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22 October 2010

International Accounting Standards Board
30 Cannon Street,
London EC4M 6XH, UK

Submitted via email to commentletters@ifrs.org

RE: Exposure Draft: *Revenue from Contracts with Customers*

Dear Chairman

We appreciate the opportunity to respond to the proposed Exposure Draft, *Revenue Recognition Revenue from Contracts with Customers* ("the ED" or "new Standard").

This letter represents a group response from the members of the Australian Constructors Association ("ACA").

ACA was formed in 1994 to advance the interests of major construction contractors ("we", "us", "our Industry" or "the Industry"). ACA has 20 members (see Appendix A) who have combined revenue of over A\$40 billion and employ over 86,000 people directly and hundreds of thousands more employed by subcontractors on member projects. Our members provide long-term construction related services to customers around the world. The services provided by ACA members are broad and can vary widely from one project to the next, and typically include some or all of the following: program management, planning, design, engineering, procurement (services and/or material procurement), fabrication, construction, construction management, logistics, start-up/commissioning, operations and maintenance, and decommissioning/closure services.

Our response reflects the collective perspective and view of the entities named at Appendix A. Although each party has their own individual perspective, we are all unified on the view that there are aspects of the ED that require revision, for the reasons expressed. Our group has participated in several industry roundtable meetings and conference calls, where the ED was the primary topic of discussion. At least 10 members have attended various meetings held to discuss the ED, and we believe our views are generally shared among our peer group

Currently, both U.S. GAAP and IFRS have unique standards for revenue recognition relating specifically to long-term contracts. The existing standards have served both financial statement users and preparers well for many decades, providing transparent information about the critical financial characteristics of long-term construction projects, including revenue and cost recognition, without significant diversity in practice within the Industry.

In order to maintain this transparency and limit future divergence in practice, we encourage the Board to consider revisions to the ED that will allow for the continued application of those principles and allow for the practical application of the ED without unduly burdening the Industry.

- ▲ Abigroup Contractors Pty Limited
- ▲ Baulderstone Pty Ltd
- ▲ BGC Contracting Pty Ltd
- ▲ Bovis Lend Lease Pty Limited
- ▲ Brookfield Multiplex Constructions Pty Ltd
- ▲ CH2M Hill Australia Pty Ltd
- ▲ Clough Limited
- ▲ Downer EDI Limited
- ▲ Fulton Hogan Pty Ltd
- ▲ Georgiou Group Pty Ltd
- ▲ John Holland Group Pty Ltd
- ▲ Laing O'Rourke Australia Construction Pty Limited
- ▲ Leighton Contractors Pty Limited
- ▲ Leighton Holdings Limited
- ▲ Macmahon Holdings Limited
- ▲ McConnell Dowell Corporation Limited
- ▲ Thiess Pty Ltd
- ▲ UGL Limited
- ▲ Valemus Australia Pty Limited
- ▲ Watpac Limited

Although we agree with many of International Accounting Standards Board (IASB) stated objectives in the issuance of this ED, we would like to see modifications to certain portions of the ED. We believe these modifications will result in a more practical and consistent application of the new Standard, in line with the underlying principles and intent of the ED.

While we recognise that one of the Board's objectives in proposing the ED is to improve comparability of revenue recognition across all industries, we believe that the ED will actually reduce comparability of revenue and profit recognition within our Industry and require burdensome activities without accomplishing the Board's objectives. In particular, there are three primary features of the ED that we believe require further consideration by the Board.

1. We do not believe multiple performance obligations exist within many of our long-term contracts and we respectfully request that the ED be modified to more clearly and affirmatively state that a single performance obligation may exist for certain long-term contracts. We believe that the ED should allow for the determination of a single performance obligation when contract activities will be performed in an overlapping, concurrent and/or highly interrelated manner. As currently drafted, the ED (including Example 11) implies that most long-term contracts will result in the identification of multiple performance obligations. We do not believe that users of our financial statements or our customers view our deliverables in this manner. Consequently, unless modified, the ED would result in burdensome activities that produce somewhat arbitrary allocations of the transaction price and more variability in application, with less meaningful information conveyed to the users of our financial statements.
2. Although we agree with the use of indicators and principles within the continuous transfer of control model, we believe the guidance provided in the ED for determining whether continuous transfer of control exists is unclear and difficult to apply to most long-term contracts, particularly contracts for services, and will lead to widespread diversity in practice. The basic principle underlying current accounting standards for long-term contracts is that revenues and profits are earned continuously as the work progresses. Our view is that the continuous transfer of control principle represents the legal essence of most long-term contracts, particularly those in the engineering and construction industries. Application of either of these two principles should produce nearly identical results under long-term contracts. However, we believe the ED should be modified to clarify the indicators of continuous transfer of control.
3. The retrospective application of the ED will be particularly burdensome for any contractor, particularly those performing contracts (i.e. facility operation and maintenance) with lives that regularly extend beyond five years. We are united in our belief that retrospective application is impractical for most companies in this industry because many of the needed records and much of the needed information may no longer be available. Prospective application of the ED should be allowed with an effective date that will reduce the burden of transition.

In addition to the three primary concerns articulated above, we also have included comments on other topics in the ED related to:

- the accounting for contract modifications,
- the use of a probability-weighted approach in determining transaction price,
- the application of time value of money to the transaction price, and
- certain disclosure requirements.

We believe that each of these aspects of the ED should also be modified to provide more accurate and useful information to financial statement users.

The following discussion provides our specific comments on the ED.

1. Accounting for Separate Performance Obligations in Long-term Contracts

1.1 The Unique Nature of Long-term Contracts

By their nature, long-term contracts, particularly those associated with specialised construction projects, are individually unique in both their design and execution, such that the terms, conditions, and deliverables are not comparable to terms, conditions and deliverables of sales contracts used in other industries, such as retail, manufacturing, technology, or financial services. In spite of the number of similar projects a contractor may perform over time (e.g., petroleum refineries, aquifers, wastewater treatment facilities, bridges, toll roads, pharmaceutical facilities, etc.), there are a myriad of variables (quality and availability of feedstocks, local water tables, types and availabilities of raw materials, soil and site conditions, etc.) that render each project unique. In contrast, contracts in other industries that truly include multiple elements are typically ones in which each individual deliverable has a specific utility for the customer, and the customer could, if so desired, procure some of the deliverables, but not all of them, and still be satisfied with those delivered. For arrangements of this type and arrangements where similar performance obligations are in fact sold separately, we agree that the goods and services to be delivered could reasonably be accounted for separately. However, for many long-term contracts in our Industry, the deliverable is the entire project, with the various activities comprising the project performed in an overlapping, concurrent or highly interrelated manner, such that, given the interdependencies, the activities do not have separate utility or risks and therefore, do not have a distinct function or margin. In their simplest form, many long-term contracts in our Industry generally contain one performance obligation: a single project that is a representation of what the entity promises to provide and what the customer specifies and expects to receive.

We believe that a single standard for revenue recognition can achieve comparability within the Industry and with other industries only if the ED acknowledges the facts described above and allows preparers to apply judgment in evaluating whether the unique characteristics of each long-term contract meet separation criteria used to identify if and when there are multiple performance obligations in long-term contracts.

1.2 Potential Issues in the Identification of Performance Obligations in Long-term Contracts

The ED indicates in paragraph 22 that, in some cases, an entity might account “for all the goods and services promised in [a] contract as a single performance obligation” if none of the promised goods or services is determined to be distinct. We believe that for many of our long-term contracts in which we perform various tasks over multiple phases that are overlapping, concurrent or highly interrelated, none of the individual goods or services, or tasks performed, are distinct.

Such tasks are merely interdependent steps in the overall process of delivering the completed project to the customer. In our Industry, project tasks are often performed as a bundled set of services or activities with a single objective: the delivery of the entire project to the customer in accordance with their specifications. Generally, in these situations we do not price the tasks individually, we and our customers do not separately negotiate the individual tasks when we establish the value of the contract, and the tasks are managed in an overlapping, concurrent manner. Consequently, we do not believe that tasks within the bundled set of services or activities should always, or by a default treatment, be determined to be “distinct” and accounted for separately just because, on occasion, we might be asked and agree to perform only one task that could be viewed by some as similar.

As a result, we believe that Example 11 in the Implementation Guidance and Illustrations should be modified to remove the implication created by the ED that a contract to provide design and construction activities (collectively, “D&C”) will always consist of multiple performance obligations. The number of performance obligations in a D&C contract should be determined based on the terms of the contract and all relevant facts and circumstances. The identification of performance obligations will require the use of business judgment applied to each set of facts.

We acknowledge that companies that perform D&C contracts might also provide design services on a stand-alone basis to customers, which would suggest, under paragraph 23, that these services, if deemed similar, would likely be considered distinct and, therefore, would be accounted for as a separate performance obligation in accordance with the ED. However, that conclusion does not give proper recognition to either the contract, the complexity of the underlying project, or to the interrelatedness inherent in many long-term contracts, including many D&C contracts, in which each of the apparent “performance obligations” are interdependent, overlapping, or concurrent activities with limited or no standalone utility to the customer. This differs from those instances in which we may provide such services individually, which is done at the request of the customer because the customer perceives a standalone utility to exist. We believe Example 11 should be clarified to state that contracts requiring the performance of multiple tasks should be evaluated to determine whether the tasks are overlapping, concurrent or highly interrelated and if so determined, the tasks may be deemed to be non-distinct, and therefore, in such circumstances, accounted for as a single performance obligation as discussed in paragraph 22.

1.3 Application of “Distinct Risks and Resources” to Long-term Contracts

D&C contracts are frequently priced, bid, negotiated, signed, executed, and monitored based on a price that is typically negotiated on a total contract basis (i.e., the design services are not regularly negotiated separately from the construction services) using a highly integrated project execution plan. Although there are generally different teams of people involved in the different services provided during the project (for example, design services often require a different skill set than do construction services), there are also overall project management personnel who are responsible for the oversight and management of the overall project and ensure that the timing of all the various interrelated activities is on schedule, performed according to specifications, properly sequenced, and that the different resources have been properly assigned to help ensure the successful outcome of the project.

Also, our customers would generally take the view that they are receiving the one project over time and they pay for this project in installments based on independent certification of the work completed at certain stages through the life cycle of the project and they account for it progressively.

Different risks can and often do affect the different phases of the project. For example, although it would initially appear that there are separate and distinct resources and risks related to the different tasks performed on a construction project, the activities performed by the design team have a direct and iterative effect on the amount and timing of procurement activities and on the outcome of the construction phase of the project. Design can be executed with no issues/cost overruns or delays in schedule, but if the design results are flawed or improper, there could be a significant impact on whether the correct type and quantities of materials are procured, and on the amount of labor and other costs incurred during construction. Furthermore, on D&C projects, design is rarely completed before procurement, fabrication, construction or construction management begins. The performance of design services normally occurs throughout typical D&C projects, as designs are updated to reflect new information and the progress of other aspects of the project proceeds, and therefore runs concurrently with procurement, construction, and all other aspects of the project. This is not reflected in Example 11. Similar interdependencies exist between other phases of a D&C project. For example, the timing and accuracy of procurement activities have a direct impact on the success or failure of the construction phase.

1.4 Potential Issues in the Allocation of Transaction Price to Multiple Performance Obligations

As stated previously, there are no standard market prices charged by participants in our industry sector and, therefore, the profit margin generated on services sold on a standalone basis may be significantly different than the profit margin that would be allocated to the services in a long-term, multi-faceted project. Pricing for standalone services varies widely, depending on the project characteristics, the contractual arrangement, the location and scope of work to be performed, the customer, the bidding form (e.g. competitively bid or negotiated), expectations for additional work, cyclical market demand, and various other conditions. As a result of these factors, two identical projects in two different locations could yield significantly different prices, because each project is unique and for each contract the pricing is determined separately.

The identification of and accounting for multiple performance obligations in most long-term contracts would produce somewhat arbitrary allocations of transaction prices and prices for contract modifications as a result of the artificial segmenting of overlapping, concurrent or highly interrelated contract phases. The reason we believe such allocations would be arbitrary is because the ED requires preparers to allocate the overall price based on the relative values of standalone performance obligation pricing. As discussed earlier, standalone pricing varies widely and should not be used as a reliable standard for allocation purposes.

Even if a satisfactory population of projects with similar characteristics were available to represent a historical pricing “standard,” historical pricing will generally not be indicative of current pricing or “as executed” results.

Therefore, in order to allocate a transaction price to the individual tasks within a contract, averages would need to be determined for and applied to each performance obligation. In our view the use of such averages would be arbitrary and not particularly meaningful to our management or the users of our financial statements.

Arbitrary allocations of transaction prices based on artificial segmenting of contract phases will not produce more meaningful information for the users of our financial statements because the users of our financial statements are interested in the overall project-level financial results of a particular business unit and the expected profit margins contained in backlog, rather than how many different services a single contract includes or which ones had higher or lower profit margins. The interrelationship between the various stages of a project is one of the primary reasons why construction projects are tracked and monitored for profitability and reporting to management, financiers and other constituents on an overall basis rather than by individual tasks performed within a project.

1.5 Changes in the Timing of Revenue Recognition

If the ED is adopted as currently drafted, we believe the timing of revenue recognised could change compared to current practice. For the majority of the types of contracts the Industry enters into we do not believe design services are separable performance obligations, therefore if design services were to be identified as separate performance obligations as currently proposed by the ED and the profit margins for these standalone design services were determined to be higher than those for construction services, an entity would recognise more revenue at a higher profit margin during the beginning stages of the project, since design is the primary activity performed during the initial stages of a project. We believe recognition of higher profits during the initial phase of a project fails to consider how the risks related to design activities impact the success or failure of later phases of the project and the economic performance of the project as a whole. We believe that the current wording and example provided (Example 11) in the ED would lead to a practice of nearly always segmenting phases of D&C contracts, and other similar contracts, into multiple performance obligations and would result in the accounting effects described above that we believe are potentially misleading to users of the financial statements and fail to accomplish the primary purpose of the ED. In addition this segmentation will not be reflected in the customers accounting, customers will continue to capitalise costs in relation to a single project. As previously stated in section 1.4, the allocation of any transaction prices and profit margins to separable performance obligations would be arbitrary.

1.6 Additional Burden to Financial Statement Preparers

In addition to the inappropriate acceleration of profit and revenue recognition described above, we also highlight to the Board that separate accounting for multiple phases of long-term contracts will significantly increase the number of separate projects that an entity will be required to track, apply controls to, and separately determine the amount of revenue to recognise during a reporting period. If a contractor does not already separately account for tasks at the outset of a contract, it will be difficult if not impossible to do so retrospectively because information required to account for separate tasks is not always tracked on a disaggregated basis. Consequently, the ED would require changes to accounting systems, potential expansion of the number of accounting and project staff, and a required breakdown of tasks, costs, and estimates to a level that is below the level that may be currently collected and reviewed by project and senior management.

In fact, as we have begun to inform our various management personnel, including operations management, about the potential changes resulting from the ED, they have expressed their intention to continue using project level information for tracking the financial progress and performance of our projects, as they do not believe that breaking projects down into multiple tasks reflects the way we meet our customers' expectations, nor the way we measure our own performance. We believe that our customers and other significant constituents, including investors, financiers, and creditors, will continue to want financial information by total project using our historical revenue recognition practices, rather than by task. The initial and on-going effort to implement these changes would be costly and burdensome, without producing meaningful information to the internal or external users of our financial statements.

1.7 Suggested Aggregation of Performance Obligations

We understand the Board's desire for entities to recognise revenue and profit for distinct functions that present different risks, utilise different resources, and provide distinct profit margins as they are earned in a contract. As discussed above, we strongly believe the ED should be modified to allow an entity to aggregate contract activities that are overlapping, concurrent or highly interrelated because the very nature of such activities may not make them distinct, as that term is defined in the ED. We believe contract activities are not distinct if the outcome and execution of one activity could *directly* affect the outcome of another activity. In those situations, we believe only one performance obligation exists. We also believe there should be a rebuttable presumption that projects that are performed in an overlapping, concurrent or highly interrelated manner will not have separate and distinct performance obligations, given the intentions of the parties and the expectation of the customer, the interrelationship of the various risks inherent in long-term contracts, and the manner in which both the customer and contractor manage their risks.

2. Continuous Transfer of Control

2.1 Criteria for Assessing Completion of Performance Obligations

Paragraphs 25 – 31 of the ED discuss the criteria used to assess satisfaction of performance obligations and thus the recognition of revenue. Those paragraphs specifically address the transfer of promised goods and services to a customer. In our industry, the customer is typically referred to as a “project owner”. This is because in fact many times the work is performed at a location owned or controlled by the customer. Where we fabricate deliverables at our own location, the project owner is usually directly overseeing the design and construction activities. Consequently, we support the concept that control of our in-process deliverables is continuously transferred.

Within the Continuous Transfer guidance we noted the following:

- Paragraphs 32 and 33 in the ED address suitable revenue recognition methods to be applied when the control of performance obligations is continuously transferred to a customer. However, these two paragraphs do not provide guidance for use in evaluating how or when control over goods and services are continuously transferred.

- Within paragraphs 25 – 31 only paragraph 30(d) mentions a scenario in which customer control is obtained as the asset is created. We note that paragraphs IG63 through IG65 and BC63 through BC65 contain additional comments about making a determination of whether control is transferred continuously, however the discussion focuses only on whether the customer has the ability to direct the use of, and receive the benefit from, the work in progress.
- Example 16 discusses a scenario in which a services contract results in continuous transfer of control.

Although we support the indicators and principles-based guidance on transfer of control, our view is that the guidance in the ED should be modified to more clearly communicate the indicators of continuous transfer of control and the weighting of each indicator.

We continue to believe that the accounting reality of performing long-term contracts is that revenue and profits are earned continuously as the work progresses and control is transferred. The continuous earnings process is a more realistic accounting concept of the contractual agreement between contractors and customers than is the transfer of control at interim points during the performance of a contract or at the completion of the contract. However, we believe that the guidance provided in the United States from paragraph 23 of Accounting Standards Codification (ASC) Topic 605-35, is an accurate depiction of the legal concept of continuous transfer of control:

“Under most contracts for construction of facilities, production of goods, or provision of related services to a buyer’s specifications, both the buyer and the seller (contractor) obtain enforceable rights. The legal right of the buyer to require specific performance of the contract means that the contractor has, in effect, agreed to sell his rights to work-in-progress as the work progresses. This view is consistent with the contractor’s legal rights; he typically has no ownership claim to the work-in-progress but has lien rights. Furthermore, the contractor has the right to require the buyer, under most financing arrangements, to make progress payments to support his ownership investment and to approve the facilities constructed (or goods produced or services performed) to date if they meet the contract requirements. The buyer’s right to take over the work-in-progress at his option (usually with a penalty) provides additional evidence to support that view. Accordingly, the business activity taking place supports the concept that in an economic sense performance is, in effect, a continuous sale (transfer of ownership rights) that occurs as the work progresses.” (Italics added)

Based upon the above, we recommend that the following be included in the ED as indicators of continuous transfer of control:

1. The customer has the right to require specific performance from the entity under the contract.
2. Under the contractual arrangement, the entity has no ownership claim to the work-in-process, but may have lien rights or other similar protective rights.
3. The customer supports his ownership investment by agreeing to a payment structure that relates to the progress of the work.
4. The customer or the customer’s agent(s) participate in the periodic evaluation of the work-in-progress.



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5. The customer has a right to take over the work-in-progress at his option, even though such a right may include a penalty to be paid by the customer to the benefit of the entity.

We recommend that the ED be modified (whether in the body of the final standard or the application guidance) to clarify that when one or more of the indicators described above or in the ED exist, such as the design or function is customer specific, continuous transfer of control exists.

We believe that the percentage-of-completion, or continuous transfer of control method, is more appropriate than the completed contract method of revenue recognition. BC33 indicates that the principle of percentage of completion can be consistent with the proposed standards and we want to enhance the current proposals to ensure this is the case. As such, we believe our suggested changes above are important in that they will clarify that companies in our Industry can continue to be able to utilise percentage of completion.

3. Retrospective Application

Paragraph 85 of the ED indicates that the new Standard would be applied retrospectively upon adoption. Retrospective application would require an entity to restate the results of their prior financial statements. Since many contracts in our Industry have a long duration (often 5 years plus), the entity may be required to look back a number of years in order to determine the appropriate adjustments to make retrospectively. Assuming an entity presents one year of comparative information, if a five-year contract ended in the period prior to the effective date, an entity would need to examine information created and maintained at the contract initiation in order to determine the price, number of contracts, number of performance obligations, whether continuous transfer of control occurred and the appropriate method to use to determine progress, and how to account for contract modifications. In addition, an entity would have to review historical records as of each reporting period, which may not always be either readily available to an entity or captured and archived in an entity's accounting system, in order to determine the amount of revenue and profit that should have been recognised during each period. Because each contract is generally unique in its terms, conditions, and set of estimates made at each reporting period, the exercise to retrospectively determine the accounting under the ED would be extremely onerous for even one historical period.

Given that estimates are a critical element in accounting for long-term contracts, retrospective application would require preparers to make assumptions about management's intent in a prior period that cannot be independently substantiated. As such, most entities in our Industry would not be allowed to adopt the ED through retrospective restatement, due to the impracticability exceptions articulated in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*.

A further complication arises with respect to retrospective application for periods in which a business combination occurred. The history of acquired contracts is not typically reviewed by the acquirer at the level of detail needed to comply with retrospective application. Instead, due diligence is performed considering the current state of the projects and the potential risks.

Therefore, the information required to identify and retrospectively account for the supposed performance obligations may not be available.

The onerous nature of this exercise is further compounded by the fact that a construction contractor can have several thousand active contracts at any point in time and accordingly, the information to be gathered, analysed and accounted for is significant. For example, over a 5 year period, a company with 1,000 active contracts may be required to review perhaps as many as 10,000 or more contracts in order to comply with retrospective application currently required in the ED. Subsequent to an entity determining the adjustments to be made to the accounting balances as a result of the ED, the entity's auditors would also be required to perform audit test-work over the restated balances, which would essentially require re-auditing the revenue, expenses, and contract accounting balances as of each period end, resulting in significant additional expense to entities and their shareholders.

While we understand the Board's desire in requiring retrospective application of the ED to improve comparability across all current and historical periods and to ensure that revenue trends are comparable over a period of time, the cost of compliance with retrospective application and the potential inaccuracy and lack of meaningfulness of the information will greatly exceed any potential benefit to investors. The industry's only practical implementation option is to adopt the ED prospectively, by applying the proposed accounting to the uncompleted value of existing contracts and any new contracts after the effective date. This simplified, modified approach has previously been permitted on the introduction of other accounting standards. Under any transition method, we believe that the Board should ensure that they provide sufficient time between the issuance of a final Accounting Standard and the effective date of the Accounting Standard to allow entities to perform the potentially complex tasks required upon adoption and make the necessary modifications to their enterprise resource systems to record and report transactions appropriately subsequent to the adoption of the ED. We suggest that the earliest date that the Industry would be ready to adopt prospectively would be sometime after 2013 which would align with other new proposed standards expected to be implemented in 2014. Allowing or requiring adoption by prospective application will also reduce the amount of time required between the issuance of a final standard and the effective date thereof.

4. Contract Modifications

Contract deliverables and price are modified frequently in the construction industry because of changes in scope or unforeseen conditions or circumstances and mechanisms (such as variations – see IAS11) are included within construction contracts to deal with these situations. While the negotiation of variations takes place throughout the execution and completion of long-term projects, variations rarely relate to the entire project and generally result from a specific event or change that is associated with one or more specific phases of a construction project. Contractors may negotiate and agree to several variations on a project at one time or may negotiate and agree to variations individually as they arise. It is common for larger, long-term projects to have hundreds, or even thousands, of individual variations on a single project.

The provisions of paragraphs 17 through 19 of the ED require a contract modification, such as a variation, to be evaluated to determine if the "prices of the modification and the existing contract are interdependent (as described in paragraph 13)" in order to determine the proper accounting for the contract modification.

For the most part, an entity will likely determine that the prices in the modification are interdependent because construction activities are normally performed concurrently or consecutively, which is one indicator noted in paragraph 13 of the ED for combination of contracts.

Additionally, when D&C contracts are bid, and prices determined, they are normally done so with one single commercial objective – construction of the ultimate deliverable, which is another indicator noted in paragraph 13 of the ED.

If an entity concluded that the prices of a variation and existing contract are interdependent, as noted in paragraph 53 of the ED, it would require an entity to allocate any change in the transaction price to “all performance obligations on the same basis as at contract inception.” Allocation of incremental revenue arising from a variation relating to a specific activity on a project to all performance obligations, including those completed and not yet begun, even though they had nothing to do with the variation in question would, in our view, mislead financial statement users. This allocation method would also override the valuations ascribed at the onset to those performance obligations which can be sold separately and were valued based on standalone selling prices. This conflicts with one of the original principles of the ED, which suggests that a performance obligation exists if it can be sold separately and that the pricing of such performance obligation should be based on its stand alone selling price. In addition, this type of allocation would be arduous, given the large number of variations that can be typical for long-term projects. Please refer to Exhibit II for further illustration of the potential accounting implications of using this model.

While we believe that many long-term contracts do not contain multiple performance obligations, as discussed in detail in the preceding paragraphs, following the guidance in paragraph 53 for contracts where multiple performance obligations do exist could result in a significant amount of revenue and profit recognition resulting simply from obtaining a variation without having made any significant progress on the related activity. The concepts and potential effects on revenue recognition are illustrated in Exhibit II.

In order to eliminate this unintended effect and to ensure that revenue recognition appropriately matches the economics of the arrangements entered into, we suggest that the Board include language that would allow an entity to allocate the price of contract modifications only to the activities affected. We further recommend that, if a contract modification relates to more than one activity, the price should be allocated to the performance obligation(s) to which it relates, rather than to all performance obligations under the contract, based on the results of the negotiation of the variation(s). This approach would acknowledge that the final enhancement to overall revenue is, in many cases, a negotiated amount based simply on what the customer is willing to pay for a variety of variations, regardless of the individual circumstances behind each variation. However, we also highlight to the Board that the aggregation of activities into a single performance obligation for certain long-term contracts, as previously discussed, would eliminate or minimise the impact of this potential issue in the ED.

Under the ED, and in contrast to the accounting for combining contract modifications with existing contracts, if an entity concluded that the prices of the variations and the existing contract are independent, an entity would account for each variation as a separate contract.

Similar to the issue noted above under the title “Identification of Performance Obligations,” with hundreds or thousands of variations arising under many projects in our Industry, it would be an onerous task to track the separate costs related to each variation (which is not currently performed by most companies in our Industry), revise the analysis of project progress, calculate a separate cumulative revenue adjustment and determine the profit and revenue recognition for each variation on a recurring basis at the end of each reporting period.

5. Determining the Transaction Price

5.1 Use of Probability-Weighted Approach

Performance-based incentives, bonuses, unpriced change orders, liquidated damages, and other pricing features that create variable transaction prices are common features in many of our contracts. Relative to these features, paragraphs 35 of the ED specifies that an entity will need to estimate the transaction price based on the probability-weighted amount of consideration that the entity expects to receive from the customer.

Current Industry practice under existing IFRS and U.S. GAAP is to utilise the entity’s best estimate of amounts that are probable of recovery, with such estimate based on all of the information available to the entity as of the end of each reporting period. This practice results in revenue recognition at each reporting date that is based on the best estimate of amounts deemed realisable.

We do not believe that a probability-weighted model results in a better estimate or better decision useful information. Estimates of transaction prices, which are inherently subjective in nature, should be based on an entity’s careful, good-faith evaluation of all available information and not based on a prescriptive method of probability-weighted outcomes. We believe that requiring the use of a probability-weighted approach to determine transaction prices associated with long-term contracts will not provide more accurate accounting and reporting or provide any additional benefits to an entity’s shareholders and users of the financial statements. We believe that using the probability-weighted model when there are binary outcomes could lead to recording revenues at amounts that are not a possible outcome under the contract, which will not result in decision-useful financial information. Furthermore, we believe that it will increase the time and expense required for an entity to prepare its financial statements resulting in costs that clearly outweigh the benefits of the probability-weighted approach. We believe that the ED should be modified to permit the use of the best estimate of probable recovery or loss, if one can be determined, based on the information and data available to the entity; particularly when the outcomes are binary. A probability-weighted approach should only be used if an entity cannot form a single best estimate.

5.2 Consideration of the Time Value of Money

As currently drafted, we believe that paragraphs 44 and 45 do not adequately explain how to determine when a contract includes a “material financing component”. While we note paragraph 45 explains that the effect is material to contracts when payment from the customer is due either significantly before or significantly after the transfer of goods or services to the customer, this does not take into account situations where continuous transfer of control occurs, nor does it adequately define the terms used within the ED.

The ED should include additional guidance to account for the time value of money for contracts with continuous transfer of control. We believe that such guidance should state that long-term contracts do not contain material financing components if payment from the customer is due in less than one year before or after the transfer of goods or services to the customer.

Because long-term contracts are performed over an extended period of time, payments are generally received from the customer as the project is being completed by the contractor. Throughout the life of the long-term contract, the contractor can be in a position of billing and collecting payment in excess of the amount of work completed to date (advance billing position) or in a position of completing work on the project in excess of the amount of billing and payments collected (unbilled position). Further, during the life of the contract, the billing position will generally move back and forth between an unbilled and advance billing position.

When trying to apply the concept of time value of money to long-term contracts, the ability to predict the timing of cash flows that are tied to performance metrics/milestones, how to account for future changes in the cash flows as the project advances, and complications in establishing the appropriate rate to use all make the concept difficult to apply.

The terms and conditions of most long-term contracts are written to provide cash flows throughout the duration of the project and are intended to follow the general pattern of work that is expected to be performed. In some cases, achievement of specified milestones triggers billings to customers; in others, progress billings occur periodically (monthly, for example, as costs are incurred by the entity). While an entity may have an initial projection of the timing of meeting milestones and/or project progress metrics required for billing, the actual timing of such achievements, and timing of actual payment, will often change throughout the performance of the contract. Further, the actual cash flow position throughout the life of a project will often bear little resemblance to what was initially projected. As a result of the subjectivity required in estimating future cash flows during the life of long-term projects and the consistent changes in the amounts and timing of cash flows that occur as a long-term project progresses, the attempted application of the time value of money in the determination of the transaction price for long-term contracts will introduce several arbitrary variables into the determination of the transaction price utilised by an entity in recognising revenue and profit, which will add no value to financial statement preparers or users and may result in the reporting of inherently inaccurate financial information.

In addition to the other judgments and estimates required for each individual contract, the transaction price would have to be updated at each reporting period to reflect any changes in the expected timing of cash flows. If the time value of money were to be applied to long-term contracts, the ED would have to include additional guidance to address how to account for changes in the actual timing of cash flows versus the estimate at the onset in determining the transaction price.

It will also be difficult to determine the appropriate rate to use in determining the discounted transaction price for a long-term contract when the contract position changes back and forth from an advance billing position to an unbilled position at different times during the life of the contract.

Using either the contractor's incremental borrowing rate or the customer's incremental borrowing rate, including credit risk, would not seem appropriate as it would not reflect the true financing element that might be present throughout the contract given that the asset/liability position will change over time.

While we understand the Board's objective behind the inclusion of a time value of money component in determining the transaction price, the concept ignores the timing of cash outflows that are made during the performance of contracts. This is especially true in long-term contracts where subcontractors are often used and/or specialised products are purchased requiring separate construction, all of which are subject to differing payment terms including similar milestone and objective triggers for payment. Currently, neither IFRS nor U.S. GAAP separately captures the time value of money effects of any potential financing components within payments made for services and materials during the performance of long-term contracts. Because revenue will be discounted while costs will not be, the usefulness of the metric presented in the income statement will be reduced.

In addition to the issues noted above, we also believe that the guidance provided in paragraphs 44 and 45 is unclear on how the time value of money consideration should be applied in practice as it could be interpreted, as currently written, as potentially applying at the onset of the contract, and updated each reporting period, to all the expected future cash inflows for the contract or only applying to the balance sheet position as of the end of each reporting period.

We suggest that the Board consider providing an exception for contracts that have continuous transfer and where the payment terms allow for payment throughout the contract that are designed to match the delivery of service over a period of time.

Alternatively, the Board should consider inclusion of language that will provide guidance in determining if there is a material financing component included in a continuous transfer situation and what constitutes payment being due significantly before or after the transfer of goods or services. The Board could consider, in these revisions, defining "significant" as being greater than one year consistent with the Board's proposals on the financial instruments and leasing projects, or by defining material financing component as financing arrangements that are considered to be outside the entity's customary business practice.

5.3 Collectability

While we acknowledge that the Board's guidance in Paragraph 43 of the ED, related to including collectability in the determination of the transaction price, is conceptually simple, we believe that the execution would be quite complex when applied to long-term contracts. Even after setting aside the fact that our financial systems do not currently have the capability to comply with this requirement and compliance would require costly changes to our systems, controls, and processes; the result of incorporating collectability into the transaction price is counterintuitive to the underlying economics of the contracts and will not result in better financial information for the readers of our financial statements.

Discounting contract values for perceived credit risk (determined at the inception of the contract) will require each and every invoice to be discounted. Assuming the client pays the contract value as invoiced, the difference between the amount received and the amount invoiced will generate income to the contractor which is not revenue.

Participants in our Industry have thousands of projects with potentially dozens of outstanding invoices on each of these projects at any given time. We believe the better approach to this issue is to continue to allow receivables to be recorded based on contract values, with any subsequent adjustments that are based on credit risk and collectability issues recorded as separate and distinct events. Alternatively we believe that only credit risk that is more than “remote” should be included in the determination of the transaction price.

6. Accounting for Onerous Performance Obligations

Similar to the requirements under current accounting literature, the ED would require the recording of a liability and expense when a long-term contract is expected to be unprofitable (i.e., the estimated cost of the project exceeds the estimated revenues for the project). While we agree with this concept in principle, we disagree with the guidance in paragraphs 54 through 56 of the ED that require both a probability-weighted approach and the recording of liabilities on an individual performance obligation within a contract that is profitable overall.

In order to determine if a performance obligation is onerous under the ED, an entity would be required to calculate the present value of the probability-weighted costs that relate directly to satisfying the performance obligation and determine if that calculated amount exceeds the transaction price allocated to that performance obligation. This proposed methodology represents both a significant change in accounting standards and an arduous task for an entity to perform for each of their individual projects. Neither accounting for costs incurred by an entity nor the estimate of cost used in determining progress under the continuous transfer of goods and services currently requires the use of a probability-weighted determination of estimated costs. As such, the requirement within the ED to do so would require a secondary set of cost estimates to be generated for each performance obligation.

Similar to the views expressed above in relation to the use of the probability-weighted approach in determining the transaction price, estimates are inherently subjective in nature and should be based on an entity’s careful, good-faith evaluation of all available information and not based on a prescriptive method of probability-weighted outcomes. Determining an entity’s best estimate of the expected cost of a long-term project requires extensive time and effort and can often include the use of internal and external experts, highly complex cost forecasting models, manual evaluation and analysis of project progress and schedules, analysis of the current risks and opportunities on the project, comparisons to historical data for similar projects, and many other estimation techniques. The result of these procedures is an estimate that is based on an appropriate methodology and a plethora of relevant data about the project, which is sufficient to determine the expected amount of costs to be incurred in excess of the transaction price. Probability weighted outcomes should only be used when a single best estimate cannot be determined.

We also note that while the ED requires that the costs to fulfill a performance obligation be discounted in determining if a performance obligation is onerous, the ED does not provide a definition of the rate to use in this required analysis. As currently drafted, the ED would be open to interpretation by each entity as to the appropriate rate to use and the rates used could vary from one entity to the next resulting in significant diversity in practice and financial information that is not comparable.

We suggest that the board modify the ED to include a definition of the rate to be used in performing this analysis. Further, we also question the Board's rationale for using expected costs that have been discounted in the determination of onerous performance obligations. As transaction prices are only discounted to the extent that they contain a material financing component, it is possible that in many situations the analysis would result in a comparison of discounted costs to an undiscounted transaction price. We believe that the comparison of an undiscounted value to a discounted value is not appropriate and will produce results that are not meaningful to users of the financial statements and will not appropriately account for all performance obligations that are onerous.

In addition to our concerns regarding the determination of when a performance obligation is onerous, we also would ask the Board to consider the usefulness of the proposed accounting for onerous performance obligations as described in paragraphs 54 through 56 of the ED. Recognising a liability and expense for certain performance obligations within an overall profitable project does not accurately reflect the true economics of the project and will confuse readers of the financial statements. Exhibit I provides an example of the accounting effects of recognising separately an expense and liability for an onerous performance obligation on an overall profitable project, demonstrating that the information does not provide any additional insight into the project and potentially skews the financial results and provides misleading information to users of the financial statements. In further support of the view expressed above that only one performance obligation exists for many long-term contracts, accounting for long-term contracts as one single performance obligation under the ED would appropriately result in the recording of a liability and expense only when a long-term contract is expected to be onerous, or unprofitable, in total, which we believe is appropriate and accurately reflects the economics of long-term projects.

7. Disclosure Requirements

7.1 Extent of disclosures required

The objective of the Board's proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. This objective is supplemented by a list of requirements contained in paragraphs 73 to 83. While we generally agree with the disclosure objective as articulated in the ED, we are concerned that the objective, combined with the long list of detailed requirements may result in unnecessarily detailed and extensive disclosures that would not meet the information needs of users. Consequently, we encourage the Board to balance the disclosure with the costs to preparers of providing such onerous information

7.2 Remaining Performance Obligations

Backlog is the volume of all work contracted to (whether or not commenced) which has not yet been performed by the contractor.

Backlog is a future performance metric that many analysts and investors utilise in their analysis of construction contractors. Although the concept of backlog is well understood within our industry, there can be slight differences among entities as to how backlog is defined and how it is measured. In this regard we note the requirement in paragraph 78 contemplates disclosure of contracts with an original expected duration of more than one year.

This can be interpreted in a number of ways. For instance, an annual maintenance contract which has a history of being rolled, may be expected to continue to roll in the future even though there is an annual renewal and such contract may be included in backlog by some contractors today. Historically, backlog has been defined differently by contractors and has been disclosed outside of the entity's financial statements, such as in the Management's Discussion and Analysis (MD&A) section of the periodic reports together with sufficient other information to allow users to understand how backlog is measured and the reasons for major changes in backlog.

The disclosure requirements described in paragraph 78 of the ED will define backlog within the accounting literature by stating how it should be calculated (the amount of transaction price allocated to the performance obligations remaining to be recognised at the end of the reporting period). While backlog using this methodology can be calculated based on the population of uncompleted contracts in place as of the end of the reporting period, significant judgment will be required to determine the appropriate allocation of progress and resulting revenue to be recognised across all future periods in which those performance obligations are expected to be satisfied. By requiring this information to be included in the notes of the financial statements, the Board is introducing a forward-looking measure into the financial statements that is based on a high degree of subjectivity and judgment. In fact, in those cases where a contract has been awarded, but has not begun, the ED will require determination of the various revenue recognition aspects, such as decisions about performance obligations, the transaction price (e.g., using the probability-weighted approach and considering the time value of money), continuous transfer of control, methods of determining progress, etc., before the contract activities are even initiated.

Since forward looking information is not normally included in financial statements, we caution the Board to consider whether this is intended or even appropriate in defining the disclosure requirements of the ED. While the information to factually determine the periods for which the goods/services will be transferred may be readily obtained for some contracts (such as retail or manufacturing contracts) most long-term contracts will not provide this factual information, and will thus require reliance on the entity's subjective judgments and projections. Separately, auditors will be required to audit the information as it is intended to be included in the notes, which could prove to be a significant and costly challenge given the inherent variability of the nature of backlog within the Industry and the forward-looking nature of the estimates.

If such a disclosure is to be made further guidance should be provided to assist the preparation and review including:

- Time period for disclosure – an entity should be allowed to determine by accounting policy choice a limit on the future time period disclosed (i.e. five years) otherwise amounts included could be several years into the future reducing their usefulness to users.
- Foreign exchange rate – guidance on the rate to be applied to backlog denominated in foreign currency for multinational contractors (i.e. the period end rate) otherwise comparability could be reduced.

While we agree that the disclosure may be useful to investors, we believe that given the subjectivity involved, the disclosure is better made outside of the financial statements to the extent an entity believes it is information that is relevant to the investors and shareholders of the entity.



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7.3 Reconciliation of Contract Balances

We do not believe that the disclosure requirements in paragraph 75 of the ED, which requires the disclosure of a reconciliation of contract assets and liabilities from the opening to the closing aggregate balance, will provide information that is more useful than the information that is already provided in other parts of the financial statements. It is unclear to us how to apply this proposed disclosure requirement to long-term contracts. Since contract assets or liabilities are determined at the end of each period based on the cumulative billings to the customer as compared to the revenue earned and are updated each reporting period, it is unclear if the roll-forward should include the net change in the balances between periods, which we believe would not be meaningful to a financial statement user, or if the roll forward should include the gross change in the balances between periods, which would be potentially redundant given that similar information is often provided in other portions of the financial statements, such as the cash flows statement when prepared under the direct method. As such, we suggest that the Board review the guidance currently provided to clarify the application to long-term contracts and to consider if the information that will be presented to users of the financial statements will provide value beyond that already included in financial statements.

7.4 Disaggregation of revenue

While we generally agree with the principle proposed in the ED that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors, we are concerned that the proposals may result in an unnecessarily large amount of disaggregation. We especially believe that the Boards should reconsider the requirement to disaggregate revenue by contract types. In our view, disaggregation of revenue should be based on the level of information provided to the key decision makers of the entity, in many entities in our Industry information by contracts is not provided to the key decision makers.

We would be happy to further discuss the specifics of these issues in more detail at the request of the Board. If you have any questions about our comments or wish to discuss any of the matters addressed herein, please contact the undersigned.

Yours sincerely,

A handwritten signature in black ink, appearing to read "Jim Barrett", is written over a faint, light-colored signature line.

Jim Barrett
EXECUTIVE DIRECTOR

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Appendix A

MEMBER COMPANIES

Abigroup Limited
Boulderstone Pty Ltd
BGC Contracting Pty Ltd
Bovis Lend Lease Pty Ltd
Brookfield Multiplex Constructions Pty Ltd
CH2M Hill Australia Pty Ltd
Clough Limited
Downer EDI Limited
Fulton Hogan Pty Ltd
Georgiou Group Pty Ltd
John Holland group Pty Ltd
Laing O'Rourke Australia Construction Pty Limited
Leighton Contractors Pty Limited
Leighton Holdings Limited
Macmahon Holdings Limited
McConnell Dowell Corporation Limited
Thiess Pty Ltd
UGL Limited
Valemus Australia Pty Limited
Watpac Limited

EXHIBIT I*Illustrative Examples – Objective*

The purpose of Exhibit I and II is to demonstrate the impact of the ED on accounting for onerous performance obligations and accounting for contract modifications assuming that a long-term construction contract has multiple performance obligations. As noted in Section 1, long-term contracts in our Industry generally contain one performance obligation: a single project that is a representation of what the entity promises to provide and what the customer specifies and expects to receive.

*Illustrative Examples – Accounting for Onerous Performance Obligations***Background**

Company A enters into a contract to perform design and construction services for a lump sum price of \$400,000, which commences upon signing of the contract on January 1, 20X1. Company A determines, that the design services represent a separate performance obligation to the construction activities.

After execution of the contract, the Company allocates the transaction price (based on standalone selling price) and estimates costs as follows:

	Design	Construction	Total
Allocated Transaction Price	100,000	300,000	400,000
Estimated Cost	(120,000)	(270,000)	(390,000)
Estimated Profit	(20,000)	30,000	10,000
Estimated Profit %	-20.0%	10.0%	2.5%

Company A determines that control is transferred continuously under both performance obligations and that the cost of inputs is the most relevant measure of progress of transfer of the goods and services under the contract.

First Reporting Period

The Company performs services under the contract through the first reporting period, March 31, 20X1, which primarily relates to design services, and expends \$72,000 of costs related to the design portion and \$54,000 related to the construction portion. As of March 31, 20X1, the following would be recorded:



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	Design	Procurement & Construction	Total
Costs incurred	72,000	54,000	126,000
Total est cost	120,000	270,000	390,000
% complete	60.0%	20.0%	32.3%
Revenue to be recognised	60,000	60,000	120,000
Costs incurred	(72,000)	(54,000)	(126,000)
Onerous liability recorded	(8,000)	-	(8,000)
Profit/(Loss)	(20,000)	6,000	(14,000)
Profit/(Loss) %	-33.3%	10.0%	-11.7%

This is in contrast to the use of one performance obligation, which would produce the following result based on a cost-to-cost method of determining percent complete for the project in total:

	Design	Procurement & Construction	Total
Costs incurred	72,000	54,000	126,000
Total est cost	120,000	270,000	390,000
% complete	60.0%	20.0%	32.3%
Revenue to be recognised			129,231
Costs incurred			(126,000)
Profit on contract			3,231
Profit %			2.5%

Finding: As illustrated above, the accounting for an onerous performance obligation within a profitable project will produce results that suggest that the Company has incurred a significantly lower margin on a project that is projected to ultimately produce profit for the entity. We do not believe that the results produced under the ED present any additional meaningful information to financial statement users.

EXHIBIT II*Illustrative Example – Contract Modifications***Background**

As outlined in the objectives above we do not agree with the concept that contracts should be segmented when interrelated, however to illustrate the potential impact of the ED as drafted in relation to variations we provide the following example. Company A enters into a contract to perform design and construction (“D&C”) services for a lump sum price of \$500,000, which commences upon signing of the contract on January 1, 20X1. Company A determines, that the design services represent a separate performance obligation to the construction activities.

After execution of the contract, the Company allocates the transaction price (based on standalone selling price) and estimates costs as follows:

	Design	Construction	Total
Allocated Transaction Price	200,000	300,000	500,000
Estimated Cost	(150,000)	(280,000)	(430,000)
Estimated Profit	50,000	20,000	70,000
Estimated Profit %	25.0%	6.7%	14.0%

Company A determines that control is transferred continuously under both performance obligations and that the cost of inputs is the most relevant measure of progress of transfer of the goods and services under the contract.

First Reporting Period

The Company performs services under the contract through the first reporting period, March 31, 20X1, which primarily relates to design services, and expends \$90,000 of costs related to the design portion and \$56,000 related to the and construction portion. As of March 31, 20X1, the following would be recorded

	Design	Construction	Total
Costs incurred	90,000	56,000	146,000
Total est cost	150,000	280,000	430,000
% complete	60.0%	20.0%	34.0%
Revenue to be recognised	120,000	60,000	180,000
Costs incurred	(90,000)	(56,000)	(146,000)
Profit	30,000	4,000	34,000
Profit %	25.0%	6.7%	18.9%



Second Reporting Period

The Company performs services under the contract through the second reporting period, June 30, 20X1, which primarily relates to remaining design services and a significant portion of the construction activities. In the performance of these activities, the customer expands the scope of the construction activities resulting in an additional \$300,000 in expected revenue and an additional \$200,000 in expected construction costs.

The transaction price was allocated 40% to design services and 60% to construction activities at contract inception. As such, in accordance with paragraph 53 of the ED, the additional revenue is allocated \$120,000 to design services and \$180,000 to construction activities.

Subsequent to the change and allocation, as required under the ED, the following are the allocated transaction prices and expected costs for each of the performance obligations related to the contract.

	Design	Construction	Total
Initial Transaction Price	200,000	300,000	500,000
Revenue Modification	120,000	180,000	300,000
Estimated Revenue	<u>320,000</u>	<u>480,000</u>	<u>800,000</u>
Initial Cost Balance	150,000	280,000	430,000
Cost Modification	0	200,000	200,000
Total Estimated Cost	<u>150,000</u>	<u>480,000</u>	<u>630,000</u>
Estimated Profit	<u>170,000</u>	<u>-</u>	<u>170,000</u>
Estimated Profit %	53.1%	0.0%	21.3%

As of June 30, 20X1, the Company has expended a total of \$120,000 of costs related to the design portion and \$120,000 related to the construction portion. As of June 30, 20X1, the following would be recorded:

	Design	Construction	ITD Total	Previous YTD Total	Recognise d Project to Date
Costs incurred	120,000	120,000	240,000		
Total est cost	<u>150,000</u>	<u>480,000</u>	<u>630,000</u>		
% complete	<u>80.0%</u>	<u>25.0%</u>	<u>38.1%</u>		
Revenue to be recognized	256,000	120,000	376,000	180,000	196,000
Costs incurred	(120,000)	(120,000)	(240,000)	(146,000)	(94,000)
Profit	<u>136,000</u>	<u>-</u>	<u>136,000</u>	<u>34,000</u>	<u>102,000</u>
Profit %	<u>53.1%</u>	<u>0.0%</u>	<u>36.2%</u>		<u>52.0%</u>

This is in contrast to the allocation of the transaction price to only the relevant performance obligation, which would produce the following result:

	Design	Procurement & Construction	Total
Allocated Transaction Price	200,000	600,000	800,000
Estimated Cost	(150,000)	(480,000)	(630,000)
Estimated Profit	50,000	120,000	170,000
Estimated Profit %	25.0%	20.0%	21.3%

Assuming the same costs have been expended for each activity, under the ED, Company A would recognise the following in revenue and profit for the period:

	Engineering	Procurement & Construction	ITD Total	Previous YTD Total	Recognized PTD
Costs incurred	120,000	120,000	240,000		
Total est cost	150,000	480,000	630,000		
% complete	80.0%	25.0%	38.1%		
Revenue to be recognized	160,000	150,000	310,000	180,000	130,000
Costs incurred	(120,000)	(120,000)	(240,000)	(146,000)	(94,000)
Profit	40,000	30,000	70,000	34,000	36,000
Profit %	25.0%	20.0%	22.6%		27.7%

Finding: As illustrated above, allocating contract modifications to only the relevant performance obligations of a contract will result in recognition of revenue and profit (\$36,000) that is more in line with the economics of the underlying modification and will also prevent recognition of revenue from unrelated performance activities that have substantial progress (\$102,000), which we believe would be inaccurate and inappropriate.