easyJet plc
Hangar 89, London Luton Airport
LU2 9PF, United Kingdom
Tel: +44 (0)870 6 000 000
Fax: +44 (0)1582 443355

International Accounting Standards Board
30 Cannon Street
London
EC4M 6XH

20 October 2010

Dear Sirs,

Comment letter on proposed Revenue Recognition standard – ED/2010/6 "Revenue from Contracts with Customers"

Thank you for the opportunity to comment on the proposed standard as referred to above. We have some specific areas to comment on and also attach a summary of responses to the questions posed within the Exposure draft.

Contract Combination and Segmentation

We found the principles governing when contracts should be combined to be helpful (although see our later comment on the use of the term "price interdependence").

However the principles governing when contracts should be segmented appear less clear since they are largely duplicated by the principles relating to separable performance obligations.

Paragraph 15 requires segmentation where the goods and services are priced independently, this being where:

- Identical or similar goods and services are regularly sold separately by the reporting entity or another entity, and
- There is no discount granted for buying goods and services together as a "bundle"

The first condition is repeated verbatim at paragraph 23 to define a "distinct" good or service. While there is no direct repetition of the second condition, this could easily be incorporated into paragraphs 50-52. Likewise the provisions of paragraph 16 could easily be incorporated into paragraphs 50-53.

This would appear, on the face of it, to be a duplication, and some users of the standard may segment contracts, whilst others would have more performance obligations within one contract.

We found this separation of similar concepts to be confusing and suggest that this is simplified along the lines we suggest.

"Price interdependence"

The standard frequently refers to price as a method to assess whether a contract can be segmented or combined. However, the examples detailed within paragraph 13 do not necessarily relate to price. Part (a) and (c) refer to the dates that contracts are entered into and when they are performed, which are not actual indicators of price interdependence.

The terminology used here should potentially be amended so that it refers to substance of two contracts and that if the goods or services of one contract are linked in terms of delivery and customer usage.

Using "price interdependence" to describe situations where price is not a factor is potentially confusing, especially for those users whose first language is not English.

Onerous performance obligations

The section within the standard is considered to be too brief to consider some complex considerations in relation to accounting for onerous performance obligations. In our business model these are:

- The passengers on any given flight will have booked at various times and therefore multiple performance obligations will be settled by a single flight
- The direct costs for a flight are to a substantial extent are incurred regardless of the passenger load on the flight
- Fares rise as the flight fills and the departure date approaches. It is well known that the first passengers to book on a flight get the best deal
- Particularly in winter a proportion of flights have low load factors and do not generate sufficient revenue to cover the direct costs of the flight

Applying the principles in the exposure draft seems to require the following steps:

- The individual contracts for the passengers on a given flight should be combined under the principle stated in paragraph 13
- In the absence of a definition of "costs that relate directly" we have used that contained in paragraph 58 (we suggest that this should be added as a defined term in Appendix A), and
- The resulting liability for onerous performance obligations should be recognised

The overall impact of this would be to book an estimated onerous contract liability for the coming winter season at year end and therefore shift loss from the first half of the year to the second half of the year. We consider that this would result in less useful information being provided to the user than at present, and wonder whether this is truly the Board's intent.

This position will not be uncommon among airlines, and may well be experienced in other types of transport business. The underlying philosophy appears to be that businesses would not knowingly provide a loss-making service, whereas in practice this does happen for various operational reasons.

Taxes

Paragraph 18 of IAS18 Revenue states that taxes collected from customers on behalf of central or local governments (such as VAT or Air Passenger Duty) should be excluded from revenue; in effect that revenue is stated net of the tax component.

The Exposure Draft is silent on this point, as is the Basis for Conclusions. In the absence of any specific provision, some preparers and auditors might conclude that, given the general prohibition on offsetting in IAS 1, revenue should be stated gross and the taxes collected on behalf of governments shown as an operating cost.

In our view this would be incorrect presentation (and the current practice of stating revenue net of taxes remains appropriate) given that our obligation is to collect and pass on taxes. The taxes themselves are not direct obligations of the entity in the same way that, for example, property occupation taxes are.

We recommend that principles covering the treatment of such taxes be included in the final standard.

Yours sincerely

A.J. Tempest.

Andrew Tempest
Group Reporting Manager

APPENDIX 1

Revenue recognition

Analysis of Exposure Draft: Revenue from contracts with customers (ED/2010/6)

Specific questions raised in Exposure Draft

Question 1 –
Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether;

a) To combine two or more contracts and account for them as a single contract;
b) To segment a single contract and account for it as two or more contracts; and
c) To account for a contract modification as a separate contract or as part of the original contract,

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment a contract and (b) to account for a contract modification as a separate contract.

As specifically mentioned within the body of our letter, a dependence on activities and deliveries within the contract, which includes price interdependence, may better reflect the principle of combining contracts or segmenting contracts.

Question 2 –
The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle?

Whilst the definition enables the user to determine whether a good or service is distinct, careful and detailed textual analysis is required to reach this conclusion.

However, there would appear to be a disjoint within the standard over whether a customer controls the service, and whether it is distinct. easyJet charges certain fees which might be generically described as booking fees. The question arises as to whether these fees should be recognised as revenue at the time of booking, which is dependent on whether the service delivered at that point is “distinct”.

These charges do have their own margin, but would not be able to be sold separately by easyJet or another provider, as they do not have utility on their own or with any other goods or services the customer already has acquired (the emphasis being on the past tense), and therefore they have to be combined with the main service of the flight and recognised in line with the flight revenue.

However, it could be argued that the customer obtains control of that seat at the point that the booking is made. The product of a flight is generic, but is to the customer’s specification of when and where they wish to fly. At this point *“the customer has the ability to direct the use of, and receive the benefit from the good or service. Control includes the ability to prevent other entities from directing the use of, and receiving the benefit from, a good or service.”* In the case of the flight, the customer has a contract to receive a flight from easyJet. However, in this case, because the booking fees are not said to be distinct, they cannot be recognised as income which does not follow the view of control passing.

The overall effect is to postpone the recognition of the booking fee until the customer takes the flight. We suspect that this is your intent, however, the language used is quite opaque.

APPENDIX 1

Question 3 –
Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, what additional guidance would you propose?

The guidance within the related paragraphs is reasonable.

Question 4 –
The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria?

No comment. Not applicable to our business.

Question 5 –
Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that a customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why not?

The key element of this will be to bring forward the estimation of customer non-payment, from the calculation at the trade receivable recovery stage, and to apply this as a reduction in revenue rather than a cost within the income statement.

The process where judgements are made over the value to include as the transaction price would result in the revenue figure reported in the statutory accounts potentially not reflecting any actual values and would be reliant upon management estimations. The revenue line within the accounts, which is of great importance to the users of accounts would not be based on any definitive values and would reflect the management's best judgement, which could lead to manipulation of the account, and not necessarily result in comparable accounts across entities or industries.

An increase in the level of management judgement to be applied could lead to manipulation and smoothing of results across accounting periods. Management may "provide" for credit risk against a number of contracts in one year, which, when are fully recovered in the next will increase income in a year when it is needed. This would also enable easier manipulation of profits from a corporation tax perspective as these would be likely to be specific, and therefore allowable as a profit deduction.

The exposure draft states that bad debt provisions against trade receivables can still occur, and this will result in two "bad debt" lines in two areas of the accounts. This again opens up the potential for manipulation of results if it is in the interest to management to reflect a better revenue line or cost line, and increases the number of areas which are based on management estimation.

Question 6 –
Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why not?

The time value of money will be insignificant for easyJet, however, we consider the concept reasonable.

APPENDIX 1

Question 7 –
Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price or the good or service underlying each of those performance obligations. Do you agree? If not, how should the transaction price be allocated?

Yes.

Question 8 –
Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (e.g. IAS 2, IAS 16 or IAS 38), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements for the costs of fulfilling a contract are operational and sufficient? If not, why not?

Yes.

Question 9 –
Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include and why?

Yes, see covering letter for detailed comments.

Question 10 –
The objective of the board's proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why not?

The current standard for revenue does not result in a significant level of disclosure being required and therefore additional disclosure to provide information on one of the most important values within a set of accounts is welcome. The standard is not overly prescriptive in terms of the level of detail required which may result in some variations in the level of analysis and detail, but enables each entity to establish the most reasonable basis for disclosure.

It also notes that where an entity includes information on revenue as part of IFRS 8 disclosures it does not have to repeat the information under this draft, but must show additional information in accordance with the standard to show how the revenue, as treated under this standard, relates to the current disclosure.

There appears to be some variations between the proposed new standard and IFRS 8. The key aim of IFRS 8 is to present information in line with how this is managed in the business, and refers to the approach of "through the eyes of management". The disclosure requirements included within this draft do not take this same explicit view, instead referring to economic conditions as a method to split revenue streams. Whilst this may still result in the same split in many entities, this will not necessarily be the case, and could result in two different notes within the accounts analysing revenue in different ways which may result in confusion for users. A better approach might be to require that revenue is disaggregated initially on the basis as used in IFRS 8 disclosure, and then break this analysis down to add further detail if required.

The key disclosure included within the draft is the inclusion of a reconciliation between the contract assets/liabilities from one year to the next. This would provide a link between the Income Statement, Statement of Financial Position and the Statement of cash flows, and could act as a useful tool to improve the user's awareness of the linkages between the

APPENDIX 1

primary statements, if the information is clearly linked in to the relevant statements. Inclusion of sample disclosures within the standard, in the application guidance section, may be useful.

Question 11 –
The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

Yes, although easyJet has no such performance obligations.

Question 12 –
Do you agree that an entity should disaggregate revenue in to categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why not?

In principle we agree, but please refer to our answer to question 10.

Question 13 –
Do you agree that an entity should apply the proposed requirements retrospectively (i.e. as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented? If not, why not? Is there an alternative?

The application of the standard should be applied retrospectively to ensure that the accounts show a fair representation of revenue across the years presented in the report. However, so as to ensure that entities have the time to amend or develop systems to change the accounting of transactions, this should be achieved by a long-term application process.

Question 14 –
The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?

The application guidance is generally sufficient, but as mentioned above, should also include some sample disclosures.

Question 15 –
The boards propose that an entity should distinguish between the following types of product warranties; (a) coverage for latent defects in the product and (b) coverage for faults arising after the product is transferred.

Do you agree with the proposed distinction, and treatment?

Question is not relevant to easyJet.

In practice we suspect that it will often be difficult to establish whether the faults are latent defects or faults arising after delivery.

Question 16 –
The boards propose the following if a licence is not considered to be a sale of intellectual property; (a) exclusive licence to use its IP, or (B) non-exclusive.

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive?

Question is not relevant to easyJet.

APPENDIX 1

Question 17 –
The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (e.g. intangible assets or PPE), the entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Theoretically, the same principles of the standard should be applied to other similar transactions so as to maintain alignment and consistency of treatment within accounts of entities.

However, we are unclear whether this would result in a gain or loss on sale of an asset reported as gross within the Income Statement, which we do not think will provide any useful purpose for the users of the accounts.