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The Quoted
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International Accounting Standards Board (IASB)
First Floor
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commentletters@iasb.org

2 November 2010

Dear Sirs,

Exposure Draft – ED/2010/6: Revenue from Contracts with Customers

INTRODUCTION

The Quoted Companies Alliance (QCA) is a not-for-profit membership organisation working for small and mid-cap quoted companies. 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 fourteen European countries.

The QCA Financial Reporting Committee has examined your proposals and advised on this response. A list of committee members is at Appendix A.

RESPONSE

Thank you for the opportunity to respond to this consultation. We submitted our preliminary views on Revenue Recognition in Contracts with Customers on 26 June 2009, and are pleased to add our further thoughts in response to the exposure draft as outlined below. Our main concern remains the determination of performance obligations and the need to satisfy these before revenue may be recognised, and the determination of the point at which control passes in order that the related performance obligation has been met.

Recognition of revenue (paragraphs 8–33)

Question 1: Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether:

(a) to combine two or more contracts and account for them as a single contract;

(b) to segment a single contract and account for it as two or more contracts; and

(c) 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 or segment contracts and (b) to account for a contract modification as a separate contract?

We agree with the principle to use price interdependence to help determine whether or not to combine or segment contracts.

We can foresee that the proposed principle could result in additional complexity to accounting processes for entities in some sectors particularly in determining whether to account for a modification as a separate contract. We anticipate that the proposals would result in an increased amount of the finance team's time being required as a result.

Question 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?

We agree with the principle that multiple element arrangements should be disaggregated into separate deliverables when that reflects their substance.

Question 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?

We think that the application guidance is helpful in determining whether control has passed. However, we can see difficulties for entities applying a control model to some service contracts (primarily those that have an 'end product'). Considerable judgement may be required to determine whether control is transferred continuously or on completion in some cases. In this regard, we would welcome additional guidance in relation to the concept of continuous transfer of control.

Measurement of revenue (paragraphs 34–53)

Question 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 be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise 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?

We agree that this approach is practical.

Question 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 recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

We do not agree with this proposal, which could have a significant effect on an entity's revenues and is a significant change from current practice without providing users with additional useful information.

As noted in previous responses we do not believe that a calculation based on a probability weighted average of the possible consideration will provide information which is decision-useful and also it will not aid the evaluation of our members' financial statements by analysts and other third parties.
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Question 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?

We agree with the Boards' proposal.

Question 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 cases?

As stated in our previous response, 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.

Contract costs (paragraphs 57–63)

Question 8: Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria.

Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

As stated in our previous response, 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 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?

We agree with the costs specified.

Disclosure (paragraphs 69–83)

Question 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?

The amount of disclosure is significantly greater than that currently required under IFRS and there will be a greater degree of judgment required in determining how to disaggregate revenue, which will reduce comparability between entities within a sector. We believe that the disclosure in relation to information on performance obligations may be excessive for some entities that offer a wide range of goods or services. We do not believe that the additional burden on entities to produce these disclosures will be offset by an equivalent benefit to the users of the accounts.

Question 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.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

We believe this requirement would add a significant additional burden on our members to keep track of the required information on a rolling basis or at each reporting date, without giving users meaningful information. The level of judgment required to determine the expected timing of satisfaction could be substantial for some sectors and would be particularly onerous for our members who have limited accounting resource. Instead, we suggest additional narrative on the general nature of contracts entered into by the entity and an indication of the time that most contracts are satisfied.

Question 12: Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

We agree this disclosure may give some benefit to users of the accounts, and will certainly make what entities may consider to be commercially sensitive information more widely available than it is at present. We believe this may create an additional burden for some entities, particularly smaller entities with several revenue streams.

Effective date and transition (paragraphs 84 and 85)

Question 13: Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?

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 it is better.

The requirements to apply the proposals retrospectively do preserve trend information, and will be acceptable so long as the Board gives sufficient lead time before the proposals become effective. This lead time should be sufficiently long to minimise the need for entities to have to go back and recalculate revenue for contracts that have already been entered. If entities only need to consider contract entered into after the date of issue of the final standard, this would reduce the cost burden.

Application guidance (paragraphs B1–B96)

Question 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 agree that the guidance is helpful, but as stated above, where services are being offered, or where it is unclear whether the performance obligations relate to goods or services, the guidance does not provide sufficient clarity.

Question 15: The boards propose that an entity should distinguish between the following types of product warranties:

(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 product warranty? If not, how do you think an entity should account for product warranties and why?

We believe that, in practice, distinguishing between the two types of product warranties may not be straightforward and will require a significant level of judgment. In addition, as users of the accounts are familiar with the current method of accounting for warranties and are comfortable with it we would propose continuing with the current approach.

Question 16: The boards propose the following if a licence is not considered to be a sale of intellectual property:

(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 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 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?

We agree with the proposal to distinguish between exclusive and non-exclusive licences, on the basis that where an exclusive licence is granted, the licensor retains an obligation to the licensee to maintain the exclusivity. We agree that proposed patterns of revenue recognition fit with this model.

Consequential amendments

Question 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?

The commercial arrangements surrounding the sale of such non-financial assets, which are by definition, outside the entity's normal operations, will be different from those in the normal course of business. It could therefore be argued that a performance obligation approach would not be appropriate. However, we can see that the model could be applied to such sales without being overly burdensome.

Non-public entities

Question 18 [FASB only]: 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?

We have no comments to make as this question is not relevant to our members.

Yours faithfully,

Tim Ward
<u>Chief Executive</u>

APPENDIX A

THE QUOTED COMPANIES ALLIANCE FINANCIAL REPORTING COMMITTEE

Anthony Carey (Chairman)	-	Mazars LLP
Peter Chidgey	-	BDO Stoy Hayward LLP
Sarah Cox	-	Ernst & Young LLP
Ian Davies	-	Victoria plc
David Gray	-	DHG Management
Chris Ogle	-	SQC Consultant
Paul Watts/Bill Farren	-	Baker Tilly LLP
Nick Winters/James Lole	-	RSM Tenon Group PLC
Tim Ward	-	The Quoted Companies Alliance
Kate Jalbert	-	The Quoted Companies Alliance

APPENDIX B

THE QUOTED COMPANIES ALLIANCE (QCA)

A not-for-profit organisation funded by its membership, the QCA represents the interests of small and mid-cap quoted companies, their advisors and investors. It was founded in 1992, originally known as CISCO.

The QCA is governed by an elected Executive Committee, and undertakes its work through a number of highly focussed, multi-disciplinary committees and working groups of members who concentrate on specific areas of concern, in particular:

- taxation
- legislation affecting small and mid-cap quoted companies
- corporate governance
- employee share schemes
- trading, settlement and custody of shares
- structure and regulation of stock markets for small and mid-cap quoted companies; Financial Services Authority (FSA) consultations
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

The QCA is a founder member of European**Issuers**, which represents quoted companies in fourteen European countries.

QCA's Aims and Objectives

The QCA works for small and mid-cap quoted companies in the United Kingdom and Europe to promote and maintain vibrant, healthy and liquid capital markets. Its principal objectives are:

Lobbying the Government, Brussels and other regulators to reduce the costing and time consuming burden of regulation, which falls disproportionately on smaller quoted companies

Promoting the smaller quoted company sector and taking steps to increase investor interest and improve shareholder liquidity for companies in it.

Educating companies in the sector about best practice in areas such as corporate governance and investor relations.

Providing a forum for small and mid-cap quoted company directors to network and discuss solutions to topical issues with their peer group, sector professionals and influential City figures.

Small and mid-cap quoted companies' contribute considerably to the UK economy:

- There are approximately 2,000 small and mid-cap quoted companies
- They represent around 85% of all quoted companies in the UK
- They employ approximately 1 million people, representing around 4% of total private sector employment
- Every 5% growth in the small and mid-cap quoted company sector could reduce UK unemployment by a further 50,000
- They generate:
    - corporation tax payable of £560 million per annum
    - income tax paid of £3 billion per annum
    - social security paid (employers' NIC) of £3 billion per annum
    - employees' national insurance contribution paid of £2 billion per annum

The tax figures <u>exclude</u> business rates, VAT and other indirect taxes.

For more information contact:

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