



7 Brook Road, Lilianton, Boksburg 1459  
Private Bag X170  
Bedfordview 2008  
South Africa  
Tel: +27 11 418 6300  
Fax: +27 11 418 6333

21 October 2010

International Accounting Standards Board

30 Cannon Street

London

EC4M 6XH

United Kingdom

Dear Sir/Madam

#### **ED/2010/6 REVENUE FROM CONTRACTS WITH CUSTOMERS**

Basil Read Holdings Limited, founded in 1952 and listed on the Johannesburg Stock Exchange, is one of the top construction companies in South Africa. Operating throughout Africa, its subsidiaries specialise in civil engineering, road construction, building, mixed integrated housing developments, property development, bitumen distribution, opencast mining, blasting operations and engineering design, procurement and construction management. In the 2009 financial year, the company generated revenues of ZAR 4.5 billion and net profit after tax of ZAR 271 million. We welcome the opportunity to comment on Exposure Draft 2010/6 – Revenue from Contracts with Customers.

We feel that accounting for revenue relating to construction contracts under IAS 11 has always contained a degree of subjectivity. However, we are of the opinion that the proposed requirements exacerbate the degree of subjectivity required, which may be difficult to explain to users through increased disclosure, without publishing commercially sensitive information. Due to this high level of subjectivity, we also feel that the auditing of the information becomes less transparent as it may be difficult

for auditors to dispute an entity's judgements if it can be shown that the entity has applied its mind in reaching its conclusions.

In addition, we believe that the implementation of the proposals in their current form could create significant volatility in an entity's earnings, which may be disconcerting to lesser sophisticated investors and comparability between entities may be compromised.

We also feel that the proposals could fundamentally alter the way in which construction companies do business, which we do not believe is an intended consequence of the proposed requirements.

### **Recognition of revenue (paragraphs 8-33)**

**Question 1:** More guidance is needed relating to price interdependence and as a result, whether to combine or segment contracts, particularly relating to contract modifications. In the construction industry, contract modifications are common and are closely related to the original contract from a performance perspective but could have indicators that point to either accounting for them as separate contracts or combining them with the original contract. Although the principle is sound, application could be extremely subjective and could lead to varying accounting treatments within the construction sector.

**Question 2:** While we agree with the principle of identifying performance obligations, further guidance is required as to the level of segregation required. One could argue, for instance, that in the construction of a building, the laying of bricks could constitute a performance obligation. In that case, would the laying of one brick constitute a performance obligation or the laying of all of the bricks to complete the building, as both of these could be argued to be distinct. In addition, there are many separate actions that constitute a construction contract that, at the time of tender, are priced separately with differing margins, although a total tender price may be submitted for the contract as a whole. Example 11 under paragraph B43 does not provide enough guidance to clearly demonstrate this principle to the construction industry, which could result in vastly differing interpretations across the sector.

Paragraph 23 makes reference to "the entity, **or another entity**" which is extremely broad as it is probable that it would be possible to break a construction contract down to an almost unlimited amount of performance obligations which may not provide useful information and is probably not the intention of the IASB. We propose that there should be a limit to the amount of segregation, not only based on the timing of revenue recognition, but that is specific to the contract itself and the customer's requirements. For example, the construction of a building could be

broken down into numerous performance obligations under the proposed requirements but the only performance obligation that the customer is interested in is the completion and delivery of a completed building. Although the principle of continuous transfer of control may apply, a semi completed building is of little value to the customer and therefore the construction entity should account for the construction of the completed building as the only performance obligation.

**Question 3:** The principle of obtaining control is sound but could be difficult to implement in practice, particularly in determining if there is continuous transfer of control or if control passes at the end. More guidance needs to be provided in this regard. For the construction sector, the real question is who controls the work in progress and we believe that it should be relatively straightforward to prove that continuous control passes given the nature of construction contracts where progress payments are made regularly based on work completed to date.

#### **Measurement of revenue (paragraphs 34-53)**

**Question 4:** We agree that an entity should recognise revenue on the basis of an estimated transaction price and are comfortable with the criteria proposed in paragraph 38.

**Question 5:** We agree that it is appropriate to consider a customer's credit risk when determining the transaction price, particularly as many industries would price this risk accordingly and it would be inherent in the sales price e.g. financial institutions charging higher interest rates to riskier clients. This, however, would require extremely subjective judgement which could lead to varying results between companies.

We do not agree with the principle that changes in the assessment of credit risk associated with that right to consideration should be recognised as income or expense rather than as revenue. The nature of revenue should remain the same regardless of any assumptions made relating to collectability. The effects of changes in the assessment of credit risk should be recognised and revenue and disclosed in the notes to the financial statements.

**Question 6:** We agree that the time value of money should be considered if the contract includes a material financing component. This however raises the question of materiality which will differ from company to company dependant on their normal terms and conditions. We suggest that guidance is provided relating to clarify what is material and at what level the materiality should be considered i.e. the individual contract, a group of contracts or the entity itself.

**Question 7:** We are of the opinion that the use of stand-alone prices in the construction industry would be difficult to implement as observable prices are virtually impossible to determine. This will result in the use of estimated stand-alone prices which would be highly subjective due to differing efficiencies in each company, and could lead to non-comparability between companies in the sector. This is evidenced by the vastly different tender prices that a number of construction companies would submit for the same tender. As each element of a construction contract is priced separately, we propose that these results are used in determining the allocation of the transaction price.

### **Contract costs (paragraphs 57-63)**

**Question 8:** We believe that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient.

**Question 9:** We agree with the costs specified.

### **Disclosure (paragraphs 69-83)**

**Question 10:** We support the need for more comprehensive disclosure but feel that the proposed disclosures are too subjective to provide the users of financial statements with meaningful information. The level of disclosure is determined by the entity and may therefore vary greatly between entities which will affect comparability. To provide the level of detail that users may find beneficial could involve the disclosure of sensitive confidential information which the entity may be reluctant to disclose due to the competitive nature of the construction industry. We propose that the disclosure requirements are limited to the judgements and estimates that the entity has made, disclosed in broad terms, in arriving at its revenue figure. A prescribed minimum amount of disclosure should also be required, without the need to disclose sensitive entity-specific information.

**Question 11:** We agree with the proposed disclosure requirements relating to an entity's remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year. This information is already disclosed to some extent in the form of order book disclosure. It must be borne in mind, however, that, under the proposed guidelines, the amounts disclosed are subject to change, particularly in the construction industry that may have longer term contracts which may change over time. Some

guidance should be provided as to how these amounts are to be calculated to ensure consistency between entities.

**Question 12:** We do not see a problem with the disclosure of information relating to the disaggregation of revenue. Much of this information is provided in the segmental report, although further detail may be required.

**Question 13:** We do not agree that the proposed requirements should be applied retrospectively as this could be a timely and costly exercise, without providing any additional benefit to users. For the construction industry specifically, which may well have construction contracts with significantly extended maintenance periods, e.g. 20 years, retrospective application may be difficult to implement. We propose prospective application for all new contracts. Existing contracts should be evaluated at the transition date, in relation to the remaining performance obligations, and accounted for under the proposed requirements from that date on, i.e. no restatement of prior year figures. Disclosure regarding the impact of the transition on existing contracts could provide greater clarity to users.

#### **Application guidance (paragraphs B1-B96)**

**Question 14:** The proposed application guidance is beneficial but does not provide enough clarity on certain issues, as detailed above, where further guidance is required.

**Question 15:** We do not believe that a distinction is necessary, specifically relating to the construction industry. Based on our understanding of the proposed requirements, we believe that revenue will be recognised on the basis of continuous transfer of control relating to the agreement of contract milestones and regular progress payments, in most instances. As the agreement of contract milestones will contain an implicit latent defect warranty, we do not believe that it is necessary to distinguish this separately. A warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer would be included as part of the maintenance period, which would constitute a performance obligation on its own.

**Question 16:** As the construction industry has limited intellectual property, we have not given due consideration to these proposed requirements and therefore, do not offer any comments.

### **Consequential amendments**

**Question 17:** We agree with the proposals regarding the accounting for the gain or loss on the sale of some non-financial assets to ensure consistency, particularly relating to the control principle.

In conclusion, we thank you for the opportunity to engage with the IASB and look forward to the publication of the improved proposals.

Yours faithfully

Handwritten signature of Donny Gouveia in black ink.

Donny Gouveia

Finance Director