International Auditing and Assurance Standards Board

529 Fifth Avenue, 6th Floor, New York, NY 10017
T + 1 (212) 286-9344 F +1 (212) 286-9570
www.iaasb.org

October 24, 2013

Mr. Hans Hoogervorst
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Hans,

Re: Comments on IASB's Exposure Draft on Insurance Contracts

I am pleased to provide comments on the International Accounting Standards Board's (IASB) July 2013 Exposure Draft *Insurance Contracts* (ED). These comments have been developed by the International Auditing and Assurance Standards Board's (IAASB) IASB Liaison Working Group (the Working Group), with a particular focus on auditability or verifiability, and reviewed by the IAASB Steering Committee.

The Working Group appreciates that the IASB has made changes to the 2010 Exposure Draft (the 2010 ED), so as to address the concerns expressed by stakeholders. However, the Working Group is of the view that the proposed requirements in the ED have become highly complex due to the changes that have been made (for example, how to account for contractual service margins in accordance with paragraph 30 of the ED, and when and how to apply the measurement requirement as defined in paragraph 34 of the ED).

In addition, the Working Group has the view that the lack of explicit explanation about some of the key concepts in the proposed standard (for example, how to select an appropriate method to calculate risk adjustments in accordance with paragraph 27 of the ED, and how to recognize contractual service margins in profit or loss over the coverage period in accordance with paragraph 32 of the ED) would pose difficulties for management and auditors in reaching a conclusion as to whether an entity's financial statements present fairly (or give a true and fair view of) the financial position and financial performance of the entity. Therefore, the application of the ED would require an insurer to call for assistance from experts, for instance, with regard to how to maintain data and to calculate an appropriate amount of contractual service margin and risk adjustments at each reporting date. In the Working Group's view, these matters are significant challenges for management and auditors to implement in the proposed standard.

Further, we believe it would be helpful if the IASB undertake a parallel educational initiative that helps ensure the consistent application of the proposed standard, especially for insurers with limited resources.

Finally, we identified several specific issues from an auditing or verifiability perspective. Detailed comments on these matters are provided in the Appendix to this letter.

I hope that you will find the comments helpful. If you require any clarification or would like to discuss this letter further, please do not hesitate to contact me or Mr. Tomokazu Sekiguchi, the Chair of the Working Group (t.sekiguchi@asb.or.jp).

Yours sincerely,

Prof. Arnold Schilder
Chairman, IAASB

Cc. Mr. Prabhakar Kalavacherla, Member and Liaison Representative, IASB

Appendix

IASB EXPOSURE DRAFT -
INSURANCE CONTRACTS
Comments of the IAASB's Working Group

I. COMMENTS ON SPECIFIC QUESTIONS IN THE ED

QUESTION 5: EFFECTIVE DATE AND TRANSITION

Issues Description

Paragraphs C5 and C6 of the ED propose to permit an entity to apply a modified retrospective approach at the time of transition. Different from general principles set out in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, this modified retrospective approach proposes to require, *inter alia*, the estimation of expected cash flows as of the date of initial recognition at the amount of expected cash flows at the beginning of the earliest period presented, adjusted as appropriate. At the same time, these paragraphs state that an entity need not undertake exhaustive efforts to obtain objective information but shall take into account all objective information that is reasonably available.

The Working Group understands that this modified retrospective approach is meant to address part of the concern that measuring amounts retrospectively is often subject to bias through the use of hindsight. This approach may also contribute to providing more relevant information at and after the transition than the approach proposed in the 2010 ED, which proposed that an entity should recognize no contractual service margin for contracts in force at the beginning of the earliest period presented. However, the Working Group feels that this transitional treatment may provide considerable leeway to management about the extent of retrospective application that should be made, and possibly create an opportunity for profit management. The Invitation to Comment section in the ED acknowledges this potential verifiability problem.

Actions that the IASB May Wish to Consider in Addressing the Issues:

The Working Group recommends that the IASB add a paragraph requiring an entity to prepare and maintain documentation demonstrating how it determined the extent of objective information that is reasonably available to implement the transitional requirements.

QUESTION 7: CLARITY OF DRAFTING

Issues Description

Paragraph 35 of the ED permits an entity to measure insurance contracts using the premium allocation approach if using such an approach would produce a measurement that is a *reasonable approximation* to those that would be produced when applying the general accounting requirements of the ED [emphasis added]. Using the premium allocation approach would make a significant difference to an entity's accounting model. However, the ED does not explain how to determine whether a reasonable approximation would be produced. The wording of paragraph 35 may be interpreted as requiring an entity to demonstrate the effect by calculating the measurement outcomes using two different measurement methods. In the Working Group's view, this is not likely what the IASB intended.

Actions that the IASB May Wish to Consider in Addressing the Issues:

If the IASB does not intend to require an entity to calculate the measurement outcomes using two different measurement methods, the Working Group recommends that the IASB provide guidance about how an entity can support its rationale that the use of the premium allocation approach would provide a measurement that is a reasonable approximation to that which would be produced when applying the general requirements.

II. OTHER COMMENTS

DISCLOSURE REQUIREMENTS

Issues Description

Paragraph 84 of the ED states that if the entity uses a technique other than the confidence level technique in determining the risk adjustment, it shall disclose a translation that explains the result using a confidence level technique. In addition, paragraph 88 of the ED proposes to require an entity to disclose information about *the effect of each regulatory framework* in which the entity operates, for example, minimum capital requirements or required interest rate guarantees [emphasis added].

In the Working Group's view, these types of information have historically been outside the scope of a financial statement audit, because such information was normally presented outside audited financial statements. Related to these types of disclosures, the IASB issued the Discussion Paper *A Review of the Conceptual Framework for Financial Reporting* in July 2013, in which the IASB asks questions about what should (or should not) be included in the notes to financial statements. Although any information has the potential to help users better understand the financial information, the Working Group believes that careful consideration is necessary in determining where such information should be presented, because it has significant implications as to whether such information is subject to audit, and how the audit is carried out.

If the IASB were to retain such proposed disclosure requirements, the Working Group believes that more specific criteria should be presented (including what is meant by "the effect" of each regulatory framework in which the entity operates and how it should be measured). Such criteria would be essential for management and auditors to reach a common understanding about how the quantitative or qualitative information should be presented.

Actions that the IASB May Wish to Consider in Addressing the Issues:

The Working Group recommends that the IASB carefully consider types of disclosures that should be included in the notes to financial statements as part of the Conceptual Framework project, having regard to the implication to the audit. In addition, if the IASB decides to retain the disclosure requirements proposed in paragraphs 84 and 88 of the ED, the Working Group recommends that the IASB provide additional guidance to support consistent application of judgment by management and auditors.