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Sir David Tweedie, Chairman International Accounting Standards Board 30 Cannon Street LONDON EC4M 6XH United Kingdom

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Dear Sir

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<u>DISCUSSION PAPER: PRELIMINARY VIEWS ON REVENUE RECOGNITION IN CONTRACTS WITH CUSTOMERS</u>

Sappi Limited is pleased to comment on the International Accounting Standards Board (the "IASB") and the US Financial Accounting Standards Board ("FASB") (hereinafter "the Boards")' Discussion paper on Preliminary views on Revenue Recognition in contracts with customers (the "discussion paper" or "DP").

Our primary basis of reporting is International Financial Reporting Standards (IFRS), but we are required to comply with certain filing requirements of the Securities Exchange Commission (SEC) in the United States of America due to our listing on the New York Stock Exchange Stock Exchange. We therefore are encouraged by the Boards' commitment to provide convergence in international accounting practices but would encourage that convergence should not merely occur for the sake of convergence, but in order to produce higher quality financial statements than would have been applicable in the two separate frameworks.

We would like to thank you for the opportunity to provide comments on this document. Our detailed responses to the invitation to comment questions are included in Appendix A.

Please do not hesitate to contact me should you wish to discuss any of our comments.

Yours sincerely

Moses Sekgobela Group Reporting Manager

Directors: Dr D C Cronjé (Chairman), Messrs R J Boëttger (Chief Executive Officer), D C Brink, J E Healey (USA), H C Mamsch (Germany), J D McKenzie and M R Thompson, Drs D Konar and F A Sonn, Mses K R Osar (USA) and B Radebe, Prof M Feldberg (USA), Sir A N R Rudd (UK)

Appendix A: Invitation to comment

General comments

The discussion paper does not make it clear whether the boards' intentions include recognition of contract assets and liabilities at contract inception - before the parties to the contract have performed (executory contracts). The boards express their discomfort with this treatment (par 5.20) and further illustrate this principle through examples in Appendix A but do not make it clear whether this is permitted.

Recognition of contracts with customers and revenue arising from the contract should only occur when parties to the contract perform in terms of the contract, except where before performance, the contract is deemed onerous. It is further noted that executory contracts fall within the scope of IAS 37. We feel that this principle should be prominently highlighted in the proposed exposure draft.

We further note that the DP only addresses revenue recognition in contracts with customers. The definition of revenue in IAS 18 Revenue could encompass revenue where such revenue does not arise from contracts with customers. IAS 40 Investment property allows recognition of increases in fair values of assets in profit or loss. For entities that acquire investment property with the main purpose of benefiting from increases in fair value; such increases would meet the definition of revenue in terms of IAS 18 especially since some revaluations can be considered permanent in nature and in certain jurisdictions such appreciations in fair value may be distributed as dividends. Currently IAS 18 does not exclude the accounting for investment properties in its scope.

The new standard would need to either address principles for such revenue recognition, have scope limitations or add further guidelines on how revenue form these transactions needs to be accounted for.

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 agree with the boards' proposal to base a single revenue recognition principle by reference to an entity's net position in a contract with a customer.

Basing revenue recognition of contract assets or liabilities would have the effect of recognising revenue only when it is earned. This would be evidenced by an increase in an entity's net position in a contract with a customer when the entity meets its obligations in terms of the contract.

One of the reasons for having standards that account for transactions that are economically similar in a different way is because those standards do not derive their principles from at least one single overriding principle(s) of revenue recognition. Instead the different standards are developed from industry specific conditions. Inconsistencies in existing standards will be addressed by at least one overriding principle(s) that are accompanied by guidance that is specific to each industry. For as long as industry specific guidance does not deviate from the overriding principle in the single revenue standard, entities will be able to produce high quality comparable financial statements.

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?

We note that certain gross inflow of economic benefits arising in the course of the ordinary activities of an entity where such inflows result in increases in equity, other than increases relating to contributions from equity participants (IAS 18) are in certain instances not dependent on the changes in an entity's net position in a contracts with a customer.

For entities that enter into contracts to trade in financial instruments or other assets that are carried at fair value and where such trading forms part of the entity's normal operating activities; it can be argued that increases in fair values of those assets would constitute revenue whereas the entity may not have satisfied a performance obligation or where there are no further performance obligations to meet.

The principle to apply in recognising revenue from these contracts would not be dependent on the satisfaction of performance obligations, especially in cases where there may be no performance obligations. The revenue standard would have to allow an alternative base of recognising revenue, where this is not related performance obligations.

The new standard would need to either address principles for such revenue recognition, have scope limitations or add further guidelines on how revenue form these transactions needs to be accounted for.

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 with the boards' definition of a contract. We note that the boards' definition of a contract can be pervasively applied across the business world. The definition is also based on a universal concept that all business parties have as an intention in entering into business transactions.

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.

We are of the view that the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract.

The intention of parties in entering into a contract is to create rights and obligations. The boards' proposed definition can be applied to contracts that business people enter into across the world. The definition also encourages the parties to a contract to separately identify all such rights and obligations and where applicable to only recognise revenue when the performance obligations are met.

The definition also has the effect of requiring similar rights and obligations to be accounted for in the same way. This will help in eliminating inconsistencies in treating transactions with similar economic terms across different industries.

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 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.

Revenue recognition faithfully represents the transactions and events that an entity engages in only when the revenue is recognised in the statement of financial performance in a manner that is consistent with the pattern in which that revenue is earned. We believe that revenue is earned only when an entity transfers the promised asset to its customers or clients.

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 believe that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation. Sales of goods with a right of return establish two obligations for the entity; an obligation to deliver the goods where a portion of the revenue needs to be recognised when the customer obtains control of the goods and an obligation to accept delivery of goods and refund the customer when the goods are returned.

We agree with the view that the right of return represents a service that an entity transfers to the customer. Some of the revenue from the sale should be attributed to the return service and only be recognised when the right of return lapses.

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?

Where agree with the view that sales incentives do not automatically result in performance obligations (par 3.32 of the DP). Granting a discount to a customer on future sales only becomes an obligation when the customer purchases additional products.

Customers may not exercise such rights to purchase goods at a discount. We accept that such rights normally have an expiration period but also note that recognition of these incentives as performance obligations may occur in different periods to which the obligating event actually occurs.

The boards' may have to add guidance to differentiate between incentives that may or may not result in performance obligations similar to the examples given in paragraph 3.27 – 3.33 of the discussion paper.

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.

We 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 because the transferred asset would then meet the definition of an asset on the customer's balance sheet. At this point the entity would have performed its obligation and would need to remove the asset from its balance sheet.

The principle of control will make sure that an asset is always recorded in one balance sheet.

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.

We note that certain gross inflow of economic benefits arising in the course of the ordinary activities of an entity where such inflows result in increases in equity, other than increases relating to contributions from equity participants (IAS 18) are in certain instances not dependent on the satisfaction of performance obligations.

For entities that enter into contracts to trade in financial instruments or other assets that are carried at fair value and where such trading forms part of the entity's normal operating activities; it can be argued that increases in fair values of those assets would constitute revenue whereas the entity may not have satisfied a performance obligation or where there are no further performance obligations to meet

The principle to apply in recognising revenue from these contracts would not be dependent on the satisfaction of performance obligations, especially in cases where there may be no performance obligations. The revenue standard would have to allow an alternative base of recognising revenue, where this is not related performance obligations.

The new standard would need to either address principles for such revenue recognition, have scope limitations or add further guidelines on how revenue form these transactions needs to be accounted for.

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?

We agree that performance obligations should be measured initially at the transaction

price because the initial transaction price reflects what the entity is reasonably expected to earn from performing its obligations under the contract.

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?

We 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? Failing to recognise a loss for the onerous provision would be an understatement of liabilities.

We however disagree with the view that the performance obligation only needs to be updated if it is deemed onerous. Entities should be allowed to reverse losses and performance obligation liabilities if it is expected that a contract that was previously written down as onerous will now yield economic benefits greater than the costs an entity expects to incur in meeting the obligation.

The standard would have to prohibit the revaluation of contracts with customers where such revaluation would result in recognition of revenue before an entity satisfies a performance obligation. This may be achieved by precluding entities from remeasuring performance obligations unless a previous loss related to the contract was recognised before. This will still ensure that expected profits under a contract with a customer are not recognised until they are earned.

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.

We are of the view that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date.

Failure to reverse previously recognised onerous provisions where it is clear that contracts have ceased to be onerous would not provide decision useful information at each balance sheet date.

Examples where the proposed principle would not provide decision useful information is where a transportation company undertakes to render a delivery service for a fixed fee. Typically the costs of delivery would include fuel; should the price of fuel increase beyond the fee that an entity stands to receive in terms of a contract, the contract would become onerous. Subsequent decreases in the fuel price, such that the entity's fee will be above its costs of rendering the service would result in the contract no longer being onerous. Should entities not be allowed to reverse previously recognised losses, information in the financial statement would be misleading and not conducive to decision making.

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.

Yes, there will be a need for another measurement approach for certain contracts. An example of this situation is described in the answer to question 10 (c) above. The measurement approach that would provide decision useful information would be to reverse previously recognised onerous contract losses but to limit this reversal to the losses recognised previously. By limiting the reversal of losses, entities will be precluded from recognising expected profits from the changes in the costs required to meet performance obligations in advance.

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?

We agree that amounts charged to customers to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligation. Where an entity undertakes to render a service to a customer – generate a contract of sale, and the customer has to pay for this service, the rendering of the service represents a performance obligation at contract inception. This is especially true if a customer has the ability to pay a third party (for example an attorney) to generate the contract. By entering into a contract at inception, an entity undertakes to incur costs necessary to make the sale legal in terms of the applicable rules and regulations.

This promise represents a performance obligation for which the customer is prepared to pay and therefore an entity needs to allocate a portion of the contract price to this promise.

(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.

Recognising contract origination costs as expenses as they are incurred would not provide decision-useful information about an entity's financial position and financial performance if an entity is in a position to recover the origination costs. Expenses that are to be recovered from a customer represent an asset and expensing these would be an understatement of assets.

Certain financial institutions and car dealerships recover initiation fees from their clients.

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 that where an entity has the ability to sell different products and services on a stand alone basis, but sells the products together in one transaction and receives one consideration from a customer, 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.

This allocation of revenue and performance obligations in relation to the stand-alone selling prices would faithfully present the pattern in which the entity earns its revenue especially when the total consideration from the customer is received in one payment from the customer while the revenue from the different products and services under one transaction is not earned at the same time.

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 that when an entity does not sell goods or services separately, that entity should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price. However we are of the view that entities need not perform this estimation for every transaction that they enter into. A monthly, quarterly or other periodic estimation or another reasonable estimation depending on each unique circumstance of an entity should suffice. Entities would calculate an allocation ratio for the total consideration and only update this on a monthly, quarterly or other interval depending on the circumstances applicable to each entity.

Estimating prices for goods or services sold separately may prove difficult and costly. The costs and effort of regularly estimating prices may outweigh the benefits obtained.