Dear Sirs,

Exposure Draft: revenue from contracts with customers

The Charity Commission for England and Wales is established by law as the regulator and registrar of charities in England and Wales. Our aim is to provide the best possible regulation of these charities in order to increase charities’ efficiency and effectiveness and public confidence and trust in them. We welcome the opportunity to respond to the consultation on your exposure draft: Revenue from Contracts with Customers. Our detailed response to the consultation questions is attached as an annex to this letter.

We recognise that the Exposure Draft is framed with reference to a contract defined as an agreement between two or more parties that creates enforceable rights and obligations. However, we anticipate that when Phase G, the Application of the Framework to Not-for Profit Entities, is begun, the preparation of a future not-for-profit framework will require appropriate accounting solutions or adaptations of commercial standards to be developed.

In defining the scope of the standard in paragraph 9, it would therefore be helpful if non-exchange transactions, which are common in the not-for-profit sector, were noted as being specifically excluded. Non-exchange transactions include grants, the free provision of goods and services, and the receipt of donations, gifts and donated goods.

In its plans for developing UK Irish Generally Accepted Accounting Practice, the Accounting Standards Board is planning to adapt the IFRS for SMEs for use by UK entities including charities. How the new IFRS will be reflected in the IFRS for SMEs is therefore important as this is likely to shape the future of UK accounting for charities.

The draft standard shows commendable pragmatism with the concession in paragraph 60 that an adjustment for the time value of money is not required if the period between the transfer of goods and services and settlement is one year or less. When considering implementing this standard in the IFRS for SMEs a further useful simplification might be to relax this requirement further to provide for no discounting if settlement is due one year or less from the date of the Statement of
Financial Position. This further simplification would ensure that current assets such as trade receivables (debtors) are not discounted and so avoid practitioners having to undertake complex calculations. It would also simplify the presentation for the reader of the financial statements. Charities would find this modified approach easier to implement.

Similarly we also welcome the option in paragraph 55 to estimate the transaction price as either the expected value, reflecting a calculation of probability, or the most likely amount. The most likely amount will be an easier estimate for charities to make. When implementing the standard in the IFRS for SMEs the IASB might usefully provide for even more flexibility in using the most likely amount. Again this simpler calculation avoids the practitioner having to undertake complex calculations and simplifies the presentation for the reader of the financial statements.

If I can be of further help concerning the nature of revenue and non-exchange transactions as they apply in the UK charity sector please do contact me.

Yours faithfully,

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Annex to Charity Commission response: Revenue from Contracts with Customers

**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?

Charities in the UK can and do lawfully trade and enter into contracts. The delivery of services such as health, leisure, education, training, welfare, advocacy and housing services are examples of charities furthering their charitable objects by trading. Charities are also active in delivering public services on a contractual basis. The formulation of performance obligations satisfied over time includes: ‘the customer simultaneously receives and consumes the benefits of the entity’s performance as the entity performs’. This formulation fits well with the most common areas of service activity undertaken by UK charities.

**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 uncollectable because of a customer’s credit risk. The corresponding amounts in profit and loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with these proposals? If not, what alternative do you recommend to account for the effects of a customer’s credit risk and why?

In the UK the Financial Reporting Council issued a consultation document on ‘cutting clutter’. With this in mind, one key objective must be the minimum line content within the Statement of Comprehensive Income which sufficiently conveys a true and fair view of the financial results of the entity. Whilst it is logical to treat uncollectable income as deduction from revenue rather than as a cost of sales, this information could be better presented and analysed in the notes to the financial statement. This would leave a net figure for revenue shown in the Profit and loss Account. This presentation is simpler than that proposed.

Along with sector partners we carried out research in 2008-09 into the charities Statement of Recommended Practice which sets out the methods and principles for preparing a charity’s financial statements on an accruals basis. One of the key findings was that the performance statement (analogous to the Statement of Comprehensive income) was too cluttered and provided excessive detail. The research found that currently: ‘there was concern that too much information was presented on the face of the SOFA and it was suggested that much of it could be relegated to the notes (but not discarded)’. Stakeholders favour the minimum of key information shown in the performance statement. This research, publication RS21 Charity Accounting and reporting: Taking Stock and future Reform, is accessed via our website: [http://www.charity-commission.gov.uk/publications/rs21.aspx](http://www.charity-commission.gov.uk/publications/rs21.aspx)
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**Question 3:** Paragraph 81 states that if the amount of consideration to which an entity 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 predicative 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?

Paragraph 81 as it is phrased is complex and wordy. The introduction of the term ‘reasonably assured to be entitled’ is a less clear formulation than probable. Probable is a better expression and is used in IAS 18 and involves the judgment that it is more likely than not that the income will be received. The indicators proposed in paragraph 82 could still be retained as indicating when the test of probable is met.

A simpler formulation that fits with the existing IAS 18 would be: ‘If the amount of consideration to which an entity expects to be entitled is variable, the entity shall recognise the amount of consideration that it will probably be entitled to receive having satisfied its performance obligations’. The indicators of the probable amount of revenue would then be as stated in paragraph 82.

**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?

Charities in the UK can and do engage in trading to further their charitable purposes and also may trade on a commercial for-profit basis to raise funds. The commercial for-profit trading falls clearly within the normal practice of for-profit standards. However when furthering a charity’s charitable objectives, a charity may choose to go beyond the contractually specified service specification to provide additional value or benefits funded from its own charitable funds.

Provided the additional value or benefits assist the charity’s beneficiaries and are in the charity’s interest this is lawful even though from a for-profit perspective the contract may then no longer be profitable. In our view this does not make the contract onerous as the charity is supplementing the contract specification voluntarily. Were paragraph 9 amended to specifically exclude non-exchange transactions (please refer to our covering letter for the
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background and reasoning behind this recommendation) then this kind of voluntary enhancement would be disregarded when applying the test for an onerous contract and we believe this would give a more true and fair view. The charity trustees would separately identify to what extent the voluntary enhancement should be recognised as a liability arising from a constructive obligation.

It is implicit within the standard that the performance obligation is derived from the terms of the contract. However it would be helpful to make this assumption explicit in relation to testing for an onerous contract.

Question 5: The boards propose to amend IAS34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports. Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports?

No comment

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 and 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?

No comment