

Point of view

Telecommunications Sector – New Revenue Standard may require system changes and could have a major impact on profile of revenue and profit recognition

In a nutshell

- The **profile of revenue and profit recognition** will change for some entities as the new Standard is more detailed and more prescriptive than the existing guidance and introduces new complexities. In particular, telecommunications companies will need to consider:
 - whether they are able to apply the **portfolio approach** to groups of contracts;
 - the impact of the new guidance on **allocating revenue** to all goods and services in a contract;
 - how to account for **contract modifications**;
 - whether particular **costs relating to obtaining a contract** must be capitalised; and
 - whether revenue must be adjusted for the effects of the **time value of money**.
- The new Standard requires significantly more **disclosures** relating to revenue and entities will need to ensure that **appropriate processes** are in place to gather the information.

What's happened?

The International Accounting Standards Board (IASB) has published a new Standard, IFRS 15 *Revenue from Contracts with Customers* ('the new Standard'). This is subject to EU endorsement. The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, which is found currently across several Standards and Interpretations within IFRSs. The core principle is that an entity recognises revenue to reflect the transfer of goods or services, measured as the amount to which the entity expects to be entitled in exchange for those goods or services.

The new Standard is effective for reporting periods beginning on or after 1 January 2017, with earlier application permitted. This is subject to EU endorsement. Entities can choose to apply the Standard retrospectively or use a modified approach in the year of application. It is the result of a convergence project with the US Financial Accounting Standards Board (FASB) that began in 2002. Almost fully converged, the most significant differences between IFRSs and US GAAP relate to interim disclosures and timing of adoption.

Implications for the telecommunications industry

Below, we highlight certain key impacts resulting from the new Standard that will be of particular interest to those in the telecommunications industry and then consider parts of the new Standard that may contribute to those impacts. Of course many more complexities exist and, as described below, Deloitte has produced further guidance which explores these in greater detail.

How might this affect you?

The timing of revenue and profit recognition may be significantly affected by the new Standard

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas relevant to the telecommunications industry. Applying these new rules may result in significant changes to the profile of revenue and, in some cases, cost recognition.

This is not merely a financial reporting issue. As well as **preparing the market and educating analysts** on the impact of the new Standard, entities will need to consider wider implications. Amongst others, these might include:

- changes to **key performance indicators** and other **key metrics** (e.g., ARPU);
- changes to the **profile of tax cash payments**;
- availability of **profits for distribution**;
- for **compensation and bonus plans**, impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **loan covenants**.

Current accounting systems and processes may require significant changes to cope with the new Standard

Within the telecommunications industry, it is common for revenue recognition to be driven off an entity's billing systems. As explained below, IFRS 15 introduces new requirements to move to a more conceptual approach. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in an industry typified by vast numbers of contracts and a multitude of product offerings may be so great as to compel entities to develop new systems solutions. The availability of a 'portfolio approach' in some circumstances may reduce this additional complexity, but it will not be eliminated.

In determining the extent to which systems modifications will be required, entities will wish to consider the need for sufficient flexibility to cope with future changes in pricing and in the variety of product offerings made to customers. The 1 January 2017 effective date may set a challenging timeframe for developing new systems.

What are the most significant changes?

How should revenue be allocated to different goods and services identified (e.g. mobile phone handsets)?

Previously, given the lack of specific guidance in IFRSs, there was greater room for judgement when identifying the goods and services within a contract and then allocating the revenue to those goods and services. Entities may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15. The new Standard requires the revenue from a contract to be allocated to each distinct good or service provided on a relative standalone selling price basis, though a 'residual' approach is permitted in limited circumstances.

Within the telecommunications industry it is common for handsets to be subsidised by the providers of airtime and to be viewed as a cost of doing business. Previously, any revenue allocated to the handset has often been limited to the amount, if any, explicitly paid by the customer towards the handset. Applying the new approach to an airtime contract with a subsidised handset will typically mean the recognition of more revenue at the start of the contract (when the handset is delivered) and less as the contract continues (and airtime services are provided) whether or not this is reflected in the pattern of billings.

This may significantly change the profile of revenue recognition for some entities and, due to the sheer volume of customers with different tariffs and service plans, entities may have to overcome significant practical challenges to ensure systems are in place to deal with the new requirements.

What is the impact if a contract is modified?

It is very common in the telecommunications industry to allow customers to modify their contracts to, for example, increase or decrease minutes or add or remove services. In the past, IFRSs included only limited guidance on such modifications. IFRS 15 includes detailed guidance on whether a contract modification should be accounted for prospectively (as an adjustment to future revenues) or retrospectively (via an adjustment when the modification occurs). This may result in a change of practice for some entities and, again, may pose a logistical challenge for the industry as a result of the vast number of different permutations of goods and services within contracts. It will be important to assess whether it is practicable to deal with such adjustments by working with current accounting systems, or whether changes may be required to those systems.

Should contract costs be capitalised (e.g. sales commissions and success fees)?

In addition to more prescriptive guidance on revenue recognition, the new Standard introduces specific criteria for determining whether to capitalise certain costs, distinguishing between those costs associated with obtaining a contract (e.g. sales commissions) and those costs associated with fulfilling a contract. In the telecommunications industry, this becomes an issue because significant costs are incurred that are directly attributable to obtaining contracts with customers, for example through 'success fees' (i.e. commissions that are only payable if a contract is obtained). At present, different entities might treat these costs differently, although most have previously been expensing them. The new Standard will require entities to capitalise success fees, which will have an impact on operating profits. In addition, the new Standard requires capitalised contract costs to be amortised on a systematic basis that is consistent with the pattern of transfer of the goods or services. Entities will need to exercise judgement to determine the appropriate basis and time period for this amortisation.

Should revenue be adjusted for the effects of the time value of money?

IFRS 15 introduces new and more extensive guidance on financing arrangements and the impact of the time value of money. Under the new Standard, the financing component, if it is significant, is accounted for separately from revenue. This applies to payments in advance as well as in arrears, but subject to an exemption where the period between payment and transfer of goods or services will be less than one year. This new guidance may change current accounting practices in some cases. For example, telecommunications companies that offer subsidised hardware (e.g. handsets, modems or set-top boxes) to customers whose contracts are paid over more than 12 months will have to consider the time value of money.

What else might change?

In addition to the key changes discussed above, the new Standard introduces detailed guidance in many areas regarding the reporting of revenue and entities will need to ensure that they have considered all of these when assessing if their accounting policy for revenue continues to be appropriate.

More detailed information on the impact of IFRS 15 can be found in Deloitte's Need to know publication available from www.ukaccountingplus.com. Further industry publications are also available here.

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