

Beyond the GAAP

No 53 – February 2012

At the time of writing this editorial, the IASB Update – the official publication reporting on Board meetings – had not yet been published, as the IASB's last meeting spanned the end of February and the beginning of March. As a result, it is difficult for us to report on the Board's provisional decisions, given that the subjects discussed were particularly complex and open to interpretation.

We have decided to use this limbo period as an ideal opportunity to re-examine one of the IASB's major projects, namely the Insurance Contracts project. A lot of water has passed under the bridge since the project was launched in 2002.

Enjoy your reading!

Michel Barbet-Massin

Edouard Fossat

Editorial

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Editors in chief:

Michel Barbet-Massin, Edouard Fossat

Columnists:

Sébastien Arnault, Pierre Boyer de Latour, Claire Dusser, Egle Mockaityte, Maxime Simoen and Arnaud Verchère.

Contact us:

Mazars
Exaltis, 61, rue Henri Régnault
92 075 – La Défense – France
Tel.: + 33 (0)1 49 97 60 00

www.mazars.com

News

Trustees appointed to IFRS Foundation

The Trustees of the IFRS Foundation, which is responsible for the governance and oversight of the IASB, have announced the appointment of three new members:

- Chandrashekhar Bhaskar Bhawe (India), the former Chairman of the Securities and Exchange Board of India (SEBI, the Indian financial market regulator) was appointed on 10 February 2012 with immediate effect;
- James Quigley (USA), a Senior Partner of Deloitte US and former Global Chief Executive Officer of Deloitte Touche Tohmatsu Limited, was appointed on 10 February 2012 with immediate effect;
- Ronald Arculli (Hong Kong), who is currently Chairman of Hong Kong Exchanges and Clearing Limited (the operator of the Hong Kong Stock Exchange) and also Chairman of the World Federation of Exchanges (the international association of stock exchanges), was appointed on 24 February 2012 with immediate effect.

The three new appointments will run until 31 December 2014 and are renewable once.

➤ Impairment of financial instruments

The two Boards continued to develop the three-bucket impairment model for financial instruments, based on expected losses.

1/ Transfers to bucket 1

The Boards discussed whether and in what circumstances assets should be transferred from bucket 2 or bucket 3 to bucket 1. The following tentative decisions were made:

- Assets purchased with an explicit expectation of credit losses at acquisition and thus initially allocated to buckets 2 or 3 ('purchased credit-impaired assets') may not subsequently be transferred to bucket 1, even if their credit risk improves.
- Other assets may be transferred to bucket 1 if they no longer meet the criteria for classification in buckets 2 or 3. However, this rule would not apply to restructured debt, the accounting treatment for which has yet to be decided. Nor would it apply to trade receivables for which the lifetime expected losses would be recognized on initial recognition (see below).

2/ Impairment of trade receivables

The IASB has tentatively decided that different impairment models should be used for different types of trade receivables:

- **Trade receivables with a significant financing component** (as defined in the Revenue Recognition exposure draft*): entities would be able to choose between the standard three-bucket model and a simplified model under which the asset's lifetime expected losses would be taken into account from the outset. This model is "simplified" insofar as it does not require the entity to monitor subsequent changes in the debtor's credit risk through the buckets of the "three-bucket" model for disclosure purposes.
- **Trade receivables without a significant financing component:** the Board has considered two options: retaining an "incurred loss" approach (similar to IAS 39) or using an "expected loss" approach, in which case the simplified model presented above would be used.

*According to the November 2011 exposure draft on Revenue from Contracts with Customers, a trade receivable is deemed to have a financing component if the promised amount of consideration differs from the cash selling price of the promised goods or services which gave rise to the receivable.

➤ Classification and measurement: moving towards less stringent criteria for the characteristics of the instrument

Readers will remember that, under IFRS 9 as published by the IASB in 2009, financial assets do not necessarily have to be measured at fair value if they meet a set of criteria, one of which relates to the asset's contractual cash flow characteristics.

To avoid measuring assets at fair value, an entity must demonstrate that the contractual cash flows are solely payments of principal and interest (P&I). Interest may be further broken down into the time value of money and the debtor's credit risk.

The two Boards have confirmed these rules, but have further stipulated that an entity must assess whether an instrument still meets the "P&I" criterion in the event that the relationship between these components (principal, time value of money and debtor's credit risk) is modified.

This is less stringent than the rules currently set out in IFRS 9, as the following example demonstrates:

- A debt instrument with a variable interest rate benchmark which does not correspond to the actual frequency of the interest rate reset does not meet the criteria currently set out in IFRS 9 (cf. IFRS 9 §B.4.13).
- Under the approach proposed by the Boards, this characteristic should be taken into account when assessing whether the P&I criterion is met, but the existence of such clause would no longer systematically lead to accounting for the instrument at fair value.

This proposal thus introduces an additional element of judgement. In order to provide a framework for such judgements, the Board has stipulated that the impact of the "modified" component should be assessed by comparison with a similar benchmark instrument which contains cash flows that are solely P&I (in our example, this would be a debt instrument whose interest rate benchmark corresponds to the actual frequency of the reset). In order to be eligible for a measurement category other than fair value through profit and loss, the difference between the cash flows of the actual instrument and the benchmark instrument must not be "more than insignificant".

European matters

⇒ EFRAG publishes conclusions of field-test study on consolidation standards

EFRAG has just published its "Feedback Report on Field-Tests on IFRS 10, IFRS 11 and IFRS 12", as a complement to its draft endorsement advice on the consolidation standards, which was published on 9 February 2012. The field-tests were carried out in partnership with European preparers of IFRS financial statements.

EFRAG used two separate questionnaires – one on IFRS 10 and the other on IFRS 11 – to gather data from preparers on the operability, costs and benefits of implementing the new standards.

In total, EFRAG received 53 responses from European preparers of financial statements (27 for the IFRS 10 field-test and 26 for the IFRS 11 field-test).

The main lessons learned by EFRAG from the preparers' responses are as follows:

- The fact that IFRS 10 provides a single basis for consolidation, a uniform approach for all types of entity and improved financial information is seen as a big step forward. However, some issuers, particularly those from the insurance industry, were still very concerned about the mandatory effective date of 1 January 2013. They recommended that the mandatory effective date of the new standards should be postponed to 1 January 2014 or even 1 January 2015.
- Classification of joint arrangements and accounting for joint arrangements created through a separate vehicle was the most challenging aspect of implementing IFRS 11, most notably because the assessment is based in large part on the facts and circumstances of the arrangement.

EFRAG's feedback report on the field-test study can be accessed via the link below:

http://www.efrag.org/files/EFRAG%20public%20letters/Consolidation/Feedback_report_on_field_tests_on_IFRS_10_IFRS_11_and_IFRS_12.pdf

⇒ Materiality in financial reporting: ESMA extends comment period

In November 2011, ESMA (formerly CESR) launched a consultation on materiality in financial reporting, as this is a recurring theme in discussions at the European Enforcers Coordination Sessions. Preparers, auditors and users of financial statements differ in their interpretations of how this principle should be implemented in practice.

ESMA is seeking comments from interested parties on their understanding of various aspects of materiality, with a view to publishing a final report later in 2012.

The comment period was initially set to end on 29 February 2012 but has been extended for a month by ESMA. Comments should now be submitted by 31 March 2012 at the latest.

ESMA's consultation document can be accessed via the link below:

http://www.esma.europa.eu/system/files/2011_373_.pdf

In line with this, EFRAG has postponed the closing date for comments on its proposed response to ESMA to 16 March 2012. EFRAG's draft letter can be accessed via the link below:

http://www.efrag.org/files/ESMA%20Consultation%20on%20materiality/ESMA_Consultation_Paper_-_November_2011_-_Draft_comment_letter.pdf

Leases: discussions continue on lessee accounting model

This month, the two Boards once again discussed the profit or loss recognition approaches for lessee accounting: more specifically, the different options for amortisation of the intangible asset (i.e. the right of use).

Readers will remember that, as the project and the discussions stand at present, the lessee shall recognise the lease expense on a non-linear basis, effectively recognising an amortisation expense (generally straight-line) and a decreasing interest expense over the duration of the contract (i.e. the financial expense decreases automatically as the lease liability is repaid).

This aspect of the exposure draft attracted widespread criticism (see *Beyond the GAAP*, January 2011), and the Boards considered the two following alternative approaches, although no decisions were made (not even provisionally).

⇒ First option discussed – the underlying asset approach

Under this approach, the right of use would be amortised in line with the “rate of consumption” of the leased asset over the duration of the lease, defined as the percentage of expected variation in the value of the asset.

For example, an underlying asset with an initial fair value of 1000 and a residual estimated value of 900 at the end of the lease term, the rate of consumption would be 10%.

The impact on the lessee’s profit or loss will vary in line with the rate of consumption for the leased asset. The impact of a higher rate of consumption will be closer to that which would have been observed if the lessee had purchased the asset and financed it separately. We believe that this would produce a profit or loss recognition pattern similar to that described in the Leases exposure draft published in August 2010.

In contrast, the impact of a lower rate of consumption on the lessee’s profit or loss will be closer to that observed in the recognition of operating leases under the present IAS 17.

Although nothing has been decided yet, this approach appears to be the option favoured by the IASB.

⇒ Second option discussed – the interest-based amortisation approach

This approach requires a preliminary analysis to be carried out in order to determine whether or not substantially all of the risks and rewards of the leased asset have been transferred to the lessee. The transfer of the risks and rewards is the key deciding factor under this approach. In other words, the analysis of this criterion will determine the pattern of amortisation of the right of use.

- If substantially all of the risks and rewards have been transferred to the lessee, the lessee shall amortise the right of use on a systematic basis which reflects the rate of consumption of the expected future economic benefits from use of the leased asset (i.e. as in the 2010 exposure draft).
- If substantially all of the risks and rewards have not been transferred to the lessee, the lessee shall amortise the right of use in such a way that the total lease expenses (that is, the interest expense relating to the amortisation of the liability, plus the amortisation expense for the right of use) are recognised on a straight-line basis over the duration of the lease, as for operating leases under the present IAS 17.

Although nothing has been decided yet, this approach appears to be the option favoured by the FASB.

We believe that this second approach would reintroduce the distinction between two categories (two types) of leases; a distinction which the proposed new Leases standard was seeking to eliminate (although the impact would be limited to profit or loss recognition pattern). This would mean that the original goal of the project had not been achieved.

Moreover, we believe that determining the amortisation expense for the right of use "by default" (i.e. based on the difference between a "total" straight-line lease expense over the duration of the contract on the one hand and the liability interest expense on the other) would not be consistent with the current standards.

In any case, this month's discussions on the profit or loss recognition approaches in lessee accounting show once again how difficult it seems to be to reach a consensus on the accounting treatment for leases.

We must wait and see which option the Boards finally settle on. We will keep you up-to-date and provide full details of the chosen approach once it has been decided and clarified.

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A Closer Look

Insurance Contracts (IFRS 4 Phase II):¹ what stage are we of the project? (part one)

The draft IFRS on insurance contracts is still under development after more than ten years of work. The delay in preparing this new standard reflects the differences of opinion at various stages of the project, notably the most recent stage: the exposure draft published by the IASB in July 2010 (ED/2010/8 Insurance Contracts).

In this issue, we revisit the origins of this long-drawn-out project, the key points of the proposed standard as set out in the July 2010 exposure draft, and the main responses to the ED.

The next issue will include a fully up-to-date report on the Board's redeliberations and the tentative decisions taken to date, as well as the sensitive topics still to be dealt with.

➤ A reminder of the project's history

The project was launched in 2002 with the publication of a DSOP¹, but it very quickly became apparent through the discussions that it would be difficult to develop a standard which would be acceptable to all stakeholders.

Many key players reacted negatively to a draft standard which required liabilities to be measured using a fair value calculation, which was felt to be complex and volatile. In response, the IASB decided to split the project into two phases in order to allow time to think.

The first phase, referred to as IFRS 4 Phase I, was issued in March 2004 and was intended as a temporary solution. IFRS 4 Phase I, as we know it today, does not stipulate the approach to be used for the recognition of liabilities, and requires issuers to retain the key elements of local standards when measuring liabilities (with certain exceptions, notably provisions for equalisation and liquidity risk provision). Most assets are measured at fair value in line with IAS 39.

This interim solution did not address issues where the various local standards diverged, resulting in differences in practice, particularly as regards levels of provision. However, the standard does require a Liability Adequacy Test.

The key difficulty under IFRS 4 Phase I is ensuring consistency between accounting treatment of assets and liabilities. For life insurance companies, this problem is only partially resolved by shadow accounting².

Incidentally, readers will remember that the effects of implementing IFRS 4 Phase I ultimately proved to be limited, with the exception of shadow accounting.

The second phase of the project was launched in May 2007 with the publication of a Discussion Paper which stipulated that liabilities should be recognised at their current exit value (the amount that an insurer would expect to pay to transfer its liability to another insurer on a hypothetical market). Discussions on this phase are still on-going.

The project is influenced, but also delayed, by other on-going regulatory and accounting standards projects (development of IFRS 9, convergence with the FASB, Solvency II in Europe, etc.).

Work on the second phase of IFRS 4 has resulted in the publication of an exposure draft in July 2010 (ED/2010/8), with the final standard hopefully expected this year, for implementation in 2015.

The exposure draft sets out several structuring principles which form a framework for the recognition of insurance contracts, and which in some cases are very different from those set out in 2007's Discussion Paper. The exposure draft stimulated a large number of contradictory reactions. Some of the principles exposed in the 2010's Exposure Draft are still under discussion, resulting in delays to the schedule.

¹ Draft Statement of Principles –this is one of the preliminary stages in the process of developing IFRSs.

² The asset/liability mismatch comes about when financial assets backing insurance obligations are re-measured at fair value, while liabilities relating to these obligations are not re-measured. This mismatch is mitigated by the participation mechanism: this means that the financial and technical profits, as measured under the local standards, are shared between the insurer and the policyholders. The revaluation of assets at fair value is corrected by allocating a portion of the asset revaluation to the policyholders via deferred participation (shadow accounting).

The publication date of the final standard is very much dependent on the format of the next publication, following the current redeliberations on the subject. The IASB has left open the option of publishing either a new exposure draft (which would involve reworking some of the principles in the previous ED) or simply a review draft.



➤ Key points of the 2010 Exposure Draft

In order to fully understand the issues currently under discussion, we first need to recall the broad themes of the exposure draft published in July 2010.

Scope of the standard: definition and unbundling of insurance contracts

Definition

The definition of an insurance contract is quite similar to that given in IFRS 4 Phase I, except for the few following amendments:

- Present value shall be used instead of absolute amounts when assessing whether an insurance risk is significant;
- Some contracts are explicitly excluded from the scope of the standard (e.g. fixed-fee service contracts where the level of service depends on a future uncertain event, such as some maintenance contracts).

However, the exposure draft proposes changes to the definition of insurance contracts with a discretionary participation feature. The criteria used to define these contracts differ from those set out in phase 1:

- Investment contracts with a discretionary participation feature are included within the scope of the standard if they participate with other insurance contracts in the same pool of assets (the concept of "pooling" still needs to be clarified);
- These contracts may be included within the scope even if they do not transfer significant insurance risk.

Unbundling the components of a contract

The exposure draft reiterates the need to unbundle financial or service components of insurance contracts which are not closely related to the insurance coverage. Three specific examples of excluded components are given:

- Financial components which reflect an explicit account balance in the policyholder's favour and which meet the following two conditions:
 - Accrued interests are the result of an explicit crediting rate;

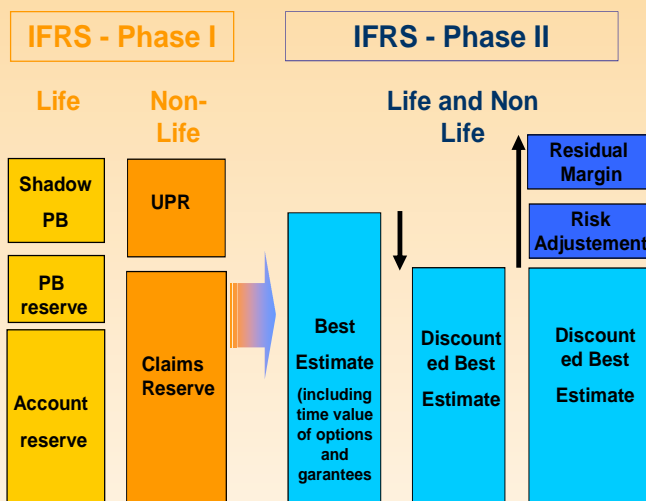
- The crediting rate transfers all the investment performance of the underlying assets to the policyholder, net of contract fees.
- Embedded derivatives that are separated from their host contract in accordance with IAS 39 (unless the contract meets the definition of an insurance contract);
- Goods and services that are not closely linked to the insurance coverage but have been included in the contract for reasons that have no commercial substance.

The first point is rather unclear (the concept of the “account balance”) and hence there are questions about the scope. For example, does this exclusion apply to savings contracts with a participation feature?

Measurement of liabilities

The approach proposed in the exposure draft is based on the present value of the portfolio holder’s fulfilment cash flows. This contrasts with the proposals in 2007’s Discussion Paper to measure liabilities at the current exit value that an insurer would expect to pay to transfer them to another insurer on a hypothetical market.

The exposure draft stipulates that the present value of fulfilment cash flows shall be calculated using a three-step “building block approach”:



- The best estimate of existing contracts; this shall be consistent with a market consistent estimation and weighted by the probability of the future cash flows for the existing contracts;
- A discount rate to adjust for the time value of money;
- Risk adjustment: this corresponds to the margin that a market player would demand to manage the risk relating to the uncertainty of future cash flows;
- Residual margin: this is calibrated to the premium paid by the policyholder, such that the insurer does not recognise a gain on entering into an insurance contract (although if the figure is negative, it is recognised immediately as a loss).

Best Estimate

The exposure draft stipulates that discounted future cash flows shall include all flows relating to existing insurance contracts (premiums, claims, expenses, etc.). It also states that cash flows relating to contract options must be taken into account, weighted by the probability that they will be exercised.

These cash flows must be updated based on the most recent data. This is a big step forward from local standards.

In principle, the proposals in the exposure draft require the insurer to consider all possible scenarios when calculating the best estimate, which would make the calculation an onerous task in practice.

Discount rate

The exposure draft stipulates that the discount rate used for the liability cash flows shall be based on the risk-free rate and adjusted to take account of the liability’s characteristics, particularly its liquidity. The rate must be adjusted at the end of each reporting period.

This approach shall be used when the cash flows for the insurance contract do not depend on the performance of specific assets (so-called non-participating contracts).

For contracts with participation features, the exposure draft stipulates that the discount rate shall take account of the return on the financial assets backing these contracts, if this performance has a direct impact on the cash flows paid to policyholders.

The exposure draft does not stipulate a methodology for calculating the discount rate and there are no plans to provide guidance. However, the exposure draft does state that:

- the rate must be consistent with observable market prices for instruments which are similar in terms of the timing and liquidity of cash flows;
- the rate must exclude any factors that are not relevant to the insurance liability;
- the rate shall only reflect the risks and uncertainties which are not taken into account in the other “blocks” of the liability calculation.

Risk adjustment

Risk adjustment is defined as the amount that a market player would demand to manage the risk relating to the uncertainty of future cash flows, in terms of both amounts and timing.

According to the exposure draft, the calculation must be updated at the end of each reporting period, using one of the three following approaches:

- confidence level;
- cost of capital; or
- conditional tail expectations.

The detailed guidance given for each approach specifies that an insurer shall apply judgement when measuring liabilities in order to take account of specific circumstances.

The exposure draft also stipulates that the notes shall at a minimum include a calculation of risk adjustment using the confidence level method, which would require insurers to use stochastic techniques, with a view to allowing a comparison of the level of adjustment across all market players.

The risk adjustment calculation shall be carried out at the level of a portfolio of insurance contracts in order to reflect the diversification within the portfolio. The exposure draft does not permit the option of taking into account the effects of diversification between different portfolios of insurance contracts.

Residual margin

The exposure draft stipulates that a residual margin shall be recognised in the accounts in order to calibrate the insurance liability to the premium, such that the insurer does not recognise a gain on entering into an insurance contract. At inception of the contract, the residual margin would thus equal the difference between the premium and the sum of the best estimate and the risk adjustment. Any negative difference relating to onerous contracts should be recognised immediately as a loss.

The residual margin shall be calculated at the level of a group of contracts within a portfolio that have the same date of inception and coverage period. It shall be amortised either on a straight-line basis, or in line with the pattern of claims and benefits determined at the date of inception. Changes in the residual margin are thus independent of changes in the best estimate and cannot be used to offset unfavourable remeasurements of the parameters of the prospective models (risk-free rate, duration of liabilities, rate of return of current assets, death rate, surrender rate, etc.)

Short-duration contracts

The exposure draft also proposes a simplified approach for contracts with a coverage period of one year or less and which do not contain embedded derivatives (primarily so-called non-life contracts). For the pre-claim period, the premium would be spread over the coverage period, while the standard “building block” approach would be used for the period after the claim. Only losses from contracts expected to be onerous would be recognised immediately.

Presentation in the statement of comprehensive income

The exposure draft introduces new rules for presentation in the financial statements.

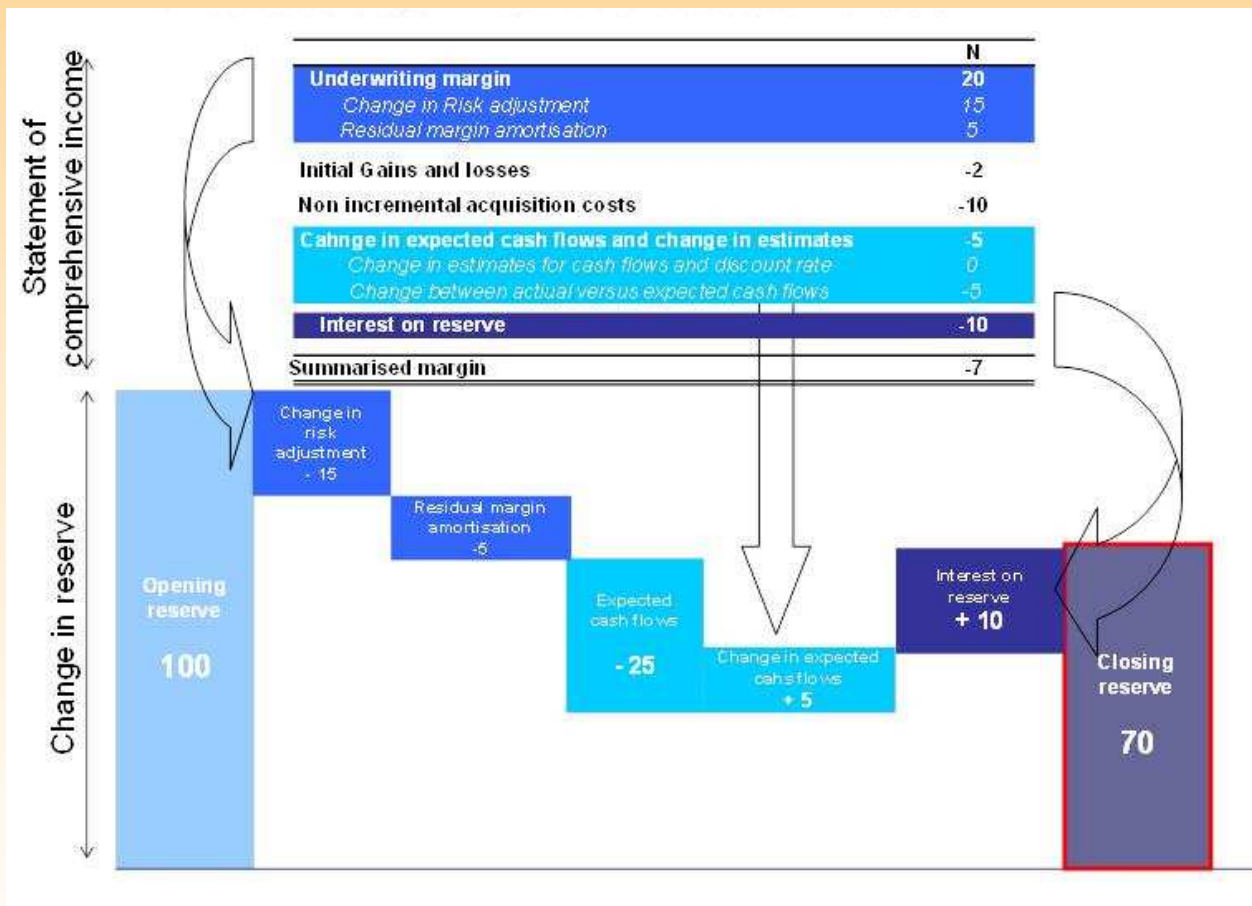
In the statement of financial position, portfolios should be presented as separate line items in assets and liabilities.

Separate presentation should also be used for unit-linked contracts and for gross and net reinsurance amounts.

In the statement of comprehensive income, the presentation should no longer show the cash flows for the year (premiums and claims), but instead should show the income and expenses for the period, in the form of a margin analysis:

- underwriting margin: changes in risk adjustment and the release of residual margin;
- gains and losses at inception: losses on contracts acquired through a portfolio transfer, gains on reinsurance contracts bought by a cedant, and losses at initial recognition of insurance contracts;
- non-incremental acquisition costs;
- experience adjustments and changes in estimates: differences between expected and actual cash flows and changes in estimates of cash flows and discount rates;
- interest on insurance liabilities.

This presentation will show the effects of changes in insurance liabilities.



Transition requirements

The exposure draft also stipulates the requirements for first-time application of the standard. The transition will necessitate adjustments to retained earnings, primarily due to:

- The difference between phase I liabilities and phase II liabilities, as the latter are calculated without the residual margin at the transition date;
- The elimination of intangible assets associated with insurance contracts, which were recognised under phase I (deferred acquisition costs, value of insurance portfolio).

It will be permissible to reclassify financial assets at fair value through profit or loss if this would significantly reduce the mismatch between liabilities whose volatility is recognised in profit or loss and a class of assets whose volatility is not recognised in profit or loss (amortised cost or AFS). This reclassification would be treated as a change in estimate (IAS 8) with an impact on reserves.

If the insurance company has already adopted IFRS 9, it may reclassify assets previously recognised at amortised cost at fair value through profit or loss.

The most problematic issue raised by the transition requirements is that it is not possible to recognise future profits from contracts existing at the transition date in profit or loss when no residual margin arises.

➤ The main responses to the Exposure Draft

The main positive responses

The general approach proposed in the exposure draft for the valuation of insurance liabilities has been welcomed by key stakeholders, as the concepts presented are consistent with frameworks such as Solvency II.

The various stakeholders identified the following as key improvements from 2007's Discussion Paper:

- All relevant cash flows are taken into account when measuring liabilities, including cash flows associated with participation features;
- Future premiums are taken into account based on relevant criteria;
- The non-financial parameters used are based on the insurance portfolios concerned;
- The risk relating to the uncertainty of future cash flows is explicitly reflected in a separate component of the liability.

The main negative responses

However, the content of the exposure draft still raised many concerns.

General reactions

The main themes of the general comments on the exposure draft were as follows:

- The approach used to measure liabilities is more complex (i.e. introduction of more sophisticated stochastic modelling);
- The volatility of profit or loss is higher and this can only partially be offset by recognising assets at fair value through profit and loss (as the measurement parameters are different for assets and liabilities). As regards this last point, the comments tended towards a consensus on the following issues:
 - The Board's solution for addressing the volatility of profit or loss by recognising all assets at fair value through profit or loss is not necessarily appropriate. Insurers say that this approach would not appropriately reflect the performance of long-term activities;
 - IFRS 4 and IFRS 9 should be considered globally in order to present insurers' performance in a way which is consistent with the scope of their activity and their asset/liability management;
 - Some stakeholders believe it would be more appropriate to present changes in insurance assets and liabilities in other comprehensive income rather than in profit or loss, as this would:
 - avoid accounting mismatches when assets are not measured at fair value through profit or loss;
 - differentiate short-term market volatility from other changes in insurance liabilities.
 - Some would prefer an approach similar to IFRS 9, using an amortised cost model for liabilities.

Cash flows

Regarding the cash flows to be used for the calculation of the best estimate, the main reactions to the exposure draft expressed by insurers and commenters were as follows:

- The proposed date of recognition for contracts does not correspond to data currently available through the information systems. Thus, insurers believe that collecting this data would be costly. Moreover, some insurers highlighted the irrelevance of recognising an impact on profit or loss linked to rate variations between the signing of the contract and the beginning of the coverage period, if there has been no change in the hypotheses;
- Some pointed out that a significant investment would be necessary in order to implement the full methodology for estimating future cash flows weighted by the probability that they will occur. Some commentators wanted the Board to state that the purpose of this estimate is to determine the average of the cash flows and that a full stochastic approach would not always be necessary or required.
- There were also many comments on the acquisition costs included in the calculation of the best estimate:
 - Some insurers felt that they should be more specifically defined;
 - Some market players felt that they should not be limited to incremental acquisition costs only, preferring a broader definition including all the costs incurred in the acquisition of the contract;
 - Most believed that it would be preferable to calculate acquisition costs at the portfolio level, rather than solely at the contract level.

Definition of the discount rate

Some insurers emphasised the following points regarding the definition of the discount rate used to measure liabilities:

- The asset/liability management which is inherent in the business model is not clearly reflected in the discount rate proposed in the exposure draft;
- The volatility induced would be difficult to explain and would not reflect insurers' performance accurately;
- Some insurers favoured a fixed discount rate which would limit volatility, while recognising the underlying assets at cost when permitted under IFRS 9.

Risk margin

The exposure draft's proposals regarding the recognition of an explicit risk margin representing the uncertainties associated with the cash flows were generally well received by most market players, with the exception of those from the US.

The main issues which commenters wished to draw to the attention of the Board were as follows:

- Some felt that risk adjustment is difficult to calculate given the statistical methods used, and difficult to compare due to the use of non-observable hypotheses based on subjective judgements;
- Most commentators recognised that the three methods of calculating the risk margin stipulated in the exposure draft are in widespread use. However, they do not agree with limiting the choice of techniques;
- Some market players pointed out that it is expensive and unnecessary to disclose the results of the confidence level technique in the notes, if the entity actually uses a different method of calculating the risk margin.

As for the residual margin, many commentators said they wished to see this margin used as a shock absorber for changes in non-financial parameters, or even for financial parameters such as interest rates.

Disclosures

The majority of commenters put forward the following points on the level of disclosures required:

- The requirements on the level of data aggregation seem too strict (at the operating segment level at a minimum);

- Some market players emphasised the need for specific information on calculating the illiquidity premium in view of its (in their opinion) discretionary nature;
- The presentation of the flow maturity analysis should be based on expected flows rather than on contractual flows.

Transition requirements

The transition requirements also attracted a lot of comments from most stakeholders. They wanted the options of recognising a residual margin on portfolio contracts at the transition date and amortising it through profit and loss over the coverage period.

Other reactions

Finally, some commenters highlighted points in the exposure draft which require clarification, such as:

- The principles for unbundling the components of a contract which are not closely related to the insurance coverage (the concept of an explicit account balance in the policyholder's favour could be clearer);
- Following on from the previous point, the accounting treatment for investment contracts with participation features could also be clarified;
- More explanation would be useful on the methodology used for measuring liabilities in contracts with participation features.

This non-exhaustive list of reactions is itself an indicator of the size of the task which still lies ahead of the Board; judging by the contents of the comment letters, there is a lot of ground yet to be covered in order to arrive at a final standard which will be acceptable to the majority of stakeholders. As indicated in the introduction to this analysis, our next issue will update readers on the Board's response to the comments and reactions expressed by stakeholders. We will summarise the progress of the Board's redeliberations to date and present the provisional decisions taken so far, as well as the challenging issues still to be dealt with.

➤ Frequently asked questions

IFRS

- Lease recognition and prospective analysis in view of the general trajectory of the leases project.
- Consolidation of a special purpose vehicle created in the context of a public-private partnership.
- Assessing when debt factoring permits derecognition.
- Recognition of reverse factoring in the supplier's accounts.
- Employee share ownership and setting up an investment fund for employees.
- Recognition of a step-by-step acquisition of a stake representing significant influence.

Upcoming meetings of the IASB, IFRS Interpretations Committee and EFRAG

IASB

19 - 23 March 2012
16 - 20 April 2012
21 - 25 May 2012

Committee

13 - 14 March 2012
15 - 16 May 2012
10 - 11 July 2012

EFRAG

20 - 21 March 2012
2 - 4 April 2012
9 - 11 May 2012

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