Deutsche Bank

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DISCUSSION PAPER - Preliminary Views on Revenue Recognition in Contracts with Customers

Dear Mr. Rees,

I am writing on behalf of Deutsche Bank to provide comments on the IASB's Discussion Paper on *Preliminary Views on Revenue Recognition in Contracts with Customers* (the "DP").

While we welcome the Board's efforts to develop a single principles based revenue recognition model that could be applied across all industries, we do not believe that it is possible to do so as there is at least one other model that exists already and (we understand) will be carried into the revised IAS 39 in respect of financial instruments through profit or loss.

There are other areas that should be addressed by the Board before moving to an exposure draft:

1. The most important issue to be addressed is the scope of the new revenue recognition standard. We believe all financial instruments should be scoped out of the proposed model/new revenue recognition standard as the nature of financial instrument contracts are fundamentally different from the contract described in the DP (see further discussion in Appendix A question 1). Financial instruments at fair value through profit or loss should be outside of the scope of the DP (as revenue is recognised based on the movements in fair value following an existing guidance in IAS 39); revenue recognition of financial instruments at amortised cost should also be addressed as part of the project to replace IAS 39.

Chairman of the Supervisory Board: Clemens Borsig
Management Board: Josef Ackermann (Chairman), Hugo Banziger, Stefan Krause, Hermann-Josef Lamberti

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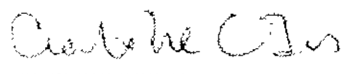
2. With regards to revenue associated with other financial instruments previously within the scope of IAS 18 – for example, loan origination fees, loan commitments on instruments not at fair value through profit or loss and financial guarantee fees, we believe these and similar fees should be brought into the scope of IAS 39 replacement standard. If this is not done, then further analysis is needed particularly involving multiple deliverable arrangements where there is a combination of a service provided and a financial instrument being purchased by the entity (for example a hard underwriting arrangement).
3. We are in broad agreement with the proposed model in the DP in respect to its application to service contracts in the financial institutions industry. Our specific views on the model in this respect are discussed in the appendix.
4. We would like to draw the Board's attention to an issue within the asset management industry, where certain distribution costs are incurred and are currently capitalised and amortised over time. We believe further analysis should be performed in respect of such expenses – and in cases where such costs are recoverable from customers through early redemption charges, these should be taken over time rather than expensed upfront. See Question 11.
5. We believe that more guidance is required to establish when it is appropriate to link transactions. We believe this should be addressed in the new standard and it should be consistent with the linkage principles already discussed in the February 2003 IFRIC paper. Specifically the inclusion of linkage criteria and other criteria to assist in ensuring that transactions reflect their substance will be important in assessing sales of commodity transactions. See Question 8.

We have responded to those questions which are significant to our organisation in the Appendix A. We are also interested in participating in any further discussions which the Boards may hold in the future regarding revenue recognition. If you have any questions regarding this letter please contact me on +44(20)754-76640 or charlotte.jones@db.com.

Kind regards,



Charlotte Jones

Appendix A- Responses to Questions

Question 1: Do you agree with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

In our view it is not possible to have one model for revenue recognition across all industries. We do not believe the proposed model in the DP is appropriate for revenue recognition on financial instruments (which should be addressed within the IAS 39 project).

Specifically we believe that a distinction should be drawn for financial instruments for the following reasons:

1. In regards to financial instruments (including derivatives) which are accounted in the current IAS 39 at fair value through profit or loss (herein referred to as 'FVTPL instruments'), revenues are based on the changes in fair value, i.e., the mark to market movements. As such the revenue from fair value accounting does not arise from the change in the entity's position in the contract with the customer as proposed in the DP. Current IAS 39 (and its replacement) and the Fair Value Measurement ED already address revenue recognition for FVTPL instruments. Therefore, we propose that such instruments are scoped out of the future revenue recognition standard.
2. In regards to other financial instruments which are accounted for at other than at FVTPL (including amortised cost instruments), these contracts often incorporate performance obligations on both parties, not just from one party to another. For example, in the case of a debt instrument, A extends a loan to B. The contract between A and B consists of two bi-lateral performance obligations- A has a performance obligation to extend cash to B, B has a performance obligation to repay that cash (plus interest) to A over a specified period of time. However the DP as drafted considers contracts where one or more performance obligations are entered into with a customer by an entity (e.g. contracts where only one party has one or more performance obligations to the other party). The situation is further complicated because the revenue recorded by A will be affected by the risk of non performance by B over its obligation to repay the cash to A. We note that IAS 39 (and its replacement) addresses both the revenue recognition (via the effective interest rate guidance) and impairment accounting for debt instruments and therefore we propose that financial instruments not carried at fair value through profit or loss are also scoped out of the new revenue recognition standard.
3. It is unclear as to whether it is in the Board's plans to address revenue recognition with regards to certain fees related to other financial instruments within the IAS 39 replacement project. We believe fees should be addressed with the revised IAS 39. If this is not done, then further analysis is needed particularly involving multiple deliverable arrangements, where there is a combination of a service provided and a financial instrument being purchased by the entity (for example, a hard underwriting arrangement, where a financial institution agrees to underwrite a debt raising, but would have to

purchase that debt if it cannot find buyers. Is this arrangement about providing a service or about writing a put option to the debt issuer?).

In summary, we believe that interest revenue on amortised cost instruments and revenue from FVTPL instruments should be excluded from the scope of the future revenue recognition standard. However the Board should perform further analysis on revenues associated with other financial instruments such as financial guarantees issued and loan commitments to determine the appropriate revenue recognition model.

We are in general agreement with the model proposed in the DP regarding its application to (stand alone) financial services. Our specific views on the model are discussed below.

Question 2: Are there any types of contracts for which the Boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

See our response in Question 1.

Question 3: Do you agree with the Boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

Subject to our response to Question 1, we agree with the proposed definition of a contract in the DP.

Question 4: Do you think the Boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

We agree in principle with the definition of a performance obligation in the DP. However we believe additional guidance and examples is required to illustrate the application of this concept to ensure consistent application in practice (particularly involving provision of financial services – for example in respect of the underwriting fees where such service may result in entity purchasing instruments that have not been placed externally).

Question 5: Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

We agree that multiple performance obligations in a contract should be separated only when the performance obligations will not all be satisfied at the same time, in order to reflect faithfully the substance of the transactions. We believe further guidance and examples are necessary to clarify the separation of performance obligations involving financial services and financial instruments.

Question 8: Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

We agree that a performance obligation is satisfied when the customer controls the promised good or service, however further examples would be useful particularly with respect to provision of financial services.

One aspect that we would like to draw to the Board's attention to is commodity based transactions. The DP states that an entity has satisfied a performance obligation when it has transferred an asset (goods/services) to a customer and the customer 'has control of the asset'. Certain commodity arrangements between a Bank and a client are documented as sales (where legal title to the commodity transfers to the Bank from the client) with contemporaneous forward agreements to buy the commodity back at a future date at a fixed price. While the customer (in this case the Bank is the customer as the Bank is the entity purchasing the good) has legal title to the goods and may be seen to have control of the asset, the transaction is in substance a financing transaction; these trades are analogous with repurchase agreements/securities lending arrangements. In such cases the existence of linkage criteria in the revenue recognition standard plus additional criteria to assess financings from sale transactions would assist in faithfully reflecting the nature of the transaction as a financing and enhance the operationality of the standard.

Our suggestion therefore is that the Board incorporate linking criteria, using as a starting point those criteria discussed by IFRIC in February 2003 and give consideration to incorporating other criteria to allow such transactions to be accounted in line with their substance.

Question 9: The boards propose that an entity should recognize revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

We refer to our response in Question 1 above.

Question 10: In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?
b) Do you agree that a performance obligation should be deemed onerous and re-measured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?
c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.
d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

Our views on a) to d) above are as follows:

Q10a: We agree that performance obligations should be measured initially at the transaction price and not the exit price. An exit price, which would reflect the price at which the entity would pay another entity to transfer its obligations, would not provide decision useful information to users as it will most often be the case that the entity has no intent or ability to transfer its obligations. Transaction price is less complex than using exit price and is more reflective of the entity's performance in a contract. As such the transaction price is the measurement basis that provides the most decision useful information to users.

Q10b to d: While we agree conceptually with the principles behind re-measuring performance obligations for onerous contracts, in particular long term contracts, we understand that the issue will be less relevant in the financial services industry. As such, we would suggest that the Board consider inserting a significance threshold for determining onerous contracts, such as those contracts that go over the reporting period would be subject to the re-measurement, in order to make the tracking and re-measurement of performance obligations more operational.

Question 11: The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (e.g., selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognize those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?
b) In what cases would recognizing contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

As stated in our response to question 1, revenue recognition for financial instruments, because of their nature, are best addressed in IAS 39. Specifically in the case of accounting for transaction costs on financial assets held at amortised cost, we suggest that the guidance be consolidated along with the other guidance on revenue in IAS 39 as suggested in Question 1.

We would like to draw the Board's attention to an issue within the asset management industry, where certain distribution costs are incurred and are currently capitalised and amortised over time. We believe further analysis should be performed in respect of such expenses – and in cases where such costs are recoverable from customers through early redemption charges, these should be taken over time rather than expensed upfront.

Question 12: Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

We agree that the transaction price should be allocated to the individual performance obligations based on the stand-alone selling prices of the goods/services.

Question 13: Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

We agree that if an entity does not sell goods/services separately, then it should estimate the stand-alone selling price of the goods/services for purposes of allocating the transaction price. We believe however that the DP could clarify that when estimating stand alone selling prices, the objective is to arrive at the price at which that good or service would be sold separately in the marketplace (assuming that is the Board's intention).