



October 15, 2010

Via website posting: <http://www.iasb.org/>

Re: Exposure Draft Comment: **Revenue from Contracts with Customers (ED/2010/6)**

Dear Sir/Madam:

The Certified General Accountants Association of Canada (CGA-Canada) welcomes the opportunity to comment on the Exposure Draft: **Revenue from Contracts with Customers (ED/2010/6)**. We have also provided additional comments at the end of our responses for expressing our views on certain related matters.

### **Question 1**

*Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether:*

- (a) to combine two or more contracts and account for them as a single contract;*
- (b) to segment a single contract and account for it as two or more contracts; and*
- (c) to account for a contract modification as a separate contract or as part of the original contract.*

*Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?*

### **Comments**

CGA-Canada is in agreement with the boards' proposal to use price dependency as a criterion for combining and segmenting contracts, as well as for accounting for modification of a contract. We note that the proposals are consistent with existing standards and will not result in any significant changes in practice. However, we contend that the specific terms of a contract can and should override this requirement. We believe that the price dependency should be a secondary criterion for combining, segmenting or modifying a contract, and subordinate to the terms of the contract. We suggest providing additional guidance on this matter. Also, we note that, as per paragraph 14, "relationship discount" is a sufficient condition for determining price dependency for the purpose of combining two contracts but, as per paragraph 15(b), it is a necessary condition for segmenting a single contract. We suggest further clarification on the character of "relationship discount" in determining the price dependency for the purpose of combining, segmenting and modifying contracts with customers.

### **Question 2**

*The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes*

*a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?*

### **Comments**

CGA-Canada concurs with the principle articulated in paragraph 23 for determining when a good or service is distinct. However, we query potential diversity in practice because, although conceptually sound, this principle (particularly the concepts of distinct function and distinct profit margin) may be difficult to apply consistently in specific instances, despite the extensive application guidance provided in paragraphs B4-B39. We also contend that the specific terms of a contract can and should override the proposed principle and, accordingly, we suggest providing additional guidance on this matter.

### **Question 3**

*Do you think that the proposed guidance in paragraphs 25–31 and related application 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?*

### **Comments**

CGA-Canada notes that the proposed guidance in paragraphs 25–31, and related application guidance, require a shift from the existing “risks and rewards” model, based on economic ownership, to a new “control model”, based on legal ownership. This shift will necessitate major change in practice for entities. We believe that the new model is relatively one-dimensional and narrowly focused on the rewards of ownership, while ignoring the risks of ownership. The proposals can be expected to create significant difficulties in application for some industries, like construction, and may lead to diversity in practice. Also, the “control model” is applied from the perspective of the customer, instead of from the perspective of the entity selling the good or service. Although this treatment would result in identical results in many cases, it would be conceptually sounder to apply the model from the perspective of the entity rather than that of the customer.

### **Question 4**

*The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonably estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.*

*Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the proposed criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?*

### **Comments**

CGA-Canada agrees that an entity should recognise revenue on the basis of an estimated transaction price. However, the ED and the Basis for Conclusions do not clarify how this new concept of “reasonable estimation” is different from the existing requirement of “reliable measurement” in IAS 18. We also expect that the revenue recognition process will quicken under the proposed requirements, compared to the existing IAS 11 and IAS 18 requirements.

### **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 recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?*

#### **Comments**

CGA-Canada agrees that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation, rather than whether the entity recognises revenue. We believe that, although the proposed requirement will result in a change in practice, it will be for the sake of betterment. The proposed requirements will rationalize, clarify and streamline the treatment of credit risk in the revenue recognition process.

### **Question 6**

*Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?*

#### **Comments**

CGA-Canada agrees with the proposed requirement that an entity should adjust the amount of promised consideration to reflect the time value of money, if the contract includes a material financing component (whether explicit or implicit). We note that the existing requirements of IAS 18 are silent on accounting treatment when the consideration is received in advance. Hence, again we believe that, although the proposed requirement will result in a change in practice for some long term manufacturing and construction contracts, the change will be for better.

### **Question 7**

*Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate, and how should the transaction price be allocated in such cases?*

#### **Comments**

CGA-Canada agrees with the proposal that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations, **subject to the qualification** that such allocation should be consistent with the express terms of the contract. We do not believe that an accounting standard can, or should, typically override the express terms of a legally enforceable contract, which is the genesis of the entity's contracted revenue and receivables.

### **Question 8**

*Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example, IAS 2 or ASC Topic 330; IAS 16 or ASC*

*Topic 360; and IAS 38 Intangible Assets or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria. Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?*

### **Comments**

CGA-Canada prefers the original position of the boards, as set out in the discussion paper, that they did not intend to include specific requirements on cost recognition in a revenue standard, and that costs would be recognised as expenses when incurred unless eligible for capitalization in accordance with other standards. We believe that providing asset recognition guidance, and industry-specific guidance on construction costs, is inconsistent with the goal of developing standards on specific topics in a non-overlapping manner and standards based on principles rather than rules. We note that the philosophy articulated in BC 171 (reproduced below in quotes) for explaining disclosure objective does not conform to the proposals made in the paragraph 57.

“The boards noted that developing principle-based disclosure requirements is necessary because it would not be possible or appropriate, given the objective of a single revenue standard, to develop specific requirements for specific transactions or industries.”

We suggest restoring the original position of the discussion paper and providing additional guidance, if required, under standards for specific topics.

### **Question 9**

*Paragraph 58 proposes the costs that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.*

*Do you agree with the costs specified? If not, what costs would you include or exclude and why?*

### **Comments**

Subject to the comments made in response to Question 9 above, CGA-Canada agrees with the proposal regarding specified costs in Paragraph 58 that relate directly to a contract for the purposes of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation. However, we are of the view that the language of the proposals is more restrictive than IAS 11 in respect of allocation of costs. IAS 11 permits allocation of direct, as well as indirect, costs to the contract, while the proposals refer only to the allocation of direct costs. We suggest clarification on this issue in the proposals.

### **Question 10**

*The objective of the boards’ proposed disclosure requirements is to help users of financial statements understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?*

### **Comments**

CGA-Canada notes that the proposed disclosure requirements are more extensive than the current requirements of IAS 11 and IAS 18. The requirement to disclose detailed reconciliation of contract balances may prove to be costly and challenging for some entities. The presentation of contract assets or liabilities on a net basis instead of gross basis would reduce compliance efforts for the preparers and, at

the same time, diminish the usefulness of the financial statements for the end users. Subject to these remarks, it is generally agreed that the proposed disclosure requirements will meet the objective of helping users understand the amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

#### **Question 11**

*The boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.*

*Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?*

#### **Comments**

CGA-Canada notes that prospective maturity analysis of future obligations is also required by other current standards; such as, for example, paragraphs 39(a) & (b) of IFRS 7 *Financial Instruments: Disclosures*, and paragraph 56 of IAS 17 *Leases*. We note that the duration of future obligations encompassed by these standards compared to the proposed requirements is not uniform and consistent. We believe that, irrespective of their origin, the prospective maturity analysis of future obligations should be uniform and consistent across the entire spectrum of IFRSs.

#### **Question 12**

*Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors? If not, why?*

#### **Comments**

CGA-Canada agrees that an entity should disaggregate revenue into the categories that best portray how the amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

#### **Question 13**

*Do you agree that an entity should apply the proposed requirements retrospectively (i.e. as if the entity had always applied the proposed requirements to all contracts in existence during any reporting periods presented)? If not, why? Is there an alternative transition method that would preserve trend information about revenue but at a lower cost? If so, please explain the alternative and why you think it is better.*

#### **Comments**

CGA-Canada agrees that an entity should apply the proposed requirements retrospectively for ensuring consistent application of the proposed revenue recognition model to all transactions of the same nature and for improving comparability. Although we appreciate that such retrospective application will require significant outlay of resources by an entity, we are unaware of an alternative reliable transition method that would preserve trend information about revenue at lesser cost.

#### **Question 14**

*The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposals operational? If not, what additional guidance do you suggest?*

#### **Comments**

CGA-Canada believes that the application guidance is sufficient to make the proposals operational. However, because revenue recognition is such a critically important standard, we suggest augmenting application guidance by providing additional guidance on the identification of contracts (paragraphs 8-11) and combination of contracts (paragraphs 13-14).

#### **Question 15**

*The boards propose that an entity should distinguish between the following types of product warranties:*

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.*
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.*

*Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?*

#### **Comments**

CGA-Canada contends that a proposed distinction between types of product warranties is simulated, and can be resultantly lacking in commercial or economic substance. It is as counter intuitive to assume that an entity would sell insurance on a stand-alone basis that provides a customer with coverage for faults that arise after the product is transferred to the customer, as it is to assume that an entity would sell a product with latent defects. We believe that this distinction is merely an accounting fiction that could serve to complicate accounting for revenue recognition. The determination of two separate performance obligations on relative stand-alone price basis would be difficult and costly without commensurate benefit of incremental useful information. We suggest not making any such distinction and to account for all product warranties as separate liabilities, consistent with the proposed accounting for sale of a product with a right of return. Also, we note that application guidance B16 makes it clear that when the entity has not satisfied all of its performance obligations arising from product warranties, the entity would recognise an asset measured in accordance with IAS 2 *Inventories*. However, application guidance B12 is not clear as to whether the asset arising out of the entity's right to recover the products from the customer should be similarly measured in accordance with IAS 2 *Inventories*. We suggest clarifying this issue in the relevant application guidance.

#### **Question 16**

*The boards propose the following if a licence is not considered to be a sale of intellectual property:*

*(a) if an entity grants a customer an exclusive licence to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the licence; and*

*(b) if an entity grants a customer a non-exclusive licence to use its intellectual property, it has a performance obligation to transfer the licence and it satisfies that obligation when the customer is able to use and benefit from the licence.*

*Do you agree that the pattern of revenue recognition should depend on whether the licence is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?*

### **Comments**

CGA-Canada agrees that the patterns of revenue recognition should depend on whether the license is exclusive or non-exclusive. We also agree that the granting of exclusive license to an intellectual property (which is not in the nature of a sale) is similar to the leasing of an asset and, in either case, performance obligation is continuously discharged over the term of the license. Accordingly, we concur that revenue should be recognized over the term of license or lease as articulated in BC 224. In the case of non-exclusive licenses with indefinite term, we agree that they should be accounted as a sale, as explained in BC 226. However, we believe that the ED, as well as accompanying application guidance, is not clear regarding accounting for non-exclusive licenses having finite term. For example, an entity may grant license for computer software on a non-exclusive basis for a finite term on advance payment of a fee (subscription). We believe that even such transactions should be accounted as a sale, and suggest clarifying this in the application guidance.

### **Question 17**

*The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model.*

*Do you agree? If not, why?*

### **Comments**

CGA-Canada supports the boards' proposal that, in accounting for the gain or loss on the sale of some non-financial assets, an entity should apply the recognition and measurement principles of the proposed revenue model. We believe that this proposal will enhance the quality of IAS 16 *Property Plant and Equipment*, IAS 38 *Intangible Assets* and IAS 40 *Investment Property*. The proposals will also converge IFRSs with US GAAP, and lessen diversity in application of IFRSs when the consideration is contingent.

### **Additional Comments**

CGA-Canada is encouraged by the issue of this ED as it is believed that this ED, and its expected finalization, mark important milestones in the convergence efforts of the IASB and the FASB – a significant conceptual breakthrough in the development of high quality globally-acceptable accounting standards. Although, overall, we consider the proposals to be fairly comprehensive and unambiguous, we believe that the proposals should also clarify principles of revenue recognition in the absence of any formal contract and, also, when a contract involves multiple counterparties.

Should you wish to discuss the contents of this comment paper or require further elaboration on any of the items presented herein, please do not hesitate to contact Kamallesh Gosalia at [kgosalia@cga-canada.org](mailto:kgosalia@cga-canada.org) or alternatively the undersigned at [rlefevre@cga-canada.org](mailto:rlefevre@cga-canada.org).

Sincerely,

[Original signed by:]

Rock Lefebvre, MBA, CFE, FCIS, FCGA  
Vice-President, Research & Standards