

October 22, 2010

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

Re: Exposure Draft - Revenue from Contracts with Customers (the “proposed standard”)

Dear ladies and gentlemen,

The Japanese Shipowners Association (“JSA” or “we”), a trade organization representing the interest of ship owners and ship operators in Japan, are honoured to write this letter to request your attention to our concern on the proposed standard, *Revenue from Contracts with Customers* issued by the IASB (“the board”). This letter summarises the views of Japanese shipping interest on the proposed standard.

We appreciate the board's efforts to establish a new set of accounting principles that provide streamlined and consistent guidance for recognising revenue. However, based on our industry experience, we think that there are four areas (listed below) needing your attention in order to improve the proposed standard in a way to better depict the economics of the ocean going cargo transport business, and thus to help ensure consistent application of the standard among various preparers of the same trade in the world:

- (1) Contract combination
- (2) Transfer of control
- (3) Cost guidance
- (4) Onerous performance obligations

Background – Freight revenue of the shipping industry

For the ease of your understanding, we first provide here with some economic characteristics that seem unique to the ocean going cargo transport industry (shipping

industry) in terms of the freight revenue from customers (either shippers or consignees, depending on international trade terms on freight payments).

- (1) The Duration of ocean going transport service (we call it a voyage) to earn freight revenue is longer than those of other transportation services such as land, air or rail.

Shipping companies (as ship operators) usually undertake transportation of cargoes of customers at a loading port, carrying them to an assigned destination port and unloading them from a vessel. The duration of a voyage will take a few days for short sea service up to four months (like a large bulk carrier’s voyage commencing at an East Asian port upon completion of the previous voyage, proceeding in ballast to a Brazilian port, then sailing back loaded with full of iron ore to an East Asia port). Because of the length of ocean going transport services, the matching of freight revenue and associated voyage cost has been a very important issue in the accounting practice of the shipping industry, especially on profit/loss calculations on a voyage basis. Shipping companies have thus accounted for the freight revenue in such a manner.

- (2) There is a variety of voyages.

A liner vessel (e.g. a containership) carries various cargoes in containers simultaneously of many shippers, with different ports of loading and unloading on a prefixed schedule. At each port, a part of cargoes will be unloaded and other cargoes will be loaded. In many instances, feeder transportation over sea and/or land bound for a final destination of cargo is utilized to complete the transportation service of cargo

For those ocean going transport service, such as trampers, a voyage could be as simple as commencing the voyage in a ballast condition to proceed to the port of loading and carrying the cargo to its destination port. The number of calling ports as well as numbers of shippers can vary, depending on a relevant charter party. Car carrier service usually commence its voyage loaded with cars and trucks to destination ports and sail in a ballast condition to the next loading port and tend to involve more shippers and destination ports than trumper services.

- (3) Shipping companies recognize freight revenue over the period of a voyage or upon completion of the voyage.

The bill of lading is a contract document binding a party to claim the goods and verifies the receipt of goods by the carrier and represents the obligation to the holder of the bill of lading to deliver the goods. In a liner trade, legally, the carrier is entitled to claim the freight charges upon loading of cargoes.

In other trades, the freight payment agreement of a relevant charter party will govern. Regardless of the legal entitlement mentioned above, however, shipping companies are recognizing freight revenue either upon completion of a voyage or over the period of a voyage in order to better match revenue and cost over the whole transportation service.

- (4) Shipping companies recognize freight revenue per voyage rather than per bill of lading.

For accounting purposes, it is not practical for shipping companies to track the delivery status of each cargo or per bill of lading, as the destination points will disperse all over the world, including inland locations in case of a liner service. In addition, it is not practical to allocate revenue and associated cost to each cargo or bill of lading, as cost for doing so outweighs the benefit. Therefore, shipping companies recognize freight revenue per voyage rather than per bill of lading.

Comments on contract combination (Question 1)

We agree with the proposed principle for combining two or more contracts and accounting for them as a single contract if the contracts are interdependent. We support the concept of interdependency as a principle, but do not believe the proposed guidance in paragraph 13 is sufficient.

The shipping companies obtain freight contracts from customers to best recover fixed cost of vessels and voyage. Companies often add multiple contracts (bill of lading) into one voyage with separate customers and variety of prices, to maximize revenue per voyage. These contracts do not always have interdependent prices as they are with separate customers. However, we believe it best accounts for the substance and economics of our business by combining contracts for the voyage, because stakeholders are most interested in how we recover cost for investment. The present revenue recognition of shipping companies is made under this principle, which we believe stakeholders are satisfied with.

Therefore, we believe it should be allowed to combine contracts when it best accounts for the economics of the business.

Comments on transfer of control (Questions 3 and 14)

According to the proposed standard, revenue results from the satisfaction of performance obligations, which occurs when control transfers, for both goods and services. We are however afraid that there are cases needing additional indicators appropriate to determine when control transfers in some service arrangements. Such additional indicators would help better determine when control of a service has transferred to a customer and increase consistency in application.

For the ocean going transport service, the criterion in the proposed draft is unclear to determine when the control of service transfers to customers. There seem multiple interpretations logically possible. One interpretation would be that the control transfers continuously as the shipper, in some cases, substantially controls the service by either occupying space in a vessel or directing the captain of the vessel. Another theory is that the control is transferred upon cargo delivery, after which the shipper can enjoy the benefit of the cargo transported. Unless an appropriate supplementary application guidance is incorporated to the proposed guidance, it would be difficult to ensure the principles are applied in a way consistent and comparable among the shipping industry.

Comments on cost guidance (Question 8)

As described in (2) of the background, there are cases to sail a vessel empty to pick up the cargo at the port of loading. The cost for this voyage is directly related to the contract of subsequent transportation, the freight of which takes this into account, though not specifically mentioned in the contract. It is not clear whether this cost meets any of the criteria in paragraph 58. We believe inevitable cost should be added as a criterion for directly related cost.

Comments on onerous performance obligations (Question 9)

We are concerned that applying the proposed standard might not reflect the economics of transactions, particularly when an individual performance obligation is not profitable but the overall contract or profit management unit (e.g., a voyage in case of the shipping) is profitable.

A shipping company might undertake cargoes at very low freight rates to maximise the profitability of each voyage due to the high fixed costs of a voyage. The onerous performance obligation guidance would require the shipping company to record liability for an onerous performance obligation when transportation of certain cargo is undertaken for an amount that does not cover all of the costs of that voyage as specified in paragraph 58, despite the shipping company having made an economically rational decision to undertake those cargoes at the freight rates.

We believe the assessment of whether a liability should be recorded should be performed at the profit management unit level so as to reflect the underlying economics of the transaction.

Costs are not tracked at the performance obligation level by the shipping companies; therefore, the allocation of costs to individual performance obligations and the assessment of whether performance obligations are onerous will take considerable time and cost in redeveloping relevant systems and business process. We do not believe the benefits of making an assessment at the performance obligation level outweigh the cost or effort.

Overall comment

Conceptually, we agree with the board's view to focus on performance obligation to warrant more consistent recognition of revenue. However, depending on the nature of business, revenue per performance obligation may not best reflect the economics and may not be beneficial to the users of financial statements. We believe further consideration should be made from this perspective.

Sincerely yours,



Mitsuo Nakamoto
Director General
The Japanese Shipowners' Association