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By email: [commentletters@hkiarpa.org.hk](mailto:commentletters@hkiarpa.org.hk)

Mr. Steve Ong  
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Dear Steve

**IASB Revised Exposure Draft – Revenue from Contracts with Customers**

We refer to your letter dated 15 December 2011. On behalf of our members, we would like to provide our comments on the International Accounting Standard Board's revised Exposure Draft (ED) – Revenue from Contracts with Customers.

We welcome the significant changes the Boards have made to the application of the originally proposed five-step model to recognize revenue when control of goods or services transfers to the customer and address the various concerns raised by constituents. We agree that the changes will alleviate the burden and address some of the issues for some entities in some industries, however they overlook some of the more significant concerns we have raised in our earlier comments as set out below:

**Unit of account for testing onerous performance obligations**

It is inconsistent to assess onerous obligations at the individual performance obligation level even though the obligations meet the criteria to be bundled for recognition and measurement purposes. The practical exemption introduced in the revised ED does not relieve this concern. Banks (and potentially other service providers) who need to stand ready to continuously provide services to their customers often enter into contracts to provide a bundle of interrelated services. It is not uncommon for these contracts to have no fixed duration as a result of which they either have no end date (for example, a current account) or an end date which is longer than 1 year (for example, a credit card). Individual performance obligations like ATM services, cheque books, access to internet banking and relationship managers meet all the criteria to be accounted for as a bundle. Fees

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charged for these services are often reduced or waived if the customer's account balance exceeds certain thresholds since the institution entity earns interest income (which is outside the scope of the proposed standard) from the customer contract. Operating costs for such services are expensed as incurred and matched with either interest or fee revenue in the income statement. Infrastructure assets capitalized by the institution to provide the services are assessed for impairment under IAS 36.

As the above indicates, requiring an assessment of onerous performance obligations and requiring provisions because the scope of the standard does not include that item of revenue (interest income, lease revenue, etc.) would result in either over provisioning for costs or providing for future operating expenses or losses (since the onerous performance obligation test under the ED includes all direct costs for a contract). We do not believe that the Boards intended this outcome and propose that the assessment of onerous performance obligation is performed at the contract level, includes only directly attributable and incremental costs incurred to provide the relevant services and includes language which does not result in double-counting if the assets the entity would utilize to provide the services were also assessed for impairment under IAS 36.

#### Presentation of credit risk in the income statement

It is common for banks and similar financial institutions involved in the business of lending to provide financing to a large population of borrowers meeting certain risk criteria and charge a rate of interest for these loans commensurate with the level of counterparty credit risk involved. The required levels of returns in these cases takes account of credit risk based on loss experiences the institution has derived from past transactions and its assessment of future risk conditions. On the other hand, a business generally not involved in the business of lending would likely not take a 10% credit risk on an individual sale transaction (as example 20 in the original ED implied) since the compensation the business would obtain from that transaction (CU 900 in the example) far exceeds the potential loss (CU 1,000) in case of default.

In our view, the accounting for a receivable (a financial asset), regardless of the transaction which gives rise to it, should be in accordance with IFRS 9 which then prescribes the recognition, measurement and presentation requirements for impairment. We also consider that the proposed standard should not prescribe how credit risk and expected impairment should be presented. Instead,

- The geography of where items are presented in the income statement should be left to the Board's project on presentation. We would not support piecemeal presentation requirements being mandated in different accounting standards



- The expected loss from financing addressed in the proposed standard would arise both at the inception of a transaction (affecting operating revenues) and during the life of a financial asset (a financing transaction). The approach advocated in the revised ED would potentially require disaggregation of the expected loss from financing (arising from initial measurement and re-measurement) in different lines across the income statement (adjacent to interest income, fee income, gains/losses from other financial assets) so that a meaningful relationship to revenue can be maintained. Not only is this presentation extremely confusing for users of the financial statements but would also encourage financial institutions to present non-GAAP disclosures for this key performance indicator.

Our response to the specific questions raised in the revised exposure draft and comments on other issues are set out in Appendix 1 and Appendix 2 respectively.

We hope you would find our comments useful. We would be happy to further clarify or discuss any of the above points should you so wish.

Yours sincerely

A handwritten signature in black ink, appearing to be "Ronie Mak", written over a horizontal line.

Ronie Mak  
Secretary

Enc.

**Appendix 1 – Response to Specific Questions in the International Accounting Standards Board’s revised Exposure Draft ED/2011/6 Revenue from Contracts with Customers**

**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 guidance included in paragraphs 35 and 36 specifying when an entity transfers control of a good or service over time and hence satisfies a performance obligation over time. In addition, we would recommend inclusion of the following additional clarifications:

- What a “right to payment” means in paragraph 35(b)(iii) of the ED;
- Whether the assessment that a (bundle of) performance obligations is satisfied over time or at a point in time is performed only at the inception of a contract or throughout the life of a contract (i.e. is it possible for an entity to switch between the two extremes of “satisfying obligations over time” and “satisfying obligations at a point in time”). For example, when a contract to provide services over time is terminated and the entity has no further obligations, an entity is unable to recognize revenue for any non-refundable upfront fees it has received from the customer using the conditions specified in paragraph 36 of the proposed standard. At the point of termination, the entity’s obligations will no longer be satisfied over time – rather, they would be satisfied at a point in time (at the time the contract is terminated). The entity would then need to use the principles in paragraph 37 to recognize as revenue any non-refundable fees it has received from the customer; and
- How a performance obligation can be satisfied continuously if the entity has to stand ready to provide services to customers over a period of time – e.g. ready ATM facilities, premier banking counters, etc. The existing guidance cannot be clearly applied to include the providing of such services (which are not necessarily restricted to the financial services industry) which are available for consumption by customers but not dependant on whether any customer uses them or not.

## 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 disagree with the proposals especially given how they would potentially impact the presentation of information for a financial institution.

Conceptually, where a transaction includes an additional performance obligation, an entity would charge a fee for that additional performance obligation. Thus, where a transaction involves a sale of goods (or the providing of a service) together with the financing, revenue would be accounted for separated from the time value of money (ignoring the practical expedients the proposed standard provides). Similarly, where an entity adjusts its routine price of goods or services so that it is compensated for the specific credit risk of a customer, the revenue arising from the compensation for the credit risk (similar to a guarantee fee) is presented separately. On the other hand, where the company is not seeking a distinct compensation for credit risk, and the risk arises on a financial asset (a receivable), we question why the cost of the credit risk is presented adjacent to the revenue.

The presentation of credit risk advocated in the proposed standard raises a number of conceptual questions:

- Presentation of the credit risk adjacent to the revenue item would potentially result in each revenue item having a credit risk (impairment or bad debt) figure presented next to it – in other words, a disaggregated impairment charge.
- An impairment provision would arise either from the initial measurement of a receivable or from a re-evaluation of the credit risk of a receivable. The remeasurement could arise either in the same period or in a subsequent period. To meaningfully link the revenue figure (for the current period) to the impairment figure, an entity would need to further analyse the impairment charge arising on initial recognition, subsequent measurement in the same period, and subsequent remeasurement in another period, and present all these figures separately.

We believe that such disaggregation, the implementation of which could result in high costs, would not only confuse readers of the financial statements but would

also render the information unusable in the absence of additional aggregated disclosures. It is unclear whether the presentation requirements in the proposed standard would provide better information on credit risk than what is already provided through the IFRS 7 requirements.

It is also unclear how these presentation requirements would interact with those being considered under IFRS 9.

Presentation of information within the financial statements and the geography of the income statement is an important issue to most, if not all entities. It is the subject of a separate project which has attracted many comments from a range of constituents. We believe that any change in the presentation aspects and the geography of items within the income statement should be left to the standard on presentation of financial statements.

### 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?**

Whilst we support the proposed constraint on the amount of revenue that an entity would recognize for satisfied performance obligations, we are concerned that the list of indicators listed in paragraph 82 (of an entity's experience to predict the amount of consideration the entity will be entitled in exchange of satisfying those performance obligations) is implied as an exhaustive list. It is possible that some entities will have access to reliable and adequate data, or will be able to reliably predict the amount of revenue the entity will be entitled to. Even though it results in volatility, an entity should be permitted to predict and account for this revenue. Whether the evidence required to support the amounts recognized is reliable and adequate or not is an issue best left to the auditors who have to provide an opinion on the figures reported by the entity.

For example, illustrative examples (IE) 12 restricts an entity from recognizing revenue as the performance-based incentive fee since the amount is contingent on what can be observed from an index at the end of the year. However, if the principle is that a company recognizes revenue when it is entitled to that revenue (and has earned it), and is reasonably assured of the amount it will be entitled, the mere fact that the amount is highly susceptible to volatility in the market, has a large number and high variability of possible consideration amounts should not be a restricting factor to revenue recognition. Derivatives and other financial instruments share similar characteristics, yet this does not preclude the recognition of gain or loss from such instruments. Similarly, the proposed amendments to IFRS 9 in relation to impairments would also result in predicting and accounting for highly uncertain amounts of expected losses, yet this is not used as a constraint to account for the expected losses.

There exists a potential argument that a variable fee arrangement in an asset management agreement might be an embedded derivative even if the variable fee were not recognized for revenue purposes until the end of the financial year. We believe this should be considered and clarified if necessary. It would seem that awarding the derivative instrument would be a form of compensation under the asset management agreement and that its initial recognition would be consistent with IFRS 9 where no amount is recognized upon initial measurement due to the fact that the inputs to the valuation are unobservable.

#### **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 manner in which the guidance over onerous performance obligations is drafted in the proposed ED and with the fact that this issue should be addressed in a standard dealing with revenues from contracts with customers. We believe that it is more appropriate for this guidance to be included in IAS 37 on Provisions, Contingent Liabilities and Contingent Assets.

We have the following specific comments in relation to how these requirements are drafted in the proposed standard:

- (1) The requirements in paragraph 86 imply that an entity considers whether “a performance obligation” is onerous (emphasis on a single performance obligation) (Basis for Conclusions (BC) 206-207). However, paragraphs 16-17 and most of the guidance in the proposed standard over the identification and satisfaction of performance obligations permits an entity to bundle performance obligations. It is not clear whether this inconsistency in the unit of account is an oversight of the drafting process or whether the Board’s deliberately intend that the onerous performance obligation test is performed at a more granular level.
- (2) The existing test for onerous performance obligations required in IAS 37 is assessed at the contract level, however, the onerous test required in the proposed standard potentially goes to a more granular level. This results in an unintended consequence that if an entity has two forms of revenues from a contract, one falling within the scope of the proposed standard (for example, fee income) but the remainder falling outside the scope of the proposed standard (for example, interest income or income from leasing), there is no provision to allocate the costs for satisfying the combined performance obligations when performing the onerous obligation test (since paragraph 92 requires the inclusion of all direct costs of a contract – i.e. it is not written from the view of “a single performance obligation”).

We agree that a standard on revenue should not seek to provide extensive guidance on allocation of costs, and by the same token, we are of the view that provisions for onerous obligations is a “cost issue” best left to IAS 37.

- (3) We appreciate that the Boards included a practical expedient in the revised ED to assess performance obligations only for contracts the duration of which exceeds one year. Whilst we welcome this relaxation, the principle behind the “one year” time limit is unclear. Many contracts do not have a fixed term – they continue till they are cancelled by the parties to the contract. Charging an annual fee to a customer for services does not fix the contract length to 12 months – an annual fee is often charged once (either at the beginning or end of a year) and at times is refunded (or charged) on a pro-rata basis (either monthly or quarterly).

The unintended consequence of this expedient could result in companies (especially those who are affected inappropriately by this requirement such as banks) being forced to amend and limit the duration of their contracts with customers.

An example of the consequence of the proposed guidance on the banking industry is as follows:



- Banks routinely provide current account services and credit cards to customers in exchange for a fixed fee which is waived if customer balances or spending exceeds a certain threshold. This is because at a certain threshold, the institution has the opportunity to earn other revenues from the customer – for example, in the form of a higher deposit interest margin, fee income from credit card transactions or interest income from lending.
- These customer contracts are often of an indefinite length. Even where the length of a contract is fixed to, say one year, the contract is frequently renewed and rolled over. This could be argued as indicating that a continuous long-term contract may be in place.
- Infrastructure used by the institution to provide support services (printing of cards, ATM facilities, internet banking, cheque books, relationship managers, etc.) are either expensed as incurred or capitalized (and assessed for impairment under IAS 36).
- Such contracts include different types of income, parts of which may be either within the scope of the proposed standard or within the scope of IFRS 9.
- The proposed standard does not provide the possibility to allocate costs. Furthermore, the proposed standard requires an assessment of onerous performance obligations at a granular level. This inadvertently results in the requirement that the entity record a provision for onerous performance obligations despite the fact that the overall contract with the customer is profitable.

#### **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.( In the IASB exposure draft, see paragraph D19 in Appendix D). 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 recognized 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.**

We fail to see why the ED amends IAS 34 by mandating certain disclosures and then adding a materiality condition. Revenue is an important metric for most, if not all, companies. If the amount involved is material, an entity will provide adequate disclosures in line with the existing principle in IAS 34.15. There is no reason why a principle based standard like IAS 34 should add on a specific disclosure requirement and encourage a checklist type disclosure approach, especially given that this approach is inconsistent with the approach IAS 34 takes in relation to disclosures required by most other standards. For example, existing standards on tangible and intangible assets and movements in level 3 fair value disclosures do not mandate the inclusion of movement schedules in interim financial statements.

#### **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 (In the IASB exposure draft, see paragraphs D17, D22 and D26 in Appendix D). 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?**

Yes, we 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. However, the proposed standard stops short of defining "revenue" and whether the gross proceeds from such transfers would form part of revenues.

**Appendix 2 – Other issues in relation to the International Accounting Standards Board’s revised Exposure Draft ED/2011/6 Revenue from Contracts with Customers**

**Identification of performance obligations**

It would be useful to define a “bundle”. Whilst a definition of a bundle can be pieced together from paragraphs 27-29 of the ED, we felt there are different ways of interpreting and applying these paragraphs – for example,

- (1) a “bundle” would include indistinct goods/services (paragraph 27) plus ones which are distinct according to paragraph 29, and meet the 2 conditions in paragraph 29.

Alternatively,

- (2) paragraph 29 specifies the conditions that any “bundle” must meet even if it only comprises indistinct goods/services.

BC 77 - 80 support (1) above since they go on to explain that paragraph 29 is applicable to distinct ones (hence the reference to paragraph 28 in paragraph 29). However, there can well be other defensible views leading to diversity (especially given the BC’s are not part of the standard)

We also believe that paragraphs 27 to 29 can be clarified further through the use of examples to show how they should be applied, especially paragraph 29(b) where we do not believe the intent is to limit its applicability to bundles that are customized for each separate customer.

**Measurement of progress towards satisfaction of performance obligations**

Paragraph 42 refers to a “right to invoice” as an output method in determining the amount of revenue to be recognized. We question why should a right to “invoice” (as opposed to having earned a right to compensation currently or at some future payment date) have any bearing on the amount of revenue recognized?

**Determination of the transaction price**

The most likely amount (paragraph 55b) includes reference to appropriateness where there is a binary outcome. We believe it should not be read as restricting the

use of that approach to binary outcomes, so some further language should be added to clarify e.g. "However this approach is not limited to such contracts". Alternatively, an implementation example can be added.

### **Accounting for time value of money**

The proposed standard requires separate accounting for the time value of money if a contract has a significant financing component and goes on to define "significant" in paragraph 59. As part of this definition, the proposed standard introduces a practical expedient by not requiring the assessment of the time value of money of the period between when control over goods or services passes and payment is less than one year.

We support the objective that the proposed standard continue to require an assessment of materiality when determining whether or not to separately account for the time value of money. We also welcome the practical expedient because it avoids entities facing the burden of having to calculate the time value of money so that they can decide whether it is material or not. However, the length of time serves only as one indicator of materiality. When the rate of interest is high (due to the general level of interest rates or due to the credit risk of the customer) the interest component for a less than a one year period would also be material and the practical expedient could be counter-intuitive.

We believe the conflict could be resolved if an entity was required to consider all the 3 conditions attached to paragraph 59 as opposed to considering a subset of the same in isolation.

### **Carry forward of guidance from existing standards and interpretations**

A number of interpretations addressing users' concerns over the application of the existing standard is currently included in existing IFRS literature (either in interpretations or rejection notes issued by the IFRS Interpretations Committee (IFRIC)) – for example, in the areas of principal versus agent, accounting for barter transactions, accounting for service contracts, etc. The fact that this detailed guidance exists indicates the need for the same. Whilst the proposed ED includes principles addressing these issues, some of these areas can be complex and in the absence of application guidance and illustrative examples, is capable of being inconsistently interpreted and applied. We believe that this existing guidance should be carried forward in the proposed standard.

### **Other inconsistencies**

Example 25 of the ED 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.” Since this analysis is from the perspective of the supplier of services, it seems inconsistent with the principle in the ED that the renewal option provides a material right to the customer.

The concept of a material right to a customer with regard to a renewal option should be clarified. Should the materiality be analyzed with respect to the customers overall worth (which would not be practicable) or as to whether it is sufficient to induce the customer to renew.

IFRIC’s Interpretation 13 is rescinded because the provision of award points under a credit card relationship is considered a performance obligation. However, the credit card holder is not the customer who provides the revenue when award points are offered. It is the merchant that is charged the exchange fee, a portion of which would be allocated to the award performance obligation. Looking through to the end user as the customer should be contemplated in the ED.

Example 14 would permit the current recognition of revenue on a trailing commission for the sale of insurance products. Example 26 would not permit the current recognition of estimated royalties on the licensure of intangibles. However, these cases seem very similar and should have similar accounting. It seems that revenue should not be recognized until the underlying sale process has been completed.