



Madrid, June 19, 2009

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Re: Request for views on Proposed Discussion Paper: “Preliminary Views on Revenue Recognition in Contracts with Customers”

Dear Sirs,

I am writing on behalf of Telefónica, S.A. one of the world’s leading telecommunication and information technology services providers. Telefónica is now a benchmark for the global Telco sector, being the 1st International integrated Telco operator by customer base, with more than 260 million accesses with operations in 25 countries in Europe, Latin America and China.

Further information about the Telefónica Group and its activities is available on our website: www.telefonica.es

Telefónica is very pleased to provide comments to the International Accounting Standards Board on its request for views on the Discussion Paper “Preliminary Views on Revenue Recognition in Contracts with Customers”.

We would like to inform you that this issue has been discussed in special meetings with other telecommunication companies, and this share of opinions have been very helpful to improve the knowledge of each company about the potential implication that the application of the Discussion Paper might have in our industry. Nevertheless, although many of the following comments were shared during these meetings, we do have specific comments that we show along this letter. Hence, this letter is exclusively under the responsibility of Telefónica Group.

If you would like to discuss any of the points we describe in this letter, please do not hesitate to contact Marta Soto, our Head of Accounting Practice, at +34914828534 or by e-mail to marta.sotobodi@telefonica.es.

Thank you for your attention and we look forward to your reaction on the points raised in this letter.

Yours sincerely,

Marta Soto



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?

We understand the objectives of the Boards to develop a new single model of revenue recognition. However we have concerns about creating consistency through a single model as an objective in itself. We consider that any new model should also bring relevant and reliable information to users.

We agree with the Boards to base the revenue recognition principle in the contracts with customers. However there are concepts used in the Discussion Paper (DP) that need further definitions and/or clarification in order to get a right understanding of the model. The main issues that we have identified are the following:

- Identification of the boundaries of the contract. Considering the definition of a performance obligation: “*a promise in a contract with a customer to transfer an asset to that customer*” and the definition of a contract: “*an agreement between two or more parties that creates enforceable obligations*”, it is not clear for us how to determine whether certain services should be considered as performance obligations or as offers (as described in § 2.17 of the DP). We refer to those services that will only be rendered to the customer upon his request. We refer to this concept as “uncertain or contingent deliverables” in this letter.
- Definition of control: the key moment for revenue recognition, according to the DP, is the transfer of control of the asset. However, control is not well defined, therefore there can be misinterpretations and revenue could be recognised inconsistently throughout entities. As far as the recognition in dependant on the transfer of control, we consider that the concept of control should be better developed.
- Definition of ordinary activities: although this concept might be counter-intuitive, according to IAS 1 §87 and §BC61, no items of income and expense are to be presented as arising from outside the entity's ordinary activities. Considering this, all parties that has a contract with the entity could be viewed as customers, and therefore all transactions could be viewed as revenues. We don't think that this was the intention of the Boards, so we, therefore, suggest defining clearer what should be understood by “ordinary activities” in the context of revenue recognition.

These issues are further discussed in the following questions.

Regarding current inconsistency in existing standards, before any discussion, we wonder whether inconsistency really is a problem (besides the technical perspective). Users and analysts understand and seem to be satisfied with current accounting rules. This is why we are not convinced that it is a problem worth being addressed, considering the substantial impacts that the new model might cause in certain industries.



As a consequence, although we agree in the development of a unique model for revenue recognition, we consider that the proposed revenue recognition model published by the Board, needs to be improved and consider a pragmatic approach for both its practical application for preparers and the utility and reliability for users.

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?

The typical contracts with customers in the mobile telecommunications industry normally include:

- a handset, or other equipment, at a discounted price as an incentive to sign for a minimum period contract for the provision of communications services (for example airtime) at a certain amount of services (e.g. X minutes) and a monthly fixed price;
- additional services over the amount agreed in the contract. This services, although being the same, would have a different tariff depending on the price established in the contract or offers or tariff plans that might exist at the time the customer request them;
- other different type of services (add-on options), such as data services, or SMSs, that are offered to the customer who has the option to purchase throughout the contract term. The prices can vary over time or even the customer might choose from a range of tariff plans and or punctual offers.

Additionally, commercial departments continuously launch new bundle offers, tariff plans, campaigns that vary quite frequently in order to gain new customers and react against competitors' offers; also those offers can include different handset models and different discounts.

Current customers are able to upgrade, renew or amend their contracts at various points in time including during, at the end of or after the end of the initial contract term.

This commercial model together with the large amount of customers that have telecommunication companies (Telefónica Group has more than 260 millions of accesses) and the presence in several countries (Telefónica Group operates in 25 countries) makes that the combination of all available commercial options result in a huge amount of performance obligations in different bundled offers to which consideration should be estimated and allocated.

We have the following concerns in applying the proposed revenue recognition model to our business:

1. Allocation method: In a bundle arrangement of a handset and the telecommunication service where generally the handset is sold with a discount, provided that the handset is a separate performance obligation, the proposed allocation method would increase the amount recognised as handset revenue, leading to large unbilled receivables which are only billable if ongoing services are provided. Furthermore, the reduction of ongoing revenue



from services reduces the ability to use the information to predict future revenue streams on renewal or extension of the contracts.

This would imply that the discount on the handset would reduce service revenues instead.

A method based on standalone selling prices will not provide decision useful information in our industry where bundled offers usually include significant discount on handsets.

Currently, in our industry cash inflows are closely linked to revenues. Users know it and they also consider cash flow generation to be one of their key indicators for their analysis. It is a correlation well understood by users. However, under the proposed model, cash would deviate from revenues so the information provided by revenues would be less representative and less relevant for users, creating inconvenience for them, and therefore it would no longer be decision useful information.

2. Identification of performance obligations and/or boundaries of the contract. Our concern relates to those deliverables that will only be delivered upon request of the customer that are not included in the monthly fee but that can be delivered to the customers at a certain price, which might or might not be included in the contract and which can also change throughout the relationship with the customer, as described above. In cases like this and considering the current definitions in the DP we are not able to conclude if such services have to be estimated from the beginning of the contract or if they constitute offers for the customer that are accepted by him upon request of the service and at that time they turn into obligations for the entity. Even considering the Agenda Papers for the Boards meetings, we are not able to conclude if this kind of services would be considered as “uncertain or contingent consideration”, as they are also “contingent deliverables”. Our view is that such services should be considered as a new or different contract at the time the customer requests them. But, as far as the DP and the agenda papers do not cover this issue, a different interpretation can be made. If those services were to be included in the first contract, the level of estimation would be so high that it would not represent any reliable information. Consider that we would be obliged to estimate what services the customer might request, in what amount, and what tariff would apply (it might depend on the time of the day the customer consumes the service, or the tariff plan he selects), and this multiplied by millions of customers, a catalogue of several services, and a large number of tariffs and offers that change over time.

Another consequence related to the previous concerns is that if the companies had to estimate the future consumption of services before allocating revenue between the sale of the handset and the services, and those services are overstated, the initial revenue allocated to the handset would be incorrect, and under the proposed model, subsequent measurement would not correct said amount, but only the deferred income for future services.

We, therefore, consider that the current model, as described in the DP do not provide useful information in our industry. We recommend that the identification of the boundaries should be clarified in order that those contingent or uncertain deliverables with contingent or uncertain consideration as described above which depend on a customer’s future decision are not considered as performance obligations of the contract and rather be considered as offers until the customer requests such deliverables.



We also suggest that in order to avoid the inconsistencies described above regarding the recognition of handset and service revenues, a different allocation method shall be permitted such as a residual type method (see also question 10. d).

These would lead to more decision-useful information in our industry.

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.

A contract is defined as:

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

We understand that the term "agreement" implies an offer and an acceptance of all the parties involved. We are not convinced that the DP is too clear in this point, so we propose that the revised text clarifies this issue to confirm that an offer to provide goods or services, whether to existing or to prospective customers, does not constitute a contract. In this regard, all "uncertain or contingent" deliverables in a contract do not constitute any agreement but are offers made to customers that are converted into agreements when the customer decides to accept the offer by the request of the contingent deliverables. Also, in our industry, there are end users that may have no ongoing purchase commitments, such as customers with 'prepay' SIM cards. End users with 'prepay' agreements may have offers from the operator to purchase future services at certain fixed prices, however do not enter an agreement to purchase such services until service credit is purchased.

We consider that allocating revenue based on expectations of a customer's acceptance of an offer would be unreliable, theoretically unsound and unhelpful to users of the accounts.

Regarding the "two or more" parties to a contract, it is also related to the definition of customers. 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. We understand that the future draft and 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. It is our understanding that with respect to agency relationships, the DP can be interpreted in a way that the definition of a contract encompasses relationships to end-users as well as to agents.

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.

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 accounting that arises from the definition to be reliable, consistent with the fundamental economics of an arrangement, consistent between reporting entities and practical (or possible) to implement, we believe that performance obligations to which revenue is allocated should:

1. be restricted to the goods or services that a customer is seeking to acquire from an entity and exclude deliverables that are incidental or that lack standalone value in the eyes of a customer; and
2. only include deliverables that are provided in the course of an entity’s ordinary activities. In this respect, further guidance on ordinary activities should be provided (see question 1).

As currently defined within the DP, the term ‘performance obligation’ can be so broadly interpreted that an unworkable and inappropriate 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;
- 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 assets that are delivered at the same time as a single performance obligation does not alleviate the inherent complexity in allocating standalone values to incidental deliverables that are never delivered to (and would not be purchased by) customers on a standalone basis. The difficulty in estimating a value for those deliverables with no observable inputs would not provide more useful information and also if those deliverables were finally considered as separate performance obligations comparability would be negatively affected.



The number of performance obligations that would be identified, combined with the huge volume of low value transactions, results in a number of relative standalone sales price that is simply impossible for a telecommunications company to apply. In each country within which they operate, telecommunication companies frequently have,:

- millions of customers, subscribing to 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.

We therefore believe that our proposed amendments are critical for telecommunications companies to be able to apply the principles of the DP.

(i) Key goods or services

To determine the existence of a performance obligation the DP 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 DP in a way that is reliable, reflects the commercial substance of transactions, is useful for management and users of the financial information 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 or if in fact they bought such services they could be treated as a separate performance obligation.

We also believe that 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, 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.

(ii) 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. As stated in previous questions, further clarity is required regarding the term “ordinary activities”.

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?

We agree with the principle that performance obligations should be separated on the basis of when an entity transfers the promised assets to the customer.

Revenue should only be allocated to identified 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.

However, some additional criteria should be met when identifying a performance obligation. Performance obligations should be determined with reference to whether the customer would purchase the asset on a standalone basis in normal circumstances. It is our view that the recognition of revenue for assets with no standalone value to the customer is inappropriate and is likely to be misleading to users of accounts. In our opinion, in the absence of standalone value, revenue should not be recognised.

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?

We do not agree that the right of return is necessarily a performance obligation; we believe that in the majority of instances for telecommunication companies it should not be. 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, therefore, that such performance obligations should be assessed on a portfolio basis, rather than on a case by case basis. 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?

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 DP 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 handsets up-front. Such offers are inducements to the customer to purchase the airtime and other 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 as a 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.

In the case of future incentives, we consider that these incentives should be included as performance obligations of the future transactions, because until that moment, there is not an enforceable obligation for the company.

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.

The DP proposes to recognise revenue when the entity satisfies a performance obligation under a contract with a customer. A performance obligation is satisfied when the promised asset is transferred to the customer. An asset is transferred to a customer when the customer obtains control of it. The DP clarifies that an asset is transferred to the customer regardless of whether goods are sold to a customer or services are rendered to the customer. In the latter case, the promised asset might be consumed immediately, i.e. an asset may also be transferred to a customer if the customer will not recognise the service as an asset.

The DP assumes that control typically is transferred to a customer if the customer takes physical possession of the asset. We believe that the concept of control or transfer of control is not defined enough to link revenue recognition to a transfer of control. Various IFRSs deal with the concept of control (IFRIC 12, IFRIC 15, SIC 12, IAS 39, ED 10) which from our perspective indicates that the concept itself is not as thoroughly defined as it should be. It is our understanding that one reason of the Boards to link revenue recognition to a transfer of control of an asset is that there is a common understanding among preparers and users of financial statements of when control passes from an entity to a customer and that hence there is a clear basis to determine whether the criteria of a passage of control are fulfilled.



We do believe that the concept of transfer of control is difficult to apply to both, the sale of goods and the rendering of services.

We do have difficulties to understand the Boards reasoning why the concept of control is more appropriate as a basis for revenue recognition than the transfer of risks and rewards as under the current IAS 18.

Under the concept of the DP the consideration to be received from the customer will have to be allocated to the various performance obligations. If for example a customer would receive an asset necessary to use services of the entity but has a general right to return the asset, the right to return the handset would be a performance obligation as well. We have difficulties to estimate the value of the right to return and believe that - depending on the facts and circumstances - it could be possible that the major performance obligation would be the right to return the asset with a recognition of revenue over the term of the right to return the asset.

The DP states that a performance obligation is satisfied if the control of the resource underlying the asset is transferred to the customer. 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.

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.

The DP proposes a single set of revenue recognition principles that would cover issues that are currently within the scope of both IAS 11 and IAS 18. Under the proposed model, revenue shall be recognized when performance obligations have been satisfied which is the case when assets are transferred to the customer.

We do have doubts that this approach is appropriate for construction-type contracts within the scope of IAS 11 (please refer to question 1). To illustrate the effects of the proposed model on an entity that enters into a limited number of high value contracts with customers over terms of three years. The constructed asset is transferred to the customer at the end of the term, i.e. at the end of year three. Since no assets are physically transferred in years one and two, the total revenue from the contract would be recognized at the end of year three.

We are not convinced that the proposed model would lead to information that is decision-useful for users of financial statements. Since the revenues recognized should have feedback value as well as predictive value for users of the financial statements especially in examples as summarized above, we do not believe this is the case. We do believe that the current model of IAS 11 that in fact assumes performance over the term of the contracts leads to information that has more feedback value and predictive value to readers of financial statements. We believe that for construction-type contracts, the proposed model does not lead to information that is relevant in decision-making for users of the financial statements and hence is not decision-useful.



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?**

Yes, we agree with the proposal. However, there is no definition of transaction price in the DP. There are many features that are not considered and might have a significant impact on how to determine the transaction price. This is the case of renewals, in the sense of length of the contracts; or amendments in the form of a change in prices and/or quantity, and/or new services or products.

In the case of contracts that include offers for future services that might or might not be consumed by the customers at a future date upon its decision ("contingent or uncertain deliverables"), in timing and in amount, and that do not specify any quantity of service, it is not clear from the DP if the transaction price should be an estimation of the future services that the customer might consume, or if the transaction price is established as the customer consumes the service under the contract (please refer to questions 2 and 4).

Considering the recent agenda papers and discussions on contingent revenue, this concept might include those potential services that depend on the customer future decision. If we had to estimate the future services that a customer might consume as a consequence of a future decision, which period should be considered, the minimum contractual period or an estimation of possible renewals? If we had to consider renewals, what price should be assumed? Taking into consideration that tariffs will normally change over time and on renewal.

Also, when estimating future services, we would need to estimate the timing of the consumption of services, as the tariffs stated in the contract might be different depending on the hour of consumption.

Accordingly that level of estimation would require a high degree of subjectivity that would lessen the reliability of information. If it is the case for only one contract, in real life, there are millions of customers and many different offers, therefore, the resulting information will probably not show the real performance of the company.

We consider that is crucial to have a clear definition on what is meant by "transaction price" within the paper. In this regard we recommend to state clearly that in the case of contracts as described above, contingent deliverables should not be considered in the original transaction price but instead it would be considered when the customer takes a purchase decision. Therefore, at inception it should only be considered the minimum fees in the contract for products and/or services.

- (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?

Yes, we agree. We consider more appropriate the cost trigger as it reflects the real potential loss 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.**

Yes, for telecommunication industry. Consider the answers to questions 2 and 10.a above.

- (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.**

Yes. We agree that for bundle arrangements where performance obligations are fulfilled at different moments, the transaction price has to be allocated to those obligations. There are other methods of allocation that would resolve the issues described in the previous questions (please refer to question 2). We consider that a residual type method of allocation as provided in IFRIC 13 would better reflect the economics of this type of transactions. Such a method would imply the deferral of the standalone selling price of the unperformed obligations. In the example of question 2, the handset revenue would be recognised at its discounted price, and the service revenues would be recognised at their selling price as agreed in the contract, and, therefore, as billed to the customer. This would provide more useful information to users giving the ability to predict future revenue streams from services.

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?**

Yes, we agree. However we would not differentiate a payment to recover origination costs from the rest of the transaction price. Any split would be open to diversity in practice, so we would only consider the total consideration in order to allocate it to the different obligations in the contract.



(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.

We consider that the DP does not include anything different regarding costs from IAS 18. Costs are currently capitalised only if they qualify for capitalisation under other standards, otherwise they are expensed as incurred. We agree with such approach.

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?

No, we do not agree.

We see some inconsistencies in the underlying principles in the DP, as the contract is used as the base to identify performance obligations but the prices agreed in that contract are not used for the allocation of the transaction price to such obligations.

We consider that we should start from the contractual prices, and then, if there were multiple performance obligations included in one contract price (for example voice + messages, in the mobile industry) another method would be used to allocate that price between their components. In this case, the standalone selling price could be used.

As regards other allocation method and its rational, please refer to our comments in questions 2, 10, c and 10 d, regarding a residual type method.

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?

Under the proposed model, the consideration to be received from the customer under a contract with that customer shall be allocated to the performance obligations under that contract. It is our understanding that the method to allocate the consideration to be received from a customer rather follows a mathematical allocation than a conceptual approach.

For each performance obligation an estimated stand-alone selling price shall be used in an allocation of the consideration to be received from the customer based on the relative value of the estimated stand-alone selling price in comparison to the sum of the estimated stand-alone selling prices of all performance obligations under the contract.

The proposed model increases complexity and potentially decreases reliability of the information in cases in which the estimates can not be based on observable inputs because there performance obligations might not sold on a stand-alone basis, i.e. no stand-alone selling price is available. The Boards therefore propose to use observable input data, whenever it is available. Nevertheless, since



the Discussion Paper does not seem to incorporate any restriction that the estimates should meet certain reliability thresholds comparability within entities and between entities might not be achievable if the procedures to determine the estimates necessary under the proposed model are not clearly set out. The increased complexity of estimating stand-alone selling prices in cases in which observable input data is not available affects not only accounting but internal control as well, since entities will have to ensure that consistent estimation techniques are used throughout the entity. From a practical point of view, these techniques would have to be applied on a contract-by-contract basis. In the mobile communications industry for example 100 handsets can easily be combined with 20 different tariffs plus additional options, the customer can choose as well. The number of handsets sold and tariffs offered change continuously which requires a constant revision of the allocation of consideration to be received from the customer upon a new customer entering into this new combination of handset and tariff. Given the numbers of handsets and tariffs above, the number of possible combinations of both illustrates the complexity of the proposed model.

From a conceptual point of view, the forced allocation of the consideration to be received from the customer to the different performance obligations under a contract with a customer would in our business lead to a recognition of revenues that is contingent on the provision of other performance obligations at a later point in time. Assume that a customer enters into a service contract and under the contract also receives a subsidized (or even free) handset as an incentive to enter into the service contract. Under the proposed model, a substantial part of the consideration to be received from the customer under the service contract will be allocated to the sale of the handset. Since the entity does not receive cash from the customer upon the sale of the handset, revenue will be recognized with a corresponding recognition of a receivable. This receivable is not enforceable on a stand-alone basis since receiving cash from the customer is contingent upon the entity fulfilling its obligations under the service contract. If the service contract is not fulfilled, the entity can not force the customer to pay the amount that has been allocated to the sale of the handset. We do not understand whether the recognition of contingent revenues is intended by the Boards under the proposed model.

Additional comments

Regarding implementation issues and cost/benefit analysis

The proposed model focuses on assets and liabilities arising from a contract with customers. It is our understanding that the question refers to the net contract position, i.e. if the information presented in the balance sheet or the statement of financial position is decision-useful or not, as the DP has not covered any disclosure issues.

In this regard, we believe that there are very significant issues that should be addressed in the future exposure draft because they might have very different consequences in the future implementation of the new model:

- Should an asset and a performance obligation be identified separately and then netted or can the net position be accounted for directly?
- Can the assets and liabilities be recognized on a portfolio basis or should an asset and a liability be recognized on a contract by contract basis?



We are strongly concerned about recognizing separate assets and liabilities as in our industry we are dealing with hundreds of millions of contracts. Having to calculate (even if netted) an asset and a liability on a gross basis for each of our contracts would lead to implementing a new IT systems replacing or duplicating the current one (as billing will remained unchanged). Current systems are not contract based but are based on the services rendered to our customers at the prices established in its contract, so it is not possible to identify the different performance obligations in each contract and to follow when and how those obligations are fulfilled.

Current systems are based on billing events at the prices agreed with the customer. This basis will not support certain performance obligations that would be identified under the DP provided that those obligations are not billing events. Therefore the new system should support the amount of revenue to be recognised which will probably differ from the amounts billed to customers, and any new systems should be compatible with current ones (for billing purposes). In our industry the implementation of the new model would be highly complex and costly. Using a portfolio approach in our case would simplify the implementation, and the resulting information would be practically the same.