

INTERNATIONAL ACCOUNTING STANDARDS BOARD

ED: REVENUE RECOGNITION

RESPONSE OF THE CONFEDERATION OF BRITISH INDUSTRY

November 2010

I INTRODUCTION AND SUMMARY

- 1. The Confederation of British Industry (CBI) is pleased to respond to the Boards' Exposure Draft.
- 2. In broad terms our position is that, whilst it may be appropriate to have an updated IFRS on revenue recognition which can be supported by the US FASB as part of the convergence agenda, we consider that the current proposals do require some significant revision and improvement to be acceptable. It is also the case that the current regime on revenue recognition under existing IFRS seems to function reasonably well in practice.

Revenue is inadequately defined

- 3. We believe that an appropriate definition of revenue is important for the effective interpretation of the standard. The current definition contained in appendix A of the ED is inadequate. We believe that the term 'ordinary activities' does in fact encompass all activities and is therefore not meaningful. We also do not believe that the definition of 'income' allows users of the standard to determine what revenue actually is.
- 4. Moreover, the IASB's stated aim is to leave current revenue recognition practices largely intact. The IASB should therefore consider if it has in fact achieved this. For example, the recognition of long term contract revenue before the customer obtains control of the goods or services. Under the ED, it seems that this may not be until the end of the contract, rather than by reference to the stage of completion of the contract under current practices.
- 5. We are also concerned about the level of estimation involved in the proposed approach for the recognition of revenue, where the amount of revenue is not fixed. It introduces a high level of subjectivity and complexity and calls for complex calculations and probability weighted expected outcomes, whereas the current approach based on best estimates is more practical and appropriate for most companies.



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Control concept

- 6. We have concerns in relation to the 'control' concept. In the ED, 'control' is the main driver for revenue recognition, so it is very important that the concept is properly developed so as to lead to appropriate accounting and that it is explained in a way that is clear and meaningful to preparers of financial statements.
- 7. The ED attempts to deal with control by setting out a principle and listing four indicators. However, the intended meaning of the principle is unclear and ambiguous, and it is expressed in terms that preparers of financial statements will often find very hard to translate into real situations. Further, the indicators are neither well developed nor well explained, and there is little or no guidance on the accounting that should be adopted when some, but not all, of the indicators are present. For such an important topic, this approach is inadequate.
- 8. In any new Standard, we would favour the use of terms that have more natural meaning for users of accounting standards than 'control'. 'Control' is a concept that works well in the context of determining when consolidation should occur. Applying it to revenue recognition is more problematic.

Credit Risk

9. We do not agree that a customer's credit risk should affect the amount of revenue recognised by an entity, since this is not priced in to many contracts. The impacts of credit risk are currently addressed by impairment testing, and we consider that to be the right approach.

Disclosures

- 10. We question whether many of the new disclosures provide the user with useful information, for example, the movement on the onerous performance obligation account, and the very detailed disclosures of movements on contract assets and liabilities.
- 11. Moreover the forward-looking disclosures in Paragraph 78 may be more appropriate for management commentary than in the financial statements.

OTHER COMMENTS

Allocation of discounts

12. Whilst we agree that the stand-alone selling price of individual performance obligations is an appropriate starting point for allocating the transaction price to performance obligations, the Standard should not mandate that discounts should similarly be allocated on the basis of stand-alone selling prices. Rather, judgement should be applied so that the allocation is made on the basis of the commercial substance of the arrangement as a whole.

Contract modifications

- 13. We do not agree that the effect of contract modifications that are price interdependent with the original should be recognised retrospectively in every case. Contract modifications occur for a wide variety of reasons, some of them purely forward looking. Where this is the case it would be anomalous for part of the effect of the modification to be allocated to previous periods, and it could lead to distorted and meaningless results where the modification accompanies a material change in the cost structure.
- 14. It would be preferable for the Standard to require the application of appropriate judgment to ensure that the accounting reflects the underlying economic circumstances of the modification.

Assessment of onerous features

15. We disagree with the proposals on onerous performance obligations. This should rather relate, as now, to onerous contracts and not onerous performance obligations.

Guidance relating to warranties

- 16. As currently drafted, the guidance relating to warranties in paragraphs B13-B19 is unclear. In particular, we note that there is widespread concern that distinguishing between latent and post-sale defects will prove extremely problematic in practice.
- 17. These provisions should be redrafted to ensure that the warranty concept is explained in terms that can be readily understood and applied.

Intellectual property rights

18. We do not agree that additional performance obligations arise merely because a licence is exclusive. Control of a 'right to use' has either been transferred or not, and this has nothing to do with whether the arrangement is exclusive.

Re-exposure should be considered if significant changes are made to the Exposure Draft

19. We are conscious that the Board is facing timetable pressures for this project, but we would prefer the Board take the time necessary to ensure that constituents have adequate opportunity to comment on revised proposals.