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30 Cannon Street  
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Dear Hans

ED/2011/6 Revenue from Contracts with Customers

We welcome the opportunity to provide comments on the IASB’s Exposure Draft ‘Revenue from Contracts with Customers’ (‘the ED’) and thank the Board for enabling us to participate in this project.

HSBC is one of the world’s largest banking and financial services organisations, with total assets of US$2,556 billion at 31 December 2011. Headquartered in London, HSBC has an international network of 7,200 offices in 85 countries and territories, representing both established and faster-growing markets, organised in six geographical regions. HSBC serves around 89 million customers through four global businesses: Retail Banking and Wealth Management, Commercial Banking, Global Banking and Markets, and Global Private Banking.

We appreciate the Board’s efforts in reconsidering their proposals in the 2010 Exposure Draft, ‘Revenue from contracts with customers’ (‘2010 ED’) and for making changes in response to the feedback received from constituents. The amendments have clarified some of the questions and concerns with the 2010 ED and we believe that the revised proposals are a step closer to a clear, principles based standard which should result in useful information. The revised proposals have addressed our main concerns about the 2010 ED, specifically the additional guidance for the recognition of revenue for performance obligations satisfied over time and the changes to the guidance on estimating variable consideration.

However, we have a few remaining concerns about the proposals:

- We are concerned about the proposed rules for the testing of onerous performance obligations and the related practical expedient which would result in many performance obligations being out of scope of any onerous test. We also believe that there should be one consistent onerous test in IFRSs which should follow the existing rules at a contract level in IAS 37.
• We believe that the proposed list of additional mandatory disclosures for interim financial statements would undermine the principle of IAS 34 which requires reporting entities to provide an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period. Excessive disclosure could reduce the focus of the disclosures on key information. In our view the cost of preparing those disclosures for many entities would outweigh their benefit.

• The proposal to present uncollectible amounts due to credit risk in a line item next to revenue is inconsistent with IAS 1, which does not mandate the presentation of specific line items and we do not believe that this presentation would always provide useful information. It also would represent a major change in the income statement presentation format adopted by many international banks, including HSBC and does not represent an improvement to our existing practice as it would not be a meaningful presentation of our business.

• In the context of the broader changes to IFRSs currently expected in 2015, we believe that restatement of comparatives would place an undue burden on preparers of financial statements. In our view, it would be more useful to apply the proposed standard retrospectively to the opening balance sheet for the period of transition without restatement of comparatives and to provide explanations of the adjustments between the closing and opening balance sheet under the old and the new standard. This would result in a single, consistent method of transition, following the approach adopted in IFRS 9.

• It is important that the Board considers any potential impact on the proposed IFRS 9 Impairment rules and the Leasing standard when finalising its proposals in the ED.

• In our view it would be helpful if the standard would be structured in a more logical way, for example following the five step approach as described in the introduction to the ED.

Our responses to the questions set out in the ED are provided in the Appendix 1 and we have included some additional comments in Appendix 2. As always, we would be pleased to discuss our comments and concerns in more detail if this would be helpful.

Yours sincerely

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Appendix 1: Questions for respondents

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?

We agree with the Board’s proposal in paragraph 35 and 36 that specifies the transfer of control of a good or service over time. It is easy to understand and results in a similar revenue recognition pattern for service contracts to the percentage of completion method in IAS 18. We believe that this pattern of revenue recognition provides useful information to the users of financial statements.

The proposal addresses the concerns we raised in our comment letter on the 2010 ED about the application of the control concept to service contracts which in our view was unclear and not capable of consistent application.

Question 2:

Paragraphs 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 310 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 generally agree with the Board that the accounting for amounts of promised consideration which are uncollectible due to customer credit risk should be in the scope of IFRS 9/IAS39 as trade receivables are financial instruments. However, it is important that the impairment requirements in IFRS 9 are suitable for trade receivables and can be applied without undue complexity. We do not agree with the proposed presentation in the income statement and believe that any changes to the presentation of line items in the income statement should be addressed through a wider project on financial statement presentation, with appropriate consultation.

Paragraphs 50 of the ED states that the effects of customer credit risk are not part of the transaction price; they are therefore not part of revenue. In our view, the effects of customer credit risk are therefore more in the nature of expenses that should be presented consistently with other expenses.
The ED proposes to show the effects of credit risk on revenue in a separate line item next to revenue where a contract does not have a significant financing component. However, if the contract has a significant financing component it would be shown together with impairment losses for other types of financial assets within the scope of IFRS 9/IAS 39. Impairment losses would therefore be presented differently for long-term and short-term trade receivables.

A presentation of the impairment of trade receivables next to revenue would not align with an income statement classification using the nature of expense method as described in IAS 1. IAS 1 does not generally prescribe where to present separate line items in the income statement. However, paragraph 99 requires an analysis of expenses recognised in profit or loss using a classification based on either their nature or their function within the entity, and encourages entities to present this analysis in the statement of comprehensive income or in the separate income statement. The proposal to present uncollectible amounts due to credit risk in a line item next to revenue is not in line with this presentation principle of IAS 1. We believe that it is important to retain the flexibility in IAS 1 to present line items in a way that best reflects the nature of the business, industry practice and materiality. In our view the proposed presentation would not always provide useful information.

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 constraint do you recommend and why?

We agree with the proposed constraint of the amount of revenue that an entity would recognise for satisfied performance obligations, if the amount of consideration to which the entity expects to be entitled is variable. In our view, the redrafting of the original proposal in the 2010 ED has clarified the principle, and addresses our concern about the guidance being open to a wide range of interpretations.

However, we would encourage the Board to reconsider the structure of the ED before finalising the standard to make it more user friendly. Given that the guidance in paragraphs 81 to 85 is solely relevant to variable consideration, it would help users’ understanding of the requirements of the standard if it were located together with the related guidance in paragraph 53 to 57.
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?

We do not agree with the Board’s proposals on the assessment and accounting for onerous performance obligations. In our view onerous obligations should be accounted for in line with IAS 37, and continue to be assessed at a contract level.

The Board’s proposal to limit the scope of the onerous test to performance obligations that an entity expects to satisfy over a period of time greater than one year would make the proposed onerous test more operational as many performance obligations would be out of scope of the proposal. However, the consequential amendments to IAS 37 in paragraph D21 would result in all performance obligations in the scope of the ED being out of the scope of IAS 37. We are therefore concerned that the proposals would result in many performance obligations being out of the scope of any onerous test.

We also believe that splitting the rules for onerous obligations between IAS 37 and the ED and within the ED depending on maturity of the contract will lead to unnecessary confusion about whether and to what extent onerous performance obligations or contracts are reflected in financial reporting. Under the proposals a provision for onerous contracts would be recognised for contracts in the scope of IAS 37, for example an onerous operating lease contract. For contracts within the scope of the ED, a provision would be recognised for onerous performance obligations which are expected to be fulfilled over a period of more than one year, for example a construction service provided over 13 months. However, for onerous performance obligations in the scope of the ED which are expected to be delivered within a year, for example a construction service provided over 11 months, no provision would be recognised.

We continue to hold the view which we expressed in our response to the 2010 ED that the assessment of onerous obligations should not be performed at the level of performance obligations as this may lead to the recognition of liabilities even if a contract is profitable. Overall the concept of onerous contracts in IAS 37 is well understood, results in useful information for users of the accounts and is operational.

The proposal of an onerous test at the level of the distinct performance obligation would create an inconsistency with IAS 37. We do not share the Board’s concern in BC207 that an onerous test at a contract level would be arbitrary. Paragraph 17 of the ED provides clear guidance on when to combine two or more contracts entered into at or near the same time with the same customer (or related parties) and account for the contracts as a single contract. The unit of account of a contract is therefore clearly defined in the ED, and IAS 37 would only
need to refer to that guidance to ensure consistent application. Furthermore, as identifying the contract is the first step in the revenue recognition process, we do not share the Board’s view that an onerous test at that level would add complexity. This is also supported by the feedback on the 2010 ED which showed that many respondents were in favour of an onerous test at a contract level. We believe that the proposals of an onerous test on the level of performance obligations for contracts in the scope of the ED would result in unnecessary complexity and inconsistent accounting for onerous obligations.

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 (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity’s remaining performance obligations (paragraphs 119–121)
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements 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.

HSBC supports robust disclosures which provide useful information for users of financial statements, and we believe disclosures should be provided in interim reports where they are needed in order to understand the financial performance during that interim reporting period. We share the Board’s view that the disclosure requirements of paragraph 114 and 115 would most likely provide useful information about entities’ performance across all industries.

However, we believe that in many circumstances the proposed disclosures in paragraph 117 to 128 would not provide useful information in year end or interim financial statements. The ED proposes one set of accounting rules which will be applicable across all industries. While we understand the importance of one single converged revenue recognition model, we do not believe that this should result in a list of mandatory disclosures across industries which often do not provide useful information. We suggest that the Board draft the disclosure
requirements in a way that encourages directors to apply judgement to determine what disclosures are relevant in the context of understanding the financial performance and position of an entity’s business rather than suggesting that all the disclosures are required.

In addition, we believe that the key principle in IAS 34 paragraph 15 - which requires reporting entities to provide an explanation of events and transactions that are significant to an understanding of the changes in financial position and performance of the entity since the end of the last annual reporting period - should not be undermined by the addition of a long list of specific disclosures which could obfuscate key information.

Overall, we therefore believe that the costs of preparing and auditing/reviewing the proposed year end and interim disclosures would outweigh the benefits of providing the disclosures in many circumstances.

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 Board’s proposal 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. However, we believe that the applicable guidance should be expanded to include the requirements for the combination of contracts.

The guidance on combining contracts can have a significant impact on the accounting for the transfer of non-financial assets that are not an output of an entity’s ordinary activities, as it may impact whether the derecognition criteria of the respective standards are met. As the Board pointed out in BC207 a contract as unit of account can be arbitrary. While we do not agree with this statement in the context of this exposure draft given the guidance in paragraphs 16 and 17 (see response to question 4), this is true if the guidance on combination of contracts is not applicable to a transaction. We therefore encourage the Board to enhance the above proposed amendment of other standards to also include the proposed guidance on the combination of contracts.
Appendix 2: Additional comments

Leases project

We appreciate that the Board is still discussing proposals in relation to the Leases project. However, we understand that in certain areas the final Leasing standard is likely to cross reference to the standard ‘Revenue from Contract with Customers’. It is important that the Board considers the potential implications of this interaction when finalising its proposals in this ED.

Transition rules

In the context of the broader changes to IFRSs currently expected in 2015, we believe that restatement of comparatives would place an undue burden on preparers of financial statements. For IFRS 9, restated comparatives are no longer required and it seems likely that modified transition requirements will be necessary for other new standards. Therefore the value of restated comparatives to users is questionable. In our view, it would be more useful to apply the proposed standard retrospectively to the opening balance sheet for the period of transition without restatement of comparatives and to provide explanations of the adjustments between the closing and opening balance sheet under the old and the new standard. This would result in a single, consistent method of transition, following the approach adopted in IFRS 9.

We acknowledge the Board’s efforts to ease the operational burden and the cost of transition to the new requirements. However, we would like to bring to the Board’s attention that the proposed practical expedients for transition to the new standard may be very limited in their usefulness. For example, paragraph C3(a) provides relief from restatement for contracts completed before the date of initial application if they begin and end within the same annual reporting period. Most accounting systems do not currently hold contract date information and it would therefore be a significant operational challenge to confirm which contracts crossed an accounting period and which did not.

If the Board continues to believe that restatement of comparatives is necessary it could in our view help to ease the operational burden of transition to the new standard if the Board emphasised the importance of materiality considerations in the context of the restatement of comparatives, perhaps through educational materials.

Drafting issues

Multiple performance obligations versus bundles
The guidance in paragraphs 29 and 30 significantly contributes to making the proposals in the ED operational and results in a pattern of revenue recognition which provides useful information. However, we noted during our testing of the proposals that this guidance could be interpreted in a variety of ways. While the ultimate accounting result achieved did not change, some users believed they should account for multiple performance obligations
together because they form a bundle, and some came to the same conclusion because they believed they would fall into the practical expedient in paragraph 30. The guidance in paragraph 29 is unclear about whether a bundle contains only indistinct performance obligations or whether it could also include distinct performance obligations.

Given that an individual performance obligation in a bundle could have a different pattern of transfer, the guidance in paragraphs 29 and 30 should be clarified. We believe that this could, for example, be achieved by combining the requirements in the following way:

‘An entity shall account for two or more performance obligations together if one of the following criteria is met:

a) The performance obligations have the same pattern of transfer to the customer; or
b) The performance obligations are part of a bundle. Performance obligations are part of a bundle if the following two criteria are met:
   a. The goods or services are highly interrelated […]
   b. The bundle of goods or services is significantly modified or customised to fulfil the contract.’

In addition it would be helpful if the Board could clarify when goods or services are considered highly interrelated and significantly modified or customised.

Illustrative examples
We would like to point out that it is unclear whether the illustrative examples are integral part of the proposed standard or not. The first sentence in the section states that ‘These examples accompany, but are not part of the [draft] IFRS’. However, the first sentence in paragraph IE1 states that ‘The following examples are an integral part of the [draft] IFRS […]’.

Structure of the ED
We would also ask the Board to consider whether the ED could be made more user friendly. For example, the standard could follow the five step approach as described in the introduction to the ED in its structure. As noted in our response to question 3 we also believe that it would help users’ understanding of the standard if, the guidance in paragraphs 81 to 85 was located together with the guidance on variable consideration in paragraph 53 to 57 to which it is solely relevant.