



June 11, 2009

By Email: www.iasb.org

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

Dear sir/madam

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Discussion Paper – Preliminary Views on Revenue Recognition in Contracts with Customers issued by the International Accounting Standards Board (IASB).

CGA-Canada, together with its affiliates and its 71,000 members and students, has long been a significant contributor to the accounting profession. The CGA designation is built on a strong foundation of ethics, education, examination and experience and CGA standards of competence continue to meet domestic and international standards. CGA-Canada contributes to accounting, and to public policy, with a view to enhancing the credibility of the profession and promoting the interest of the public.

We will preface our discussion with an overall general comment and then proceed to provide response to thirteen (13) questions (*italics*) identified by the Board.

General comment:

The Discussion Paper – Preliminary Views on Revenue Recognition in Contracts with Customers has covered the broad principles of the revenue recognition model based on changes in contract assets and liabilities. As noted in the paper, there are a large number of topics to be discussed and resolved before this standard can be released as an exposure draft. The concepts included in this model require a level of knowledge of contracts which may present an important learning curve for many accountants and auditors. Nevertheless, we believe that it represents a positive step in the right direction; which is, of course, to articulate a standard for revenue recognition that will produce consistent and decision-useful information.

Question 1: *Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?*

Response

We agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability. The contract, as defined in the discussion paper, is the element common to all revenue producing transactions. Once the concepts of contract rights and obligations, and the net changes that result in revenue recognition are understood, the principle can be applied to the multitude of customer contracts. This approach emphasizes the legal

rights and obligations of the entity to determine the timing and measurement of revenue recognition and these rights and obligations are absolute.

We believe also that, although it may represent a steep learning curve for some applying the principle, this approach achieves the objective stated in paragraph 1.19 to “bring discipline to the earning process approach so that entities can recognise revenue more consistently”.

Questions 2: *Are there any types of contracts for which the boards’ proposed principles would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?*

Response

We have reviewed different types of contracts to determine how they might be affected by the boards’ proposed principles. In a number of current complex situations, we contend that the application of this principle will improve the decision-making usefulness of information. The revenue will only be recognized as based on the increase in contract assets or the decrease of contract liabilities; leading to more consistent revenue recognition. For example, since a contract liability for warranty remains after control of the product is transferred to the customer, a portion of the revenue will only be recognized once that liability is reduced to zero. This example indicates that the resulting reporting will more faithfully represent the operations of the entity.

However, the use of the contract based revenue recognition concept for financial instruments does prompt reservation and invites some analysis. Where a financial instrument is contracted between an issuer and a primary holder, it appears to fit the proposed concept. If A issues a mortgage to B, in exchange for the use of B’s funds for a fixed period, A is obligated to make a series of payments of interest over time in exchange for acquiring the use of B’s cash asset. If B is in the business of lending funds on mortgages, there seems little argument to not rely on the contract based revenue recognition approach. If A sells the mortgage in a secondary market to C, and this is a part of their normal operations as brokers, then the proposed contract basis still applies.

If A writes a put option on B’s capital stock in an option market, we are compelled to examine what has happened. A has undertaken to purchase from an unknown holder, a specific number of B shares at a fixed price before the expiry date. The option premium received by A will either be part of the cost of purchased B shares or a gain from the expired option. It seems that this is not revenue as defined in the discussion paper.

Recognizing these types of scenarios, clarification and guidance will be required in the area of financial instruments.

Question 3: *Do you agree with the boards’ definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.*

Response

We believe that the definition of a contract is clear and succinct. It leaves little room for confusion and will support the consistency objective.

Question 4: *Do you think the boards’ proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.*

Response

Because the description of a performance obligation includes both explicit and implicit promises in the contract, (consistent with IAS 37) it is believed that the boards' proposed definition would help entities to identify consistently the deliverables in (or components of) a contract. That said, the examples provided in paragraphs 3.27 to 3.42 could be improved upon if the goal is to advance the consistency of application of the principle. These examples lay out alternate ways of applying the principle and draw no conclusions; thus revealing that the goal of consistency is not being met.

Question 5: *Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?*

Response

Yes, it is believed that the recognition of revenue, when the promised assets are transferred, is the appropriate approach. If there are numerous promised obligations to be performed at different times, then they should be separated in order to reflect faithfully the substance of the transactions. One of the main aspects of many revenue recognition issues is the omission of the recognition of promised obligations. In the past, contract assets were fully recognized in most cases but not contract liabilities; thereby distorting (and in some cases manipulating) the decision usefulness of the financial reporting.

Question 6: *Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?*

Response

It is agreed that the presence of "the right to return" in a contract results in a performance obligation and that the complexity of this approach will result from the measurement of this obligation. In order for the measurement of the obligation representing this right to return to reflect faithfully the underlying transaction, it will be necessary to estimate the probability of the product being returned. This in itself is not an insurmountable challenge as there are many areas within financial reporting where estimates are involved. Practical approaches such as the use of the probabilities in entities, or the industry's past experience as a basis to determine probabilities of returns are not new. As discussed later in response to Question # 13, the disclosure of the assumptions underlying the estimates will be integral parts of making the revenue recognition model meet its objectives.

Question 7: *Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods or services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?*

Response

To be consistent, sales incentives might better be treated as performance obligations if they are provided in a contract with a customer. When attempting to engineer principles based standards, which we reasonably expect is the boards' preference; it is detrimental to the objective to have performance obligations which are included in the contract, exempted from the principle.

As in Question # 6 above, the issue will be the measurement of this obligation in a manner that faithfully represents the obligation.

Question 8: *Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.*

Response

It is agreed that the entity satisfies the performance obligation when the customer controls the promised good or when the customer receives the promised service.

The dimension coming to mind throughout the review of the discussion paper is the need for knowledgeable individuals to be able to read the contracts with customers and to ultimately determine the effects of the terms of the contract on revenue recognition. The more complex the contract, the more knowledgeable the accountant will necessarily need to be. We continue to agree with the overall principle but clearly recognize the consistent, yet complex, nature of its application. An important element of this knowledge and judgement will be the ability to determine when the customer attains control over the asset.

The example in paragraph 4.43 represents a prime example of the complexities arising in contracts. The need for professional judgement is shown by the use of the term “suggest” when analyzing the contract terms. The example states that certain terms would “suggest that control of the girders is transferred to the customer throughout the contract”. All terms of the contract must be analyzed to arrive at a conclusion regarding the timing of the transfer of control.

Question 9: *The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.*

Response

The information produced by this model for some long-term construction projects may not be decision-useful at first because it is so different from the current accounting treatment in Canada. It will take extensive orientation to acclimatize users to this new model. Where the contract is for the construction of a building that takes 2 years to complete and the control does not transfer to the customer until the completion, no revenue will be recognized for 2 years. Until users adjust to this new model, this may not be decision-useful. Users will have to look to the assets and to the notes of the financial statements to evaluate the results of the operations of the construction company.

If we examine the situation where a contractor partially completes the construction of assets (e.g. a plant for a manufacturer, or a bridge for a municipality) and then fails to complete the contract, one might wonder where the “customer” stands. In matters related to construction on land, the customer in many jurisdictions would have a supportable legal claim to the partially completed asset. Perhaps the guidance materials eventually prepared should suggest that such realities be reflected in the contract and concomitantly be reflected in revenue recognition.

In other instances, such as the manufacture of a major piece of equipment, although a great deal of work may have been performed toward meeting the performance obligations under the contract, a failure to complete, for any reason, could well leave the customer with no asset at all. In such a case, the asset transfer (obligation performance criteria) would require no recognition before delivery. We agree with such an outcome where it reflects the real-world situation for customers.

If the contract for a long term construction project transfers the asset to the customer throughout the contract, the revenue will be recognized throughout the contract.

Question 10: *In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.*

- a) *Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?*
- b) *Do you agree that a performance obligation should be deemed onerous and re-measured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?*
- c) *Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.*
- d) *Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.*

Response

It is agreed that performance obligations should be measured initially at the transaction price and that this is the readily available valuation normally negotiated at arm's length. There is little need to introduce any other transaction valuation. It follows logically however, that guidance ultimately may be required for valuation of such obligations between entities not operating at arm's length.

The decision to deem performance obligations as being onerous using the cost method is much more workable in the real world. The alternative current price test would reflect more faithfully the operation of the entity in a specific period but the complexity of the test tentatively outweighs the advantages.

Expectedly, the users will likely adjust to the new model and the universal application of the new model will correspondingly enhance the adjustment. When an exception to a model is made, complexity typically arises resulting in negative impact to comprehension and decision-usefulness of the information. Exceptions to rules in the United States for example, have resulted over time in over 100 standards for revenue recognition. As, and where, possible this must be avoided for sake that this project would not seek to attract such a pattern or to duplicate this history.

Question 11: *The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognize those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.*

- a) *Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?*
- b) *In what cases would recognizing contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.*

Response

The costs of obtaining the contract should be expensed as they are incurred.

Question # 11 (a) suggests that these costs should be included in the initial measurement of the performance obligations. These costs have been incurred prior to the signing of the contract. They do not create, in and of themselves, an asset for

the customer and might better be identified as a sales expense. Whether or not the price calculation includes the costs of obtaining the contract, the price should be allocated over the product(s)/service(s) to be provided under the contract. It is difficult to understand how these costs are (or ever were) an obligation.

Since contract origination costs are sunk costs, they will not be recovered if the contract is not signed, and as such they do not meet the requirements to be recognized as an asset under the framework; there should likely be no exception allowed here to the framework.

Question 12: *Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?*

Response

This seems the most reasonable and objective approach to allocating the transaction price. The cost of applying this standard should not be excessive as the entity has the underlying pricing available on which to base any estimates.

Question 13: *Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?*

Response

Estimates are used extensively in IFRS and to that extent see little reason why estimates should not be used in this case to allocate the transaction price to the good or service. The entity should be able to make a best estimate evaluation of the stand-alone selling price of each element of the transaction.

Should the International Accounting Standards Board (IASB) wish elaboration on any of the aspects of the proposed response or wish to further discuss the matters envisioned by the Discussion Paper, it is encouraged to contact directly Amar Goomar, M.Sc., CGA, Director, Accounting Standards, at (613) 789-7771 ext. 223 or agoomar@cga-canada.org or alternatively, the undersigned.

CGA-Canada consents to the posting of its submission on the IASB Web site.

Sincerely,
[Original signed by:]

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