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Re: File Reference 1820-100
International Accounting Standards Board and Financial Accounting Standards Board Exposure Draft on Revenue Recognition (Topic 605)
Revenue from Contracts with Customers

Dear Sir/Madam,

I very much appreciate the opportunity to provide comments on your Joint Exposure Draft on Revenue from Contracts with Customers. This letter represents my own personal views and is being submitted to both the IASB and FASB.

Let me start by commending you all for your efforts at drafting an excellent Exposure Draft on the topic of Revenue Recognition. It's clear to me that you are advocates of a principles based approach to revenue accounting. I can see that you are trying to establish one standard for everyone in relation to accounting for revenue arising from contracts with customers, and for that, you carry my full support and best wishes for success.

I sincerely admire your intentions, and understand that this is an enormous undertaking. Personally, I view this effort as the accounting equivalent of attempting to build "Noah's Ark" and I wish you every success in your efforts. I hope you don't mind my use of "Noah's Ark" as an analogy. I think it's a particularly useful analogy given the similarities in the size and the nature of the challenges associated with such a large scale project, and like Noah, I'm sure you will encounter many people with less foresight than yourselves, who will tell you that this effort is unnecessary.

It is clear from the Exposure Draft that the goal of this joint project is to clarify the principles for recognizing revenue and to develop a common revenue standard for U.S. GAAP and IFRSs that would:

(a) remove inconsistencies and weaknesses in existing revenue recognition standards and practices;
(b) provide a more robust framework for addressing revenue recognition issues;
(c) improve comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets; and
(d) simplify the preparation of financial statements by reducing the number of requirements to which entities must refer.

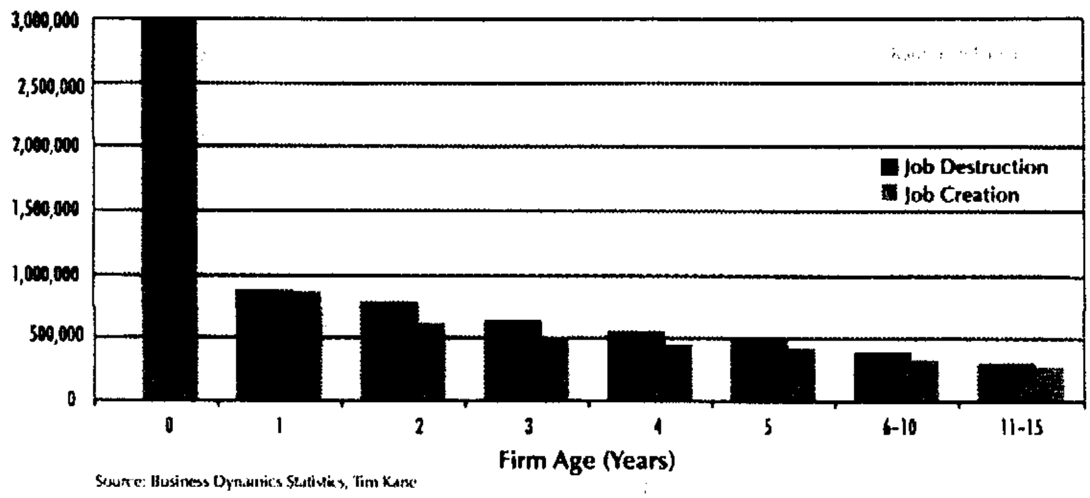
With these goals in mind, I had the following comments that I wanted to share with you:-

I'd like to see the Exposure Draft amended to prominently reflect that a key goal of this joint project is to "First, do no harm".

Please give careful consideration to avoid creating any negative unintended consequences for smaller entities, as a result of this joint project. I think we all have a moral obligation to create an environment that allows smaller entities the opportunity to compete with larger institutions, and it would be most unfortunate for the world economy, if your good intentions were to make it more difficult for smaller entities to flourish.

For example, the following chart is an excerpt from some extensive research conducted by "The Kauffman Foundation", which illustrates the historical importance of 'start up' companies, to job creation. These statistics relate only to the USA, but nevertheless the chart below illustrates that when annual job creation is analyzed by company age, job creation comes predominately from new 'start up' entities.

Figure 4: Job Creation and Loss by Firm Age
(Average per year, by year-group, 1992–2006)



The analysis above was based on data extracted from the U.S. government "Business Dynamics Statistics" department, which provides details about the age and employment of businesses started in the U.S. since 1977. The full report can be found at the following website:

http://www.kauffman.org/uploadedFiles/firm_formation_importance_of_startups.pdf

Accelerating revenue recognition for 'non-exclusive' time based software licenses will dramatically reduce comparability of revenue recognition practices across entities, industries, jurisdictions, and capital markets.

Take, for example, software vendors that currently execute contracts for non-exclusive rights to use their software over a defined period of time. Often, these contracts have payment terms that allow the customer to pay on a monthly or quarterly basis, in return for a software vendor providing access codes to their software products, at regular intervals throughout the subscription period.

Under existing rules, many software firms would currently recognize revenue, for the type of subscription arrangement described above, evenly over the duration of the subscription period, because that is often, a very fair reflection of the substance of such arrangements.

This existing method of "ratable" revenue accounting would appear to be consistent with your objectives, as it is relatively simple and improves comparability of revenue recognition. It also fairly reflects the economics of the transaction since the software vendor has a constant and continuous obligation to deliver software products, and this is consistent with how the purchaser would typically record the expense for that type of contract.

Under the proposed guidance, it would appear that you want software firms to recognize revenue immediately at the beginning of the subscription period, where the right to use the software is 'non-exclusive'.

In the case of a typical software subscription which includes the right to future software products, when and if they become available, the application of the proposed guidance would require considerable judgement to determine how much revenue should be assigned to the first, and subsequent deliveries of software products.

Additionally, if this aspect of the proposed guidance is not amended, I believe that the ability of a user to compare revenue across, even the most similar of, entities will be dramatically impaired because of the impact that the timing and duration of software contracts would have on revenue recognition.

In my humble opinion, if you remove the ability to recognize software revenue on a regular monthly basis for contracts which are subscriptions in substance, it will be impossible for users to compare revenue across software entities.

Also, a further concern would be the unintended consequences that this accelerated revenue recognition might have on a fragile world economy, particularly if these changes in the revenue recognition rules make it more difficult for smaller entities to compete with larger ones.

Earlier recognition of revenue on subscription contracts, where customers typically pay in installments over the duration of the subscription contract, would also result in earlier tax liabilities related to the earlier revenue recognition. While this would be the same for all entities, the cash flow problems could be particularly severe for smaller entities with less negotiating power on the timing of customer payments. As a result, many smaller entities could be faced with paying large tax bills before being able to collect from their customers.

The abolition of the residual method of accounting for software transactions should be reconsidered because it could provide unintended advantages to larger companies over smaller ones.

Software can often have multiple uses which benefit users in different ways. In fact, software users often determine the fee that they are prepared to pay for a software product, based on the value they perceive that they will extract from their intended use of that particular software product.

As many of the smaller software firms don't have the resources to tailor their software product into multiple subset offerings, those software firms can often be found selling the same software product for very different prices. This is because the prices are often based upon the value that each customer perceives it will derive from their particular use of each product. In instances where these types of software product are sold alongside other multiple elements, the application of the residual method is a very effective way of ensuring that the fee allocated to the software portion of the contract is a fair reflection of the substance and the economics of the transaction.

By removing the residual method as an option, I fear that smaller entities could be faced with the choice of either (i) accepting that their revenue recognition will not reflect the substance or economics of the transaction, or (ii) they will be forced to suffer unnecessary expenditure to alter their software product offerings to achieve a more reasonable accounting outcome.

Once again, this would appear to be an example where the Exposure Draft favours larger entities over smaller ones, and the consequences to the greater economy could be dire indeed, if we make it more difficult for smaller companies to succeed.

The downgrading of 'Collectibility' is a tax on optimism

Currently, for software revenue recognition, collectibility must be reasonably assured before revenue can be recognized. However, I understand that you intend to downgrade the subjective consideration of whether or not a fee is considered collectible, to allow those with greater optimism in their ability to collect some portion of their fee, the ability to recognize revenue in advance of collection of debts from less creditworthy customers.

Given the recent turmoil in financial markets, much of which appears to have been exacerbated by poor credit decisions, this appears to be a change that is fraught with danger for the broader economy. Also, the introduction of such a significant amount of subjective judgement would appear to be contrary to your stated goals and principles to improve comparability of revenue recognition practices and simplify the preparation of financial statements.

I fear that this change is likely to lead to a significant increase in bad debt expense write offs, particularly for those with a tendency to be overly optimistic. Another unfortunate punishment for the optimistic will be the acceleration of tax liabilities that result from earlier revenue recognition on contracts with less creditworthy customers.

I'd like to finish by re-iterating my support for your efforts and highlight that I do not underestimate the size of the undertaking. I am very sincere when I write that I believe you are tackling the accounting equivalent of building "Noah's Ark", and just as Noah must surely have had a duty of care to protect the hens from the foxes when he brought everyone on board his Ark, I think we also need to ensure we apply a similar duty of care to protect smaller entities from larger predators during this particular transition.

To that end, I implore you to reconsider the topics that I've highlighted above.

I hope these comments are useful to you. I would be pleased to respond to any questions or comments you may have regarding this matter.

Yours sincerely,

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