.

b. Insurers should make the disclosures required by [ASC Topic 250-10] [IAS 8], and the following more specific disclosures:
   i. If full retrospective application is impracticable, the earliest practicable date to which the insurer applied the guidance retrospectively
   ii. The method used to estimate the expected remaining margin for insurance contracts inforce as of that earliest practical date including the extent to which the insurer has used information that is objective and separately, the extent to which the insurer has used information that is not objective, in determining the margin.
   iii. The method and assumptions used in determining the "locked-in" discount rate during the retrospective period

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(c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
(i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
(ii) would have been available when the financial statements for that prior period were authorised for issue from other information."

c. An insurer need not disclose previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it first applies the new guidance. Furthermore, if it is impracticable when an insurer first applies the new guidance to prepare information about the claims development that occurred before the beginning of the earliest period for which the insurer presents full comparable information, it shall disclose that fact.

Background

9. This section summarizes the:
   a. Existing guidance under Topic 250 and IAS 8 on changes in accounting principles,
   b. Method of transition in the IASB ED,
   c. Staff 's analysis of comment letters regarding transition,
   d. Feedback from the June 2012 insurance working group meeting, and
   e. Feedback from the outreach on revenue recognition transition method (see Appendix B).

<u>Existing U.S. GAAP and IFRS on changes in accounting principles</u>

10. ASC Topic 250-10 and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* require an entity to apply a change in accounting principle through *retrospective application* of the new accounting principle to all prior periods, unless it is impracticable to do so. This means that all carrying amounts of assets and liabilities should reflect the new accounting principle, the cumulative effect of the change in accounting principle should be reported to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) and the financial statements for each individual prior period presented shall be adjusted to reflect the period-specific effects of applying the new accounting principle.

11. However, both US GAAP and IFRS recognize that retrospective application may be impracticable in some circumstances. If it is impracticable to determine the cumulative effect of applying a change in accounting principle retrospectively to:
    a. all prior periods, the entity is required to apply the new policy prospectively from the start of the earliest period practicable and disregard the portion of the cumulative adjustment to assets, liabilities and equity arising before that date.
    b. any prior period, the new accounting principle shall be applied as if the change was made prospectively as of the earliest date practicable
12. Appendix A contains the guidance from Topic 250-10 and IAS 8 as it relates to retrospective application and the circumstances under which it would be impracticable.

<u>IASB ED/ FASB DP method of transition</u>

13. The IASB exposure draft, *Insurance Contracts* (ED) required that at the beginning of the earliest period presented, an insurer shall, with a corresponding adjustment to retained earnings:
    a. measure each portfolio of insurance contracts at the present value of the fulfillment cash flows. It follows that for insurance contracts to which these transitional provisions are applied, the measurement, both at transition and subsequently, does not include a residual margin.
    b. derecognize any existing balances of deferred acquisition costs.
    c. derecognize any intangible assets arising from insurance contracts assumed in previously recognized business combinations. That adjustment does not affect intangible assets, such as customer relationships and customer lists, which relate to possible future contracts.
14. The FASB did not address transition in its Discussion Paper (DP).

<u>Analysis of comment letters on transition method of IASB ED/FASB DP</u>

15. At the January 2011 joint board meeting, the staff reported to the boards a summary of significant comments received on all aspects (including transition) of the IASB ED/FASB DP in agenda papers 3F/55F (FASB) and 3E/55E (IASB). This section

focuses on the aspects of the comment letter analysis that dealt with the issue of transition.

16. Of the total 329 comment letters to the IASB ED (256) and FASB DP (73), 182 respondents (IASB 144 and FASB 38) addressed the topic of transition (55.3%). Although the FASB's DP does not address transition, many of the respondents either attached their submission of response to the IASB's ED or addressed transition as part of their general concerns.
17. The majority of respondents are overwhelmingly concerned with the proposal in the ED. For insurance contracts in force at transition, the measurement, both at transition and subsequently, does not include a residual margin, which would be a different measurement approach than for new business written. For life contracts, this effect could significantly increase equity at the time of transition and decrease subsequent earnings from the in-force business.
18. The following alternatives for determining the residual margin were included in the comment letters:
    a. Retrospective application except when impracticable.
    b. An approach that calibrates the residual margin to the difference between the pre-transition carrying amount and the calculated fulfilment value.
    c. An approach that applies the business combination guidance with the deferred profit / residual margin being set to the calculated value of business acquired.
    d. An approach that sets the residual margin to the difference between the insurance liability measured using the building blocks approach with original assumptions and with current assumptions, prorated.
19. Some respondents suggested that the boards consider specific transition arrangements to ease the first-time application of the insurance contracts standard in the context of the new requirements in IFRS 9 and the FASBS's guidance in the proposed Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815).* These include:

a. Align the effective date of the insurance contracts standard with IFRS 9 or the FASB's proposed financial instruments Update, even if this were to mean delaying the effective date of IFRS 9 for a year.
b. Permit an entity to redesignate financial assets if an entity is required to apply IFRS 9 or the FASB's proposed financial instruments Update before the effective date of the insurance contracts standard. The IASB's ED proposes that an entity would be permitted to redesignate financial assets as measured at fair value (ie to use the fair value option) when it applies the insurance contracts standard for the first time.

<u>Feedback from Insurance Working Group Meeting 25-26, June 2012</u>

20. Members of the Insurance Working Group (IWG) noted the following at the meeting:
    a. A member referred to a paper submitted by the American Council of Life Insurers (ACLI) suggesting that the standard be applied retrospectively to all prior periods unless it impracticable to do so in which case insurers should apply the guidance retrospectively as far back as is practicable. For contracts written prior to that date, insurers should use a practical expedient to determine the remaining margin (i.e., profit) that should be recorded as of the transition date.
    b. There was additional support from the other participants for retrospective application of a new insurance contracts standard, which would reflect current values for expected cash flows and the risk adjustment (IASB only). Participants noted that retrospective application would require judgment to determine the margin and there was general recognition that the boards' decisions on other comprehensive income would introduce some potential complexities.
    c. Users noted that the transition adjustment would have a significant effect not only in the year of transition, but in the reported profitability for years to come which will have an impact on stock prices and capital allocation. As such, some noted their belief that transition is one of the most important topics.
    d. There were differing views on the extent to which the boards should provide broad principles or should be more specific on approaches:

i. Some participants indicated that insurers should apply retrospectively as far back as possible.
ii. Some expressed the view that there should be a cut-off period for the retrospective approach.
iii. Most believed that an estimate should be made for the margin on contracts written prior to the earliest period for which it would be practicable to apply the proposed model retrospectively.
iv. Some participants indicated that the period of time to which the new model should be applied retrospectively, as well as how to estimate the margin for the periods prior to that date, should be left to the judgment of preparers and their auditors.

e. Several participants indicated that the transitional requirements should affect only contracts inforce at the date of transition.
f. Some participants indicated that they believed the discount rate applied to the retrospective period should be locked in and based on the guaranteed rate to the policyholder.

Staff analysis

Objectives

21. The staff have identified the following objectives that the method of transition should attempt to accomplish:
    a. **Objective #**1: Achieve *consistent measurement of the insurance contracts liability and the margin* (that is, single or residual margin) on the insurance contracts inforce at the date of transition and contracts written subsequent to transition.
    b. **Objective #2:** Allow for *comparability of earnings* on the inforce insurance contracts at the transition date and on new contracts written subsequent to the date of transition. That is, the amount of single or residual margin earned and the volume information that is recognized (i.e., premium and claims).

c. **Objective #3**: Be *practical* and meet the *cost-benefit test.* That is, the benefits of providing that information should justify the costs.

22. The boards should keep in mind that insurers face challenges that may impede their ability to fully meet these objectives including:
    a. Some inforce contracts can be very old, perhaps over 50 years. Specific data, such as the expected profit at contract inception, may not have been stored.
    b. Some pertinent data may be lost through acquisitions or the sales of companies and portfolio transfers.
    c. Systems and data transformation may have caused some important data to be lost.
23. However, regardless of the above, all insurers should have at a minimum for contracts inforce as of the transition date, the contract inception date and the amount of premiums received or expected to be received for the contract.

Measurement of the insurance contract fulfillment cash flows

24. Paragraph BC 246 of the Basis for Conclusions to the IASB's ED, stated:

    The Board has identified no specific transitional problems for the introduction of the direct measurement component of the measurement. That measurement is current and reflects circumstances at the measurement date. Therefore, provided an insurer has sufficient lead time to set up the necessary systems, performing that direct measurement on transition to the new model will be no more difficult than performing that measurement for a later date.

25. The staff do not believe that the changes to the measurement of the liability during deliberations since the IASB's ED and the FASB's DP have an impact on the statement above. In addition, constituents have not provided input regarding problems with measuring the insurance contract liability at the transition date using the proposed model.

Deferred costs of acquiring or renewing insurance contracts

26. In most jurisdictions, the costs of acquiring an insurance contract are recorded as an asset if specific criteria are met and amortized based on the nature of the underlying insurance product (i.e., proportional to revenues, estimated gross profits or estimated

gross margins). The boards have tentatively decided that these costs should affect the determination of the single margin or residual margin included in the measurement of the liability.

27. Paragraph BC250 of the IASB's ED states: "When an insurer applies the new measurement model, it would need not only to adjust the measurement of its insurance contracts, but also to eliminate some related items, if any, such as deferred acquisition costs and some intangible assets relating solely to existing contracts. Those items could be viewed as corrections for a previous overstatement of the insurance liability, and so their elimination is likely to coincide with a reduction in the measurement of the insurance liability."

28. This would result in the outstanding costs at transition essentially being reclassified, which should not create a transition adjustment. However, the board's tentative decisions regarding which costs can be included as part of the measurement of the liability (and therefore which costs should be expensed as incurred) is a change from current accounting in many jurisdictions.

29. As of 1 January 2012, insurers reporting under US GAAP were required to adopt ASU 2010-26 (EITF 09-G), *Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts.* This ASU modified the definition of the types of costs incurred by insurance entities that can be capitalized in the acquisition of new and renewal contracts including limiting the costs that can be capitalized to costs relating to successful contract acquisitions. Therefore, the boards tentative decisions will not be significant to insurers that adopted this guidance however may have a more significant impact on other insurers.

30. Because these costs cannot be measured at a point in time, but rather are an accumulation of costs incurred over time as insurance contracts are sold, the implementation efforts and costs are much more significant than for the measurement of the fulfilment cash flows. This has the largest impact on life insurance and long-term care or disability contracts where the costs currently recorded were determined at inception of the contract which could be many years ago. This will have a lesser effect on non-life insurance contracts with coverage periods of a short-duration given

that the acquisition costs initially recorded are amortized over that coverage period and therefore applying a retrospective approach will not be difficult.

31. The transition provisions for ASU 2010-26 gave insurers the option of applying the guidance prospectively or retrospectively to all prior periods, with appropriate disclosures for both approaches. The board also considered whether a practical expedient could be developed to allow more entities to retrospectively adopt the amendments (for example, using the current-year data and applying those data to prior years for which historical information was not available).
32. The basis for conclusions stated that "Ultimately, the Task Force decided against providing a practical expedient. However, Task Force members stated that an entity may need to make reasonable estimates of the effect on prior years on the basis of its specific circumstances in order to adopt the amendments retrospectively. In electing retrospective application, the Task Force did not believe that an entity is necessarily expected to reperform its detailed capitalization, amortization, and premium deficiency calculations for every prior year if it has ways to reasonably estimate those amounts in accordance with Subtopic 250-10, Accounting Changes and Error Corrections—Overall."
33. While many non-life insurers applied the ASU prospectively, most, if not all, life insurers applied the ASU retrospectively. Insurers faced several challenges in applying the standard retrospectively, including loss of or lack of necessary data andthe ability to retrospectively apply further for some lines of business than others. In addition there were impacts on other accounts such as the allocation of ceding commission from reinsurance arrangements, the 'shadow' accounts required under existing US GAAP, equity method accounting for insurance entity investments, etc. Despite these challenges, most insurers felt the benefits of applying the guidance retrospectively outweighed the costs. In addition, the ASU was applied to just one element of the model whereas the proposed guidance would require adjustment of all the related accounts.
34. The staff believe that to achieve Objectives 1 and 2, which would have consistency in the costs that are included in the measurement of the liability, including the costs of acquiring an insurance contract for contracts written prior to transition and contracts

written subsequent to transition, insurers will need to determine these costs retrospectively.

Question 1: Measurement of the insurance contract fulfilment cash flows
Do the boards agree with the staff recommendation that at the beginning of the earliest period presented, an insurer shall: a. measure the present value of the fulfillment cash flows using current estimates at the date of transition. b. account for the acquisition costs in accordance with the board's existing tentative decisions for acquisition costs and derecognize any existing balances of deferred acquisition costs

Alternatives to determining the single or residual margin at transition

35. The single or residual margin, collectively referred to as the margin in this section, only exists in the building block approach. Therefore this section only applies to contracts that are accounted for under the building block approach. The staff considered the following alternatives for determining the single or residual margin:
    a. Alternative 1: Record no margin (IASB ED proposal)
    b. Alternative 2: Record the margin equal to the difference between the new measurement of present value of the fulfillment cash flows and the carrying value prior to transition
    c. Alternative 3: Full retrospective approach
    d. Alternative 4: Retrospective approach with a practical expedient for contracts written prior to the earliest practical period.
    e. Alternative 5:Record the margin as the difference between the fair value of inforce contracts and the new measurement of the present value of the fulfillment cash flows at transition date
    f. Alternative 6: Record the margin as the difference between the current entity-specific price that the insurer would hypothetically charge the policyholder for a

contract equivalent to the inforce portfolio of insurance contracts and the new measurement of the liability.

Alternative 1*: *At transition date, record no margin

36. Alternative 1 was proposed in the IASB's ED. In the Basis for Conclusions to the IASB's ED, BC 248 states that: "The Board concluded that retrospective determination of the residual margin would sometimes be impracticable in that sense and, if not impracticable, it would often cause costs disproportionate to the resulting benefit for users. Accordingly, the exposure draft proposes that an insurer should, on first applying the new IFRS, measure its existing contracts at that date by setting the residual margin equal to zero."
37. The Board also noted that the impact of this proposal would result in insurers not recognizing margins as income in subsequent periods for its business inforce at transition while recognizing margins as income for contracts written subsequent to transition.
38. Although this alternative is relatively simple for preparers, as previously noted, preparers and users have strongly indicated that the benefits of applying the proposed guidance retrospectively far outweigh the costs. The largest concern is the inconsistency in the earnings for contracts written prior and after the transition date. As such, none of the objectives described above would be met by this alternative.

Alternative 2*: *At transition date, record the margin equal to the difference between the new measurement of the present value of the fulfillment cash flows and the carrying value prior to transition

39. The Basis for Conclusions of the IASB's ED also addresses this alternative. Paragraph BC249 states: "That approach would have had the advantage of maintaining some continuity with previously reported profit or loss, without imposing significant additional costs. However, the Board rejected that approach because the resulting residual margins would not have been comparable with residual margins for subsequent contracts and would have depended significantly on the pattern of income recognition under previous accounting models, which are not uniform."

40. Several of the comment letters suggested this approach and some would argue that it meets objective 3 as it would be the least costly alternative, however, objectives 1 and 2 would not be met. Besides the fact that this would result in no transition impact to retained earnings, which on the surface does not appear reasonable given that the liability measurement is changing, the margin on the inforce business would not be comparable to the margin on the new business written subsequent to the transition date. This of course leads to inconsistency in the amount of margin recognized as revenue for all subsequent periods until the inforce contracts are derecognized (through non-renewals, lapses, occurrence of insured event, etc.) which will not happen for many years for a number of lines of business. To mitigate this inconsistency, if the boards adopt this approach, it may be worth considering separate disclosure about the margin arising from contracts that were in force at transition.

Alternative 3: *Full retrospective approach.*

41. This approach would require insurers to estimate the single or residual margin by applying the building block approach as if it had been used at the inception of the insurance contracts. ASC Topic 250-10 and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors,* require an entity to apply a change in accounting principle through *retrospective application* of the new accounting principle to all prior periods, unless it is impracticable to do so.
42. This approach would achieve objectives 1 and 2. That is the measurement of the margin recorded for portfolios of contracts written prior to the transition date and the earnings of that margin would be consistent with the measurement of the margin for contracts written subsequent to the transition date and the earnings thereof. Financial statement users have indicated that full retrospective application is desired as:
    a. It would facilitate their analysis of the margin balance and the earnings trends after a one time impact at the transition date rather than having to analyze separately for contracts written prior and subsequent to the transition date.
    b. In addition, users projections of future earnings could be consistent for all contracts.

c. Finally, it would enhance the users ability to compare entities that previously used different accounting methods.

43. A significant disadvantage of this method is that it may be impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. The standards allow for estimates to be made however, in determining the margin, those estimates needs to reflect the circumstances that existed and the information that would have been available when the insurance contract was issued and subsequently to determine the amortization and/or unlocking of the margin, without influence from hindsight. The longer period of time that might have passed since the contract was written, the more difficult this estimation is.
44. Many types of insurance contracts are long-duration. For example, a life insurance contract can span a person's life-time. Data to apply the proposed model may not have been collected in the prior periods and it may be impracticable to recreate the information.
45. IFRS 8 paragraph 52 indicates that it is impracticable to apply a new accounting policy retrospectively if an insurer cannot distinguish information that:
    a. provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and
    b. would have been available when the financial statements for that prior period were authorised for issue.

Alternative 4: *Partial retrospective approach with a practical expedient for contracts written prior to the earliest period practical*

46. This approach would require insurers to estimate the margin by applying the building block approach prospectively from the earliest period practical (i.e., apply retrospectively as far back as is practicable) and to estimate the margin on contracts written prior to that "earliest period practical".
47. The staff believe there are three alternatives to account for the margin on contracts written prior to the earliest period practical:
    a. Do not include a margin

b. Record the margin as the difference between the new measurement of the liability and the carrying value as of the earliest period practical
c. Estimate the margin by using an estimate of the expected profit based on:
   i. Historical assumptions
   ii. An average of the periods determined

For portfolios of contracts written prior to the earliest period practical do not include a margin

48. ASC Topic 250-10 and IAS 8 indicate that for all periods prior to the earliest period practical to apply a new accounting standard retrospectively, the portion of the cumulative adjustment to assets and liabilities should be disregarded. By requiring insurers to disregard, or write off, the margin for all contracts written prior to the earliest period practical to apply the proposed insurance contracts standard retrospectively, will encourage insurers to go as far back as possible, thus resulting in consistent measurement of the liability and comparable earnings for contracts written subsequent to the transition date and subsequent to the earliest period practicable. In addition, the margin that is recorded, and subsequently earned, would be measured consistently as the insurer would not be allowed to apply estimates, which could involve substantial management judgment, to a portion of the margin for contracts written prior to when the insurer could retrospectively apply the proposed guidance.
49. However, at the transition date there could be a substantial amount of margin on portfolios of contracts written prior to the earliest period practical to apply the proposed guidance retrospectively. Insurers should not be penalized for lacking data which could be attributed to upgrading systems or acquisitions.
50. Should the margin on portfolios of contracts written prior to the earliest period practical to apply the proposed guidance retrospectively be written off as an adjustment to retained earnings, neither Objective 1 (measuring the assets and liabilities consistently for all portfolios of contracts) nor Objective 2 (comparability of earnings for all portfolios of contracts) would be fully met as portfolios of contracts written prior to the earliest period practical would not include a margin and subsequent earnings. However, this approach is preferable over Alternative 1 as it

would account for some of the margin on portfolios of contracts written prior to the transition date.

For portfolios of contracts written prior to the earliest period practical record the margin as the difference between the new measurement of the liability and the carrying value at the earliest period practical

51. Several constituent suggested that the margin on portfolios of contracts written prior to the earliest period practical to apply the proposed guidance retrospectively should be determined as the difference between the carrying amounts of the insurance liabilities and the present value of the fulfilment cash flows. This is similar to Alternative 2, however it requires the amount of margin to be determined at the earliest period practical with subsequent recognition for the periods between the earliest period practical and the transition date (and thereafter) consistent with portfolios of contracts for which the proposed guidance can be applied retrospectively and portfolios of contracts written subsequent to the transition date.
52. Some believe, that if an insurer can go back far enough, using this approach as a proxy for the margin would not result in a substantially different margin then if it had been determined applying the full proposed model. This is because it is unlikely that the margin remaining on contracts written prior to the earliest period practical will be a significant portion of the total margin for all portfolios of contracts written prior to the transition date. This approach would be less costly to apply then a full retrospective approach with perhaps not a substantial difference.
53. However, this approach could encourage insurers to not go back as far as they potentially could or would under other approaches.
54. Applying this approach would achieve a greater amount of consistency in the measurement of the assets and liabilities (objective 1) and comparability of earnings (objective 2) for all portfolios of contracts than if the margin were required to be written off for these portfolios of contracts, if insurers go as far back as they would under other approaches.

For portfolios of contracts written prior to the earliest period practical estimate the margin by using an estimate of the expected profit margin:

55. The board's could require insurers to estimate the margin for portfolios of contracts written prior to the earliest period practical to apply the proposed model retrospectively. Some feedback suggested that this estimate should not be prescriptive and rather preparers should be able to apply judgment. However, some believe this could result in less comparability and because of the ongoing significance the transition adjustment will have on the financial statements for many years into the future, the transition guidance should be written "tightly".
56. The staff considered two methods to estimate the margin for portfolios of contracts written prior to the earliest practical period for which the proposed model can be applied retrospectively:
    a. Historical assumptions: there are several pieces of data that an insurer must have for all contracts inforce including the contract inception date, the amount of premium received or expected to be received, the age of the insured for a life, health, or long-term care or disability contract, and the features of the contract. To estimate the margin at contract inception an insurer can apply the percentage of expected profit on the portfolio of contracts when written to the total premiums received or receivable to determine an opening margin. The expected profit percentage can be estimated several ways. The most accurate would be to determine the percentage of net premium[3] to gross premium. Another approach is to determine the return on equity that the insurer wrote contracts at in those years. It is unclear whether this data will always be available however, using some historical data to estimate the margin would result in the most comparable measurement of the margin and consistent earnings for all portfolios of contracts.
    b. Using an average of the margin percentage for the periods for which the guidance is applied retrospectively adjusted for external factors. The insurer will have already determined the margin at inception for the portfolios of contracts for which the insurer can apply the proposed guidance prospectively. Because the

[3] The net premium is the expected gross premium less acquisition costs less some profit.

insurance industry is a competitive market, internal factors don't typically drive profit percentages. However, the expected profit is impacted by external variables such as the investment market for life products and the severity and frequency of catastrophes for non-life contracts. As the business of insurance goes through hard (high prices) and soft (low prices) markets, the profit margin percentage would vary over time and across different portfolios.

57. After determining the margin at the inception of the portfolio of contracts, the insurer can amortize that margin through the transition date using the boards' tentative decisions (FASB - based on the reduction in the uncertainty of expected cash flows based on the insurer's release from risk; IASB - over the coverage period on a systematic basis that is consistent with the pattern of transfer of services provided under the contract). However, due to lack of data, a practical expedient would be to amortize the margin straight-line until the earliest practical period that the proposed guidance could be applied retrospectively and then in accordance with the proposed model thereafter. If the insurer previously adjusted its balances due to loss recognition, insurers should consider that when determining the estimate of the margin at the earliest practical period.
58. When full retrospective application of the proposed model is not practicable, recording an estimate for the margin on portfolios of contracts written prior to the earliest period practical to apply the proposed model retrospectively, would achieve the highest amount of consistency in the measurement of the assets and liabilities and comparability of earnings for all portfolios of contracts. Because the insurance business is in a competitive market, the estimates should not be significantly different amongst insurers. Requiring insurers to disclose their assumptions for the transition adjustment would provide users with information that would allow them to compare entities. While this may be more costly to apply then writing off the margin or using the difference between the new measurement of the liability and the carrying value as of the earliest period practical, the staff believe the benefits of estimating the margin for those contracts written prior to the earliest period practical outweigh the costs.

Should the earliest period practical be consistent across all products written by an insurer and/or across all insurers?

59. If the earliest period practical to apply the proposed guidance prospectively differs across products written by an insurer and amongst companies there could be a lack of comparability.

Common or different dates to apply retrospectively?

60. Some have suggested that the boards specify the retrospective period of time for which the proposed guidance should be applied, such as ten years. This would provide users with comparability across companies however users have indicated they prefer preparers apply the proposed guidance as far back as possible such that there is higher consistency in the measurement of the margin and comparability of earnings for insurers entire portfolios. By specifying a period of time for which to apply the proposed guidance retrospectively, there would be less consistency in the measurement of the margin and lower comparability of earnings for contracts written prior to the earliest practical period and those written after. However, this may be appropriate if the boards were to require insurers to write off the margin for all portfolios of contracts written prior to that specified date.

Common or different dates for portfolios of contracts written by an insurer?

61. The amount of data and systems that an insurer has may differ across the various products they write. This may be common for acquired blocks of business and when an insurer has upgraded their systems and may not have carried forward all the data to allow them to apply the proposed standard.
62. Allowing insurers to determine the earliest practical date that the proposed standard can be applied retrospectively by portfolio of contracts would provide better consistency of the measurement of the margin and comparability in future earnings for a higher portion of the insurers portfolios of contracts than if insurers were hampered by certain portfolios. If the boards tentatively decide to allow insurers to estimate the amount of margin remaining at transition for portfolios of contracts written prior to the earliest practical date, the staff believe allowing different dates to

be used as the earliest practical date is appropriate since it reduces the amount of margin being determined by the practical expedient.

63. However, some believe that insurers should determine the earliest practical date that the proposed standard can be applied retrospectively for all its business. This would provide the most comparability within the entity if the insurer were to write off the margin for all portfolios of contracts written prior to that date or if the insurer were to record the margin as the difference between the new measurement of the liability and the carrying value at the earliest period practical. The staff believe that having a common "cut-off" date would be the easiest for users to understand if the margin for contracts before a specified date were written off.

Alternative 5: *Record the margin as the difference between the fair value of the portfolio of insurance contracts and the new measurement of the liability at the date of transition*

64. This alternative is similar to the accounting for a business combination by an acquiring insurer. Under this alternative, the insurer would determine the fair value of the portfolio of insurance contracts and compare that to the new measurement of the liability applying the building block approach; the difference would be recorded as the margin.
65. The advantage of this approach is that insurers are generally familiar with using fair values in portfolio transfers and business combinations involving insurance contracts. The use of fair value method of transition could lead to more consistent and comparable information within the insurer and among insurers because of the use of market assumptions which may differ from entity-specific assumptions.
66. However, because of the lack of an observable market for insurance liabilities insurers would need to use level 3 fair values. In addition, the fair value of the portfolio of insurance contracts will partly depend on the transition date given that current assumptions are used. Therefore if the transition date occurs when the economy is in a recession, the fair value of the portfolio of insurance contracts will most likely be lower than if the economy was growing and thus the margin will be lower, even though some portfolios of contracts could have significant margins which

won't be recognized because the margin is not fair valued at subsequent reporting dates.

67. The boards have tentatively decided that current fulfilment value and not fair value is the most relevant measurement attribute for insurance liabilities. Therefore applying fair value to determine the margin would appear to be inconsistent with the boards' previous tentative decision and would not meet Objective 1 (consistent measurement of the margin) or Objective 2 (comparable earnings) for portfolios of contracts written prior to and subsequent to the transition date.
68. In addition, it could be extremely time consuming and costly to determine the fair value of the business (objective 3). While these costs would be replacing some of the costs to apply the proposed guidance retrospectively, the models that are built to determine the fair value will not be used subsequently for the measurement of the liability, whereas companies will continuously utilize the systems that are built to implement the new measurement model.

Alternative 6: *Record the margin as the difference between the hypothetical price for the portfolio of insurance contracts and the new measurement of the liability at the date of transition*

69. This alternative would incorporate the boards' tentative decision made regarding the accounting for a substantial modification to an insurance contract. The boards tentatively decided that when an insurer makes a substantial modification to an insurance contract, the gain or loss on extinguishment of the original contract should be determined by measuring the existing insurance contract using the current entity-specific price that the insurer would hypothetically charge the policyholder for a contract equivalent to the newly recognized insurance contract. However, under this alternative insurers would be required to determine a hypothetical price they would charge policyholders at the date of transition for equivalent contracts for their entire portfolio of contracts.
70. One of the primary disadvantages of this alternative is that the hypothetical price that an insurer would charge today for an equivalent contract does not reflect the actual price that the contract was sold at and therefore the expected margin at the inception

of the contract and remaining at the transition date. The boards have tentatively decided that current fulfilment value and not hypothetical transfer price is the most relevant measurement attribute for insurance liabilities. In addition, the hypothetical price could be subject to unacceptable use of hindsight. This alternative would not meet Objective 1, consistency in the measurement of the margin or objective 2, comparability of earnings, for portfolios of contracts written prior to and subsequent to the transition date. In addition, this alternative could include judgment which insurers may not have a reference point to compare it to. For example, if the current insurance products no longer have the same features as the previously sold insurance contracts, it would be difficult to determine what the insurer would sell that contract for at the transition date.

71. This alternative may be less costly to apply than others given that insurers have pricing models for contracts that are still sold. However, for contracts that are no longer sold, insurers would need to determine a pricing model that would not be utilized in the future. This could be a substantial portion of an insurers portfolio of insurance contracts given that contract features change considerably often to meet the demands of policyholders which are partially driven by the financial market.

Should contracts have different transitional requirements depending on the approach used to measure the insurance contract liability?

72. As previously noted, some inforce contracts could have been written over 50 years prior to the transition date. It will be much more difficult for insurers to apply the standard fully retrospectively for these types of contracts then contracts that have a shorter coverage period, such as those accounted for under the premium allocation approach. As such the staff considered whether there should be different transitional requirements for different types of contracts.
73. First the staff considered whether contracts accounted for under the premium allocation approach (PAA) and the building block approach (BBA) should have different treatment.
    a. For contracts accounted for under the PAA, because the liability for remaining coverage is calibrated to the amount of premium charged at

contract inception, the amounts recorded under the new model would not be significantly different than that recorded under existing guidance. The recognition of the liability for remaining coverage may change for some insurers from straight-line on the basis of time to the expected timing of incurred claims and benefits, however, this will only impact specific types of insurance products. And finally, because the margin is included in the liability for remaining coverage, either explicitly or implicitly, and that period is a short duration, insurers will not need to explicitly calculate the margin and amortize it through the transition date. However, there may be a liability for claims incurred on contracts accounted for under the premium allocation approach that were written more than 20 years prior to the transition date such as for workers compensation claims or asbestos and environmental claims. Therefore, the most significant concern for these types of contracts is the determination of the discount rate which is addressed in Agenda Paper 2C/89C.

b. Contracts accounted for under the BBA will include an array of products given that contracts that don't meet the criteria to be eligible to apply the PAA will apply the BBA and the IASB permits insurers to choose to apply the BBA even if the eligibility criteria to apply PAA are met. This means there are some shorter duration contracts such as short term and non-life products. Other contracts have a longer coverage period such as whole life and annuity contracts. Under the building block approach, a margin will be established for these types of contracts..

74. In considering the various contracts accounted for under each approach, the staff could not think of a reason why the objectives laid out in paragraph 21~~20~~ would differ by the accounting approach that was applied nor how the alternatives would meet those objectives.

75. Next the staff considered whether the transitional guidance should be different by product type. Setting aside the fact that it would be cumbersome, if not impossible, to create a list of insurance contracts to determine what transitional requirements should

apply, nowhere else in the proposed insurance contracts guidance do the boards specify an accounting approach by product.

76. Based on this analysis, the staff do not believe that the transitional requirements should be different based on the approach applied (i.e., PAA vs. BBA) or by products.

Summary and Staff recommendation

77. The table below illustrates the time period for which the six alternatives would apply.

1955 Oldest contract inception date	1985 Earliest period practical to apply retrospectively	2015 Transition Date
		Alternative 1 – write off
		Alternative 2 – set to the difference between the new measurement model and the carrying value
Alternative 3 – full retrospective		
Alternative 4.c. – Estimate margin for contracts written prior to earliest period practical	Alternative 4 – partial retrospective: a. Write-off for any portfolio of contracts written prior to this period b. Set to the difference between the new measurement model and the carrying value for contracts written prior to this date	
		Alternative 5 – set to difference between fair value of portfolio of contracts and new measurement of the liability
		Alternative 6 - set to difference between hypothetical price of portfolio of contracts and new measurement of the liability

78. The table below illustrates how the six alternatives discussed achieve the objectives of a successful transition approach.

	Alternative	Objective 1: Achieve consistent measurement	Objective 2: Allow for comparability of earnings	Objective 3: Be practical and meet the cost-benefit test
1	Write-off margin for portfolios of contracts written prior to transition date	Does not achieve	Does not achieve	Fully achieves
2	Set the margin to the difference between the new measurement of the present value of the fulfillment cash flows and the carrying value	Does not achieve	Does not achieve	Fully achieves
3	Full retrospective application	Fully achieves	Fully achieves	Does not achieve
4	Retrospective approach with a practical expedient for portfolios of contracts written prior to earliest period practical to apply the proposed guidance retrospectively a. Write off b. Set to the difference between the new measurement model and the carrying value c. Estimate	Partially achieves a. Partially achieves b. Partially achieves c. Close to fully achieves	Partially achieves	Partially achieves
5	Set the margin to the difference between the fair value of the portfolio of insurance contracts and the new measurement of the liability	Does not achieve	Does not achieve	Partially achieves
6	Set the margin to the difference between the hypothetical price of the portfolio of insurance contracts and the new measurement of the liability	Does not achieve	Does not achieve	Partially achieves

79. The staff recognize that none of the alternatives will fully achieve all of the objectives of a successful transition approach. However, the staff believe that Alternative 4c accomplishes the best balance and is most consistent with Existing guidance on change in accounting principles under ASC Topic 250-10 and IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

80. In addition, the staff recommend that the guidance not include a specific method on estimating the margin for portfolios of contracts written prior to the earliest period practical to apply the proposed guidance retrospectively but include in application guidance the two methods discussed above: using historical data or an average of the

margin for the period between the earliest period practical and the transition date. To prescribe an estimation method would be overly prescriptive in the staff's view.

81. Finally, the staff do not recommend that the boards specify a common date for which the new measurement model should be applied retrospectively. The staff believe that if the boards tentatively agree with the staff recommendation to allow insurers to estimate the amount of margin remaining at transition for portfolios of contracts written prior to the earliest practical date, allowing different dates to be used as the earliest practical date is appropriate since it reduces the amount of margin being determined by the practical expedient.
82. The staff believe that this is responsive to users feedback for a model that requires retrospective application for the longest period practical such that the earnings in the future will be comparable for all of an insurers portfolios of contracts regardless of when those portfolios were written.
83. The most significant costs in implementing the proposed model are expected to be associated with building the systems to apply the new measurement model. Incremental additional costs will be recognized to apply this model retrospectively to the earliest period practical. However, the staff believes that the benefits to financial reporting, such as consistency in the measurement of the margin and comparability of earnings for all of an insurers portfolios of insurance contracts, are in excess of the costs.

Question 2: Determining the single or residual margin at transition

Do the boards agree with the staff recommendation to:

a. Determine the margin through *retrospective application* of the new accounting principle to all prior periods, unless it is impracticable to do so.

b. If it is impracticable to determine the cumulative effect of applying that change in accounting principle retrospectively to all prior periods, the insurer is required to apply the new policy prospectively from the start of the earliest period for which retrospective application is practicable (i.e., apply retrospectively as far back as is practicable)

c. For earlier periods for which retrospective application would normally be considered impracticable because it would require significant estimates that are not based solely on objective information, an insurer shall determine the margin through retrospective application of the new accounting principle. In such cases, an insurer need not undertake exhaustive efforts to obtain objective information, but shall take into account all objective information that is reasonably.

d. If it is impracticable to apply the new accounting policies retrospectively for other reasons, an insurer shall apply the general requirements of ASC Topic 250-10/ IAS 8 relevant to situations in which there are limitations on retrospective application.

Practical issue of determining the margin

84. The boards have tentatively decided[4] that a portion of the cash flows are allocated to a portfolio. Whether recognizing the single margin under the FASB approach or recognizing the residual margin under the IASB's approach, both determine the margin at a portfolio level and recognize it in the statement of comprehensive income at a level higher than the contract. The nature of an insurance portfolio is that a portion of the premiums from all contracts in the portfolio is used to pay claims when incurred. This may result in some of the expected profits on contracts that have been extinguished to be recognized with the contracts that persist.
85. If the boards were to tentatively decide that at transition, only the portfolio of contracts inforce at that date should be included in the determination of the expected cash flows and margin, the remaining expected margin to be allocated to earnings as the company is released from risk may be different amounts then if the margin was determined for the portfolio of contracts that was written.
86. Consider the following example:

[4] At the 21 March 2012 joint meeting the FASB and IASB tentatively decided that the single / residual margin should be determined at the portfolio level. The FASB also tentatively decided that the release of the single margin should be at the portfolio level and should be recognized as the insurer satisfies its performance obligation to compensate the policyholder; as it is released from exposure to risk as evidenced by a reduction in the variability of cash flows. The IASB did not specify the unit of account at which the residual margin should be released but did indicate that the residual margin should be released by the end of the coverage period and had tentatively decided that insurers should allocate the residual margin over the coverage period on a systematic basis that is consistent with the pattern of transfer of services provided under the contract.

The boards have not yet decided on how to recognize premium for contracts accounted for using the building block approach, but should the boards tentatively decide to recognize premium using a earned premium approach, the earnings pattern is based on a portfolio of insurance contracts.

Assume the following:

a. 20 year contract, transition to new standard after 10 years (beginning of earliest period presented)
b. Total margin at inception 4 million = 4,000 per contract
c. Total contracts at inception 1,000
d. Total expected to be still in force on transition 800
e. Margin amortisation straight-line for the portfolio
f. Ignore time value of money
g. Assume no experience adjustments and changes in estimates

If the insurer were applying the standard retrospectively:

a. The margin at transition would be CU 2 million (CU 4 million * (10/20)), with CU 2 million already recognised in the income statement
b. In principle, the margin already recognised in the income statement over the first 10 years is made up of the following components:
    1. Full margin on contracts no longer in force (CU 0.8 million (200* 4,000))
    2. The rest from contracts still in force (CU 1.2 million (2 million – 0.8 million) or CU 1,500 per contract)
    3. Remaining balance = CU 2 million or CU 2,500 per contract.
c. However, if the guidance indicates that the proposed standard should apply to just portfolios of inforce contracts, insurers may erroneously calculate a margin of CU 1.6 million (CU 4 million * 800/1,000 *10/20)

87. However, considering the expected cash flows and resulting margin on the portfolio of contracts that were written that may not be operationally possible to obtain as some of the contracts may have been extinguished . While insurers may have archived data on all contracts written, because of the duration of some contracts, that data is not easily accessible either because current systems cannot read the data or the time and costs to access the data would be unduly burdensome. Other insurers may not have the data which may be the case for portfolios of business that were acquired.

88. In addition, certain types of contracts have their future cash values closely correlated with a high lapse ratio of the insurance company's book of business (i.e., lapse supported products). In essence, the contract is specifically designed so that if it is surrendered, its surrender value would be less than its value had the contract persisted. In theory, gains resulting from these lapses will result in a greater surplus

account, thereby building the future cash values of the portfolio of policies that don't lapse[5].

89. Insurers do not have specific lapse assumptions by contract but rather have the same lapse assumption for all policies within the portfolio of contracts written. As the policies move through their life cycle, insurers know which ones lapsed and which ones persisted. However, the question is whether there is enough margin at contract issue on those contracts that are not lapsed at the time of transition to represent the unamortized portion of the margin on the portfolio of contracts written. This will depend on the percentage of policies that were supposed to lapse. If only a small percentage were supposed to lapse and did lapse then the unamortized margin on the contracts inforce is probably not significantly different than the amortized margin on the portfolio of contracts written. However, if a large percentage were supposed to lapse and/or the results are different than expected, the differences could be significant.
90. In estimating the margin at transition, the staff believe that if insurers cannot apply the model to the entire portfolio of contracts written, insurers should adjust the amortization pattern of the margin on the inforce contracts during the retrospective period to reflect the remaining margin on the portfolio of contracts written. One method to do this is to estimate the percentage of contracts that are inforce compared to the total number of contracts written.
91. The staff believe that this is inherent in retrospective application and therefore the staff will address this point in drafting.

Transitional disclosures

92. Because the IASB ED transition required an insurer to measure its portfolio of insurance contracts at the present value of the fulfillment cash flows with no margin, no specific transitional disclosures were proposed, beyond those required by IAS 8.

[5] Every product design has a persistency assumption built into the pricing. Generally if lapses are less than assumed, profitability improves because present value of the income stream increases more than the present value of the future benefits plus the acquisition cost. If instead profitability is reduced, the product is technically lapse supported.

93. However, as previously noted, ASC Topic 250-10 and IAS 8 requires an entity to apply a change in accounting principle through *retrospective application* of the new accounting principle to all prior periods, unless it is impracticable to do so. Those standards require disclosures of the method of applying the changes as well as other information. See Appendix A for full guidance.
94. The staff believes these disclosures are appropriate and recommend that the guidance reference those respective standards.
95. In addition to the requirements in ASC Topic 250-10 and IAS 8, the staff believe additional disclosures are needed, including:
    a. If full retrospective application is impracticable, the earliest practicable date to which the insurer applied the guidance retrospectively and the method used to estimate the expected remaining residual or single margin for insurance contracts inforce as of that earliest practical date.
    b. The determination of the discount rate during the retrospective period
96. Finally, the IASB's ED and Memo No. 87A for the August FASB only Education Session, requires claim development back to the period when the earliest material claim arose for which there is uncertainty about the amount and timing of the claims payments, but need not go back more than ten years. Paragraph 101 of the IASB ED stated:

    > An insurer need not disclose previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it first applies this [draft] IFRS. Furthermore, if it is impracticable when an insurer first applies this [draft] IFRS to prepare information about the claims development that occurred before the beginning of the earliest period for which the insurer presents full comparable information that complies with this [draft] IFRS, it shall disclose that fact.

97. The staff recommend this paragraph be included in the disclosure requirements as it would be unduly burdensome to require insurers to recreate this disclosure going back ten years.

Staff recommendation

98. Staff recommends that the boards require insurers to disclose information in subtopic 250-10-50-1 through 50-3 appropriately adjusted to reflect the transition method under the insurance contract standard. The additional information in the transitional disclosures should enable financial statement users to understand and analyze the resulting financial statements in making resource allocation decisions about the insurer. We summarize in the box below the suggested transitional disclosures.

Questions 3 and 4: Transitional disclosures

3. Do the boards agree with the staff recommendation that insurers should make the disclosures required by [ASC Topic 250-10] [IAS 8], and the following more specific disclosures:

a. If full retrospective application is impracticable, the earliest practicable date to which the insurer applied the guidance retrospectively

b. The method used to estimate the expected remaining residual or single margin for insurance contracts inforce as of that earliest practical date including the extent to which the insurer has used information that is objective and separately, the extent to which the insurer has used information that is not objective, in determining the margin

c. The method and assumptions used in determining the “locked-in” discount rate during the retrospective period

4. Do the boards agree with the following staff recommendation:

d. An insurer need not disclose previously unpublished information about claims development that occurred earlier than five years before the end of the first financial year in which it first applies the new guidance. Furthermore, if it is impracticable when an insurer first applies the guidance to prepare information about the claims development that occurred before the beginning of the earliest period for which the insurer presents full comparable information, it shall disclose that fact.

Appendix A: Existing guidance on change in accounting principles under ASC Topic 250-10 and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

A1. US GAAP

45-5 An entity shall report a change in accounting principle through retrospective application of the new accounting principle to all prior periods, unless it is impracticable to do so. Retrospective application requires all of the following:

a. The cumulative effect of the change to the new accounting principle on periods prior to those presented shall be reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented.

b. An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period.

c. Financial statements for each individual prior period presented shall be adjusted to reflect the period-specific effects of applying the new accounting principle.

45-6 If the cumulative effect of applying a change in accounting principle to all prior periods can be determined, but it is impracticable to determine the period-specific effects of that change on all prior periods presented, the cumulative effect of the change to the new accounting principle shall be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the new accounting principle can be applied. An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period.

45-7 If it is impracticable to determine the cumulative effect of applying a change in accounting principle to any prior period, the new accounting principle shall be applied as if the change was made prospectively as of the earliest date practicable.

45-8 Retrospective application shall include only the direct effects of a change in accounting principle, including any related income tax effects. Indirect effects that would have been recognized if the newly adopted accounting principle had been

followed in prior periods shall not be included in the retrospective application. If indirect effects are actually incurred and recognized, they shall be reported in the period in which the accounting change is made.

45-9 It shall be deemed impracticable to apply the effects of a change in accounting principle retrospectively only if any of the following conditions exist:

a. After making every reasonable effort to do so, the entity is unable to apply the requirement.

b. Retrospective application requires assumptions about management's intent in a prior period that cannot be independently substantiated.

c. Retrospective application requires significant estimates of amounts, and it is impossible to distinguish objectively information about those estimates that both:

1. Provides evidence of circumstances that existed on the date(s) at which those amounts would be recognized, measured, or disclosed under retrospective application

2. Would have been available when the financial statements for that prior period were issued.

50-1 An entity shall disclose all of the following in the fiscal period in which a change in accounting principle is made

a. The nature of and reason for the change in accounting principle, including an explanation of why the newly adopted accounting principle is preferable.
b. The method of applying the change, including all of the following:
    i. A description of the prior-period information that has been retrospectively adjusted, if any.
    ii. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for the current period and any prior periods retrospectively adjusted. Presentation of the effect on financial statement subtotals and totals other than income from continuing operations and net income (or other appropriate captions of

changes in the applicable net assets or performance indicator) is not required.

iii. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

iv. If retrospective application to all prior periods is impracticable, disclosure of the reasons therefore, and a description of the alternative method used to report the change

c. If indirect effects of a change in accounting principle are recognized both of the following shall be disclosed:

   i. A description of the indirect effects of a change in accounting principle, including the amounts that have been recognized in the current period, and the related per-share amounts, if applicable

   ii. Unless impracticable, the amount of the total recognized indirect effects of the accounting change and the related per-share amounts, if applicable, that are attributable to each prior period presented. Compliance with this disclosure requirement is practicable unless an entity cannot comply with it after making every reasonable effort to do so.

Financial statements of subsequent periods need not repeat the disclosures required by this paragraph. If a change in accounting principle has no material effect in the period of change but is reasonably certain to have a material effect in later periods, the disclosures required by (a) shall be provided whenever the financial statements of the period of change are presented.

50-2 An entity that issues interim financial statements shall provide the required disclosures in the financial statements of both the interim period of the change and the annual period of the change.

50-3 In the fiscal year in which a new accounting principle is adopted, financial information reported for interim periods after the date of adoption shall disclose the effect of the change on income from continuing operations, net income (or other appropriate

captions of changes in the applicable net assets or performance indicator), and related per-share amounts, if applicable, for those post-change interim periods.

A2. IFRS

19 Subject to paragraph 23:

(a) an entity shall account for a change in accounting policy resulting from the initial application of an IFRS in accordance with the specific transitional provisions, if any, in that IFRS; and

(b) when an entity changes an accounting policy upon initial application of an IFRS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.

22 Subject to paragraph 23, when a change in accounting policy is applied retrospectively in accordance with paragraph 19(a) or (b), the entity shall adjust the opening balance of each affected component of equity for the earliest prior period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.

23 When retrospective application is required by paragraph 19(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period-specific effects or the cumulative effect of the change.

24 When it is impracticable to determine the period-specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

25 When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity

shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.

26 When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing statements of financial position for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of equity of the earliest prior period presented. Usually the adjustment is made to retained earnings. However, the adjustment may be made to another component of equity (for example, to comply with an IFRS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.

27 When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, in accordance with paragraph 25, applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period. Paragraphs 50–53 provide guidance on when it is impracticable to apply a new accounting policy to one or more prior periods.

50 In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 51–53, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.

51 It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognised or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting period. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

52 Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that

(a) provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and

(b) would have been available when the financial statements for that prior period were authorised for issue from other information. For some types of estimates (eg a fair value measurement that uses significant unobservable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

53 Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management’s intentions would have been in a prior period or estimating the amounts recognised, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in calculating its liability for employees’ accumulated sick leave in accordance with IAS 19 *Employee Benefits*, it disregards information about an unusually severe influenza season during the next period that became available after the financial statements for the prior period were authorised for issue.

The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

Disclosure

28 When initial application of an IFRS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:

(a) the title of the IFRS;

(b) when applicable, that the change in accounting policy is made in accordance with its transitional provisions;

(c) the nature of the change in accounting policy;

(d) when applicable, a description of the transitional provisions;

(e) when applicable, the transitional provisions that might have an effect on future periods;

(f) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment:

(i) for each financial statement line item affected; and

(ii) if IAS 33 *Earnings per Share* applies to the entity, for basic and diluted earnings per share;

(g) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(h) if retrospective application required by paragraph 19(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied. Financial statements of subsequent periods need not repeat these disclosures.

Appendix B: Feedback from Revenue Recognition Exposure Draft

Feedback from Revenue Recognition ED and outreach on transition method

99. The staff reached out to the Revenue Recognition team to gain insight on the comments that they have received in response to the 2011 exposure draft that required *retrospective application* with practical expedients.

100. Users prefer full retrospective transition while preparers and auditors express impracticality concerns. User groups feel that all periods presented should reflect the guidance retrospectively as a necessity of being able to meaningfully analyze financial data with trend information. Additionally, users acknowledge the burden this transition method would place on preparers, therefore, they suggest delaying the effective date of the proposed guidance to give preparers more time to comply.

101. Almost all other respondents oppose the full retrospective transition method. Many acknowledge the conceptual merit of retrospective transition, however, these respondents overwhelmingly believe that the cost required to comply with those transition requirements would far outweigh the benefits. Many feel that the boards should permit prospective application with sufficient disclosures to outline the qualitative and quantitative effects of transition. Other respondents suggested different alternatives including: no restatement of completed contracts, exception to retrospective transition when the effect is immaterial, providing a retrospective or prospective option, and dual reporting of revenue information using previous and proposed guidance.

102. It is important to note that, unlike insurance contract which would recognize all the expected future cash flows (plus a risk adjustment under the IASB model) plus a margin, revenue recognition does not recognize the entire contract day one and therefore there is no deferred profit. Revenue recognition would recognize the costs as they occur and the revenue at a point in time or over time – and if over time that typically matches when costs are incurred – with the difference being recognized as profit.