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The Quoted Companies Alliance

International Accounting Standards Board (IASB)
First Floor
30 Cannon Street
London, EC4M 6XH
commentletters@iasb.org

26 June 2009

Dear Sirs,

Preliminary View on Revenue Recognition in Contracts with Customers

INTRODUCTION

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation dedicated to promoting the cause of smaller quoted companies (SQCs), which we define as those 2,000+ quoted companies outside the FTSE 350 (including those on AIM and PLUS) representing 85% of the UK quoted companies by number. Their individual market capitalisations tend to be below £500m.

The QCA is a founder member of European**Issuers**, which represents over 9,000 quoted companies in thirteen European countries.

RESPONSE

Thank you for the opportunity to respond to this consultation. We fully welcome the underlying aim of the project to clarify the principles of recognising revenue and the need to simplify and reduce the number of standards involved. However, we do have some areas of concern, most particularly the proposal that revenue should be recognised only when a performance obligation is satisfied. This response has been produced by our Accounting Standards Committee, a list of members is at Appendix A. Our detailed comments are outlined below.

Chapter 2

Question 1: *Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?*

The IFRS guidance on revenue recognition is limited such that guidance has been developed by different standard setting bodies and is fragmented, frequently industry-specific and often leads to different accounting results for economically similar transactions. We agree therefore that a single revenue recognition model using a recognition principle that can be applied consistently to all revenue transactions would be beneficial. We do not, however, agree that revenue should be recognised only when a performance obligation is satisfied, as we believe revenue is more accurately reflected as a measure of the activity carried out to fulfil a contract with a customer.

Question 2: *Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?*

The proposed model may have a significant effect on revenue recognition where industry-specific guidance is currently being followed, for example the accounting by construction contractors, as such entities will not be able to recognise revenue during the construction phase if control of the asset under construction does not transfer to the customer until completion. As outlined above we believe that the earnings process approach is more representative of the substance of a business.

Question 3: *Do you agree with the boards' definition of a contract? Why or why not?*
Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

We would agree with the boards' definition and expect that most entities will be able to readily identify contracts that relate to the transfer of assets as part of their ordinary revenue-generating activities.

Chapter 3

Question 4: *Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.*

We anticipate considerable practical issues for certain transactions in determining whether an asset is a good or a service, for example where service activities transfer intellectual property over the contract term or a tangible deliverable detailing the results of activities is presented at the conclusion of the service period. These have the potential to result in significant changes to current practice for some entities.

Question 5: *Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?*

We agree that an entity should separate the performance obligations in a contract.

Question 6: *Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?*

We do not believe that a return right represents a performance obligation. We would argue that a return right represents a failed sale and that provided an entity is able to estimate the proportion of goods that are likely to be returned an entity would be able to recognise revenue for the remainder. Although this alternative may not completely reconcile to the principles of the proposed model it continues a current approach with which many users and preparers are comfortable.

Question 7: *Do you think that sales incentives (e.g. discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?*

We agree with the view expressed on sales incentives. In order to allocate the transaction price to these incentives however, entities will need to estimate the stand-alone selling price of each incentive, which will likely be a change for most entities and could prove to be a challenge.

Chapter 4

Question 8: *Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.*

Although we agree that the determination of when a performance obligation has been satisfied is on the transfer of control of an asset, questions arise as to the point at which control transfers based on whether an entity is providing a good or a service and if the customer does not take physical custody to indicate transfer of control. For example, in the case of a contract to provide services, there may be no physical transfer of an asset. Similarly, many contracts include multiple performance obligations, some for tangible goods for which physical transfer occurs, coupled with one or more services (such as warranty, return rights, incentives, etc.) where physical transfer does not occur. In practice, we anticipate that entities may find it is difficult to define what is being transferred and at what point in the contract it is transferred.

Question 9: *The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.*

The principle that revenue should not be recognized for a performance obligation until control of the assets underlying the performance obligation has been transferred to the customer could have significant implications for entities that currently recognize revenue using percentage-of-completion accounting. Revenue recognition will be precluded if an entity cannot demonstrate that the assets are transferred to and controlled by the customer as the construction (or contract) period progresses. If assets are not transferred to the customer, the entity has not satisfied the related performance obligation(s); therefore, there is no change in the net contract position. Accordingly, to the extent the customer does not control the asset being constructed, the pattern of revenue recognition will differ greatly from current practice. We do not believe this will result in decision-useful information as it does not reflect the activity undertaken in fulfilling a contract with a customer.

Chapter 5

Question 10: *In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.*

(a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

(b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?
(c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.
(d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

We agree with the preliminary view that performance should be measured initially at the transaction price. We also agree that the cost trigger is the most appropriate for identifying an onerous performance obligation because it remeasures onerous performance obligations to reflect current economics. We note however that this could result in increased income statement volatility in some sectors.

Question 11: *The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.*

a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?
(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

This preliminary view could have a significant effect on entities that incur and defer significant upfront costs associated with customer contracts, as all of these costs will need to be expensed as incurred in the absence of specific applicable guidance that provides for capitalization of such costs. Because the proposed model precludes revenue recognition at the inception of a contract (unless a performance obligation is satisfied at that time), entities could recognize costs with no related revenue in the early stages of a contract and users will need to be educated in order to make useful decisions based on the information.

Question 12: *Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?*

In most instances, we expect entities will be able to make estimates of standalone selling prices that represent management's best estimate considering observable inputs and therefore we agree with the board's proposed basis for allocation of the transaction price. We would point out that for some customised service contracts this allocation is likely to be highly judgmental which would impede comparability. It may also require additional effort for our members to produce this information with the limited resources they have available.

Question 13: *Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?*

We agree with the board's proposal for the use of estimated selling prices. We would expect that entities will still be able to determine a reasonable stand-alone selling price when considering the cost of that good or service and the return the entity expects for that good or service. As above this allocation will require judgment to be applied.

If you wish to discuss these issues with us, we will be pleased to attend a meeting.

Yours sincerely,

John Pierce

John Pierce
Chief Executive

APPENDIX A

THE QUOTED COMPANIES ALLIANCE ACCOUNTING STANDARDS COMMITTEE

Tim Gordon (Chairman)	-	Ernst & Young LLP
Anthony Carey	-	Mazars LLP
Peter Chidgey	-	BDO Stoy Hayward LLP
Sarah Cox*	-	Ernst & Young LLP
David Gray	-	DHG Management
Chris Ogle	-	SQC Consultant
Paul Watts/Bill Farren	-	Baker Tilly LLP
Nick Winters/James Lole	-	Vantis plc
John Pierce	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

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