



Milan, June 18, 2009

Sir David Tweedie
Chairman
International Accounting
Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Ref.: Discussion Paper “Preliminary Views on Revenue Recognition in Contracts with Customers”

Dear Sir David,

We are writing in response to your invitation to comment the Discussion Paper “Preliminary Views on Revenue Recognition in Contracts with Customers” published by the IASB in December 2008 (the “DP”).

We would like to inform the IASB that we have discussed the DP with other European telecommunications companies in order to compare each company understanding and expected impacts of DP. While some of the following comments have been shared by other companies, we have raised in this letter some specific comments and views. Nevertheless, this letter is solely submitted in our capacity and does not engage others companies.

Our comments with a briefly introduction of Telecom Italia Group are set forth in the appendix herein enclosed.

We thank you for the opportunity to submit our contribution on this matter.

Very truly yours,

Riccardo Taranto
Chief Accounting Officer



APPENDIX

1. PROFILE OF TELECOM ITALIA GROUP

Telecom Italia S.p.A. and its subsidiaries operate mainly in Europe, the Mediterranean Basin and South America.

The Telecom Italia Group is engaged principally in the communications sector and, particularly, the fixed and mobile national and international telecommunications sector, the television sector and the office products sector.

In 2008, the Group recorded revenues for 30,158 million euros.

2. TELECOMMUNICATIONS INDUSTRY BACKGROUND

The telecommunications industry is capital-intensive with operators investing heavily in licences and network infrastructures. Deregulation, increasing competition and continuing development of new technologies characterise the industry. Operators have responded mainly by offering bundled service packages to customers through different distribution channels, and by investing in the acquisition and retention of customers.

3. GENERAL COMMENTS

3.1. Risk of inconsistency with the “Substance over form” principle

The proposed approach for revenue recognition is focalised on the contract between an entity and a customer.

The DP defines the contract as “an agreement between two or more parties that creates enforceable obligations” (§10). Other concepts of DP derive from the “contract” definition:

- “customer” is defined as “a party that has contracted with an entity to obtain an asset” (§10);
- “asset” (such as a good or a service) represents an output of the entity’s ordinary activities (§10);
- “net contract position” is a contract asset, a contract liability or a net nil position that depends on the measurement of the remaining rights and obligations in the contract (§15);
- an entity’s performance obligation is a promise in a contract with a customer to transfer an asset to that customer (§17); and
- an entity satisfies a performance obligation and, hence, recognises revenue when it transfers a promised asset to the customer (§20).

At the end, revenue recognition directly and indirectly depends on the contract definition. The application of such a conceptual structure leads to focus on the contract terms (the “form”) and therefore it seems not to be consistent with the “substance over form” principle (IFRS Framework, §35); as a result of this, the reliability of financial statements could be undermined.

3.2. Alleged inconsistency between IAS 18 (Revenue) e IAS 11 (Construction contracts)

The discussion paper identifies the current difference in accounting between IAS 18 and IAS 11 as one of the reasons to introduce a new standard on revenue recognition.



We agree with this position, however, in our opinion, the alleged inconsistency between IAS 18 and IAS 11, does not represent a significant issue in the telecommunications industry.

In particular, the IAS 11 can be considered as an exception, to the IAS 18 base rule, for a specific case (construction contract). The differences between IAS 18 and IAS 11 are even necessary to reflect the substance of different transactions (a simple sale of a mobile phone has a different economic substance than a bridge building).

3.3. In telecommunications industry the application of DP could be complex or even not practicable and, in some cases, highly expensive

In telecommunications industry the literal application of DP could be complex or even not practicable due to the features of the telecommunications transactions. Telecommunications industry is characterised by a customer base of millions of people, several products and kinds of services and offers, several tariffs (regulated and not), different country markets, and different terms of payment due from customers (e.g. pre-paid, post-paid).

This means a huge number of combinations in contracts with customers. Therefore the application of the DP on a contract-by-contract basis could result difficult to manage or in some circumstances not feasible.

Furthermore, the abovementioned complexity of the DP would involve for the telecommunications companies the incurrence of significant expenditures in order to upgrade their information technology systems, operational procedures, internal control and reporting systems.

3.4. DP leads to a revenue recognition pattern that does not reflect the substance of the telecommunications business

In multiple element transactions, the DP proposes the allocation, at the inception of the contract, of the transaction price in proportion to the stand-alone selling price of each performance obligation (the relative stand-alone selling price method).

This method does not reflect the substance of the telecommunications business where the huge amount of capital expenditures for network is earned from the rendering of services rather than through the sale of equipments to customers.

Furthermore, the equipment (and in particular the SIM inside the handset) represents just the tool enabling the customer to access the network and receive services.

For example, in a bundled offer composed of a handset and airtime traffic, the relative stand-alone selling price method emphasizes the portion of revenue to be allocated to the handset in respect to the portion of revenue to be allocated to the undelivered services.

Please see also the comments provided for the questions 10 and 13.

3.5. DP open topics

The discussion paper leaves open several topics, some of these are critical in telecommunications industry (i.e. reporting revenue gross as principal or net as agent, the time value of money, contract renewal and cancellation option, etc.). We believe that providing comments on a discussion paper that does not represent a comprehensive picture is not meaningful and useful.

Therefore, in order to address the missing topics, we ask for the Board to revise the DP on revenue recognition before the issue of the related exposure draft.

4. RESPONSES TO THE QUESTIONS ASKED IN THE DISCUSSION PAPER

QUESTION 1 - Do you agree with the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or contract liability? Why or why not? If not, how would you address the inconsistency in existing standards that arises from having different revenue recognition principles?

We believe that the boards' proposal to base a single revenue recognition principle on changes in an entity's contract asset or a contract liability is a worthy initiative to foster a discussion on revenue recognition; however, as described above in the general comments, this approach is difficult to manage in telecommunications industry.

We understand that the proposed single principle would simplify the revenue recognition in USA where there are more than 100 standards, nevertheless from an IFRS user standpoint, we believe that it does not provide a more reliable and decision-useful information in comparison with the current IFRS.

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?

We would draw your attention to the case of a sale and repurchase agreement (or agreement in which the seller has a call option or the buyer has a put option).

In the first step of the agreement (sale) an entity (the seller) transfers a good to the counterparty and the counterparty acquires the control of the good.

Following literally the DP the entity satisfies its contractual obligation by transferring the good. Therefore the entity should derecognise the asset transferred and should record the revenue arising from the sale.

At the same manner in the second step (repurchase) the entity should recognise the asset (repurchased) and account for the cost arising from the repurchase.

This seems to be inconsistent with the "substance over form" principle and could lead to the recognition of fictitious revenues (inflating revenue in a specific period and recording cost in subsequent periods).

In particular, this concern derives from the adoption of the proposed concept of "control" in determining when the entity has satisfied its performance obligation.

In such a case, it would be appropriate the application of the current standard IAS 18 whereas the revenues from the sale of goods shall be recognised when, among others, the entity has transferred to the buyer the significant risks and rewards of ownership of the goods.

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 inclusion of constructive or implicit obligations in the contract could give rise to uncertainties in the application of the discussion paper. Hypothetically, an implicit obligation may be considered as an obligation only by one party of the contract and as a result of this it may lead to a mismatching between the parties of the contract in the accounting for the same transaction.

Moreover it is not clear how to treat contingent obligations. It would be desirable to clarify whether the contingent obligation could imply performance obligation at the inception of the contract..

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.

We believe that the proposed definition of performance obligation would help the entities to identify more consistently the deliverables in (or component of) a contract.

However, we outline that the definition of performance obligation does not cover contracts in which the receiver of the asset is a third party (contracts negotiated on behalf of a third-party beneficiary). Therefore we ask for the Board to clarify this issue.

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, we agree; in our view the concept 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, makes sense. A critical issue is related to the components of the entity's offering that are "functional" to the delivery of other components of the same offering and that are without any practical use on a stand alone basis (e.g.: a SIM card or an activation service without the related telecommunication services).

We believe that in such cases it would be necessary to consider the interaction between all the performance obligations and therefore do not consider "functional" components as a separate performance obligations.

QUESTION 6 - Do you think that an entity's obligation to accept a returned good and refund the customer's consideration is a performance obligation? Why or why not?

We believe that an obligation to accept a returned good and refund the customer's consideration is not a performance obligation and hence it is not eligible to give rise to revenues.

These kinds of obligations are generally stated by international business law in commercial transactions as a right of the customer (for which, as a common sense, the customer has not to pay). Such customer's rights are to be considered incidental obligations of the contract and imply possible costs for an entity and do not generate revenues unless the entity charge such costs to the customer. Therefore we believe that such obligations should be considered as contingent liabilities and treated under IAS 37 (*Provisions, Contingent Liabilities and Contingent Assets*).

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?

Current IFRIC 13 (*Customer loyalty programmes*) already covers this point. We believe that outside the context of loyalty programmes, sales incentives should not be considered as performance obligations. These obligations are usually promises of the entity subject



to future actions of the customer other than the original purchase (e.g. future purchases) that sometimes imply a new contract.

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 our opinion, the concept of “control” could not be a resolving key in determining whether or not the asset has been transferred.

From a legal standpoint, in some cases, an entity can control an asset without having the legal ownership of the asset (i.e. control by proxy or asset received by a trustee).

We believe that the concept of the “transferral of the significant risks and rewards of the ownership” is more relevant in determining whether the asset has been transferred, especially in telecommunications industry where the products are usually not “physical” and the assets could not be localised close to customer (e.g. a server hosted by an ITC provider).

A further example in which the simple “physical possession” of the asset is not a indicator of the asset transfer, is when a sale is subject to the positive outcome of a working test of the good and the good is already at the customer hand.

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.

We agree with the proposal as a base rule for revenue recognition. Notwithstanding, we think that a business involving a small number of very high value contracts with a long-term period of completion, such as construction-type contracts, deserves a different treatment in order to consider their economic substance.

We believe that the current model of IAS 11, that in fact assumes performance over the term of the contracts, provides a more decision-useful information to readers of financial statements.

QUESTION 10 - In the boards’ proposed model, performance obligations are measured initially at the original transaction price. Subsequently, the measurement of a performance obligation is updated only if it is deemed onerous.

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

Yes, we agree with the proposal, nonetheless we underline the following comments.

In § 24, the discussion paper refers to the “transaction price” as the “promised consideration”. In § 26, the discussion paper states that “*the total amount of revenue that an entity recognises over the life of the contract is equal to the transaction price*”.

Apart from the above, the discussion paper does not provide a definition of “transaction price”, as a result, it is not clear to us what “transaction price” shall include.

Following the § 5.18. the “transaction price” would include “*components that may not relate to the remaining performance obligations that exist once the contract is formed*” that are, for example, “*price amounts to recover their costs and margin associated with obtaining the contract*”. Since the measurement of the rights at contract inception would be greater than the measurement of the remaining performance obligations, this



approach may lead to a net contract asset and the recognition of revenues at the contract inception.

Furthermore, § 6.43 provides that the contract acquisition costs are to be expensed as incurred unless they are eligible for capitalisation in accordance with other standards.

We believe that this approach does not reflect the economic substance of the transactions in the telecommunications industry that is characterised by a trend of profit margin erosion (mainly due to regulatory decisions) and where the contract acquisition costs generally are not recovered by charging the customer with additional mark-up. However, in limited cases these costs are recovered through the revenues generated by the services during the life of the contract. In such cases, in accordance with the “costs with revenues matching” principle, we believe that the contract acquisition costs should be capitalised and amortised over the life of the contract and that the component of the revenues related to their recovery, included in the transaction price, should be recognised over the life of the contract together with the associated service revenues.

Moreover, it is not clear to us how to treat some features of the contracts according to the discussion paper. This is the case of:

- i) a contract that includes an option for the customers to obtain, if they wish, future services at discounted price (for example, 300 hours/month of Internet connection at euros 50 and further 300 hours/month at euros 30);
- ii) a contract that includes a tacit renewal at the end of the original life of the contract (for example, a bundle offering - handset and airtime service - binding the customer for 24 months and that after the original contractual term provides only for airtime with an automatic monthly renewal).

It is not clear from the discussion paper if the transaction price should be an estimate of the future services that the customer might consume, or if the transaction price is established as the customer requires the service under the contract.

In the first case, some critical issues could arise in connection with the difficulty in estimating the length of renewals, the tariff changes, the timing of consumption and the kind of service would be consumed. Considering millions of customer and their combination with several offers, we believe that such activity of estimate is highly expensive and challenging.

Accordingly, that level of estimate would require a high degree of subjectivity that would lessen the reliability of information and therefore the resulting information would probably not show the real performance of the company.

We consider that is crucial to have a clear definition on what is meant by “transaction price” within the discussion paper.

- (b) Do you agree that a performance obligation should be deemed onerous and re-measured to the entity’s expected cost of satisfying the performance obligation if that cost exceeds the carrying amount of the performance obligation? Why or why not?**

Yes, we agree. We consider more appropriate the cost trigger method as it reflects the real potential loss and is consistent with current standards. Moreover the “cost trigger” method is easier to apply than the alternative “exit price” method where an entity has to estimate the exit price with a risk of errors.

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



Yes, for telecommunications industry. Bundle offers are affected by the proposed measurement approach. In a bundle arrangement of a handset and airtime traffic where generally the handset is transferred with a discount or for free, provided that the handset is a separate performance obligation, the proposed allocation method would allocate a significant amount of the transaction price to the handset component. The transfer of the handset to the customer is normally satisfied at the beginning of the contract triggering the revenue recognition of such performance obligation, while the entity does not receive cash (or a little consideration). As result, this approach leads to large unbilled receivables which are contingent to future services and are billable only if ongoing services are provided.

Furthermore, the proposed allocation method results in different amounts allocated to the undelivered services according to the different discount applied to the handset in the various offers even if the undelivered services are the same.

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

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

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

Yes. We agree that for multiple deliverable arrangements, where performance obligations are fulfilled at different times, the transaction price has to be allocated to those obligations. There are alternative methods of allocation that would resolve the issues described in the previous question. We believe that the residual type method of allocation as provided in IFRIC 13 would better reflect the economic substance of this type of transactions. Such a method would imply the deferral of the standalone selling price of the unperformed obligations. In the example of question 10.c, the handset revenue would be recognised at its discounted price, and the service revenues would be recognised at their selling price as agreed in the contract, and, therefore, as billed to the customer. This would align the billing stream with the revenue recognition pattern simplifying the entity's operations and would provide more decision-useful information.

QUESTION 11 - The boards propose that an entity should allocate the transaction price at contract inception to the performance obligations. Therefore, any amounts that an entity charges to the customers in order 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, we agree. However we would not differentiate a payment to recover origination costs from the rest of the transaction price. Any split would be open to diversity in practice, so we would only consider the total consideration in order to allocate it to the different obligations in the contract.

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

We understand that the discussion paper does not include anything different regarding costs from IAS 18. Costs are currently capitalised only if they qualify for capitalisation under other standards, otherwise they are expensed as incurred. We doubt whether the proposed approach is coherent with the "costs with revenues matching" concept of the IFRS framework since the contract acquisition costs should be considered in relation to the contract as a whole and hence associated with the future revenues along with the contract life. Please see also our position included in the answer to question 10.a.

QUESTION 12 - Do you agree that the transaction price should be allocated to the performance obligations on the basis of the entity's stand-alone selling prices of the goods or services underlying those performance obligations? Why or why not? If not, on what basis would you allocate the transaction price?

No, we do not agree that the transaction price should be allocated to the performance obligations on the basis of the entity's "relative stand-alone selling price" method as described in the discussion paper.

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

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

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

QUESTION 13 - Do you agree that if an entity does not sell a good or service separately, it should estimate the stand-alone selling price of that good or service for purposes of allocating the transaction price? Why or why not? When, if ever, should the use of estimates be constrained?

The proposed allocation method of the transaction price give rise to concerns for the following reasons:

- The proposed model increases complexity and potentially decreases reliability of financial information – The DP requires to estimate the stand-alone selling price of a promised good or service even if observable prices are not available. Moreover discussion paper does not preclude or prescribe a particular method to estimate a stand-alone selling price. As a result, entities would be forced to apply mathematical models increasing complexity of the estimation process. The outcomes of such estimates might be not reliable and not comparable between the entities.
- In the telecommunications industry the practical application of the proposed model is complex and in some case it is not feasible – Telecommunications industry is characterized by a large number of offers (products, services, tariffs



and their combination in bundled packages) and a high turnover of kinds of offers. Due to these features and the very high number of possible combinations, the literal application on a contract-by-contract basis would result complex or even not feasible.

- The proposed model does not reflect the economic substance of telecommunications industry business model and might lead to recognition of contingent revenues – The application of the proposed model within telecommunications industry would result in a revenue recognition pattern that does not reflect the substance of its business model. Coming back to the example of a transaction including a free or highly discounted handset and airtime traffic, under the proposed model would be accounted for allocating a substantial part of the transaction price to the handset. Since the entity receive a little amount in cash or it does not receive cash on the transfer of the handset to the customer, revenue recognition would result in a related receivables recognition. These receivables would be not enforceable and the cash expected to be received would be contingent to the entity's fulfilment of the undelivered assets (airtime traffic). In conclusion, the proposed model could lead to recognition of revenues with uncertainty in its cash collection in contrast with the "neutrality" and "prudence" principles (Please also see the above mentioned general comments).