Syntec informatique

SYNTEC INFORMATIQUE's comments on IASB Exposure Draft
"Revenue from Contracts with Customers"

Dear Madam or Sir,

Syntec Informatique's members acknowledge the improvements contained in the ED, compared to the proposals in the DP. We understand that some of our concerns and comments have been addressed in the ED, particularly though the introduction of indicators of control in paragraph 30 and through various examples included in the application guidance.

However, overall, we still believe that the current requirements in IAS 11 and IAS 18 have proved to work well for our industry and that they are applied in a way that provides useful information to users. We are concerned that the proposals in their current form, despite the above mentioned improvement, are still not clear enough, particularly regarding the transfer of control and the identification of separate performance obligations, and therefore, we believe that if a new standard were to be published as drafted, this would result in a significant increase in practical implementation and interpretation difficulties, and accordingly in an increased diversity. Revenue recognition being a key element in financial reporting, an increased uncertainty, even if it is temporary, until practice develops, is not acceptable as it would impair the decision usefulness of the information, creating confusion for the users of financial statements. We believe that this would not represent an improvement in financial reporting justifying the burden of high costs born by preparers.

Particularly, Syntec Informatique's members do not believe that paragraphs 25 to 27 appropriately convey the evolution the IASB introduced through examples, remains tangible goods oriented, and therefore we are concerned that they may be misinterpreted when applied to our contracts. We describe below our concerns in this respect and strongly recommend the IASB to reconsider the description of the principle in paragraphs 25 to 27, because this is a key element in the future revenue standard that shall not remain unclear due to the sensitivity of revenue recognition issues.

Our other comments relate to the combination of contracts, the identification of separate performance obligations, accounting for pre contract costs and disclosure of remaining performance obligations.

1. Transfer of control (Question 3)

We understand that under the ED, specifically in accordance with paragraphs 30(d), we could consider that there is a continuous transfer of goods or services in the followings types of arrangements:

- "Design" advisory Services: these are services consisting in accompanying the client in a specific project. Consulting services are aimed at improving the strategic intent, overall design, efficiency and effectiveness of IT capabilities or building and improving client's strategy. Consulting services can also consist in processes re-engineering and transformation that necessitate on site, intensive interaction with client executives. A report is frequently delivered to the client at the end of the contract.
- "Build" integration services: these are services consisting in developing a specific solution for a client. They can be defined as a project, or set of projects, focused on design, development and implementation of a custom or packages (software or system) solution on behalf of a client. At the end of the contract, the IT Company delivers a solution to the client.

This is because the services in these arrangements are specifically adapted to the client's needs and there is a continuous collaboration between the client and the provider that may result in significant modifications to design or function during production process. Example 16 - Consulting services (paragraph B67) appears to confirm our interpretation of the ED.

However, paragraphs 25 to 27 are based on a transfer of control concept in terms that appear to require the transfer of all aspects of control over the work in progress, because control is usually understood as being exclusively retained by only one party. As stated in our comment letter to the DP, we do not believe that such a principle is appropriate for our types of arrangements discussed above: "For these two types of services, during which the IT services company works in close conjunction with its client during a given period in order to deliver a solution, the client does not actually obtain control of the underlying asset during the development of the solution. An ongoing collaborative process between the IT Company and the client is engaged. During this process of constant interaction with the client, the rights and obligations of both parties are changing progressively as the solution is defined and developed, even if the control over the solution is not formally transferred. There is no actual transfer of control of asset to the client but a continuous collaboration with the client to develop the solution he needs."

Syntec Informatique's members believe that it is fundamental that the description of the principle itself is modified to accurately convey all the elements that should be taken into account to determine whether there is a continuous transfer of goods or services without appearing to conflict with indicators and the application guidance. We believe that there is a continuous transfer of goods or services when a supplier dedicates resources to fulfill one client's specific and unique needs, and accordingly, in the case of a contract termination by the client, would be entitled, contractually or according to law or business practices, to a fair compensation for the work performed.

Other comments relating to transfer of control issues are the following:

Indicators of controls: We are uncertain about the role of indicators in paragraph 30. We understand that they are not intended to constitute a check list of situations where it is certain that control is transferred, but then we do not understand how the existence of one or more of these situations interact with the principle in paragraph 25 to 27. Particularly, paragraph 31 could be read as meaning that one indicator is always insufficient to demonstrate the transfer of control, and two indicators would always be sufficient for these purposes. For service contracts, as indicated in paragraph 31, physical possession and legal title would usually be

irrelevant, and therefore one could conclude that both unconditional obligation to pay and customer specific design or function would be necessary. We believe this is not the IASB's intention and accordingly paragraph 31 should be modified to avoid any confusion relating to the use of these indicators in assessing the transfer of goods or services.

Unconditional obligation to pay: As described in our comment letter to the DP, in the event of early termination of the contract by the client, IT services companies are usually paid for part of the work performed until termination irrespective of the terms of the contract. This situation does not generally result from specific termination provisions in the contracts as suggested by example 16, or from legal rules, but are common business practice in the IT services sector. This illustrates the fact that the performance obligations are continuously satisfied until the completion of the contract. Therefore, we would like the IASB to clarify in paragraph 30(a) that the customer's unconditional obligation to pay does not necessarily require a legal obligation but includes business practices in the industry.

Possession of work in progress: In scenario 1 in Example 15, it is concluded that the performance obligation of the manufacturing services is satisfied continuously and therefore revenue is recognised over the service period. Among the arguments for the conclusion, we do not understand the importance of the following sentence "the customer also has the ability to take possession of the equipment during manufacturing and engage another entity to complete the manufacturing". We would like to draw the attention of the IASB that this kind of clause is very rare in practice, and therefore we do not believe that a conclusion in the application guidance should be based on it. We believe that this element is not necessary to reach the conclusion as other factors indicate that the customer has the ability to prevent from other entities from receiving the benefit from services provided.

2. Combination of contracts (Question 1)

We understand the principle of combining contracts when prices are interdependent. Especially, this principle should be easy to apply when contracts are negotiated and signed at the same time as a package. We believe that such an approach already exist in the current standards. However, we have difficulties to understand how this principle would apply when a second contract is negotiated and signed well after the execution of the first has begun. Especially because paragraph 14 explains that price interdependence is different from the effect of an existing customer relationship. There is no guidance in the standard to distinguish them, and the application guidance does not give further elements. We believe that the final standard should more clearly explain when a new contract should be combined with a former one, because as currently drafted, it could lead to significant diversity of application.

3. Identification of separate performance obligations (Question 2)

As explained in our comment letter to the DP, we believe it is neither possible nor appropriate to separate our comprehensive services into separate performance obligations. The performance obligation of our comprehensive services consists in rendering the continuous collaborative work with the client in order to develop and deliver the final solution. For these services, the performance obligation is not related to an individual product or service but to whole process aiming at developing specific solution. This is true, even if some parts of the development could be sub contracted, because the supplier is responsible towards its client for

an integrated solution and therefore covers the risks of a unique combination of tasks, as explained in Example 11.

In effect, according to Example 11, it seems that one should consider the effects of integrating in one contract a unique combination of tasks including products which are highly interrelated. In such a situation, the entity would not identify separate performance obligation for each task. However, the first part of Example 11 and the principle described in paragraph 23 does not accurately convey this concept. On the contrary, the latter appear to be based on a purely technical approach, which ignores the specific contractual arrangement and related risks, and requires identifying separately every single element in a contract that could be sold separately by any entity in any type of contract. In our view, "integration" and "interrelation" are one of the key criteria in determining the identification of a separate performance obligation. Therefore, we request the IASB to modify the principle described in paragraph 23 to reflect these factors. At the same time, the final standard should clarify how to determine if tasks and products are integrated or interrelated.

4. Accounting for pre contract cost (Question 8)

As we described in the comment letter to the DP, we disagree with the requirement to expense when incurred all costs of bid and proposals to obtain a contract. For example, as explained in our comment letter to the DP, "technical pre sale costs consist in starting to understand the client's specific needs and starting to engage the collaborative business solution that will be developed after the contract is signed." When such costs are incurred at a time where it is probable that the contract will be signed, we believe that they are in substance the beginning of the rendering of the services under the contract, as currently required by IAS 11.

In our view, these costs are able to satisfy requirements in paragraph 57 and shall be recognised as assets. However, paragraph 59(a) states costs of obtaining a contract shall be expensed when incurred. Therefore, we request the IASB to clarify that costs meeting requirements in paragraph 57 shall be recognised as assets even though they are incurred before signing contract and those costs shall be excluded from the scope of paragraph 59.

5. Disclosure of remaining performance obligations (Question 11)

We strongly disagree with disclosing the amount of performance obligations remaining at the end of the reporting period (paragraph 78). Such information, being by essence forward-looking, would be very difficult to be made reliable and auditable, particularly in the absence of further guidance. The cost of preparing such information would be very huge and would not outweigh benefits. Therefore, we do not believe this information should be disclosed in the financial statements.

We hope you will find these comments useful and would be pleased to provide any further information you might require.

Kind regards,

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