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Sent electronically through the IASB Website (www.iasb.org)

27 October 2010

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sirs,

IASB Exposure Draft
"Revenue from Contracts with Customers"

We welcome the opportunity to respond to the Exposure Draft issued by IASB.

In general, we support the Boards' proposal to develop a single principle-based revenue recognition model on contracts with customers across transactions and industries. The change of revenue recognition principle to the "control" model and the withdrawal of IAS 11 "Construction Contracts" will have significant impact on the operational and accounting processes of companies, especially those in the construction sector. It will also be a challenge for preparers to articulate the new accounting principles and the disclosure requirements, and integrate them into the financial statements in a manner that can provide decision-useful information to the users without being excessive.

Our comments to the specific questions set out in the Exposure Draft are included in the Appendix to this letter for your consideration. The following are the key areas which we would urge the Board to consider making changes to the present draft of the Exposure Draft.

Combination and Segmentation of Contracts

We agree that contract combination and segmentation should be considered for revenue recognition purpose. However, we believe that the proposed "price interdependence" principle should be broadened to include other "non-price" factors such as risk and inter-relationship of performance obligations within a contract or among two or more contracts. The indicators for the combination of contracts as addressed by the ED under paragraph 13 (c) "performed either concurrently or consecutively" can also be applied to the segmentation of performance obligations in a contract.

We do not agree with the conclusion in Example 11 of the Application Guidance that the contract should be segmented. We consider that the interdependency in the execution of all the activities in the construction activities should be an important criterion in the identification of any separate performance obligation.

The example is a typical Design and Build contract in a construction company. Such contract will normally be tendered on the basis of one single project. Prices of the different

contractual works under the contract are interdependent. Each type of works is highly interrelated. The construction company, as the main contractor in the project, will perform the key project management role to ensure the coordination of all the works and cover the overall project risk to provide the integrated construction services for which the customer has contracted. Accordingly, the delivery of the project as a whole to the customer should be treated as one single performance obligation.

We urge the board to fine-tune the principle by adopting "non-price interdependence" indicators in paragraph 15 in addition to "price interdependence" and amend the conclusion in Example 11.

Onerous Performance Obligation

Recognition –

We are concerned by the ED's proposal that an entity should evaluate whether separate performance obligations are onerous (paragraphs 54-56). This could result in an entity recognising losses from certain performance obligations even if the overall contract is expected to be profitable. The test of onerousness at the performance obligation level, not the contract level, does not seem to reflect commercial reality. We believe that the recognition principle based on obligations under a contract in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" (paragraphs 66-69) would be more appropriate.

Disclosure -

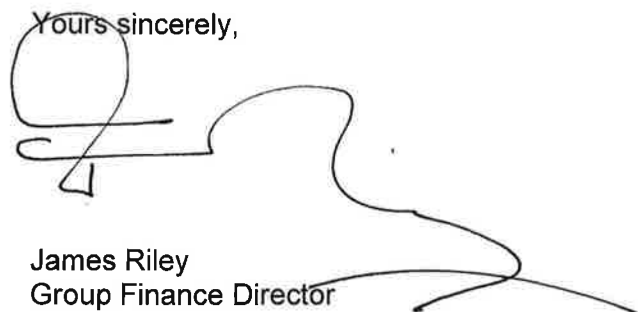
We are concerned by the proposed disclosure of detailed information relating to onerous performance obligations. This information required under paragraph 79 (a) to (c), including the nature, amount and reason for becoming onerous performance obligation, is commercially sensitive and may jeopardize the entity's position in negotiation and final settlement in particular for company with only one or a few contracts on hand. We suggest that the disclosure should be limited to reconciling the aggregate movements of the onerous performance obligations in a year and not to disclose the contractual information.

Effective date and transition

We understand the merit of the full retrospective application of the new requirements in order to ensure comparability of the financial information between current and prior reporting periods. However, from a practical standpoint, a full retrospective application may require re-analysis of legacy data from periods prior to current ownership and system. An extended lead-in time, such as 3 to 4 years, for the introduction of the new standards would enable a more robust and reliable analysis of data in the relevant period.

If you have any questions on the content of this letter, please do not hesitate to contact me.

Yours sincerely,



James Riley
Group Finance Director

c.c. Hong Kong Institute of Certified Public Accountants

About the Jardine Matheson Group

Founded as a trading company in China in 1832, Jardine Matheson is today a diversified business group focused principally on Asia. Its interests include Jardine Pacific, Jardine Motors, Jardine Lloyd Thompson, Hongkong Land, Dairy Farm, Mandarin Oriental, Jardine Cycle & Carriage and Astra. These companies are leaders in the fields of engineering and construction, transport services, insurance broking, property investment and development, retailing, restaurants, luxury hotels, motor vehicles and related activities, financial services, heavy equipment, mining and agribusiness. The Group had a revenue (including the revenue of associates and joint ventures) of US$36 billion in 2009, total assets of U$39 billion at the end of 2009 and employs over 270,000 people.

Jardine Matheson Holdings Limited is incorporated in Bermuda and has a primary share listing on the London Stock Exchange, with secondary listings in Bermuda and Singapore.

Jardine Matheson is one of the pioneers in adopting International Financial Reporting Standards, having first prepared its financial statements in accordance with IFRS in 1990.

APPENDIX

Comments on questions set out in the ED "Revenue from contracts with customers"

Recognition of revenue (para 8-33)

> 1. *Paragraphs 12-19 propose a principle (price interdependence) to help an entity determine whether:*
>
> (a) *to combine two or more contracts and account for them as a single contract;*
>
> (b) *to segment a single contract and account for it as two or more contracts; and*
>
> (c) *to account for a contract modification as a separate contract or as part of the original contract.*
>
> *Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?*

We agree with the concept of contract combination and segmentation for revenue recognition purpose. However, we consider that the proposed "price interdependence" principle should be broadened to include other "non-price" factors such as nature, risk and inter-relationship of performance obligations within a contract or among two or more contracts. The indicators for the combination of contracts as addressed by the ED under paragraph 13 (c) "performed either concurrently or consecutively" can also be applied to the segmentation of performance obligations in a contract.

The ED presents an example in the Application guidance (Example 11) to illustrate the identification of separate performance obligations in a construction contract. In the example, the construction project requires engineering (design), procurement and construction activities which include site preparation, foundation, structure erection, piping, site finishing and contract management service. The ED regards design, site preparation and site finishing as 3 separate performance obligations that would have specific revenue attached to each of them. However, the ED considers procurement, remaining construction activities and contract management should be accounted for as a single performance obligation.

We do not agree with the above conclusion. The contract in Example 11 should not be segmented. We consider that the interdependency in the execution of all the activities in the construction activities should be an important criterion in the identification of any separate performance obligation. The example is a typical Design and Build contract of a construction company. Such contract will normally be tendered on the basis of one single project. Prices of the different contractual works under the contract are interdependent. Each type of works is highly interrelated. In particular, it is quite often that the design evolves over a substantial part of the contract period. The construction company, as the main contractor in the project, will perform key contract management role to ensure the coordination of all the works and cover the overall project risk to provide the integrated construction services for which the customer has contracted.

We urge the board to fine-tune the above principle to include "non-price interdependence" indicators and amend the conclusion in Example 11.

2.	*The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?*

We agree with the proposed principle for determining when a good or service is distinct.

However, in the context of a single construction contract, we consider that the inter-relationship of performance obligations arising from the inter-dependency of operational execution needs to be taken into account when assessing whether performance obligations are distinct.

3.	*Do you think that the proposed guidance in paragraphs 25-31 and related application guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?*

We agree in principle with the "transfer of control" approach in determining when a performance obligation is satisfied and hence, revenue shall be recognized.

However, 30(a) states that "An obligation to pay is unconditional when nothing other than the passage of time is required before the payment is due." In a construction contract we consider it appropriate to recognise revenue when work capable of being certified has been done. We consider this recognition point to be aligned with the intent of paragraphs 32 and 33 and should be recognised as such.

Measurement of revenue (para 34-53)

4.	*The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.* *Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?*

We agree that revenue should be recognized based on the estimated transaction price if the consideration is variable. We also agree with the proposed criteria under paragraph 38.

5.	*Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?*

We agree with the principle to reflect customer's credit risk, to the extent that it can be reasonably estimated and is material, in the measurement of the revenue as the credit risk-adjusted revenue will reflect the amount of consideration that an entity expects to receive upon satisfaction of a performance obligation.

Before entering into a business contract with a customer, an entity will normally have evaluated the credit risk of the customer before granting any credit term on settlement or agreeing on a payment schedule which may include a deposit. Hence, we believe that in most cases there is no need for an entity to reduce the amount of promised consideration to reflect the customer's credit risk unless a specific potential default case is identified before or at the time when an entity obtains an unconditional right to receive a consideration.

6.	*Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?*

We agree with the proposal to adjust the promised consideration to reflect the time value of money if there is a material financing component contained in the contract. We believe that this would provide a fair presentation of the economics of the revenue and earnings arising from such contract.

7.	*Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?*

We are concerned by the ED's proposal that an entity should evaluate whether separate performance obligations are onerous (paragraphs 54-56). This could result in the recognition of losses from performance obligations even if the overall contract is expected to be profitable. The test of onerousness at the performance obligation level, not the contract level, does not seem to reflect the commercial reality. We believe that the recognition principle based on contract in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets" (paragraphs 66-69) should be more appropriate.

We do not believe that the proportionate allocation of transaction price to all separate performance obligations based on their respective stand-alone selling price would faithfully represent the economics of a contractual arrangement.

An entity will take into account different discount levels when pricing a contract with multiple components or performance obligations. It is not uncommon for it to provide higher discounts on the high-margin components and lower or none on low-margin

components. It is not appropriate to adopt a mechanical pro-rata allocation of discounts to all performance obligations in a contract as it may result in the entity reporting a loss on the low-margin components which does not reflect the economic reality of the contractual arrangement. Notwithstanding the Boards' conclusion in BC127-128, we urge the Boards to provide an exception for the allocation of discount on a pro-rata basis if management can provide evidence on providing discount using a different basis.

Similarly, we also urge the Boards to review the proposal under paragraph 53 in relation to the allocation of subsequent changes in the transaction prices on the same basis as at the contract inception.

Contract costs (para 57-63)

8. *Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 or software), an entity should recognise an asset only if those costs meet specified criteria.*

   Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

We believe the proposed requirements are operational and sufficient.

9. *Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.*

   Do you agree with the costs specified? If not, what costs would you include or exclude and why?

We agree with the costs specified under paragraph 58.

Disclosure (para 69-83)

10. *The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?*

We welcome the Boards' approach to develop a principle-based disclosure requirements and specifying the disclosure objective for this single revenue standard (BC171). In principle, we agree with the disclosure objective.

However, we observe that the proposed disclosure requirements are substantially more extensive and detailed than the existing ones under IAS 18 "Revenue" and IAS 11 "Construction Contracts". Additional implementation costs and efforts are expected in order to ensure the compliance with the proposed disclosures.

In addition, we are concerned by the proposed disclosure of information relating to onerous performance obligations which are commercially sensitive and may jeopardize the entity's position in negotiation and final settlement. Such proposed requirements (paragraph 79 (a) to (c)) involve a discussion of the nature of the performance obligations, reasons for them becoming onerous and expected timing of satisfying the liability. We suggest that the disclosure should be limited to reconciling the aggregate movements of the onerous performance obligations in a year and not to disclose the above discussion relating the contractual information.

> 11. *The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.*
>
> *Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?*

The ED prescribes the disclosure of 4 specific time-bands for the above maturity analysis under paragraph 78 (a) to (d) which covers maturity period ranging from less than one year to maturity over three years. It is unclear in the ED the rationale for choosing such time-bands. If the Boards maintain this disclosure requirement in the eventual Standard, we would urge the Boards to elaborate on the disclosure principle for the time-bands and consider if exception can be provided to preparers of the financial statements to adopt an appropriate set of time-bands which will reflect such disclosure principle.

> 12. *Do you agree 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? If not, why?*

We agree with the proposed basis for revenue disaggregation.

<u>Effective date and transition (para 84 and 85)</u>

> 13. *Do you agree that an entity should apply the proposed requirements retrospectively (ie as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why?*
>
> *Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.*

We understand the merit of the full retrospective application of the new requirements in order to ensure comparability of the financial information between current and prior reporting periods. However, from a practical standpoint, a full retrospective application may require re-analysis of legacy data from periods prior to current ownership and system. An extended lead-in time, such as 3 to 4 years, for the introduction of the new standards would enable a more robust and reliable analysis of data in the relevant period.

Application and guidance (para B1-B96)

> *14. The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?*

We appreciate the Boards' efforts in developing the application guidance (which are covered under 48 pages out of a total of 88 pages of the ED) to facilitate preparers' understanding and enable the proposals to be operational. However, we believe it is more important to ensure the appropriateness, clarity and consistency of the principles to be included in the main text of the proposed accounting standards on revenue recognition.

> *15. The boards propose that an entity should distinguish between the following types of product warranties:*
>
> (a) *a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.*
>
> (b) *a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.*
>
> *Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?*

In practice, it is not straightforward to draw the distinction between "quality assurance" (for initial defects) and "insurance" (for subsequent faults) product warranty for determining whether a separate performance obligation exists. Significant management judgement will have to be exercised to disentangle them and to allocate the transaction price between the promised product and the promised "insurance" warranty service under a contract as required by the proposed revenue recognition model.

It is common for construction contracts to contain warranty provisions and in certain cases, the warranty period could last for up to 25 years after contract completion. Such defects, in most circumstances, will not be common after the issue of the maintenance certificates. Hence, it is expected that the revenue attributable to warranty service which is deferred and reported over such a long warranty period after contract completion will not be material. The cost and effort to distinguish and accounting for the different types of product warranties will outweigh its benefit to the users of the financial statements.

Currently, appropriate provisions against defect liabilities or warranty obligations (irrespective of the type of warranties) will be made in accordance with IAS 37 "Provisions, Contingent Liabilities and Contingent Assets". The ED does not mention any amendment to IAS 37 (para 39 and example) in respect of its proposed accounting treatments for the different types of warranty. We consider that more meaningful information can be provided to users of the financial statements if all warranty obligations are treated similarly and recognized in accordance with IAS 37.

16. The boards propose the following if a licence is not considered to be a sale of intellectual property:

(a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and.

(b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.

Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

We agree with the proposed revenue recognition basis in relation to the granting of a non-exclusive right to use an entity's intellectual property as stated in (b) above.

However for (a) which involves the granting of an exclusive right to use an entity's intellectual property, we believe that it is more appropriate to consider its accounting treatment for lessor under the scope of the ED on Leases (as mentioned in BC224).

Consequential amendments

17. The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

We agree with the proposal to apply a consistent revenue recognition and measurement principles to the above asset sales.