IASB/FASB meeting 11 May 2011
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Views on Certain Revenue Recognition Issues

IASB/FASB educational session
London, May 11, 2011

TeliaSonera

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TeliaSonera in Brief

- **A global telecom pioneer**
  - TeliaSonera is an international group with a ***global strategy***, but wherever we operate ***we act as a local company***. We offer our services in 20 markets in the Nordic and Baltic countries, the emerging markets of Eurasia, including Russia and Turkey, and in Spain.

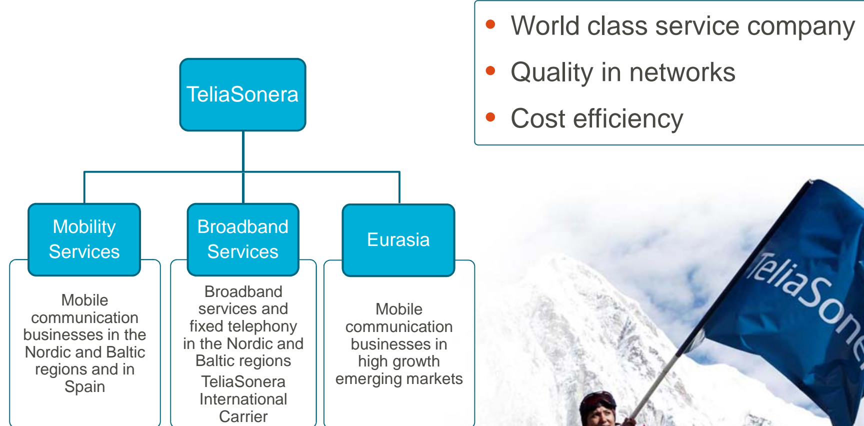
- **Our footprint**
  - **Almost 460 million population**
  - **Total 158.0 million subscriptions**
    - **Consolidated operations 57.4 million**
    - **Associated companies 100.6 million**

- **Europe's 5th largest telecom operator**

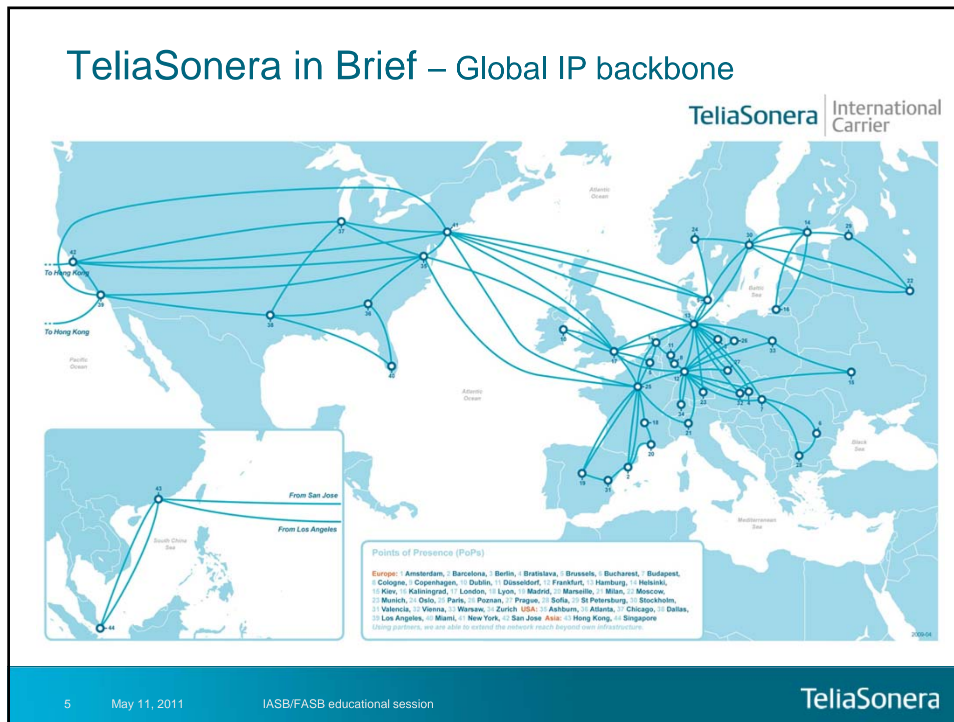
	Market cap, April 2011	EURm
1	Vodafone	104.2
2	Telefónica	80.4
3	Deutsche Telekom	48.6
4	France Telecom	41.3
5	TeliaSonera	24.1
6	Telenor	18.9
7	Telecom Italia	18.9
8	KPN	18.0

Source: Bloomberg, April 2011

TeliaSonera in Brief - Organization and focus areas



- World class service company
- Quality in networks
- Cost efficiency



Why we are here - background

- Why did we react?
  - The Staff's wording in the agenda paper on the method of constraining revenue recognition, i.e. to consider prescribing "contingent cap" instead of "reasonably estimated" just because you are in the telecommunications industry
- What risks do we see?
  - Brings in elements of accounting on a cash basis
    - Why cash basis for equipment sales while accruals basis for services (e.g. airtime)?
    - Proceeds from customers are reported in the statement of cash flows
  - Opens up for a rules-based approach on an industry-by-industry basis
    - But not **one** telecom industry way of running the business
    - There will be changes over time, will the Boards cope with the trend shifts?
    - What will happen with other standards?
- What do we like to see?
  - A revenue recognition standard that is not only principles-based as such but also that the principles laid down are global cross-border as well as cross-industry

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What information do users need to understand the telecom business?

- **Business is local and conditions may vary from market to market**
  - Emerging vs mature markets
  - Many customers – many small contracts
  - Prepaid vs postpaid
  - Payment terms
  - Sales channels – own shops vs dealers vs webshops (agent vs principal)
  - Regulated vs non-regulated areas (SMP, USO, interconnect, etc.)
- **CAPEX …**
- **Technology …**
- **EBITDA…**
- **Revenue growth and drivers …**
- **Etc.**

- **Operational data (KPIs) by market**
  - No. of subscriptions ('000)
  - MoU (minutes of use) (min/month)
  - ARPU (average revenue per user) (CU/month)
  - Blended churn (%)

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How can the problems referred to by the industry be resolved in a manner consistent with the core principles of the model?

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Constraints on revenue recognition – telecom industry specific?

- Is it always true that "reasonably estimated" is not robust enough just because you are a telecom operator? We would answer "No". Let's take a illustrative example from our portfolio of offerings:
- For a simple bundled offering (handset and subscription for a fixed minimum period), our business model consists of the following revenue components, each component disclosed separately on the invoice to the customer:

1. **Traffic fee,** i.e. voice, text, data and other airtime fees based on the customer's actual usage of the service. Traffic fees are charged also after the fixed minimum period as long as the customer does not terminate the contract;
2. **Subscription fee**, i.e. a fixed recurring (normally monthly) fee for granting continuous customer access to the network. Subscription fees are charged also after the fixed minimum period as long as the customer does not terminate the contract; and
3. **Equipment (handset) fee**, which could be either a fixed up-front fee or a fixed recurring (monthly) fee during the contract term or a combination of an up-front and a recurring fee. The recurring part of handset fees are charged only during the fixed minimum period.

Constraints on revenue recognition – telecom industry specific?

- Traffic fees
  - We believe that traffic fees are not possible to reasonably estimate as they are totally dependent on each customer's individual behavior- no obligation
  - ➢ The customer has no obligation to use airtime and we have no performance obligation to provide any traffic services not directly initiated by the customer itself
  - As we interpret the application guidance in paragraph B26 to the ED, this is also the view of the Board
- Subscription fees
  - Under our general contract terms, the customer has to pay all remaining subscription fees even if he or she should terminate the contract before expiry of the fixed minimum period
  - ➢ We have a deliverable (network access) with a consideration that can be reasonably estimated (fixed fee for a fixed period) and is legally enforceable (binding customer contract)
  - In addition, we mitigate credit risks by requiring solvency information based on group-internal information on payment behavior, if necessary supplemented by credit and business information from external sources

Constraints on revenue recognition – telecom industry specific?

- Equipment fees
  - We regard equipment sales as a separate part of the product portfolio of our Mobility Services business area
  - We sell handsets to end-customers, either bundled with a subscription or stand-alone from such other services, as well as in bulk to distributors and retailers
  - Equal to the subscription fee, an end-customer has to pay all remaining recurring handset fees even if he or she should terminate the contract before expiry of the fixed minimum period
  - ➢ We have a deliverable (handset) with a consideration that can be reasonably estimated (fixed fee either up-front or for a fixed period) and is legally enforceable (binding customer contract)
- Consequently, we allocate discounts given in a bundled offering to the deliverables *network access* and *equipment* based on their relative fair values, but *exclude airtime* invoiced based on usage from the allocation
- No contract modifications - no upgrades or downgrades allowed during minimum period

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"TS GAAP" – Accounting for bundled offerings

- The subsidy/discount related to the handset is allocated between handset and subscription based on actual numbers of handsets and subscriptions sold
  - Services invoiced based on usage are not included in the allocation
  - High probability that the customer will pay, i.e. no cash restriction applied (in Annual Reports for 2004 and 2005 treated as a US GAAP difference)
  - Allocated figures (by customer segment) used for external presentation as well as for internal follow-up and KPIs (e.g. ARPU)
- TeliaSonera fair value hierarchy
  1. TeliaSonera price / cash paid by customer when bought without subscription
  2. Cost plus
  3. Manufacturer cost
- Allocation method used (portfolio approach)
  1. Actual information from OSS: No. of sold handsets and subscriptions per type and contract period length, which gives the total consideration but also the consideration per type or group of handsets and subscription
  2. Calculated information: Average subscription consideration per type or group of handsets and contract period length; average handsets consideration per type or group
  3. Stand-alone selling price / fair value: For subscriptions equal to the average consideration calculated under 2.; for handsets based on the TeliaSonera fair value hierarchy (mainly cost plus)
  4. Allocation of discount based on relative fair value
- Disclosed as an example of estimation uncertainties since management judgment is required in determining fair value and if and when revenue should be recognized

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Do we have other “bundled” offerings? Yes – to corporate customers we offer

- Service agreements
  - Long-term functional service agreements for total telecom services, which may include switchboard services, fixed and mobile telephony, data communication and other customized services
  - Predominantly providing a service (solution) to the customer
  - Revenue is recognized over the service period but part of the recurring fixed fee is deferred to meet the costs at the end of the contract period (maintenance and upgrades)
- Leasing agreements
  - Long-term agreements focused on providing equipment; separate service agreement
  - Predominantly providing a financing arrangement to the customer for the acquisition of telecom equipment
  - Sales-type lease (manufacturer or dealer): Sales revenue recognized on delivery of the equipment and interest revenue over the term of the agreement. The customer sees the acquisition of the equipment as a separate transaction.

Comments on other issues raised by telecom respondents

- Marketing gifts vs discounts on goods sold
  - TeliaSonera view
    - Subsidies/discounts are always given “to sign up” customers which is not specific to the telecom industry. Must bee seen together with all items in a contract, except for minor gifts
- Direct vs indirect sales channel transactions
  - TeliaSonera treatment – we believe there is a difference
    - Direct sales channel: we bill the customer for a bundled offer and recognize revenue for equipment and services, net of any discounts
    - Indirect sales channel: we bill the customer for services and might bill the customer for a financing arrangement (equipment), and recognize revenue for services. Most TeliaSonera dealers act as principals. In addition, commission to the dealer might be based on the customers' behavior, not always earned directly

What cost benefit issues should be considered by the Boards?

We believe disclosure requirements* to be the most important issue

Our concerns:

- Every new standard adds further layers of disclosure
  - ➔ increases preparers' disclosure burden
  - ➔ increases clutter in financial statements without adding benefits to information users
- Disclosure requirements are too detailed; excessive disaggregation will
  - ➔ be costly
  - ➔ lead to information overload, no benefits to users
  - ➔ potentially reveal commercially sensitive information
- We see an obvious risk that recently issued/to be issued standards/proposed standards will together increase disclosure complexity to the extent that
  - ➔ preparers will have to seek alternative ways of presenting the information in the financial statements to their investors; large funds as well as small private shareholders, which in turn
  - ➔ may lead to a diminishing rationale and value of IFRSs

* Referring to all IFRSs and including use of statements like "presented on the face of" in other paragraphs of a standard

We believe disclosure requirements* to be the most important issue

Our proposal:

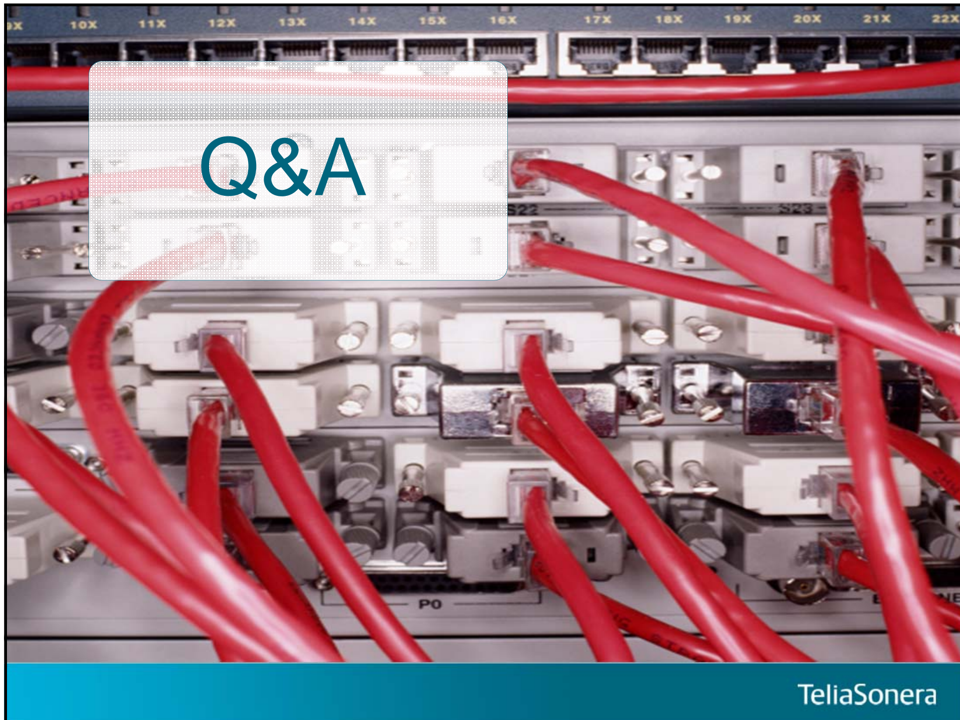
– Make also the disclosure requirements principles-based
  - ➔ Prioritize disclosures on what is important to users; key words might be
    - – Strategy, key risks and uncertainties
    - – Understanding the underlying business
    - – Cyclicality / Seasonality
    - – Segment information
    - – Impact of foreign currency movements
    - – Sustainability of cash flows
    - – Operational gearing (% of costs that are fixed in the short to medium term)
    - – Debt coverage, hedging policies
    - – Etc.
  - ➔ Reduce rules-based disclosure requirements
    - – Mandatory reconciliation tables
    - – Stress materiality aspect

- Referring to all IFRSs and including use of statements like ”presented on the face of” in other paragraphs of a standard

What analysts look for in financial reports

- **Areas of attention are**
  - – Operating cash flow compared to operating profit
  - – Working capital movements (there was a plea not to aggregate this movement but to provide a reasonable amount of detail)
  - – Net debt (companies should show a reconciliation of movements in net debt)
  - – Tax (are tax rates sustainable, divergence between effective vs cash-tax rates, the degree of certainty of tax provisions, clear explanation of unusual tax items and meaningful reconciliations including a reconciliation of the geographic weighted average tax charge and the actual tax charge)
  - – Business combinations (the analyst would like to see the impact of the first full year irrespective of when the purchase actually took place as well as a clear analysis of the impact on the cash flow statement by line item)
- **In the present economic climate with a heightened focus on survival, five areas were highlighted as key to the assessment of the financial strength of the company**
  - – Pensions (what are the future cash flows anticipated to be)
  - – Balance sheet strength (how well is the organization equipped to cope with a double dip recession, if it occurs)
  - – Capital raising ability (is the company near to banking covenant thresholds, does the company have unused lines of credit, how likely is it to be able to negotiate rollovers of existing credit or generate new lines of credit)
  - – Stock options (what has been granted to date and when are they likely to mature)
  - – Leases (these are another form of debt and in the case of operating leases off-balance sheet)

Source: Nick Topazio, technical specialist, CIMA - Chartered Institute of Management Accountants


Q&A
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