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Paris, 18 June 2009

Dear Sir,

Response to "Preliminary Views on Revenue Recognition in Contracts with Customers"

We welcome the opportunity to comment on the joint IASB-FASB Discussion Paper (DP) “Preliminary Views on Revenue Recognition in Contracts with Customers”.

In the context of this answer, France Telecom Orange together with other telecom companies representing approximately 300 billions € annual revenue have had two meetings with the Staff and we have a further meeting scheduled. These discussions have helped improve each companies understanding and assessment of the potential consequences of the DP. We would like to thank the Staff for the time that they have invested and hope these meetings have provided him useful insights. While we believe many views raised in this letter are shared by our peers, this letter presents our own analysis and comments. Hence this letter represents solely the views of France Telecom Orange.
About France Telecom Orange and the Industry

At the end of 2009, France Telecom Orange had consolidated sales of 53.5 billion euros and at 31 March 2009, the Group had a customer base of almost 184 million customers in 30 countries. Orange, the key brand of France Telecom covers fixed line telephony, internet, television and mobile services and, under the brand Orange Business Services, offers telecommunication services to multinational companies.

In telecommunications, the business model is historically based on connecting customers to the network and retaining them to generate telecommunications and other revenues in order to recover the fixed costs of the network and the variable costs represented mainly by the selling expenses and interconnection net payments. As the industry evolves, the reach of services expands towards adjacent offers like content or network integration services.

This induces acquisition and retention strategies through direct and indirect distribution channels. These market segmented strategies are often based on a wide selection of, often, heavily discounted equipment or service options available to the customer as an incentive to enter/continue a service contract.

The connection of a customer on the network involves different economic elements, such as
- the provision of activation services, associated to a phone number,
- the delivery of equipment (often a handset or a modern, set-top box) that is given for free, sold at a discount, or rented,
- the delivery of a service with or without a minimum service period associated with access to additional services at prices defined in the offer elected by the customer.

The natures of services offered are numerous, constantly evolving both in terms of technology, marketing, and pricing. There is a high level of pricing flexibility that is market-driven. Thereby, on their own or upon the proposals of operators, customers are constantly adapting their choices by upgrading, downgrading or discontinuing their service packages, e.g. a 25% or higher churn rate is not uncommon in the mobile industry.

Another specific characteristic of the industry are the ways the production and billing information systems are connected to the accounting systems at a highly aggregated level due to the volumetry of data they handle: a large number of customers generating a very large number of low value transactions on a wide range of offers.

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About the revenue recognition project

France Telecom Orange welcomes work being carried on revenue recognition because we believe that there is some missing guidance under IFRS that leads us to turn to the US literature and that it will help all the IASB’s constituents if the existing material on the subject could be enhanced.

In the telecommunications industry, the current accounting model generally used 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. Revenue recognition questions are therefore limited and relate to:
- Timing of recognition of connection or upfront fees and separability of equipment furnished to connect to the service (SAB104)
- Accounting for promotional and loyalty programs (the latter dealt with by IFRIC13)
- Net vs. gross accounting in agent vs. principal (EITF 99-19) or in linked transactions (EITF 01-9)
- Allocation of consideration in multiple deliverables arrangement (EITF 00-21)

Also in connection with revenue, additional questions are mainly related to the recognition of acquisition or retention costs, which in Europe and in the United States are usually expensed.

We believe that the revenue accounting model described above is consistently applied by all the major operators within Europe and the United States. Advantages of this model are that comparability between telecommunications companies is recognized by users as good; it is consistent with the underlying nature of the business as viewed by of management and users; by avoiding the accrual of material amounts of revenue which will only be received if future services are provided, it results in revenue that closely links to the cash flows from customers; it is highly appreciated by users as being only marginally sensitive to management estimation.

Therefore, we believe that any new accounting standard should:
- as a minimum match the above characteristics of existing standards & practices; and
- provide valuable incremental benefits that match, or exceed, the costs of compliance,
- the latter being understood not only as upfront or ongoing costs to preparers to adapt their accounting systems and processes but also as any potential drawbacks to both preparers and users in terms of confidence in or clarity of reported figures.

This letter presents in Section One three prerequisites to the development of a revenue recognition principle, in Section Two five key comments to the proposed model and in Section Three overall recommendations to the Boards.

Because of the important and pervasive impacts of potential changes to revenue reporting, these comments also take into account (i) inputs from 5 top analysts of the European telecommunications industry relating to the Boards proposals and (ii) a preliminary analysis of the potential changes that could be required in the Information Systems based upon simulations of the various potential accounting entries induced by the model. Those reports are attached to this letter.
SECTION ONE

We would like to encourage the Boards to thoroughly analyze three areas that have fundamental consequences on how to develop a new model for revenue recognition:

A - The Boards should define what revenue should portray in the income statement, and the desirable attributes of revenue for its decision-usefulness to users.

Revenue is the very first key performance indicator and therefore attracts special scrutiny from management, users, and market regulators.

Based on the interviews, analysts list the following key desirable attributes of revenues: (i) the close link between revenue and cash-inflows from customers, (ii) the sensitivity of the reported figures to evolutions in the environment (whether economic, technological, marketing or competitive), (iii) the minimization of inputs estimated by preparers (esp. relating to future events). They also mention that comparability is more of a concern within an industry. In fact, they evidence that reliability of measurement and clarity are two desirable qualitative characteristics which they rank higher than comparability across industries. Associated to Operational Key Performance Indicators, analysts appreciate to be able to use the reported figures under the existing standards to build and monitor their models of projections of income and cash-flows.

B- The Boards should build in at an early stage of their standard setting an assessment of the risk of altering the control environment of financial reporting

Financial Reporting is a regulated dialog between management and users that is built on confidence. As evidenced recently by the market turmoil, without confidence in the information provided, financial markets do not operate properly. We also note that revenue accounting has been an area of much regulatory actions in some industries.

In recent discussions at the Board's, the existing standards and practices that constrain revenue recognition of uncertain consideration were qualified as inconsistent because some deal with this uncertainty as a measurement issue and others as a recognition one. We believe this apparent disparity only reflects various degrees of acceptable uncertainty under specific circumstances, not a conceptual issue around recognition vs. measurement.

Existing standards and practices have been disqualified as "tradition" and as "conservatism/abuse prevention". These statements fail to identify the positive benefits of the existing standards in terms of internal control and confidence. This is why we find little comfort in the idea that not constraining revenue would be closing part of the "measurement gap" with IAS39 financial instruments.
C- Similarly, the Boards should embed earlier into their developing process an evaluation of the possible accounting processes changes

Contrarily to the statement in Par 1.20 of the DP, we believe the proposed model will result in significant changes to the current accounting processes. This is because it will de facto require (i) the traceability (and hence distinct accounting) of the asset and of the liability, (ii) the reestimation of the amounts of individual contract asset and liability as the boundaries of the contract evolve with interference from the unconstrained allocation between performance obligations. The impacts are Information Technology (IT) and Internal Control (IC) related.

The IT impact can be gigantic or less significant depending on the type of transactions and contractual relationships established with the customers. Distracting human resources from business development and cash generation toward compliance accounting is unlikely to be a stimulative environment for IC. Here again, such potential consequences should not be overlooked in the development of a new accounting model.

SECTION TWO

With respect to the proposed revenue recognition model, we would like to focus on five fundamental areas:

A- The contemplated boundaries of a contract raise significant concerns for the telecommunications industry: we strongly encourage the Boards to assess the positive benefits associated with not accounting for options that are difficult to value.

By retaining the contract as the basis for revenue recognition, consideration has to be given to the options for additional goods or services associated to the contract. The DP considers simple situations with little or no optionality in the contract while Par 2.17 states that “offer - although binding against the entity in many jurisdictions - is not an agreement between the entity and another party, because the other party has not accepted the terms of the offer”.

In their more recent discussions, the Boards have tentatively decided
- to treat renewal periods and optional services as a performance obligation if the stand-alone selling price can be determined without undue cost, i.e. if it is close to zero then no consideration would be allocated to it;
- to include within the contract boundaries contingent consideration relating to options (the “looking through” approach) when the stand-alone price of the option can not be determined without undue cost.

We welcome the Boards decision not to retain the “looking through” approach as the standard method for accounting but believe that retaining it as the default method is not adequate. We therefore encourage the Boards to reassess the positive benefits associated with not accounting the options that are difficult to value.
The "looking through" approach is problematic in an industry where most of the revenue is contingent upon rendering a service that constantly evolves and where a contract is in substance a subset of the overall economic relationship with the customer, which continuation rests significantly in the hand of the customer. Although we are convinced that many options have little value to the customers (options are specific to the contract and contracts are not transferable), demonstrating their insignificance when applied across hundreds of millions of customers and many thousands of tariff and equipment combinations, would become impractical, if not impossible. By default, this means that the "looking through" practice would apply.

Indeed when pricing their offers operators expect to receive contingent amounts during the initial contract term and in secondary terms:
- additional pay-as-you-go revenue during the contract period,
- contract extension (upgrade or downgrade of services),
- renewal options,
- and indirect revenues (incoming calls).

Hence, except for the identification of the customer, the situation for a contract option is similar to that of an offer described in Par 2.17 where the operator stands ready to give access at the offered service at the offered price upon the (potential) customer’s acceptance. This is true both for offers without commitment from the customers (frequently referred as prepaid contracts) or for offers with some commitment from the customers (frequently referred as “postpaid contracts”) because the legal enforceability is impacted by costs as well as retention strategies. This illustrates a key weakness of the "looking through" approach.

Furthermore, the measurement of a contract should not include cash-flows that an entity can not compel. We wonder whether the conclusion of a contract is a sufficient past event in that case and whether a sufficient degree of certainty exists to warrant the recognition of an asset, esp. in the telecommunications industry with the fluidity of customers and offers. Such practice would therefore be inconsistent with the IFRS framework. We disagree with the analogy made in the Staff’s paper with the right to dividend of an equity security or the reasoning that the performance obligation being equal to the asset at inception, no net asset arises nor revenue. Neither do we believe that the logic of “large numbers” of portfolios of similar contracts would alleviate errors in the individual measurements of contract assets or liabilities.

It also clearly presents a risk in the control environment by the potential for significant revenue adjustments to arise as the result of management estimates.

B- The proposed definitions of a customer and of a performance obligation do not enable to segregate sales incentives from other performance obligations and affect comparability

We agree to the definition of revenue in the DP through that of the customer in Par 2.21: “a customer is a party that has contracted with an entity to obtain an asset that represents an output of the entity’s ordinary activities”. We understand the concept of a performance obligation and the proposals on the separation of performance obligations. However, the current proposal needs to be clarified with respect to the notions of (i) output of ordinary activities and (ii) of sales incentive as not all performance obligations should be allocated revenues.
The handset (or any external good or service) which is not manufactured by the operator, is an enabler to the operator mainstream service activities. Should the notion of output be understood in an extensive manner, the handset is likely to be considered as performance obligations to which revenue should be allocated if sold directly or through an agent relationship. When sourced and sold by an independent distributor together with the operator service, no consideration of the service contract would be apportioned by the operator to the handset. The proposal will therefore introduce a disparity in the recognition of the service revenue that will neither reflect any pricing differential in the bundle offer nor any difference in the business purpose.

From the perspective of the analysts who were interviewed, this will result in a lessened comparability between operators and in the loss of a key information in revenue reporting, that is the amount of monthly cash payment accepted by the customers which signals the customers appetite for the operator’s services and its evolution. In fact even today, analysts focus on the service component of revenues and often analyze the payments made by customers on subsidized elements as a reduction of cost (i.e. a customer’s initial investment).

The upfront delivery of a subsidized handset differs also from the sales incentive considered in the Boards paper which focuses on price reduction on future deliveries of similar goods with the Boards allocating part of the consideration received on an initial delivery to a future delivery: please refer to section C hereunder.

Finally the proposed definition of an entity’s performance obligation as a promise in a contract with a customer to transfer an asset (such as a good or a service) to that customer will lead to identify more performance obligations than the current analysis of units of accounting performed under IFRS or US GAAP. This will generate new dissociations from the customer billing, and add additional complexity to the accounting systems, especially because of the accounting for individual contract not position. Please refer to section E hereunder.

C- We encourage the Boards to consider “constraining revenue to consideration that is certain” by evaluating the advantages of such an approach, especially in terms of confidence in reported figures.

Beyond the definition of an output, we have tested the mechanisms of the proposed allocation rule in various situations. This test evidences that:
- the highly segmented approach of the market and frequent changes in the prices may lead to inconsistencies in the reported services prices between offers and operators;
- a major mismatch between the timing of recognition of revenue and billing for services (and cash) will arise due to an up-front accrual of material amounts of revenue for incentives provided up-front to customers;
- any allocation is highly sensitive to management’s estimates of the customer’s behaviour.

We welcome the recent debate at the Boards about whether or not to constrain revenue recognition and the Boards tentative decision to constrain the expected consideration approach in those rare situations where a consideration amount cannot be reasonably estimated. However those rare situations are too restricted in the way they are described. In fact with respect to the desirable attributes of revenue reporting, an unconstrained allocation is acceptable only when the consideration received covers part of future deliveries. We therefore encourage the Boards to reconsider the alternate “constraining revenue to consideration that is certain” by evaluating the advantages of such an approach, especially in terms of confidence in reported figures.
D- Beyond our industry, the notion of transfer of control as defined is not fully operative and does not provide the expected decision usefulness to users

In the telecommunications industry, the notion of transfer of control appears similar to the current notion of delivery of the service if we put aside two areas: the timing of recognition for connection activities or the nature of the equipments used by the customer to access the services. In the latter cases, we note that the control notion is not as clear as to require a rebuttable presumption (Par 4.56) and that we do not know whether it gives an answer to the telecom example of Par 1.5.

The notion of transfer of control is not clearly defined in the DP. Even in the illustrative simple cases the criteria are unclear: e.g. what are the respective roles of physical possession, legal title, and cash? How does this translate for a service? What about complex contractual clauses where both parties try to secure their position if 'things go wrong'?

It is also somewhat legalistic and away from the economic substance of commercial arrangements: e.g. both the sale with a right of return and the free trial period are in fact a free right of use secured or not by cash before completion of a sale; it appears difficult in those situations in contracts associating the delivery of a good and a service (e.g. DP 4.39 or DP 4.35).

If retained, this notion will need to be better defined and field tested to determine its workability and to check convergence in interpretation.

As users of financial statements of our suppliers, partners and customers, we are concerned that the proposed model for revenue recognition may delay revenue recognition until full completion and deprive financial statements for significant long term activities from reporting performance in a relevant manner; those industries may be forced into non-GAAP financial reporting in order to cope with useless IFRS compliant financial reporting; we do not believe that such an outcome is desirable.

E- In our industry, the pervasive constraint of cost to preparers cannot be met with the proposed asset/liability accounting model

Per necessity our preliminary analysis of the contemplated model is limited to assumptions on contracts boundaries (with options included or excluded), changes in estimates of consideration (as we believe some remeasurement will be needed after the contract inception) and allocation of consideration to performance obligations (including any upfront delivered equipment). We have not assessed other key areas like time value of money, collectibility and disclosures.

Our conclusion is that the proposed model will result in significant changes to the current accounting processes. This is because (i) it will require the traceability (and hence distinct accounting) of the individual contract asset and liability, (ii) the amount of asset and liability will be impacted by the boundaries of the contract and the unconstrained allocation between performance obligations.

As documented in Appendix 3 because of the characteristics of the industry in terms of number of systems impacted (above 1,000), volumetry of data and constant evolution of the relationships with the customers, the IT impact is close to unbearable, feasibility is highly doubtful and assuming feasibility could be secured (which we do not believe) the required lead time to effective implementation would be in the range of 8 to 13 years.
SECTION THREE

Overall our recommendations to the Boards are the following:

Key revisions to the Discussion Paper are needed to make it relevant and workable for the telecommunications industry: Definition of an Output, Definition of a contract and its boundaries, Allocation of uncertain consideration to performance obligations, Related accounting of the contract asset or liability.

The timetable considered by the Boards needs revision, all the more so that the Boards are as of today showing all signs of confidence that an acceptable standard can be derived from the DP consultation process and be ready for issuance in June 2011 at a time when:

- The prerequisites to developing the framework for revenue recognition remain to be analyzed while they affect the directions of any future standard;

- At this stage absent from the DP, clear answers need to be given to the questions raised in Par 1.3 to 1.6 “Problems in US Gaap” and Par 1.7 to 1.16 “Problems in IFRSs”;

- The issues not fully addressed in the DP (definition of contract boundaries, contingent consideration, collectibility, recognition of a contract asset or liability and its presentation in the balance sheet, time value of money, disclosures...) are of such magnitude that they warrant public exposure at a DP stage before developing an Exposure Draft.

- A significant uncertainty remains about the possibility of defining single workable revenue recognition if it remains based on the transfer of control criteria.

We respectfully suggest:

- the Boards reconsider their search for a single model for the time being; maintaining the current accounting models does not appear to cause significant difficulties to preparers and users alike under IFRS; This could be done by keeping the current two standards or alternatively by integrating both of them with their respective model into one standard, with some tidying up and clarifications on the choice of applicable model;

- the Boards develop additional guidance like the IASB recently did for principal vs. agent based on US practice in the following areas: identification and evaluation of components of contracts or distinction between goods / services;

- the Boards take the necessary time to make a thorough analysis of the desirable attributes of revenue for users, of the desired level of certainty in revenue accounting, and of the processes impacts, having in mind the control environment of financial reporting before reassessing whether a single revenue recognition principle is feasible or not.
If you would like to discuss our comments further, please do not hesitate to contact Nicolas de Pailierets (nicolas.de.pailierets@orange-ftgroup.com) or myself (gervais.pelissier@orange-ftgroup.com).

Yours sincerely,

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Copies to:
- Mrs Christine Lagarde, Ministre de l’Économie, de l’Industrie et de l’Emploi
- M. Jean-Pierre Jouyet, Président de l’Autorité des Marchés Financiers
- M. Jean-François Lapetit, Président du Conseil National de la Comptabilité
- M. Charles McGreevy, European Commissioner for the Internal Market and Services
- M. Eddy Wyneersch, Chairman of CESR
- M. Göran Tidström, Chairman of EFRAG
- Members of ETAF

In support to the main comments of this letter, are attached:
- a report on analysts’ reactions (Appendix 1),
- an IT preliminary assessment (Appendix 2),
- answers to the detailed questions of the invitation for comment (Appendix 3).
Appendix 1 to France Telecom Orange comment letter on the joint FASB/IASB Discussion Paper

Telecoms analysts’ perception of new revenue recognition methods

Introduction

In view of France Telecom’s response to the Discussion Paper relating to a new method of revenue recognition, FD organized a round table bringing together five Telecom sector analysts, including two of the top six and three of the top 40 ranked analysts of the 2008 Thomson Extel survey.

Based on a presentation of the Discussion Paper *Preliminary views on Revenue Recognition in Contracts with Customers*, by a firm of independent auditors and illustrated with examples, the objective of the round table was to gather the opinions of the analysts and to measure the potential impact of the norms on their analytic approach and how this may affect the perception of the sector.

In order to better evaluate the relevance of the proposed norms, how appropriate they are for the Telecom sector and their potential impact on their analytical approach, the analysts considered it necessary to lay out the principal characteristics and key indicators of the industry.

I. Valuation of Telecom operators

A. Sectoral peculiarities, key indicators and valuation of Telecom operators
B. Financial communication of the Telecom operators

II. Analysis of current and proposed revenue recognition methods

A. Current methods
B. Proposed norms
C. Positive aspects of the new norms
D. Comparability of financial information

III. Potential impact of the new norms

A. Analytic and valuation methods
B. Risk premium and investor perception
I. Valuation of Telecom operators

- **Cash**, closely linked to revenues, is the **number one operational indicator**

- A **significant correlation of FCF and revenues** in the Telecoms sector

A. Sectoral peculiarities, key indicators and valuation of Telecom operators

FD questioned the invited analysts so as to understand what distinctive qualities they attributed to Telecom operators compared to other industrial sectors.

**Cash flow generation** was put forward by all of the analysts as the key indicator for their analysis of Telecom operators. They stressed the **capital intensity** of the sector as well as the close correlation between revenues and cash flow generation, allowing a reactive reflection of the telecom **industry's activity** (as opposed to a contracts industry such as construction). On the other hand, working capital or financial results are indicators of secondary importance, quite unlike other industries.

- **Sectoral peculiarities**

  “The Telecoms sector is characterized by its capital intensity. Unlike in construction or other industrial sectors, working capital remains an indicator less important for the analysis of Telecom operators.” ANALYST 1

  “Recurring revenues or the visibility of revenues is something that is well understood by investors and is clearly a positive during periods of uncertainty. The impact of regulation is a weak point of the sector, which investors find difficult to understand.” ANALYST 2

- **Key indicators and valuation methods**

  “ARPU, churn rate, SAC/SRCS, % of revenues in interconnection, EBITDA, capex and net debt are the most important for me.” ANALYST 1

  “Currently, MOU (Minutes of Use) and ARPU are the operational indicators that I look at most and, at the financial level, EBITDA and EBITDA margin. Looking at costs, operators give too few details to create an overall view (data varies too much from one operator to the next), so I’m more interested in the dynamic of indicators given by each of the operators.” ANALYST 2

  “My preferred indicator is cash.” ANALYST 3

  “In terms of valuation, when analyzing telecoms operators, free cash flow is the most important indicator. They also look at the results but in the telecom sector, they are of secondary importance.” ANALYST 4

  “I always use a number of methods for my valuations, with no particular preference.” ANALYST 2

A. Financial communication by Telecom operators

- The analysts noted that the operators were increasingly communicating their guidance at the cash level rather than using revenues, demonstrating the importance of **cash generation** for the sector.
In the current economic environment, the analysts note the bigger scarcity of both the information communicated and its detail in terms of financial objectives.

“For a year now, we have seen operators are increasingly communicating their cash positions and concentrating less and less on revenues. We’ve also witnessed a focus on operating margins trends.” ANALYST 1

“Indicators which are prevalent include revenues, margin, capex and cash flow with each company offering different degrees of granularity. France Telecom tends to concentrate on cash. Other operators give more detail.” ANALYST 4

“I believe that the quality and quantity of reported guidance has been getting worse. For example they have been publishing objectives with a universal organic FCF without breaking down the revenues or cash flow by division.” ANALYST 2
II. Analysis of current and proposed revenue recognition methods

A. Current methods

According to the analysts, existing methods of revenue recognition present many advantages:

- apart from their close correlation to cash, existing methods of revenue recognition offer a dynamic and reactive insight into the telecom operators’ activities.
- revenue recognition based on actual invoices and not on estimates offers a reliability that analysts prefer
- with the correlation of cash and revenues, revenue indicators help establish cash forecasts and vice versa. This relationship allows analysts to test their models more thoroughly.

B. Proposed methods

- The new norms leaves estimates, which are then used to calculate revenues, to the discretion of the companies and this is perceived as a risk factor by the analysts and causes a distortion of the precautionary principle. To illustrate the risks, the analysts cite examples of accounts that have been published adopting a similar style to the new norms and created problems: for example in the interpretation of certain long-term contracts or the accounting problems that were revealed in the United States when the equity bubble burst at the beginning of this decade, in particular in the energy sector.
- As a direct consequence, the analysts believe the new norms leave the door open to an artificial inflation of revenues. It is their thinking that estimates and the allocation of revenues could be a source of errors due to possible manipulation on the part of the companies.
- Another major problem stressed by the analysts is the inappropriate nature of the methods used in the new norms when applied to contracts typical of the telecom operators. In effect, this industry is based on numerous small contracts and not on the long-term contracts which characterize large accounts better suited to the style of revenue recognition included in the Discussion Paper. Similarly, the accountable part of revenues would not reflect the rapid evolution of offers in the telecoms industry.
- In sectors such as the telecoms sector, where cash is the main indicator of performance used by the analysts, any further de-correlation between cash and revenues would oblige analysts to carry out additional adjustments and calculations on the published figures to arrive back at the cash figure.
- Following this logic, analysts noted that the integration of hypothetical options on assets and liabilities of contracts and the allocation of part of the service
revenue to equipment revenues are a major inconvenience. According to the analysts, the tendency towards statistical calculation, which accompanies the new norms, creates a greater potential risk to their estimates.

“In our work, we look at cash before anything else, so if revenues do not reflect cash, we will try and get the figure by looking at the working capital requirement to come to the same result. In any case, we will work to get back to the previous method, so it is just going to complicate our jobs.” ANALYST 4

“There is no impact on final revenues but the net debt position will change in that, at any given moment, there will not be a « quasi cash situation » like today. There is a risk of calculating too high a cash position during certain periods, or indeed the reverse. At the time of a transaction, the logic of the new norms implies that the debt position can vary and that in turn can have an impact on the transaction itself.” ANALYST 2

“These rules do nothing but make our work more complicated: to value a company, we analyze its cash, it is cash which is important to us and not revenues if these differ.” ANALYST 1

“The proposed standards will result in increasing seasonality of the Telecom sector, which is quite a paradox as the sector’s seasonality is very weak today hence risks limiting the ability to predict short-term cash positions.” ANALYST 2

“Precautionary principles are brought into question as the new accounting standards force us to make calculations based on statistics. The telecoms industry evolves fast, the offerings and the position of the participants change frequently making statistical calculations more risky. It is these calculations that would be needed under the new norms implying a greater risk.” ANALYST 3

“These standards appear to want to achieve comparability at any price, even though it is not that important to us. My belief is that the first consequence will be an increase in revenues without reference to cash, so I think this drawback outweighs any benefits.” ANALYST 1

“I believe the new standards are massively risky and could encourage some underhand behaviour. CEOs who know they only have one or two more years in the job could be tempted to boost their bonuses by inflating their results. These new rules could leave the door open to manipulation.” ANALYST 3

“My biggest worry is that individual companies have the discretion to calculate their own revenues. This lack of transparency could lead to impropriety. It could encourage companies to allow revenues to drift from one quarter to the next to hide disappointing quarters.” ANALYST 4

“We have a very good example of the limitations of these standards: we just need to look at X. They estimated the value of their own contracts, they overestimated their revenues and all their results, without making any reference to FCF for about a year or a year and a half. We, the analysts are now unable to work out the link between the real FCF and the P&L figures. The result is plain to see: they have had to readjust downwards their EBITDA for the last nine months just to balance out FCF and their EBITDA. Asking the operators to determine the value of their contracts is the best way of encouraging opaque accounting and other underhand behavior. The example of X proves the limited nature of the new norms.” ANALYST 3

“The new accounting standards infer a notion “of performance obligation”, which has an impact on consumption outside fixed contracts. It forces a monthly allocation of revenues in place of the fixed price contracts and forces the operator to assume month-by-month revenues.” ANALYST 3

“I’m worried that the norms are going to have an enormous impact on revenues, even though this is the indicator that is most commonly used to evaluate mobile operators in Europe. It is the operators’ perception of the client that brings this project into question!” The telecoms
sector, people have the impression of paying something each time and it’s that which corresponds to the cash received by France Telecom. For clients, unlike in other sectors like insurance, the value of their contract is not long term but what they are paying on a monthly basis. For analysts, this relationship is important as it helps us understand what the client is prepared to pay every day for the services rendered.” ANALYST 5

- **Another difficulty** that the analysts see is that the new norms will by their nature lead to a period of transition and adaptation. This period will be troubling and could be a source of errors and misunderstanding. Putting these norms into action would necessitate the publication of historical data on a pro-forma basis to facilitate comparison with previous periods. A lack of consistent indicators would be damaging for the clarity of financial information and for analysts’ visibility.

“**The difficulty is not being able to recreate a historic comparison if the new standards are to be adopted. There is nothing worse than not being able to say whether or not the latest quarter is better or worse than the previous one** on a pro forma basis.” ANALYST 1

“As analysts, we are used to juggling with revenues that do not reflect cash and between different accounting methods, this is our job and how we add value. The difficulty does not arise from making these adjustments but from the absence of perpetuity... **it’s the changes in accounting standards that cause the problems.** However, if things remain unchanged, we know the indicators and we know how to adapt them.” ANALYST 1

“There will be a transition period and the need for some education to clarify the situation in about a year or a year and a half, just as we did when IFRS was introduced.” ANALYST 2

“If the new model is adopted, **there would an initial period of flux surrounding all the valuation methods, accompanied by a cost of transition.** But in the end, we would still be interested by the cash position so not much would change. **We would have to work out how to best forecast cash positions.”** ANALYST 5

C. Positive aspects of the new norms

Among all the responses gathered, only one of the analysts was able to find an advantage in the text. He noted believed that the new norms would create a better reflection of the cost per minute - due to the current differences that exist between countries that authorize subsidies (which translates into a higher cost per minute) and countries that do not. The transfer of a portion of the network revenues to the sale of the handset would reduce de facto the risk of network revenues being allocated in relation to the services rendered.

“The new accounting norms have one constructive element: it better reflects the cost per minute for the operator, notably in countries like France, where the cost per minute is higher because of the handset subsidy. In comparison with other countries where subsidies are not allowed, there are differences which lead us to think that this or that market is expensive, when actually it’s only a question of how the costs are split. If we apply the hypothesis that subsidies are split between the handset and the minute of communication, we get a better reflection of the real costs to the operator. ANALYST 4

D. Comparability of financial information

- The existing method of revenue recognition, or in other words the co-existence of two accounting norms IAS18 and IAS11, does not cause major problems for the analysts
• As one of the analysts noted, companies in the same sector generally have a tendency to publish comparable data.

• The analysts underline that this comparative work was part of their job and constituted part of their value add.

• A new accounting procedure is at best unnecessary and at worst dangerous. The analysts don’t think the new norms will be a factor in improving comparisons. They think that a system based on estimates is bound to lead to greater risks.

   “I’m not criticizing the initial objective of the reforms, facilitating comparison between sectors is praiseworthy. However, analysts are quite able to make the comparisons themselves. I don’t believe we have the need for a new accounting procedure.” ANALYST 3

   “I don’t think the fact the new process relies on a series of estimations of client behaviour improves comparability between companies. In fact, everything that relies on estimations, models, etc., seems to me even more complicated and even more dangerous.” ANALYST 5

   “I don’t think the new standards will improve comparability. It’s up to the analyst to create the hypothesis or the estimates, not the company.” ANALYST 2

   “Within a sector, I don’t believe that the new standards will improve comparability between companies. With the existing norms, companies in the same sector already publish comparable data.” ANALYST 4

   “The new accounting rules clearly do not improve anything in terms of comparability. In effect, as they rely on estimations, the reliability of the comparisons is already bought into question. If, for example, a country is overly optimistic in its economic forecasts, this would have an impact on consumption forecasts.” ANALYST 1
III. Potential impact of the new norms

A. Methods of analysis and valuation

- The majority of analysts believes the application of the new norms could lead to the prevalence of DCF valuations being brought into question and create a preference for valuation ratios. This could increase the risks of market bubbles, which have been associated to valuation ratios in the past.

“I think the proposals bring into question the ability to forecast cash positions and, therefore, DCF valuations will become more complicated.” ANALYST 5

“Due to a loss of visibility of FCF, we will without doubt move towards valuation ratios. This is not a good thing, using ratios in valuations is more risky, and market bubbles are the normal result. DCF valuation is not in itself totally trustworthy but it allows us to fix parameters.” ANALYST 3

“At least at the beginning, DCF valuations will be given less weight than other valuation methods. There is a risk of having a multiplication of estimates: those given by the companies and those maintained by the analysts which will produce an increased volatility in DCF valuations.” ANALYST 2

“If we embrace the spirit of the new norms we would be more likely to lean towards ratio valuations rather than FCF. That would increase the risk of future bubbles, which are often linked to ratio valuations.” ANALYST 1

- Even if the adoption of the new norms does not change the approach of certain analysts, it forces them to modify their models to construct their cash flow forecasts.

“If the new norms were adopted, I would not change my valuation method. However, I would have to find a new way of forecasting the company’s cash position.” ANALYST 4

“If the new norms were adopted, I would not change my valuation approach but I would simply adopt a different way of modeling the working capital requirement.” ANALYST 1

B. Risk premium and investor perception

- Most of the analysts foresee an increase in the risk premium of the sector.

“The problem of the new norms is that the analysis becomes dependent on the company’s estimates. This doesn’t increase transparency and, for that reason, the risk premium may be reviewed. We can’t yet measure the real impact of the new norms on the risk premium. I think seasonality could increase but I’m not sure whether this will render the results less predictable or not. I would have to see what happens in other sectors.” ANALYST 5

“If the new standards are adopted, there would be a small chance of the risk premium of the sector increasing. The new rules will make it more difficult to calculate FCF and analysis will rely on estimations fixed by the company. In theory, these factors reduce visibility and will impact the risk premium. We’ll have to wait and see if this happens in practice.” ANALYST 3
“I don’t have a risk premium for the sector but a risk premium for the market, which is given to me, and weighted according to a sector Beta. If all sectors are affected in the same way, which I doubt, the relative volatility of the sector won’t be affected much but I think that’s unlikely. Therefore, it’s not just the Beta of the sector that will be affected but the perception of the sector’s specific risk. What I mean is, not just the Beta but also the visibility and the understanding of the sector.” ANALYST 2

“No, the possible adoption of the new norms will not change my perception of the sector’s risk premium." ANALYST 1
Conclusion

Analyst consensus clearly demonstrates a generally negative perception and a strong opposition to the potential changes.

As cash flow generation is the prime operational and financial indicator looked at by telecom analysts, the main fault of the new model of revenue recognition is the distortion it creates between revenues and cash. In addition, because estimates are left to the discretion of the companies, the analysts believe the proposals introduce an extra element of risk to their evaluations with them having to rely on the hypotheses of the operators.

Taking into account the objectives of the norms, the analysts doubt the new accounting methods can attain the desired results. They also note that the inconveniences caused and the possible changes in perception of the sector would outweigh any of the hypothetical benefits. The analysts also believe the adoption of these new norms would naturally alter the risk premium of the sector.

“If the investors are not asking for it, I don’t see the point in launching a new set of accounting standards.” ANALYST 3

“The new norms and the new accounting methods risk changing many things without obtaining the desired results. It is not certain that it will make comparisons between companies any easier and it introduces new risks linked to problems of understanding, historic comparisons, training and education of investors and analysts.” ANALYST 2

“The nature of the contracts, apart from long-term commercial contracts, means these new standards are not desirable for the telecommunications sector.” ANALYST 1
Appendix 2 to our letter on the joint FASB/IASB Discussion Paper

Revenue Recognition DP

IT impact assessment

Group IT evaluation
Contents

section 1  The existing IT architecture
section 2  Consequences of the DP accounting model on processes
section 3  Tentative evaluation of IT impacts
Section 1
The existing IT architecture
FT Group has defined its own architecture framework

Customer Front-End manages all customer interactions, self service, audience and content, and points of contact (direct and indirect distribution)

Aggregation Layer

- Customer Platforms
- SCA, Service Platforms, Network
- Mediation Bus

Customer Platforms perform master data management (hosting repositories such as customers, installed base, purchase orders and products), order management and delivery, customer interaction & support, billing services

The Mediation Bus provides data flow capabilities linked to service usage, which can be in « passive mode » (after usage) or active mode (e.g. authorisation, credit control, reservation…)

S&CA, SPFs and Network block hosts functionality such as service Activation and Configuration, technical repositories, Service Assurance (QoS in the wider sense), and standard interactions with Service Platforms and network elements

Partners management

The Aggregation Layer receives requests from the front-end or from a back-end module to another back-end module, translates them when appropriate and routes them to the targeted modules. It works in real time from a “customer” perspective
Main blocks impacted by DP accounting model

Process starts with a contact with the customer whatever the channel
The selling act starts here (e.g. mobile contract with handset)

The Revenue Recognition process is supported by several domains of Customer Platforms

WEB PORTAL

Distribution Channels Portal

Web Self service
IVR, Wap
SMS, MMS

Direct
Indirect

Points of sales
Contact Centres

Phone
Mail
E-mail

Aggregation Layer

Customer Front-End

VNOs, wholesale

Third Party Application

Third Party Operator Relationship module

Third Party Services

Third Party

Customer Platforms

SCA, Service Platforms, Network

Points of sales

Contact Centres

The Revenue Recognition process is supported by several domains of Customer Platforms

Mediation Bus

The Selling act starts here (e.g. mobile contract with handset)

Process starts with a contact with the customer whatever the channel
Customer platform main functions and data

- **Customer data repository**: main customer data associated to a Mass market or Enterprise customer (e.g. customer name, segment, addresses...)

- **Offer catalogue**: description of the offers, of the products & services that belong to this offer, parameters, options...

- **Customer order**: stores a customer order from initialization to delivery. (According to country capability and legal rules order may be kept beyond delivery date)

- **Customer Installed base**: keeps current and on-going offers, products and services held by the customer (According to country capability and legal rules, history may be kept beyond cancellation date)

- **Contract**: only for Enterprise business processes, main commitments and conditions associated to offers.

- **Billing account**: main billing data associated to billing account (e.g. billing cycle, payment method, type of account: prepaid, postpaid, hybrid)

- **Billing Installed base**: Customer Installed base copy for billable elements
Remarkable characteristics of some repositories for both Mass market and Enterprise

- A given customer may have several contracts (implicit or explicit)
- A given customer may have several billing accounts.
- The Customer Installed Base provides the billing accounts for a given offer. The link with contractual conditions is not straightforward
- Customer relationship processes do not rely on contracts, but rather on the (order, customer installed base, billing account) set
- It is the customer’s choice to have one or several billing accounts
- The contract which will apply for an offer depends on the contract that was valid at the time the offer was signed. The contract terms periodically change over the offer life time
- The billing account structure may be changed at any time on customer’s request
Order to Cash (1) – Selling goods

Process
Sale of an equipment in a shop or on the Web (eShop) associated to a pre-paid or post-paid service. Sale is registered in a sales log without any link with the pre-paid/postpaid contract (e.g. the type of equipment sold is not registered in the Customer or Billing Installed Base

Accounting impacts
Revenue is accounted as a whole (not per customer) in G/L from the sales log on a daily basis
Order to Cash (2) - Customer data management

Customer Front End

Customer management
- Customer Data Repository
- Offer catalogue
- Customer order
- Contract
- Customer Installed Base

Delivery Process Manager
- Billing
  - Billing Installed Base
  - Billing Accounts
  - Balance management (pre-paid)
  - Billing / Invoicing (post-paid)
  - Balances
  - Invoices

Billing
- Usage collection & Real-time mgmt
- Customer Financial management
- Accounts receivable sub-ledger
- General Ledger
- General Ledger management

Accounting

SCA, Service platforms & Network

Process
Creation or update of customer data

Accounting impacts
No accounting impact (no accounting entry)
Order to cash (3) – Order a new offer or up Selling / down Selling

**Process**
- Order configuration
- Order validation (by customer and FT Group)
- Order recording in Customer order repository
- Update of Customer Installed base all along ordering/delivery process
- Triggering of delivery

**Accounting impacts**
- No accounting impact (no accounting entry)
Order to cash (4) – Service activation

Order delivery
Creation of the access (when relevant)
Service configuration and activation
Update of customer order and customer installed base
Note: end of service delivery marks service availability day 1

Accounting impacts
No accounting impact (no accounting entry)
Order to cash (5) – Billing activation

**Process**
Offer is set as a billable status in the Billing Installed base
Creation of a billing account (done by IN - Intelligent Network - when pre-paid is managed by IN) describing tariff conditions associated to the offer

**Accounting impacts**
For post-paid only, creation of an auxiliary account in the A/R sub-ledger
Order to cash (6) – Prepaid billing

Process
Balance management logs all events concerning a customer (top up or charging events) in the Balance database. Customer credit is checked before and during use of the service.

Accounting impacts
Accounting in G/L is made on a daily basis for consumption and top up, under aggregated entries (no customer individualization). Top up generates a deferred revenue and consumption generates actual revenue that decrements the deferred revenue.
Order to cash (7) – Postpaid billing

Customer Front End

Customer management
- Customer Data Repository
- Offer catalogue
- Customer order
- Customer Installed Base
- Contract
- Order management

Delivery Process Manager
- Billing Installed base
- Balance management (pre-paid)
- Balances
- Invoices
- Billing / Invoicing (post-paid)

Accounting impacts
- Customer Financial management
- Accounts receivable sub-ledger
- Usage collection & Real-time mgmt
- General Ledger management

Process
Customer invoice is calculated from recurring charges (e.g. recurring fee) and from traffic. Customer can be invoiced every month or the other month. There are generally several billing cycles for a monthly invoicing (~10)

Accounting impacts
A/R sub-ledger is updated on a per customer basis every time an event occurs: billing cycle or customer payment (batch mode). G/L is updated on an aggregated basis:
- every day for payments
- at every billing cycle for revenue recognition
- at end of month for cut off

IT impact assessment of the DP revenue recognition model – June 2009

France Telecom Group
Resilience of data, two kinds of repositories

- **“Flow type” repositories**
  - Generally event data
  - Information is created, can be updated until “closure” date. After closure, information is definitely fixed
  - Information is kept during the time it is useful and then cancelled, except for legal reasons
  - Example: order

- **“Stock type” repositories**
  - Resilient data
  - Information is updated as soon as an event occurs
  - Information is kept during the life time of the managed object
  - Example: customer data
Number of applications per impacted domain

**Customer domain**

- Customer Referential (Customer repository & Offer catalogue) 146
- Loyalty & retention 10
- Order capture 110
- Sales 134
- Multi-domain (Applications covering several sub-domains) 205

**Billing domain**

- Customer Financial Management 94
- Partner Billing and Settlement 60
- Rating Billing Invoicing 239
- Multi-domain (Applications covering several sub-domains) 108

**Finance domain**

- Finance 263

**Total applications with potential impact out of a total of 4200 main applications (conservative assessment).**

IT impact assessment of the DP revenue recognition model – June 2009

France Telecom Group
Section 2
Consequences of the DP accounting model on processes
Consequences of DP accounting model on processes

- To try to identify what changes would imply the new revenue model, we focus on a very basic & theoretical business case.

- The following example describes an offer to show up how FT group imagine the way contracts will be accounted for if the discussion paper apply.

- Preliminary remark: Identification of performance obligations and balance sheet entries are based on hypothesis as
  - no guidance is provided for in the discussion paper
  - some issue are still not addressed in the discussion paper
Consequences of DP accounting model on processes
Example 1: basic offer

- Sale of a bundle: handset + 12 months talk plan.
  - Stand-alone value of the handset: 180 € (purchase price identical)
  - Stand-alone value of the talk plan: 240 € (12 x 20 €)
  - Sale price of the bundle: 300 €
    - Handset 60 € upfront,
    - Talk-plan: 20 € per month,
    - Total subsidy = 120 €

- For simplicity reason, we do not take into account time value for money, recoverability issues and any other kind of PO that may arise in a standard Telco contract (loyalty program, warranty, options….)
Consequences of DP accounting model on processes

Example 1: changes in allocating the discount

<table>
<thead>
<tr>
<th></th>
<th>S/A price</th>
<th>Discount</th>
<th>Allocated discount</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Today</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Handset</td>
<td>160</td>
<td>-120</td>
<td>60</td>
</tr>
<tr>
<td>Talk plan</td>
<td>240</td>
<td>0</td>
<td>240</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>420</td>
<td>-120</td>
<td>300</td>
</tr>
</tbody>
</table>

**Accounting treatment**

<table>
<thead>
<tr>
<th></th>
<th>Day 1</th>
<th>Each month</th>
<th>Cumulated (12 months)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>60</td>
<td>20</td>
<td>240</td>
</tr>
<tr>
<td><strong>Cost of sales</strong></td>
<td>-180</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>-120</td>
<td>20</td>
<td>240</td>
</tr>
<tr>
<td><strong>Cash in</strong></td>
<td>60</td>
<td>20</td>
<td>240</td>
</tr>
<tr>
<td><strong>Cash out</strong></td>
<td>-180</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Cash flows</strong></td>
<td>-120</td>
<td>20</td>
<td>240</td>
</tr>
<tr>
<td>Difference cash in/revenue</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

**DP model**

<table>
<thead>
<tr>
<th></th>
<th>S/A price</th>
<th>Discount</th>
<th>Allocated discount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Handset</td>
<td>160</td>
<td>-51</td>
<td>122</td>
</tr>
<tr>
<td>Talk plan</td>
<td>240</td>
<td>-88</td>
<td>171</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>420</td>
<td>-120</td>
<td>300</td>
</tr>
</tbody>
</table>

**Accounting treatment**

<table>
<thead>
<tr>
<th></th>
<th>Day 1</th>
<th>Each month</th>
<th>Cumulated (12 months)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Revenue</strong></td>
<td>120</td>
<td>14.25</td>
<td>171</td>
</tr>
<tr>
<td><strong>Cost of sales</strong></td>
<td>-180</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Gross Margin</strong></td>
<td>-61</td>
<td>14</td>
<td>171</td>
</tr>
<tr>
<td><strong>Cash in</strong></td>
<td>60</td>
<td>20</td>
<td>240</td>
</tr>
<tr>
<td><strong>Cash out</strong></td>
<td>-180</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td><strong>Cash flows</strong></td>
<td>-120</td>
<td>20</td>
<td>240</td>
</tr>
<tr>
<td>Difference cash in/revenue</td>
<td>60</td>
<td>-5.75</td>
<td>-68</td>
</tr>
</tbody>
</table>
Consequences of DP accounting model on processes
Example 1: changes in accounting entries

- In order to keep a clear link between billing & accounting we will need to maintain a kind of "account receivables" account which will be a part of the total value of the contract asset (called "billed contract asset" in the example),
- As a consequence, we will need to follow each contract asset on a "per customer" basis.
Consequences of DP accounting model on processes

At point of sale

- When a contract is signed:
  - Today: nothing, this kind of event in ordering processes doesn’t trigger any accounting process
  - New: need to create a new accounting process in ordering; this event need to be tracked in point of sales and in customer installed base to build an account entry for performance obligation. Currently nothing can be reused or extended from the ordering process.

- When device is transferred:
  - Today: one event and one account operation, the way device revenue is accounted relies on price paid by customer upfront.
  - New: need to extend existing accounting processes to take into account the stand alone selling price, creating a new account entry per customer in charge of performance obligation.

- When device is paid:
  - Today: cash is accounted in one global account entry
  - New: need to account cash per customer
Consequences of DP accounting model on processes
At every billing cycle

- When an invoice is sent:
  - Today: one event and one account operation, revenue (recurrent fees, usage, ...) is accounted according to catalogue terms
  - New: need to extend existing accounting processes, creating a new account entry per customer in charge of performance obligation

- When invoice is paid:
  - Today: cash is accounted through one event and one account entry
  - New: no impact, re use existing process
Consequences of DP accounting model on processes
Even if previous example seems complex, it is only purely theoretical…

- In Telco industry, quite none of our customers behave just as presented in the previous example:
  - Minimum price contract:
    - Overstepping fixed-price contract usage:
      - Over usage
      - Overtaxed calls
      - Roaming
      - Content consumption (TV, music, games…)
    - Contract effective duration (will almost always differ from the initial one)
    - Contract changes (renewal, churn…)
    - Options in the contract
  - Others contract (mainly without a minimum term):
    - Fixed-line business
    - Pre-paid model in mobile
    - Business contracts
  - Loyalty programs to deal with
  - Regulatory constraints
  - …
Consequences of DP accounting model on processes

... as a consequence

- The theoretical model (example 1) is too simple.

- Processes and thus IT system should be able to adapt to the customer behaviour and to predict it in order to value the contract asset and PO.

- As it will be nearly impossible to valuate each and every contract at any time (in IT capability terms / costs), it will be necessary to define trigger events that will release the calculation of the value of the asset & the PO at pre-determined dates.

- Illustration follows.
Consequences of DP accounting model on processes
Example 2: the offer

- Sale of a bundle: handset + 12 months talk plan.
  - Stand-alone value of the handset: 180 € (purchase price identical)
  - Stand-alone value of the talk plan: 240 € (12 x 20 €)
  - Sale price of the bundle: 300 €
    - Handset 60 € upfront,
    - Talk-plan: 20 € per month,
    - Total subsidy = 120 €

- But customer consumes 10 € more than his plan each month during the first 8 months…

- 2 examples of possible accounting models:
  - Re-assessment of the value of the contract asset & PO at the end of the 8 months period
  - On-going accounting of the increase of the contract asset & PO
Consequences of DP accounting model on processes
Example 2: first example of accounting model

<table>
<thead>
<tr>
<th>Today accounting entries</th>
<th>Balance Sheet</th>
<th>P&amp;L</th>
</tr>
</thead>
<tbody>
<tr>
<td>When contract is signed</td>
<td>Contract Asset</td>
<td>Account receivables</td>
</tr>
<tr>
<td>When device is transferred</td>
<td>80</td>
<td>60</td>
</tr>
<tr>
<td>When device is paid</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Total Day 1</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>When invoice is sent</td>
<td>20</td>
<td>0</td>
</tr>
<tr>
<td>When invoice is paid</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

New Model - +10 months - end of period

<table>
<thead>
<tr>
<th>Each Month</th>
<th>Balance Sheet</th>
<th>P&amp;L</th>
</tr>
</thead>
<tbody>
<tr>
<td>When invoice is sent</td>
<td>Contract Asset</td>
<td>Billed contract assets</td>
</tr>
<tr>
<td>When device is transferred</td>
<td>300</td>
<td>60</td>
</tr>
<tr>
<td>When device is paid</td>
<td>300</td>
<td>60</td>
</tr>
<tr>
<td>Total Day 1</td>
<td>300</td>
<td>60</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Cumulated 8 months</th>
<th>Balance Sheet</th>
<th>P&amp;L</th>
</tr>
</thead>
<tbody>
<tr>
<td>When invoice is sent</td>
<td>Contract Asset</td>
<td>Billed contract assets</td>
</tr>
<tr>
<td>When device is transferred</td>
<td>240</td>
<td>240</td>
</tr>
<tr>
<td>When device is paid</td>
<td>240</td>
<td>240</td>
</tr>
<tr>
<td>Total 8 months</td>
<td>240</td>
<td>240</td>
</tr>
</tbody>
</table>

- Contract asset = 0 but minimal period is not over: need to re-book a new contract asset
- PO ≠ 0 : need to catch-up revenue as promise was delivered
### Consequences of DP accounting model on processes

**Example 2: second example of accounting model**

#### Today accounting entries

<table>
<thead>
<tr>
<th>Contract Asset</th>
<th>Account receivables</th>
<th>Performance Obligation</th>
<th>Inventories</th>
<th>Cash</th>
<th>Revenue</th>
<th>Cost of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>When contract is signed</td>
<td>80</td>
<td>60</td>
<td>190</td>
<td>60</td>
<td>60</td>
<td>180</td>
</tr>
<tr>
<td>When device is transferred</td>
<td>80</td>
<td>60</td>
<td>0</td>
<td>0</td>
<td>180</td>
<td>80</td>
</tr>
<tr>
<td>When device is paid</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>180</td>
<td>80</td>
<td>0</td>
</tr>
<tr>
<td>Total Day 1</td>
<td>0</td>
<td>0</td>
<td>80</td>
<td>60</td>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>

- When invoice is sent
  - Contract Asset: 20
  - Account receivables: 20

- When invoice is paid
  - Contract Asset: 20

#### New Model - +10 months - on going input

<table>
<thead>
<tr>
<th>Contract Asset</th>
<th>Billed contract assets</th>
<th>Performance Obligation</th>
<th>Inventories</th>
<th>Cash</th>
<th>Revenue</th>
<th>Cost of Sales</th>
</tr>
</thead>
<tbody>
<tr>
<td>When contract is signed</td>
<td>300</td>
<td>60</td>
<td>120</td>
<td>300</td>
<td>120</td>
<td>180</td>
</tr>
<tr>
<td>When device is transferred</td>
<td>80</td>
<td>60</td>
<td>120</td>
<td>300</td>
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<tr>
<td>When device is paid</td>
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<tr>
<td>Total Day 1</td>
<td>300</td>
<td>60</td>
<td>80</td>
<td>60</td>
<td>120</td>
<td>300</td>
</tr>
</tbody>
</table>

- Each Month
  - When invoice is sent
    - Contract Asset: 10
    - Billed contract assets: 30
    - Performance Obligation: 14,25
    - Inventories: 10
    - Cash: 30
    - Revenue: 14,25

- When invoice is paid
  - Contract Asset: 0

- Cumulated 8 months
  - When invoice is sent
    - Contract Asset: 380
    - Billed contract assets: 380
    - Performance Obligation: 240
    - Inventories: 240
    - Cash: 240
    - Revenue: 240

- When invoice is paid
  - Contract Asset: 0

- Total 8 months
  - Contract Asset: 380
  - Billed contract assets: 380
  - Performance Obligation: 240
  - Inventories: 240
  - Cash: 240
  - Revenue: 240
  - Cost of Sales: 180

- **Contract asset and PO are reassessed each and every months on a “cash received” basis.**

- **But, this accounting model underlies that out of bundle usage is not a real PO because revenue derived was not allocated to each deliverables. Is revenue correctly accounted for?**
Consequences of DP accounting model on processes
Beyond this two examples, which trigger events should lead to re-calculation of the contract assets or PO?

- End of minimum commitment period
- Explicit Renewal of contract or substantial evolution
- If client still on our network but contract asset = 0
- If client still on our network but PO = 0
- After average life & value used to calculate contract assets on a global basis. But if average may appear to be ok on an aggregated basis, it will never represent the actual value of an individual contract.
- At each closing date (quarterly)
- Or many other possible events… ?
Consequences of DP accounting model on processes

Conclusion

- All our IT should be adapted to take into consideration the change in processing:
  - The valuation of the contract asset both initially (estimations) and over the life of the contract.
  - The performance obligation over the life of the contract

- Need to create a new management rule in charge of taking into account the variation between:
  - Estimated upfront assumption
  - Real usage

- Need to adapt the way our IT deals with customer contract today, from a flow model to a stock model

- Need to adapt the size of our IT and its capability to deal with historical data
Section 3

Tentative evaluation of IT impacts
Tentative evaluation of IT impacts

Preliminary Remark

- Figures presented hereafter are based on our understanding of accounting of the Discussion Paper model of revenue recognition.

- All evaluations are based on hypothesis:
  - limited number of trigger events during a year (cf. part 2).
  - only 3 POs per contract (minimal approach)

- Calculation provided hereafter are based on example 2 (cf. section 2): no reallocation that adds complexity.
Tentative evaluation of IT impacts
Overall assessment of magnitude

- On processes:
  - Point of Sales process (internal and also third party)
    - Need to extend accounting process for device transfer
  - Ordering process
    - Need to introduce the device in installed base repository taking into account the offer *
      device combination matrix (hundred of thousand possibilities)
    - Need to create accounting process for initialization of performance obligation
  - Billing cycle process
    - Need to extend accounting process to manage performance obligation
  - Accounting processes
    - Need to develop a full new system capable of estimating contract value: this value would result from a combination of an estimated duration and an estimated measurement of the value of the options
    - Need to create a new function in charge of taking into account the variation between estimated upfront assumption and real usage
    - Need also to create a new function in charge of calculating cut off on performance obligation

- Accuracy constraint: accounting on individual base
  - The performance obligation requirement transform the foundation of A/R accounting principle for the revenue: it is mandatory to move from an accounting level global “by bill cycle” to an accounting level detailed by customer/invoice/contract
Tentative evaluation of IT impacts
Overall assessment of magnitude per domain

Customer domain

- **Customer Referential**
  (Customer repository & Offer catalogue)
  Impact on Offer catalogue
  - Medium

- Loyalty & retention
  Impact on performance obligation + detailed accounting
  - Medium

- Order capture
  Impact on installed base management for devices
  - High

- Sales
  Generation of new accounting events
  - Medium

- Multi-domain
  - Medium

Billing domain

- Customer Financial Management
  Move to individual management + contract asset mgmt + accurate mgmt of performance obligation
  - Huge

- Partner Billing and Settlement
  Same impact for third parties
  - High

- Rating Billing Invoicing
  New accounting scheme + move to individual accounting
  High on prepaid / medium on postpaid
  - Medium

- Multi-domain
  - High

Finance domain

- Finance
  New accounting scheme + volume impact + accurate management of performance obligation
  - Medium

IT impact assessment of the DP revenue recognition model – June 2009

France Telecom Group

441 applications with high or huge impact

928 applications with medium impact
Tentative evaluation of IT impacts
Measurement of increase in accounting entries

- Beside all the changes needed in the different IT applications the hereafter slides present a tentative measurement of the volume of accounting entries needed in the new model.
## Tentative evaluation of IT impacts
### Measurement of increase in accounting entries

<table>
<thead>
<tr>
<th></th>
<th>Balance Sheet</th>
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<tbody>
<tr>
<td><strong>Today accounting entries</strong></td>
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<tr>
<td>When contract is signed</td>
<td>Contract Asset</td>
<td>Account receivables</td>
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<tr>
<td>When device is transferred</td>
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<td>When device is paid</td>
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<tr>
<td><strong>Total Day 1</strong></td>
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<td>When invoice is sent</td>
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<td>When invoice is paid</td>
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<td><strong>New Model - 10 months - end of period</strong></td>
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<tr>
<td>When contract is signed</td>
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<td><strong>Total Day 1</strong></td>
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<td>Each Month</td>
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<td>When invoice is sent</td>
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<td>When invoice is paid</td>
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<tr>
<td><strong>Total 8 months</strong></td>
<td>300</td>
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<tr>
<td><strong>New Model - 10 months - on-going input</strong></td>
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<tr>
<td>When contract is signed</td>
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<td><strong>Total 8 months</strong></td>
<td>300</td>
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</table>

IT impact assessment of the DP revenue recognition model – June 2009
Tentative evaluation of IT impacts
Volume calculation: executive summary

- In today accounting environment, number of acc. entries (Group figures) is:
  - A/R : ~ 2.5 billion
  - G/L : ~ 0.1 billion

- Forecasted changes would require:
  - A/R :
    - Post paid only: ~ 12 billion
  - G/L :
    - Post paid only: almost no change

- Moreover, if pre-paid contracts are in the scope of the “contract” as defined in the discussion paper, we also evaluate that it will require more than 130 billion new entries each year.
Tentative evaluation of IT impacts
How Telcos deal with customer accounting today

- Customer accounting is managed either by:
  - A billing environment:
    - Billing editors and their software (e.g. Amdocs, Oracle, Comverse,....) provide a specific Telco solution
    - This customer accounting is:
      - focused on accounts receivables
      - not G/L centric: very few functionality regarding G/L, very few account analysis, limited automatic accounting entries...
    - Those solutions can support high volume of data
  - An ERP environment:
    - ERP editors (e.g. SAP, Oracle, EBS, PSFT, JDE) offer a customer accounting module embedded in their solutions
    - as this customer accounting is integrated in a more global solution it offers much more functionality than a billing one.
    - in general, it does not support a huge volume of accounting entries and account receivables

- Two years ago, FT Group asked ERP providers if they would be able to deal with 1 billion accounting entries per year. Only one provider answered positively to the question.
Tentative evaluation of IT impacts
How to deal with customer accounting if model is changing

- If the new revenue recognition model would apply:
  - In terms of volume:
    - the first analysis done by FT Group IT Division is that today solutions are not able to bear the increase in accounting entries mentioned in previous slides without a dramatic impact (time to process data, capacity to close the book, data logging and archiving).
  - In terms of data processing (automatic accounting entries, account analysis with balancing of accounts):
    - the first analysis done by FT Group IT Division is that such topic are mostly covered by G/L functions rather than A/R one. As a consequence either:
      - very strong evolution of Billing and/or ERP would be necessary (with consequences on timing before implementation and availability of such demand)
      - full new specific developments would be required (with consequences linked to such specificity)
Tentative evaluation of IT impacts
Overall assessment on change needed

- IT billing was historically organised by product and by market. Beside rationalization efforts done over the IT application portfolio, many billing systems still co-exist in many countries.
  - Products: mobile pre-paid, mobile post-paid, fixed, internet, data, services...
  - Market: Mass Market, Enterprise

- Letting aside any cost or HR constraint (skills and competencies availability), and ignoring actual technical feasibility:
  - Keeping in mind that any upgrade on an existing IT billing system requires between 15 to 30 months,
  - Keeping in mind that the DP accounting model may require brand new systems,
  - Keeping in mind that the required changes will have to be implemented on most of customer oriented systems (markets / products),

- Our assessment is:
  - Implementation Road Map across all our geographies would require between 7 (optimal calendar) to 10 years.
  - As a roll-over period of 3 years would be required for financial communication, we estimate that such a project needs 10 to 13 years to be implemented.
Appendix 3 to our letter on the joint FASB/IASB Discussion Paper

“Preliminary Views on Revenue Recognition in Contracts with Customers”

Answers to the specific questions raised in the invitation for comments

Note to the reader

These answers should be read in conjunction with the cover letter

***

Chapter 2: A contract-based revenue recognition principle

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?

France Telecom Orange understands the objectives of the Boards when attempting to build up a new and robust model of revenue recognition principle. France Telecom Orange welcomes work being carried on revenue recognition because there is some missing guidance under IFRS that leads us to turn to the US literature and that it will help all the IASB’s constituents if the existing material on the subject could be enhanced. Similarly, under US Gaap, a variety of revenue recognition rules has been developed with some of them being industry -or product- specific. The extent of such a guidance did not always improve comparability across industries, probably increased the risk of errors, and did not ensure that all issues were adequately addressed.

Characteristics of the current accounting model in the telecommunications industry

In the telecommunications industry, the current accounting model generally used 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. Revenue recognition questions are therefore limited and relate to:

- Timing of recognition of connection or upfront fees and separability of equipment furnished to connect to the service (SAB104);
- Accounting for promotional and loyalty programs (the latter dealt with by IFRIC13);
- Net vs. gross accounting in agent vs. principal (EITF 99-19) or in linked transactions (EITF 01-9);
- Allocation of consideration in multiple deliverables arrangement (EITF 00-21).

Also in connection with revenue, additional questions are mainly related to the recognition of acquisition or retention costs, which in Europe and in the United States are usually expensed.

France Telecom Orange believes that the revenue accounting model described above is consistently applied by all the major operators within Europe and the United States. Advantages of this model are that:
- comparability between telecommunications companies is recognized by users as good;
- it is consistent with the underlying nature of the business as viewed by of management and users;
- by avoiding the accrual of material amounts of revenue which will only be received if future services are provided, it results in revenue that closely links to the cash flows from customers;
- it is highly appreciated by users as being only marginally sensitive to management estimation;
- it fosters the regulated dialog between all parties as they are useful to management, shareholders, analysts and other users of the accounts.

**Objectives of a new standard**

Therefore, any new accounting standard should:
- as a minimum match the above characteristics of existing standards & practices;
- provide valuable incremental benefits that match, or exceed, the costs of compliance,
- the latter being understood not only as upfront or ongoing costs to preparers to adapt their accounting systems and processes but also as any potential drawbacks to both preparers and users in terms of confidence in or clarity of reported figures.

Creating consistency through a single model should not be an objective in itself. The objective should rather be to build a model that brings relevant information to users with its desirable attributes.

Based on the comments they will receive, if the Boards conclude that their objective of a single revenue recognition principle proves too difficult to achieve, France Telecom Orange suggests maintaining the current accounting models, which do not appear to cause significant difficulties to preparers and users alike under IFRS; this could be done by keeping the existing two standards or alternatively by integrating both of them with their respective model into one standard, with some tidying up and clarifications on the choice of applicable model.
Building a standard around a customer’s contract

The Boards are right in using the contract as a basis for a revenue recognition standard in that no revenue should be accounted for without an agreement with a customer. This is because revenue should at the end of the contract have reflected the cash flows that the entity has received pursuant to a contract with a customer.

Nevertheless this represents a significant shift. By retaining the contract as the basis for revenue recognition, consideration needs to be given:
- to Offer and Acceptance and the options for additional goods or services associated to the contract
- to the Definition of enforceable and the nature of commitments of the parties to the contract
- to Definition of a customer esp. the meaning of “the output of the entity’s ordinary activities” and its interaction with the proposed model.

Please Refer to Question 3

About changes in the contract assets and liabilities

France Telecom Orange understands the concept of right (asset) and obligations (liability). However complying with the asset/ liability approach does not mean that revenue, which is defined as the increase or decrease of any group of assets or liabilities, even if they are the assets and liabilities arising from contracts with customers, will mechanically ensure that the income statement conveys relevant information. On the other hand whichever revenue recognition principle is retained, the balance sheet will ultimately always capture transfers of assets between an entity and its customers. This question is connected to the choice made by the Boards to trigger revenue recognition on the transfer of control of the promised asset: Please refer to Question 8.

In an industry with hundreds of millions of contracts with customers, France Telecom Orange has also significant concerns about the consequences of the proposed asset/liability approach in terms of systems and processes. Using a portfolio basis seems does not appear as a solution in the proposed model. A contract-by-contract accounting of the asset and of the liability (even if netted) would inevitably mean that extremely substantial IT systems modifications would be required. The delivery and billing of equipment are handled by systems that are not necessarily part of the mainstream systems. If a customer makes a phone call under its contract the minutes he used trigger a billing event and the customer will be billed the price he agreed upon in the contract with the operator. Several performance obligations to be identified under the proposed model are not relevant for billing processes since they do not constitute a billing event. As a consequence the purpose of the IT system modifications is to remeasure the amount billed to the customer to the amount of revenue to be recognised under the proposed model. In addition, since telecommunications operators typically do not use a single billing system
but several billing systems, compatibility to those several systems need to be assured. This explains the operational complexity of the proposed model and the costs necessary to comply with the proposed model.
Please refer to the Report attached to the cover letter.

Addressing the inconsistencies in today’s revenue recognition principle

France Telecom Orange believes that there is much more consistency within IAS 11 and IAS 18 than it is usually recognized. IAS 11 and IAS 18 are both based on a risks & rewards analysis. Inconsistency arises when in IAS 18 introduces for the sale of goods criteria that are in fact close to the notion of transfer of control as described in the DP:

- This apparent inconsistency within IAS 18 could be viewed as a pragmatic approach for dealing with repetitive and swift transfers of goods.
- The differences in application of the risks & rewards approach mentioned by the Board have probably more to do with a concept rich enough to translate different business models and the activity performed under a contract than with a broken concept needing repair.

In fact, a single revenue recognition model if accounting standard should include concepts that accommodates the diversity in business and economic environment. Inconsistency should be looked through the prism of business. To illustrate, one may wonder whether it is pertinent to say that revenue recognition principle are inconsistent when comparing a construction contract, a short term service contract and a simple sale of goods? When trying to compare different activities other indicators than revenue such as operating income may be more relevant.

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?

Contracts in the Telecommunications Industry

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. 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 and how consideration would have to be allocated under the principles of the DP.

This unique combination of extreme flexibility of services accessible, mass market, low value mass transactions where the contract is merely the support of offers are characteristics that are found in few other industries if any: it is different from mass market utilities like gas or electricity or water where optionalities within a contract are usually extremely limited (mostly renewal with no guaranteed price); it is different from mass production or distribution; it is different from contract activities in construction, consulting or systems integration etc. where contracts have often limited optionalities and where the contract is what is managed.

The principles proposed with the DP would eliminate most of 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 DP, 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 highly 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.

Long term contract activities

As users of financial statements of our suppliers, partners and customers, France Telecom Orange is concerned that for significant long term activities the proposed model for revenue recognition may delay revenue recognition until full completion and deprive financial statements from reporting performance in a relevant manner; those industries may be forced into non-GAAP financial reporting in order to cope with useless IFRS compliant financial reporting; France Telecom Orange does not believe that such an outcome is desirable. Please Refer to Question 8.

**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.*

The Boards should consider whether the definition of a contract in the DP and in IAS32 should be aligned.
By retaining the contract as the basis for revenue recognition, consideration needs to be given:

- to Offer and Acceptance and the options for additional goods or services associated to the contract:
  
  - France Telecom Orange regrets the DP considers only simple situations with little or no optionality in the contract and that this subject has been postponed to later discussions because the nature of the relationships with the customer in the industry is built around offering access to services.
  
  - France Telecom Orange believes that the contract boundaries should exclude any consideration to which the customer is not committed: renewal options, access to supplementary services should not be considered for revenue recognition purposes if the stand alone value of the option is insignificant or is too difficult to value.

- to the Definition of enforceable and the nature of commitments of the parties to the contract:
  
  - Commercial contracts do include (either explicitly or implicitly, due to legal requirements or common litigation outcomes) detailed clauses that may make the commitment by one or the other party more or less substantive. Limiting the conditions bearing on the existence of a contract as the contract being "legally enforceable" is not adequate: the future standard should rely on the exercise of judgement, so that all facts and circumstances are duly considered.
  
  - The analysis of how parties to the contract are committed should not be based on a legal analysis only, but also acknowledge that parties are compelled to rational economic behaviour. Indeed B to C operations often handle great numbers of customer transactions, most of which would not result – on an individual basis - in amounts worth recovering in case customers fail to pay amounts due. In those cases, the customer cannot be considered bound to pay the agreed price.

- to the Definition of a customer esp. “the output of the entity’s ordinary activities” and its interaction with the proposed model
  
  - For users and preparers, differentiation between turnover and other income is a critical indicator. Moreover, the link between ordinary activities, performance obligation and revenue is also not fully clear in the DP.
  
  - To illustrate this question, as Telcos are primarily providers of network services and not handset manufacturers, does the sale of the handset represent “an output of ordinary activities”? Providing a handset can potentially be viewed as a sale incentive to enter into a commercial relationship, a necessary tool to
connect to our network (and profit our services) or a useful way to encourage customers to spend more on the mainstream services.

- 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 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.
Chapter 3: Performance Obligations

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 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, 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’.

As currently defined within the DP 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);
- 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 inherent complexity and estimation processes involved in allocating standalone values to incidental deliverables that are never delivered to (and would not be purchased by) customers on a standalone basis due to the sheer quantum of customers and possible permutations involved.
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.

France Telecom Orange therefore believes amendments are critical for telecommunications companies to be able to apply the principles of the DP.

**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?

Yes, performance obligations should be separated only if it affects the amount of revenue to be recognized and subject to the comments in Question 4.

Whether that basis should be when an entity transfers the promised assets to the customer is discussed in Question 8.

Whether sales incentives give rise to a performance obligation is addressed in Question 7.

**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?

The case illustrated in the DP is about a right of return after a limited period of time to determine whether a sale has taken place at the time of delivery. The question may be viewed differently: grant of a free right of use and ultimately a sale. Please Refer to Question 8
Legal obligation to take back an equipment that was sold at the end of its usage or contractual buy back clause of used goods is apparently not in the scope of the question.

**Question 7**

*Do you think that sales incentives (e.g. 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?*

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 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 by users of the accounts as part of the cost of acquiring a customer. The allocation of revenue from the mainstream activities to such inducements reduces the comparability, usefulness and the reliability of reported revenue figures.

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 per the DP, however, would be likely to result in higher equipment revenue and lower monthly airtime revenue. Although it is arguable that different contractual circumstances apply, such different accounting treatments should not arise in these circumstances and such differences would be unhelpful to users of the accounts.
Chapter 4: Satisfaction of Performance Obligations

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.

In the telecommunications industry, the notion of transfer of control appears similar to the current notion of delivery of the service if two areas are put aside: the timing of recognition for connection activities or the nature of the equipments used by the customer to access the services. In the latter cases, the control notion is not as clear as to require a rebuttable presumption (Par 4.56) and it is unclear whether it gives an answer to the telecom example of Par 1.5.

In fact the DP states that a performance obligation is satisfied when the customer controls the resource underlying the promised asset.

The Boards should clarify what the promised asset is, what the resource underlying the asset is and whether there is a difference between controlling the asset and controlling the resource underlying the asset:
- the debate about the sale with a right of return and the free trial period are an illustration of probably inadequate identification of the promised asset: is it not a free right of use secured or not by cash before completion of a sale?
- In the telecommunications industry customers typically need devices such as handsets, modems or internet 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 provided but on the other hand the devices may generally be used with the services provided by others. If the resource underlying the handset asset is the telecommunications network or the access to it, then the customer would never control it.

The DP itself does not provide a definition of control. A number of standards within IFRS consider the concept of control, including IFRIC 12, IFRIC 15, SIC 12, IAS 39 and ED 10, which suggest that the concept of control is, in itself, a complex one.

In the illustrative simple cases the criteria to determine the transfer are unclear:
- e.g. what are the respective roles of physical possession, legal title, and cash? How does this translate for a service?
- What about complex contractual clauses where both parties try to secure their position if ‘things go wrong’?

It is also somewhat legalistic and away from the economic substance of commercial arrangements:
- e.g. both the sale with a right of return and the free trial period are in fact a free right of use secured or not by cash before completion of a sale;
- it appears difficult in those situations in contracts associating the delivery of a good and a service (e.g. DP 4.39 or DP 4.35).

If retained, this notion will need to be better defined and field tested to determine its workability and to check convergence in interpretation.

Finally, for significant long term activities, the emphasis on the transfer of control of the asset (and physical control) may delay revenue recognition until full completion and deprive financial statements from reporting performance in a relevant manner. In those contracts, it is likely that the rights and obligations of each party are in fact entangled and that the vendor will progressively transfer resources to the contract and hence to the customer (if one puts aside the notion of physical access, and one views the subordination of payment to various conditions as guaranty) and conversely that the buyer will progressively gain a form of control on the work in progress (limiting access by others). Here again, questions arise about the promised asset and about the separation of various performance obligations. A standard should not eliminate the complexities encountered in real life but recognize them. Depending on the answers that will be given, it might be possible to work out a principle that alleviates the perceived inadequacy of the proposed model.

**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.

Please refer to Question 8.
Chapter 5: Measurement of Performance Obligations

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, the transaction price approach is more relevant to users and management 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.

However because there is a lack of description of the transaction price in DP, France Telecom Orange’s view is that revenues should ultimately equal the cash flows received pursuant to the contract with a customer and that revenues recognized should have the qualitative attributes described in Question 1. Therefore France Telecom Orange does not support the recognition of contingent revenues.

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 costs exceeds the carrying amount of the performance obligation? Why or why not?

Yes, this approach is appropriate as it reflects the real potential loss, is simpler to apply and is consistent with current standards. Such a remeasurement should not be reported within revenue in order to maintain the link between reported revenue and cash inflows from the customer.

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.

No. Please refer to Question 12 with respect to the proposed allocation rule.
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?

No.

**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 (e.g. 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, it is not practical or appropriate to differentiate a payment to recover origination costs from the rest of the transaction price if they are not identified in the contract; 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.

Currently costs are capitalised only if they qualify for capitalisation under other standards, otherwise they should be expensed as incurred. As the DP covers revenue recognition, rather than cost accounting, this question should be part of DP on cost accounting, a subject that will need to be addressed if the model is intended to replace IAS11.
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?

Allocating the transaction price to the performance obligations on the basis of the entity’s stand-alone selling prices is not consistent with identifying performance obligations according to a strict interpretation of contractual obligations which represent the law between the parties. The proposed allocation of consideration follows a mathematical allocation, rather than a conceptual approach.

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.

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

Otherwise the proposed allocation rule will have the following undesirable effects to users:
- the highly segmented approach of the market and frequent changes in the prices may lead to inconsistencies in the reported services prices between offers and operators;
- a major mismatch between the timing of recognition of revenue and billing for services (and cash) will arise due to an up-front accrual of material amounts of revenue for incentives provided up-front to customers;
- any allocation is highly sensitive to management’s estimates of the customer’s behaviour.

France Telecom Orange welcomes the recent debate at the Boards about whether or not to constrain revenue recognition and the Boards tentative decision to constrain the expected consideration approach in those rare situations where a consideration amount cannot be reasonably estimated. However, those rare situations are too restricted in the way they are described. In fact with respect to the desirable attributes of revenue reporting, an unconstrained allocation is acceptable only when the consideration received covers part of future deliveries. France Telecom Orange therefore encourages the Boards to reconsider the alternate “constraining revenue to consideration that is certain” by evaluating the advantages of such an approach, especially in terms of confidence in reported figures.

Beyond the requirement of the model, when a single contractual price includes multiple elements delivered in the same period, such as entitlements to voice minutes and SMS
usage, then allocations between such elements based on relative standalone selling prices might be an adequate basis for financial communication if this is how management monitors the sources of revenues.

**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?

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 the industry’s ordinary course of business.

In such circumstances, it might be more appropriate to consider that the contract obligation represents an obligation to which no revenue should be allocated.

Otherwise, the use of estimation techniques to determine standalone selling prices may be appropriate but it has limits that should be recognized:

- The proposed model increases complexity and potentially decreases reliability of the information presented under the proposed model in cases in which the estimates cannot be based on observable inputs when no stand-alone selling price is available. The Boards therefore propose to use observable input data, whenever it is available. Nevertheless, since the DP 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.
The forced allocation of the consideration to be received from the customer to the different performance obligations under a contract with a customer would 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 recognised 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.

Therefore further guidance should be provided by the Boards in respect of the use of estimation techniques to determine standalone selling prices and certain reliability criteria are required. For example, residual pricing methods should be allowed, in certain circumstances, and the contingent revenue cap should be applied.