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Constructing Australia's Future

The Chairman
Australian Accounting Standards Board
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via email standard@aasb.gov.au

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Dear Sir

Discussion Paper: Preliminary Views on Revenue Recognition in Contracts with Customers

Abigroup is pleased to submit its comments on the above Discussion Paper ("DP"). Abigroup Limited is a wholly owned subsidiary of Bilfinger Berger Australia Pty Limited, a subsidiary of Bilfinger Berger AG, a leading international multi-services organisation. Abigroup is one of Australia's largest and most highly experienced engineering contractors having undertaken significant and prominent road, rail, industrial and water, mining and infrastructure projects via a number of different delivery methods to suit client specific requirements. Abigroup is also active in the building sector in property development and commercial building. Abigroup's current turnover is in the order of $2 billion per annum.

Whilst Abigroup supports the need to standardise accounting standards globally, there is some concern that the proposal under the DP has the potential to cause "lumpiness" in profit recognition, reduce transparency whilst increasing compliance costs, has the potential to manipulate profit recognition via deferral or advance recognition of revenue and / or costs when recognising revenue for long term construction contracts and will be less useful to the reader of the financial information. Abigroup supports the Australian Constructors Association ("ACA") paper and summarises its concerns below.

SUMMARY

The construction industry produces non homogenous products ranging in size, timing of delivery (usually across multiple reporting periods) and via different contract delivery methods.

Abigroup believe that the DP as drafted causes the following areas of concern for recognition of revenue and consequently profit on long term construction contracts:

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- Lack of clarity regarding when control of an asset passes to the client. Notwithstanding the client has ultimate control of what will be delivered, how it will be delivered and by what mechanism, the DP could be interpreted in a number of ways which would result in different revenue recognition outcomes. For example work completed on Abigroup property is defined as not being under the control of the client and accordingly is accounted for differently to if it were completed on the client's property. The lack of clarity extends to contract delivery by different contract methods. For example could delivery by design and construct where Abigroup are responsible for the design component result in different revenue recognition to a construct only contract where the design is the responsibility of the client?

- The concentration on the legal form of contracts over substance combined with different contract delivery types could result in different methods of recognising revenue.

- Revenue is measured based on the original transaction price and is silent on scope variations. Does this mean that scope variations are recognised on completion of the project? How would the costs relating to scope variations be dealt with? Could this result in costs not being matched against revenue causing lumpiness in profit recognition and less meaningful information being provided to the information user?

- Increased complexity by moving to performance measurement from a revenue base rather than cost base. Contingencies and provisional sums which are unrelated to revenue are often included in construction contracts.

- Increased complexity in revenue recognition will result in increased compliance costs with little or no increased usefulness to the reader.

- The move to performance measurement based on revenue will lead to additional "sets of books" to enable management to monitor the performance of projects on a cost basis which is consistent with existing construction principles worldwide. This will lead to increased costs with no additional usefulness to management or the reader of the financial information.

Although AASB 111 – Construction Contracts may be an old standard that is not entirely consistent with the Accounting Framework for revenue recognition, it provides an easily understandable mechanism for revenue and profit emergence over the life of the project which is related back to project costs incurred as a percentage of final forecast costs. This includes provisional sums and contingencies which are required due to inherent uncertainties such as inclement weather and unknown conditions involved in construction contracts. Interpretation of the DP could potentially lead to deferral of revenue and profit into future years or conversely recognition in the current year depending on circumstances. Some identified potential anomalies that could result are as follows:

- D&C contracts where continuous transfer to the client may be difficult to demonstrate could result in revenue and profit being recognised at the end of the project. As many D&C construction contracts are very large and run over multiple reporting periods, this could lead to the full contract value and profit being deferred to the point of practical completion;

- Often to assist with working capital management, the profit and overhead recovery will not necessarily emerge on a straight line basis. Interpretation of the DP could result in the whole job profit being recognised during the early stages of the project with no matching of profit to revenue. Alternative interpretation could result in all of the revenue being deferred to the completion of the project. AASB 111 provides a formula that takes a conservative approach in profit emergence over the life of the project once a project has reached a stage of completion that it can be reliably measured to be profitable;

- The DP is silent on treatment of loss making jobs. How should onerous contracts be accounted for in the absence of guidance from AASB 111?

- Where a continuous transfer to the client can be demonstrated, revenue would be recognised on the basis of certified claims plus a best estimate of current month's claims. This could lead to manipulation of profit in a period by increasing or decreasing the best estimate of current month's claim recognised which has an immediate bottom line impact on the result. Under AASB 111, the formula approach reduces the impact as it is related back to the forecast cost;

Significant deviation of revenue and consequently profit recognition from existing principles under AASB 111 will result in a second set of books being maintained in order to track the performance of projects for management purposes. This will lead to increased costs and time with no additional benefit. Further, due to differing interpretations, financial information will become less transparent and less useful to the reader. Additional disclosures in the financial reports will be required further increasing compliance costs to reconcile deviations between revenue and profit recognition as determined for financial reporting purposes and management reporting purposes.

RECOMMENDATION

It is our opinion that the principles ensconced in AASB 111 and AASB 118 provide the necessary elements for revenue and profit emergence on long term construction contracts to be reliably measured over the life of the contract. These principles need to be incorporated within the DP to provide meaningful, reliable and accurate information that is transparent without increasing the compliance cost burden. The percentage of completion method of profit recognition is an easily understood and recognised principle world wide which provides a consistent approach across all contract types and all construction companies.

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Moving to performance based on revenue recognition would result in

- less transparency;
- potential for manipulation of results;
- increased compliance costs;
- increased management costs; and
- reduced consistency across all contract types and construction companies.

Should you wish to discuss our response, please do not hesitate to contact us.

Yours faithfully
Abigroup Limited

David Walker
Finance Director