

October 22, 2010

Sir David Tweedie
Chairman
International Accounting Standards Board
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Subject: Comment letter on the June 2010 exposure draft on Revenue from Contracts with Customers

Dear Sir David Tweedie,

Bombardier welcomes the opportunity to provide comments to the International Accounting Standards Board on the June 2010 Exposure Draft on Revenue from Contracts with Customers.

We are a Canadian world-leading manufacturer of innovative transportation solutions. We operate under two broad manufacturing segments: aerospace and rail transportation. We generate 95% of our revenues outside Canada, with a global workforce of 63,000 employees and 68 production and engineering sites in 23 countries and a worldwide network of services centers.

Our transportation segment designs and manufactures highly complex rail equipment and systems and provides related services. Most of its business is conducted under fixed-price contracts that extend over a long term period and involves considerable use of estimates in determining contract costs, revenues and percentage of completion. These contracts bring many different complexities such as accounting for change orders, claims, penalties, options, combining and segmenting that are driven by the nature and complexity of the work to be performed.

Our aerospace segment designs and manufactures aviation products for the business, commercial and specialized aircraft markets and provides related services. The aerospace industry is capital intensive, requiring significant investments in product development and long recovery periods. The industry also tends to be cyclical, and brings additional complexities such as customer financing, high standard of product performance and stringent certification and approval requirements.

Therefore, the specific nature of our business involves complex transactions and revenue recognition is of particular interest for a large company like Bombardier.

We support convergence of International Financial Reporting Standards and U.S. GAAP (GAAP) towards single harmonized accounting standards. We also support the Boards'

efforts to create a revenue recognition standard that improves consistency across various industries and geographies and reduces the number of standards to which entities have to refer. However, we are concerned by certain features of the proposal and in particular that the proposed standard may bring unwarranted changes to accounting for long term production-type contracts currently within the scope of IAS 11. Certain principles set forth in the ED will not accurately reflect the underlying economics of our business or provide decision-useful information to investors.

Question 1

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

- (a) combine two or more contracts and account for them as a single contract;
- (b) segment a single contract and account for it as two or more contracts; and
- (c) 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?

Answer

1. Segmenting conditions

We agree with the proposed “pricing” principle for combining and segmenting contracts, as it is conceptually consistent with existing literature. However, we do not agree with its application to segmenting. For purposes of evaluating whether an entity shall combine two or more contracts, the Board provided several qualitative indicators of pricing interdependence in paragraph 13. These indicators allow preparers to exercise judgment in concluding whether the contracts in substance represent a single arrangement between the entity and its customer and, therefore, have interdependent pricing. We believe that this application of the pricing principle is consistent with the Board’s intent as described in BC36 to provide qualitative indicators of price interdependence. However, for purposes of evaluating whether an entity shall segment a single contract, the Boards have provided two conditions that are effectively a prescriptive, quantitative test, as illustrated in paragraph B2. As written, we are concerned it could result in a proliferation of segmenting that would be inconsistent with the spirit of the related guidance on identifying performance obligations.

We believe qualitative indicators of pricing independence should be used for segmenting contracts, consistent with the combining approach. These indicators would allow the preparers to use judgment in concluding whether an entity in substance has agreed to perform certain elements of the contract for the customer without regard to the other elements and, therefore, have been priced independently. These indicators may include the following:

- Some or all of the deliverables were bid and negotiated separately, such that the customer could accept or reject them on an individual basis.
- The performance (and/or profit) of some or all of the deliverables does not impact or relate to the other elements.

We believe this approach would create conceptually complementary indicators of pricing interdependence in paragraph 13 and pricing independence in 15, as well as resolve our concern that the current conditions in paragraph 15 could lead to non-substantive segmentation.

2. Evidence of interdependent pricing

Example 1 in paragraph B2 is straightforward assuming simple products in an active marketplace that provides observable pricing. However, with complex products using multi-tier subcontractors or less active marketplaces, the application of paragraph 15(a) is less clear. For example, would a prime contractor be required to segment a contract by virtue of the fact that its subcontractors regularly sell a particular good or service separately? The application of paragraph 15(a) should be clarified by stating that an entity selling regularly the goods or services to its customers as separate products is an indicator of segmenting conditions.

Another example is an entity that provides complex products in response to a customer's request for proposal, which specifies the scope of goods and services to be provided. Those goods and services may be sold together or independently from customer to customer. In either case, the goods and services provided and the corresponding pricing are being driven by the customer's unique requirements, not by an active market for similar goods or services. A similar example is discussed in paragraph BC56 with respect to how significant contract management services impact the evaluation of performance obligations. We believe the concept of significant contract management services is an important indicator of price interdependence that is not apparent in paragraph 15(a)'s description. In other words, the customer is buying an integrated product, not the individual goods and services within the contract, and these goods and services cannot be bifurcated in the performance of a complex, highly customized project. This may not necessarily be evident in the form of a significant discount as described in paragraph 15(b). Therefore, we believe the Board should clarify that goods and services are not evaluated separately under paragraph 15 when they are sold as part of an integrated product (consistent with paragraph 23).

3. Contract modifications

We agree with how the pricing principle is applied to contract modifications.

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?

Answer

We generally agree with the Board proposed guidance on identification of performance obligations. We appreciate that the Board has acknowledged in the application guidance in Paragraphs BC56 – BC59 that, in many instances, it does not make sense to separate long-term contracts into multiple performance obligations due to significant over-arching contract management services and pervasive risks involved in the production of highly complex deliverables. We believe that this concept should have more prominence in the proposed standard, supplementing the guidance provided in paragraphs 23 (a) and (b) for determining whether a good or service, or a bundle of goods or services, is distinct. Inclusion of this concept will ensure that contracts for highly complex deliverables with integrated contract management services and risks are accounted for consistently and the resulting accounting provides decision-useful information to financial statement users.

Also, we are concerned that the introduction of the concept of distinct profit margin may result in negating the intent of the Board in accounting for contract modifications. Under paragraph 10 of the current IAS 11 rules for construction contracts, the following conditions are considered for the manufacturing of an additional asset at the option of the customer to be treated as a separate contract;

- a) The asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or
- b) The price of the asset is negotiated without regard to the original contract price.

In situations when a base contract is entered into together with multiple options to increase the number of goods to be produced, the conditions of ED paragraph 19 and of IAS 11 paragraph 9 for combining the options with the base contract will often be met. In these circumstances, the options and the base contract are accounted for as a single unit of accounting and the cumulative contract revenues are adjusted accordingly. We are concerned that introducing an unconditional ‘distinct profit margin’ element as an element of the determination of ‘distinct’ for purposes of identifying the separate performance obligations will prevent accounting for options exercised in the context described above together with the base contract. In many instances, the tasks to be performed under the options and the base contract are highly interrelated, with shared costs, a shared risk profile and significantly shared contract management, which are themselves inseparable from the risks of the underlying tasks. In most cases, base and option contracts refer to quasi-identical products as the asset manufactured under the option does not differ significantly in design, technology or function from the covered by the original contract. Therefore, we believe that the current accounting treatment

consisting in accounting for such options as contract modifications should be retained when the price of the option is negotiated as a single package at the time of entering into the base contract, even when the goods to be produced under the options have distinct profit margins.

Furthermore, we believe that the concept of inconsequential and perfunctory should be carried forward from existing guidance. We do not agree that revenue recognition should be deferred for portions of performance obligations that are considered inconsequential and perfunctory. We recommend that the Boards carry-forward this concept from existing standards.

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?

Answer

The Board guidance with respect to determining when control of a promised good or service is transferred is directionally correct but we are greatly concerned that, as currently written, the method to account for construction contract under IAS 11 (the percentage of completion method) would not be allowed in our industry while in our view, this method best depicts the economic performance of entities conducting their business through long term production-type contracts.

In our industry, it is typical to retain legal title and physical possession of the goods manufactured until delivery, mostly to protect the manufacturers' rights under the contracts. As a result, the customers do not have an unconditional obligation to pay for the goods until final delivery. As such, we would not meet indicators of transfer of control a), b) and c) of ED paragraph 30. The conclusion that control has transferred can therefore solely be based on criteria d), *the design of the goods or service is customer specific*. In our view, the indicators of transfer of control listed in ED paragraph 30 do not provide enough clarity on how customer-specific design and customer involvement in the design and development of the function of a product or service are to be considered when determining if a transfer of control has taken place. Accordingly, the proposed standard should be improved to clarify that transfer of control is deemed to have taken place in situations of customer-specific design or function. Such situations are usually evidenced by significant initial efforts to define the asset's design or function and/or by the customer's continuous involvement throughout the contract performance period. In our view, customers' involvement during the contract performance period is strong evidence of continuous transfer of control and guidance should be added highlighting additional indicators of continuous customer involvement such as:

- bid conditions include compliance with the customer specifications and need to continue to meet the specifications over the entire contract performance period.
- the scope of work involves the production of specific, unique assets rather than the mass production of identical assets, as evidenced by the customer's ability to customize the product or service.
- customer's ongoing input in specifying major changes (including its ability to issue change orders);
- the contract calls for progress or milestone payments as the work is performed;
- acceptance of completion of performance obligations.

Although it could be argued that only meeting criteria d) of ED paragraph 30 is sufficient for continuous transfer of control in circumstances generally found in our industry, we believe the current guidance could be interpreted in a way which could be detrimental to our industry. In practice, ED paragraph 31 could be read literally to require that at least two of the four criteria be satisfied in order for control to be transferred. This is not what we believe to be the Board's intent. Therefore, other than for the above suggested deemed transfer of control, ED paragraph 31 should be revised to clarify that the presence or absence of any one or more of the suggested indicators should not substitute for an overall evaluation of the facts and circumstances when determining if control has transferred.

Question 4

The Boards propose that if the amount of consideration is variable, an entity should recognize 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 recognize 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 recognizing revenue when the transaction price is variable and why?

Answer

In our industry, a company must often use an estimated selling price (including a variable fee) to make the economic decision of whether or not to enter into a contract. Generally, we would not enter into a contractual relationship to produce a good or service if we could not reasonably estimate the expected value to be received, including a variable fee component. In such circumstances, estimation of the selling price is an essential element of a long-term contract. As such, we agree with the Board that if the amount of consideration is variable, an entity should include it in the measurement of the transaction price that is allocated to performance obligations if it can be reasonably estimated. However, we do not agree with the decision making criteria provided in Paragraphs 38 and 39 as we feel that it is too prescriptive. The factors identified in ED paragraph 39 are

among the factors an entity will consider when estimating the transaction price (i.e. they are elements of the measurement of the performance obligation) but the existence of such factors should not prevent revenue recognition.

We believe that the main focus of the guidance should be that an entity has to consider all the relevant factors that affect the estimated transaction price and develop its best estimate of the transaction price based on its experience or based on the use of an appropriate forecasting methodology. The Board should acknowledge that an entity's experience will almost always provide it with the ability to appropriately estimate a transaction price and only in rare circumstances would an entity be unable to satisfy the requirement to estimate the transaction price.

Very often in contracts where the goods or services to be provided are dependent upon customer design or function, or are usable in limited applications for a relatively small number of specialized customers, a portion of the selling price of the goods or services is variable and dependent upon product performance or external factors. An entity generally has the ability to estimate the variable consideration based on its historical experience or expected performance under the contract. When such contracts are negotiated with customers, an entity estimates the economic of the transaction, including an assessment of any variable consideration. Generally, contractors would not be willing to enter into a contractual relationship to produce a good or service if they could not reasonably estimate the expected value to be received for their efforts, including a variable fee or margin component. In such circumstances, estimation of the selling price expected to be realized on the contract is an essential element of the transaction.

Therefore, we believe ED Paragraphs 38 and 39 should be eliminated in their entirety and replaced by guidance currently provided in SOP 81-1, paragraph 24, as follows:

“For entities engaged on a continuing basis in the production and delivery of goods or services under contractual arrangements and for whom contracting represents a significant part of their operations, the presumption is that they have the ability to make estimates that are sufficiently dependable. Persuasive evidence to the contrary is necessary to overcome that presumption. The ability to produce reasonable dependable estimates is an essential element to the contracting business.”

In summary, a better approach would be to provide guidance on how uncertainty affects the ‘measurement’ of the performance obligation and only consider denying recognition of revenues for a given performance obligation in the rare circumstances where a reasonable estimate cannot be made. Accordingly, we suggest that the text of both ED paragraphs 38 and 39 be deleted and replaced by the above suggested text. This would ensure that revenues are always recognized where an entity is able to make a reasonable estimate of the transaction price and will limit delayed revenue recognition only to rare circumstances. The Board has tentatively agreed on conceptually similar guidance in the lease accounting project.

If an entity is not able to support an estimate for variable consideration included within a contract, no revenue for the variable part of the arrangement should be included in the amount of the transaction price to be allocated to those performance obligations.

Furthermore, we do not agree with a probability-weighted approach in determining the amount of variable consideration. When estimating the transaction price for contracts with variable consideration, the use of probability-weighted amounts, especially when there are binary outcomes, would likely lead to recording revenues at an amount that is not a possible outcome under the contract. The approach adds unnecessary complexity to the assessment of transaction price for a result that would not accurately reflect the underlying economics of the transaction or provide decision-useful information to a user of the financial statements. Rather, we support the use of management's best estimate for the measurement of a variable transaction price. We believe that management's best estimate is the most useful measure as it allows for the exercise of management judgment based on experience to determine the transaction price. It also provides the most decision-useful information for investors as it would reflect management best estimate of the transaction price expected to be received rather than an amount in a range of possible outcomes.

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?

Answer

We do not agree that a customer's credit risk should be reflected in the estimate of the transaction price. We believe that this approach would lead to counter intuitive results and would not be decision-useful. Furthermore, the cost to implement a process to distinguish initial collectability estimates from subsequent changes and ensure appropriate presentation in the financial statements would likely be significant as compared with the benefits of making such a distinction. Therefore, a customer's credit risk should be accounted for as an adjustment of income through bad debt expense and a corresponding allowance for bad debts.

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?

Answer

We agree with the concept of introducing Time Value of Money (TVM) to accounting for revenues from contracts with customers. However, we believe that practical accommodations must be introduced and additional guidance is required on issues such as the discount rate to be used and the requirements (or absence of requirements) for updating (or not) the financial component of the contract upon certain events taking place (e.g. changes in market interest rates).

Under the proposed standard, many long-term production-type contracts will meet the transfer of control criteria throughout the contract period and therefore will be accounted for under the percentage of completion method. In these situations, it is common for manufacturers to receive advances from customers that are often received as payments on account of work performed under the contract and not for financing purposes. Of course, the advances will not perfectly match costs incurred, which will give rise to advances in excess of work in progress or work in progress in excess of advance payments. In our view, simply relying on the general application of the materiality concept to avoid the burden of having to track each and every situations where payments received do not perfectly match the work performed would not be sufficient. In situations where the entity executes numerous contracts at the same time, each of them comprising its own multiple payment scenarios, the mere demonstration of whether the impact is material or not to an entity would be a significant burden.

Long-term contracts involve the possibility of multiple payments and uncertainty related to timing of delivery of goods or services in a contract, which affects the assessment and calculation of the TVM. This may trigger the need to use simultaneous equations, which would be overly complex. Additionally, if variable elements are present in the arrangement, such as contingent consideration, these calculations may become even more complex. Significant costs will be incurred to design and maintain a system to track and recalculate interest on payments received in advance or after the transfer of goods or services. These costs will be substantial. We believe that the costs to comply with this guidance would significantly outweigh the benefits to investors and users of financial statements.

Therefore, we propose to add in the final standard that entities be required to compute TVM adjustments only when funding is received greater than one year before or after the planned date of satisfaction of the related performance obligation. A one-year exemption to the application of TVM would avoid the significant burden of tracking a potentially very large number of situations when payments received from customers do not perfectly match the work performed on the related contract. The planned date rather than the actual date of satisfaction of the performance obligation should be retained to avoid the issues highlighted in the previous paragraph. The Board is contemplating conceptually similar accommodation in the proposed lease standard and a revised approach would be aligned with the on-going practice not to discount current assets and liabilities. With this limited exemption, a substantive financing component embedded in a contract would still be accounted for separately.

In addition, the new standard should clearly state how the discount rate should be established. In our view, a simple and correct approach would be to require that TVM be computed using the entity's incremental borrowing rate at contract inception. This rate should not be updated subsequent to contract inception unless there is a contract modification such that the financing component of the contract is materially altered. Adjustments to the discount rate for market interest rate movements could require a very significant amount of work with limited corresponding benefits to the users of the financial statements. Our suggested approach reflects the position of the parties at the time the investment/financing decisions were made (i.e. at the time of entering into the contract) and is aligned with the proposed approach in the lease project and how most loans held by manufacturing entities are accounted for under IAS 39 (under the amortize cost method).

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 standalone 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?

Answer

We agree with the proposed approach but we recommend that the Board clarifies that when a variable consideration or changes in variable consideration relate to a single performance obligation, an entity should assign that contingent consideration and subsequent changes thereto directly to the specific performance obligation.

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, Topic 330 or IAS 2; Topic 360 or IAS 16; and Topic 985 on software or IAS 38, *Intangible Assets*), an entity should recognize an asset only if those costs meet specified criteria.

Do you think that the proposed guidance on accounting for the costs of fulfilling a contract is operational and sufficient? If not, why not?

Answer

See question 9.

Question 9

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

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

Answer

Our responses to the related questions 8 and 9 on costs follow.

The guidance relating to cost accounting is only relevant in this standard because it is expected that some of the current accounting guidance on cost accounting (e.g. IAS 11 and SOP 81-1 in the US) will be replaced by the new revenue standard. The issue of accounting for costs is an important one mostly because there is a very significant gap between the current rules under US GAAP and IFRS in this respect, in particular the requirement under US GAAP to expense R&D expenditures as incurred. In our view, providing guidance for cost accounting should be tackled separately from this project, as it is not directly related to accounting for revenues and could interfere with guidance in IAS 2 and IAS 38. Since this accounting is a vital consequence of the adoption of the revenue standard, the two projects should be addressed concurrently. The IFRS/US GAAP overall convergence project currently being deployed makes these new rules even more important as it is a major source of differences in accounting between IFRS and US GAAP.

Onerous Obligations

We believe that recording an onerous liability for a performance obligation at inception of an overall profitable contract does not provide decision useful information. We understand the Board believes it is preferable to apply the onerous test at a performance obligation level to ensure that adverse changes in circumstances are reported timely. However, if losses are expected to be realized on early performance obligations followed by profits on later performance obligations, we do not believe that up front recognition of the anticipated losses would depict an adverse change in circumstances. Rather, decision-useful information would be to understand when a contract, due to cost overruns or unanticipated production issues, has fallen into an overall loss position. This would truly represent an adverse change in circumstances for which a liability should be recorded, with the change in circumstances disclosed in the financial statements.

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?

Answer

Given our numerous contracts with customers in our industry, certain additional quantitative disclosures and tabular reconciliation of balance sheet amounts described in the ED, such as activity in significant balance sheet accounts, reconciled to the income statement, would impose a significant burden on entities while not providing decision-useful information to financial statement users. Our concern is particularly acute in connection with the reconciliation of contract balances suggested in ED paragraphs 73 and 75. We believe that quantitative disclosures should be limited to what is currently required under IAS 18, including the information required in ED paragraph 74, as well as disclosing unusual or infrequent items that would provide additional useful information to financial statement users about the performance on particular contracts. Furthermore, we believe that the information systems and personnel costs that would be required in providing such information outweigh any benefit that might be provided to the users of financial statements. Much of the information required to complete contract balance roll forwards and reconciliations would be tracked outside normal systems and databases, leading to a significant administrative efforts and system costs to gather this information.

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?

Answer

Our industry operates with very long cycles, leading to a significant amount of backlog. Various outside factors impact the satisfaction of our backlog. The proposed requirement to disclose the total amount of backlog and the expected timing of its satisfaction would not provide decision-useful information to the financial statement users nor add to the users' understanding of the amount, timing, and uncertainty of revenues and cash flows.

The requirement to disclose such information, consisting in a partial forecast of future revenues, will significantly expand the scope of the financial statements and is inappropriate in an accounting standard that is otherwise devoted to the reporting of historical financial results. This disclosure would result in material, non-public information based on projections of forward-looking data being included in the audited footnotes. This level of information exceeds what is currently provided to shareholders

and analysts in typical earnings guidance and would disclose sensitive information to competitors in our industry. The auditors would be required to audit long-term planning information that is subject to many changes and variability. In addition, this information is likely to be of limited benefit to the financial statements users as it provides only limited information on future revenues since for most entities, future revenues depend in great part on on-going contract awards. If the Board views this information as necessary, requiring qualitative disclosure would be a better approach.

We believe that existing backlog disclosures included in Management's Discussion and Analysis of Financial Condition and Results of Operations ("MD&A") are sufficient and appropriately positioned in MD&A as the disclosures contain forward-looking information. Furthermore, we do not currently have financial systems that would be able to capture the expected timing of satisfaction of performance obligations. In order to produce the disclosure, we would have to incur significant costs to change systems and procedures to capture the appropriate data. The costs of readying the systems and procedures to prepare such disclosure would far outweigh the benefit of the disclosure.

We strongly oppose the disclosure of onerous performance obligations as such information is often misleading when set apart from the overall economic conditions attached to relevant contracts. Furthermore, such information could reveal pricing strategies and other information that is competitive information and could be detrimental to our negotiations with our customers. Current disclosures about onerous contracts could be enhanced to provide financial statement users with additional information, but there should be no disclosure requirement at the level of specific performance obligations.

Question 12: statement of comprehensive income

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?

Answer

We generally support the Boards' view that an entity should disaggregate revenue into the categories that best present how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors. Most companies either already provide such information in their financial statements or can provide such disclosures at minimal cost.

Question 13

Do you agree that an entity should apply the proposed guidance retrospectively (that is, as if the entity had always applied the proposed guidance 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.

Answer

We do not agree that the proposed guidance should be mandatory applied retrospectively due to the impracticality of such restatement. IAS 8, *Accounting Policies, Changes in Accounting estimates and Errors*, provides a definition of ‘impracticable’ which include the following conditions:

- a) The effects of retrospective application or retrospective restatement are not determinable;
- b) The retrospective application or retrospective restatement requires assumptions about what management’s intent would have been in that period; or
- c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objective information about those estimates that:
 - I. Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and
 - II. Would have been available when the financial statements for that prior period were authorized for issue from other information.

Our contract base is composed of thousands of contracts that often span for a period of several years. It would be extremely complex and time-consuming to recast these contracts from their inception. Such exercise would require the revision of annual and quarterly estimates of profitability on a contract-by-contract basis over a multi-year period. To track this population of contracts across a wide range of systems and manual records would impose significant costs to an entity without corresponding benefits for the financial statement users.

In addition, assumptions and estimates are made at multiple points throughout a contract’s life. Retrospective adoption presupposes that an entity has available information for historic contract assumptions and estimates and, as such, can make a fully informed decision under the proposed guidance for each past contract decision point. Absent such information, new assumptions would have to be made and it would be impossible to avoid the use of information that was not available at the time in making these new estimates (the use of hindsight information). Examples of such estimates and assumptions may include the following;

- the initial price allocation to contract performance obligations;
- the amount of variable consideration assumed as contract revenue;
- the allocation of contract costs, if on a different basis;
- the assessment of the timing of transfer of control;
- risk provisioning at the level of each performance obligation; and
- elements related to TVM adjustments.

To the extent historical information is not available, an entity would necessarily compute the restatement in a manner that would be inconsistent with an identical contract being accounted for under the proposed standard from its inception. We therefore suggest that the new standard be applied prospectively for new contracts with customers entered into or materially modified after the effective date of the standard, with an option to apply the standard retroactively for entities capable of doing such restatement. Some major revenue recognition standards have been applied on a prospective basis in the past, including AICPA Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts, and Multiple-Deliverable Revenue Arrangements, a consensus of the FASB Emerging Issues Task Force. We are not aware of significant drawbacks to this approach. An acceptable alternative to our suggested approach would be to require accounting under the new rules for new contracts signed from a specified date in the future but prior to the mandatory adoption date, as long as entities have sufficient time to prepare for the requirement to compute data under the current and new rules during the transition period.

To address the Board concerns regarding the lack of comparability of financial statements if retrospective application is not mandated, entities should be required to disclose information that enables users of the financial statements to understand the effect of the change in accounting principle. Such disclosures may include some or all of the following items:

- a description of the method of applying the change;
- a qualitative discussion of the entity's major products and services for which revenue recognition under the proposed guidance will be materially different; and/or
- the portion of the entity's revenues and/or earnings in the period that have transitioned to the new accounting method.

Also, the Board will likely issue new accounting standard on several topics during 2011 and 2012, including revenue recognition, leasing, provisions, fair value measurement and financial statement presentation. We believe that the Board should address transition to the new accounting standards in the context of the workload that all these changes will require from preparers of financial statements. This consideration should include a realistic assessment of the cost/benefit associated with retrospective versus prospective implementation.

Question 14

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

Answer

1. Implementation examples

The implementation guidance covers only a small sample of possible simplified transactions that would be sufficient to make the proposed guidance operational. We appreciate the implementation guidance Paragraphs BC56 – BC59 on the role that contract management services may play in determining performance obligations in a contract. However, we believe that a more complex example of application of the rules to long-term manufacturing contracts should be provided.

2. Principal v. agent relationship

The principal vs agent relationship issue occurs in our industry and therefore more detailed guidance should be provided. We recommend that current US accounting guidance on this matter contained in current consensus of the FASB Emerging Issues Task Force be incorporated in the revenue recognition standard.

3. Residual value guarantees

Residual value guarantees (RVG) are common in our industry. RVGs provide protection to the guaranteed parties in cases where the market value of the underlying asset is below the guaranteed value. While RVGs may be arranged between one entity and another entity that is not the customer, these RVGs relate directly to the transfer of a product to a customer and are considered a linked arrangement. The Board should include guidance in the new accounting standard stating that other contracts that are linked to a contract with a customer should be assessed by an entity as part of its revenue recognition process.

Similar to warranties in Question 15 below, we believe that RVGs provided in our industry mostly in connection with the sale of aircraft are not separate performance obligations as the conditions in paragraph 23 are not met:

- a. Are not sold separately; and
- b. Do not have a distinct profit margin.

As these guarantees are not separate performance obligations, the current accrual for estimated costs to be incurred at the time of sale should remain.

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?

Answer

The current accounting guidance is appropriate for a warranty offered by an entity, whether for latent or post delivery defects, when an entity does not separately charge for the warranty. Accruing for the expected cost of warranty coverage at the time of transfer provides decision useful information to users.

In our industry, we do not believe it is either practical or feasible for an entity to distinguish between warranties for latent defects and warranties for defects that arise after the product is transferred to the customer, even when considering the factors in paragraph B18. At the time of sale, we do not have knowledge of defects, and this is supported by the fact that our products must generally go through rigorous internal and external inspections before they are accepted by the customer. Defects are only known later, when identified and communicated by the customer. The defects identified by the customer thereafter may relate to the original conception of the product or its operation and use after the transfer. Either way, the defects would be covered under the terms of the warranty as long as the product was properly maintained, for the simple reason that it is nearly impossible to dissociate the two. Therefore, we would normally address the correction of such defects without regard to whether the issue arises from a latent defect or a fault that arise after the product is transferred

Despite these facts, the three criteria in paragraph B18 seem to indicate that we should distinguish between the types of product warranty, as:

- (a) the warranty coverage provided generally exceeds the legal requirement;
- (b) our products could technically be sold without this warranty (but it is almost never done as it is an industry practice expected by customers); and
- (c) the period of coverage varies based on the individual component and can be fairly lengthy for some components.

Such distinction would not be in line with the way our industry operates, and would be almost impossible to perform given the difficulties in dissociating these types of product warranties.

With respect to accounting for warranties, we believe most warranties provided in our industry in connection with the sale of manufactured products are not separate performance obligations. The conditions in paragraph 23 for being distinct are not met as these warranties:

- have no stand alone value or market;
- are not sold separately for the normal coverage period; and
- do not have a distinct profit margin and are only priced as a bundle for the entire product.

As these warranties are not separate performance obligations, the current accrual for estimated costs to be incurred at the time of sale should remain.

Separately-priced extended warranty coverage, which may be purchased at the discretion of the customer, meet the conditions in paragraph 23 and should be accounted for as a separate performance obligation, with revenue recognized as the related services are delivered.

Question 16

The Boards propose the following if a license is not considered to be a sale of intellectual property:

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

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

Answer

We do not have comments on this question.

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?

Answer

We agree that an entity should apply the recognition and measurement principles of the proposed revenue model for the sale of some non financial assets, absent other specific standard applicable to the transaction.

Please do not hesitate to contact the undersigned if you wish to discuss our comments with us.

Best regards,

Signed in Montréal: Jean Paré

Jean Paré
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