



European Financial Reporting Advisory Group
13-14 Avenue des Arts
1210 Bruxelles
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Dear Sir

Revenue recognition

The Association of Chartered Certified Accountants (ACCA) is pleased to have this opportunity to comment on the Discussion Paper (DP) 'Revenue recognition – a European contribution'. The DP was considered by ACCA's Financial Reporting Committee and I am writing to give you their views.

Overall comments

ACCA welcomes EFRAG contributing to the debate on revenue recognition and measurement. Clearly it is helpful that a wide range of views is offered to the IASB in contributing to their joint project with the FASB.

In arriving at that view, we believe it is imperative that due consideration is given to the viewpoint of users and to what they understand as being revenue.

Clearly there are some issues with the two main standards that deal with revenue recognition, especially as they are evidently based on differing principles. Although some of the gaps between IAS11 and IAS18 have been filled with various IFRICs, we believe a single approach should be aimed for, which could be applied universally.

Central to this would be accounting standards based on a set of principles and not providing very detailed prescriptions of how revenue should be recognised because of the variability of transactions that entities deal in. By putting less stress on rules, we acknowledge that greater emphasis on the judgement of preparers will be required. However, with the appropriate level of importance given to disclosure we believe that this should not be an issue.

ACCA responses to specific questions raised by EFRAG

Q1 It is stated in the discussion paper (paragraphs 1.4 - 1.10 and Appendix II) that there are weaknesses in the IASB's existing revenue recognition standards, IAS 11 and IAS 18. In particular, the standards do not address certain types of transaction (for example they say little about multiple-element arrangements), they are based on different principles (which leads to inconsistencies and uncertainties and makes it difficult to know how to use the standards to fill the gaps) and there are internal inconsistencies within IAS 18. The paper goes on to say that these gaps, inconsistencies and uncertainties are causing real practical problems. Do you think these comments about the existing standards are fair? (If you do not, could you please explain which comments you think are not fair and why.) Do you have any additional concerns about existing standards? (If you do, please could you explain them.)

It is apparent that IAS11 and IAS18 are based on different principles. This is particularly evident within IAS18, where the contract for the sale of goods takes a 'critical event' approach for revenue recognition. However, when IAS18 is applied to contracts for services is similar to IAS11 and takes the 'continuous approach'.

We agree that there would be cases when the two opposing principles, without adequate guidance on when to be applied, could result in similar transactions being accounted for in different ways. Although recent IFRICs (for example, IFRIC11 *Service Concession Arrangements*; IFRIC 13 *Customer Loyalty Programmes* and IFRIC21 *Real Estate Sales*) have looked to provide some of this additional guidance, they are for specific scenarios and not likely to provide assistance in other circumstances.

Appendix II.11 argues that there may be occasions when there is little difference between the sales of a good (as accounted for under IAS18) from a construction contract (using IAS11). Again we agree that this is a conflict which may arise, and although we supported the principle of applying IAS18 in the case of real estate sales as set out in IFRIC D21, we believe that this was because real estate is a unique asset (not replaceable by another identical asset) and would not be extended in the example provided.

Q2 Paragraph 1.20 states that the objective of the paper is to develop a framework within which to address revenue recognition issues in a consistent way. Paragraph 1.26 explains further that the ultimate objective of the revenue recognition debate should be to develop a set of principles that can be applied to all kinds of industries and business. In other words, rather than have different, competing principles like we do now, we would have a single

principle or a single set of principles that apply generally and can be used to address any future gaps in standards.

(a) Do you believe this is an appropriate and realistic objective? (If you do not, please could you explain your reasoning and what you believe is an appropriate and realistic objective.)

(b) Do you believe the paper should explore sector-specific issues?

As stated in our overall comments, we are in favour of a single set of principles that can be applied to all industries and businesses. We strongly believe that due to the considerable range of transactions that those principles would need to encompass, actual standards themselves should not be prescriptive. We believe that the goal should be a set of principles which would enable sound judgement to be made by preparers, appropriate to their circumstances, but whose treatment could be verified and substantiated.

Q3 Chapter 2 of the paper discusses what revenue is. It does so by examining what the Framework says about revenue (paragraphs 2.5 - 2.13) and what other attributes revenue should have (paragraphs 2.14 -2.33). It concludes that:

(a) Revenue is a particular type of increase in assets or decrease in liabilities.

We believe that the use of the asset and liability model in defining revenue is consistent with the Framework's definitions and therefore accept (a) in principle.

(b) Revenue is a gross notion. In other words, if an entity sells an item for €10, making a profit of €2, it will be the €10 rather than the €2 that will be recognised as revenue.

We would strongly agree with (b), as the decision usefulness of the gross figure is more key than the net figure, especially in the context described in paragraph 2.14 of the DP.

(c) Revenue does not necessarily arise only from enforceable rights and obligations.

We are not comfortable with the recognition of revenue outside contracts with customers. Indeed, the general focus of the DP is on contractual rights and obligations, and clearly these rights and obligations typically in the form of contracts are fundamental to most companies. Much of the current literature both in the US and IAS envisage a customer, and any transaction with a customer either explicitly or implicitly involves a contract.

(d) Revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. Therefore, without a contract there can be no revenue. Furthermore, revenue will not arise simply from entering into the

contract, because at that point there will have been no activity undertaken by the supplier pursuant to the contract.

In this respect we would also agree with point (d). Whilst some industries might argue that their revenue arises long before an exchange with a customer is envisaged, focusing on the contract is the most appropriate basis. Indeed even with such sectors as the agricultural industry, which may fall into this bracket, exceptions should not be made for the recognition of revenue pursuant to a contract, rather that it may be acknowledged that profit may be recognised prior to the contract, but not revenue.

(e) Revenue does not necessarily involve an exchange.

When an entity enters into an enforceable contract with a customer, it exchanges promises with the customer, which imposes obligations on the entity to transfer economic rights to receive consideration from the customer in exchange. Therefore, in relation to point (e) we believe that this exchange of rights and obligations are inextricably linked because neither are enforceable without the other.

(f) Revenue is something that arises in the course of ordinary activities.

The current consideration for when revenue arises in the Framework (FW.74) and IAS18.7 both refer to ordinary activities, and we see no reason for this not to be the case. It is the income from ordinary activities which users are more interested in, and therefore accept (f). However, we believe that a definition and guidance on what constitutes ordinary activities for an entity would be required.

(g) On the basis of the conclusions summarised above, a working definition of revenue is that revenue is the gross inflow of economic benefits that arises as an entity carries out activities pursuant to a contract with a customer. Do you agree with these conclusions?

We have no issues with the basics of the working definition.

Q4 As mentioned in Q3(d), revenue is some sort of measure of activity undertaken pursuant to a contract with a customer. However, the paper's analysis is not conclusive as to exactly what "sort of measure of activity" revenue measures; it could for example be a measure of completion activity (in other words, a measure of the things the supplier has completed) or a measure of activity towards completion (in other words, a measure of the things the supplier has done under the contract). This issue arises again and again in the paper and is the main issue that separates the critical event approaches discussed in Chapter 3 from the continuous approaches discussed in Chapter 4. The authors believe that a very important test of any proposed accounting solution is whether it is the most useful approach from a user perspective. Which activities do you believe the revenue number should measure: completion, or activity towards completion? Or are there other

alternatives that need to be considered? (Please give your reasons for the answer you have given.)

This question is considered in conjunction with Question 8.

Q5 Chapter 3 discusses when revenue arises and, in doing so, introduces various critical event approaches to revenue recognition and explores three of them (Approaches A, B and C) in detail.

(a) Do you believe the discussion of Approaches A to C is fair and complete? For example, do you believe that one of the approaches has some additional benefits or weaknesses that have not been mentioned? Or that some of the weaknesses mentioned are not weaknesses? (If you do, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)

(b) Do you believe there are any critical event approaches other than Approaches A to C that have merit and are worth exploring in greater detail? (If you do, please could you describe those approaches and explain why you think they are worth exploring further.)

We believe the analysis provided in Chapter 3 provides a sound basis for the objectives of the paper, with the examples in general, providing adequate representation of how the various approaches would resolve the questions raised.

As mentioned in our response to Question 8, we believe that principles based on a variation of Approach C would be supportable. Therefore in the example of 'The Bridge' (paragraph 3.67(d)), where we acknowledge that the critical event could be the completion of the bridge itself, we believe that in practice for such long term contracts, there will be a number of stages to the completion of the project. Disaggregation would be possible based on these phases built into the contract, with revenue being recognised at each stage.

We also note our response to Question 2, and the implicit need for preparer judgement, soundly based on a single set of principles. This is particularly evident in Approach C, where in practice there would be difficulties relating to disaggregation of contracts. Clearly this is a complicated process and would be highly dependent on management's judgement of separate elements of a contract and when the critical event occurs.

Q6 Chapter 4 continues the discussion of when revenue arises by introducing and exploring another type of approach to revenue recognition: the continuous approach (Approach D). Again, do you believe the discussion is fair and complete? (If you do not, please could you explain what you think is unfair and incomplete about the discussion, together with your reasoning.)

Again we believe the rationale for the use of the continuous approach is well supported by the examination of approach D in Chapter 4.

Paragraphs 4.31 to 4.37 discuss the continuous approach in the context of the asset / liability model. We certainly accept that this approach is consistent with that model. We do believe that if revenue is to be defined in terms of changes in assets and liabilities, the approach needs to be clear about the assets and liabilities which it refers.

Q7 The discussion in the paper is about concepts and principles—and not at this stage practicalities—and the paper uses a variety of simple examples to illustrate the various approaches and various conceptual discussion points. The examples are set out in Appendix IV. Do you believe there are other examples that would illustrate or highlight issues of concept or principle that are not so far identified in the paper? If you do, what are those examples and what new aspect of the debate is it that you think they illustrate or highlight?

As stated in our response to Question 2, we believe that focus should be placed on principles and standard setters should steer away from prescribing specific rules in the area of revenue recognition. It would be impossible to provide examples for all potential scenarios, although we do believe that the examples provided certainly capture the key types of transactions that entities would face.

Q8 What are your views on the relative merits of the approaches discussed in the paper? Do you believe that one approach is preferable to the others and could—perhaps after some further development work—be applied satisfactorily in all circumstances? (Please explain your reasoning.)

We believe that an accruals based approach is consistent with the Framework, and as such consider activity towards completion as the appropriate measure of revenue. However, although this implies a continuous recognition of revenue, we believe that this should be supportable by a series of contractually determined events. This appears to be akin to Approach C in Chapter 3, which is described as a critical event approach, which includes disaggregating the contract into part-outputs that have value to the customer.

To this end, we view the continuous approach as described in paragraph 4.5(a), which sees it as a 'critical approach that involves an extreme form of disaggregation'. Our response to Question 9 further elaborates on the issue of from whose perspective performance should be measured, which we believe is crucial to the measurement of activity and therefore to recognition of revenue.

Q9 At various points in the paper the authors discuss the issue of perspective; from whose perspective or point of view (ie through whose eyes) should performance be assessed? The suppliers or the customers? For example:

(a) the issue is first mentioned in paragraphs 3.36-3.39, where it is explained that one perspective is not necessarily better than the other, although one may be better suited (or even an inherent feature) of one particular approach, whilst another might be better suited or a feature of another approach;

(b) the issue is also discussed in paragraphs 4.4(c), 4.5(b) and 5.7(c), where it is explained that critical event approaches generally (but not necessarily always) apply a customer perspective whilst continuous approaches tend to apply a supplier perspective. In your opinion is this discussion complete and sufficiently conclusive? If you think it is not, could you please explain what more you think should be said and why.

Our response to Question 8 showed that we support an accruals based continuous approach which would inevitably be measured from a supplier perspective. However, we equally support the use of contractually determined events in verifying the various critical stages in the continuum of a contract, which would include the customer perspective also, if only to substantiate the supplier outlook.

In this respect we also draw attention to UITF Abstract 40 '[Revenue recognition and service contracts](#)' which raised a number of significant questions for revenue recognition in the UK and in particular for those businesses that provided professional and other services. Specifically, we felt the UITF failed to recognise the fact that there are critical events, revolving around the customer, in the business operating cycle which should influence the recognition of revenue. These include both customer acceptance and the value accruing to the customer.

We therefore believe that the perspective of the customer, who will play a significant part in the determination of any critical points, will also have a bearing on the ultimate recognition of revenue.

Q10 Do you believe there are particular aspects of the revenue debate that have not been covered in this paper but are worthy of consideration. If you do, what are they and why do you believe they are worth exploring further?

As previously mentioned we believe that the main objective for the revenue recognition debate should be to form a set of principles which would serve as guidance to all types of business. In this respect, we appreciate EFRAG's attempts to move towards this goal through this DP. However, we do believe

that certain areas of the revenue recognition debate have not been considered in the DP, and these include

- **Measurement** - the DP has not attempted to consider the measurement of revenue, and we believe that this is fundamental to the development of a framework in relation to revenue and its recognition.
- **Ordinary activities** - as mentioned in our response to Question 3(f), we believe that a definition of ordinary activities would be required, as there may be transactions, such as the proceeds from disposal of assets, which certain entities may argue constitute ordinary activity and therefore should be disclosed as revenue. As such a clear definition, along with appropriate guidance, would clarify such issues.
- **Taxation** - we believe that DP has not considered the impact on revenue recognition of when income tax falls due, as this is often a consideration for many entities.

If there are matters arising from any of the above please be in touch with me.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Aziz Tayyebi', is written over a horizontal line.

Aziz Tayyebi
Financial Reporting - Technical Officer