



Madrid, 22 October 2010

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

Re: ED 2010/6 *Revenue from Contracts with Customers*

Dear Sirs,

I am writing on behalf of Telefónica, S.A. one of the world's largest telecommunications companies by market cap. Its activities are centred mainly on the fixed and mobile telephony businesses, while its broadband business is the key growth driver underpinning both. It operates in 25 countries and its customer base exceeds 277.8 million globally. Telefónica's growth strategy is focused on the markets in which it has a strong foothold: Spain, Europe and Latin America. Further information about the Telefónica Group and its activities is available on our website: www.telefonica.com

Telefónica is very pleased to provide comments to the International Accounting Standards Board on its ED 2010/6 *Revenue from Contracts with Customers* (the "ED").

Telefónica supports the joint work carried out by the IASB and the FASB to develop a single revenue standard. Also, we would like to thank the Board members and Staff for engaging in discussion with the telecommunications industry and appreciate their willingness in this respect. As you know, the impacts of the Board's proposals and the significant industry challenges that would arise from their implementation have been addressed in previous correspondence and discussed in several meetings held between Board members and Staff and relevant companies on the telecommunications sector over the last year.

We would like to highlight a number of issues that could significantly impact our industry unless the final standard is adapted to reflect the particular features of our business model. Our main concern relates to the proposed allocation method that would result in a shift from ongoing service revenue to the devices we provide to customers to allow them to access our services. Under the ED's proposals, the reallocated revenue would be recognised upfront, in advance of billings, and would give rise to an asset (an unbilled receivable) which is not legally enforceable if the operator does not fulfil its contractual obligation to provide future services to the customer. For that reason, we do not think that such an item meets the definition of an asset under the Framework. Moreover, we believe that the proposed revenue recognition model, which involves accruing significant amounts of service fees upfront as equipment revenue, would lead to telecommunications companies maintaining two sets of accounting records (one to comply with the accounting standard and one to manage the business and provide useful information to the investor and analyst community), a result that would reduce the quality and relevance of



reported revenue. Further, the practical application of this methodology would be extremely complex and would most likely need to be assessed on a contract-by-contract basis. All this would require a high investment in IT systems in each of our subsidiaries solely for the purposes of complying with the requirements of the proposed model. Also considering that we believe that the outcome of applying the proposed model does not reflect the economic substance of the transactions carried out by our company. In this sense we miss a cost-benefit analysis of implementing the proposed model.

In our view, all these issues should be taken into consideration in the final standard by adding a limitation in the transaction price allocation method such as the following: "The amount allocable to a performance obligation should be limited to the amount that is not contingent upon the future satisfaction of additional performance obligations (the non-contingent amount)", meaning that the transaction price allocated to performance obligations that have been satisfied, should be deferred to the extent that there are unperformed obligations in the contract that need to be satisfied in order to earn the amounts allocated to satisfied performance obligations. We believe that this approach would avoid the accrual of material amounts of revenue which will only be received if future services are provided and would result in recognised revenue that correlates closely to the cash flows generated from customers, providing strong predictive information about the likely value of future cash flows.

Furthermore, the proposed model involves the use of estimations to a greater extent thereby increasing complexity and potentially decreasing reliability and comparability of the information. This high degree of estimations affects not only to accounting but to internal control as well, since entities will have to ensure that estimation techniques are used consistently throughout the entities composing the Group.

If you would like to discuss any of the issues described herein, please do not hesitate to contact Marta Soto, 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 concerns raised in this letter.

Yours sincerely,

Marta Soto



Telefónica's responses to the questions asked in ED 2010/6 *Revenue from Contracts with Customers*

Recognition

Question 1 — Paragraphs 12–19 propose a principle (price interdependence) to help an entity determine whether:

- (a) to combine two or more contracts and account for them as a single contract;
- (b) to segment a single contract and account for it as two or more contracts; and
- (c) to account for a contract modification as a separate contract or as part of the original contract.

Do you agree with that principle? If not, what principle would you recommend, and why, for determining whether (a) to combine or segment contracts and (b) to account for a contract modification as a separate contract?

In general terms, Telefónica could support the proposed guidance for combining and segmenting contracts and contract modifications. However, we definitely think that the guidance should be clarified, as it does not seem sufficient to assist an entity in applying the notion of "price interdependence". Example 2 in the application guidance is not illustrative or clear, and we do not quite understand how the IASB has reached its conclusions and what is the reasoning behind them as it is not explained. Thus, we consider that the notion of "price interdependence" requires further clarification.

Question 2 — The boards propose that an entity should identify the performance obligations to be accounted for separately on the basis of whether the promised good or service is distinct. Paragraph 23 proposes a principle for determining when a good or service is distinct. Do you agree with that principle? If not, what principle would you specify for identifying separate performance obligations and why?

Telefónica supports the separation of performance obligations, but we consider that the notion of "distinct" is not clear enough. Moreover, the indicators included in par. 23 seem to be inconsistent with par. 20. Par. 20 states that an entity should evaluate its customary business practice to identify all promised goods and services and determine whether to account for each promised good or service as a separate performance obligation, whereas par. 23 (a) requires an entity to consider also the business practice of other entities.

In our view, to be consistent with the core principle of the ED as stated in par. 2, the way to unbundle the entity's contracts should only be based on the entity's own business practice. Further, we believe that determining how to unbundle performance obligations should be based on the entity's own business practice, regardless of what other companies do, and should not include deliverables that do not have value to the customer on a standalone basis or are incidental to the transaction.



Question 3 — Do you think that the proposed guidance in paragraphs 25–30 and related application guidance is sufficient for determining when control of a promised good or service has been transferred to a customer? If not, why? What additional guidance would you propose and why?

The ED requires an entity to recognise revenue when it satisfies a performance obligation by transferring a promised good or service to a customer. A good or service is transferred when the customer obtains control of that good or service. A customer obtains control of a good or service when the customer has the ability to direct the use of and receive the benefit from the good or service through substantially all of its remaining economic life or to consume the asset. Control includes the ability to prevent other entities from directing the use of and receiving the benefit from a good or service.

Telefónica believes that the notion of control is not defined enough to link revenue recognition to a transfer of control. Several IFRSs deal with the notion of control (IFRIC 12, IFRIC 15, SIC 12, IAS 39) which from our standpoint indicates that the notion 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 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 therefore there is a clear basis to determine whether the criteria of passage of control is fulfilled. Also we do not quite understand the Boards reasoning why the notion of control is more appropriate as a reference for revenue recognition than the transfer of risks and rewards, as under the current IAS 18.

Telefónica has concerns about the application of the proposed guidance to the rendering of services transactions.

We would, therefore, propose the Boards to reconsider the inclusion of the risks and rewards approach and otherwise further develop the meaning of transfer of control on a broad basis.

Measurement

Question 4 — The boards propose that if the amount of consideration is variable, an entity should recognise revenue from satisfying a performance obligation only if the transaction price can be reasonable estimated. Paragraph 38 proposes criteria that an entity should meet to be able to reasonably estimate the transaction price.

Do you agree that an entity should recognise revenue on the basis of an estimated transaction price? If so, do you agree with the criteria in paragraph 38? If not, what approach do you suggest for recognising revenue when the transaction price is variable and why?

Telefónica supports that when the transaction price is variable, revenue should only be recognised for the part of the transaction price that can be measured reliably, i.e. when it becomes fixed or determinable. The recognition of contingent or variable revenues under the



proposed model entails the use of estimations in a degree that will likely reduce reliability and comparability of reported information across entities, hence moving us away from the general objective of providing decision-useful financial information for users. Moreover, from a telecom company's standpoint there are a series of operational considerations to be made. In our industry companies provide a huge variety of combinations of products and services for millions of customers, with prices changing constantly in response to changes in customers' demands, marketing strategies, competitors' actions and regulatory requirements. The application of the proposed model in this context is so complex that it is likely that it would not lead to reliable estimations unless the analysis is performed on a contract-by-contract basis, which would be impracticable.

Question 5 — Paragraph 43 proposes that the transaction price should reflect the customer's credit risk if its effects on the transaction price can be reasonably estimated. Do you agree that the customer's credit risk should affect how much revenue an entity recognises when it satisfies a performance obligation rather than whether the entity recognises revenue? If not, why?

Telefónica does not agree with the proposal that requires an entity to adjust the amount of promised consideration to reflect the customer's credit risk. The revenue line should not be affected by credit losses as we believe that users of financial statements normally consider credit losses on receivables separately, given that they represent estimations which involve more level of judgment and do not refer to the revenue transaction itself. Moreover, we believe that users find the amount of sales that are not collected a valuable performance indicator. In addition to this, we find that the ED is not clear enough as to whether the adjustment to reflect customers' credit risk should be presented netting the revenue line or else if it could be presented separately as an expense. We suggest that the final standard clarifies this point, treating it as an expense.

Question 6 — Paragraphs 44 and 45 propose that an entity should adjust the amount of promised consideration to reflect the time value of money if the contract includes a material financing component (whether explicit or implicit). Do you agree? If not, why?

Telefónica agrees with the proposal that the financing component in a contract should be recognized separately from revenue, if material.

However, we note that according to the ED, this principle should be applied to each distinct performance obligation included in a contract and the discount rate to be used should be the rate that would be used in a separate financing transaction between the entity and its customer. Telefónica is very concerned that this principle could be very costly to implement in the telecommunication services industry, where the business model is featured by an extremely large customer base generating a very large number of low value transactions, each customer selecting from a very wide range of frequently changing tariffs and additional service options. In order for the principle to be applied in a less costly manner and to make it workable for our industry, we suggest that the final standard clarifies that when it is not practicable to determine



the rate that would be used in a separate financing transaction between the entity and its customer, the entity's incremental borrowing rate of interest can be used instead.

Question 7 — Paragraph 50 proposes that an entity should allocate the transaction price to all separate performance obligations in a contract in proportion to the stand-alone selling price (estimated if necessary) of the good or service underlying each of those performance obligations. Do you agree? If not, when and why would that approach not be appropriate and how should the transaction price be allocated in such cases?

The ED defines the stand-alone selling price of a good or service as the price at which the entity would sell a good or service separately to the customer, and requires an entity to allocate the transaction price to all separate performance obligations in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations at contract inception.

Telefónica does not agree that the initial (estimated) transaction price should be allocated to all separate performance obligations in a contract in proportion to the stand-alone selling price. In a bundle arrangement of a handset and airtime service where the handset is generally sold with an important discount as a means to acquire future service revenues, the proposed allocation method would result in a significant amount of service fees being accounted for as equipment revenue upfront, in advance of billings, and would lead to an asset which is not legally enforceable if the operator does not fulfil its contractual obligation to provide future airtime services to the customer. According to BC95 the Boards believe that such contract asset meets the definition of an asset, although they acknowledge that such a contract asset has to be separately presented from receivables, as it does not represent an unconditional right to consideration. The following Example 1 illustrates the contractual asset that typically would arise in a standard wireless contract:

Example 1

Customer A enters into a wireless service contract over 18 months with a tariff plan of CU30 per month and a free handset (the contract amounting to CU540 in its total term). For the purposes of this Example, assume that the handset has a standalone selling price of CU200. Under the proposed model, CU146 would be allocated to the handset and CU394 would be allocated to the service (i.e. CU22 per month). This would give rise to a contract asset of CU146, amount that will only be earned if the company performs its services, i.e. it depends on the occurrence of a future event.

The Framework defines an asset as "a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity" (FW par. 49). In this context, the point of discussion would be determining which is the "past event" that gives rise to that contract asset. According to the ED's basis for conclusions, par. 95, the entity "clearly has a valuable contractual right as a result of satisfying performance obligations" (in our Example, the delivery of the handset). However although the entity could have a "valuable contractual right", it is the result of the underlying contract, rather than the result of the



delivery of the handset, i.e. the previously satisfied performance obligation. The mere contractual right to receive compensation already exists at contract inception while an unconditional right to such consideration (that is, a receivable) only arises upon performing the promised wireless services. In other words, the delivery of a free or subsidised handset does not change the entity's rights concerning the compensation for future wireless services and therefore cannot be viewed as the "past transaction" that gives rise to "valuable contractual rights". In our view, the event that eventually generates future economic benefits which give rise to an asset for the company is the wireless service contract, rather than the sale of the handset. Therefore we think that it would be appropriate to defer recognition until the entity performs the services that, pursuant to the contract, give rise to the right to receive compensation.

Furthermore, the shift of revenues between service revenues and equipment revenues would produce a significant difference between our revenue figure for reporting purposes and the way our management, our investors, our analysts and other users of financial information view our business. Cash inflows are closely linked to revenues in our industry and users consider cash flow generation as a key indicator for their performance analysis. Under the proposed model, however, cash would deviate significantly from revenues and so the information provided by reported revenues would be less representative and less relevant for users. As a result, in our view the proposed allocation method would not provide decision-useful information in our business, nor would it depict the economic substance of our business.

In order to avoid the inconsistencies described above regarding the recognition of handset and service revenues in our industry we suggest that the amount allocable to a satisfied performance obligation should be limited to the amount that is not contingent upon the fulfilment of additional future performance obligations ("contingent revenue cap"). For bundled arrangements including performance obligations that are fulfilled at different moments in time, revenue should only be allocated to those obligations 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 services. We consider that applying the contingent revenue cap would result in financial information that better reflects the economics of this type of transactions. Such limitation would entail the deferral of the transaction price allocated to the unperformed obligations. Accordingly, in the example of a bundled offer (discounted handset plus airtime service), the equipment revenue would be recognised at its discounted price, and the service revenue would be recognised at its selling price as agreed in the contract, and, therefore, as billed and collected from the customer. This would provide more useful information to users enhancing the predictability of future revenue streams from services.

Based on the same facts considered in Example 1 above, the following illustrates the inconsistencies of the proposed model in our business. The company has the right to receive CU540 for the services billed on a monthly basis over an 18-month period if and when such services are performed. According to the ED, the entity would have to allocate part of the CU540 consideration to the handset and recognise this amount as a contract asset and revenue at the time of delivery. Besides, an entity could offer different handset models, which would have



different stand-alone selling prices, together with the same CU540 wireless contract. The future economic benefits, i.e. the cash flows resulting from performing the telecommunications services, remain the same, i.e. CU540 over a period of 18 months. However, the “contract assets” would be measured differently, depending on the varying equipment discount as compared to the stand-alone selling price of the future services. The outcome would be two contract assets valued differently while the future economic benefits of the contract from which they result are exactly the same. Example 2 below illustrates this.

Example 2

A telecom operator, Company A, offers a wireless & data service plan for CU432 over an 18-month contract period, plus a free or discounted handset supplied when a customer enters into the contract. The total price of the bundled offer depends finally on the handset model that the customer decides to choose, which is entirely at his own discretion. For the purposes of this Example, assume the standalone selling price of the wireless & data service plan is CU24/month. The standalone selling price of Handset A is CU439, and it is offered at a CU99 discounted price when a customer enters into the contract. The standalone selling price of Handset B is CU225, and it is supplied free of charge together with the wireless & data service contract. The variable discount for the different handset models is due to promotions and marketing strategies. In summary:

| | Price Offer | | Standalone Selling Price | |
|--------------------|--------------|--------------|--------------------------|--------------|
| | Handset A | Handset B | Handset A | Handset B |
| Wireless Service | CU162 | CU162 | CU162 | CU162 |
| Data Service | CU270 | CU270 | CU270 | CU270 |
| Equipment | CU99 | CU0 | CU439 | CU225 |
| Total Offer | CU531 | CU432 | CU871 | CU657 |

The plan is cancellable subject to a CU200 penalty that decreases pro rata over the contract term. For the purposes of this Example, Company A does not expect any credit loss, and no connection fee is charged at contract inception.

| | Current | | Proposed | |
|---------------------------|--------------|--------------|--------------|--------------|
| | Handset A | Handset B | Handset A | Handset B |
| Contract Asset (Day1) | CU0 | CU0 | CU169 | CU148 |
| Equipment Revenue | CU99 | CU0 | CU268 | CU148 |
| Wireless Services Revenue | CU162 | CU162 | CU98 | CU107 |
| Data Services Revenue | CU270 | CU270 | CU165 | CU177 |
| Total Revenues | CU531 | CU432 | CU531 | CU432 |
| Monthly revenues | | | | |
| Wireless Services | CU9 | CU9 | CU5 | CU6 |
| Data Services | CU15 | CU15 | CU9 | CU10 |



This Example illustrates how the requirement to use a relative standalone selling price method will result in different accounting for economically identical transactions (wireless and data services) depending on which handset model the customer decides to buy. We therefore do not believe that the proposed model on revenue recognition will improve the quality of information provided to users. In fact, the information provided by reported revenues under the proposed model is misleading; in this Example leading users to believe that Company A could be performing better (lower upfront revenues but higher ongoing services revenues) if the customer chooses Handset B than if he elects Handset A, whereas exactly the same service is provided in both cases, being the only difference the discount offered for each handset because of the marketing strategy existing at the time of the contract. The application of a contingent revenue cap would in contrast lead to the reporting of limited equipment revenue upfront, also providing users the information that reported service revenues are equal for both contracts and depicting the marketing tools applied by the company at contract inception.

In addition to such inconsistency, in our industry the proposed model would also lead to a significantly different recognition of reported revenue depending on the sales channel used, despite the fact that in the direct channel transactions the economic substance is not different from the indirect channel transactions (i.e. through dealers that purchase handsets and then sell them to customers together with service contracts). The sale of long-term service contracts entails certain costs in the form of commission payments (indirect channel) or handset subsidies (direct channel). According to the proposals in the ED (par. 59), dealers' commissions should be expensed as incurred, in contrast with subsidies (discounts) in the sale of handsets although they follow the same economic rationale. As a result, selling customer contracts via the indirect channel entails the recognition of upfront losses, while selling the same contracts via the direct channel does not. In our view, the proposals do not meet the objective of providing useful and relevant information to readers of financial statements in our industry.

We further believe that the transaction price should be allocated to the various performance obligations on the basis of observable representative standalone selling prices only, meaning that when the entity does not provide the good or service in its ordinary course of business, a separate performance obligation should not be identified. We believe that reducing the use of estimates and judgments for standalone selling prices and transaction prices, helps reducing the complexity of the model and increases the reliability of the information presented under the proposed requirements.

Also, Telefónica believes that the proposed model could lead to the recognition of a liability for onerous performance obligations within an overall profitable contract (please refer to our response to question 9).

Question 8 — Paragraph 57 proposes that if costs incurred in fulfilling a contract do not give rise to an asset eligible for recognition in accordance with other standards (for example IAS 2 or ASC Topic 330; IAS 16 or ASC Topic 360; and IAS 38 *Intangible Assets* or ASC Topic 985 on software), an entity should recognise an asset only if those costs meet specified criteria.



Do you think that the proposed requirements on accounting for the costs of fulfilling a contract are operational and sufficient? If not, why?

Telefónica considers it is important to clarify which costs are eligible for capitalization as contract costs, but we do not support the proposal to expense any costs incurred before the contract inception unless they are used in the process of satisfying performance obligations related to the good or service to be delivered to the customer. For consistency reasons, in our view, the criteria in par.57 should be applied to all costs relating to a contract, including costs of obtaining a contract. Also, we note that if, as proposed in the ED, costs of obtaining a contract are expensed as incurred, there would be an inconsistency with the way such costs are accounted for when related to insurance contracts.

Question 9 — Paragraph 58 proposes the costs that relate directly to a contract for the purpose of (a) recognising an asset for resources that the entity would use to satisfy performance obligations in a contract and (b) any additional liability recognised for an onerous performance obligation.

Do you agree with the costs specified? If not, what costs would you include and why?

The ED requires an entity to recognise a liability and a corresponding operating expense if a performance obligation is onerous. A performance obligation is onerous when the present value of the probability-weighted costs that relate directly to satisfying that performance obligation exceeds the amount of the transaction price allocated to that performance obligation.

Telefónica does not agree with the proposal to require the “onerous test” at a performance obligation level rather than at contract level, as this could result in the recognition of a provision for an onerous performance obligation within a contract that is profitable as a whole. We do not think it is reasonable to provide for an onerous performance obligation if the contract as a whole is profitable. Rather, and in consistency with IAS 37, we believe that a provision for an onerous contract should be recognised only if the entire contract is onerous, i.e. according to the approach in IAS 37, an entity should consider the unavoidable costs of meeting the obligations and the economic benefits expected to be received under the contract as a whole. As a matter of fact, in our industry it is very common that, for commercial reasons, an entity enters into a contract where some performance obligations are onerous but the contract as a whole is profitable. In our view, satisfying these onerous performance obligations forms part of the cost of fulfilling the contract.

Regarding the capitalization of costs, Telefónica agrees with the ED's proposal that requires an entity to apply the full direct cost method (i.e., including in the cost of an asset both incremental and allocated costs that relate directly to the asset) to measure those contract costs that are eligible for capitalisation.

Disclosure



Question 10 — The objective of the boards' proposed disclosure requirements is to help users of financial statements understand the amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Do you think the proposed disclosure requirements will meet that objective? If not, why?

Telefónica agrees that the disclosure requirements will help in meeting the objective of providing decision useful information to users, although in our view, the need for important disclosure in order to understand the amount, timing and uncertainty of revenue reveals that the proposed revenue recognition model is based on weak principles and requires the use of judgment and estimations in a manner that we consider excessive. In addition to this, Telefónica is quite concerned about the cost of preparing all the disclosures required by the ED, although we believe that the materiality threshold should ensure that the disclosures are not provided when their usefulness is not clear.

Question 11 — The Boards propose that an entity should disclose the amount of its remaining performance obligations and the expected timing of their satisfaction for contracts with an original duration expected to exceed one year.

Do you agree with that proposed disclosure requirement? If not, what, if any, information do you think an entity should disclose about its remaining performance obligations?

Telefónica agrees with the proposal.

However, the process to obtain the information required by these disclosures could be very costly to implement in the telecommunication services industry and therefore we suggest that the final standard clarifies that the disclosure should be provided on an aggregate level and not for each performance obligation.

Question 12 — Do you agree that an entity should disaggregate revenue into the categories that best depict how the amount, timing, and uncertainty of revenue and cash flows are affected by economic factors? If not, why?

Telefónica agrees with the proposal to allow an entity to disaggregate revenue into those categories which are considered relevant for management reporting purposes.

Effective date and transition

Question 13 — Do you agree that an entity should apply the proposed requirements retrospectively (that is, as if the entity applied the proposed requirements to all contracts in existence at the effective date and in the comparative period)? If not, why?

Is there an alternative transition method that would preserve trend information about revenue but at a lower cost to preparers? If so, please explain the alternative and why you think it is better.



From a strictly technical standpoint, Telefónica agrees that the final requirements should be applied retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. It is true that prospective application would lead to inconsistent information for the reporting periods presented in the financial statements. However, we must highlight that retrospective application of the proposed revenue recognition model would require telecommunications operators to implement new IT-Systems with high implementation costs solely for the purposes of compliance with the new revenue recognition standard as proposed.

Question 14 — The proposed application guidance is intended to assist an entity in applying the principles in the proposed requirements. Do you think that the application guidance is sufficient to make the proposal operational? If not, what additional guidance do you suggest?

Telefónica thinks that the proposed application guidance is not sufficient to understand the “practical implementation” side of the model or to make the proposals of the ED operational in the telecommunications services industry in particular. The examples contained in the application guidance are too simple and do not respond to real transactions, which are commonly more complex in certain industries, such as ours. Also, we think that the explanation on the way to reach certain conclusions is unclear.

Question 15 — The Boards propose that an entity should distinguish between the following types of product warranties:

(a) **a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation, but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.**

(b) **a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.**

Do you agree with the proposed distinction between the types of product warranties? Do you agree with the proposed accounting for each type of product warranty? If not, how do you think an entity should account for product warranties and why?

Although there may be situations where it is not easy to draw a line between both types of product warranties, Telefónica agrees with the proposal to distinguish a warranty from an uncompleted sale. We consider that coverage for future defects should be accounted for as a separate performance obligation only when the warranty would be a separate service with a distinguishable fair value. However, in those cases, we believe that the amount allocated to such performance obligation should be measured by reference to the cost of repairing or replacing an item, rather than by reference to the stand-alone selling price of the replacement or repair service.



Question 16 — The boards propose the following if a license is not considered to be a sale of intellectual property:

(a) if an entity grants a customer an exclusive license to use its intellectual property, it has a performance obligation to permit the use of its intellectual property and it satisfies that obligation over the term of the license; and

(b) if an entity grants a customer a non-exclusive license to use its intellectual property, it has a performance obligation to transfer the license and satisfies that obligation when the customer is able to use and benefit from the license.

Do you agree that the pattern of revenue recognition should depend on whether the license is exclusive? Do you agree with the patterns of revenue recognition proposed by the boards? Why or why not?

Telefónica does not agree with the proposal, because in our view, whether the entity has granted a customer an exclusive or non-exclusive right does not by itself affect the nature of the performance obligation that an entity has in relation to the contract after the customer is able to use and benefit from the license. In our view, an entity has a performance obligation if it has a continuous involvement with the contract after the customer is able to use a license that cannot be separated from the license agreement and therefore we think that continuous involvement rather than exclusivity is what determines whether or not a performance obligation remains to be satisfied after the customer is able to use a license.

In addition to this, we think that a 'right to use' an intangible asset is in substance a leasing agreement regardless of whether the right relates to tangible or intangible assets. We therefore wonder why such arrangements have been included in the scope of the standard on revenue recognition, rather than being included in the scope of the new standard on leases.

Question 17 — The boards propose that in accounting for the gain or loss on the sale of some non-financial assets (for example, intangible assets and property, plant and equipment), an entity should apply the recognition and measurement principles of the proposed revenue model. Do you agree? If not, why?

Telefónica agrees with the proposal. If IAS 18 *Revenue* is replaced by a new standard on revenue recognition, the requirements for recognition and measurement of gains or losses on the sale of certain non-financial assets, such as intangibles or property, plant and equipment, should be consistent with the requirements of the new standard.

Additional issues

Contract modifications

We believe that the provisions for contract segmentation and allocating the total amount of consideration to the performance obligations identified should be clarified. It is unclear whether estimates regarding options representing a material right for customers should be taken into account when segmenting contracts. In addition to this, in our view the ED is not clear as to



whether or not, for example, cancelling one type of service plan and simultaneously signing up for a new one is considered a contract modification to the original contract or a separate contract. Clarification on this topic would be helpful.

We believe that the treatment for contract modifications should also be better developed, specifically with regard to the connection between contract modifications and subsequent changes in the transaction price. For instance introducing clear guidance regarding the connection between contract modifications and the subsequent exercise of a contractual option that did not qualify as a material right at contract inception (B25). We believe that the subsequent exercise of such option should always be considered as a new contract, therefore eliminating the requirement for subsequent assessment each time a customer exercises an option already included in the contract. Otherwise the model is not feasible within our industry for application on a contract-by-contract basis. We manage a very large number of customers and an extremely large possible combinations of pricing, price changes and other contractual changes (e.g., changes in rate plans, adding on or removal of certain features or services such as data plans, international calling flat rates) which depend solely on our customers' decisions. The proposed model would require constant revisions to update for new products and offers and changes in stand-alone selling prices in order to appropriately allocate considerations for new contracts, and at the same time maintain documentation of historical information for existing contracts.