Duncan Magrath  
Chief Financial Officer

13 March 2012

Mr Hans Hoogervorst  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London  
EC4M 6XH

Dear Mr Hoogervorst

Exposure Draft Revenue from Contracts with Customers

We are leading UK companies in the construction and support services industries with combined annual revenues of £31Bn and 170,000 employees.

We are writing as an industry body to comment on the proposals in the revised 14 November 2011 exposure draft 'Revenue from Contracts with Customers'.

Our industry body participated in the comment process for the discussion paper and the first exposure draft, comment letters 169 & 572 respectively.

We note that several concerns raised previously by us and others have been helpfully addressed in the revised exposure draft.

However there are areas we believe require further consideration before the Boards refine the exposure draft proposals into the eventual standard, in particular:

1. We are concerned that much of the proposed disclosure is highly onerous for preparers in terms of cost and systems implementation. This is particularly so for subsidiary companies and for private companies who do not currently adopt IFRS 8;

2. We believe that in evaluating the decision-usefulness of disclosure requirements the Boards should take more cognisance of the information used by preparers in the management of their businesses;

3. We do not believe the 'collectability' model is clear, necessary or will improve the usefulness of financial statements;

4. We believe the Boards should reconsider the requirement to identify onerous performance obligations within a contract that is profitable overall;

5. We believe the drafting of the paragraphs concerning contract modifications is confusing;

6. We suggest that preparers should have the option to account and provide disclosure information for all contracts in aggregation and not be required to treat contracts with a duration of under one year in a different manner.
We respond to the Boards’ questions in Appendix 1.

Appendix 2 contains some further fundamental points not covered in our response to the Boards’ specific questions.

Appendix 3 contains some less fundamental points and those of a drafting nature.

We continue to support the IASB/FASB initiative to replace IAS 18, IAS 11 and various IFRIC pronouncements with a single standard applicable to both goods and services across all industry sectors.

Finally, we commend the Boards for the extent of their consultation with users, preparers and others; their flexibility in addressing issues raised by respondents; the extent of the outreach process; and the availability of the Boards’ project team for discussion and clarification with our industry group, which has informed our response.

We would be happy to meet your staff to discuss our views further.

Yours sincerely

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APPENDIX 1
RESPONSE TO IASB SPECIFIC QUESTIONS

Recognition of revenue (section IN38)

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?

We agree that where control passes over time the performance obligation is being settled over time. We also agree that in these circumstances revenue should be recognised over time.

However we have one comment of a drafting nature.

Paragraph 35 (b) (ii) is as follows.

"Another entity would not need to substantially re-perform the work the entity has completed to date if that other entity were to fulfil the remaining obligation to the customer. In evaluating this criterion, the entity shall presume that another entity fulfilling the remainder of the contract would not have the benefit of any asset (for example, work in progress) presently controlled by the entity. In addition, an entity shall disregard potential limitations (contractual or practical) that would prevent it from transferring a remaining performance obligation to another entity."

We have highlighted the two sections in bold italics because we believe they are inconsistent, certainly in the case of a long-term contract performed over time.

In the case of a half-finished hospital where there was no “need to re-perform the work the entity has completed”, satisfying the first part of 35 (b) (ii), clearly another entity would need the benefit of the half-finished hospital in order to finish it.
**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?

We understand the Boards’ proposal is to disclose, as the contract progresses, a separate line item adjacent to revenue for unrecoverable revenue from a customer compared to that stated in the contract with the customer at the point of initial recognition of revenue.

However we do not find the Board’s proposals, or indeed purpose or objective, clear and to the extent the proposals are clear we do not find them persuasive.

Areas of ambiguity include:

1. Does the draft standard mean that unconditional rights to consideration arising from contracts from customers are financial instruments according to IFRS 9? Or that they are not financial instruments, but they are accounted for as if they were financial instruments?

2. If customer credit risk is assessed at say 2% and a provision is made in the financial statements at the reporting date, what is the appropriate treatment if the customer subsequently pays in full? We are unclear whether the provision is released to revenue or treated as a negative cost;

3. In a contract that is performed over time activity will not culminate in an IFRS receivable until some way into the contract, so we do not understand how paragraph 69 will be applied in practice;

4. It is unclear whether IAS 1 will be revised to ensure consistency of application; and

5. It is not clear, but we believe that the Boards’ intention is that only a significant customer specific risk is relevant, not the generic risk that is always present when selling to customers. For example, if an entity is selling to an AA rated corporate customer, then no allowance would be made for the expected loss on an AA rated customer debt. Conversely, allowance should be made when the transaction price for a customer incorporates a risk premium relating specifically to that customer, for instance where the customer is known to have liquidity problems or is in an inherently unstable part of the world.

We therefore do not believe paragraph 69 assists the Boards’ aims of ‘removing inconsistencies’ and ‘simplifying preparation’ of financial statements.

Furthermore and more fundamentally, we are concerned that this, as yet unnamed, figure will cause confusion to users of the financial statements and will in fact undermine rather than enhance their decision-usefulness.

We therefore strongly recommend that the Board deletes paragraph 69 from the standard.
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?

We agree that consideration should only be recognised as revenue when entitlement to payment is reasonably assured. We do not believe this represents a significant change from the 'probable' definition in IAS 11, which works very well in respect of contract variations that have not been agreed and are recognised when the performance obligation is being completed and it is reasonably certain the amount of consideration will be paid.

We therefore agree with the proposed constraint on the amount of revenue an entity should recognise.
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?

The proposed definition of "onerous" in paragraph 87 is workable, and we note it is broadly similar to IAS11 paragraph 36 though without the clarifications in IAS 11 paragraph 37.

We strongly believe that the onerous test should operate at the level of the contract, not individual performance obligations. Entities do not set out to undertake onerous performance obligations unless there is some other benefit within the contract overall.

We do not agree that the scope of the onerous test should only apply to performance obligations that an entity satisfies over time. We believe it should also apply to performance obligations that will be satisfied at a point in time in the future.

Our final concern relates to the timescale for the exclusion.

We feel that the requirement not to provide for an onerous contract because at inception it is expected to have less than a 52 week duration is arbitrary, inconsistent, not congruent with the objectives of financial statement preparation and contravenes the IFRS Framework principles of 'substance over form', 'Prudence' and 'Completeness' (Framework paragraphs 35-38). We believe this has the potential for a material overstatement of profit and net assets in the construction industry when compared to IAS 11.

We strongly feel that preparers should have the option of treating all their performance obligations, irrespective of duration, in accordance with paragraphs 86-90.

This is on the basis that:
- All performance obligations will be treated consistently;
- Significant time and expense will not be incurred in separating and measuring performance obligations between more than and less than one year; and
- The users of the financial statements, particularly institutional investors, may require additional information to be provided to them detailing known expected losses which have not been provided for under the one year exclusion. In some instances they may require this additional disclosure to be audited at extra cost.

There is precedent elsewhere in the standard for a cut-off period to be optional, for instance paragraph 97 relating to the incremental costs of obtaining a contract, where the one year cut-off is optional.

Another approach would be to require preparers, or preferably give them the option, to exclude onerous items if the contract will be completed within a one year reporting period.
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 recognised from the costs to obtain or fulfil 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.

We do not agree with these proposed disclosure requirements because the interim financial statements will become disproportionately weighted with revenue disclosure, much of which is subjective, complex or commercially sensitive, and hence will lead to boiler-plate disclosure.

Refer to Appendix 2 for our observations on the extent of disclosure requirements generally in the revised exposure draft.

Finally, we note with interest and concur with the dissenting view of Mr Jan Engström who voted against publication of the revised exposure draft. We agree with him that it is inappropriate to require such disclosure in interim financial reports without undertaking a holistic review of IAS 34.
**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?

We agree with the control criteria in paragraph 37 of ‘right to payment’, ‘legal title’, ‘physical possession’ ‘risks and rewards’ and ‘customer acceptance of the asset’ being applied to other non-financial assets that are not an output of an entity’s ordinary activities. We also agree with the application of the proposed measurement requirements.
APPENDIX 2

ADDITIONAL FUNDAMENTAL POINTS

Disclosure generally

Paragraphs 109 to 129

While we agree with the principle of decision-useful disclosure, we do not believe the Boards' proposals will achieve this aim, nor do they strike a reasonable balance between cost and benefit.

We are concerned that much of the proposed disclosure is highly onerous for preparers in terms of cost and systems implementation and will produce information that is neither decision-useful for users of accounts nor used in the management of our businesses.

We believe the information that management routinely uses to manage the business will be the most relevant and reliable information and have the lowest incremental cost to produce.

Moreover many of the proposed disclosures are subjective, overly complex or commercially sensitive and hence will lead to boiler-plate disclosure rather than decision-useful information.

We appreciate that when asked, analysts and other users of the financial statements state that increased disclosure would be helpful to them. However, this should be balanced with the significant additional work and cost that this places on preparers.

We are also mindful of the burdensome level of disclosure being required in the proposed standard for certain entities, in particular that:
1. The additional disclosures required in subsidiary entities will be extensive and of limited value to users of the financial statements.
2. The amount of disclosure is particularly burdensome for private companies, who are currently not required to provide this information as they are outside the scope of IFRS 8.

We agree that the following disclosures are appropriate in the consolidated financial statements for listed companies if an exemption is provided for their subsidiaries:
1. The disaggregation of revenue.
2. An analysis of the entity's remaining performance obligations.

We believe it would be more useful to users of the financial statements and less burdensome on preparers if paragraph 119 was applied to all contracts with customers, perhaps as an option, rather than only applying to contracts with an expected original duration of more than one year.

We strongly believe that the proposed disclosure of the reasons why onerous contracts are considered to be so is undesirable and counterproductive because of the commercial sensitivities. We believe this will either:
1. Result in boiler-plate disclosures, or
2. May influence the amounts reported by some preparers for tactical reasons related to their negotiations with the customer, giving rise to unreliable estimates in the financial statements.
Furthermore establishing the reasons why a contract has become onerous is an inherently subjective exercise and preparers and their customers may have a greatly differing view, derived from their own standpoint.

For these reasons we do not believe these disclosures will provide reliable information that is decision-useful.

We therefore strongly believe paragraph 122 should be removed.

In view of the wide range of views on the disclosure proposals in the initial exposure draft, we are surprised that the Boards did not include a question on disclosure generally when exposing the second draft but only on disclosure in interim financial statements.

Finally, we note with interest and concur with the dissenting view of Mr Jan Engström who voted against publication of the revised exposure draft, solely on the issue of excessive disclosure. We too are convinced that the benefits to users of the resulting disclosure would not justify the costs that preparers would incur to provide those disclosures.

**Contract modifications that are not a separate contract**

Paragraph 22

We find this paragraph confusing, particularly 22 (c).

It would be helpful if the standard could include a flowchart showing the interaction between the various paragraphs concerning contract modifications.

**Disclosure of future performance obligations one year cut-off**

Paragraph 119

In a similar point to one we made on onerous contracts, we believe the one year cut-off should be optional, not mandatory.

We note the inconsistency with the derogation for performance obligations invoiced by reference to eg a fixed amount for each hour of service provided in paragraph 121, which is optional.

**Effective date and transition**

**C3 practical expedients**

As a general comment, these practical expedients which have been introduced into the revised exposure draft are very helpful.
APPENDIX 3

OTHER POINTS

Paragraph 25
Set-up costs & mobilisation costs

Some contracts, including many construction and service contracts, require significant mobilisation activities and costs. The status of these costs is unclear because paragraph 25 implies these tasks will be of an administrative nature. In a different context, Application Guidance B32 makes the explicit assumption that set-up costs will only be of an administrative nature.

As a general drafting point, it would assist clarity and hence understanding if mobilisation and other set-up costs were allocated a specific section in the eventual standard, either in the primary mandatory requirements or in a dedicated section in the Application Guidance.

Paragraph 29
Distinct goods and services

This paragraph is helpfully taking on board a point we and others made on the original exposure draft, that of operational interdependence, where the entity performs a service of integrating or modifying the original inputs to create something new.

In doing so, the Boards will naturally wish to ensure entities cannot use cosmetic interdependencies to combine performance obligations. However we believe the existing wording is too restrictive and will lead to unintended consequences.

In particular, the effect of paragraph 29 (a) and (b) being individually necessary conditions will have the effect of overriding 29 (a) in many circumstances.

Taking a simplified construction example in the context of paragraph 29 (b) to illustrate the point, cement powder, water and sand are significantly modified to make cement, but the individual bricks that are cemented together are not modified in any way. They are therefore not distinct in the meaning of the exposure draft and would be a separate performance obligation.

Taking more general construction activities:
1. How can initial demolition be modified or customised?
2. How is this to be interpreted for design, which by definition is already customised so you cannot customise it further?

We suggest combining 29 (a) and (b) to say “the goods or services in the bundle are highly interrelated and transferring them to the customer requires that the entity also provide a significant service of integrating, modifying or customising the goods or services into the combined item(s) for which the customer has contracted.”
Paragraph 58  
The time value of money

We understand from paragraph 58 and BC 146 that the test relates to the individual contract, rather than a portfolio approach being taken, however this is not clear.

We understand from paragraph 58 and BC 147 that retentions by the customer are not adjusted for the time value of money, but advance payments are adjusted for the time value of money by virtue of BC 149-150, however this is not clear.

Paragraph 71  
Allocation of a discount between performance obligations

Allocating the transaction price or a relative stand-alone selling price basis is appropriate in straightforward cases.

However, this approach will not reflect the underlying commercial reality where a discount is given on a relatively high margin performance obligation. Part of the discount will be allocated to the low margin performance obligations leading to even lower, minimal or negative margins on these performance obligations, which does not faithfully reflect the economic substance of the contract as a whole.

In such a case the transaction price should be allocated to the ostensibly loss making performance obligations so as to give rise to nil profit on these performance obligations, with the revenue being taken pro rata from the other performance obligations.

Paragraph 91  
Costs to fulfil a contract and mobilisation costs

The position of mobilisation costs is unclear, particularly the application of paragraph 91 (b) which means there is a danger they will be regarded as general and administrative costs and expensed in accordance with paragraph 93 (a).

Mobilisation costs are mentioned in a different context in Application Guidance B32 under the description "set-up costs", where reference is made to the guidance in paragraph 91.

Paragraph 106 (b)  
Status of certified but not invoiced work in progress

We are unclear whether certified but not invoiced work in progress would be presented as a contract asset or a receivable.

Paragraph 108  
Presentation of onerous performance obligations

In paragraph 108 we are unclear whether a liability recognised for an onerous performance obligation should be disclosed within provisions, where it is currently disclosed under IAS 37.
Paragraph 114
Disaggregation of revenue

In the second line the word "excluding" is misleading, since revenue from contracts with customers does not include amounts presented for customers' credit risk. From BC 252 a more appropriate phrase would be "but not".

Paragraph 117
Reconciliation of contract balances

We believe cash received and amounts transferred to receivables may overlap in many cases.

Paragraph 119
Disclosure of future performance obligations

For comparability it would be helpful for both preparers and users if the Boards clarified the following:

1. The status of framework contracts, where a customer agrees a contract with one or more entities establishing rates and/or working methods for work that is certain to arise but whose timing may be uncertain or where the quantum is to be allocated between the framework contractors. It is unclear whether such contracts would give rise to performance obligations at the reporting date and if so how they would be measured. If they constitute a performance obligation, we believe the appropriate measure is a probability weighted estimate of the transaction price allocated to the performance obligations that are expected to be performed under the contract;

2. Contracts with market testing or benchmarking provisions. We believe the analysis should include the value of the transaction price allocated to the performance obligations up to the first market-testing or benchmarking point but not beyond; and

3. Where the transaction price has been adjusted for the time value of money, whether this disclosure is before or (our preference) after the adjustment for the time value of money.

If the Boards do not widen the guidance in the exposure draft to include these areas, then, to assist users in assessing comparability between different entities, we believe the boards should require disclosure of the measurement bases entities have used in their financial statements.

Paragraph 121
Right to invoice a customer in an amount that corresponds directly with the value to the customer of the entity's performance completed to date eg those invoiced by reference to a fixed amount for each hour of service provided

We are unclear why contracts containing such a right should give rise to an optional exemption from the disclosure requirements in paragraph 119.
Application guidance B32
Non-refundable fees (and some related costs)

Section B32 clarifies the status of set-up costs in the determination of progress in accordance with paragraph 45.

However, as a drafting point, we believe B32 sits uneasily with B29 – B31.

Paragraph 45 would be a more appropriate place for the wording currently in B32. Preparers of financial statements and other users of the standard will be unlikely to refer to Application Guidance headed “Non-refundable fees (and some related costs)” for guidance on the determination of progress or the treatment of set-up costs.

Furthermore the point in B32 is relevant even if a non-refundable fee is not charged in respect of these set-up activities.

Effective date and transition
C4 (b) Qualitative assessment

In practice if this sub-paragraph leads to any disclosure at all, it is likely to be boiler-plate.

Most preparers will take the view that it will only be possible to make a qualitative assessment of the estimated effect of applying the expedients by performing the work that can only be avoided by applying the expedient.