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Dear Sirs

Comments on exposure draft – Revenue from contracts with customers

The following is the response of the Co-operative Performance Committee (CPC) of Co-operatives UK in relation to the Exposure Draft.

CPC is a standing committee of Co-operatives UK, which brings together professionals from within the co-operative movement to take responsibility for the movement's performance indicators and for promoting best practice on accounting standards. The number of co-operative organisations in membership exceeds 540 and have a combined turnover in excess of £19 billion. They employ over 98,000 staff trading through 4,500 retail outlets.

Refund liability

The CPC would like to highlight its objections to paragraphs 37 and 48 of the exposure draft. From reading these, it seems that the IASB has not taken account of the differences between the Cooperative business model and the standard investor model of PLCs when formulating these paragraphs. In particular, the CPC is concerned about the implications of these paragraphs for the treatment of co-operative distributions and the dividends paid to members.

In the standard investor model (e.g. limited liability companies) the entity divides the dividend it pays between shareholders in proportion to the number of shares they hold. In the co-operative model, Co-operatives pay a dividend to their members in proportion to the amount of trade they transact individually with the society over the year. By applying these paragraphs in the exposure draft, it could be argued that a co-operative dividend could be regarded as a refund of some of the consideration to the customer and therefore a refund liability should be recognised, purely because the share of dividend paid to each member is related to the level of purchases.

The CPC contests these paragraphs for the following reasons:

A member of a co-operative must pay a capital contribution to the co-operative to become a
member. This amount is credited to share capital and is regarded as equity capital as
interpreted by IFRIC 2. When a co-operative pays a dividend to a member, it is essentially
paying a dividend to an equity holder and must therefore not recognise a liability as stated in
IAS 10.12 until that dividend is approved. Therefore, from a Co-operative perspective, these
paragraphs directly contradict the requirements of IAS 10.

- PLCs can continue to pay dividends to their shareholders and will not deduct the dividend from revenue. However, using the interpretation above, Co-operatives would have to deduct the dividend from revenue. This would lead to an unfair disadvantage when comparing Cooperatives' revenue against PLCs and lead to incomparability across accounts.
- A Co-operative dividend is discretionary and based on the profitability of the entity. It must be
 proposed by the board but can be rejected by the members who need to approve it at a
 general meeting, just like any other entity. The CPC argues that a Co-operative dividend
 should not be treated in the same way as a refund liability as there is no enforceable right at
 the time of purchase to pay a dividend.
- Paragraph 49 is unclear on when the entity should account for a refund liability. It states that it should be when "the entity promises to pay the consideration (even if the payment is based on a future event)". The CPC would like to know what specific future events were considered when drafting this paragraph and believes that reference to "promises" and "future events" need to be carefully defined. CPC strongly believes that "future events" should include only events directly related to the commercial relationship between the entity and the customer and that events relating to the ownership relationship with co-operative members should be specifically excluded.
- Although the payment of a co-operative dividend is a payment to customers, these payments
 are in their roles as a member/equity holder and not as a customer. Furthermore, it is
 membership at the time of payment that is the relevant qualification, not when a purchase
 occurs.
- When a member purchases from a Co-operative, it is hard to determine the amount that may be paid to that member as a dividend. This is not only because the dividend eventually paid is dependent on the profits of the co-operative and the approval of a general meeting but also because the dividend is one of a number of distribution made by a co-operative. Different proportions of the distribution may be paid to members as a dividend, be paid into community projects or charities or applied in other ways set out in the rules of the co-operative.
- The ways in which a co-operative's profits may be applied and distributed is set out in its rules
 and one option will be a dividend paid to members in proportion to their trade with the
 society. CPC believes that the exposure draft, as currently drafted, could be in conflict with the
 legal constitution of co-operatives if it requires member dividends to be deducted from
 revenue rather than shown as a distribution of profits.

The link between members' purchases and the dividend they receive is purely a mechanism for apportioning the overall dividend reflecting the nature of a co-operative rather than the conventional investor model. This apportionment is not known until approved at the AGM in the following year. Therefore if you apply paragraph 37 and 38 theoretically together, then a Co-operative cannot apply all revenue upon point of sale because the entity does not know the dividend yet and therefore the transaction price.

The CPC would like to ask the IASB to reconsider their proposals in respect of promises that are conditional on members approval (or similar), in light of industry practice.

Disclosure

The CPC is concerned about the ever increasing disclosures the IASB is demanding from accounts preparers. This exposure draft is no different. For example, the exposure draft is asking for further disaggregation of revenue on top of IFRS 8 disclosures, more reconciliations and additional information on contracts. More disclosures lead to the following issues which the IASB should be aware of:

- We are getting to the stage where annual reports are so large due to the IASB demanding so
 many disclosures that the readers of accounts are becoming disillusioned with the accounts.
 Rather than increasing the usefulness of financial information, the volume of disclosure is now
 such that average readers of financial statements find it increasingly difficult to recognise
 what is significant to an assessment of the reporting entity's performance and financial
 position.
- Accounts preparers are struggling with the increased demand of disclosures from the IASB leading to resource constraints and the risk that accounts will not be prepared in time.

Collectability

Paragraph 43 seems to contradict itself. The paragraph demands that the expected bad debt is deducted from revenue, but if the bad debt is paid, the expected lost consideration now received is recognised as income or expense rather than revenue.

In terms of practicality, an entity with many customers and contracts may find this paragraph hard to adopt. For example, what happens when a new customer is taken on? It is not realistic to separately assess the credit risk of individual customers in most high volume, relatively low value industries.

In addition to these specific comments, the attached appendix lays down the CPC's answers to the questions set by the IASB in the exposure draft.

APPENDIX 1 – Q&A FOR REVENUE FROM CONTRACTS WITH CUSTOMERS

#	Question	Response	
Sco	Scope		
1	Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether:	No comment.	
	 To combine two or more contracts and account for them as a single contract; 		
	 To segment a single contract and account for it as two or more contracts; and 		
	 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 segment contracts and (b) to account for contract modification as a separate contract?		
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? If not, what principle would you specify for identifying separate performance obligations and why?	No comment.	
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, why? What additional guidance would you propose and why?	Paragraph 30 gives good guidance, but the IASB should explicitly define what the difference is between "major" and "minor" changes to design or function as specified in section (d).	
		Paragraph 31 gives an entity an opportunity to ignore the list it sets out in paragraph 30. This will mean more judgement is involved leading to less comparability across accounts. The IASB could determine which factor of paragraph 30 is more important so that entities could apply revenue recognition criteria consistently leading to more comparability across accounts.	
Measurement of revenue			

#	Question	Response
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 reasonably estimate the transaction price. Do you agree that an entity should recognize revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?	See above point in covering letter about dividends issue. It also seems strange that an entity cannot recognize revenue if it enters a new industry or gains a new customer where revenue is hard to estimate. It would look odd in a financial report where an entity boasts about taking on new customers or business streams, but revenue has actually stayed the same. Maybe an industry average could be used if revenue is hard to determine. i.e. if a company enters a new industry, then it should recognise revenue based on other companies/industries' experience, rather than its own. This measure is permitted in paragraph 52 (b) on separate performance obligations.
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 the customer's credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue.	There could be a lot of subjectivity around this. Perhaps guidance needs to state that the probability weighted outcome should be based on historical experience (i.e. if the customer pays 90% of all invoices in the past, then 90% of the revenue should be recognized). There needs to be explicit guidance so that there is comparability of revenue across the accounts. If that is not there, it brings to dispute the whole purpose of this exposure draft which was to increase comparability.
		The CPC asks if this is also applicable to rental income in investment property or any other fixed assets?
		What happens if it's a new customer and the entity has had no experience in dealing with this customer? Should the revenue figure be based on a credit check score? This could significantly increase operating costs so could the board give more guidance on methods that could be used to

#	Question	Response
		assess this?
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?	There seems to be a growing trend within the IASB to use discounting as much as possible in accounts. This makes the accounts more complicated for readers and leads to more judgements and estimates by the entity when assessing revenue. The CPC therefore disagrees with this proposal.
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 (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such way?	Agreed.
Contract costs		
8	Paragraph 58 proposes the costs that directly relate 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 or exclude and why?	No comment.
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 or exclude and why?	No comment.
Disclosure		
10	The objective of the boards' 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?	Paragraph 70 is asking for entities to use their judgement. The CPC asks if this will lead to entities hiding from what they should really disclose to meet this objective.
		Paragraph 75 is not clear as to whether disclosure is needed for a

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		refund liability. Just "contract liabilities". The paragraph needs to be more explicit.	
		Paragraph 77 seems excessive. Does this mean an entity has to disclose information about all its contracts or just significant ones? If significant ones, how do you measure significant? Contracts that earn 5% or more of total revenue could be a good threshold.	
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.	As stated in the covering letter, all these disclosures make the annual accounts even bigger leading to disillusionment across users and preparers.	
	Do you agree with that proposed requirement? If not, what, if any, information do you think any entity should disclose about its remaining performance obligations?		
12	Do you agree that an entity should disaggregate revenue into categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why not?	Paragraph 74 needs to be more explicit. The CPC does not see how entities can judge which categories best depict the amount, timing and uncertainty of revenue. Entities may shy away from disclosing this information unless the disclosure requirements are more explicit. We can't see how this will add to what is already disclosed under IFRS 8. Management reports (which IFRS 8 disclosures are based on) are disaggregated in a way that the Chief Operating Decision Maker can best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors. The CPC can't see how these disclosures will add anything.	
Effe	Effective date and transition		
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 period	There would be a lot of impracticalities around applying this standard retrospectively. For example, for 5 year summaries in annual reports, entitles would have	

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	presented)? If not, why?	to adjust revenue for all its past bad debt.	
	Is there an alternative transition method that would preserve trend information about revenue, but at a lower cost? If so, please explain the alternative and why you think its better.		
Арр	Application guidance		
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?	We have offered explanations of additional guidance in other parts of this letter.	
15	The boards propose that an entity should distinguish between the following types of product warranties:	No comment.	
	 (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract. (b) A warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract. 		
	Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of warranty? If not, how do you think an entity should account for product warranties and why?		
16	The boards propose the following if a licence is not considered to be a sale of intellectual property:	No comment.	
	 (a) If an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and (b) If an entity grants a customer a non-exclusive licence to use its intellectual property, it has a 		

#	Question	Response
	performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.	
	Do you agree with that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?	
Cor	nsequential amendments	
17	The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment); an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?	No comment.
18	Should any of the proposed requirements be different for non-public entities (private companies and not-for-profit organisations)? If so, which requirement (s) and why?	No comment