

March 13, 2012

To: The International Accounting Standards Board

Comments on the revised Exposure Draft “Revenue from Contracts with Customers”

While expressing our high regard for many years of hard work by the International Accounting Standards Board (“IASB”) and the Financial Accounting Standards Board (“FASB”) to develop common standards for revenue recognition, we are grateful for the opportunity to comment on the revised Exposure Draft “Revenue from Contracts with Customers” (“ED”).

This ED contains several proposals that affect accounting practices in Japan. Thus, in addition to our response to the questions for respondents, we would like to express our comments on important matters regarding the ED.

We would be delighted if our comments could serve as reference material for the IASB to finalize the IFRS revenue recognition project.

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Question 1: Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

Response:

We agree with the proposal.

When we apply paragraph 35 (Performance obligations satisfied over time) of the ED to general contracts in Japanese construction practice, the requirements stated in (a), or (ii) or (iii) of (b) of paragraph 35 would be satisfied, therefore we regard them as performance obligations satisfied over time.

As for (a), it is because we hold possessory liens until the time of delivery of completed works and we regard such liens as protection rights against the customer's failure to pay and do not preclude customers from obtaining control of such works. As for (ii) and (iii) of (b), it is because, in general, another entity does not need to re-perform the work completed to date, and the work completed to date is transferred to the customer and we receive the payment for performance completed to date, even in case of discontinuation of construction, as stated in BC98.

Question 2: Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a customer's credit risk and why?

Response:

In respect to receivables relevant to revenue, we agree to account for the amount expected to be uncollectible as a profit or loss item separate from the revenue line item. However, we do not agree to present the amount expected to be uncollectible including subsequent changes in such amount in profit or loss as a separate line item adjacent to the revenue line item.

We do understand the intentions to clarify to all users of financial statements that a portion of the entity's gross revenue is expected to be uncollectible by linking the presentation of the revenue line

and the impairment loss line. The proposed method would be highly effective at initial recognition.

However, as stated in BC172, there is not necessarily a connection between the revenue recognised in a particular reporting period and the impairment losses recognised in that period that fluctuate along with changes in the customer's credit risk. It is meaningless to compare the impairment losses of receivable due to deterioration of customers' credit standing, that is, the uncollectible amount relevant to revenue in the prior period and the amount of revenue recognised in the current period.

Accordingly, we consider that linking the presentation of the revenue line and the impairment loss line could mislead the users of the financial statements and that it would be sufficient to present, as before, the impairment losses together with impairment losses on other financial instruments in sum total, disclosing the composition thereof.

Question 3: Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

Response:

We agree with the proposal.

Question 4: For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

Response:

We do not agree with the proposal.

We disagree with limiting the scope to “performance obligations that an entity expects at contract inception to satisfy over a period of time greater than one year,” even though we do not oppose to considering practical expedient.

In the Japanese construction industry, it is common to recognize provisions for all contracts that are expected to result in losses, and users of financial statements including analysts give considerable attention to such figures.

There is not necessarily a correlation between the length of performance period and the amount of loss. We do not believe the proposed accounting treatment is appropriate because, by limiting the scope to “performance obligations that an entity expects at contract inception to satisfy over a period of time greater than one year,” losses could be carried over to the financial statements in subsequent periods (this is not the case when the contract would be completed within the same fiscal year). Also, we presume that changing accounting treatments along with the length of performance period would be cumbersome.

Thus, we propose that “an entity may not recognise a liability for onerous performance and a corresponding expense if the performance obligation is satisfied within one year or less” as is the case with paragraph 97 “the amortisation period of incremental costs of obtaining a contract,” instead of limiting the scope according to the attribute of performance obligations.

Question 5: The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.* The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119–121) • Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)
- A tabular reconciliation of the movements of the assets recognized from the costs to obtain or fulfill a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

Response:

Although we agree with disclosing the disaggregation of revenue, we do not agree with the other disclosures. It would be a heavy burden for the entities and auditors in Japan if the required disclosures in the interim financial report were equal to those of the annual financial report because promptness is required for the release of quarterly financial statements. Also, the benefits to users of having that information and the costs to entities to prepare and audit that information do not balance because the users are not so much interested in the information on future accounting periods but in the information on the expectation of obligations performed in the current accounting period and the promptness of disclosure. Therefore, we propose that, besides the disaggregation of revenue, the scope of disclosure should not be specified for interim financial reports and an entity should be able to decide which items to be disclosed at its own discretion for the information relevant to the annual financial report.

Question 6: For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset.* Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

Response:

We agree with the proposal.

We consider that the determination of the timing of transfer of control for non-financial assets (property, plant and equipment and the like) and its measurement are relatively explicit. Besides, if there are differences in the accounting treatments between ordinary activities and non-recurring activities for basic matters such as the determination of the timing of transfer of control and its measurement, such differences might cause confusion in accounting practice, therefore we agree to apply those requirements on control and measurement in the ED to other standards.

The following are other important matters relevant to the ED:

Presentation (paragraphs 104 - 108)

Response:

Although we agree that an entity shall present the contract in the statement of financial position as a contract liability, a contract asset, or a receivable depending on the relationship between the entity's performance and the customer's payment, we make the following two proposals because the costs to entities to prepare due to the requirements in the ED substantially exceeds the benefits to users having that information:

1. "A contract asset or a receivable shall be determined by whether it is substantiated by (a) performance obligation(s)."

In the construction industry, any of the requirements in (a), or (ii) or (iii) of (b) of paragraph 35 is generally satisfied, and we understand that revenue from construction contract shall be recognised as

a performance obligation satisfied over time so that not a contract asset but a receivable shall be recognised at the time of revenue recognition. On the other hand, the ED defines that a receivable is “an entity’s unconditional right to consideration that nothing other than the passage of time is required before payment of that consideration is due,” and illustrative examples 17 and 18 suggest that there is no connection between recognition of a receivable or a contract asset and recognition of revenue (performance obligations) because a receivable is recognized when the consideration becomes due or the contract condition that allows the entity to receive the consideration is met. In other words, illustrative examples 17 and 18 suggest that a receivable is recognised when the consideration becomes due under the contract condition regardless of whether a performance obligation is satisfied or not. However, we believe that a receivable should be substantiated by revenue, or (a) performance obligation(s) satisfied. This is because, even if the consideration is due or received, there is a possibility that such amount is necessary to be returned to the customer unless the entity satisfies its performance obligation.

2. “A contract liability shall be recognised only when a customer pays consideration before an entity satisfies its obligation(s) by transferring a good or service to the customer and shall not be recognised just because the payment is due.”

If a contract liability shall be recognised when the payment is due but the consideration has not been collected, some entities will have to assess a vast number of contracts and change accounting treatments depending on the due date, and we do not think that the benefits to users of having that information and the costs to entities to prepare that information balance.

Also, in general, the requirements for presentation in the ED are obscure and difficult to understand. Especially, when an entity obtains an unconditional right to consideration is not clarified in the ED. Accordingly, we strongly urge that the standards include a specific explanation of when an entity obtains an unconditional right to consideration and an illustrative example of performance obligations satisfied over time since illustrative examples 17 and 18 are examples of performance obligations satisfied at a point of time.

Disclosure (paragraphs 109 - 129)

For annual financial statements, in addition to disclosures of qualitative information regarding revenue recognition, disclosures of quantitative information (disaggregation of revenue, reconciliation of contract assets and contract liabilities, analysis of remaining performance obligations, information on contract costs and onerous liabilities, etc) are proposed. Do you agree with this? If not, which disclosures do you think does not achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information?

Response:

We do not agree with the following items:

1. A maturity analysis of remaining performance obligations (paragraphs 119 and 120),
2. Qualitative information regarding onerous performance obligations (paragraph 122), and
3. Contract costs (paragraphs 128 and 129).

Also, regarding reconciliation of contract balances (paragraph 117), we strongly urge that an illustrative example be presented for performance obligations satisfied over time.

The reasons for the above-mentioned items are as follows:

1. A maturity analysis of remaining performance obligations (paragraphs 119 and 120)

Out of disclosures of information about performance obligations, we do not agree with disclosing quantitative information about a maturity analysis of remaining performance obligations. In the construction industry, there are many contracts with a period exceeding one year, and the contents vary by contract. Furthermore, the performance obligation is satisfied over time. It would be a heavy burden for the entities to estimate when the entity typically satisfies its performance obligation(s) for each remaining performance obligation based on the expected progress, and therefore it does not balance with the benefits to users of having that information. Also, it would be impossible to appropriately audit such uncertain estimation. Therefore, as an alternative, we propose a method where an entity discloses the transaction price allocated based on the maturity date of each remaining performance obligation, which would not require making any estimation.

(Specific example)

In case of a major construction company, they have more than two thousands of units to be accounted for. They vary in various kinds of construction works (for building works, for example, works for office buildings, plants, school plants and the like and, for civil engineering works, works for roads, bridges, dams and the like), and the construction works are under constraints of regional characteristics (country and region, and cold or rainy region and the like), timing (busy or slack period and the like) and other conditions (requiring special construction methods or materials, tight

deadlines and the like). In addition, it becomes more complex practically due to diversity resulting from consolidation of subsidiaries engaged in the construction business for the settlement of accounts. As the performance obligations for the construction industry are generally satisfied over time, the progress of the remaining performance obligations is to be estimated individually considering each specific condition. Information about the date of completion of construction works, which is the important deadline to deliver the ordered work, is managed and controlled by the company, but the company does not have a data relevant to the progress toward completion, and such data can only be prepared by the cumulative estimation based on experience and sense of the person in charge. The estimation is highly specific in nature, and there is no criteria for making such estimation within the company or in general. Moreover, it is not the kind of thing that is subject to audit by the auditors. If such estimation of progress made without reasonableness is reported in the financial statements, it will put excessive burdens of responsibility on the managements and can be very misleading for the users of the financial statements.

As we explained through the specific example above, we emphasize that collecting data about the maturity analysis of remaining performance obligations is difficult when the performance obligation is satisfied over time and many entities would have problems that the data collected is not reliable and proper to be reported as financial reporting to the investors, hence we propose the alternatives, such as the allocation method as discussed above and the disclosure limiting to the timing of completion of construction works.

2. Qualitative information regarding onerous performance obligations (paragraph 122)

It would be a heavy burden for the entities to disclose all the information regarding onerous performance obligations due to their various reasons and contents. Also, there is a possibility that disclosing the details of onerous performance obligations will have an impact on the entity's strategy or negotiation with customers. Therefore, we agree with disclosing quantitative information as in paragraph 123. However, for paragraph 122, we propose disclosing general qualitative information about onerous performance obligations without disclosing the details of each onerous performance obligation.

3. Contract costs (paragraphs 128 and 129)

Regarding the disclosure of contract costs which was added to in the ED, neither its purpose nor the benefit for the users can be understood even after referring to BC271. Usually, in the construction industry, we believe that contract costs are included in the cost of work and amortised in accordance with the progress rate of the construction. Therefore, we do not agree with the proposal because extracting contract costs from the cost of work and preparing the reconciliation of contract costs would be a heavy burden for the entities.