



10 April 2012

International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

Dear Sirs

### **Exposure Draft ED/2011/6 'Revenue from Contracts with Customers'**

With a membership of in excess of 32,000, the London Society of Chartered Accountants (LSCA) is the largest of the regional bodies which form the Institute of Chartered Accountants in England & Wales (ICAEW). London members, like those of the Institute as a whole, work in practice or in business. The London Society operates a wide range of specialist committees including Technical (accounting and auditing), Tax, Regulation and Ethics Review and Financial Services and Insolvency, which scrutinise and make representations to bodies such as yourselves.

### **GENERAL COMMENTS**

The LSCA welcomes the opportunity to comment on the revised proposals set out in the International Accounting Standards Board's (the Board) Exposure Draft ED/2011/6 'Revenue from Contracts with Customers' (the ED). We note that IN5 of the ED indicates that the revisions to the original proposals did not necessitate re-exposure for public comment but given the particular importance of revenue as a measure of performance to all stakeholders in a business, we consider that the Board has made absolutely the right decision in choosing to seek further feedback on the subject.

We continue to support the objective of the IASB and FASB to develop a single revenue model that can be applied across virtually all industries and we note that, in these revised proposals, the Board has taken further significant steps in achieving this objective. We do, however, have some continuing concerns about the overall approach taken in some areas and about the detailed drafting of the ED that we think need further consideration before any final standard is issued. We share many of these concerns with the ICAEW and, in consequence, we would refer the Board to their comment letter (Ref: ICAEW Rep 48/12). We set out below the concerns that we consider to be of the highest significance:

- **Presentation**

As explained more fully below, we are concerned that there may be an inconsistency between the presentation proposals set out in the ED and the requirements in IAS 32 which may lead to inappropriate differences in the required accounting for contracts that differ only in respect of their payment terms.

- **Definition of revenue**

We echo the ICAEW's view that the Board should consider refining and restricting the definition of revenue set out in Appendix A of the ED. We consider there currently to be insufficient guidance on what transactions should give rise to 'top line' revenue and which transactions should be reflected further down the income statement. In our view only income generated from an entity's principal activities should give rise to 'top line' revenue.

- **Onerous performance obligations**

We are very strongly of the view that 'onerousness' should be assessed at a contract level, not at a performance obligation level and, also, that it is not a matter that should be addressed by a revenue standard.

- **Suggested drafting improvements**

We also draw your attention to the appendix to this letter and to the appendix to the ICAEW's comment letter, in which a number of additional drafting points on the text of the standard are listed. We wish to emphasise the importance that we place on these drafting points because, although many of them are individually minor, we feel that addressing them will significantly improve the clarity of the final proposals.

## **DETAILED COMMENTS**

### *Presentation*

We are concerned that the relationship between contract assets and receivables as currently set out in paragraphs 104 to 108 of the ED may be inconsistent with the requirements of IAS 32 and may lead to inappropriate differences in the required accounting for contracts that differ only in respect of their payment terms.

Example 17 in the ED illustrates the proposed treatment for a contract to deliver a good to a customer where payment is due in advance of delivery. In that example, a receivable is recognised on 31 January. We have the following observations on this proposed treatment:

1. The recognition of a receivable on 31 January appears to be inconsistent with the requirements of IAS 32.AG21 which states that "A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit."
2. It is not clear why an asset (either a contract asset or a financial asset) is appropriate on 31 January but not on 1 January as the right to cash is conditional on nothing other than the passage of time at both dates and, at both dates, the right to *retain* the cash is conditional on the entity's future performance.
3. Under these requirements, different accounting treatments would arise for contracts identical in every respect other than the contractual payment date. We do not consider this to be appropriate.

In our view, a performance obligation should only be recognised when a financial asset is recognised.

In addition, although IAS 32.AG21 refers only to goods, it would seem inconsistent not also to apply it to services. A right to receive payment should not be recognised as a receivable until the entity has performed under the terms of the contract (i.e. when its right to demand or retain payment is conditional on nothing other than the passage of time).

### *Specific questions*

We set out below our comments on the specific questions raised in the ED:

**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 consider the requirements set out in paragraphs 35 and 36 of the ED to be a significant improvement on those set out in the previous ED, although we share the views set out in the ICAEW's comment letter that further refinements could be achieved. In particular paragraph 35 currently reads as if it were a list of rules whereas we feel it would be improved if the drafting focused more on the principles. For instance, paragraphs 35(a) and 35(b)(i) appear to share a common principle, i.e. that revenue should be recognised when there is continuous transfer of benefit to the customer. Paragraph 35(b)(iii) is a separate point that appears to be based on the principles in paragraphs 32 and 37(a) that control is transferred if the seller does not have an alternative use for any work in progress and has the right to demand payment (or retain payments made in advance) for the proportion of the performance obligation that has been completed to date. The need for paragraph 35(b)(ii) is unclear. It appears to us that paragraph 35(b)(ii) is an example of the principle in paragraph 35(b)(i).

In addition we note that, whilst the ED includes an example of how an entity's ability to readily direct the promised asset to another customer might be restricted contractually, there is no guidance in respect of what level of 'inconvenience' might be sufficient to create a practical limitation. We would support some added guidance in this respect.

**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 presentation of credit losses separately from revenue. We do not, however, see the need for credit losses to be presented on the face of the income statement (unless they meet the criteria set out in IAS 1.85-86). We are also unconvinced about the argument to mandate the presentation of such losses in gross profit when presentation further down the income statement has historically been the common and accepted practice.

**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?**

We agree that the amount of revenue recognised should not exceed the amount to which the entity is reasonably assured to be entitled but we share the concerns set out in the ICAEW's comment letter at paragraph 27.

**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?**

No, we do not agree with the proposed scope of the onerous test. As noted above, we are very strongly of the view that 'onerousness' should be assessed at a contract level, not at a performance obligation level and that this is not a matter that should be addressed by a revenue standard. We are very concerned about the inconsistencies in accounting treatment for economically similar contracts that these proposals would introduce. We consider the existing provisions of IAS 37 to be adequate. It appears to us that the proposals in paragraph 86 have been included with the aim to achieve further convergence between IFRSs and US GAAP. Whilst we support the objective of the convergence project, we are unconvinced that this particular issue should be dealt with in this manner and propose that the Boards should set it aside in finalising the revenue standard. We acknowledge that this might lead to a temporary GAAP difference but in our view the Boards should deal with this as a separate project.

**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 (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 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 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 are opposed to the introduction of any mandatory disclosures into IAS 34. Our preference is to maintain the more general approach of allowing judgement in terms of the disclosure of significant events and transactions in an interim report. This point notwithstanding, we are also concerned that paragraph 110 has not been included in IAS 34. We feel that this risks the inference that the proposed disclosures are to be more rigidly adhered to than they might be in an annual report.

In our view, the Board should address the issue of a disclosure framework first then review and update IAS 34 as a whole rather than add to it on a piecemeal basis.

**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. 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 the principles proposed for the new revenue standard should be extended to encompass derecognition of non-financial assets that are not an output of the entity's ordinary activities. However, we believe that the issue of measurement merits further consideration, in particular in situations where part or all of the consideration is contingent on future events, for example obtaining planning consent for change of use of land. There are essentially two main approaches to measurement of the consideration received: (i) the approach set out in the ED, under which the contingent element would not be recognised until the contingency has been resolved and (ii) a fair value approach which would take into account probabilities in the measurement of consideration and hence the gain or loss recognised. We note that IAS 27.34(c)(i) requires consideration received on the loss of control of a subsidiary to be measured at fair value. We also note that a fair value basis would in some cases be more consistent with how the asset derecognised had been carried in the accounts, for example measurement of investment property under the fair value model in IAS 40 would have taken into account the potential for a change of use.

We trust you find our comments helpful in the consultation process and please do not hesitate to contact our Chairman, Brian Creighton on +44 (0) 207 7893 3415 if you wish to discuss any of our comments further.

Yours faithfully

A handwritten signature in black ink that reads "Brian Creighton". The signature is written in a cursive, slightly slanted style.

**Brian Creighton**  
LSCA Technical Committee Chairman

## APPENDIX - SUGGESTED DRAFTING IMPROVEMENTS

In the table below we highlight some drafting points on the text of the standard which we urge the Board to consider. They are in addition to the suggested drafting improvements set out in the appendix to the ICAEW's comment letter that we refer to above.

Paragraph	Observation
28(b)	We share the ICAEW's concern over the intended effect of paragraph 28(b). For example, an entity supplies a satellite TV broadcast service and also a device which is needed for the customer to receive the service (and has no alternative use with, for example, another satellite broadcaster). The device is not sold separately – the customer buys it with the first year of service – but thereafter, the customer can renew by buying additional years of service. Is the device distinct? One interpretation of paragraph 28(b) could result in the delivery of the device being considered a distinct performance obligation because the customer can benefit from the device in conjunction with a readily available resource that is sold separately by the entity (i.e. the satellite broadcast). We do not think the transfer of the device should give rise to a distinct performance obligation unless it does have an alternative use
29	Terms such as “highly interrelated”, “significant service of integration” and “significantly modified” are all highly judgemental concepts on which further guidance should be provided. We believe that application of this paragraph may be very subjective leading to a risk of significant divergence in practice.
49	This paragraph includes a sentence referring to a limit on the cumulative amount of revenue that may be recognised. This concept is revisited in much more detail in paragraphs 81-85. Paragraph 49 should include a cross-reference to these more detailed requirements.
85	This paragraph could be better explained or redrafted to draw out the underlying principle more clearly. We do not support the inclusion of requirements that are, or appear to be, making special cases for specific types of asset. The term “intellectual property” used in this paragraph can potentially be interpreted to include a wide range of assets.
110	Whilst we understand and agree with the aim of this paragraph, we think that its practical application and enforcement could be difficult. In addition, we do not consider the revenue standard to be the most appropriate place for this guidance. In our view, it would more appropriately be included within the existing guidance on materiality in IAS 1/IAS 8.
B13(c)	It is unclear what tasks are intended to be caught by this paragraph and why.
IE4	Example 3 illustrates the effect of a contract modification in a single performance obligation satisfied over time. As the construction of a house is unlikely to straddle more than one balance sheet date, and the modification occurs at the beginning of the second period, it does not illustrate clearly the potential effect of the proposed accounting treatment. It would be better to choose an example that would clearly straddle more than two reporting periods. In addition, the rounding of the 45.7% has a significant effect on the adjustment, which can be confusing if you are working through the example in detail.
IE13	This paragraph includes an illustrative example on management fees (EG13). It is not clear why there are two “discrete increments of service” that would need to be grouped together into a single performance obligation under paragraphs 28-30. We can see only one performance obligation: The provision of investment management services.
IE17	There is insufficient information in EG19 to verify the/understand the illustrative disclosures.