

21st Oct 2010

Sir David Tweedle  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M6XH  
United Kingdom

Dear Sir David,

**EXPOSURE DRAFT ED/2010/6**

**REVENUE FROM CONTRACTS WITH CUSTOMERS**

We thank you for the opportunity to respond to the International Accounting Standards Board's Exposure Draft ED/2010/6 Revenue from Contracts with Customers.

Singapore Technologies Electronics Limited (ST Electronics) is the electronics arm of Singapore Technologies Engineering Limited, a company listed on the Singapore Stock Exchange, an integrated engineering group providing solutions and services in the aerospace, electronics, land systems and marine sectors (please visit [www.stengg.com](http://www.stengg.com) for more information).

ST Electronics is a leading provider of electronics, ICT (information communications technologies), IT (information technology), satcom and digital media, e-government and homeland security solutions in the region. ST Electronics' core capabilities lie in its design, development and integration of advanced electronics systems such as wired and wireless communications, broadband radio frequency and microwave communications, e-government and ICT solutions, rail and traffic management, real-time command & control, training and simulation, digital media, intelligent building management, and information security and mobile commerce solutions. It undertakes continuing research and development to help create cost-effective purpose-built products at both system and component levels to provide quality solutions to customers.

ST Electronics has a network of offices in Africa, Australia, China, Hong Kong, United Kingdom, the Gulf States, Kazakhstan, Malaysia, Mexico, Taiwan, Thailand and the US. These offices cater to a customer base spanning more than 60 countries including Africa, Albania, Australia, China, Hong Kong, the Gulf States, Europe, Korea, Malaysia, Mexico, Taiwan and the US in government, commercial, industrial, defence and security sectors.



ST Electronics has many subsidiaries, associated companies and joint ventures operating in different parts of the world. In reviewing and responding to the ED/2010/6, we have taken into account the relevant inputs and comments of the companies under ST Electronics group, especially those where the proposed changes in IFRS would have a significant impact on their revenue recognition..

Our responses to the Board's questions in this Exposure Draft focus on the practicality, issues and feasibility of the application of this Exposure Draft to the Electronics / IT / Defence industry.

Our responses to the various questions are set out below:

Question 1:

The ED proposes 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?

No, we do not agree with the principle.

Like many companies, we considered business and other relevant risk factors in drafting and structuring the contracts. Most of our contracts are unique and are negotiated and structured to suit customer's requirements and to generate reasonable returns on the business. We do not think it is reasonable to combine or to segment contracts solely to comply with revenue recognition for accounting purposes. Hence, we think revenue recognition should follow the contract structure, terms and the intent of the business objectives so as to reflect the economic substance of the contract. Existing accounting standards are adequate to address the recognition of revenue.

In a cross-border transaction for a turnkey project, it is common for a company to structure the contracts (which may entail entering into several sub-contracts for one project) after taking into account relevant factors such as tax implications, transfer pricing issues and deliverables for the contract so as to provide reasonable returns to the company while meeting the requirements of the customer. Each sub-contract has its own pricing and deliverables, as well as its terms and conditions to fulfill its contractual obligations to the customer. In our type of industry, where contracts are customized and unique, it is very



difficult to prove whether pricing is not interdependent as benchmark to independent market is not readily available.

In addition, given the diverse capabilities of the companies in our group, we may have instances where one company will take the role of a Prime Contractor and sign a contract for a turnkey project with the customer and thereafter, subcontract certain portions of the project to other related companies within the group on an arms-length basis. We opine that these different contracts between the Prime Contractor and the other related companies should be accounted for separately based on the terms and conditions of the separate contracts, after taking into account the guidance relating to the Principal and Agent relationship. The customer prefers to contract with one party rather than enter into contracts with several parties which are related to one another within the group.

Contract modifications or variations to contracts, which are common in infrastructure and turnkey projects, should not be viewed as a separate contract, but in conjunction with the original contract unless the intention of such contract modifications is for the modifications to be treated separately from the original contract.

#### Question 2:

The ED proposes 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. The ED 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?

No, we do not agree with the principle.

Due to the nature of our turnkey project business, each contract is unique with its different customized configurations and specifications. The various milestones/deliverables of the contract are distinct and cannot be split up and sold independently due to customers' unique requirements and/or security reasons. In particular, there is no ready market for each of the distinct deliverables / milestones for defence contracts and those of security interests. We also do not sell the separate deliverables to other 3<sup>rd</sup> parties in the ordinary course of business. Hence, it is not practical to recognize revenue based on separate performance obligations since it is not possible to estimate a reasonable price or fair value for each milestone/deliverable in the absence of a ready market.

Given the nature of our turnkey projects, it is not practical to separate performance obligations for such projects.

Question 3:

Do you think that the proposed guidance in the ED 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?

No, we do not think it is sufficient, and it would be quite difficult to come up with an exhaustive list to address the revenue recognition criteria for every industry and situation since there will be too many variables to consider. In the absence of specific guidance, revenue recognition becomes very subjective and judgmental, depending on the merit of each case, resulting in unnecessary cost outlays that far outweigh its benefits. In addition, we will need a multi-faceted team of people within the organization who needs to be conversant with the proposed guidance to negotiate contracts so as to be able to account for revenue properly and tailored the contracts based on accounting principles rather than base on good commercial viability and best returns to the organization.

We think the current guidance is inadequate for turnkey projects, where the contracts are normally long-term in nature and involve a series of customized specifications / scope of work to be performed over a period of time. For such contracts, legal title, physical possession and receipt of full benefits from the assets by the customers usually occur after the completion of the whole project. However, our customers do participate actively in the various design phases and closely monitor the various stages of completions. In this regard, we believe that the customers have substantive control of the assets at each milestone of completion and thus other indicators such as customers' active involvement or acceptance at each milestone / deliverables, milestone payments after acceptance by customers, etc should also be included in the guidance. In our type of long-term contracts, the indicators on legal title and physical possession of the goods are not relevant and would be very problematic to implement. The ED should provide for more robust and broader indicators on transfer of control and allow for wider latitude in its interpretation to cater to the requirements of different industries and business models. We are also of the view that the current guidance may be inconsistent with many business models across industries.

Measurement of revenue

Question 4:

The ED proposes 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. It also 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 the ED? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

In general, we agree that revenue can be recognised based on reasonable estimates. However, using estimated probability-weighted measurement in recognition of revenue introduces more elements of subjectivity and judgment and could be counter-productive.

Relating specifically to variable revenue, we are of the view that it is more accurate to reflect revenue based on actual amounts received and/or the targets met based on the contractual deliverables. For example, in situations where one of the components of revenue is dependent on meeting of performance KPIs (to determine bonus/penalty in addition to fixed revenue), revenue recognised should be based on actual achievement/non-achievement of performance KPIs and should not be estimated based on probability. Furthermore, such estimation based on probability would complicate the computation of revenue recognition, depending on the complexity of the contract arrangements. We would not be able to reasonably estimate the variable revenue until nearer the end of the contract. As a result, our companies may have to incur additional costs to revamp the accounting systems or engage more staff to administer this. We think the revenue recognition based on this ED would not be reflective and would not provide information that is useful to our investors and stakeholders.

Question 5:

The ED 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?

No, we do not agree.

From a business perspective, we think credit risk should be assessed separately from revenue recognition. From a logical business viewpoint, no company should enter into a contract or transact with customers if it knows that there is a high risk that the outstanding amounts will be uncollectible even before the contract is signed. In most instances, uncollectible / doubtful debts could be due to various reasons such as unresolved disputes with customers or unforeseen circumstances which gave rise to liquidity issues faced by the customers. As such, the current accounting standard to address allowance of doubtful debts is more practical to provide for amounts which are not recoverable due to disputes or reflect customers' credit risk.

If credit risk is considered in determining revenue recognition, we think there would be inconsistency in revenue recognition especially in a situation when the amount of revenue recognized fluctuates with economic conditions that will in turn affect customers' credit risks from time to time. For example, during the 2009 financial crisis or recession periods, customer's credit risk would potentially be rated higher as compared to other better years, and for long-term contracts, this would mean that we would need to adjust our revenue every year to align that to changes in the economic conditions. The timing of when we assess the credit risk and the experiences with our customers over a period of time may also be factors in determining the probability of the estimates.

As such, there is much subjectivity involved in assessing customers' credit rating and the lack of reliable detailed information upfront may hamper a thorough analysis of credit assessments for a reliable measure of revenue to be recognised.

Question 6:

The ED proposes 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?

No, we do not agree.

We think the concept of notional interests confuses users of the financial statements rather than helping them better understand the financial performance of the Group and distorts the comparability of year-to-year financial results especially if the impact straddles over more than one financial year/reporting period. This will also have the impact of distorting financial ratios and tax computations. In addition, notional interest does not coincide with the timing of actual cash flow from or to the company; hence, this would add to the confusion.

The term "material financing component" is very subjective since the definition of material is, in itself, subjective and would vary with people and situations. It is not clear whether this should be applied to individual projects or to the company as a whole.

For example, say we have Project A with a contract value of \$10 million which may have substantial portion of material financing component (e.g. say 70% or \$7 million), and Project B with a contract value of \$100m with a much lower portion of material financing component (say 10% or \$10m). Based on what we understand of the ED relating to the "material financing component", we will need to record the notional interest for Project A but not for project B, although in terms of absolute figures, the financing portion for Project B is of a higher value than for Project A. In both of these projects, from the company's viewpoint, the material financing component may not be significant or material to the company.

The same arguments apply to the proposal to reflect the consideration of time value of money in the ED on changes or delays in project schedules. The question arises as to whether the Company or its customer should record the notional interest in situations where the Company has procured all the necessary materials but is not able to fulfill its part of the contract due to delays by the customers. It would also be difficult to comprehend the need to account for the time value of money for delays that are a result of natural disasters. We are also not able to ascertain what rate should be used to account for the time value of money under such circumstances.

Again, there is a lot of subjectivity involved in determining the time value of money which may allow room for manipulation. Furthermore, each company may apply different discount rates to account for the time value of money, depending on their financial credibility, access to capital as well as the cost of capital. Take for example, an entity which receives advance payments from its customers and which uses the same amount to make an advance payment to its suppliers. Both these entities (i.e. the customer and the supplier to the contractor) receiving the same amount may record different notional interest amount based on its own discount rates. For long term contracts, an entity may potentially need to apply different discount rates to account for the time value of money for every year that the project is ongoing as their cost of capital may fluctuate every year. Different discount rates will also need to be applied to different customers to factor in the credit risks, which again make it very judgmental and difficult to administer. Although it may not be the intention, this ED may end up affecting how businesses are run and decisions are made.

#### Question 7:

The ED 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?

No, we do not agree.

In order to allocate, the assumption that independent selling prices are determinable must be made. However, as mentioned earlier in our responses to the above questions, companies in the ST Electronics are involved in turnkey projects which are individually unique and it is not possible to determine the market price for each milestone/deliverable.

For example, we may have a contract given by a customer to design, develop and produce a prototype for testing of a complex system. Under the contract we worked very closely with the customer on their system requirements and the performance specifications. The system requirements are further broken down into various subsystems requirements. In each of the subsystems we went through the stages of preliminary design reviews, critical design reviews and final design reviews. The output of each design reviews are design documents with various degree of details as stated in the deliverables / milestones in the contract. The deliverables can be clearly distinguished and are priced separately. Nevertheless, there is no open market prices for the various stages of design as it is custom-made to meet the exact requirements of the customer. Upon the completion and approval of the designs by the customer, we will proceed to build the prototype. It is a distinguishable deliverables with price stated under the contract and again there is no open market price due to it being custom-made. The completed prototype will be subject to various tests as agreed with the customer to demonstrate that it complies with the performance requirements. This is another deliverable / milestone in the contract.

If all tests go well, the customer may award us the contract for the mass production of the system.

Hence, we are of the view that transaction price should be based on price schedules that is agreed with the customers based on the milestones / deliverables.

### Contract costs

Question 8:

The ED 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?

No, we do not think the requirements are operational and sufficient.

We think the requirements need to be clearer and be more comprehensive. The question on definition of direct costs can be very subjective, as this may depend on the size of the company, how the company is structured and organized etc. We could be splitting hairs trying to define what costs relate or not relate to contract activities. We think the strict allocation criteria would mean very tedious and time-consuming efforts to trace the specific costs attributable to the projects for expenses such as Project Administration Support, Rental of Premises, Legal Costs and other relevant costs. This is especially so as there is

the need to distinguish between past and future performance obligations [as envisaged by the ED].

Practical considerations need to be evaluated in deciding whether or not to implement this point, as the costs of implementation may far outweigh the benefits derived.

Question 9:

The ED 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?

No, we do not agree.

(a) Please refer to our responses for Question 8 above.

(b) Accounting for additional liability for onerous performance obligation does not reflect business reality whereby turnkey projects are usually negotiated, reviewed and monitored as one contract in totality even though there may be several deliverables. In a long-term turnkey contract, we may have different design phases, prototype or variation of prototypes, and then production stage. Each stage of the project entails different complexities and requirements, depending on the unique requirements and specifications of the customers, margins are not established for each stage of completion, and we will negotiate with customers by assessing profit margin on an overall contract basis.

(c) Furthermore, accounting for additional liability at each performance obligation does not reflect the true profitability of the total contract and creates fluctuations in the accounting profits for each deliverable / milestone. Hence, we opine it is more reflective to review overall profitability of the project to assess and determine any additional liability arising from onerous performance obligations.

## Disclosure

Question 10:

The objective of the ED's 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?

No, we do not think it will meet the objective.

We think substantial costs will need to be incurred to implement and comply with the proposed disclosure requirements, including necessitating changes to the current financial systems and processes to capture such detailed information for a consolidated group of companies like ours where there would be a large number of ongoing projects at any point in time. The implementation costs will far outweigh the benefits to be reaped

We are not able to appreciate the benefits arising from complying with requirements of 73B, 73C and 75 of the ED and we are of the view that this depletes rather than enhances shareholders' value.

As the information required to be disclosed are based on estimates, it is inherently very subjective and judgmental. Thus, we do not see how such information will be useful for the shareholders.

Question 11:

The ED proposes 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?

No, we do not agree.

Such information is commercially sensitive and especially in a small economy like Singapore, the information could potentially be detrimental in view of the competitive business environment. Moreover, we will need to involve more people (Accountants, Lawyers, Operational staff) and upgrade or customized to a more complex accounting system to track and record the terms, duration and other details of all performance obligations for all contracts to meet such detailed level of disclosures, not to mention the subjectivity and judgment involved in this detailed processes.

Our view is that the requirement to disclose information on total order book should be adequate and only to be imposed on listed entities.

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?

No, we do not agree.

We cannot see any significant value add to the shareholders in providing such information. Additional costs will need to be incurred to implement and comply with the proposed disclosure requirements, including necessitating changes to the current financial systems and processes to capture such detailed information. The implementation costs will outweigh the benefits to be reaped.

The information relating to the amount and timing of cash flows can already be obtained from the disclosures requirements under IFRS 7 and 8.

Effective date and transition

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.

No, we do not agree. However, we noted that the application of this ED is going to be very challenging.

The costs involved in assessing and determining the retrospective impact will definitely outweigh the benefits. There are too many variables which are subjective and judgmental in this exposure draft that would render retrospective application on old but existing uncompleted contracts not relevant and useful, especially now that such contracts are applied and viewed from hindsight perspectives.

We think this should only be applied prospectively (i.e. on new contracts) as retrospective application would also impact retained earnings and would have an impact on dividend payments that have already been made.

Having said this, applying this ED prospectively also entail great challenges as intensive changes to the financial systems cannot cater to accounting for existing uncompleted multi-years contracts based on current IFRS, while at the same time adopting the proposed ED to handle the accounting for new multi-years contracts prospectively from the effective date of this implementation.

### Application guidance

#### 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?

No, reading the application is insufficient as it does not cater specifically to certain industries, such as those involved in turnkey and long term projects, or contracts requiring unique customers' requirements.

We think over simplification of the accounting standards to fit all companies from different industries is not practical and may only portray a lack of understanding and insight into the complexities of the business world.

We are of the view that the ED may open the door to much greater subjectivity and judgment, creating an environment that may be more open to manipulation and financial engineering and it may not help in comparability of financial results between each reporting period.

#### Question 15:

The ED proposes 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?

Revenue recognition for warranty should not be changed. Warranty should not be recognized as a reduction in revenue but should be accounted for as a provision for cost. Our companies offer warranty as part of the contractual requirements to deliver our products or services. We do not offer warranty as a separate contract with profit margins, and hence should not be treated as a separate performance obligation.

We think it is not necessary to distinguish between the two types of warranty contracts.

Question 16:

The ED proposes 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 license is exclusive? Do you agree with the patterns or revenue recognition proposed by the ED? Why or why not?

We think revenue recognition should not be dependent upon whether a license is exclusive or not. Revenue for sale of licences should be recognized upon granting the use of the licence and accounted for over the period of use. We think the key factor for consideration is on the granting of the license and not whether the license is to be used exclusively or non-exclusively.

#### Consequential amendments

Question 17:

The ED proposes 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?

We do not agree with the recognition and measurement principles of the proposed revenue model, and hence we are afraid that we have to disagree here as well.



Revenue should be recognized upon sale of the non-financial assets (i.e. when the risks and rewards pertaining to the non-financial assets have been transferred) to the buyers.

Thank you for providing us the opportunity to express our concerns and opinions.

Yours faithfully,

Laurence Ong

Snr VP - Finance