

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

13 March 2012

Dear Mr. Hoogervorst,

**Exposure Draft ED/2011/6
Revenue from Contracts with Customers**

Standard Chartered PLC (the Group) is an international banking group, listed on the London, Hong Kong and Bombay stock exchanges. It operates in more than 70 countries principally in Asia, Africa and the Middle East.

We welcome the opportunity to comment on the International Accounting Standards Board's (the "Board") Exposure Draft – *Revenue from Contracts with Customers* (the "ED"). We are supportive of the Board's joint efforts with the US Financial Accounting Standards Board to develop a single standard that addresses revenue recognition across industries. Considerable progress has been made in achieving this goal, and we appreciate the changes that have been made in response to the many comment letters provided, including those of the Group, on the initial exposure draft issued in June 2010.

However, the practical application of many of the ED's proposals continues to be a major concern and while the illustrative examples included within the ED are helpful, we still feel that significant diversity in practice could arise. For instance, the ED provides limited guidance around the recognition of fee income and the settlement of performance obligations on depository, credit card and similar financial services contracts with customers. We believe that the financial services industry would benefit from the inclusion of such examples in the ED.

While our overall conceptual concerns with the ED are discussed below, our responses to the specific questions outlined in the ED are noted within Appendix A. Additional comments are provided within Appendix B.

Definition of Customer – We believe that the definition of a customer needs to be expanded to consider third parties that are beneficiaries of a contract but are not direct parties to the contract. For example, under the ED, loyalty award credits granted to customers as part of a sale transaction represent separate performance obligations to which some portion of the transaction price should be allocated. However, an issue arises for credit card award programs in that the credits are granted to the card holder for transactions that generate interchange fee revenue from the vendor. There is no transaction based revenue from the customer to allocate to the award credits. Existing practice under IFRIC 13 *Customer Loyalty Programs* is to allocate a portion of the interchange fee to the award credits, and we believe this practice should continue. The ED should be clarified to look through to the credit card holder in these and similar situations.

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Definition of Control – We continue to have concerns with a control based standard as a basis for revenue recognition and believe that this has resulted in proposals based on highly theoretical concepts which face significant issues in practical application. Ascertaining whether a customer controls a service is particularly problematic. We believe that the transfer of risks and rewards should be a more prominent criteria for when revenue is recognised and would suggest changing the definition of control to the ability to direct the use of an asset thereby obtaining substantially all of the risks and rewards of the asset.

In addition, we are concerned that the guidance on repurchase agreements does not align with other areas of IFRS and may not appropriately indicate when control has passed. For example, the sale of a commodity that meets the definition of a financial instrument is subject to the derecognition provisions of IAS 39 *Financial Instruments: Recognition and Measurement* and IFRS 9 *Financial Instruments* (which are primarily risk and rewards based standards), while the sale of a commodity that is not a financial instrument would be accounted for under the ED.

Paragraph B40 of the ED states that control has not transferred if an entity has an unconditional obligation or unconditional right to repurchase the asset. The application guidance in IAS 39 provides several examples of put and call options that consider whether the option price is deeply in or out of the money and whether the asset is readily obtainable when determining whether a financial asset should be derecognised. We would suggest that the Board consider incorporating similar guidance into the ED.

Paragraph B43 of the ED states that if an entity has an unconditional obligation to repurchase the asset at the customer's request (a put option) at a price that is lower than the original selling price of the asset, the entity shall consider at contract inception whether a customer has a significant economic incentive to exercise that right. The trigger in the ED for evaluating whether there is a significant incentive to exercise the put option is based on a comparison of the option price to the original selling price. We suggest that the evaluation be based on a comparison of the option price to the expected fair value of the asset at the date the option becomes exercisable – similar to the analysis in IAS 17 *Leases*.

We would be pleased to provide any additional information or clarification of our comments if you so wish.

Yours sincerely,



Chris Innes-Wilson
Head, Group Accounting Policy & Advisory

Appendix A: Responses to specific questions

Question 1

Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

While the Group supports the Board's approach in avoiding the use of industry specific guidance and focusing on principles as an overall framework for financial reporting, we are concerned around the challenges in reaching a suitable set of principles for consistently recognising revenue from both goods and services across industry sectors. It is for this reason that we believe that, for revenue recognition only, the addition of sector specific principles, perhaps in the form of application guidance would be a worthwhile consideration for the Board.

As feedback from the Board's outreach process has shown, there are numerous instances where application of the proposals so far (from both the 2010 and 2011 ED) do not effectively reflect the substance and economics of the underlying transaction. A prime example is the recognition of revenue for service contracts with variable consideration, where the conclusion under the present proposals has the potential to lead to greater divergence in practice. With revenue recognition one of the most fundamental elements of financial reporting, we are of the view that promoting consistent application amongst preparers on this topic should be a primary consideration when developing the standard.

While control is an important aspect in determining when revenue is recognised, our concern is that practical application of a pure control based model may not provide users with decision useful information, for every type of transaction on a consistent basis, particularly where the application of control as proposed in the ED differs amongst services, goods, and the work-in-progress being transferred. As illustrated further in our response to question 3, for large financial services groups such as ourselves, we are not confident that the application of a control model, particularly in relation to contracts with variable consideration arrangements, is appropriate.

Nevertheless, in response to the specific questions raised by the Board on this ED, we appreciate the Board's attempts to clarify when a performance obligation is satisfied over time and generally consider that the criteria in paragraphs 35 and 36 of the ED to be appropriate. However, we believe that clarification is needed with in regards to paragraph 35(b)(iii) which states that "the entity has a right to payment for performance completed to date and it expects to fulfil the contract as promised ...". The reference to "right to payment" could be understood to mean the right to demand immediate payment from the customer. In addition, the term "payment" implies that the amount is fixed, although paragraph 54 permits an estimate of variable consideration to be recognised. We understand that the intent of this criterion is that the right to compensation has been earned for performance completed to date. The timing of the payment of that compensation or the fixing of the amount should not be relevant considerations. We suggest that the reference to "right to payment" be changed to "right to compensation", which will also be consistent with the wording used further on in the paragraph. Likewise, the reference to a "right to invoice" in paragraph 42 regarding output methods would be more appropriately stated as a "right to compensation".

The reference to "performance completed to date" could imply that performance must be performed on a continuous basis to meet the criteria. For some contracts, the satisfaction of

performance obligations will be met through the completion of milestones that do not correspond with a level pattern of transfer. The criteria should specifically incorporate a milestone concept. Furthermore, we would suggest that the Board clarify that the assessment of control is not necessarily dependent on whether the customer would recognise a related asset in its own financial statements.

We have also noted that these paragraphs do not consider those instances where a contractual limitation would cease to exist upon cancellation of the contract. It appears that the proposals as presently worded refer to limits to an entity's obligation to supply a contractually specified asset rather than an asset with no alternative use.

Question 2

Paragraph 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 210 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

We do not support the proposed presentation of credit impairment and question whether a proposal of this nature is appropriate in the context of a revenue recognition project particularly considering the considerable uncertainty which exists around the final form of the financial instruments impairment project. Despite the explanation provided in BC174-175, we do not agree that this is the best way of providing increased transparency around the effects of credit risk. These proposals introduce the risk of divergent practices arising in presenting credit losses for similar contracts. We believe that any changes made to the face of the financial statements should be made in connection with the standalone project on revising IAS 1 *Presentation of Financial Statements*.

Nevertheless, in evaluating the ED's proposals, the proposal for differentiating receivables with and without a significant financing component is without merit. Both types of receivables represent financial instruments that were received as compensation for the provision of goods or services and should be accounted for in a similar manner consistent with the impairment provisions of IFRS 9 or IAS 39.

We are also concerned that these proposals do not address situations where entities specifically enter into contracts with customers with high credit risk as the present guidance meets these concerns through a measure of probability.

The ED involves a significant change to well-established and understood practices and we are doubtful on whether these proposals are the best way of providing increased transparency on the effects of credit risk. We are of the view that such information on credit losses be provided in the footnotes.

Question 3

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraints do you recommend and why?

While we are generally supportive of a principle that limits the amounts of revenue to that which is reasonably assured, we believe that additional clarity could be provided as to what "reasonably assured" means, particularly when considered in the context of the guidance in paragraph 55 of the ED. We also wish to highlight that "reasonably assured" implies a higher threshold for recognition under current US GAAP compared to the criteria in paragraph 81 of the ED.

Paragraph 55 of the ED identifies two methods that may be used to estimate the transaction price: expected value (sum of probability weighted amounts in a range of possible consideration amounts) and the most likely amount (the single most likely outcome). When considered within a range of possible outcomes, it is not clear whether reasonably assured means a consideration amount with a very high probability of occurrence or the lowest consideration amount in the range regardless of its probability of occurrence. In addition, it is not clear to what extent reasonably assured represents a departure from the criteria in IAS 18 which requires the amount of revenue recognised to be reliably measured.

We are aware that there may be a view that a variable performance fee in an asset management agreement is a derivative. Such a conclusion would result in variable performance fees being recognised in income (as unrealised gains on a financial instrument) during interim periods even though the fee might otherwise not be recognised as revenue until the end of the contract period when the amount is crystallised, as is the case in illustrative example 13 of the ED. It would be helpful if the Board's addressed this issue in the ED, perhaps in example 13 itself.

We question whether a variable fee would meet the definition of a derivative under IAS 39 because the performance effort to earn the right to the fee would be inconsistent with the requirement for a derivative to require no initial net investment, or one that is smaller than would be required for a contract with similar response to changes in market factors. We also note that a financial asset is a right to cash without further obligations to perform. Notwithstanding whether a variable fee would meet the definition of a derivative, if the compensation provided under a revenue contract is a financial instrument, we do not believe that the financial instrument should be initially recognised until which time the revenue criteria have been met – which would require that the initial quantum and value of such financial instrument be reasonably assured.

We do not believe that market volatility or the length of time before the amount of consideration is fixed (as identified in paragraph 82(a) and (b) of the ED) should necessarily be constraints on the amount of revenue recognised. For instance, where an entity concludes that it is not reasonably assured to an incentive fee until the end of the year, does this mean that as the entity continues to record the ongoing costs of generating revenue (e.g. employee

remuneration), with no corresponding revenue to match these costs being recognised, that the investment management agreement is an onerous contract at interim reporting periods? That this would constitute an onerous contract appears counter intuitive.

The assessment of whether revenue is reasonably assured should be based on conditions that exist as of the reporting date. Future market volatility that could reduce or even eliminate previously recognised revenue reflects events after the reporting date. This can be distinguished from incentive payments that are subject to the judgment of third parties when such judgments are not known as of the reporting date. Derivatives and other financial instruments measured at fair value share similar characteristics to revenue subject to market based volatility adjustments, yet this does not preclude the recognition of unrealised gains or loss from such instruments. Users of financial statements of asset managers would benefit from understanding the amount of performance fees earned to date under current market conditions with appropriate disclosures of the potential for clawbacks or reductions due to future market conditions.

Question 4

For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

The onerous test in the ED compares the lowest cost of settling a performance obligation and the amount of the transaction price allocated to it. This is a significant departure from the existing criteria in IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, which compares the unavoidable costs of meeting the obligations under a contract and the economic benefits expected to be received.

While we acknowledge the Board's extensive deliberations on this area, we strongly believe that the existing guidance for evaluating onerous revenue contracts in IAS 37 should be maintained and the question of onerous contracts not be addressed within the revenue recognition project as the matter of onerous contracts primarily relates to the recognition of costs not revenues.

As a particular point on the Board's proposals, we are of the view that an onerous contract liability should be recognised at the contract level rather than at a performance obligation level, in line with the economic substance of how such contracts are negotiated. It is also not clear why the onerous contract criteria only apply to contracts performed over time. A contract that is performed at a point in time may also be onerous. We recognise that many contracts that are performed at a point in time may be satisfied out of existing inventory (which is subject to impairment analysis); however, this is not always the case. We also note that the term contract inception (which is used in several contexts within the ED) is not defined. Contract inception should be defined such that it is clearly distinguished from the commencement of the contract.

Question 5

The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraph 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period.
- An analysis of the entity's remaining performance obligations (paragraph 119-121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraph 122 and 123)
- A tabular reconciliation of the movement of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

The proposed requirement in the ED to make specific revenue recognition disclosures in interim financial statements is a departure from the principles based nature of IAS 34 *Interim Financial Reporting*. For example, IAS 34 does not mandate the interim disclosure of movement tables for tangible and intangible assets and level 3 fair value measurements of financial instruments that are required in full year financial statement disclosures.

As noted through the Alternative Views of Mr Engström, we agree that IAS 34 should be reviewed comprehensively rather through targeted, unstructured amendments, particularly those which conflict with the principle of the standard.

We believe that many of the disclosure requirements such as those concerning performance obligations are excessive in nature and impractical to implement and provide on a continuous basis. The cost of compiling such extensive disclosures – aside from the impractical nature of doing so – is likely to outweigh the benefits ascribed to them by the user community.

The requirement to disclose the aggregate amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue may be applicable to long term construction and similar contracts. However, we believe that such disclosures would represent a significant change for many service contracts where the transaction fee is structured primarily as a success fee. To make the proposed disclosures in the ED would likely require the disclosure of potentially sensitive and confidential information and require a high degree of speculation as to the likely success of such assignments.

Question 6

For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

We agree with the proposal to apply the control and measurement requirements in the ED to account for the transfer of non-financial assets that are outside the scope of the ED. The principles in the ED are applicable to such items and applying the ED would result in more consistent accounting. It would also eliminate the need to separately identify principles for derecognition of non-financial assets in other standards such as leasing.

Appendix B: *Additional comments*

We have the following additional comments that are outside the scope of the specific questions posed within the ED:

1. ***Bundles as Distinct Performance Obligations*** – Paragraph 29 identifies the criteria by which a bundle of otherwise distinct goods or services should be treated as a single performance obligation. We support this concept as it will address practical concerns in many industries of having to allocate the transaction price to numerous individual performance obligations. However, the criterion in sub-paragraph (b) that “the bundle of goods or services is significantly modified or customised to fulfil the contract” is not clear. On its face, it would seem to imply that the bundle must be customised specifically for each customer. We understand from the IASB staff that the intent of this sentence was to clarify that stand-alone installation services should not be included in a bundle of goods (such as software). We do not believe that this clarification of sub-paragraph (a) need be made by creating additional criteria. We suggest that sub-paragraph (b) simply be deleted from the ED.
2. ***Options that Provide a Material Right*** – Further clarification should be provided as to when an option provides a material right to a customer. This concept is important in assessing whether short term contracts that automatically renew are essentially long-term in nature and whether they should be assessed as onerous contracts or contracts with multiple performance obligations.

Paragraph B21 states that an option to acquire additional goods or services (e.g., a renewal option) gives rise to a separate performance obligation only if the option provides a material right to the customer that it would not otherwise receive. If the option provides a material right, the customer in effect pays the entity in advance for future goods or services. The ED is, however, unclear as to how an option would be assessed as providing a material right. Should the option value be compared against the customer’s overall worth (which would be impracticable) or against the overall contract value? Or should the evaluation be based on whether the value of the option is sufficient to induce the customer to exercise it (which we believe is the intent of the ED)?

Illustrative example 25 provides an example of when a renewal option provides a material right to the customer in the context of a maintenance services agreement. The example states that “the entity concludes that the renewal option provides a material right to the customer because the entity expects to undertake progressively more maintenance work each year if a customer renews.” The example does not demonstrate the principle in the ED. Whether an option provides a material right should be analysed from the perspective of the customer, not the entity. While there may be reasons that the contract in the example provides a material right (e.g., a customer may not be permitted to purchase maintenance services in future years – when the maintenance is most needed – if it had not previously purchased and annually renewed the contract from initiation), those reasons are not articulated in the example.

3. ***Variable Consideration*** – Additional clarification is needed concerning how variable consideration should be considered when determining the transaction price. It is not clear how variability should be allocated to multiple performance obligations, and the conceptual basis for not recognising future revenue under intellectual property licenses needs better articulation.

In the case of multiple performance obligations, in the private equity context, a variable performance fee (i.e. carried interest) might be reduced for management or other fees previously received. The question arises as to whether some of the management fee should be allocated to the activities that generate the variable performance fee and potentially deferred.

In regards to revenues from the sale of intellectual property rights, paragraph 85 of the ED states that if an entity licenses intellectual property to a customer and the customer promises to pay an additional amount of consideration that varies on the basis of the customer's subsequent sales of a good or service, the entity is not reasonably assured to be entitled to the additional amount of consideration until the customer's subsequent sales occur. This constraint on revenue recognition is applicable only to the sale of intellectual property rights. While we support the principle in paragraph 85, we believe that it should be extended to all revenue that is contingent upon the subsequent sale of goods or services.

In illustrative example 14, an entity sells an insurance policy on behalf of an insurance company for a stated commission. In addition, the entity will receive an additional commission each year for as long as the policyholder does not cancel its policy. After selling the policy, the entity does not have any remaining performance obligations. The revenue recognised includes an estimate of trailing commissions based on the entity's past experience with customer cancellation rates. We believe that example 14 is flawed in that it treats the customer's failure to cancel the policy as if it represented a right of return where the returns can be reasonably estimated. Failure to cancel an insurance policy where such a right exists is in substance no different than an explicit act to renew the policy – which represents a separate sales transaction for which a separate transaction price should be identified. There should be a consistent application of the ED when the right to part or all of a transaction price is contingent on a future transaction – whether that transaction is the sale of future goods or services derived from intellectual property rights or the subsequent sale of insurance.

Rather than serving as an exception to the general principles in the ED, we suggest that paragraph 85 be revised to create a principle that revenue should not be recognised until the underlying sales cycle is complete. Example 14 should be revised to articulate that there is an ongoing renewal occurring and, therefore, trailing commissions should not be recognised until the underlying renewal occurs.

4. **Time Value of Money** – In regards to reflecting the time value of money in the transaction price, we believe the guidance in the ED is problematic in several respects. Firstly, the guidance overlaps and, in some respects, conflicts with existing guidance in IAS 39 and IFRS 9 that requires that a financial instrument be initially recognised at fair value. The guidance in paragraph 61 of the ED would require that the discount rate used be based upon the relevant rate at the inception of the contract and not be subsequently updated. This would mean that a financial asset, such as a trade receivable with extended payment terms, could initially be recognised at an interest rate that differs from the effective rate at the date the financial instrument is initially recognised. Secondly, we believe it is unnecessary for the ED to specify that the financing component only be recognised if it is significant to the contract and provide specific indicators of such insignificance in paragraph 59. It is already understood that any specific IFRS does not apply to immaterial items, and such a determination should be left to the judgment of preparers and their auditors. Thirdly, we do not believe that there should be an explicit exemption for contracts with a term of less than one year as indicated in paragraph 60 of the ED as such amounts could be material depending on the amount of consideration and prevailing interest rates

and credit spreads at such time. Lastly, it is not clear how the guidance should be applied in situations where the timing or payment of consideration is variable or when there are contract modifications or whether time value applies to contract assets and liabilities. For example, how should the time value of money be factored into the amount of a contract asset that should be recognised when the timing of payment by the customer is contingent upon reaching a milestone or when the amount of the payment varies based on when the milestone is reached? Such calculations would require constant revision and could be circular in nature.

We believe that the recognition of interest income or expense should only be applied to financial instruments, which is already addressed in existing IFRS. The ED should simply address the question of how interest income and expense should be classified (i.e., as an increase or decrease in revenue) when it arises from a financial instrument received as compensation in connection with revenue from contracts with customers. Contract assets and liabilities for which the amount of compensation is not fixed and for which the entity does not have an unconditional right to receive cash are not financial assets or financial liabilities. In addition, customer advances which are non-refundable other than for non-performance by the entity do not represent financial liabilities – they are performance obligations. We do not believe it is necessary or desirable to identify an interest component in performance obligations just as cash sales of inventory are fully recorded as revenue even though some part of the transaction price would reflect compensation for the financing cost of the inventory.