



May 12, 2009

Technical Director
International Accounting Standards Board
30 Cannon Street, 1st Floor
London, EC4M 6XH
United Kingdom

Dear Technical Director:

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

The Committee on Corporate Reporting of Financial Executives International Canada ("FEI Canada") is writing to provide its response to the Discussion Paper - Preliminary Views on Revenue Recognition in Contracts with Customers. FEI Canada is the all-industry professional membership association for senior financial executives. With eleven chapters across Canada and more than 2,100 members, FEI Canada provides professional development, thought leadership and advocacy services to its members. The association membership, which consists of Chief Financial Officers, Audit Committee Directors and senior executives in the Finance, Controller, Treasury and Taxation functions, represents a significant number of Canada's leading and most influential corporations.

The Committee on Corporate Reporting ("CCR") is one of two national advocacy committees of FEI Canada. CCR comprises more than 20 senior financial executives representing a broad cross-section of the FEI membership and of the Canadian economy who have volunteered their time, experience and knowledge to consider and recommend action on a range of issues related to accounting, corporate reporting and disclosure. In addition to advocacy, CCR is devoted to improving the awareness and educational implications of the issues it addresses, and is focused on continually improving the standards and regulations impacting corporate reporting.

The body of this letter includes our general comments and observations on the Discussion Paper. Appendix A to this letter includes our responses to the specific issues raised.

In summary, we recognize the need and greatly appreciate the Boards' efforts to develop a simplified, consistent, principles-based standard for revenue recognition in contracts with customers. In addition, we appreciate the complexity of the project. In general, we are in agreement with the basic principles set out. There are certain aspects of the model however that we feel would benefit from further deliberation, and other areas that could be enhanced with the introduction of additional considerations.

We agree with the proposed definition of a contract, but feel that certain types of contracts as envisioned in the Discussion Paper should be scoped out. In general, where recognition, measurement, and/or disclosure guidance for a specific type of



performance obligation is set out currently in non-revenue literature, we believe those performance obligations should continue to be accounted for according to those requirements. These obligations would include derivatives within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and IAS 39, *Financial Instruments: Recognition and Measurement*, guarantees within the scope of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, and standard warranties within the scope of SFAS 5, *Accounting for Contingencies*. We feel that a standard warranty obligation which is provided at no additional charge on all sales is a different performance obligation than a PCS obligation, where the customer either pays a separate fee for the service and/or receives services above and beyond diagnosis and correction of product defects. The latter we agree should be considered a performance obligation to which some portion of the total arrangement consideration should be allocated. The former we believe is a contingent liability and should remain within the scope of the literature applicable to all contingent liabilities.

It should also be noted when considering how to structure any scope exceptions in the final model, the performance obligations as listed above may be performance obligations within a multiple-element customer contract where certain deliverables within the customer contract would be subject to the proposed revenue recognition model, so any scope exceptions should be written specific to the nature of the performance obligation itself as opposed to the nature of the contract.

We agree with the principle of recognizing revenue on the basis of increases in an entity's net position in a contract with a customer. However, we note that this definition of revenue is very technical, and will likely be more difficult for non-accountants within the affected entities as well as the users of financial statements who are not accountants to fully understand.

We agree with the proposed definition of a performance obligation; however, we recommend introducing an additional consideration around significance to help avoid some of the potential churn around identification and tracking of all possible promises within a customer contract so that entities can focus on significant promises to the customer (similar to the concept of inconsequential and perfunctory under SAB 104, *Revenue Recognition*, in US GAAP). There are potentially many subtle promises within any given customer contract, and it could become difficult to identify and track every customer promise within a large multiple element contract.

We understand the logic behind transfer of control when determining whether a performance obligation has been satisfied. However, we think the model would improve tremendously by clarifying the definition of control (e.g. whether a buyer can control the asset without physical possession (i.e. impact on FOB shipping point/FOB destination terms), does "control" transfer for a software license when the license is granted or evenly over the term of license), as well as introducing additional considerations to apply under certain circumstances. For example, additional considerations should be applicable to consignment sales similar to those included in SAB 104 under US GAAP



literature, Question 2, to ensure the obligation is satisfied in economic substance and not only in form. In addition, recognizing revenue for long-term contracts based on who owns the work-in-progress may not be the best measure of revenue for long-term contracts where the vendor is building a product to customer specific requirements (where materials cannot be used to satisfy other contracts). Therefore, additional considerations may be helpful for revenue recognition on long-term contracts.

The most concerning area of the Discussion Paper from our perspective is the potential change to the accounting for long-term contracts. In our view, one of the underlying drivers of modifying the existing revenue recognition standards is to allow a more principles-based approach which results in revenue recognition that more closely aligns to the underlying economics of the customer contract. Therefore, we believe creating a model which results in “lumpy” revenue recognition, where revenue is deferred for long periods of time, (longer than twelve months in some cases), with a waterfall effect in one accounting period at the very end, is not useful to the readers of financial statements.

Overall, we agree with the basic principles as set out so far in the Discussion Paper, but believe that certain enhancements and clarifications as set out above would improve the practicality of the model and the usefulness of the resulting financial information for the readers of the financial statements.

Furthermore, given the complexity of issues surrounding revenue recognition, numerous examples reflecting this complexity have been used in country-specific pronouncements to assist preparers and users in understanding their applicable guidance. We suggest that the Boards enhance the current examples provided within the Discussion Paper to be more substantive in supporting each position, and in essence, reflecting the current complexity of revenue recognition.

The Committee on Corporate Reporting is pleased to have the opportunity to provide our views on this topic and trusts that you find our comments constructive. We would be happy to discuss our comments with you at any time.

Yours truly,

A handwritten signature in black ink, appearing to read 'Victor Wells', written in a cursive style.

Victor Wells
Chair
Committee on Corporate Reporting
FEI Canada

Appendix A

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? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

"For a contract with a customer, *revenue is recognized* when a contract asset increases or a contract liability decreases (or some combination of the two)." [2.35]

Yes, we agree with the Boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability. We support the Boards' efforts to resolve inconsistencies, simplify the revenue recognition model, and move towards convergence. However, as noted in some of the responses below, we think additional clarification is needed in certain areas in order to ensure consistent application, and additional considerations should be introduced in other areas in order to maximize the practicality of the model and the usefulness of the financial information it produces.

As a general comment, we think additional disclosures may be required in order to clearly explain to the non-accountant population how revenue is recognized. This model is written for accountants and will be difficult in our view for non-accountants to grasp a model based on changes to contract assets and liabilities.

Question 2

Are there any types of contracts for which the Boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

In our view, any scope exclusions included in the final draft should be based on the nature of the performance obligation, as opposed to the nature of the contract. There may be many instances where a single contract with a customer includes performance obligations within the scope of this model, and those that were not envisioned to be within the scope of this model.

In general, where recognition, measurement, and/or disclosure guidance for a specific type of performance obligation is set out currently in non-revenue literature, we believe those performance obligations should continue to be accounted for according to those requirements. These obligations would include derivatives within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and IAS 39, *Financial Instruments: Recognition and Measurement*, guarantees within the scope of FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, and standard warranties within the scope of SFAS 5, *Accounting for Contingencies*. We feel that a standard warranty obligation which is provided at no additional charge on all



sales is a different performance obligation than a PCS obligation, where the customer either pays a separate fee for the service and/or receives services above and beyond diagnosis and correction of product defects. The latter we agree should be considered a performance obligation to which some portion of the total arrangement consideration should be allocated. The former we believe is a contingent liability and should remain within the scope of the literature applicable to all contingent liabilities.

There may be circumstances where transfer of control is not enough (or should not be enough) to recognize revenue. In our view, additional considerations should be included and specifically applicable to consignment sales to prevent improper recognition of revenue. For example, in pure legal form, control of the goods may have transferred to the buyer. However, realization of the benefits from the sale may ultimately be contingent upon the intermediary's successful sale to an end customer. These criteria could be captured as part of the Discussion Paper's considerations around measurement of rights under a contract (e.g. collectibility, fixed or determinable fee, etc.)

Long-Term Contracts

Depending on the interpretation of "transfer of control" and how it is applied to long-term contracts, we feel the financial results may not reflect what is economically transpiring under a long-term contract. Based on our understanding of the transfer of control concept, the proposed model could cause financial information for long-term contracts to be materially different across different industries, when economically, the same activity is occurring (producing an asset or performing a service to buyer specifications). For example, if an asset (e.g. a ship) is constructed on an entity's site, thereby being controlled by the entity while on its site, and then once completed transferred to the customer's site, then according to the proposed model revenue would be recognized upon delivery to the customer (i.e. at the point the asset is "transferred" to the customer). However, if an asset (e.g. a house) is constructed on a customer's premises and hence controlled by the customer as the work progresses, then according to the proposed model revenue would be recognized as the asset is built (since the asset is located on the customer's premises). In both examples, an entity is constructing an asset for a customer based on a performance obligation negotiated/promised in a contract. However, based on our understanding of the model, the performance of the ship building project would be considered an "activity" as defined by the proposed model, whereas the performance of the housing construction would be considered a "service."

Current international and US standards acknowledge that the completed contract method results in irregular recognition of income and possible mismatch of revenue with related period costs. In our opinion, for long-term contracts that span more than one accounting period, financial information is more useful where revenue is recognized based on the performance that is occurring under the enforceable rights of the contract.

Where a vendor is not allowed to recognize revenue as progress is made on a long-term contract, we believe the model should allow the contract costs to be deferred as well, assuming recoverability, until revenue is recognized. Our interpretation of paragraph



6.43 leads us to believe that is the intent of the proposed model. We support that approach and agree with the results.

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.

"A *contract* is an agreement between two or more parties that creates enforceable obligations." [2.11]

Yes. The Boards' definition should (and does) agree with the legal definition of a contract. Accounting literature should not create a different definition of the legal term. That would cause too much confusion for users, preparers, and auditors of financial information. We are not aware of jurisdictions or circumstances where it would be difficult to apply. Contracts can be explicit or implicit under today's guidelines, so this is not new. As under today's guidelines, companies will still require diligence in this area to identify and account for commitments (either verbal or in writing) made to customers outside of an executed contract ("side agreements").

Chapter 3

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.

"An entity's *performance obligation* is a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer." [3.2]

We believe the proposed definition of a performance obligation is open-ended and will entail more record keeping and potentially lead to divergent interpretations of an obligation. It is not clear whether the model intends to capture any and all promises to the customer in the contract, or whether the model only intends to capture a vendor's promise to transfer an "asset". It becomes difficult to determine whether something is a performance obligation when the vendor considers the concept of services that are used up immediately by the customer. Many customer contracts include subtle promises; for example, agreements to meet with the customer on a regular basis, periodically provide product roadmaps, provide updates and corrections to user manuals, etc. These could all be considered services that are "used up" by the customer upon delivery and therefore could be deemed to fall into this "transfer of an asset" category. In order to assist preparers and auditors, we support incorporating a consideration around



significance for promises within contracts in determining whether something is a recognizable performance obligation. This would improve application consistency.

Additionally, we would like to see the model define the terms “service” and “activities”. As noted in our response to Question 2, we are concerned that the location of construction will determine whether the action is a performance obligation (i.e. service) and permit revenue recognition, or whether the action is not a performance obligation (i.e. activity) thereby not permitting the recognition of revenue, when fundamentally, the economics of the two contracts are the same.

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?

Yes. We support separating an entity’s performance obligations in a contract on the basis of when the entity transfers the promised asset to the customer. There is no benefit in our view of tracking performance obligations separately when they are completed in the same accounting period. It just adds unnecessary complexity.

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?

Yes. We feel a return right offered to a customer is a performance obligation. The vendor’s obligation to accept returned materials is a service deliverable. We believe a vendor should ascribe some value to the performance obligation and recognize that amount when the obligation expires.

Question 7

Do you think that sales incentives (for example, discounts on future sales, customer loyalty points, and “free” goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

Depending on the type of sales incentive being offered in a contract with a customer, we feel a sales incentive may or may not be considered a performance obligation. In situations where a customer is being provided a free good or service or where a significant and incremental discount applicable to future purchases is being offered as part of a current contract, the sales incentive should be considered a performance obligation. However, where discounts on future purchases are not incremental to comparable contracts, incremental to the discount on the current contract, or significant, the discounts should not be considered a performance obligation. In those cases, the discounts should be factored into the measurement of the total transaction price on the future purchases if and when made by the customer. For example, in conjunction with the sale of products or services under a current contract, a vendor may offer a small

discount or discounts on future, optional purchases (for example 5% off future purchases of a certain product line). In that case, we do not believe the insignificant discount on future optional purchases should be considered an additional performance obligation, but rather a reduction of the total contract price on the future optional purchases if and when the customer chooses to make them. This view is in line with Technical Practice Aids (“TPA”s) 5100.50 and 5100.51 in the US GAAP literature.

Cash incentives offered to customers in contracts should be considered reductions of the total transaction price and should be taken into consideration when measuring the vendor’s rights under the contract.

Chapter 4

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.

Yes. We agree that an entity transfers an asset to the customer when the customer controls the promised good or when the customer receives the service. However, we support additional clarification on the definition of “control”, especially as it applies to long-term contracts. It would be helpful to clarify whether physical custody of the asset is required in order for control to have transferred (for both long-term contracts and merchandise sales).

We believe that additional factors could be introduced for long-term contracts such as whether the vendor is performing a service or constructing an asset to customer specifications, and whether the materials used in the construction can be used to satisfy performance obligations under other customer contracts. In those cases, we think it better reflects the economic reality to recognize revenue on a percentage-of-completion basis. Refer to our discussion on long-term contracts within Question 2.

In addition, we think the definition of “control” should be clarified as it relates to the transfer of a software right-to-use, (i.e. whether it is transferred when the license is granted or ratably over the right-to-use period).

Question 9

The Boards propose that an entity should recognize 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.

Depending on the final definition of a performance obligation and whether the Boards approve any scope exceptions (as discussed in Question 2), certain performance obligations may not fit the transfer of control recognition model. We support the Boards’

initial consideration on decision-useful information with the exclusion of financial instrument and some non-financial instrument contracts within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* and SFAS 133 *Accounting for Derivative Instruments and Hedging Activities*, insurance contracts within the scope of IAS 4 *Insurance Contracts* and SFAS 60 *Accounting and Reporting by Insurance Enterprises*, and leasing contracts within the scope of IAS 17 *Leases* and SFAS 13 *Accounting for Leases*.

Although we have concerns with the concept of transfer of control as it may be applied to long-term contracts, we agree that these contracts should be included within the scope of this guidance.

Chapter 5

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?

Yes. We agree that performance obligations should be measured initially at the transaction price. Application of an alternative method, such as the current exit price, to recognize revenue or a gain on execution of a contract (or even when verbally agreeing to the terms and conditions of a contract) when no performance obligations have been fulfilled does not align to the basic concepts underlying revenue recognition. Execution of a contract does not represent the culmination of an earnings process.

(b) Do you agree that a performance obligation should be deemed onerous and remeasured 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?

Onerous is when "a performance obligation should be remeasured upwards if its carrying amount does not depict faithfully the entity's obligation to provide goods and services to the customer." [5.58]

Cost trigger approach is when "a performance obligation is onerous when the expected costs to satisfy that performance obligation exceed its carrying amount." [5.62]

Yes. In our view, losses should be recognized in the period they become known. Under an executed contract with enforceable obligations, any excess cost over the allocated transaction fee meets the definition of a liability.



We also believe the total transaction fee should be reallocated where contracts are modified either through amendments or concessions, which may or may not result in onerous performance obligations.

(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.

We support the view that re-measurement should not be required at each financial statement date except in certain circumstances as noted above (i.e. one or more performance obligations become onerous or where the performance obligations are modified either through contract amendment and/or concession). We agree with the Boards' discussion that this would be extremely cumbersome to implement and would add a tremendous amount of overhead to the revenue recognition process.

(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.

Depending on the final definition of a performance obligation (and whether there are any approved exceptions in the final model), there could be some performance obligations identified in customer contracts where identification, measurement, and disclosure requirements are already set out in existing US GAAP, Canadian GAAP, and/or IFRS literature. In those cases, it is our view that the accounting should follow the model already established. For example, under US GAAP literature, SFAS 133 sets out the valuation guidelines for derivatives, FIN 45 sets out the valuation guidelines for certain guaranties and SFAS 5 sets out the accounting requirements for standard warranties. In our view, the proposed revenue recognition framework should only address those performance obligations where identification, measurement, and disclosure are not already established in existing GAAP or IFRS literature. It becomes too cumbersome and sets up conflicts within the authoritative literature when these obligations are accounted for pursuant to one set of requirements outside of a customer contract and pursuant to a separate set of requirements if entered into within a customer contract. We should keep the valuation requirements consistent whether entered into as part of a customer contract or not. The nature of the performance obligations doesn't change based on what type of contract the obligation is contained within. Therefore, we would recommend a general exception in the final model that states that in the event identification, measurement, or disclosure requirements are set out in other authoritative literature for a particular performance obligation, that those requirements should be applied to the performance obligations within the customer contract. (This assumes this model will nullify existing revenue recognition literature so that those valuation requirements would not be captured by this type of clause.)

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 (for example, 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?

Yes, we believe any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the total transaction fee and allocated to the remaining performance obligations under the contract. We do not agree that these activities should be recognizable as revenue upon execution of the contract. They do not represent the transfer of an asset to the customer (neither the transfer of goods nor services), and therefore do not meet the definition of a performance obligation.

(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.

We support recognizing contract origination costs as expenses when incurred.

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's standalone 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?

Yes. We agree that the transaction price should be allocated to the performance obligations based on an entity's standalone selling prices of the goods or services underlying the performance obligations. Standalone selling prices are the most objective and reliable evidence of the fair value of performance obligations.

However, as stated in Question 10(d), for performance obligations where measurement is covered by existing authoritative literature (e.g. SFAS 133, FIN 45, SFAS 5), we believe measurement should be based on the value determined by the other authoritative literature. This means certain performance obligations would not be allocated a portion of the transaction price, but it would keep the accounting for those types of obligations (derivatives, guarantees, and contingent liabilities) consistent with the broader principles applicable to those types of obligations irrespective of whether they are contained within a customer contract.



Question 13

Do you agree that if an entity does not sell a good or service separately, it should estimate the standalone 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?

Yes. We agree that if an entity does not sell a good or service separately, it should estimate the standalone selling price of that good or service for purposes of allocating the transaction price. Revenue recognition should not be held to a higher standard than other critical areas of accounting where estimates are required and allowed. We feel the current practice of deferring revenue due to a lack of fair value artificially inflates liabilities on the balance sheet and understates financial performance, even though in most cases a vast majority of these obligations have been performed and/or delivered to a customer.

The use of estimates should be constrained in cases where similar performance obligations exist under multiple contracts within the same company, a consistent valuation approach and valuation assumptions should be applied.