Andy Halford BAFCA

Chief Financial Officer



Sir David Tweedie Chairman International Accounting Standards Board C/o: commentletters@IASB.org

18 June 2009

Discussion Paper "Preliminary Views on Revenue Recognition in Contracts with Customers"

Dear Sir David

We are responding to your request for feedback to the Discussion Paper 'Preliminary Views on Revenue Recognition in Contracts with Customers' the 'Discussion Paper'). Vodafone Group Plc is the world's largest mobile communications group by revenue, with revenue of over £41 billion and operations in over 30 countries across Europe, Africa, Asia-Pacific and the United States.

As part of our review of the Discussion Paper we have had several meetings with other European telecommunications companies. These meetings have proved very useful to each company involved, and aided the understanding and assessment of the Discussion Paper. However, this letter represents the views solely of Vodafone Group Plc.

We and other industry representatives have also had two meetings with the IASB staff and we have a further meeting scheduled. We believe that these meetings have proved to be mutually helpful and would like to thank the IASB staff for the time that they have invested.

The telecommunication services industry typically operates using a model that has the following features:

- a large number of customers, commonly many millions generating a very large number of low value transactions; the companies in which Vodafone has an equity interest have an aggregate of almost one billion customers;
- each customer selects from a wide range of tariffs and service options;
- as an incentive to enter a service contract, customers also select from a wide selection of, often, heavily discounted handsets and other equipment options; and
- a rapidly evolving package of additional goods and services that are available for the customer to purchase in additional to their existing service package together with the potential under certain circumstances to switch between service packages during the contract term.

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The wide range of customer-dependent variables impacting the charges paid by the customer would result in hundreds of thousands, if not millions, of possible permutations of performance obligations determining how consideration would have to be allocated under the Discussion Paper principles.

The current accounting model generally used by the industry is the relative fair value model, with a 'contingent revenue cap' applied to up-front equipment incentives provided to the customer such that equipment revenue is typically the net price paid up-front by the customer.

We believe that the revenue accounting model described above is consistently used by all the major operators within Europe and the United States. Advantages of the model are that comparability between telecommunications companies is good, it avoids the accrual of material amounts of revenue which will only be received if future services are provided, is consistent with the underlying nature of the business as viewed by of management and other users of the accounts, results in recognised revenue that closely links to the cash flows generated from customers, is less sensitive to management estimation and has strong predictive value.

We believe that any new accounting standards should:

- provide more useful, reliable and comparable information to management, shareholders, analysts and other users of the accounts than provided by existing standards; and
- provide valuable benefits that match, or exceed, the costs of compliance.

For the telecommunications industry, we currently believe that the Discussion Paper principles would be likely to result in:

- a major mismatch between the timing of recognition of revenue and billing for services due to an up-front accrual of material amounts of revenue for incentives provided up-front to customers;
- a revenue accounting process that, when applied across hundreds of millions of customers and many thousands of tariff and handset combinations, would become impractical, if not impossible, to implement;
- inconsistent revenue recognition for customer agreements that are the same, depending on whether owned or indirect sales channels are used;
- a direct reduction to shareholder value due to the highly significant IT infrastructure costs and ongoing process costs that would be required in order to comply with the principles of the Discussion Paper; and
- the potential for significant revenue to be recognised as the result of management estimates, depending on the boards' conclusions regarding contingent revenue.

The key revisions that we believe should be made to the Discussion Paper to make it relevant and workable for the telecommunications industry are as follows:

• The telecommunications industry currently applies the 'contingent revenue cap' principle, as per paragraph 14 of EITF 00-21 and EITF 08-1, which we believe to be compatible with IAS 18. Revenue allocated to discounted handsets and other equipment provided to customers as an incentive to enter service contracts



is restricted to the discounted up-front cash price paid by the customer. The Discussion Paper requires arrangement consideration to be allocated between performance obligations on the basis of relative standalone selling prices. We believe that for the telecommunications industry the contingent revenue cap remains appropriate for the following reasons:

- Recognised equipment revenue equates to the amounts receivable from customers without the delivery of other future services.
- Although services contracts may be legally enforceable against customers, the typically low values means that contracts are often not practically enforceable in the event that the customer fails to make their contract payments.
- Contingent revenue (in excess of contract minimums)
 - Although not directly covered in the Discussion Paper, we believe that revenue should not be recognised on the basis of estimated future customer purchasing decisions and that such practice would assume the existence of an asset which the entity does not control and would therefore be inconsistent with the IFRS framework.
 - We believe that the accounting considerations relating to contingent revenue are potentially so significant to users and preparers of accounts that a new Discussion Paper should be issued when consensus has been reached by the board on these proposals.
- Performance obligations to which revenue is allocated should:
 - not be separately recognised for deliverables that are incidental to the primary goods or services that the customer is seeking to acquire;
 - be determined with reference to whether the customer would purchase the deliverable on a standalone basis in normal circumstances; and
 - relate to deliverables that represent 'an output of the entity's ordinary activities'. Further guidance should be provided for identifying the ordinary activities of an entity.

Definition of a contract:

- The definition of a contract needs to be expanded. In particular, it should be confirmed that a contract requires an offer and acceptance. Offers to a customer, without acceptance, should not be a revenue-generating event.
- 'Enforceable' needs to be defined. Contracts may be legally enforceable, but not practically enforceable. Where contracts are not practically enforceable, guidance should be added.

Definition of a customer:

- The Discussion Paper doesn't to reflect that entities may supply goods or services to end-users via distributors, resellers, agents or third party providers of the relevant goods or services. The exposure draft and final standard should provide guidance on determining customer and agency relationships for arrangements involving multiple parties, combined with associated guidance on determining the 'gross' or 'net' treatment of payments or other consideration provided to customers or others in the supply chain.



Overall, we believe that the impact of the Discussion Paper will be extremely significant to the telecommunications industry and that significant revisions are required to make a standard appropriate and workable for the industry. Also, there are significant open areas that are not covered within the Discussion Paper. We therefore believe that it would be appropriate for the board to issue a new Discussion Paper, taking into account the comment letters received to ensure that preparers and users of the accounts alike are given an appropriate opportunity to comment.

Please refer to our full responses to the each of the questions in the Discussion Paper on the following pages.

Yours faithfully

Andy Halford

Chief Financial Officer

Copies to: Henry Rees, Senior Project Manager, International Accounting Standards Board.

April Pitman, Project Manager, International Accounting Standards Board.

Members of the European Telecommunications Accounting Forum:

- Belgacom
- Bell Canada
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- R1
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Question 1

Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

Response

Any new accounting standard should:

- provide more useful, reliable and comparable information to management, shareholders, analysts and other users of the accounts than provided by existing standard; and
- provide valuable benefits that match, or exceed, the costs of compliance.

In our view, the IASB's objective to create a single revenue recognition principle is laudable and basing the principle on a contract asset or liability is theoretically sound. However, we do not believe that it is necessarily realistic to expect that a single revenue recognition standard can achieve these goals for all industries.

We believe that the application of current revenue recognition standards to the telecommunications industry has resulted in revenue policies that are applied with a high level of consistency across all major European and US telecommunications companies. We also believe that current standards result in reported revenue figures that are useful to management, shareholders, analysts and other users of the accounts and are reliable because a comparably low level of management estimation is required to derive reported revenue.

Our interpretation of the principles in the Discussion Paper suggests that none of the desired criteria for a new accounting standard would be met for the telecommunications industry. In particular, we have concerns that the usefulness, reliability and comparability of information will all significantly reduce as a result of:

- the potential for significant revenue to be recognised as the result of management estimates;
- a major mismatch between the timing of recognition of revenue and billing for services;
- inconsistent revenue recognition for customer agreements that are the same, depending on the sales channel used; and
- the inherent complexity of the proposed model, which when applied across hundreds of millions of customers and many thousands of tariff and handset combinations makes the proposed model impractical if not impossible to apply.

Furthermore, we believe that the proposals will directly reduce shareholder value due to the IT infrastructure costs and ongoing process costs that would be required in order to comply with the principles of the Discussion Paper. Typically, Vodafone's in-country operations have several independent billing platforms. These platforms do not capture the information that would be required by management in order to comply with the Discussion Paper principles; we believe that data warehouses would need to be built for each location in order to capture such information. Experience of constructing data warehouses in other areas of the business suggests that it is likely to



take a number of years to develop and implement these solutions and that development and implementation costs may reach tens of millions of pounds for each of the many countries in which we operate.

In our responses below, we have provided some detailed thoughts regarding revisions that could be made to the accounting proposed in the Discussion Paper which would improve its relevance to the telecommunications industry. Unless these revisions could be adopted, we do not believe that the single revenue model proposed within the Discussion Paper would be appropriate for our industry.

Question 2:

Are there any types of contracts for which the boards' proposed principle would not provide decision-useful information? Please provide examples and explain why. What alternative principle do you think is more useful in those examples?

Response

Customer agreements entered into by telecommunications companies frequently have the following features:

- a handset, or other equipment, is offered to a customer at a discounted price as an incentive to enter into a contract for the provision of communications services;
- customers have the option to subscribe to additional 'bolt-on' services, such as data services during the contract term. Such offers to the customer may change and customers may be able to cancel such additional services during the contract term;
- customers have the option to purchase, through usage, additional 'out of bundle' services, such as additional airtime minutes, once their monthly bundle allowances are used up;
- a large number of tariffs and offers are marketed to potential customers at any point in time and change very
 frequently. Each tariff is typically available with a wide selection of discounted handsets or other equipment
 or differing values; and
- customers frequently upgrade, renew or amend their contracts at various points including during, at the end of or after the end of the initial contract term.

Telecommunications companies commonly have many millions of customers. The companies in which Vodafone has an equity interest have an aggregate of almost one billion customers. Each customer will select a service contract from a large range of tariff options and equipment incentives available in each country. The wide range of customer-dependent variables impacting the charges paid by the customer would result in hundreds of thousands if not millions of possible permutations of performance obligations determining how consideration would have to be allocated under the principles of the Discussion Paper.

Currently the telecommunications industry applies a revenue recognition model whereby the revenue allocated to up-front discounted equipment is usually restricted to the subsidised up-front price paid by the customer. Monthly



service revenue broadly equates to the amount billed monthly to the customer, subject to certain adjustments, for example to defer revenue for unused service entitlements. The benefits of this treatment are:

- handset revenue is restricted to the amount that the company is actually entitled to receive up-front for the equipment. This avoids the early recognition of revenue which the company is not entitled to receive unless communications services are provided;
- up-front equipment discounts are viewed by management as 'acquisition costs'. The telecommunications industry, shareholders and analysts view the provision of handsets and similar equipment to customers solely as an incentive for customers to enter communication services agreements. The ability to clearly identify acquisition costs from the financial statements and to compare these with ongoing communication services revenue is key for these users of the financial statements:
- the recognition of revenue accords closely both with cash flow and with the amounts that the company has the legal right to bill and to recover from the customer. This eliminates much of the risk of determining revenue given the large number of customers and variety of agreements that are offered;
- additional billings to the customer, for example those relating to usage in excess of contractual allowances, are recognised only when the customer decides to purchase and consumes such services;
- it significantly reduces the burden of compliance with IAS 18.

The principles proposed with the Discussion Paper would eliminate the benefits of the current revenue accounting treatment and result in:

- a significant allocation of revenue to handset or other subsidised equipment that would obscure the true nature of the transactions entered into from users of the financial statements. Revenue relating to ongoing service revenue (as billed), the key activity of the industry, would no longer be determinable;
- any measurement of the cost of acquiring and retaining customers, a key indicator for internal and external users of the financial statements, being less reliable; and
- revenue no longer correlating to billings and cash flow, which will decrease the usefulness of the financial statements in measuring performance or estimating future revenue and cash flows; it will also increase the inherent risk of error.

In addition, although not covered directly in the Discussion Paper, the boards' proposals to estimate contingent revenue for the purposes of allocating revenue between performance obligations at the outset of the contract would result in the recognition of revenue based on subjective management estimations and on the presumption of the receipt of income from customers which is in no way enforceable until such a time as a customer decides to purchase additional services.

Furthermore, as discussed in our response to question 1, the costs of compliance for us, and for the industry, would be very high.



In our responses to the subsequent questions, we provide our thoughts as to how some of the principles suggested in the Discussion Paper might be adapted in order to provide decision-useful information for the telecommunications industry. These include:

- the definition of a contract should be refined to confirm that a contract requires both an offer and acceptance;
- performance obligations should be identified being as the goods or services that a customer is seeking to acquire and should only include deliverables that are provided in an entity's ordinary course of business. Deliverables that are incidental or lack standalone value to the customer should be excluded;
- contingent revenue that is dependent on customers' future purchasing decisions should not be allowed to increase the allocation of revenue to performance obligations that are delivered before such purchase decision has been made by the customer. Performance obligations should be recorded only for significant and incremental discounts; and
- the focus on control and the physical custody of assets in determining revenue recognition may result in the increased opportunity to accelerate revenue recognition in circumstances when nothing of value has been delivered to the customer. We also believe that the concept of the risks and rewards of ownership allows the substance of a transaction to be reliably reflected, without the onerous requirement having to value every part of an arrangement as a separate performance obligation.

Question 3:

Do you agree with the boards' definition of a contract? Why or why not? Please provide examples of jurisdictions or circumstances in which it would be difficult to apply that definition.

Response

A contract is defined as:

"an agreement between two or more parties that creates enforceable obligations".

We believe that this definition requires further clarification. Although not specifically requested within the Discussion Paper, we also have comments on the definition of 'customer' within chapter 2. We believe that the points to be addressed are:

- (i) Offer and acceptance: Legally, a contract must comprise offer and acceptance. An offer to a third party or a customer does not constitute an agreement or a contract.
- (ii) Definition of enforceable: The definition of "enforceable" needs to be addressed. A contract may be legally enforceable, but this does not mean that it is enforceable in practice.
- (iii) Definition of a customer: The definition of customer should reflect that a wide range of routes to market may exist using, for example, agency models. Guidance should be provided on identifying and accounting for such arrangements.



(i) Offer and acceptance

In the telecommunications industry, there are broadly two types of customer:

- users with ongoing service contracts stipulating minimum fees to be paid by the end user over a minimum contractual term and providing the customer with pre-designated levels of usage entitlements, for example a certain number of voice minutes per month; and
- users with no ongoing purchase commitments.

Both types of customer may have offers from the operator to purchase additional future services at certain fixed prices that the customer may agree to purchase the services through usage or subscription. Whether revenue arises from such offers is contingent on future customer decisions ('contingent revenue').

Although not covered in the Discussion Paper, we are aware of the current debate on accounting for contingent revenue. We believe that anticipating contingent revenue when allocating revenue between performance obligations at contract inception could materially affect the revenue allocation to other goods and services provided to the customer under the agreed contract before the customer has agreed to any additional purchases.

We believe that contracts require both offer and acceptance by the parties to the contract and that the Discussion Paper should be clarified to confirm that an offer to provide goods or services, whether to existing or to prospective customers, does not constitute a contract. We also believe that revenue should not be recognised on the basis of estimated future contingent income from a customer. Such practice would assume the existence of an asset which the entity does not control and would therefore be inconsistent with the IFRS framework. Despite the current proposals for a 'reliability' hurdle, we consider that such a practice would reduce the reliability and comparability of financial statements and would significantly reduce the usefulness of information for users of the accounts. We do not believe that requiring entities to increase their reported revenue as a result of simply making offers to customers provides useful or reliable information for users of the accounts.

Offers made to the customer at contract inception should be accounted for as a performance obligation only to the extent that such offers may result in an onerous contract or in instances where goods or services are offered at a significant and incremental discount as compared to the existing customer contracts.

We believe that the accounting considerations relating to contingent revenue are potentially so significant to users and preparers of accounts that a new Discussion Paper should be issued when consensus has been reached by the board on these proposals.

(ii) Definition of enforceable

Within the telecommunications industry it is common to have very large numbers of customers with contracts of low monetary value. When a contract exists, constituting offer and acceptance, then typically a legally enforceable right exists to obtain payments from the customer. However, whilst contracts are legally enforceable, they are frequently not practically enforceable because the costs of legally enforcing a contract for a customer in default outweigh the



financial return of doing so. We therefore believe that a definition of enforceable should be included and that the implication of contracts that are not practically enforceable should be considered.

(iii) Definition of a customer

The definition of 'customer' in chapter 2 states that:

'A customer is a party that has contract with an entity to obtain an asset (such as a good or service) that represents an output of the entity's ordinary activities'.

In practice, entities may supply goods or services to end-users via distributors, resellers, agents or third party providers of the relevant goods or services. The exposure draft and final standard should provide guidance on determining customer and agency relationships for arrangements involving multiple parties, combined with associated guidance on determining the 'gross' or 'net' treatment of payments or other consideration provided to customers or others in the supply chain.

Question 4

Do you think the boards' proposed definition of a performance obligation would help entities to identify consistently the deliverables in (or components of) a contract? Why or why not? If not, please provide examples of circumstances in which applying the proposed definition would inappropriately identify or omit deliverables in (or components of) the contract.

Response

The definition of a 'performance obligation in chapter 3 states that:

'An entity's performance obligation is a promise in a contract with a customer to transfer an asset (such as a good or service) to that customer'.

The definition of a performance obligation is theoretically sound. However, in order for the resulting revenue accounting to be reliable, consistent with the fundamental economics of an arrangement, comparable and practical (or possible) to implement, we believe that performance obligations to which revenue is allocated should:

- (i) exclude deliverables that are incidental to the primary goods or services that the customer is seeking to acquire;
- (ii) be determined with reference to whether the customer would purchase the deliverable on a standalone basis in normal circumstances. and
- (iii) relate to deliverables that represent 'an output of the entity's ordinary activities'. Further guidance should be provided for identifying the ordinary activities of an entity.



As currently defined within the Discussion Paper the term 'performance obligation' can be so broadly interpreted that an unworkable and inappropriately high number of such obligations may be identified for even a simple agreement. For example, in a regular mobile airtime contract a performance obligation may be construed as encompassing transfers of 'assets' including:

- handset;
- network connection;
- SIM card:
- allocation of a 'phone number;
- monthly allowances for various airtime services;
- fixed rates for airtime services used in excess of the monthly allowances;
- add-on options (e.g. DSL broadband, SMS or other airtime bundles, mobile TV, etc);
- right to return options;
- warranty;
- helpdesk or shop-based customer support;
- promotional gifts.

Accounting for deliverables that are provided to the customer at the same time as a single performance obligation does not alleviate the extensive estimation processes that would involved in allocating standalone values to deliverables that may be incidental and are never delivered to (and would not be purchased by) customers on a standalone basis. The allocation of consideration between performance obligations would also be extremely complex due to the huge number of customers and contract permutations that exist. We believe that the allocation of value to deliverables that have no observable selling prices would reduce the comparability of financial statements and that it would not be practical to provide sufficient additional disclosures within the financial statements to adequately explain the measurement process

In each country within which they operate, telecommunication companies frequently have:

- millions of customers, subscribing to hundreds or thousands of different tariffs, with a wide range of handset options for each tariff (i.e. many millions of possible permutations);
- multiple unlinked separate billing systems handling different types of customer or tariff; and
- complex supply arrangements for goods and services involving many different parties.

The number of performance obligations that would be identified, combined with the sheer volume of low value transactions, results in a number of relative standalone sales price permutations that is simply impossible for a telecommunications company to apply. We therefore believe that our proposed amendments are critical for telecommunications companies to be able to apply the principles of the Discussion Paper ('Discussion Paper'). Further detail on our proposed amendments is provided below.



(i) Key goods or services

To determine the existence of a performance obligation the Discussion Paper focuses on whether a good 'could' be sold separately:

'Assessing whether a good could be sold separately in a contract with a customer is a useful way of identifying a performance obligation'

We believe that in order to apply the principles of the Discussion Paper in a way that is reliable, reflects the commercial substance of transactions, is useful for management and users of the accounts and is consistent with customer accounting for purchases, deliverables that are incidental to the provision of the key goods or services that the customer is purchasing should be excluded from the performance obligations to which revenue is allocated. For example, a customer on a standard consumer mobile airtime agreement is likely to consider that the key service that they are purchasing is the provision of airtime, whereas helpdesk support is likely to be viewed as an incidental service. This may contrast with a large corporate customer for whom bespoke communication solutions are configured; in this context the need for quick and effective helpdesk support may be a significant factor in the customer's purchase decision. We believe that performance obligations for goods and services should be assessed according to whether a customer would, in normal circumstances, buy such goods or services on a standalone basis.

(ii) Standalone value

If performance obligations are not identified based on a principle of a customer's willingness to buy the related goods or services on a standalone basis, we also believe that:

- revenue may be recognised for the delivery of assets to the customer that have no value to the customer;
 and
- such revenue recognised may be based on significantly flawed estimates of standalone selling prices since the ability of management to reliably estimate a standalone selling price is likely to be impaired.

We also note that focusing only on control to assess the transfer of assets to a customer could result in the inconsistent treatment of transactions that are, in substance, identical. For example, there is little substantive difference between the trial period in the 'Toolco' example (Discussion Paper, chapter 4) and the accounting for rights of return, discussed in chapter 3. In both cases, consideration of whether a right of return, trial period or right for a seller to reclaim an asset is a substantive clause that is likely to impact a customer's purchasing decision would be a sound basis for determining the appropriate accounting in a way that reflects the commercial reality of an arrangement.

(iii) Ordinary activities

The definition of 'customer' refers to the transfer of an asset 'that represents an output of the entity's ordinary activities'. We believe that performance obligations should also relate to goods or services provided in the ordinary course of business. Further clarity is required regarding the term 'ordinary activities'. It is common for



telecommunication companies to provide handsets, routers or other equipment to customers as an incentive to the customer to subscribe for services. Whilst this is usual practice, we consider the ordinary activity of entities in the sector to be the provision of telecommunication services, rather than the provision of equipment which is considered by management, investors and analysts to merely represent a net cost of acquiring customers rather than a revenue-generating activity in its own right.

Question 5

Do you agree that an entity should separate the performance obligations in a contract on the basis of when the entity transfers the promised assets to the customer? Why or why not? If not, what principle would you specify for separating performance obligations?

Response

We broadly agree with the principle that performance obligations should be separated on the basis of when an entity transfers the promised assets to the customer. However, as discussed in our response to question 4, some additional criteria should be met when identifying a performance obligation. Performance obligations should:

- (i) not be separately recognised for deliverables that are incidental to the primary goods or services that the customer is seeking to acquire;
- (ii) be determined with reference to whether the customer would purchase the deliverable on a standalone basis in normal circumstances. It is our view that the recognition of revenue for deliverables with no standalone value to the customer is inappropriate and is likely to be misleading to users of accounts. Absent standalone value, revenue should not be recognised; and
- (iii) relate to deliverables that represent 'an output of the entity's ordinary activities'. Further guidance should be provided for identifying the ordinary activities of an entity.

Revenue should only be allocated to performance obligations using relative standalone selling prices to the extent that the allocated revenue does not exceed the legally enforceable payments due from the customer under the terms of the contract without the delivery of future assets to the customer.

Current revenue recognition principles under US GAAP, and as generally applied by the telecommunications industry, ensure that revenue is not recognised for payments from customers that are contingent on the delivery of future services. We believe that this is of great value to users of the financial statements as recognised revenue is closely related to billings and cash received from the customer and the impact of management estimation is reduced. It is our belief that discarding the contingent revenue cap would be viewed negatively by users of the financial statements.



Question 6

Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

Response

We do not agree that the right of return is necessarily a performance obligation; we believe that in general for telecommunication companies it should not be. Although customers may occasionally be prepared to pay additional consideration to obtain a right of return, in many cases the right of return solely arises from local consumer protection legislation and is unlikely to be a factor in customers' purchasing decisions. As discussed in question 4, we therefore believe that additional tests are required to determine whether a performance obligation exists. When a right of return is incidental to the primary goods or services that the customer is seeking to acquire, we do not believe that the right represents a performance obligation.

When a right to return does meet the criteria set out in our response to question 4, it should be accounted for as a performance obligation. We believe that treating a right of return as an acceptance clause on a contract by contract basis would lead to a potentially misleading deferral of revenue. We believe, therefore, that any such performance obligations should be assessed on a portfolio, rather than on a contract by contract basis.

However, it would be impractical to determine any revenue on a relative standalone selling price due to the vast number of different arrangements available to customers (potentially millions for a telecommunications company). It would be necessary, therefore, to allow revenue to be deferred on the basis of the standalone selling price for a right of return, rather than on a relative standalone selling price basis, similar to the permitted treatment for customer loyalty programmes under IFRIC 13.

Question 7

Do you think that sales incentives (eg discounts on future sales, customer loyalty points and 'free' goods and services) give rise to performance obligations if they are provided in a contract with a customer? Why or why not?

Response

We do not believe that sales incentives that are incidental to the main goods or services that the customer is seeking to acquire are performance obligations. Future incentives are not necessarily 'chosen' by the customer.

We note that the examples provided in the Discussion Paper focus on the provision of future incentives, rather than those delivered up-front to the customer. In respect of the telecommunications industry, it is common to offer customers free or discounted equipment, such as handsets, up-front. Such offers are incentives to the customer telecommunications services that typically represent the ordinary activity of telecommunication companies. To the extent that the customer receives handset discounts, this is viewed by the industry and, we believe, by users of the



accounts as part of the cost of acquiring a customer. We believe that the allocation of revenue to such inducements reduces the comparability, usefulness and the reliability of reported revenue figures (please see our response to question 2).

A separate consequence of allocating revenue to customer incentives using relative standalone selling prices would be that revenue recognised for services would vary according to the sales channel used. For example, if a customer signs up to an airtime tariff via a distributor who also provides a discounted handset then the monthly billing broadly equates to monthly airtime revenue. If another customer signs up to the same tariff and receives the same discounted handset directly from a telecommunications company, then under the existing revenue accounting methodology, the monthly airtime revenue recognised is generally the same as for the customer acquired through a distributor. Applying the relative standalone sales price methodology without the application of a contingent revenue cap, per the Discussion Paper, would be likely to result in the allocation of some of the monthly airtime charges to up-front equipment revenue so that the discount on the handset is shared between deliverables. Therefore lower monthly airtime revenue would be recorded when compared with a sale through a distributor. Although it is arguable that different contractual circumstances apply, we do not believe that such different accounting treatments should arise in these circumstances and that such differences would be unhelpful to users of the accounts.

Question 8

Do you agree that an entity transfers an asset to a customer (and satisfies a performance obligation) when the customer controls the promised good or when the customer receives the promised service? Why or why not? If not, please suggest an alternative for determining when a promised good or service is transferred.

Response

The Discussion Paper states:

'the customer has the promised asset when it controls the resource underlying that promised asset'

However, the Discussion Paper itself does not provide a definition of control and the 'Toolco' examples within chapter 4 contain different answers to arrangements that are likely to be, in substance, the same. A number of standards within IFRS consider the concept of control, including IFRIC 12, IFRIC 15, SIC 12, IAS 39 and ED 10, which suggests that the concept of control is, in itself, a complex one.

We have the following concerns in relation to applying the concept of control to revenue recognition:

- (i) the focus on control and physical custody of an asset increases the risk of manipulation of revenue;
- (ii) the Discussion Paper allows revenue to be recognised when performance obligations have been fulfilled, even if nothing of value has been delivered to the customer; and
- (iii) the concept of control does not work well for services.



In conclusion, we currently believe that the current concept of the risks and rewards of ownership is more appropriate; it allows the substance of an arrangement to be reflected without needing to assess and value customer right in a contract as a separate performance obligation. Our detailed comments are discussed below.

(i) Focus on control and physical custody

It is possible to transfer control of an asset without transferring the risks and rewards of ownership, for example in a consignment inventory arrangement. Conversely, it is possible to transfer the risks and rewards of ownership of an asset without transferring control.

We believe that the focus on control and physical custody of an asset in determining revenue recognition may make it relatively easy to manipulate revenue. The 'Toolco' examples provided within chapter 4 of the Discussion Paper demonstrate this; in the first example the customer has the right of return during a trial period. In the second example the customer still has the right of return and ToolCo can also legally take possession during the trial period. The Discussion Paper implies that the repossession clause in the second example results in no revenue being recognised and that the absence of the term in the first example results in revenue recognition. We believe that a narrow focus on the legal terms is inappropriate; the accounting should follow the substance of the arrangement, considering factors such as the purpose of the repossession clause, whether is practical to invoke (e.g., is the location of the customer or the tools even known) and whether repossession is ever likely to occur in practice.

(ii) Value delivered to the customer

As discussed in our response to questions 4 and 5, we believe that it is important that for fulfilment of a performance obligation to result in revenue, something of value should have been delivered to the customer. We believe that it is inappropriate to recognise revenue in circumstances when nothing of standalone value has been delivered to the customer. Without such a concept, we believe that it would be possible for entities to increase revenue through the partial fulfilment of a contract even although a customer has not received an asset with any value to them. Furthermore, in such circumstances, payment against such partial fulfilment may often not be legally enforceable.

The Discussion Paper states that a performance obligation is satisfied when the customer controls the resource underlying the promised asset. We believe that the boards should clarify what the resource underlying the asset is and whether there is a difference between controlling the asset and controlling the resource underlying the asset. In the telecommunications industry customers typically need devices such as handsets, modems or laptops to use the services of the entity. Although customers typically take physical possession of those devices at contract inception, the devices are of very limited use unless telecommunications services are also provided. It seems reasonable to conclude that the resource underlying the handset asset is the telecommunications network, which the customer never controls and that revenue should be recognised as services are delivered.



(iii) Concept of control for services

For services, the application of the control concept seems contrived. For example, a mobile airtime customer may have an entitlement to one hour of voice minutes in a month. Prior to using the airtime the customer arguably has an asset, which is the ability to use the airtime at a time of their choosing during the month up until the time the asset is consumed through usage or expiry; the customer has more ability to control the asset prior to consumption than afterwards. We therefore believe that a different principle may be more appropriate for services.

Question 9

The boards propose that an entity should recognise revenue only when a performance obligation is satisfied. Are there contracts for which that proposal would not provide decision-useful information? If so, please provide examples.

Response

The impact of the methodology described in the Discussion Paper is likely to mean that entities with a low number of long term construction contracts where an asset transfers to the customer at the completion of the contract that revenue is likely to be recognised only on contract completion, which would be unlikely to represent decision-useful information for users of the accounts. It seems possible that entities will seek to overcome this effect by ensuring that the legal form of such contracts provides for the continual, or frequent, transfer of assets to the customer. We believe that such legal changes, however, are unlikely to change the substance of arrangements since each party will continue to be legally obliged to complete their entire obligations under such contracts and customers are highly unlikely to accept, take control of, or make non-refundable payments for a partially completed asset.

Whilst the idea of having a single revenue recognition standard is admirable, we do not believe that one set of principles is necessarily effective in providing decision-useful information in relation to all different types of industries. We therefore believe that separate principles or rules are likely to be appropriate for the construction type arrangements.



Question 10

In the boards' proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

a) Do you agree that performance obligations should be measured initially at the transaction price? Why or why not?

Response

We agree with the proposal and agree that the transaction price approach is far more relevant to users of accounts than alternative measure that may lead to the recognition of revenue or profit at contract inception or otherwise based on notional movements in the value of an arrangement.

We note that there is no definition of transaction price in the Discussion Paper and we believe that such a definition is necessary. We note the boards' recent deliberations on contingent revenue; within the telecommunications industry, contingent revenue might include income from future customer decisions to:

- purchase additional airtime or other services;
- renew or upgrade contracts; or
- continue existing contracts beyond the minimum agreed term.

The nature of offers to customers and their prices may vary significantly during the initial contract period and may further vary depending on the time of day or a customer's location. If contingent revenue were included within the measurement of performance obligations at the inception of a contract then revenue recognition could be materially impacted.

Even taking into account the 'reliability' requirement that we understand has been tentatively proposed by the boards, we do not consider that it is acceptable to users of the accounts that the amount of revenue recognised within the financial statements should be dependent on management estimates of customers' future purchasing decisions. We also consider that such treatment is inconsistent with the IFRS framework. We believe that this point is so significant to any future revenue recognition standard that an updated Discussion Paper should be issued, outlining the boards' proposals in this area. Please refer to our detailed comments in our response to question 3.



b) Do you agree that a performance obligation should be deemed onerous and remeasured to the entity's expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?

Response

Yes, we agree. We consider this approach to be appropriate as it reflects the real potential loss, is simpler to apply and is consistent with current standards.

c) Do you think that there are some performance obligations for which the proposed measurement approach would not provide decision-useful information at each financial statement date? Why or why not? If so, what characteristic of the obligations makes that approach unsuitable? Please provide examples.

Response

We do not believe that the proposed measurement approach would provide decision useful information for the telecommunications industry. Our primary concerns are:

- (i) Contingent revenue that is dependent on customers' future purchasing decisions should be excluded from allocations of income between performance obligations
- (ii) Income should only be allocated against performance obligations that:
 - are not incidental to the primary goods or services that the customer is seeking to acquire;
 - have standalone value in the eyes of the customer; and
 - relate to deliverables that are provided in an entity's ordinary course of business.

(i) Contingent revenue

Contingent revenue that is dependent on customers' future purchasing decisions should not form part of the original transaction price and should not be allowed to impact revenue recognition prior to a customer's purchasing decision unless a significant and incremental discount is offered. We do not believe that this represents decision-useful information to users of the accounts and increases the risk of revenue manipulation and error. Please refer to our responses to questions 3 and 10(a).

(ii) Performance obligations

Performance obligations to which revenue is allocated should exclude those obligations that are incidental to the key products and services that the customer is purchasing, have standalone value in the eyes of the customer and relate to deliverables that are provided in an entity's ordinary course of business. Without such principles we believe that the accounts we provide less decision-useful information on the basis that:

• revenue may be recognised even if delivered items have no value to the customer;



- revenue may be recognised even if under contractual terms the entity has no right to receive income from the customer until further performance obligations are fulfilled;
- revenue recognition will become overly complex.

In the telecommunications industry, equipment such as handsets is commonly provided to customers at the inception of a service contract. Currently the revenue recognised against equipment is typically the discounted amount received from the customer, having applied the 'contingent revenue cap'. Under the proposed measurement approach significant revenue would be accrued for equipment at the inception of a contract. We believe that this would be inappropriate because:

- Equipment such as handsets is provided to customers as incentives to enter service agreements which the
 industry requires to cover its substantial investment in network infrastructure. As such, net equipment costs
 are regarded by the both management and users of the accounts as acquisition costs. The allocation of
 equipment discounts to service revenue could potentially mask the underlying level of service billings to
 customers.
- The volume, variety and complexity of transactions makes the allocation and recognition of revenue for different performance obligations very complex and significantly increases the risk of material error.
- Although service contracts are usually legally enforceable, they are frequently not practicably enforceable due to the low contract values involved and the potential difficulty that exists in locating a customer. We do not believe that accruing material amounts of revenue up-front for contracts that are not enforceable in practice is appropriate.

We believe that the current revenue recognition model works well for telecommunications companies and that the contingent revenue cap should be retained. For further detail, please refer to our response to question 4.

d) Do you think that some performance obligations in a revenue recognition standard should be subject to another measurement approach? Why or why not? If so, please provide examples and describe the measurement approach you would use.

Response

We believe that some performance obligations in a revenue recognition standard should be subject to another measurement approach; we are concerned that by only allowing the allocation of revenue based on the relative standalone selling prices of performance obligations that certain issues arise:

• Where there are very high numbers of customer agreements with very high numbers of possible agreement permutations, as is often the case in the telecommunications industry, a pure relative standalone selling price approach is simply not practical to apply. Please see our response to question 4 for further detail.



• We believe that the reallocation of service revenue to handsets would be expensive and complex to apply and would result in less decision-useful and less reliable information for users of the accounts. Please see our responses to questions 4 and 10(c) for further information.

We believe that the following amendments to the Discussion Paper would result in a more appropriate accounting treatment:

- We do not believe that incidental deliverables to the customer should be considered to be performance obligations to which revenue is allocated. In certain agreements, for example, this may include features such as the right of return or warranties. However, if the boards conclude that such customer rights should be classified as performance obligations, we believe that for practical purposes the option should exist to account for these rights at their standalone value, rather than their relative standalone value. We note that such an approach is consistent with the requirements of IFRIC 13.
- We believe that allowing the residual method of accounting for equipment provided up-front to the customer would result in more reliable accounts and more decision-useful information.

Question 11

The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges customers to recover any costs of obtaining the contract (eg selling costs) are included in the initial measurement of the performance obligations. The boards propose that an entity should recognise those costs as expenses, unless they qualify for recognition as an asset in accordance with other standards.

a) Do you agree that any amounts an entity charges a customer to recover the costs of obtaining the contract should be included in the initial measurement of an entity's performance obligations? Why or why not?

Response

Yes, we agree. We do not believe that it is practical or appropriate to differentiate a payment to recover origination costs from the rest of the transaction price; any split would be open to diversity in practice.



b) In what cases would recognising contract origination costs as expenses as they are incurred not provide decision-useful information about an entity's financial position and financial performance? Please provide examples and explain why.

Response

Currently costs are capitalised only if they qualify for capitalisation under other standards, otherwise they should be expensed as incurred. As the Discussion Paper only covers revenue recognition, rather than cost accounting, it is unclear to us what the relevance is of this question or of the comments relating to cost accounting within the Discussion Paper.

Question 12

Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

Response

We do not agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices. We do not believe that it is consistent to identify performance obligations according to a strict interpretation of contractual obligations, whilst disregarding the contractual allocation of consideration to those obligations.

For the telecommunications industry, we believe that contractual prices better reflect the obligations of the customer in paying for deliverables delivered at different times. Consequently they also better reflect the amount of non-refundable payment that the entity is entitled to recover at each stage of the contract. When a single contractual price includes multiple elements, such as entitlements to voice minutes and SMS usage, then allocations between such elements should be based on relative standalone selling prices.

Please also refer to our responses to questions 10(c) and 10(d) regarding the allocation of revenue to equipment provided to the customer.



Question 13:

Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

Response

In principle, we agree that if an entity does not sell a good or service separately, it should make an estimate of what the stand alone-selling price would be. However, we believe that the absence of a standalone selling price may be indicative that a contract obligation either:

- lacks standalone value to the customer;
- is a deliverable that is incidental to the customer; or
- is not a deliverable provided in an entity's ordinary course of business.

In such circumstances we do not believe that a contract obligation should represent a performance obligation to which revenue should be allocated.

The use of estimation techniques to determine standalone selling prices may have the following implications:

- the complexity of administering revenue processes will increase significantly;
- substantial costs may be incurred in administering internal controls to ensure the consistency of estimation techniques in a multinational operating environment;
- the reliability and comparability of reported revenue may decrease.

We therefore believe that further guidance should be provided by the boards in respect of the use of estimation techniques to determine standalone selling prices and that certain reliability criteria are required. Residual pricing methods should be allowed, in certain circumstances, and the contingent revenue cap (as per EITF 00-21) should be applied.