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Sir David Tweedie: IASB Senior Project Manager International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom

Dear

RE: Response to "Preliminary Views on Revenue Recognition in Contracts with Customers" Discussion Paper

Thank you for the opportunity to provide feedback on the discussion paper regarding the "Preliminary Views on Revenue Recognition in Contracts with Customers". The Province of British Columbia, Canada, is responding to this discussion paper as the proposed changes to revenue recognition standards would have a direct impact on government business organizations (GBE's), and may significantly affect our terms of procurement with private sector entities engaged in public private partnerships (P3's) within our jurisdiction.

The province is concerned that the proposed revenue recognition standard provides guidance that may have the unintended effect of causing accounting standards to drive business practices rather than reporting on the results of business practices. For example, entities involved in the construction of capital assets may be compelled to revise the wording of contracts to be able to continue to recognize revenue on their financial statements consistent with their current practice. Similarly, business entities with significant upfront costs may be compelled to change their business practices to structure their costs differently. This consequence would not be useful for financial statement users or preparers.

Needs of the Financial Statement Users

The proposed revenue recognition standard places too much emphasis on the Statement of Financial Position. The Statement of Operations is of critical importance to the statement users in determining the allocation and use of an entity's economic resources, as well as the nature and extent of the entity's economic activities during the period.

The proposed revenue recognition standard does not address some key issues related to revenue recognition such as the time value of money and impairments or collectability which are especially important now given the state of the global economy. The proposed standard should discuss collectability in chapter 4. (Paragraphs 4.33, 4.34 & 4.35) and a discussion about the time value of money should be added to chapter 5. ("Measurement of performance obligations")

Understandability and Clear Presentation

The proposed revenue recognition standard is less practical than existing standards. The definition of control is (Paragraphs 3.19, 3.20 & examples on page 44 & 45 of ED) difficult to apply to contractual arrangements where the purchaser is actively involved in the design, inspection and certification of a unique, customized asset as it is being built. In these cases, it is unclear at which point control of the constructed asset transfers from the vendor to the purchaser. From a legal standpoint, the purchaser's level of participation in the design, inspection and certification may make them responsible for the payment of incurred costs even though control has not passed to the purchaser.

Volatility and Representational Faithfulness

The proposed revenue recognition standard may result in entities to including forecasted future costs with respect to onerous contracts on financial statements. (See the terms "expected costs" and "expected contract costs" on paragraphs 5.62, 5.63, 5.67 & 5.68 of ED) This would likely have the effect of introducing volatility to the Statement of Operations and make it more difficult for financial statement users to accurately assess the financial performance of entities. It would also result in the recognition of expected future losses in the current accounting period. (Paragraph 5.63 of ED) This would not accurately represent the economic substance of transactions within the reporting period in which the loss occurred and would reduce the comparability of financial statements. As an alternative, the board could consider directing entities to provide such forecasts in the notes to the financial statements.

Responses to specific questions posed in the exposure draft are attached. Should you have any comments or questions, please contact me at (250) 387-6692 or by e-mail: Cheryl.Wenezenki-Yolland@gov.bc.ca, or Carl Fischer, Executive Director, Financial Reporting and Advisory Services Branch, at (250) 356-9272 or by e-mail: Carl.Fischer@gov.bc.ca.

Sincerely,

Cheryl Wenezenki-Yolland, CMA, FCMA

Comptroller General

Province of British Columbia, Canada

encl.

cc: Graham Whitmarsh, Deputy Minister

Ministry of Finance

Nick Paul, Deputy Secretary to the Treasury Board Ministry of Finance

Carl Fischer, Executive Director Financial Reporting and Advisory Services Ministry of Finance

Ouestion 1

"Do you agree with the board's 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?"

We disagree with the board's proposal. We are concerned that the proposed revenue recognition standard places an undue emphasis on the Statement of Financial Position and treats the Statement of Operations as merely a clearing account for asset/liability values. In our view, the Statement of Operations and the Statement of Financial Position are both critically important for financial statement users in determining the allocation and use of an entity's economic resources during the accounting period. Revenue is a separate element of financial statement reporting and as such, should be defined separately, not in terms of net differences between assets and liabilities.

In our view, the board should address the inconsistency in existing revenue recognition standards (See pages 17 to 20 of ED) by developing high level principle based guidance for revenue recognition which emphasizes the substance of transactions over their legal form. For example, if a purchaser is highly involved in the design, certification, and inspection of a unique, custom-made asset then in our view, it is in substance controlling it and assuming the risk and rewards of ownership pertaining to it during construction even if legal title does not transfer until after construction is complete. In such cases, the percentage of completion method should be used to recognize revenue.

Question 2

"Are there any types of contracts for which the board's 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?"

The proposed principle would not provide decision-useful information for long-term construction contracts where capital assets are constructed on the vendor's premises and the purchaser is actively involved in the design, certification, and inspection of the constructed asset. In such cases, control and the risks and rewards of ownership transfer from the vendor to the purchaser throughout the construction period even if legal title does not transfer until after construction of the infrastructure asset is completed. The board's proposal appears to equate the physical transfer of an asset with the transfer of control. (Paragraphs 3.18, 3.19, 3.20 & last sentence of paragraph 4.5) This in our view does not always reflect what actually occurs. An example is when a public sector entity

engages a private sector partner to construct a fleet of unique hybrid buses that are built specifically to meet the unique needs of the public sector entity. A strong argument can be made that in this case, control over the infrastructure is transferred throughout the construction period due to the purchaser's high degree of involvement in the process and the unique nature of the asset. From a legal standpoint, the purchaser's level of participation in the design, inspection and certification may make them responsible for the payment of incurred costs even though control has not passed to the purchaser.

We are also concerned that board's proposed approach may significantly affect our terms of procurement with entities engaged in the construction of infrastructure and that these entities may feel compelled to change their contract wording to be able to continue to recognize revenue on the percentage of completion basis.

The board should provide clear guidance on how and when control transfers from the vendor to a purchaser that is actively involved in the design, certification and inspection of the constructed asset. The percentage of completion method should be used when control and with it the risks and rewards of ownership are transferred throughout the construction period. Also, the board should provide guidance on when it considers an asset to be a stock asset and when it considers it to be a custom built asset.

Question 3

"Do you agree with the board's 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".

We agree with the board's definition of a contract because it can be applied very broadly. We are not able to provide examples in which it would be difficult to apply as the definition encompasses everything from simple retail transactions to complex multi-year contracts such as private public partnerships (P3's).

Question 4

"Do you think the board's 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."

We agree that "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." Our difficulty is that it is not always clear when an asset transfers from a vendor to a purchaser. For example, assume that a public sector entity engages a private sector partner to construct a fleet of hybrid buses. It is actively involved in the construction process by contributing to the design, certification and inspection of the on-going work. The hybrid buses have unique features and are built specifically for that public sector

entity. In our view, by its degree of involvement and due to the uniqueness of the constructed asset, the purchaser is controlling and assuming the risks and rewards of ownership over the constructed asset throughout the construction process. Therefore, the vendor is meeting its performance obligation to the purchaser over time as construction milestones are met and the work is completed, even if legal title over the asset does not transfer until after it is completed. From a legal standpoint, the purchaser's level of participation in the design, inspection and certification may make them responsible for the payment of incurred costs even though control has not passed to the purchaser.

In our view, the board should provide clear guidance on what is the distinction between a stock and a custom built asset and when control over a custom built asset transfers from the vendor to the purchaser. The percentage of completion method should be used to recognize revenue when in substance, control and the risks and rewards of ownership are transferred throughout the construction period.

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?"

We disagree with this approach because in our view under certain circumstances control and the risks and rewards of ownership over a constructed asset transfer from the vendor to the purchaser throughout the construction period, not when the asset is legally transferred from the vendor to the purchaser. The board's proposal appears to equate the physical transfer of an asset with the transfer of control. (Paragraphs 3.18, 3.19 & 3.20) This in our view does not always reflect what happens in real life.

In our view, performance obligations are met when in substance, control and the risks and rewards of ownership transfer from the purchaser to the vendor. This sometimes happens before the purchaser formally accepts the completed asset. In our view, the percentage of completion method should be used to recognize revenue under these circumstances. The amount of work completed, milestones reached or the amount of time worked on a project can be used to estimate the appropriate amount of revenue to recognize in a given accounting period.

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?"

We do not agree. In our view, a failed sale resulting in a refund is a separate future event, not a separate performance obligation. Entities often have the ability to estimate the proportion of sales that are likely to fail and set up provisions for this in their financial statements. A failed sale results in a decrease in cash and revenue, an increase in

inventory and a decrease in cost of goods sold. We are also concerned that the proposed standard may cause accounting standards to drive business practices. In some cases, entities may stop offering refund policies to avoid the additional administrative cost of having to allocate them to a separate revenue stream.

Question 7

"Do you think that sales incentives (e.g. 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?"

We disagree because this, in our view, does not reflect the economic substance of the transaction. We view such incentives as marketing costs, not separate performance obligations. Sales incentives are a part of an entities' marketing strategy. They represent something that an entity gives up in order to make a sale. If an entity is able to estimate the future cost of sales incentives based on historical information then they should be recorded in the same accounting period as the related sales. This would reduce the volatility of financial results on the Statement of Operations and make it easier for financial statement users to assess the long-term performance of entities.

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."

We agree that an entity transfers an asset to a customer when the customer controls the promised good or when the customer receives the promised services. Our difficulty is that under certain circumstances, it is not clear at which point or points the customer controls the promised good.

The board should provide clear guidance on what is the distinction between a stock and a custom built asset and when control over a custom built asset transfers from the vendor to the purchaser. The percentage of completion method should be used when in substance, control and the risks and rewards of ownership are transferred throughout the construction period. We are concerned that board's proposed approach, if enacted may significantly affect our terms of procurement with entities engaged in the construction of infrastructure. Our private sector partners may feel compelled to revise contract language to be able to continue to recognize revenue on the percentage of completion method over the terms of construction projects.

In our view, performance obligations are met when in substance control and the risks and rewards of ownership transfer from the purchaser to the vendor. If the purchaser is highly involved in the design, certification and inspection of a unique, custom asset throughout the construction period, then control over the asset transfers during the construction

period even though legal transfer may not occur until completion. In our view, the percentage of completion method should be used to recognize revenue under these circumstances. The amount of work completed, milestones reached or the amount of time worked on a project can be used to estimate the appropriate amount of revenue to recognize in a given accounting period.

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."

There are contracts for which that proposal would not provide decision-useful information because the board appears to equate the satisfying of a performance obligation with the physical transfer of a completed asset from the vendor to the purchaser. (Paragraphs 3.18, 3.19, 3.20 & last sentence of paragraph 4.5) This in our view does not always reflect reality.

In our view, there are circumstances under which performance obligations are satisfied before the customer formally takes physical possession of the asset. For example, assume that a public sector entity engages a private sector partner to construct hospital. It is actively involved in the construction process by participating in and approving the design, certification and inspection of the on-going work. The hospital has unique design features to facilitate the development of a cancer ward, children's ward etc. These were specifically requested by the public sector entity. In our view, the performance obligation is satisfied over the term of the contract as time is spent on the project and milestones are met. This is because by being actively involved in the on-going work, the purchaser is controlling the unique infrastructure asset as it is being built and assuming the risks and rewards of ownership during the construction phase of the project. Therefore, in such a case, the vendor is meeting its performance obligations during the construction phase, not all at once after the customer formally takes physical possession of the asset. From a legal standpoint, the purchaser's level of participation in the design, inspection and certification may make them responsible for the payment of incurred costs even though control has not passed to the purchaser.

Also, in our view, it is not appropriate to recognize revenue when a performance obligation is satisfied but customer payment is doubtful. This is not conservative and would not accurately reflect the economic substance of the transaction. The board's proposal is silent on the issue of allowances for doubtful accounts. Also, a revenue recognition standard should discuss the issue of impairments as often revenue is initially recognized but subsequently, the receipt of payment from the customer becomes doubtful. (Paragraphs 4.32 to 4.37)

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?

We agree. Performance obligations should initially be measured at the transaction price because this is what the customer agrees to pay in exchange for the goods and/or services that the entity provides.

(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?

We disagree because the board's proposal would introduce undue volatility to financial statement reporting and reduce the transparency of financial statements.

Performance obligations should be based on known current costs, not on forecasted increases in costs and outlays which may or may not actually occur. (See the terms "expected costs" and "expected contract costs" on paragraphs 5.62, 5.63, 5.67 & 5.68 of ED) The future costs of materials (commodities) and labour are volatile and difficult to predict. The board's proposal would lead to the recognition of forecasted future losses in the current accounting period. (See Paragraph 5.63 of ED) This introduces volatility to financial reporting, may understate profitability and does not reflect the economic substance of transactions. The practice of re-measuring expected costs will reduce the transparency of the financial statements for the users as it will not be clear to them whether the increase in the performance obligation represents higher unearned revenue or higher accrued liabilities.

(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.

There are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date. This is because it encourages the use of estimated costs (See the terms "expected costs" and "expected contract costs" on paragraphs 5.62, 5.63, 5.67 & 5.68 of ED) which would likely have the effect of introducing volatility to the Statement of Operations and result in the recognition of future losses in the current accounting period. (See paragraph 5.63 of ED) Also, some users of financial reports may misinterpret increases to performance obligations caused by rising cost estimates to be future revenue increases.

For example, let's assume that a company with a October 31 year end has entered into a long term construction contract whose outcome is highly dependent on steel prices. The cost of steel was approximately US \$ 700/metric tonne in May of 2008 and rose to US \$ 1,200/metric tonne in November of 2008 and fell to approximately US \$ 800/metric tonne in March of 2009. (Source: MEPS (International) Ltd.) So, under the proposed revenue recognition model, the company would deem the contract onerous at its year end date and recognize a fictitious loss. (See paragraph 5.63 of ED) Also, it would not subsequently be able to reverse this loss because the "onerous" test is one sided.

Under the proposed standard, unstable oil prices would also introduce a high degree of volatility to financial statement reporting as energy is a significant input into a variety of commercial activities. The price of oil was approximately US\$ 140/barrel in June of 2008, then fell to approximately US\$ 50/barrel in November of 2008 and rose to approximately US\$ 70/barrel in March of 2009.(Source: NYMEX light sweet crude oil prices)

(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."

We think that performance obligations should be measured at the lower of cost or market and adjustments should be made based on known information, not on forecasts. This approach is conservative, understandable, verifiable and reduces volatility in financial reports. For example, an entity enters into a multi-year contract to provide goods to a customer. The total sales price is 100 CU and the total cost is 80 CU. If the sales price is subsequently renegotiated to 60 CU, then a loss of 20 CU (100 - 80) would be recognized in the year of the change. If cost subsequently increases to 120 CU, then the cost increase and the related liability would only be recognized in the accounting period to which they relate.

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 (e.g. selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise 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?

We agree that all amounts that an entity charges to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligation. These amounts make up the original transaction price. (Cost plus Mark-up)

(b) In what cases would recognising 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."

Recognizing contract origination costs as expenses as they are incurred would not provide decision-useful information. Instead, it would create volatility in financial reporting by causing related revenues and expenses to be reported in different accounting periods. An example is a hydro company that investigates the possibility of connecting independent power producers to its grid system. Under the current standards, it may be possible to defer the investigation costs and recognize them in future periods against the related incremental revenues earned by transmitting the power generated by the independent producers. The proposed standard may consider the investigation costs to be pre-contract and require that they be recognized as income in the current accounting period. This may cause the users of the entity's financial reports to underestimate its profitability. To avoid this, the entity may choose not to investigate the possibility of connecting the independent power producers.

We are also concerned that some business entities with significant upfront costs may be compelled to change their business practices to structure their costs differently. Accounting is a measurement tool used to report financial results. It should not drive business practices.

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?"

We agree with this allocation method because it is verifiable. Also, materiality must be carefully considered when making such an allocation. The entity needs to first determine that the benefits of allocating the amounts exceed the cost of doing so. Further, in our view, costs should be recognized on the Statement of Operations on the same basis and in the same accounting periods as the revenue items to which they relate. This will help to improve the decision-usefulness of financial reports, avoid artificial volatility in financial reports and will make financial reports more understandable.

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?

We agree because allocating the transaction price to separate revenue sources would help the users of financial reports to better understand the nature and extent of the entity's economic activities during the accounting period, report revenue in a manner which emphasizes economic substance over legal form and improve comparability across accounting periods and between entities.

The use of estimates to allocate the transaction price should be constrained when the allocation is too detailed to provide decision-useful information to the users of financial reports or when the allocation cannot be reasonably estimated.