



## Impact of the Proposed Revenue Recognition Model on the Telecommunications Industry

IASB / FASB Meeting, 11 May 2011



# Introduction.

- ▶ The purpose of this presentation is to highlight the concerns with the proposed revenue recognition model as it impacts telecommunications financial statements' preparers and users.

## Reduction of decision usefulness of information and high complexity of implementation.

- Divergence from current revenue recognition model, which is well understood by users and provides relevant and reliable information.
- Reduced comparability within the industry - especially with respect to industry key performance indicators.
- Complexity of implementation.
- Significant cost of implementation.



Proposal for changes to the ED to address the concerns of the telecommunications industry.  
Recommendation to re-expose the proposed standard.

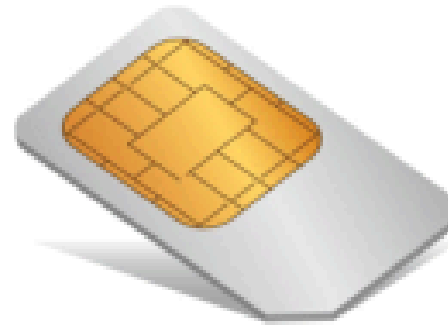


# What is telecommunication business all about?



*“Selling handsets is not a line of business but a means to attract customers to networks.”*

*“Telecommunication business is about providing access to networks.”*



# How does telecommunications business model work?

We are practicing a **mass-market business model** with millions of customers and thousands of **customer-specific agreements** which can change every day.

To provide comparability between telecoms, **industry-specific KPIs** have been successfully established.

Customers usually receive subsidised handsets when entering into minimum-term service agreements.

From customer's perspective the subsidised handset represents an incentive for (re-)entering into the agreement.

In our business model handset subsidies are viewed as costs of acquiring the customer (**SAC\***).

**ARPU\*\*** is applied by users to compare the performance of telecoms regarding the provision of telecommunications services.

\*SAC: Subscriber Acquisition Cost

\*\*ARPU: Average (Monthly) Revenue per User

## Customer agreement (24 months)



Contractual price for the handset e.g. 50 €

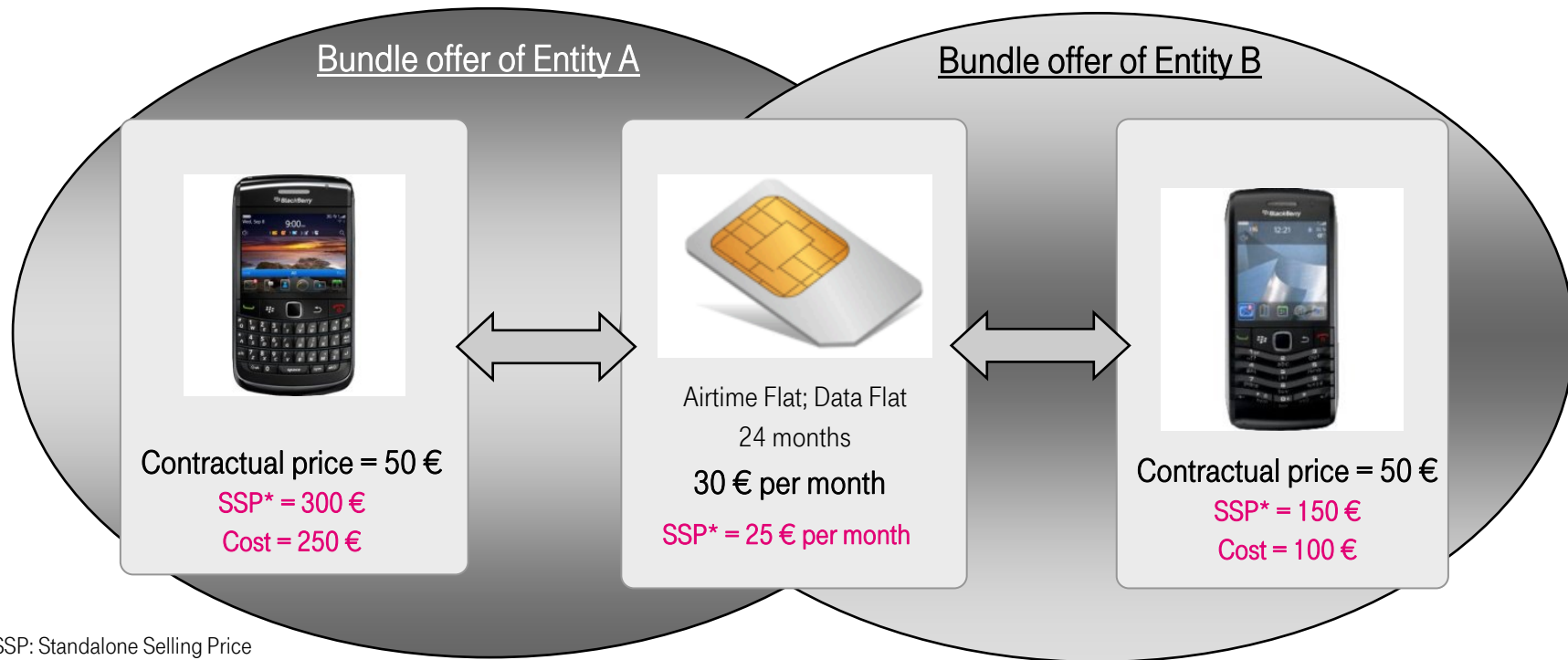
bundled with



Contractual price for the service e.g. 30 € per month



Similar offerings do not automatically mean similar economic positions.



Which information is useful for users?

From an economic perspective, Entity A needs to incur higher costs of acquiring the customer (by offering a more valuable handset for the same price) to receive the same cash flows / ARPU as Entity B.



## Current accounting model including contingent revenue cap.

| Current accounting model: <u>direct</u> distribution channel. |                |                |                |  |
|---------------------------------------------------------------|----------------|----------------|----------------|--|
| Reported figures of Entity A                                  |                |                |                |  |
|                                                               | t <sub>0</sub> | t <sub>1</sub> | t <sub>2</sub> |  |
| Handset revenues                                              | 50             |                |                |  |
| Service revenues                                              |                | 360            | 360            |  |
| Cost of handset                                               | 250            |                |                |  |
| Income*                                                       | -200           | 360            | 360            |  |
| Cash flow                                                     | -200           | 360            | 360            |  |
| SAC                                                           | -200           |                |                |  |
| Information usefulness                                        |                |                |                |  |
| Reported figures of Entity B                                  |                |                |                |  |
|                                                               | t <sub>0</sub> | t <sub>1</sub> | t <sub>2</sub> |  |
| Handset revenues                                              | 50             |                |                |  |
| Service revenues                                              |                | 360            | 360            |  |
| Cost of handset                                               | 100            |                |                |  |
| Income*                                                       | -50            | 360            | 360            |  |
| Cash flow                                                     | -50            | 360            | 360            |  |
| SAC                                                           | -50            |                |                |  |

Current accounting model provides information using the cost perspective.  
 Direct and comprehensive connection between income, cash flows, ARPU and costs of acquiring the customer (SAC) provides useful information to users.

\*Service costs are not considered in this example.



## Proposed accounting model.

| Proposed accounting model: <u>direct</u> distribution channel. |       |       |       |  |
|----------------------------------------------------------------|-------|-------|-------|--|
| Reported figures of Entity A                                   |       |       |       |  |
|                                                                | $t_0$ | $t_1$ | $t_2$ |  |
| Handset revenues                                               | 256   |       |       |  |
| Service revenues                                               |       | 257   | 257   |  |
| Cost of handset                                                | 250   |       |       |  |
| Income*                                                        | 6     | 257   | 257   |  |
| Cash flow                                                      | -200  | 360   | 360   |  |

Information usefulness

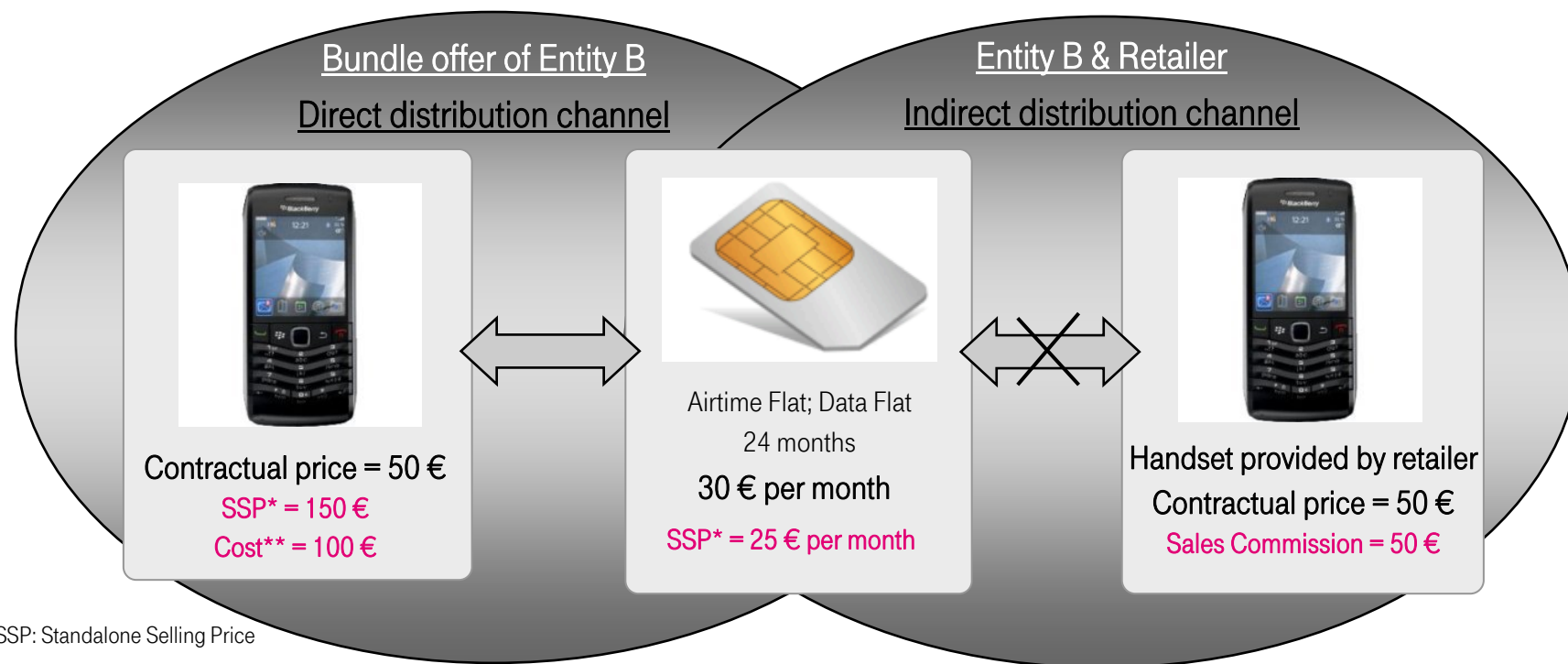
| Reported figures of Entity B |       |       |       |  |
|------------------------------|-------|-------|-------|--|
|                              | $t_0$ | $t_1$ | $t_2$ |  |
| Handset revenues             | 154   |       |       |  |
| Service revenues             |       | 308   | 308   |  |
| Cost of handset              | 100   |       |       |  |
| Income*                      | 54    | 308   | 308   |  |
| Cash flow                    | -50   | 360   | 360   |  |

Proposed accounting model provides information using the revenue perspective.  
 Revenue in  $t_0$  indicates better performance of Entity A: No predictive value for future periods.  
 Front-loading of revenues and income for entities incurring higher costs of acquiring customers to achieve the same cash flow stream.

\*Service costs are not considered in this example.



## Identical service contracts sold using different distribution channels.



\*SSP: Standalone Selling Price

\*\*Cost of handset include 10 € internal sales commission.

Which information is useful for users?

The offerings of Entity B and the Retailer are identical from customer's perspective.

Entity B has sold two identical service contracts.



## Impact on service revenues depending on sales channel.

### Current accounting model

#### Entity B: direct distribution channel

|                  | t <sub>0</sub> | t <sub>1</sub> | t <sub>2</sub> |
|------------------|----------------|----------------|----------------|
| Handset revenues | 50             |                |                |
| Service revenues |                | 360            | 360            |
| Cost of handset  | 90             |                |                |
| Sales commission | 10             |                |                |
| Income           | -50            | 360            | 360            |

Service revenues are equal for identical contracts sold using different channels.

#### Entity B: indirect distribution channel

|                  | t <sub>0</sub> | t <sub>1</sub> | t <sub>2</sub> |
|------------------|----------------|----------------|----------------|
| Handset revenues | 0              |                |                |
| Service revenues |                | 360            | 360            |
| Cost of handset  | 0              |                |                |
| Sales commission | 50             |                |                |
| Income           | -50            | 360            | 360            |

### Proposed accounting model

#### Entity B: direct distribution channel

|                  | t <sub>0</sub> | t <sub>1</sub> | t <sub>2</sub> |
|------------------|----------------|----------------|----------------|
| Handset revenues | 154            |                |                |
| Service revenues |                | 308            | 308            |
| Cost of handset  | 90             |                |                |
| Sales commission | 10             |                |                |
| Income           | 54             | 308            | 308            |

Service revenues are higher for contracts sold using the indirect channel.

#### Entity B: indirect distribution channel

|                  | t <sub>0</sub> | t <sub>1</sub> | t <sub>2</sub> |
|------------------|----------------|----------------|----------------|
| Handset revenues | 0              |                |                |
| Service revenues |                | 360            | 360            |
| Cost of handset  | 0              |                |                |
| Sales commission | 0              | 25             | 25             |
| Income           | 0              | 335            | 335            |



## Proposal to introduce the contingent revenue cap.

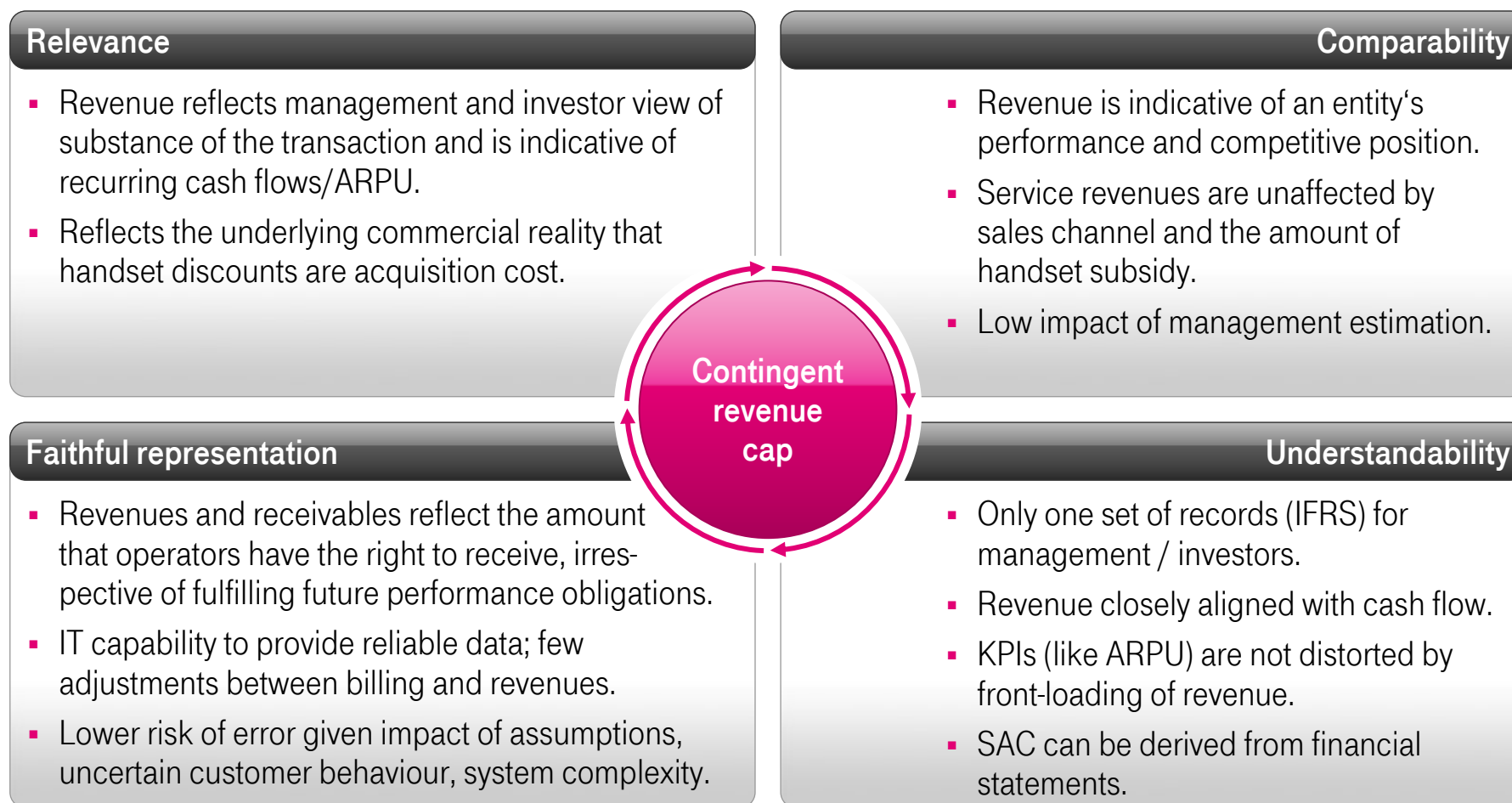


We propose to introduce the contingent revenue cap to avoid the negative implications of the proposed accounting model.

The allocation of the transaction price to a satisfied performance obligation should not exceed the amount receivable without satisfying future separate performance obligations.



## Contingent revenue cap leads to provision of useful information.



## Possible limitations of applying the contingent revenue cap.

Application of contingent revenue cap could be limited to certain conditions:

### Option 1

- The legal or practical ability of management to enforce performance (payment) by the customer for future deliverables is uncertain.

### Option 2

- Applying the cap better achieves the qualitative objectives of the IFRS framework.

### Option 3

- Applying the standalone price allocation method cannot be achieved without unreasonable effort.

### Option 4

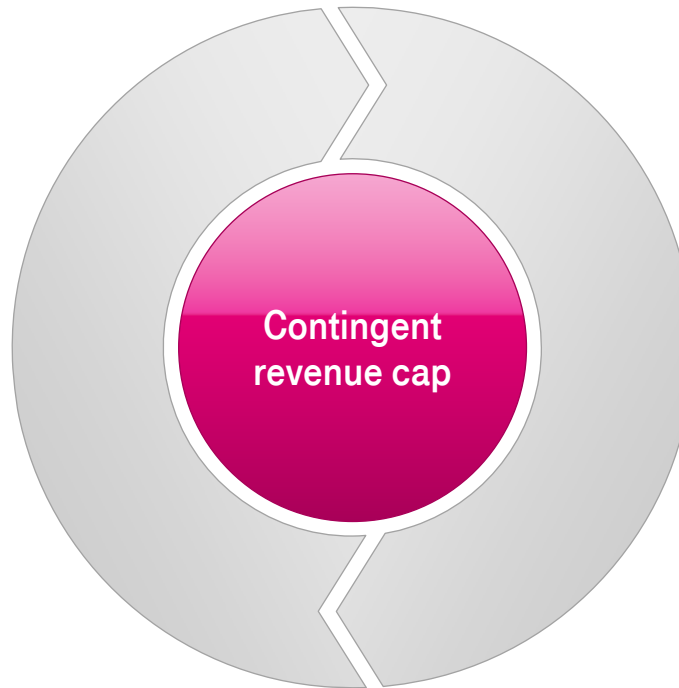
- Additional disclosures are provided.



# Is the contingent revenue cap consistent with core principles in new accounting models?

## New revenue model

- Contract asset definition:  
*„An entity's **right to consideration** from a customer in exchange for goods and services transferred to the customer.“*
- A right to consideration is a legal concept and, if applied to a single performance obligation, should not be contingent on the fulfilment of other future performance obligations.

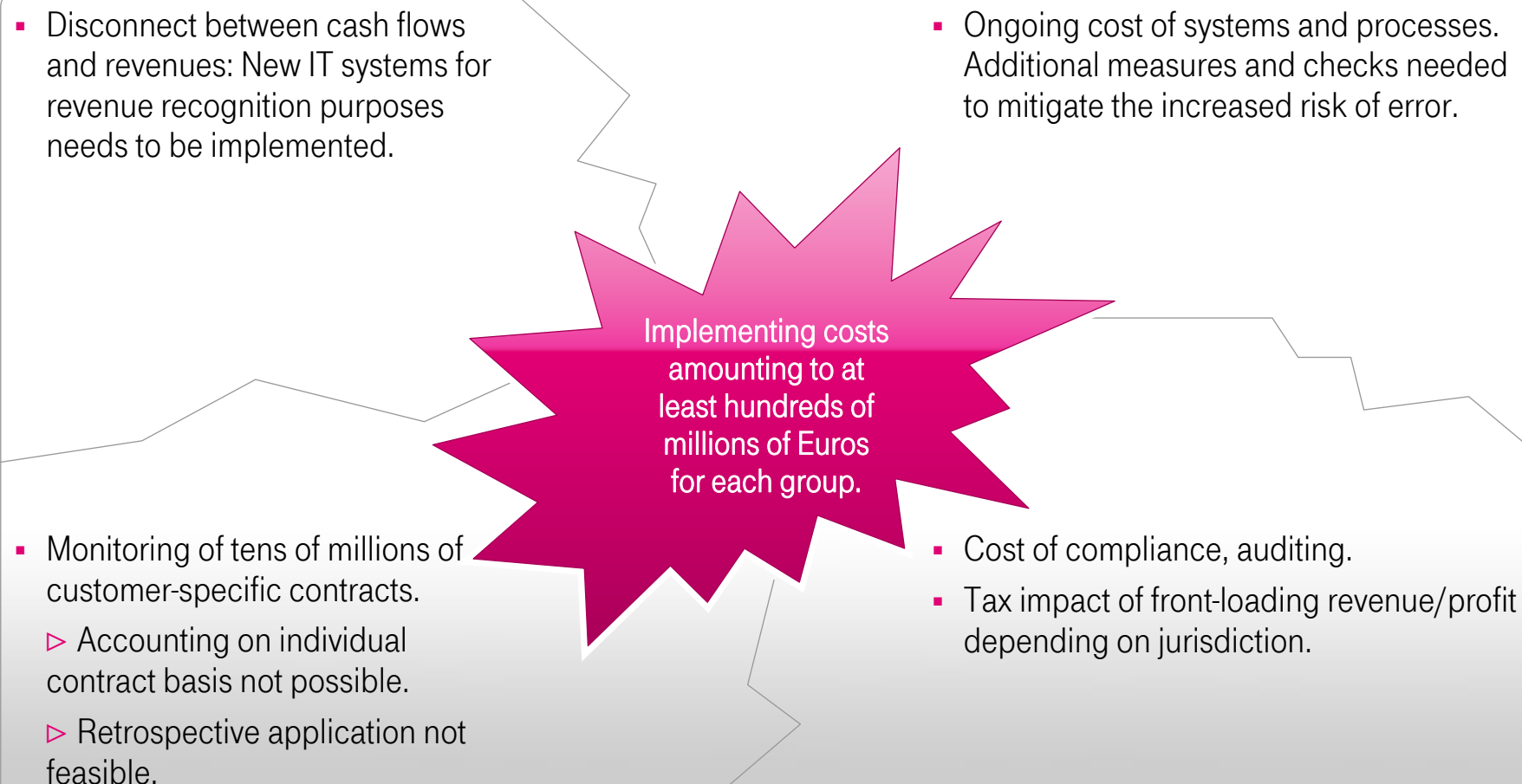


## New lease model

- No inconsistency with up-front revenue recognition under derecognition approach for lessor accounting.
- „Right to receive lease payments“ asset results from a single performance obligation satisfied over time and is therefore not contingent on additional future performance obligations.



## Cost of implementing the proposed model are not justified by increase in information usefulness.



Thank you for your attention!

.....T.....Life is for sharing.