

Comptabilité

1820-100 Comment Letter No. 484

Accounting

Vice-President

Serge Pharand Vice-président et contrôleur général

935, rue de La Gauchetière Ouest Montréal (Québec) H3B 2M9 Canada T 514 399-4784 Tc 514 399-8604 serge.pharand@cn.ca and Corporate Comptroller

935 de La Gauchetière Street West

Montreal, Quebec H3B 2M9 Canada T 514-399-4784 F 514-399-8604 serge.pharand@cn.ca

October 22, 2010

Financial Accounting Standards Board Attn: Technical Director 401 Merrit 7 P.O Box 5116 Norwalk, CT 06856-5116

File Reference: 1820-100

Re: Revenue Recognition (Topic 605): Revenue from Contracts with Customers

Dear Sir or Madam,

Canadian National Railway Company (CN) is a publicly held corporation with its common shares listed on the New York and the Toronto Stock Exchanges. The Company is engaged in the rail and related transportation business operating approximately 20,800 route miles of track in Canada and the U.S. CN prepares its financial information based on U.S. generally accepted accounting principles.

We appreciate the opportunity to comment on the Financial Accounting Standards Board's (FASB) Proposed Accounting Standards Update, Revenue Recognition (Topic 605): Revenue from Contracts with Customers. We fully support the FASB's continuing efforts to issue improved and converged global standards, which remove inconsistencies in practice and improve comparability across industries, jurisdictions and capital markets.

While we support the FASB's efforts to issue a principles based revenue recognition model under which entities recognize revenue as they satisfy the performance obligations included in contracts with customers, we believe that the exposure draft in its current form lacks clarity as to when revenue should be recognized in the service industry and in particular for transportation companies. Please refer to our detailed comments and suggestions in response to the questions in the proposed accounting standards update, included below.

Question 3: Do you think that the proposed guidance in paragraphs 25–31 and related implementation guidance are sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

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While we agree conceptually with the control based principle outlined in paragraph 25, we believe that applying this principle to "service" contracts will require a significant amount of judgement on behalf of financial statement preparers as to whether there is a continuous transfer of control or whether control passes only once the service has been completed. Current practice in the rail industry is to recognize freight revenue using the percentage of completed service method, based on the transit time of freight as it moves from origin to destination. The proposed standard provides little guidance and limited examples which relate to transportation services, and as such it is unclear as to whether recognizing revenue under the "continuous transfer" basis, as is current industry practice, would continue to be acceptable.

It is our belief that the current indicators and guidance provided in paragraph 30 are insufficient in so far as transportation services are concerned to determine when control is transferred. Different interpretations and applications of the indicators outlined in paragraph 30 could lead to companies in the same industry applying a different accounting treatment for economically similar transactions thereby reducing the comparability of financial statements.

Respondents to the original Discussion Paper asked the Board to provide additional guidance on what control of a good or service is and how an entity would determine when control has transferred to the customer. As stated in BC62 the Board has decided that the definition of control (of a good or service) should include the following components:

- (a) ability—a customer must have the present right to direct the use of, and receive the benefit from, a good or service for an entity to recognize revenue. For example, in a contract that requires a manufacturer to produce an asset for a particular customer, it might be clear that the customer will ultimately have the right to direct the use of, and benefit from, the asset. However, the entity should not recognize revenue until the customer has obtained that right (which might occur during production or after, depending on the contract).
- (b) to direct the use of—a customer's ability to direct the use of a good or service refers to the customer's right to deploy that asset in its activities, to allow another entity to deploy that asset in its activities, or to restrict another entity from deploying that asset. The source of that right in the context of revenue recognition typically is an enforceable right as a consequence of a contract.
- (c) to receive the benefit from—the customer must have the ability to receive the economic benefit from a good or service for the customer to obtain control of it. In concept, the economic benefit from a good or service is a potential cash flow (either an increase in cash inflows or a decrease in cash outflows). An entity can obtain the benefit directly or indirectly in many ways such as by using, consuming, disposing of, selling, exchanging, pledging or holding an asset.

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While the clarifications provided by the Board in the Basis for Conclusions can be easily applied to the sale of physical assets, it is more difficult to apply these components in relation to a transportation services contract.

Transportation services can be construed in either of two manners. In the first, it represents an agreement to provide freight transportation service from origin to destination, where we satisfy the performance obligation over a period of time as the goods move between the two points, and where revenue would be recognized on a continuous transfer basis. In the second manner, it is a promise to deliver goods to their ultimate destination at which point the performance obligation is not satisfied and revenue would not be recognized until the end of the move. This is further complicated in the rail industry as many moves are originated and terminated by different railroads, however the entire receivable is collected by only one of the parties which then allocates the other parties share of revenue to them. Each railroad records only their share of the revenue (i.e. net revenue) as they provide their portion of the transportation service.

Further if revenue is only recognized at the end of a move, once delivery has occurred, it is unclear as to whether or not the costs incurred, which are associated with the freight in transit would be deferred as an asset until the move is completed, or expensed as incurred. Paragraph 57 of the proposed standard states:

If the costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with another Topic (for example, Topic 330 on inventory, Topic 360 on property, plant, and equipment, or Topic 985 on software), an entity shall recognize an asset only if those costs:

- (a) relate directly to a contract (or a specific contract under negotiation) as described in paragraph 58;
- (b) generate or enhance resources of the entity that will be used in satisfying performance obligations in the future (that is, the costs relate to future performance); and
- (c) are expected to be recovered.

If the costs incurred related to the transportation of goods in transit are not eligible for deferral under point b of paragraph 57, revenues would no longer be recorded in the same period as the costs incurred to perform the service, decreasing the overall usefulness of the financial statements to investors.

It is our belief that the current practice of using the percentage of completion method, which is similar to concept of "continuous transfer", best reflects the economic realities of companies engaged in the freight transportation business and best reflects the financial position of companies in the eyes of investors by matching revenues with their related expenses in the same period. Given that the current exposure draft can be interpreted in different ways in respect to transportation services, we would like for additional clarification to be added to any proposed standard to enable us to determine if the guidance in IG63 to IG 66 results in a different treatment than what is current industry practice.

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Question 5

Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognizes when it satisfies a performance obligation rather than whether the entity recognizes revenue? If not, why?

The Board's proposal to have entities reflect a customers credit risk against revenue, with changes in their assessment being recognized as either other income or expense, in our opinion, increases the subjectivity and complexity in the financial reporting process, and reduces transparency for the users of financial statements. Based on historical experience bad debt in the railway industry has been minimal in relation to overall revenues/receivables and based on IG 78 "In many contracts, the effect of the customer's credit risk on the transaction price is immaterial. In such cases, an entity measures the transaction price at the original invoice amount" most companies in the industry will continue to measure revenues at the invoiced amounts. That being said, it is our belief that the current accounting and disclosure requirements in ASC 310 Receivables are not improved by the proposed changes. The current literature provides investors with adequate transparency while at the same time not affecting the direct comparability of an entity's revenue vis-à-vis its peers.

Sincerely,

Serge Pharand