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March 27, 2012

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

Dear Sirs:

**Re: Exposure Draft, Revenue from Contracts with Customers
IASB Reference ED 2011/6**

This letter is the response of the Canadian Accounting Standards Board (AcSB) to the Exposure Draft, *Revenue from Contracts with Customers*, issued jointly by the International Accounting Standards Board (IASB) and the Financial Accounting Standards Board (FASB) (together “the Boards”), in November, 2011.

The AcSB invites Canadian preparers, auditors and users to comment on all proposed accounting standards. Responses to the questions posed in the Exposure Draft reflect comments gathered from these constituents as well as the views of AcSB members.

The AcSB commends the Boards for producing a common single standard for revenue recognition. As noted in our letter of October 22, 2010, we agree that a standard based on one over-arching principle applied to all types of contracts with customers is desirable. We continue to think that the transfer of control of the goods or services to the customer is not the most appropriate principle upon which to base revenue recognition in all circumstances. We are concerned that without the clarifications outlined below, the proposed standard and related application guidance might fail to result in consistent recognition of revenue from economically similar contracts.

We appreciate that users of financial statements need information about many aspects of a reporting entity’s revenue-generating activities and that more frequent reporting of such details is desirable. We think that it would be helpful to reconsider all of the proposed disclosure requirements in the light of a comprehensive framework for disclosure that should be developed independently of this project. We

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are particularly concerned that the proposed standard would change interim reporting requirements in a way that might not be as useful as possible. We think that implementation of the proposed interim reporting disclosures should be delayed, ideally pending a comprehensive review of IAS 34 *interim Financial Reporting*, but failing that, until reporting entities have the benefit of a few years' experience completing the disclosures for their annual reports.

We have included in the Appendix our responses to the questions set out in the Exposure Draft.

We would be pleased to elaborate on our comments in more detail if you require. If so, please contact me, Peter Martin, Director, Accounting Standards (+1 416 204-3276 or email peter.martin@cica.ca) or Kate Ward, Principal, Accounting Standards (+1 416 204-3437 or email kate.ward@cica.ca).

On behalf of the Board

A handwritten signature in black ink that reads "G.C. Fowler". The signature is written in a cursive, flowing style.

Gordon C. Fowler, FCA
Chair, Accounting Standards Board
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APPENDIX

Question 1:

We think that distinguishing between performance obligations that are satisfied at a point in time and those that are satisfied over time is a useful way to establish criteria for patterns of revenue recognition that reflect the economic effect of various revenue-generating activities. We agree that this approach avoids potential problems with requirements based on possible definitions of service contracts. We think that paragraphs 35 and 36 will resolve concerns about the ability to apply percentage-of-completion accounting to service and long-term construction contracts.

We continue to think that the over-arching principle should be the creation of a right to payment and that drafting clarifications to paragraph 35 would make the proposed standard easier to apply. In practical terms, we think that the criterion in paragraphs 35(b)(iii) and 37(a), i.e., the right to payment, is the pertinent indicator that the entity is satisfying a performance obligation related to a customer-controlled asset.

We appreciate that paragraph 35(b) is intended to preclude recognizing revenue for activity that creates inventory to the reporting entity. We think that the paragraph would be clearer if the reference to alternative-use assets was replaced by a more direct reference to inventory. In this context, we think that the notion of customer-specific design and function might be helpful in distinguishing between inventory and an asset constructed for a specific customer in accordance with a contract.

We think that the first sentence of paragraph 35(b)(ii) is sufficient to establish a right to payment for partial performance. We do not understand how control of work-in-progress assets relates to the ability to apply percentage-of-completion accounting for work completed. We think that control of work in progress is only relevant to determining the portion of the total contract to which the entity has a right to receive payment. If the Boards are unable to provide a clear rationale as to how control of work-in-progress assets should determine whether percentage-of-completion accounting is appropriate, we think that the last two sentences of paragraph 35(b)(ii) should be removed.

Consistent with our view that the right to receive payment for work completed is the principle underlying revenue recognition, we think that paragraph 35(b)(iii) should be reworded. We do not agree that it should also be necessary to link the entity's expectation of fulfilling a contract with its right to payment for work completed to date as a condition precedent to percentage-of-completion accounting for that work. We agree that an entity needs to consider the consequences of breaching a contract and of customer termination clauses in assessing whether the right to payment exists.

We also think that the last sentence of paragraph 35(b)(iii) should be clarified. Compensation for loss of profit implies a derivative rather than an executory contract. We think that this sentence should clarify that an entity's right to receive payment that is a reimbursement of costs is not revenue. An entity should only recognize revenue if it is entitled to payment because the customer receives the benefits of

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the entity's performance immediately, the work would not need to be reperformed if the contract is terminated, or the contract clearly establishes a right to payment regardless of any expectations about future phases on the contract.

Question 2:

We agree that impairment losses should be presented in a separate line in the income statement when material. Some of our stakeholders think that credit risk is a relatively insignificant risk for entities outside the financial services industry and think that entities should present individual line items only for significant risks.

We disagree that this line should be adjacent to the revenue line. Such presentation makes some sense when it captures any difference between the transaction price and the initial fair value of the resulting receivable. However, we think that presentation of deterioration in the collectability of trade accounts receivable adjacent to revenue earned in subsequent periods could be confusing. We think that bad debt expense should be grouped with cost of sales or selling, general and administrative expenses for most businesses.

We have been told by our User Advisory Council and others that users of financial statements prefer to see credit losses reported below gross margin because this facilitates analysis of the adequacy of the margin to cover costs that are managed separately. Although a user can reconfigure the income statement as long as credit losses are presented on a separate line or disclosed in the notes, we think that the proposal inconveniences users without providing any practical benefits.

Question 3:

We agree that an entity should be able to estimate variable revenue using the more appropriate of the expected value and the most likely amount. This will avoid measuring revenue transactions at amounts that are absolutely incorrect. This change also more closely reflects the "future economic benefits ... expected to flow to the entity" of the asset resulting from the transfer of goods or services. We do not think that the constraint on recognizing variable revenue in paragraph 81 is consistent with the calculation of the transaction price. The guidance in paragraphs 49 – 57 already constrains the recognition of variable revenue to the amount the entity expects to receive. Revenue transactions are reciprocal transfers; the entity gives up one asset in exchange for another. We think that the amount attributed to the asset received should be the same amount as the amount recognized for the transfer of the goods or services provided to the customer. Although we agree that an entity should not overstate its revenue expectations, we think the constraint on recognizing variable revenue could result in reporting that is not representationally faithful.

We are concerned that "reasonably assured" will be interpreted as a quantitative hurdle that is higher than might be suggested by a simple reading of the words used. Audit standards in some jurisdictions have prescribed quantitative measures for this term that we think might affect the interpretation of the

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term in this context. The result will be inconsistent application. We think that the phrase should be replaced or clarified by the provision of additional guidance.

The experience requirement in paragraph 81 will limit profit reporting by new ventures and by established entities developing new product lines in a way that impedes evaluation of developing businesses. Meeting the experience requirement will be highly subjective. The results of new businesses will not be comparable with those of more experienced peers for economically similar transactions. We think that additional guidance should be provided if this criterion is retained.

We think that the guidance in paragraph 81 could result in an inappropriate recognition of a loss on the transfer of a non-financial asset for consideration that is partially fixed, but less than the asset's carrying amount, and partially variable, for example a royalty based on the transferee's future use of the asset. The variable component of this kind of transaction would be less likely to meet the experience requirements of paragraph 81 although it is unlikely the entity would engage in such a sale without a reasonable expectation of profit.

We also think that the proposed standard will accelerate revenue recognized on contracts with partially variable or contingent consideration because revenue recognized as the contract progresses will be based on the total expected consideration rather than the fixed portion. This will distort margins: higher margins will be reported until the cap is reached while lower margins or losses will be reported until the contingent consideration becomes reasonably assured. If this is what the Boards intend, we think that additional guidance should be provided to ensure consistent application.

We do not agree with the experience criteria for meeting the entitlement requirement. We think that it would make more sense to limit the constraint on revenue to the periodic recalculation of the transaction price. This would ensure a more realistic pattern of revenue recognition of contingent amounts. However, the term "reasonably assured", as used in paragraph 49, would still require clarification to avoid inconsistent application.

Question 4

We question whether the IFRS version of the revenue standard needs separate guidance on onerous contracts. We think that the requirements of IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* and IAS 2 *Inventories* should be sufficient. We think that standards should be of general application to avoid the creation of multiple and potentially conflicting models dealing with the same issue. If the IASB thinks that the model in IAS 37 for onerous contracts needs clarification for application to contracts with customers, we think this should be reflected in IAS 37.

We agree that the onerous test should not be applied to obligations that will be satisfied within a year as a practical expedient. However, we disagree with the proposal to apply the onerous test to individual performance obligations. This is inconsistent with the unit of account in IAS 37. We also disagree that the onerous test should only be applied to contracts satisfied over time. We think that the appropriate unit of account for the onerous test is the aggregate outstanding performance obligations in a contract

unless there is a reason to apply a unit of account that is larger than the individual contract. Applying the onerous test to individual performance obligations, whether satisfied over time or at a point in time, will give misleading information about the profitability of unperformed contracts.

Question 5:

The proposed disclosure requirements are extensive. They will increase costs to preparers, if not costs to compile the information, then audit and assurance costs, and may delay financial reporting. Some of the requirements, such as those in paragraphs 118 and 119, specify information that may be commercially sensitive to smaller entities. We question the need for paragraphs 114 and 115; members of our User Advisory Council think that the requirements for disaggregation should be as specified in IFRS 8 *Operating Segments*. The requirement in paragraph 117 to provide a reconciliation of contract balances is confusing to both users and preparers with whom we have consulted. Users think that, to be useful, the reconciliation needs to specify that contract assets and contract liabilities must be reconciled separately with clear indications to amounts recognized in the income statement and to cash received.

We disagree with the proposal to significantly increase interim disclosures without undertaking a comprehensive review of IAS 34 *Interim Financial Reporting*. This requirement will be particularly onerous for North American entities that are required to report on a quarterly basis with relatively tight deadlines. We think that, in the absence of such a review, the transition period for the proposed interim disclosures should be extended by at least two years to give preparers the opportunity to establish the processes necessary to complete the disclosures and to give users an opportunity to determine how the additional information helps with their analyses.

Question 6:

The AcSB agrees that the criteria for derecognizing non-financial assets other than any created by its ordinary activities should be consistent with that for revenue recognition. Although we do not agree that transfer of control should be the principle upon which revenue should be triggered, we agree that transfer of control is a sufficient indicator to trigger revenue recognition in the transfer of a non-financial asset. However, we are concerned that neither IAS 16 *Property, Plant and Equipment* nor IAS 38 *Intangible Assets* provides guidance on partial dispositions of tangible or intellectual property. There is currently diversity in practice within our resource industry on the treatment of partial dispositions of resource properties. We think that similar issues are possible in some transactions involving partial or conditional sales of licenses. We also disagree with the constraint on variable revenue in paragraph 81 and its potential effect on transfers of non-financial assets, as noted in our response to Question 3.

Effective date and transition

We think that a mandatory effective date of the standard that does not exceed three years from the publication of the final standard will be a significant challenge for many entities. Canadian telecommunications companies think that four years will be preferable to allow for systems changes and

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contract input in time to generate comparable figures. Other industries are concerned with the overlap between the revenue standard and the anticipated new leasing standard. We agree that concurrent adoption of these new standards would be desirable.

Many entities are unsure whether the new standard will result in a significant change in the pattern of revenue recognized. The practical expedients are expected to be helpful in this regard. We think that entities should also disclose revenue that was recognized in previous periods using the old standards that is now recognized later and revenue that would have been delayed under the previous standards that has been accelerated such that it is recognized in opening or comparable balances.