



15 March 2012

Our ref: ICAEW REP 41/12

European Financial Reporting Advisory Group
35 Square de Meeûs
B-1000 Brussels

By email: commentletter@efrag.org

Dear Mme Flores

Revenue from Contracts with Customers

ICAEW is pleased to respond to your request for comments on your draft response to the IASB regarding their exposure draft ED/2011/6 *Revenue from Contracts with Customers*.

Please contact me should you wish to discuss any of the points raised in the attached response.

Yours sincerely

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ICAEW REPRESENTATION

REVENUE FROM CONTRACTS WITH CUSTOMERS

Memorandum of comment submitted in March 2012 by ICAEW, in response to EFRAG's draft response to the IASB on their exposure draft ED/2011/6 *Revenue from Contracts with Customers* published in January 2012.

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INTRODUCTION

1. ICAEW welcomes the opportunity to comment on EFRAG's **draft response** to the IASB on their exposure draft ED/2011/6 *Revenue from Contracts with Customers*, published on 20 January 2012.

WHO WE ARE

2. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 138,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
3. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
4. The Financial Reporting Faculty is recognised internationally as a leading authority on financial reporting. The Faculty's Financial Reporting Committee is responsible for formulating ICAEW policy on financial reporting issues, and makes submissions to standard setters and other external bodies. The faculty also provides an extensive range of services to its members, providing practical assistance in dealing with common financial reporting problems.

MAJOR POINTS

Support for the project

5. We have been keen supporters of the Board's project to establish a single consistent, conceptually coherent model for the recognition of revenue. We agree with the Board's instinct that it is desirable both to establish more robust principles in this area and to move to international convergence on this important topic. In our draft response to the Board we are therefore urging them to carry this project, now largely complete in our opinion, across the finishing line.

We welcome the improvements made since the 2010 Exposure Draft

6. Although we are advocates of the project and supportive of the principles underpinning the control-based model, we did express some concern in our previous response to the IASB (ICAEW REP 116/10) that the standard would not have been operable as drafted. The principles were not at that time communicated clearly enough to be applied consistently in practice. We are pleased to observe that the Board has taken note of these concerns and has produced an improved new exposure draft. We do have some specific observations on the drafting of this new ED, which are explored below, but assuming these issues can be suitably addressed we feel that the Board should now move to implementation. We urge EFRAG to lend their strong support to this project.

Endorsement should not be delayed

7. We are rather disappointed that endorsement of IFRS 9 continues to be delayed and that while EFRAG has recommended endorsement of the package of standards dealing with consolidation, joint arrangements and related matters, an extended adoption timetable is suggested. The series of standards developed over the past few years are the culmination of an extensive process of consultation and refinement. Intended to either address critical financial crisis issues or to achieve international convergence, they represent solutions to real business problems. These solutions have been demanded by market participants and in our

opinion should not be delayed further. We note that in paragraph 38 EFRAG disagrees with the IASB's proposed effective date. There may well be valid arguments to support a call for extension, but we believe these are relatively minor considerations when compared to the real benefits to be gained from the adoption of improved financial reporting standards. We strongly believe that the endorsement process should not stand in the way of improved accounting and therefore, were the IASB not to adopt EFRAG's suggestion of an extended application date, would be opposed to any modification of the standard as a condition of endorsement.

Specific concerns

8. While overall we support the Board's revenue project and believe that the exposure draft could operate effectively in practice, we do have some specific observations on points of detail that we suggest the Board should address in finalising the standard. These are set out in our separate response to the IASB, a draft version of which has been supplied to EFRAG.

RESPONSES TO SPECIFIC QUESTIONS AND ADDITIONAL COMMENTS

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?

9. We agree with paragraphs 7 to 13 of EFRAG's draft letter. The example discussed by EFRAG in paragraphs 12 and 13 is a good example of how the new standard will act to improve the conceptual consistency of the revenue recognition model in practice. We also agree with the point EFRAG raises in paragraphs 14 to 15; it is important that the model operates effectively to faithfully represent the economic reality of the underlying transaction. Paragraphs 16 to 22 of our draft response explore this area in more detail.

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?

EFRAG is asking constituents for their views on the following:

(a) In which standard(s) do you think guidance for impairment of conditional and unconditional rights to consideration should be provided?

10. We agree with the Board's proposal that unconditional rights to consideration should continue to be assessed under IFRS 9. We would not wish to see an exception created to the general requirement established by that standard.

(b) Should specific guidance be developed for how to present uncollectible amounts or should the general guidance of IAS 1 be applied?

11. We support the principles based approach of IAS 1 and do not believe that an exemption should be created in this instance. This provision risks overriding a general principle with a specific rule, this is not desirable. In our draft response we therefore oppose the mandate of presentation on the face of the income statement for adjustments relating to uncollectible amounts.

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?

12. We agree with paragraph 25 of EFRAG's response; the term 'uncertain' may be preferable in some circumstances. However, we disagree with EFRAG's conclusion regarding paragraph 82(b) of the ED. Admittedly in many cases this criterion will not be relevant; however, in some industries it may well be an issue. It is sensible to set a general time limit to the predictive value of past experience, as such a prediction is indeed likely to become less accurate as time passes.
13. Finally, we also disagree with the approach in paragraph 26 and 27. Paragraph 85 of the ED introduces a rule as an exception to the measurement principle established by paragraph 81. We do not agree with this approach and we think the Board should reconsider the logic for not anticipating revenues based on a customer's sales. In our view, the appropriate distinction is of recognition, not measurement: revenue should not be recognised until the customer has an obligating event such that it can no longer avoid a liability for the additional consideration. Often, this will be based on the customer choosing to make sales, but other scenarios may be possible.

Question 4, 5 & 6:

14. We agree with EFRAG's response to questions 4, 5 & 6.

Appendix 2: Additional comments

Scope

15. We agree that further guidance may be useful in differentiating contracts with customers from those with a partner or collaborator.

Allocation of contingent amounts

16. We do not have any specific concerns in this regard, but we agree that it may be useful to provide further clarification on how to allocate contingent amounts.

Time value of money

Do you think a practical expedient regarding the time value of money should be included in the ED (see paragraphs 10 - 13 above)? If so, what should be included in its scope?

17. We believe that in most cases where normal commercial credit terms are observed the time value of money is likely to be immaterial. We therefore welcome the inclusion of a practical expedient here to avoid doubt as to whether this adjustment is required in normal commercial situations. It is rather arbitrary to use one year as the cut-off point, but in practice we believe that the practical expedient will ease application and therefore we favour its retention.

Offsetting contract assets and advances received

18. In our opinion the exposure draft proposals are not particularly problematic in this area, particularly as they merely replicate current practice under IAS 11.

Right of return

Are you concerned that in practice it will often be difficult to distinguish between the different situations listed in paragraph 25 above where a customer has not irrevocably taken control of assets provided by the entity?

19. We agree in part with EFRAG in this area. It may be hard to distinguish customer acceptance from a right of return. However in practice it may be possible to differentiate repurchase agreements by the pricing of the contract.

Do you think the three situations listed in paragraph 25 above differ economically? If so, how and in what circumstances would it be important to distinguish between the three circumstances?

20. We believe that the situations can differ economically and therefore support their separate treatment in the exposure draft.

Do you think there are situations where a customer has a significant economic incentive in exercising a return right, but the transaction should not be accounted for as a lease?

21. We believe that it is appropriate to treat arrangements of this type as a lease and therefore would not support any change to the application guidance in this regard.

How do you think the three situations listed in paragraph 25 above should be accounted for?

22. We agree with the current proposed treatment in the exposure draft.

Disclosures

EFRAG would welcome comments regarding the usefulness and the cost of preparing the disclosures required by the ED and an assessment of whether an acceptable trade-off between costs and benefits is met.

23. In general we are content with the proposed disclosure package. However, we do acknowledge EFRAG's concerns. As set out in the exposure draft, the disclosure package does appear rather daunting, and while we appreciate that it is intended as an illustration of disclosures that may be appropriate rather than a prescriptive list of requirements, the Board may wish to consider giving further thought to its operation in practice. In particular, we believe it is important to clarify the extent of disclosure expected and whether or not each individual element is required or merely suggested. We would therefore support the inclusion of this theme in EFRAG's response.

Early application and effective date

EFRAG has discussed whether early adoption should be allowed for existing IFRS reporters. Permitting early adoption by existing IFRS reporters would reduce comparability between companies, but it would allow them to move to the improved standard sooner.

Do you think early application of the new standard on revenue recognition should be allowed for entities already reporting under IFRS?

24. Given that the new proposals represent an improvement over current practice it is not desirable to impede entities from implementing the new standard as soon as it becomes available. It has habitually been the case with new IFRSs that early adoption is permitted and we see no reason why an exception should be made in this case.

Boundaries of a contract

Do you share the concern expressed by some in relation to the boundaries of a contract (see paragraphs 52 to 54 above)?

25. We have no particular concern in this regard but we acknowledge that clarification in the drafting may be helpful.

Clarity of proposals

Do you have additional concerns in relation to the clarity of the requirements and to whether the proposed requirements can be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers? If so, could you describe in details the issue and the reason for your concern?

26. In general we are supportive of the proposals. They are an improvement over current practice and the IASB should therefore move as swiftly as possible to make them available to constituents. We have set out further considerations in this regard in paragraphs 5 to 7 above.

Appendix 3: Field testing activities

27. We welcome the work EFRAG is performing through its field-testing proposals to assist the Board in ensuring that the proposed new standard operates as intended in practice. In the area both of field testing and post implementation reviews, bodies such as EFRAG and national standard setters play a valuable role in helping the Board to assess the practical implications of its work.

28. At the time of responding we have not seen the output from this exercise, but we would like to make some general comments which EFRAG may find useful as it analyses the final results. In particular, we note that the sample size in a test of this type is necessarily often rather small and there is therefore a risk that the results may not be fully representative of the experience of constituents as a whole. Therefore while we agree that these tests can provide a useful indication of potential problem areas we feel that a degree of caution is necessary in drawing conclusions from the results.

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