



**The Quoted  
Companies Alliance**

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International Accounting Standards Board  
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[commentletters@ifrs.org](mailto:commentletters@ifrs.org)

14 March 2012

Dear Sirs,

**IASB: ED/2011/06 Revenue from Contracts with Customers**

***INTRODUCTION***

The Quoted Companies Alliance 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 Quoted Companies Alliance is a founder member of European **Issuers**, which represents over 9,000 quoted companies in fourteen European countries.

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

***RESPONSE***

We welcome the opportunity to comment on the revised proposals for the future recognition of revenue from contracts with customers. Given the importance of the subject matter we particularly welcome the Boards' decision to re-expose their revised proposals.

We consider ED/2011/06 to be a significant improvement on ED/2010/06 and commend the Boards on responding positively to the comments received on the earlier Exposure Draft. Many of the criticisms to the earlier proposals were concerned with problems of application, whether arising from difficulties of interpreting the text or cost effectively applying them in practical situations. The Boards have made significant progress in addressing such difficulties.

In particular, we welcome the:

- New guidance on identifying distinct performance obligations where a bundle of goods or services are interrelated and their transferral required a significant service of integration. This will address some of the key concerns of the construction sector, for example;
- The elimination of the requirement to segment a contract given the requirement to identify separate performance obligations;
- The revised approach to warranties which better reflects the economic substance of such obligations and is significantly more straightforward to apply in practice; and
- The introduction of limited transitional reliefs and the commitment to provide an appropriate lead time from issuing the final standard to its mandatory application.

In other areas, we welcome the improvements made but consider further improvements are necessary for the requirements to be clear and their application consistent and effective. Where there is no specific question addressing an area of concern we have included our comments as a response to the

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general question set out in paragraph IN 36. Our response to that general request and the six specific questions are detailed in the Appendix A to this letter.

If you would like to discuss this in more detail, we would be pleased to attend a meeting.

Yours sincerely,



Tim Ward  
Chief Executive

**Response to the consultation questions**

**General questions per IN36**

***Are the proposed requirements clear and can they be applied in a way that effectively communicates to users of financial statements the economic substance of an entity's contracts with customers?***

***If a proposed requirement is not clear, the boards invite suggestions on how to clarify the drafting of the proposed requirement.***

**Disclosures (paragraphs 109 - 129)**

At a time when many organisations are considering the breadth and complexity of IFRS disclosures and in many cases publishing proposals and/or consultation documents on the subject it is disappointing that more has not been done to provide clear guidance on the extent to which the disclosures listed should be presented. We refer the board to, for example, the UK Financial Reporting Council's Cutting the Clutter project, the joint report of ICAS and NZICA Losing the Excess Baggage, EFRAG's thought leadership project on a Disclosure Framework for the Notes to the Financial Statements and, most recently, the Feedback Statement of the IAASB following its discussion paper The Evolving Nature of Financial Reporting: Disclosure and its Audit Implications.

We consider the current exposure draft to provide the IASB with an excellent opportunity to respond to these wider deliberations and to address some of the concerns of preparers, auditors and regulators by providing clear guidance on the importance of materiality assessments in determining the extent and nature of disclosures. The IASB has recognised these concerns and on page 17 of its published "Snapshot" on the revised Exposure Draft states that

*"the proposals emphasise that companies should not consider the proposed disclosures to be a checklist of minimum disclosure. A company would only be required to disclose information that is material."*

This would be an excellent first step towards addressing some of the concerns raised on the issue of disclosures but we can find no evidence of such an emphasis being given in the proposals. We would urge the Boards to:

- include such emphasis in the final standard;
- reiterate the concept in paragraph 31 of IAS 1 that disclosures are only required where they are material, irrespective of the materiality of the line item in question;
- reconsider if all the disclosures are required for economic decision making; and
- redraft each paragraph of the disclosures section to ensure each disclosure is seen in this context.

We consider the last point to be of particular importance as the use of categorical language (such as "An entity shall disclose information about...") when setting out each disclosure requirement is, in practice, leading to inappropriate responses by preparers, auditors and regulators. Excessive disclosures are being presented despite the context given by paragraph 31 of IAS 1. The Boards should consider how the structure and language of individual standards can begin to change such behaviours.

With regards to the breadth of specific disclosures listed, we question whether they are all necessary for the economic decision-making usefulness which can be expected of general purpose financial statements. As paragraph OB6 of the IASB's Conceptual Framework states:

*"general purpose financial reports do not and cannot provide all of the information that existing and potential investors, lenders and other creditors need."*

Listing all disclosures that might be of interest to some reduces the usefulness of the financial statements *as a whole* if the notes become excessively long, dense and impenetrable.

#### **Time value of money (paragraphs 58 – 62 and IE8)**

We welcome the added guidance that calculation of the transaction price should only be adjusted for the time value of money where there is a financing component that is significant to the contract and the introduction of a practical expedient in paragraph 60.

However, the practical expedient as described may be difficult to apply where the promised goods or services are transferred over time and milestone payments are made over the period of the contract. This is because the one year comparison is made between the date the consideration is substantially paid in full and the goods are transferred, but the substance of the arrangement is that each milestone payment is, effectively, consideration for the recently and periodically supplied goods and services. The wording could easily be amended or guidance added to ensure such contracts can easily be excluded from the requirement to measure the time value of money.

#### **Specific questions**

***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?***

We consider paragraphs 35 and 36 provide reasonable and readily applicable tests for determining when revenue should be recognised over time. Whilst agreeing with the outcome (i.e. we consider revenue will be recognised at appropriate times that reflect the economic and commercial realities of the activities) we would note that paragraphs 35 (b) (ii) and (iii) describe situations where the key condition for recognition as set out in paragraphs 31 and 32 are not necessarily met. In other words, the rules of paragraphs 35 are not consistent with the underlying principle of the model that revenue is recognised when control of the asset is transferred to the customer.

This is most obviously clear in paragraph 35 b (iii) which requires that revenue is recognised when the entity has a right to payment for performance completed to date and it expects to complete the contract. This condition for revenue recognition could be met without the transfer of control of any goods or services to the customer.

We consider the introduction of paragraphs 35 and 36 was a necessary improvement in the standard because the underlying principle of paragraphs 31 and 32 is insufficient to identify all situations where the recognition of revenue is appropriate. The Boards may wish to reflect on the principle as expressed given then need for specific rules which are not necessarily consistent with it.

***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?***

We do not agree with the proposal to present all impairment losses arising on contracts with customers as a separate line item adjacent to revenue. We do not consider such a presentation provides useful information to users.

Firstly the presentation within the proposed line item of impairment losses arising from a subsequent re-measurement of contract balances may create a mismatch between the revenue (arising in the current period) and the losses (which may relate to revenue arising in a previous period). Secondly, we do not consider impairment losses to be rightly portrayed as adjustments to revenue as they are generally closer related to payment collection activities rather than selling activities.

We believe that impairment losses should be presented after those expenses more directly related to revenue generation; for example, after gross profit.

**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?**

Yes we agree with these proposals.

**Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?**

We do not agree with the proposals in respect of onerous performance obligations and contracts. The proposed exclusion of contracts with customers from the scope of IAS 37 removes any onerous test at the contract level, whilst the ED proposes limiting any onerous test at the performance obligation level to those obligations performed over a period greater than one year. Taken together these changes may result in expected losses remaining unrecognised even if the entire contract and each performance obligation are onerous. We do not consider such an approach to be consistent with the provision of useful information for users on the nature of the contracts entered into by the reporting entity.

Whilst it may appear more consistent with the revenue recognition model to apply onerous tests at the performance obligation level, such consistency is not sufficient justification for these proposals. The recognition of revenue by reference to performance obligations does not predicate the same reference point should be used for the recognition of unavoidable losses.

We recognise that assets, such as inventories under IAS 2, will continue to be subject to impairment reviews irrespective of changes made to the recognition of revenue or losses on onerous obligations. However, in some cases, there will be no assets to impair at the time the contract becomes onerous, so the ED should not restrict the recognition of further losses on onerous contracts.

On the other hand the proposal would lead to the recognition of losses on an onerous performance obligation performed over more than 12 months even if the entire contract is expected to be profitable. Irrespective of the timing of revenue recognition, the economic reality of such a contract, which justifies the rational decision of the reporting entity to enter into it, is that overall the agreement is profitable. To anticipate a loss on part of such a contract would belie this economic reality.

In our opinion an onerous test should be applied at the contract level on all contracts with customers.

**Question 5: The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.(In the IASB exposure draft, see paragraph D19 in Appendix D.)**

**The disclosures that would be required (if material) are:**

- **The disaggregation of revenue (paragraphs 114 and 115)**
- **A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)**
- **An analysis of the entity's remaining performance obligations (paragraphs 119–121)**

- *Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)*
- *A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).*

*Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.*

We do not agree that IAS 34 should be amended to include mandatory disclosures in respect of revenue recognition. We are concerned that these disclosures are excessively detailed and may set a precedent for future expansion of the mandatory disclosures in IAS 34. If such information was necessary to explain changes in financial position and performance since the last annual financial report then paragraph 15 of IAS 34 would already require disclosure. If the board believe IAS 34 should be amended then this should be as part of a dedicated project on interim reporting subject to the usual due process.

Furthermore, as explained above, we consider the mandatory list of disclosures for annual financial statements to also be excessive and urge the Boards to reconsider the principles applied in identifying so many disclosures.

***Question 6: For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. (See paragraphs D17, D22 and D26 in Appendix D of the IASB ED) Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?***

Yes, we agree with these consequential amendments.

**Financial Reporting Committee**

Anthony Appleton	PKF (UK) LLP
Edward Beale	Western Selection Plc
Nigel Bostock	Crowe Clark Whitehill
Anthony Carey	Mazars LLP
Peter Chidgey	BDO LLP
Ian Davies	Victoria PLC
Jack Easton	UHY Hacker Young
Bill Farren	Deloitte LLP
Jonathan Ford	PricewaterhouseCoopers LLP
David Gray	DHG Management
Kate Jalbert	Quoted Companies Alliance
Shalini Kashyap	Ernst & Young LLP
Nicole Kissun	PKF (UK) LLP
James Lole	RSM Tenon Group PLC
Jonathan Lowe	Baker Tilly
Kern Roberts	Smith & Williamson Limited
Nigel Smethers	One Media Publishing
Chris Smith	Grant Thornton UK LLP
Ian Smith	Deloitte LLP
Matthew Stallabrass	Crowe Clark Whitehill
Jacques Sultan	Quoted Companies Alliance
Tim Ward	Quoted Companies Alliance
Paul Watts	Baker Tilly
Nick Winters	RSM Tenon Group PLC

## THE QUOTED COMPANIES ALLIANCE (QCA)

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

The Quoted Companies Alliance 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;
- political liaison – briefing and influencing Westminster and Whitehall, the City and Brussels
- accounting standards proposals from various standard-setters

The Quoted Companies Alliance is a founder member of **EuropeanIssuers**, which represents quoted companies in fourteen European countries.

### **Quoted Companies Alliance's Aims and Objectives**

The Quoted Companies Alliance 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 exclude business rates, VAT and other indirect taxes.

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