



Accounting Standards Board

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Dear Stig

EFRAG's Draft Comment Letter on the IASB's Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers'

This letter sets out the Accounting Standards Board's (ASB's) views on the EFRAG draft comment letter (DCL) to the above IASB discussion paper (DP).

The Board has responded directly to the IASB and a copy of our letter is attached. You will see from that letter that the ASB is generally supportive of the proposals in the IASB's DP and, as a consequence, does not share EFRAG's view that revenue should be a measure of activity carried out to fulfil a contract with a customer.

General comments on the DCL

Acknowledging the difference of view we have on the proposed model for revenue recognition, the ASB does share many of the views set out in Appendix 1 of the DCL.

On a point of the structure of the DCL, the ASB notes that paragraph 1 of Appendix 1 of the DCL states that EFRAG will leave aside its proposed alternative model (as described in Appendix 2) when considering its responses (set out in Appendix 1) to the IASB's proposed model on revenue recognition. However, Appendix 1 often refers to the EFRAG proposed model and does not (as promised) focus only on the IASB model (for example, paragraph 98 of Appendix 1). We think it would be preferable to more clearly differentiate between the two appendices, which we think will be more useful to the IASB in analysing EFRAG's views on its proposals.

In terms of the EFRAG proposed model for revenue recognition, the ASB would draw your attention to our response to the Pro-active Accounting Activities in Europe (PAAinE) DP 'Revenue Recognition', which was sent to EFRAG on 10 December 2007. In that letter, the ASB argued against the adoption of a 'continuous approach' to revenue recognition, as implied by the EFRAG proposal. In addition to our response, the ASB notes (in Appendix 1 to this letter) some aspects of the approach which would need to be addressed if it were to be considered further.

Other comments on EFRAG's suggested responses (Appendix 1 of the DCL).

The ASB has some of comments with regards to EFRAG's suggested responses to the detailed questions in the IASB's Invitation to Comment:

Question 8 (paragraph 61 -63 of Appendix 1 to the DCL)

The ASB considers that the critical issues are raised in paragraph 62 (a) and (b); and that the focus of the EFRAG response should be to focus more on the validity of the 'risk and rewards' test. This would be consistent with the comments made in EFRAG's response of 8 April 2009 to ED 10 'Consolidated Financial Statements' (please also refer to the ASB response to question 8 in the attached letter).

Question 9

Given that the ASB supports the approach proposed by the IASB, our response to this question differs from the EFRAG response.

EFRAG questions in the DCL

The ASB's responses to the questions posed by EFRAG in Appendix 1 of the DCL are set out in Appendix 2 to this letter.

Should you wish us to expand on any aspect of this response, please contact myself or Jennifer Guest j.guest@frc-asb.org.uk

Yours sincerely



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Chairman

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APPENDIX 1

ASB Comments on the EFRAG alternative view on 'Revenue Recognition'

In our response to the PAAinE Discussion Paper 'Revenue Recognition—A European Contribution' we expressed a number of reservations about the 'continuous approach' which seems to be the same as the model advocated by EFRAG in its draft response to the IASB's ED. We continue to have a number of reservations about EFRAG's proposed model and, if it is to be considered further some issues, including the following, need to be addressed.

- (i) Why is the information under the proposed model likely to be useful? It seems self-evidently useful for financial statements to report the amount that has been sold in a period and to compare that with the costs incurred in achieving those sales. With this view the main objectives for a standard on revenue recognition are to specify the circumstances in which sales should be recognised and how sales should be measured. It is not self-evident that the objective of reporting activity undertaken pursuant to contracts with customers is useful, or why it should replace information on sales and cost of sales, rather than being reported elsewhere in the financial statements (for example, by recording an increase in work in progress.)
- (ii) Under the model revenue is to be recognised only on work undertaken pursuant to contracts with customers. But if the objective is to be that of reporting economic activity, it is not clear why a contract is necessary. The economic activity incurred in manufacturing goods for stock—the increase in value over costs incurred—would not, apparently be recognised. An entity may manufacture some items that have been the subject of a specific order and others that are not, but will be sold in due course. It is not clear that it is useful to recognise some of this activity in revenue and not others. Whilst the sale of manufactured goods may be more certain where there is a contract, this may not always be particularly important—for example where there is ready demand for the product. It would seem that recognising revenue as contract activity progresses would imply that a supplier is always 'better off' if manufacturing under a contract, but this is not necessarily that case: the contract places a limit on its ability to take advantage of any price increase that might arise before the sale takes place, and this advantage may be greater than the additional certainty that the contract provides.
- (iii) Implementation of the EFRAG model would require a definition of 'progress towards completion'. It would not seem adequate to provide that all costs that the entity believes are necessary to fulfil its contractual obligations should trigger the recognition of revenue, as this would result in revenue potentially being recognised in a wide variety of circumstances. (See the ASB response to the PAAinE Discussion Paper, Appendix paragraph A6.3).

APPENDIX 2

ASB suggested responses to the questions EFRAG posed in its DCL.

Definition of a contract (paragraph 25 of Appendix 1)

We would like to know of any difficulties constituents think there might be in applying the proposed definition in particular jurisdictions?

The ASB is not aware of any difficulties in applying the proposed definition of a contract in the UK.

Sales incentives giving rise to performance obligations (paragraph 56)

We would particularly welcome comments on this issue. How would you analyse the transaction and why? What are the consequences for the way it should be accounted for?

The ASB agrees with the EFRAG analysis of the gift card example in the DP; that the gift card should be accounted for as a separate performance obligation.

Other issues not covered in the DP (paragraph 118)

Appendix C of the DP contains a list of issues not covered in the DP. As we expect these issues to be addressed in any ED developed from the DP, we would welcome any comments constituents have on those issues at this stage.

The ASB notes that issues relating to the effects of the time value of money were considered at the IASB's March 2009 meeting. At that time, the IASB tentatively agreed that the carrying amount of an entity's net contract position should reflect the time value of money, whenever its effect would be material. The ASB would support this view.