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International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
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Dear Sir/madam, we are pleased to submit our comments on the Discussion Paper: Preliminary Views on Revenue Recognition in Contracts with Customers (“the Discussion Paper”).

Overall comment

Overall, from a conceptual viewpoint, we support the Board’s objective to have a single standard that deals with all aspects of revenue recognition and that can be applied by all industries. However, as discussed in more detail below, we disagree with the artificial approach proposed in the discussion paper around the treatment of certain contracts like long term construction contracts.

We also question the need for development of a new standard at this point in time especially where the proposals are not expected to have a major impact on current practice and where there are other, more urgent, issues to be addressed. Even though it would be useful to have more explicit guidance around transactions involving multiple components, in practice the current standards are fairly well understood and applied. We note with interest the Board’s view that IAS 18 and IAS 11 are “inconsistent and vague” when IAS 18 actually cross refers to IAS 11 and thereby imply consistency between IAS 11 and IAS 18.

Whilst the approach being discussed may be technically correct and pure, it would involve a change in thinking, in particular in considering whether you have revenue from an earnings viewpoint, to considering the impact on the balance sheet to determine if there is revenue.

We are concerned that the Boards have moved too fast in directions that do not have the common support of many people who are engaged in accounting in practice. All too often we hear negative comments about current accounting standards and the Board’s that issue them and we have serious concerns that this is creating a culture of disrespect. We believe that the Board’s have gone too far in

many of their disclosure requirements and unfortunately some of their measurement requirements.

Application of the proposals to long term construction (and similar) contracts

It is proposed in the Discussion Paper that activities that do not result in a transfer of assets to a customer would result in no revenue being recognised even though the contracted services are provided. In particular, for long term construction type contracts, the contractor will have to “continuously transfer ownership rights” to the customer to be able to have any revenue recognised over the life of the contract. This is not reflective of what is happening in practice and as acknowledged in the discussion paper, this will result in significant change from current practice where these types of contracts have generally been accounted for using the percentage of completion method. A change that we believe is not warranted because:

- Generally, under long term construction contracts, both parties have rights and obligations that are comparable to “control” of the underlying asset. It is highly unlikely that an entity would be contracted to deliver a major project, to receive progress payments and still be able to claim that it “controls” the asset such that it would be comparable to “inventory” in that entity’s financial statements. The entity does not have the practical ability to sell these assets to others. Equally, it is highly unlikely that a customer would be prepared to make progress payments in respect of a project that it contracted someone to deliver without having some level of control over the output as the project progresses even if it has not taken possession.
- It introduces an artificial decision making process into the consideration of these types of contracts – i.e. whether the asset is continuously transferred or not – which could lead to manipulation of the accounting for these contracts. In the long term, we believe this will negatively impact the industry.
- Current construction contract accounting requirements are generally well understood, implemented and support good business practices and discipline.
- The proposals could introduce a level of volatility over the term of the contract that is not reflective of the rights and obligations under the contract.

Response to questions for respondents

The following is our responses to the specific questions for respondents raised in the Discussion Paper.

Question 1

Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

We support a single revenue recognition principle based on changes in the rights and obligations under a contract. We agree that revenue should be recognised as goods or services are delivered. We still believe there is validity that revenue recognition should be dealt with by way of understanding the effects on the earnings statement, rather than focus on the broad principles of asset or liability changes, if only for the fact that it is simpler.

Question 2

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

As discussed above, we believe the proposed principle would not provide decision-useful information if it results in no revenue being recognised in respect of major long term projects over the term of the contract. As mentioned under question 1, revenue should be recognised as goods and services are provided. By not recognising any revenue over the period of long term contract this key principle would not be met. It is generally accepted that contract obligations under long term contracts are satisfied over the contract period even though physical delivery might not occur until the end of the contract. The principle here is an ongoing assessment of progressive value and associated payments where both parties have a degree of control. Any attempt to manipulate this valuation is fraught with danger.

Question 3

Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

We agree.

Question 4

Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

Yes, however it is vital that the eventual accounting standard makes it clear that separate identification does not mean separate accounting for micro parts of the contract. The risk is that the requirements become impractical to apply where contracts are analysed into an infinite number of immaterial components.

Question 5

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

We agree. It seems to be a practical approach to deal with the concern we raised under question 4.

Question 6

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

We disagree. Although the entity has an obligation of some sort, it doesn't meet the definition of a performance obligation as set out in the discussion paper. Saying that, we do believe the financial statements should reflect this obligation. We considered the two views expressed in the discussion paper and the resulting accounting proposed under each view and have the following concerns with each approach:

- If it is accounted for as a performance obligation (view 1) it will mean that a portion of each sale should be deferred until the right of return period expires. Not only will this require unnecessary administration for very little benefit, but it will also require a very subjective and in most cases unsupportable amount being attributed to the "right of return".

- If it is accounted for as a failed sale (view 2) it will mean that inventory will continue to be recognised even though the entity no longer controls that inventory.

We came to the conclusion that the best accounting outcome is where an obligation is created with the resulting debit to revenue based on the estimated proportion of transactions that is expected to fail. This will ensure that the balance sheet correctly reflect the obligation to accept the returned goods but inventory is not overstated (i.e. if the debit is to inventory, it will mean that the balance sheet reflects assets that are not currently under the control of the entity). In addition revenue will be recognised in the correct period.

Question 7

Do you think that sales incentives (e.g. discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

We agree.

Question 8

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

In most instances physical control of an asset or receipt of the service will confirm that the performance obligation under the contract has been met. However, as mentioned before, in long term contracts it is not always practical to physically transfer the asset until the end of the contract. In this instance we believe alternative indicators of the fact that control of parts of the asset have transferred could include non-refundable progress payments, surveys, cost to date or completion of a component.

Question 9

The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

Refer response to question 8.

Question 10

In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

- (a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?
- (b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?
- (c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.
- (d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

We note the discussion paper currently ignores time value of money and assumes consideration is fixed and paid in cash. In our view these factors could have a significant impact on the amount of revenue to be recognised and hence the measurement of the performance obligations and therefore we suggest the impact of these factors be further considered before the requirements around the measurement of performance obligations are finalised.

We agree with the requirements around onerous performance obligations.

Question 11

The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (e.g. selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

(a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?

(b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

We agree that costs incurred to obtain a contract should be expensed as incurred. However, if the customer is reimbursing the entity for such costs, by implication one of the performance obligations in the contract has been satisfied (i.e. the customer has paid for receiving the service or goods). Therefore it goes against the principle of revenue recognition proposed in the Discussion Paper to defer the consideration paid by customers as reimbursement of those costs.

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

We agree.

Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

We agree.

If you have any queries or require clarification of any matters in this submission, please contact me.

Yours sincerely,

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