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Sir David Tweedie  
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Your reference

Our contact **Michael Brücks**  
Phone **+49 228 181 87100**  
Date **October 19, 2010**  
Subject

### **Exposure Draft ED/2010/6 “Revenue from Contracts with Customers”**

Dear Sir David,

We appreciate the opportunity to respond to the International Accounting Standards Board’s Exposure Draft “Revenue from Contracts with Customers”. This letter represents the view of Deutsche Telekom AG, one of the world’s leading integrated telecommunications companies with over 131 million mobile customers, around 37 million fixed-network lines and nearly 16 million broadband lines (as of June 30, 2010). The Group provides fixed-network, mobile-communications, Internet and IPTV products and services for consumers, and ICT solutions for business and corporate customers.

In our Comment Letter on the Discussion Paper “Preliminary Views on Revenue Recognition in Contracts with Customers”, submitted to the IASB in June 2009, we have expressed our concerns regarding the proposed revenue recognition model. In follow-up discussions held with the IASB we reiterated the reasons why we believe that the proposed model on revenue recognition will not improve the quality of information provided to users and simultaneously increase costs extremely, both for users and preparers of financial statements.

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We are disappointed to find that the primary concern from the perspective of the telecommunication sector on the proposed revenue recognition model is not addressed by the principles presented in the Exposure Draft. This concern relates to the proposed reallocation of ongoing service revenue to the device we provide to customers to allow them to access our service. According to the proposed model reallocated revenue would be recognised upfront, in advance of the provision of service and customer billings. Additionally, as a result of this “reallocation” assets would be recognised which are (1) not legally enforceable if we, as an operator, do not fulfil our contractual obligations to provide future services to the customer and (2) measured at varying values without relation to the future economic benefits they may represent. We have strong doubts whether the model proposed in the Exposure Draft will ultimately improve the quality of information provided in financial statements.

We further have major concerns that the proposed model will be impossible to apply for telecom operators given the tremendous volume of transactions we face every day. Because of the differences in individual customer contracts we feature in our industry, the model, as proposed, would require us to account separately for tens of millions of contracts. This would require telecom operators to implement new IT systems, solely for the purpose of revenue recognition, with estimated implementation costs amounting to at least hundreds of millions of Euros for each company.

We would like to inform the IASB that we have discussed the revenue recognition Exposure Draft with other European telecommunications companies. These discussions have improved each company’s understanding and assessment of the potential consequences of the Exposure Draft. While many comments raised in this letter are shared by other companies, we do have some specific comments or views. Hence this letter is solely under the responsibility of Deutsche Telekom and does not engage any other company.

Our comments should be read in the context of existing IFRSs. We recognise that future developments in standards - for example derecognition of financial instruments, insurance contracts and the Framework - will have implications for the principles on which a general standard for revenue recognition in contracts with customers should be based.

Please find our comments in the Appendix to this letter. We would be pleased to discuss them with you at your convenience.

Yours sincerely,

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**Appendix**  
**Comment Letter on ED “Revenue from Contracts with Customers”**  
**by Deutsche Telekom AG**

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

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

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

**Response:**

- 1 We generally agree with the principle to use price interdependence when determining whether to combine two or more contracts, to segment a contract or when determining how to account for a contract modification.
- 2 However, we believe that the principle should be better specified in the Standard. We are especially concerned that par. 14, which states that price interdependence does not solely exist “because the customer receives a discount on goods or services in the contract as a result of an existing customer relationship arising from previous contracts”, might lead to confusion as it is not clear under which circumstances it should be applied. When a customer enters into a subsequent contract and receives a discount on it, it is not obvious, whether par. 13 (c) – indicating the existence of price interdependence in consecutive contracts - or par. 14 – indicating the non-existence of price interdependence – would apply.
- 3 We further believe that the provisions for contract segmentation and allocating the total amount of consideration to those segmented contracts have to be more specific. Par. 16 requires the allocation of the total amount of consideration to each identified contract in proportion to stand-alone selling prices (of the contracts). The connection between the amount of consideration as required in par. 16 and the transaction price is not clear and might lead to confusion. It is, for example, unclear whether estimates regarding options representing a material right for customers should be taken into account when segmenting contracts. We would therefore recommend providing a better distinction between contract segmentation and allocating the transaction price to performance obligations, as well as introducing specific terminology, like “combined contracts” and “sub-contracts”.



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- 4 We believe that similar ambiguity exists regarding contract modifications, specifically with regard to the connection between contract modifications and subsequent changes in the transaction price. A contract modification is defined as any change in the scope or price of a contract. In contrast, par. 53 states that after contract inception, an entity shall allocate any changes in the transaction price to all performance obligations on the same basis as at contract inception. When considering a contract with two or more performance obligations and a subsequent change in the contractual price of one of the goods or services underlying one of those performance obligations, it is not clear how the entity has to deal with that change. Shall it provide an assessment on a contract level first according to par. 19 (contract modification) or proceed as described in par. 53 (subsequent change in the transaction price)? We suggest that further guidance be included in the Standard in order to clarify the level and order for assessing subsequent changes in contractual prices/transaction prices.
- 5 We would further suggest introducing clear guidance regarding the connection between contract modifications and the subsequent exercise of a contractual option that did not qualify as a material right at contract inception (B25). We propose that the subsequent exercise of such option should always be considered a new contract, based on the rationale that an existing option not representing a material right to the customer at contract inception is rather not priced interdependently with the initial contract. This guidance would avoid the necessity of a subsequent assessment each time a customer exercises an option already included in the contract. As a telecom operator, we experience a significant volume of contract modifications on a daily basis (e.g., changes in rate plans, adding on or removal of certain features or services such as data plans, international calling flat rates), which depend solely on our customers' decisions. In a typical mobile air time contract, the offer made to customers at contract inception contains different options and add-ons, some of them containing a discount, thus being priced interdependently to some extent, and some not. It would not be feasible for us to assess, each and every time the customer decides to subsequently book an add-on, whether this add-on is priced interdependently and if so, make a cumulative adjustment to the contract. Additionally, the ED is not clear as to whether or not, for example, cancelling one type of service plan and simultaneously signing up for a new service plan is considered a contract modification to the original contract or a separate contract. Board clarification on this topic would be helpful.
- 6 A further major issue that is not addressed in the ED is under which circumstances a portfolio approach to the evaluation of contracts might be applied. The ED requires, in our understanding, a contract-by-contract accounting analysis. A portfolio approach may be helpful to telecommunications companies. However, specific guidance or examples would have to be provided as to when and how a portfolio approach could be used. From reasons mentioned above, a contract-by-contract treatment is not possible within our industry.



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

**Response:**

- 7 We generally agree with the proposal of the ED but we believe that only an entity's own ordinary course of business shall be considered when determining whether a good or service is distinct. This restriction would provide consistency with the commercial substance of an arrangement, as well as comparability between reporting entities and practicability (or possibility) to implement. We therefore suggest that separate performance obligations should:
  - a. be restricted to the goods or services that a customer is seeking to acquire from an entity and exclude deliverables that are incidental or that lack standalone value in the eyes of a customer; and
  - b. only include deliverables that are provided in an entity's ordinary course of business.
- 8 Consider an example from the telecommunication industry, where complex network solutions are provided to customers. For connecting customers to our network we might use specified equipment that we never sell separately. As we ourselves buy that equipment from our suppliers, it is obvious that other entities sell it separately. Even though we effectively transfer control over that equipment to customers, we do not believe our customers perceive the receipt of that equipment as that of a distinct good.
- 9 We also refer to our response to question 7.



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

**Response:**

- 10 We believe that the concept of transfer of control is not defined well enough to link revenue recognition to it. Various IFRSs deal with the concept of control (IFRIC 12, IFRIC 15, SIC 12, IAS 39, ED 10) which from our perspective indicates that the concept itself is not as thoroughly defined as it should be. We therefore believe that the definition of control should be developed at the conceptual framework level to ensure consistency across the standards.
- 11 It is our understanding that one reason the Boards decided to link revenue recognition to a transfer of control of an asset is that there is a common understanding among preparers and users of financial statements as to when control passes from an entity to a customer and that hence there is a clear basis to determine whether the criteria of a passage of control are fulfilled.
- 12 However, we do not understand why the Boards consider the concept of control to be a more appropriate basis for revenue recognition than the transfer of risks and rewards as under the current accounting rules. The benefits of the concept of risks and rewards is that - since it focuses more on substance than on form – it is less affected by legal structures which might ensure the transfer of control but not the transfer of risks and rewards. In our opinion, the legal and contractual circumstances would have a major impact, especially on the assessment of the transfer of control for services. For globally operating companies, this could consequently lead to similar transactions being treated differently in different jurisdictions with regard to the timing of revenues. Furthermore, this could lead to many companies adjusting their contracts in order to achieve a specific accounting treatment with regard to the point of time when control has passed. We do not believe that such an impact, solely implied by changes in accounting rules, is appropriate. An alternative for avoiding such negative impacts would be retaining a principle based on risks and rewards. In our view, a revenue recognition concept based on a 'risk and rewards' principle is far more comprehensible because it is solely focused on the economic substance of a transaction. By contrast, the 'control' principle is partly based on legal and partly based on economic considerations making it difficult to determine which factors take precedence in determining the point of satisfying an obligation.
- 13 Regarding the proposed guidance we believe that the concept of transfer of control is difficult to apply to both the sale of goods and the rendering of services. We agree that in most of the cases the transfer of control for goods is straightforward. But we do have difficulties in understanding the principle with regard to the transfer of control for services. From our perspective, a possible alternative, when adhering



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to the concept of control, would be to provide two principles, one for the sale of goods and one for the rendering of services, accompanied by a clear distinction of what is a good and what is a service.

- 14 We further would like to point out that the concept for principal versus agent considerations as presented in the application guidance is misleading. We understand that according to the guidance an entity would be in the position of a principal if the entity obtains control of the goods or services before it transfers them to another party. The indicators for being in the position of an agent on the other hand are based on the concept of risk and rewards. As these concepts could overlap, we believe that a specific principle is required for this issue. It is further not clear which principle – that of control or that of risk and rewards – has to be given the higher priority.



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

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

**Response:**

- 15 We have major concerns about the proposal on estimating the transaction price. We believe that the criterion of being able to “reasonably estimate” the transaction price is too vague, not sufficiently understandable and, therefore, unreliable to link revenue recognition to it.
- 16 Our concerns also relate to the requirement in par. 38 for the entity to assess the ability (or inability) to “reasonably estimate” based on the past experience or the experience of other entities. We believe that this requirement would be applied very inconsistently by entities as it is subjective. It would result in diminished comparability and reliability of recognised revenues. A conceptual weakness of this criterion is that it relies on the assumption that past events are indicative of future events. This assumption however ignores the business risk of the future and might result in overly optimistic expectations being used by start-up entities which would base their estimates on the experience of well-established entities.
- 17 In our understanding of the principles of IFRS, a relevant reported figure from a user’s perspective is one that provides feedback and predictive value. By incorporating entities’ past business practices and expectations on the future in the process of “determining” revenue, we believe that such reported figure is not more relevant than a figure based on objective criteria, like a minimum enforceable consideration which the customer is obliged to pay under the contract. Under the proposed model users would have to explicitly analyse the disclosures made by each entity in order to understand the basis for estimating the transaction price and subsequently adjust reported revenue by their own expectations.
- 18 From an entity’s perspective the increased complexity of estimating the transaction price 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. With regard to the tremendous volume of individual customer contracts we face as a telecom operator as well as the countless possible options the customer can initially or subsequently choose, this requirement will be impossible for us to apply.
- 19 We also refer to our response to question 7.



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

**Response:**

- 20 We do not agree with the proposal that customer credit risk should affect revenue.
- 21 We believe that information provided to users of financial statements is more relevant if it reflects the "gross" amount of revenue separately from the credit losses.
- 22 We do not believe that expectations of credit default should determine how much revenue an entity recognises, especially when deviations from those expectations are subsequently recognised in other positions.
- 23 Par. 43 states that changes in the customer's credit risk should be recorded as an expense/other income once the entity has an unconditional right to consideration (receivable). That is, in cases where an entity may not recognise a receivable but only a contract asset after having delivered subsidised equipment not yet giving rise to an unconditional right to consideration, the wording suggests that subsequent changes in the customer credit risk would still run through revenue for those contract assets which have not yet been reclassified to receivables. The complexity of such process can be demonstrated by the following example: Assume that a wireless operator records a contract asset of CU100 after delivery of a free-of-charge handset. When the entity charges its first monthly bill, e.g. CU30, CU20 will be revenue/receivable for the monthly service. CU10 will be the amount by which the contract asset becomes "unconditional". If the customer credit risk increases in that period, the CU20 plus CU10 receivables will be adjusted against expenses, the remaining CU90 contract asset will be adjusted through revenue. We consider such differentiation not only impractical but also incomprehensible. Board clarification on this topic would be helpful.
- 24 We further refer to our answer to question 4 regarding the use of estimates and entity's expectations.



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

**Response:**

- 25 We agree with the proposal to account for the time value of money if the contract has a material financing component. However, it might be necessary to clarify what constitutes presence or absence of a “material” financing component.
- 26 In the wireless operators’ business any handset subsidy will be effectively recovered through future payments made by the customer over the contract term and thus any contract asset recognised upon sale/delivery of the handset would have be adjusted to reflect the time value of money. However, telecom operators do not view handset sales and related subsidies/discounts as a financing transaction. Instead, billings occur rateably throughout the term of the service contract and the handset is viewed as a competitive marketing tool to attract customers and enable them to access wireless services, and the discounted prices are market-driven. Further, customers do not think they are financing handsets; in fact, service charges are generally not adjusted after the customer fulfilled his two-year contract or after the handset discount has been recouped. As a result, we do not believe that our typical service contract contains a material financing component.
- 27 Evaluating handset transactions for the effects of the time value of money would be extremely burdensome because of the large number of customers and handset/rate plan combinations. The materiality assessment is highly judgmental and could drive different evaluations between operators.
- 28 In addition, we believe that the interest rate used for discounting the consideration should indeed only reflect the time value of money, i.e. by using a risk-free rate, while the customer credit risk should be reflected through the adjustment for collectibility under par. 43. As pointed out in par. 43, an entity shall recognise revenue (and thus, also a contract asset) at the probability-weighted amount of consideration that the entity expects to receive. That is, an entity may possibly expect that eventually it will not be able to collect all of the promised consideration. By contrast, discounting the consideration using a credit risk adjusted interest rate assumes that the collectibility risk diminishes over time, at least if the contract asset is accreted (through interest income) in subsequent periods by using the same rate. In our view, such inconsistent treatment of credit risk adjustments, depending on whether a financing component is involved or not, leads to conceptually flawed results as you can see in the following simplified example.
- 29 Assume an entity sells subsidised handsets together with a two-year service contract. The relative stand-alone selling price for the handset is CU100. The entity expects a bad debt rate of 10%, i.e. it expects that CU90 will be the nominal



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amount which will eventually be collected from customers. However, as the handset will be implicitly financed through future monthly service payments over two years, the entity has to discount the revenue at a credit risk-adjusted interest rate (B82). Assuming a 10% discount rate, the entity would recognise revenue of CU90 at the time of the sales transaction. The question is what interest rate should be used to accrete the contract asset in future periods. B83 (Example 21) states that entities shall account for its unconditional rights to consideration (and interest) in accordance with the guidance on receivables in IFRS 9, thereby suggesting the effective interest method. However, the ED is silent on the subsequent accounting treatment in case of a contract asset which has not yet given rise to such unconditional right to consideration. Assume further that at the end of the following period the entity has accreted the contract asset through interest income to CU95. To reflect the estimated bad debt rate of 10%, the entity would then have to reduce the contract asset again to CU90. If the entity already had an unconditional right to consideration and thus recorded a receivable instead of a contract asset, it would be able to record that further reduction of CU5 as an expense. By contrast, prior to having such unconditional right, the guidance in par. 43 suggests that the entity would have to record any further reduction of the contract asset as a contra-revenue. In the end, over the total two-year period, the estimated collectibility risk of CU10 (10%) would be reflected as a revenue reduction of CU20, partly offset by interest income (BC103) of CU10. Such accounting would not only be excessively burdensome to maintain, but it also would not reflect the economic substance of the transaction. We can hardly imagine that such accounting has been actually intended by the Boards and, should this indeed have not been the case, we strongly suggest that the Boards clarify the wording of the final standard.



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

**Response:**

- 30 We generally agree that the transaction price should be allocated to all separate performance obligations in a contract in proportion to the stand-alone selling price of the good or service underlying each of those performance obligations. However, we strongly recommend maintaining the FASB's provision under ASC 605-25-30. That is, the amount allocable to a satisfied performance obligation should be limited to the amount that is not contingent upon the fulfilment of additional future performance obligations ("contingent revenue cap").
- 31 We further believe that the transaction price should be allocated to the various performance obligations on the basis of observable stand-alone selling prices only.
- 32 Revenue should only be allocated to performance obligations identified using relative standalone selling prices to the extent that the allocated revenue does not exceed the legally enforceable payments due from the customer under the terms of the contract without the delivery of future services. We believe that users of financial statements strongly appreciate and support this fact as it limits management judgement and, in addition, firmly links revenue recognised in a period to the amounts billed to the customer and, eventually, to cash received for that period. It is our understanding that any dissolution of revenues and cash received would be viewed negatively by users of financial statements.
- 33 By removing the contingent revenue cap, an entity would recognise revenue for a "contract asset" which is not legally enforceable at the time of recognition, e.g. when revenue is allocated to a performance obligation within a multiple-element arrangement and the entity is contractually not compensated for fulfilling that obligation. For example, under a customer contract an entity has the obligation to deliver a free-of-charge (subsidised) handset up-front and to perform wireless services over a period of two years. It has the right to receive CU1,000 for the services billed on a monthly basis over a two-year period if and when such services are performed. According to the ED, the entity would have to allocate part of the CU1,000 consideration to the handset and recognise this amount as a contract asset and revenue at the time of delivery. The Boards acknowledge that such a contract asset has to be separately presented from receivables as it does not represent unconditional rights to consideration. However, they do believe that such contract asset meets the definition of an asset (BC95).
- 34 Assets are resources controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity (FW 49). In the example above, the future economic benefits are the CU1,000 which the entity has



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the right to receive in the future upon rendering its wireless services. The question is, however, what the past transactions are which give rise to the recognition of an asset and, correspondingly, revenue.

- 35 The Boards state that in such situation an entity “clearly has a valuable contractual right as a result of satisfying performance obligations” (BC95), which in our example would be the delivery of the handset. In our opinion, while the entity may have “valuable contractual rights”, such rights are the result of the underlying contract irrespective of the previously satisfied performance obligation. For example, the right to receive CU1,000 as a return for rendering wireless services already existed at contract inception (providing that the entity would deliver its promised services). However, the Boards precluded the recognition of revenue at that point of time (BC29). That being said, the delivery of a subsidised handset does not change the entity’s rights with regard to compensation for future wireless services. The mere contractual right to receive compensation already existed at contract inception while an unconditional right to such consideration (that is, a receivable) only arises upon performing the promised wireless services. It is therefore not clear how the delivery of a subsidised handset can be viewed as a past transaction which gives rise to any “valuable contractual rights” between those points of time. It would therefore be consequent to defer recognition until the entity performs the services which, pursuant to the contract, give rise to the right to receive compensation. In our view, *these* are the transactions eventually resulting in the future economic benefits which give rise to an asset.
- 36 Besides, assume that, at different points of time, an entity would offer different discounts on the identical handset model together with the CU1,000 wireless contract. Those handset prices differ across sales channels within short periods of time or sometimes even only within certain locations. The future economic benefits, i.e. the cash flows resulting from performing the wireless services, remain the same, i.e. CU1,000 over a period of two years. However, the “contract assets” would be measured differently depending on the varying equipment discount as compared to the stand-alone selling price of the future services. The outcome would be two assets valued differently when the future economic benefits of the contract from which they result, are exactly the same. Similarly, the customer may elect to pair any variety of handset models, which would have different stand-alone selling prices, with the same CU1,000 wireless contract. In this case again, the contract assets would be valued differently although the future economic benefits to which they relate would be expected to be the same. The Example below illustrates this:
- 37 Example 1:  
Two customers, Customers A and B, enter into two-year contracts with Wireless Co. on December 20, 2010 and January 20, 2011 respectively. Wireless Co. offers the identical handset model for CU100 and CU200 on said dates respectively, the increased discount in the December timeframe is due to holiday promotions. The standalone selling price is CU300 and the cost is CU290. In its direct sales channel (e.g., Wireless Co. retail store) Wireless Co. incurs sales commission costs of CU50 for each contract. Wireless Company offers a wireless service plan for CU60/month over a two-year contract period. For purposes of this example, assume the standalone selling price of the wireless service plan is CU60/month. The plan is cancellable subject to a CU175



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penalty that decreases pro rata over the contract term. For purposes of this example, Wireless Co. does not expect any credit loss, and no rebates, incentives or other discounts are provided.

	Current		Proposed	
	Customer A	Customer B	Customer A	Customer B
Contract Asset (Day1)	CU0	CU0	CU166	CU83
Equipment Revenue	CU100	CU200	CU266	CU283
Services Revenue	CU1440	CU1440	CU1274	CU1357
<i>Total Revenues</i>	<i>CU1540</i>	<i>CU1640</i>	<i>CU1540</i>	<i>CU1640</i>

- 38 In addition, consider the following example: Two telecom operators, entity A and entity B, are providing an identical wireless plan to their customers for a period of 24 months. Both entities supply handsets for free when a customer enters into the contract. Entity A supplies handsets with a stand-alone selling price and costs which are 100% higher than the stand-alone selling price and costs of the handsets supplied by entity B. From the perspective of both entities, the costs for those handsets are subscriber acquisition costs (SAC). From a commercial perspective entity B has SAC that – measured on a per customer basis – are 50% lower than those of entity A. The proposed revenue model, however, requires entity A to recognise much higher revenues than entity B at contract inception, as the allocated stand-alone selling prices of the handsets supplied by entity A are higher. Assuming a similar customer base, entity A would report much higher revenues in year 1 than entity B. When using reported revenue as a basis for predicting future revenues, users of financial statements would expect that in the following year entity A would outperform entity B. This, however, will not occur; instead, entity A will recognise lower future revenues from its service contracts. The information provided by reported handset revenues under the proposed model are misleading; in this example leading users to believe that entity A is performing better than entity B, whereas exactly the opposite is true. Entity A probably struggles to maintain its competitive position and to connect customers to its network. As a result, it is forced to incur higher SAC by giving more valuable free-of-charge handsets to customers upon contract inception with the dubious accounting “benefit” of a higher front-loading of revenues compared to its competitor.
- 39 The application of a contingent revenue cap would in contrast lead to the reporting of handset costs (SAC) at contract inception, providing users the information that entity A is carrying higher costs of acquiring customers for similar service contracts than entity B. This information would be complemented by reported service revenues which would be equal for both entities.
- 40 Furthermore, the proposed model would lead to a significantly different recognition of revenue and/or net income depending on the sales channel. For example, in the indirect channel a dealer purchases handsets either from a mobile operator or



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directly from a supplier/wholesaler and sells them to customers together with service contracts for which he acts as an agent. From our business perspective, the economic substance is not different from direct channel transactions. In order to sell long-term service contracts, we have to incur subscriber acquisition costs which either relate to handset subsidies (direct channel) or commission payments (indirect channel) compensating the dealer not only for his sales efforts but also for granting handset subsidies to customers. The ED explicitly states that costs of obtaining a contract should be expensed as incurred (par. 59). However, while dealers' commissions clearly fall under this definition, the Boards do not acknowledge that selling subsidised equipment by a mobile operator itself follows the same economic rationale. As a result, selling customer contracts via the indirect channel will incur up-front losses while selling the same contracts via the direct channel will not. Shifts between those sales channels from one reporting period to another will inevitably lead to significant changes in revenue and/or net income even if, from a business perspective, key performance indicators have not changed at all. In our opinion, such accounting will not only result in less comparability within our industry and less period-to-period comparability but will eventually distort the objective of providing useful and relevant information to readers of financial statements.

41 The Example below illustrates how the requirement to use a relative stand-alone selling price method will result in different accounting for economically similar transactions depending on whether they are direct (i.e., handset sold by the entity through its own retail store) or indirect (i.e., handset sold through a third-party retailer) channel sales.

42 Example 2:

Assume the same fact pattern as above for Customer A. However in Case 1, Customer A purchases the handset in the Wireless Co.'s direct channel. In Case 2, Customer A purchases the handset in Wireless Co.'s indirect channel (e.g., 3rd party retailer). In Case 2, Wireless Co. sells the identical handset to the retailer for CU300 and will pay a commission of CU250 for a 2 year contract. The third-party retailer elects to sell the handset to Customer A for CU100, the same price as offered directly by Wireless Co.

	Current	As Proposed	Current & Proposed
	Case 1	Case 1	Case 2
Contract Asset (Day1)	CU0	CU166	CU0
Equipment Revenue	CU100	CU266	CU300 (upon sale to indirect)
Services Revenue	CU1440	CU1274	CU1440
<i>Total Revenues</i>	<i>CU1540</i>	<i>CU1540</i>	<i>CU1740</i>
Cost of Handset	CU290	CU290	CU290
Sales Commission	CU50	CU50	CU250
<i>Total Costs</i>	<i>CU340</i>	<i>CU340</i>	<i>CU540</i>
<i>Net Loss on Customer Acquisition (handset revenues less costs)</i>	<i>CU240</i>	<i>CU126</i>	<i>CU240</i>



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- 43 Another argument in BC95 is the notion that a third party would compensate an entity for its past performance if the remaining rights and performance obligations of the contract were transferred. That is certainly right but it would be true for all activities that an entity has already undertaken to fulfil its contractual obligations, not only those activities for already completed performance obligations. For example, if a customer contract was transferred to a third party prior to delivering the subsidised handset, the third party would still compensate the entity for costs that already have been incurred to fulfil its contractual obligations (e.g. purchase of handset, activation costs). We therefore consider this argument somewhat inconsistent with the fact that the Boards explicitly rejected an activities-based revenue recognition model (BC32-34).
- 44 Given the fact that the Boards rejected the notion of recognising revenue solely based on activities performed without passing control of an “asset” to the customer, it is not conceivable why fulfilling a performance obligation for which the customer is not obliged to pay any consideration, should be treated differently. In both cases the activities by themselves (whether control of an asset is passed or not) only entitle an entity to receive future economic benefits if additional future services are performed. From both an economic and a legal perspective, if an entity satisfies a contractual performance obligation for which it is entitled to receive a distinct compensation, such fulfilment clearly changes the entity’s contract position. If the customer is not obliged to pay such compensation, the entity is not in any better position as if it undertakes activities and incurs cost prior to passing control of any contractual asset to the customer.
- 45 In addition, we would like to point out that a contract asset comprising contingent revenue significantly differs from a lease asset which a lessor recognises in connection with a finance lease. The lessor is entitled to receive the future lease payments without being obliged to provide any future services. By contrast, the contract asset embodies future economic benefits which an entity will only obtain if it satisfies an additional, possibly totally different, future performance obligation.
- 46 Apart from these conceptual concerns, the model is impractical to apply within our industry on a contract-by-contract basis because of the very large number of customers and the extremely large possible combinations of pricing, price changes and other contractual changes. The proposed model would require constant revisions to update for new products and offerings and changes in stand-alone selling prices in order to appropriately allocate considerations for new contracts, yet at the same time maintain documentation of historical information for existing contracts. Current accounting systems do not have the capability to account for individual contracts which literally number in the tens of millions for the larger wireless providers. Multiple billing systems hold much of the detailed individual contract information but it is passed to the accounting systems at an aggregated level. Many of the informations required by the proposed model is not tracked in current systems.



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- 47 Because of the disconnect to billing systems, the proposed model would require telecom operators to implement new IT systems, solely for the purpose of revenue recognition, and to permanently monitor each of the tens of millions of contracts, in order to reallocate parts of future payments for telecommunication services to subsidised handsets. This would result in tremendous implementation and ongoing costs, which we estimate to amount at least hundreds of millions of Euros, without visible advantages to users of financial statements. We strongly believe that our investors prefer us investing in our business rather than in revenue IT systems and the cost-benefit view should be taken into account when assessing the advantages of the proposed approach.
- 48 Additionally, as outlined above, the elimination of the contingent revenue cap will create inconsistencies between how much revenue is recognised for the same handsets or the same wireless plans. It will also create a distortion between cash and revenues, which is an important relationship that analysts and other users regularly measure.
- 49 Another concern that we have with the proposed revenue model relates to the use of estimates for stand-alone selling prices. The increased complexity of estimating stand-alone selling prices in cases in which observable input data is not available would make this requirement impossible for us to implement. In the mobile communications industry for example, 100 handsets can easily be combined with hundreds of different tariffs (monthly rate plans) plus additional options, which the customer can choose. The number of handsets sold and tariffs offered change continuously which would require 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. It increases complexity while potentially decreases the reliability of the information presented under the proposed model, especially in cases in which the estimates can not be based on observable inputs when no stand-alone selling price is available.
- 50 Therefore, we believe that the transaction price should be allocated to the various performance obligations on the basis of observable stand-alone selling prices only. As referred to in our response to question 2, we believe that when the entity does not provide the good or service in its ordinary course of business, a separate performance obligation should not be identified.
- 51 Another provision that we do not agree with is allocating subsequent changes of the transaction price in the same way as at contract inception. Consider the following example: A customer enters into a contract with a telecom operator for the provision of a wireless plan for 24 months. The customer receives a handset for free at contract inception. After one year, the entity decides to reduce the monthly price for the wireless plan. This change obviously meets the definition of a contract modification, as it is a change in the price of a contract (par. 17). According to par. 19 the entity has to assess whether the price of the contract modification is interdependent with the price of the existing contract. The result of this assessment



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would in our understanding determine whether the change should be accounted for separately or as a change in the transaction price. This however is not clearly enough specified in the ED. When automatically considering the contract modification as a change in the transaction price and applying the provision of par. 53 by reallocating the subsequent change in the transaction price to both performance obligations (handset delivery and wireless plan) this would lead to an adjustment of revenues, as well as of contract assets for handsets already transferred to the customer one year ago. We do not think that doing so results in the provision of relevant information to users. We believe that an accounting impact that instead provides the information that services have become cheaper – for whatever reason – is more relevant than reallocating the change to handset revenues. This inconsistency would be avoided if a contingent revenue cap had been applied, as proposed above.



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

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

**Response:**

52 We support the Boards' effort to specify the treatment of costs under a contract with a customer. We believe that the proposed requirements are operational and sufficient.

53 However, we would like to ask the Boards to revise the requirement regarding the treatment of costs of obtaining a contract. We do not believe that a general treatment of those costs as an expense when incurred is appropriate. We believe that the criteria of par. 57 shall also be applied to costs of obtaining a contract.

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

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

**Response:**

54 As mentioned in our response to question 8 we believe that costs of obtaining a contract should also be considered if they meet the criteria set out in par. 57

55 We do not agree with the proposal to identify and respectively account for onerous performance obligations within an overall profitable contract. We believe that the verification whether the direct costs exceed the amount of transaction price should be provided on a contract level only.



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

**Response:**

56 We refer to our concerns with the proposed model described above. We believe that many of the disclosures proposed would become obsolete when considering those concerns and simplifying the model. We especially refer to the retention of the contingent revenue cap (question 7) as well as a reduction in use of estimates and judgements for stand-alone selling prices and the transaction prices.

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

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

**Response:**

57 We generally agree with this proposal. However, we would like to point out that the amounts disclosed would be more informative if a contingent revenue cap is applied as described in our response to question 7. In that case the amounts disclosed for the remaining performance obligations would provide information about the timing of expected cash-inflows. We strongly believe that this information is more relevant and reliable to users.

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

**Response:**

58 We agree with the proposal.



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

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

**Response:**

- 59 We do not agree with the proposal of a retrospective application of the proposed model. We would like to point out that a retrospective application of the revenue recognition model as presented in the Exposure Draft is not possible for telecommunications companies.
- 60 In order to make a retrospective application of the new Standard feasible, the proposed model should be modified especially considering our concerns presented in our response to question 7 regarding the retention of the contingent revenue cap.

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

**Response:**

- 61 We appreciate the Board's intention to provide guidance on how to apply the proposed principles on revenue recognition. However, we believe that the extensive application guidance reveals that the principles proposed in the Exposure Draft are not clear enough. We would therefore recommend improving the proposed principles rather than providing detailed guidance.



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

- (a) a warranty that provides a customer with coverage for latent defects in the product. This does not give rise to a performance obligation, but requires an evaluation of whether the entity has satisfied its performance obligation to transfer the product specified in the contract.
- (b) a warranty that provides a customer with coverage for faults that arise after the product is transferred to the customer. This gives rise to a performance obligation in addition to the performance obligation to transfer the product specified in the contract.

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

**Response:**

62 We agree with the proposal to distinguish between a warranty for future faults and a failed sale. In many cases, however, it would be difficult to distinguish between defects existing at the time of the sale from defects arising after the sale. Therefore assumptions would need to be applied, such as defining warranties as those not being required by law or not being customary business practice.



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

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

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

**Response:**

63 We do not agree with the proposal that the pattern of revenue recognition should depend on whether the licence is exclusive or not. We believe that whether a performance obligation has been satisfied or not shall be assessed with regard to the continuing involvement of the entity.

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

**Response:**

64 We agree with the proposal.