8 March 2012

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

Dear Hans

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

Thank you for the opportunity to comment on this Exposure Draft (ED). Australia and New Zealand Banking Group Limited (ANZ) is listed on the Australian Securities Exchange. Our operations are predominately based in Australia, New Zealand and Asia and our most recent annual results reported profits of USD5.8 billion and total assets of USD641 billion.

<u>Summary</u>

We agree with the Board's objective to establish a single principle based standard for recognising revenue and believe the current ED does provide a platform for achieving that objective.

Generally we are supportive of the proposals in the ED, and we support the changes made to the previous ED. There are, however, some specific areas of the ED that we do not agree with, or areas where we believe the ED could be improved. These concerns and recommendations for improvement are outlined below and in the Appendix to this letter, which specifically answers the ED's questions for respondents.

Interaction with IFRS 9 Financial Instruments (IFRS 9)

We have a number of contracts which give rise to both a financial instrument and a service contract. The ED states that if other IFRSs specify how to initially measure parts of the contract and/or separate parts of the contract, then an entity shall first apply that standard. For our contracts, therefore, IFRS 9 would be applied first as it addresses the initial measurement of a financial instrument. However, IFRS 9 does not provide guidance on separating financial services income into that which is part of the effective yield and that which is not part of the effective yield.

We believe that the scope of the ED should be changed to state that entities should only apply other IFRSs first, where those standards address both measurement and separation. We also consider that the ED should provide guidance that addresses how consideration should be allocated between the new revenue standard and IFRS 9. Without such guidance, there may be inconsistencies in accounting across different entities or some counter-intuitive financial impacts. For example, a credit card product may provide the customer with additional services, however, no on-going/annual fee may be charged to the customer. The only consideration earned on the card would be the interest charged if a customer does not pay the outstanding balance in full. Under the ED, IFRS 9 would be applied first, in which case the interest revenue would be recognised in accordance with IFRS 9. This treatment would not leave any consideration to match the performance obligation to provide additional services recognised in accordance with the ED. This would trigger an onerous contract liability under the ED; we would not be supportive of such an outcome.

We note that the Appendix to existing IAS 18 *Revenue* (IAS 18) provides useful guidance on the recognition of revenue for financial services fees (paragraph 14 of the Appendix). This guidance serves to articulate the principles to apply in determining whether financial services fees are an integral part of the effective interest rate of a financial instrument (in which case they are effectively accounted for under IFRS 9) or whether they are fees for providing a service. The guidance therefore provides the principles to support identification of the separate parts of a financial services contract. We ask that the Board includes similar guidance as 'illustrative examples' to the ED.

Accounting for bundled services

Under the ED, there are situations where distinct services provided under one contract are accounted for as a single performance obligation, namely where the services are highly interrelated and the bundle of services is significantly modified (paragraph 29 of the ED).

We consider that paragraph 29 would apply to many of our transactions, for example where we are lead arranger and book runner on loan syndications, or where we earn arranger fees, underwriting fees and establishment fees on a financial product. It is unclear how we would determine the basis of recognition for such contracts where some of the services are satisfied over time and other services are satisfied at a point in time.

In our view the key obligations of the contract should be determined and, if those are delivered at a point in time, all revenues should be recognised at that point. However, if the key obligations are satisfied over time, revenue should be recognised on that basis. We would be concerned if the Board's intention is that these contracts would need to be unbundled in such circumstances, as this would fail to address the concerns which led to the introduction of paragraph 29.

Allocation of transaction price to performance obligations

Under the ED's proposals, to allocate an appropriate amount of consideration to each separate performance obligation, an entity determines the stand-alone selling price at contract inception of the good or service underlying each separate performance obligation.

As a matter of commercial practice we regularly offer our customers bundled products such as credit card contracts that include insurance cover, or bank accounts that offer roadside assistance and travel insurance.

The services that are provided, as an addition to a core banking product, are generally not sold by us on a stand-alone basis. The additional services that we provide are offered as stand-alone products by many competitors in a very competitive market. To continually reassess the stand-alone selling price of these bundled services would be very impractical and the benefits of doing so would not appear to merit the cost.

We believe that a more practical approach, particularly where the entity does not sell the service separately, is to determine an allocation when the bundled product is first sold and then to adjust the allocation only where facts or circumstances indicate that there might have been a significant change in the relative stand-alone selling price. This would avoid the need for continual reassessment of allocations. The final standard should also provide examples of indicators that might suggest a significant change in the relative stand-alone selling price such as a significant change in the costs of providing the service, or a significant change in the market price of the service.

Customer's credit risk

We are not supportive of the proposal for expenses arising from the initial estimate of the impact of customer's credit risk and the ongoing credit impairment for short term trade receivables to be presented as separate line items adjacent to the revenue line item. We believe that showing certain credit related adjustment as a contra revenue and others as an expense increases complexity in financial statements.

We also note that, under the ED, the transaction price is the amount of consideration to which an entity expects to be entitled, but that this does not include the effects of the customer's credit risk. We note in BC 171 that 'the boards expect that an entity would typically not recognise a loss on initial recognition because the receivable normally would initially be measured at the original invoice amount if the contract with a customer does not include a financing component that is significant'. Accordingly, if at inception there is a difference between the amount recognised as a receivable and the consideration to which an entity expects to be entitled of a contract, we consider that, in substance, the entity is providing some form of discount which should therefore be netted off against the revenue. We do not believe it is appropriate for the entity to recognise the full transaction price as revenue and the cost of the customers credit risk as a contra-revenue as proposed by the ED.

Onerous performance obligations

We do not agree with the onerous performance obligation approach set out in the ED. Whilst we support the approach to identifying separate performance obligations as a means of determining the pattern of revenue recognition, in our opinion, an entity that is performing a number of services under one contract does not have a contractual obligation to deliver any one of these services unilaterally. We do not consider that the entity has an onerous obligation in relation to any individual service – given that an obligation under IFRS is generally legally enforceable. We consider that onerous contracts should continue to be accounted for under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* (IAS 37).

Detailed comments on the questions raised in the ED are attached to this letter. Should you have any queries on our comments, please contact me at Shane.Buggle@anz.com.

Yours sincerely

Shane Buggle
Deputy Chief Financial Officer

Copy: Chairman, Australian Accounting Standards Board (AASB)

Appendix

ED's 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 support the principle that recognition of revenue should be as the entity satisfies a performance obligation by transferring a promised good or service to a customer. We note that the board has sought to make this concept applicable to both the sale of goods and services. To achieve this the ED has introduced the concept that the transfer of a good or service is equivalent to the entity transferring an asset to a customer, once the customer has control of the asset, the performance obligation has been performed.

In our opinion this is not easily understood in the context of a service contract. We also note that in paragraph 37 of the ED, which lists the indicators for when an obligation is satisfied at a point in time, only one of the indicators is clearly applicable to a service contract. We believe the standard should provide further simple examples which apply the concept to a service contract, both where the obligation is satisfied over time and where the obligation is satisfied at a point in time.

> 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 support the proposal that an entity would apply IFRS 9 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk.

We are not supportive of the proposal for expenses arising from the initial estimate of the impact of customer's credit risk and the ongoing credit impairment for short term trade receivables to be presented as separate line items adjacent to the revenue line item. We believe that showing certain credit related adjustment as a contra revenue and others as an expense increases complexity in financial statements.

We also note that, under the ED, the transaction price is the amount of consideration to which an entity expects to be entitled, but that this does not include the effects of the customer's credit risk. We note in BC 171 that 'the boards expect that an entity would typically not recognise a loss on initial recognition because the receivable normally would initially be measured at the original invoice amount if the contract with a customer does not include a financing component that is significant'. Accordingly, if at inception there is a difference between the amount recognised as a receivable and the consideration to which an entity expects to be entitled of a contract, we consider that, in substance, the entity is providing some form of discount which should therefore be netted off against the revenue. We do not believe it is appropriate for the entity to recognise the full transaction price as revenue and the cost of the customers credit risk as a contra-revenue as proposed by the ED.

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 and 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 support the proposal under paragraph 81, where consideration is variable, to restrict the cumulative amount of revenue the entity recognises to the amount to which the entity is reasonably assured to be entitled. However, we are unclear as to the interaction of this proposal with the proposals in paragraph 48.

Under paragraph 48, where the outcome of a contract cannot be reasonably measured, the entity shall recognise revenue only to the extent of the costs incurred.

We believe there will be situations where both paragraphs 48 and 81 could equally apply i.e. an entity may not be able to reasonably measure the outcome of a performance obligation for which the entity receives a variable consideration. We are not clear as to which paragraph an entity would apply first, or in which order the paragraphs should be applied.

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 onerous performance obligation approach. Whilst we support the approach to identifying separate performance obligations as a means of determining the pattern of revenue recognition, in our opinion, an entity that is performing a number of services under one contract does not have a contractual obligation to deliver any one of these services unilaterally. We do not consider that the entity has an onerous obligation in relation to any individual service – given that an obligation under IFRS is generally legally enforceable.

We consider that onerous contracts should continue to be accounted for under IAS 37, in other words the assessment should be made for the contract as a whole and should apply to all contracts.

We also note that the onerous performance obligations proposals do not make it clear whether the proposal is that:

- an 'onerous obligation test' is only required to be performed at the inception of each contract where obligations are expected to be satisfied over a period of time greater than one year, or
- whether it is requirement, at each reporting date, to perform an 'onerous obligation test' for all existing obligations expected to be satisfied over a period of time greater than one year.

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 (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 propose 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 propose 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 do not support the current proposal, whereby, for every asset and liability recognised, a tabular reconciliation of the movements is required as a matter of course. We encourage the Board to perform a full cost and benefit analysis for each reconciliation to consider whether or not such disclosures are really of benefit to users.

We believe the application of the proposed disclosure requirements to interim reports to be particularly onerous. We would support the following disclosures in interim reports:

- disaggregation of revenue;
- where there has been a change in accounting policy during the period, a clear explanation of the recognition and measurement basis for each class of revenue where there has been a change;
- where there has been a change in accounting policy during the period, a clear explanation of the recognition and measurement basis for costs to acquire and costs to fulfil contracts with customers, where these are recognised as assets; and
- information on any onerous performance obligations recognised.

We would support the following disclosures for full year reports:

- disaggregation of revenue;
- clear explanation of the recognition and measurement basis for each class of revenue disclosed in the accounting policy note;
- clear explanation of the recognition and measurement basis for costs to acquire and costs to fulfil contracts with customers in the accounting policy note, where these are recognised as assets; and
- information on any onerous performance obligations recognised.

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 proposed 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 do not have any comments to make on this proposal.