



BASEL COMMITTEE ON BANKING SUPERVISION

BANK FOR INTERNATIONAL SETTLEMENTS

Chairman

VIA EMAIL: commentletters@iasb.org

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

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Discussion paper – Preliminary Views on Revenue Recognition in Contracts with Customers

Dear Sir David

The Basel Committee on Banking Supervision welcomes the opportunity to comment on the International Accounting Standards Board's Discussion Paper *Preliminary Views on Revenue Recognition in Contracts with Customers*. The Committee has a strong interest in consistent application of revenue recognition standards and provides some high level comments on the scope of the revenue recognition discussion paper (DP).

The Committee generally supports the notion of a principles-based standard for revenue recognition based on changes in an entity's contract asset or liability. The principles-based approach is consistent with other International Financial Reporting Standards as well as with the project to converge the IASB's and the US Financial Accounting Standards Board's accounting standards. However, the Committee believes there is a general lack of clarity regarding the scope of the revenue recognition project as discussed in the DP regarding key areas of relevance to the financial services industry. These include the recognition of revenue from interest, unrealised gains and losses, dividends, and certain fees on financial instruments.

In principle, interest income earned on financial instruments would be included in the scope of the DP and, in fact, interest income is currently included in paragraph 29 of *IAS 18 – Revenue*, but the Committee is of the view that interest income is linked to the measurement of financial instruments. Thus we believe the model proposed in the DP for revenue recognition is not decision-useful for interest income and recommend that it be addressed in *IAS 39 Financial Instruments: Recognition and Measurement* or its replacement. In fact the IASB raises this issue in the DP in paragraph S11(a), which indicates that, because of the potential volatility in the value of financial instrument contracts, the IASB questions whether the proposed model would be decision-useful for financial instruments and some non-financial instrument contracts that otherwise would be in the scope of standards such as *IAS 39* and *SFAS 133, Accounting for Derivative Instruments and Hedging Activities*.

An additionally important revenue recognition issue for financial service entities relates to unrealised gains and losses on financial instruments. As noted above, the potential volatility in the value of financial instrument contracts raises the question as to whether the DP's revenue recognition principle would be decision-useful for financial instruments. The Committee believes that unrealised gains and losses on financial instruments should be addressed in IAS 39 or its replacement. This is because the DP does not provide guidance on potential remeasurement issues resulting from the impact of any changes to contractual terms and the way the fair value of certain performance obligations should be measured.

On the topic of dividends, the Committee believes that additional clarity is needed. Paragraph 30 of current IAS 18 indicates that dividends should be recognised when the shareholder's right to receive payment is established. However, the recognition of dividend income could be viewed in the context of a financial instrument as the return for the provision of risk capital. Further, the DP does not consider the recognition of dividend income in relation to the measurement of an asset. In paragraph 2.38 of the DP, the concepts of what is a "contract" and who is a "customer" appear to suggest that a shareholder does not fit the definition of a customer.

As for fee revenue arising for financial service entities, the Committee believes that some additional clarity is needed. Currently, IAS 18 addresses fees that are an integral part of the effective interest rate of a financial instrument; fees earned as services that are provided by the financial services entity; and fees that are earned on the execution of a significant act. The accounting treatment of these fees is outlined in the table below. We recommend that those fees now treated as an adjustment to the effective interest method be included in IAS 39. However, for the other relevant fees, several questions need to be addressed in order to demonstrate the application of the DP's general asset/liability principle. These questions are also summarised in the table below.

Category of financial service fee currently identified in IAS 18	Examples of transactions concerned	Current accounting principle as required by IAS 18	Clarity required / Questions
Fees that are an integral part of the effective interest rate of a financial instrument	<p>Origination fee (eg for loan granted, requiring evaluation of borrower's financial situation, negotiation, etc.)</p> <p>Commitment fees on loan commitment outside IAS 39 (commitment of the bank to originate a loan) if it is <u>probable</u> that the entity will enter into a specific lending arrangement.</p>	<p>Generally these fees are deferred and recognised as an adjustment of the effective interest rate.</p> <p>However, if the related financial instrument is measured at fair value through profit or loss, the fees are recognised as revenues when the instrument is initially recognised.</p>	- We believe these fees should be included in IAS 39

Category of financial service fee currently identified in IAS 18	Examples of transactions concerned	Current accounting principle as required by IAS 18	Clarity required / Questions
Fees earned as services are provided	<p>Fees for servicing a loan</p> <p>Commitment fees on loan commitment outside IAS 39 if it is <u>unlikely</u> that the entity will enter into a specific lending arrangement.</p> <p>Investment management fees</p> <p>Fees on means of payment</p>	Fees recognised as the services are provided. Commitment fees recognised on a time proportion basis over the commitment period.	<p>- How is performance obligation measured for the recognition of these fees?</p> <p>- Do performance obligations have to be defined within the contracts?</p>
Fees that are earned on the execution of a significant act	<p>Placement fees (arranging a loan between a borrower and an investor)</p> <p>Loan syndication fees</p> <p>Movement fees (asset management)</p>	Fees recognised when the significant act has been completed.	- The proposed model could probably be easily applied to this category of fees, the performance obligation could be considered as the completion of the significant act.

Given that additional clarity is required in several key areas, the Committee recommends that the IASB liaise with financial services entities to ensure that all revenue streams are appropriately considered.

These comments have been prepared by the Committee's Accounting Task Force, chaired by Sylvie Mathérat, Director of the Banque de France, and have been approved by the Committee. The Committee trusts that you will find its comments useful and constructive. The team that has analysed the DP will be pleased to meet with the IASB staff to discuss these comments further.

If you have any questions regarding our comments, please feel free to contact Sylvie Mathérat (+33 1 4292 6579), Karen Stothers (Canada's Office of the Superintendent of Financial Institutions), who chairs the Financial Statement Presentation Work Team (+1 416 973 0744), or Xavier-Yves Zanota at the Basel Committee Secretariat (+41 61 280 8613).

Yours sincerely,



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