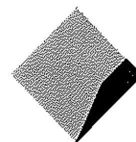
**Commonwealth** Bank
Commonwealth Bank of Australia
ABN 48 123 123 124



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Michael Venter
Deputy Chief Financial Officer

22 October 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC 4M 6XH
UNITED KINGDOM

Dear Sir David

**Comments on ED/2010 Revenue**

Thank you for the opportunity to comment on this Exposure Draft. The Commonwealth Bank of Australia (CBA) is one of the four major Australian banks with a market capitalisation of approximately $78bn, an annual revenue of $42bn and over 786,000 shareholders. We have prepared financial statements under IFRS since 2005, having previously prepared financial statements under Australian GAAP (AGAAP) and US GAAP.

Our comments on the specific questions raised by the boards are addressed in the Appendix; however we have set out below our general thoughts on the Exposure Draft.

While we agree with the conceptual principles in the ED we also believe that the current standard works well in practice and that there are more urgent issues to be addressed in other accounting standards. We question whether reporting entities will be able to cope with the degree of change proposed when considering all of the forthcoming accounting standards.

We would like to highlight the need for the standards to clearly state which types of revenue it intends to cover and the potential need for further consideration to be given to revenue recognition for products that fall within different standards. As a financial institution we would note that structured financial products not only generate a yield but include structuring, arranging and other services all of which are negotiated in contemplation of one another. Requiring an entity to split the services then independently price them in order to establish profit margin to finally recognise revenue is a departure from business practice and the underlying substance of the negotiated transaction.

We do not support the proposal that reporting entities be required to immediately expense the costs of acquiring contracts with customers under paragraph 59(a) of the ED. We believe that this approach is not consistent with the treatment of intangible assets under IAS 138, the proposed requirements of the Insurance ED (paragraph 39) and the requirements of paragraph 43 of IAS 39. We believe that one approach would be to account for these costs under IAS 38 or an alternate approach would be to make the requirements of the revenue ED more consistent with the other standards.

We would also like to highlight the practical difficulties that a move away from percentage of completion accounting for construction contracts would cause in measuring revenue. Although not material for the financial services industry, it will be impacted through, for example, exposure to infrastructure deals and the requirements under IFRIC 12 – service concession arrangements.

Our response to matters on which specific comment is requested is included in the attached Appendix 1.

Please contact myself with any questions or comments.

Yours sincerely

Michael Venter
Deputy Chief Financial Officer

**Appendix 1**
**ED/2010 Revenue**

**Recognition of revenue (paragraphs 8-33)**

**Q1:** Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether:

(a) to combine two or more contracts and account for them as a single contract;

(b) to segment a single contract and account for it as two or more contracts and

(c) to account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

We agree with the principle that price interdependence can help determine whether contracts should be combined or segregated for accounting purposes. This would work well for homogenous goods sold in an active market. However we believe that in many cases it will be very difficult to determine the price interdependence where the price is the subject of a commercial negotiation. For instance if an entity was to charge a structuring/arranging fee for a lending product and an establishment fee that are all negotiated together (and hence not merely interdependent but the same fee) as one upfront amount; guidance on what portion of the fee is recognised under 139 and what portion is under the ED (and hence recognised under its principles) would be useful.

**Q2:** The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

We agree with the criteria proposed in paragraph 23. However we do not believe that goods and services will always have a distinct profit margin because they have distinct risks – the profit margin could be part of a commercial negotiation. For example if a structured lease or loan includes a structuring/arranging fee on top of its establishment fee and yield, the recognition of the structuring/arranging fee would need to be considered in contemplation with market yields on the underlying products rather than in isolation based on disparate principles as the current standards may imply.

**Q3:** Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

We agree with a control based approach on a conceptual basis but note that in practice confusion might arise if it is applied to service contracts, where the continuous transfer approach would seem more appropriate. We note that the new standard would not have the equivalent guidance currently in IAS 18 which is currently used by the financial services industry. Again we refer to potential opportunities to change the timing of revenue recognition based on the contractual cash flows of structured products rather than the underlying substance.

**Measurement of revenue (paragraphs 34-53)**

**Q4:** The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be

reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.
Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraphs 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

We agree that revenue should be recognised based on the estimated transaction price. We believe that industry practice or experience would be better evidence of estimated prices than an entity's own experience where available. However we again request guidance on establishing a transaction price should industry practice result in a wide range of fees for similar services due to negotiation.

**Q5:** Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather that whether the entity recognises revenue? If not, why?

We agree that where the credit risk of a customer is a determinant of the contract price, the revenue recognised should be adjusted. However, we believe that the receivable should be accounted for under the relevant standard and any subsequent deterioration in credit should be accounted for under that standard. We would also suggest the material 'curve-out' suggested in paragraph 45 be applied to credit risk adjustments.

**Q6:** Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

We agree that it is appropriate to adjust the revenue recognised for the time value of money. If all revenue is to be adjusted for credit risk (see our comments above however), then it should also be adjusted for the time value of money. Introduction of a materiality concept into paragraphs 44 and 45 might lead to inconsistencies between entities.

**Q7:** Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?

We agree with the theoretical principle, however we believe that it may not be practical and may not always add value for users of financial statements to allocate the transaction price to all separate performance obligations (e.g. when they are all performed at the same time). Where this is not in line with the operations of the business/ product (for instance in discounted service related performance obligations offered as part of a market yielding structured financial package/ product) it would not reflect the substance of the transaction to allocate stand alone selling prices to each component or indeed be practical to do so.

**Contract costs (paragraphs 57-63)**

**Q8:** Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 Inventories or ASC Topic 330; IAS 16 Property Plant and Equipment; and IAS 38 Intangible Assets on software), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

We agree that the proposed requirements are operational and clear.

**Q9:** Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include or exclude and why?

We do not support the proposal that reporting entities be required to immediately expense the costs of acquiring contracts with customers under paragraph 59(a) of the ED as they are directly related to said contracts. We believe that this approach is not consistent with the treatment of intangible assets under IAS 138, the proposed requirements of the Insurance ED (paragraph 39) and the requirements of paragraph 43 of IAS 39. We believe that one approach would be to capitalise these costs under IAS 38 or an alternate approach would be to make the requirements of the revenue ED more consistent with the other standards. We would further note that industry practice identifies profit margin on certain financial services products net of the amortising upfront costs associated with acquiring the product (e.g. Funds Under Management). Therefore to recognise these costs upfront will be a departure from the substance and economics understood within the industry.

**Disclosure (paragraphs 69-83)**

**Q10:** The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

We support the objectives but think that the required disclosures will be onerous for many preparers. We understand that in certain industries where long term contracts are in place that the information is currently provided in the MD&A. We would prefer the disclosures to be provided only where there is significant judgment applied. In addition we would request further guidance/examples of how these disclosures will look.

**Q11:** The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

We do not believe the proposed disclosures will be appropriate for all industries applying the standard. We agree that for long term contracts an analysis of the contract debtor would be appropriate.

**Q12:** Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

We do not think that this information will be meaningful for our users. Segment disclosures should be sufficient.

**Effective date and transition (paragraphs 84 and 85)**

**Q13:** Do you agree that an entity should apply the proposed requirements retrospectively (i.e. as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.

We agree that the proposed requirements should be applied retrospectively.

**Application guidance (paragraphs B1-B96)**

**Q14:** The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

We believe that further application guidance would also be useful in addition to examples. The guidance provided for financial institutions under IAS 18 has been removed and examples have not been provided for the same situations. We request additional examples that address financial institutions revenue be included.

**Q15:** The boards propose that an entity should distinguish between the following types of product warranties:

(a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.

(b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

N/A

**Q16:** The boards propose the following if a licence is not considered to be a sale of intellectual property:

(a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence: and

(b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

N/A

**Consequential amendments**

**Q17:** The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

We agree with the proposals.

**Non-public entities**

**Q18** [FASB only]: Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement(s) and why?

N/A FASB only.