#### MTN GROUP LIMITED

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International Accounting Standards Board 1<sup>st</sup> Floor, 30 Cannon Street London EC4M 6XH United Kingdom

MTN Group Limited 216 14<sup>th</sup> Avenue Fairland South Africa

# Re: Exposure Draft ED/2011/6 - Revenue from Contracts with Customers

We hereby respond to the invitation by the IASB to comment on the revised exposure draft, ED/2011/6 - *Revenue from Contracts with Customers* ("the Exposure Draft"), dated November 2011.

MTN Group Limited is a multi-national telecommunications group with more than 164 million subscribers offering voice and data communications products and services to individuals and businesses in Africa and the Middle East. We would like to thank the IASB for re-exposing the proposals for public comment. We welcome the couple of practical expedients but are concerned about a number of practical consequences resulting from the requirements in the Exposure Draft and the recognition of revenue that is in certain aspects contrary to management's view of the business, as described below.

Our responses to the specific questions in the Exposure Draft provide further detail on the views expressed below and are attached in the Appendix to this letter ("Appendix A").

## **Bundled transactions**

The Exposure Draft proposes that bundled transactions should be analysed and distinct performance obligations identified. One of these performance obligations frequently offered in a bundled transaction in the telecommunications industry is a handset. The application of the Exposure Draft will require that revenue on a handset be measured through an allocation of the contract revenue to the handset based on the stand alone selling price of the handset in relation to the aggregated stand alone selling prices of all the components in the bundled offering. We believe it is not appropriate to recognise the allocated revenue on the handset upfront as:

- The handset is provided as an enabler to access the voice, data and SMS services that the Telecommunications Entity ("Telco") provides over the life of the contract.
- The Telco is obliged not only to deliver the handset but also to provide ongoing services to the
  customer. The Telco cannot cancel the contract after delivering the handset and expects the
  customer to pay for the handset as the recovery of the consideration relating to the handset is

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**Reg No**. 1994/009584/06 VAT No. 4100154626 through monthly subscriptions that are only payable if the Telco is able to provide the related services. It is therefore inappropriate to recognise revenue on the handset upfront when the consideration relating to the handset is contingent on providing a future network service.

- Handsets are considered a cost of attracting customers to a service provider and are an
  alternative to paying commission to an agent to offer incentives (such as handsets) to
  customers. Commission is however seen as a contract cost that is amortised whereas the
  handset is considered a distinct performance obligation.
- The prices of handsets (and other components of the bundled offering) change frequently
  during a reporting period as technology changes and in reaction to competitive forces. The
  allocation of revenue to performance obligations will therefore change frequently in reaction to
  changes of individual components in the bundled offering.
- The changes in revenue allocation will take place across a number of bundled product ranges
  that include various individual performance obligations and also across geographic regions in
  a group where each country has its own pricing structure. This places an additional
  administrative burden on a Telco to monitor changes in the stand alone selling prices even
  though the pricing of the bundled offering remains unchanged.
- A bundled offering may be provided by two entities in the same group where one entity acts as
  an agent for the second entity with regards to the connection services but as a principal with
  regards to the sale of the handsets. The revenue allocation will be performed twice and
  recognised over the contract period for both the principal service provider as well as the group
  (refer example on page 9).

To counter the complications created by the Exposure Draft it is proposed that the following condition be added to paragraph 29:

.29 "Notwithstanding the requirements in paragraph 28, a good or service in a bundle of promised goods or services is not distinct and, therefore, the entity shall account for the bundle as a single performance obligation if both the following criteria are met:

- (a) ... and
- (b) ... or
- (c) the consideration received for goods or services provided in a bundle is contingent on the provision of further future distinct but related goods or services."

This proposal will have the effect that revenue is allocated over the contract term as and when the services on which the consideration is contingent are performed.

## Tracking and measurement of performance obligations

Within the Telco industry a bundled offering may consist of various distinct performance obligations as defined in the Exposure Draft including a handset, SIM card, voice minutes, data bundles, SMS bundles, loyalty awards as well as a number of added services that may have stand-alone selling prices. The delivery of these products does not have the same pattern of transfer. The Exposure Draft requires that revenue be allocated to each of these performance obligations based on the individual fair values of each of the stand alone selling prices. The following practical problems exist in complying with the Exposure Draft:

• The stand alone selling prices can be highly variable over time and revenue allocated to each performance obligation will, as a result, vary significantly during a reporting period.

- Commission paid to agents has to be spread across the various performance obligations and recognised as each individual performance obligation is satisfied.
- Credit impairment adjustments relating the collectability of the revenue recognised must be allocated as these various performance obligations are met.
- Breakage (forfeiture) that is reasonably assured must be estimated and recognised over time as an adjustment to revenue as and when the related performance obligation is satisfied.
- Return of goods (unsatisfied customers) and warranty claims (defective products) must be separately tracked for goods delivered in a bundled offering.

Furthermore the Exposure Draft requires the following which, in combination with the points above, create significant practical complications for revenue recognition:

#### a) Contract modifications

A modification of a contract will take place in terms of the Exposure Draft when a client accepts additional goods or services (such as itemised billing, free music downloads, loyalty awards etc) that are provided to a group of customers in an existing client base where these items may have stand alone selling prices and are provided free of charge or at significant discounts to the stand alone selling prices (after marketing discounts. Although these activities are considered normal marketing incentives to retain customers for future periods the Exposure Draft considers it as further separate performance obligations under the existing contract. The contract modification will trigger a re-allocation of the revenue relating to the remaining unsatisfied performance obligations under the initial contractual relationship. This creates a significant accounting administrative burden that may not have been intended.

To avoid this unintended consequence it is proposed that paragraph 21 (b) be deleted to allow for the accounting of contract modifications that are distinct as separate performance obligations not linked to an existing contract with a customer. This change will avoid the absurd scenario where business lunches, year-end gifts or similar goods or services trigger a reallocation of revenue relating to an existing contractual relationship.

## b) Discounting of consideration

Paragraph 60 of the Exposure Draft allows an entity not to discount the consideration if it expects the payment of all or substantially all of the promised consideration and the transfer of the promised goods or services to occur within one year. Goods and services may however be transferred over a period in excess of a year and the related payment for the goods or services may be in the same pattern as the delivery of the goods or services. It is therefore not clear why discounting will be required in terms of the Exposure Draft if payments take place as and when goods or services are provided over a number of years.

In instances where various goods and services are delivered in return for a series of payments it is unclear how the consideration should be allocated to each good or service.

It is therefore proposed that paragraph 60 rather refers to the time difference between satisfying (or partially satisfying) *performance obligations* and the receipt of the related consideration from the customer. Further guidance may be required to indicate how consideration received over a period should be allocated to individual performance obligations. For example, consideration received in terms of a contract is allocated to performance obligations in the sequence of the satisfaction or partial satisfaction of the performance obligation.

The application of the time value of money proposals in the Exposure Draft is currently not clear and if it is ultimately applicable to bundled contracts in the Telco environment will cause significant

practical difficulties in the measurement of revenue, given the complications of bundled transactions.

On a technical point, the application of the Exposure Draft will result in revenue of which the consideration is payable within a year not being discounted whereas the related financial asset will be discounted. The discount element of the financial asset will be accounted for as a credit loss disclosed adjacent to revenue in profit or loss. The practical expedient not to discount revenue of which the consideration is receivable within a year will therefore only change the line where the discount is accounted for and not prevent a loss being recognised. It is proposed that a similar practical expedient is added for the financial asset to prevent the recognition of an upfront loss for consideration received within a year.

# c) Onerous performance obligations

Paragraph 86 of the Exposure Draft requires that an entity raise a liability for onerous performance obligation satisfied over a period in excess of a year. A performance obligation is onerous if the cost to satisfy or exit the performance obligation exceeds the revenue allocated. Performance obligations are effectively all goods or services delivered with stand alone selling prices. This requirement requires that sophisticated costing models be maintained across an entity's operations to determine the direct cost of delivering a service to the level of each performance obligation described previously – voice minutes, data bundles, SMSs etc. In addition, to ensure that the results of the onerous test is audited an entity's costing process will have to be audited to ensure that the onerous test is accurate. The cost of creating and maintaining such a detailed costing system, coupled with significant audit cost to validate the calculations, seems to overshadow the benefits from such detailed calculations. In addition, although direct costs are explained in the standard, the allocation of costs will not be done consistently in practice as different allocation methodologies and bases will be used and will reduce the practical effectiveness of the standard.

For the purposes of testing for onerous performance obligations, entities should be allowed to group performance obligations together that are provided using the same asset or group of assets and recognise an impairment loss on the asset or group of assets as required in terms of IAS 37.69, rather than recognising impairment losses at a performance obligation level. Allocation of costs to a performance obligation level is not considered appropriate where the asset or group of assets used to provide the service is used for numerous performance obligations and incremental revenue contributes to the profitability of the infrastructure as a whole.

In addition, to avoid an annual costing and audit of all performance obligations that is known to be profitable, the test for onerous contracts should only be required for contracts if indications exist that a performance obligation or a group of performance obligations is onerous. Where these performance obligations are satisfied through an asset or a group of assets, these assets should be impaired with no further requirement to perform a test for onerous performance obligations.

## **Disclosure**

Significant disclosure requirements are proposed for year-end reporting with regards to revenue. Although the requirements are onerous we can see the benefits for the user. However, we believe the requirement to provide such detailed reconciliations in an interim result announcement is adding clutter to interim reporting and is excessive compared with disclosure required for other items. We propose that qualitative or quantitative information on any significant change in the recognition, composition or timing of revenue since the publication of the financial statements be disclosed for interim reporting.

# **Application date**

Given the significant changes in systems required to implement the standard, the relative long term nature of contracts in the Telco industry, the requirement to implement the requirements

retrospectively and the requirement to show an opening statement of financial position in your first year of adoption, we recommend that the IASB provide sufficient time to implement these changes and that the required effective date is not before 1 January 2016.

## Other

Paragraph 46 covers the recognition of revenue on a performance obligation satisfied over a period of time based on the input methodology where a client obtains goods before obtaining services relating to those goods. The application of this paragraph seems unclear and contradictory to other sections of the Exposure Draft as it seems to allow for performance obligations relating to distinct goods and services to be grouped together. We propose that the application be clarified.

We trust that the IASB will consider the practical implications as set out in this comment letter and provide further practical solutions to some of the challenging technical proposals.

Yours faithfully,



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Philisiwe Sibiya

General Manager – Group Finance

# **Exposure Draft on Revenue from Contracts with Customers**

#### Question 1

Appendix A

Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?

## Response to question 1

We agree with the proposal for recognising revenue over time subject to the changes proposed on identifying performance obligations in paragraph 29 as suggested above.

## Question 2

Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a

customer's credit risk and why?

# Response to question 2

Paragraph 68 and 69 appears to be wider than just credit risk relating to the promised consideration as it also requires that the initial measurement of the receivable and the accounting for the receivable should be in terms of IFRS 9, which requires fair value.

Accounting for the purchase consideration receivable in terms of IFRS 9 will imply that discounting should be applied in recognising the financial asset (debit) which will be contrary to the practical expedient allowed for with regards to the revenue (credit) side of the transaction. In terms of Paragraph 60 discounting of revenue is not required if it is expected that goods and services will be paid within a year after transfer. This difference between the amounts initially recognised for revenue and the financial asset will be accounted for as a credit impairment. The discounting element of consideration receivable within one year will be accounted for as a credit loss on initial recognition.

To eliminate this mismatch between revenue and the financial asset it is proposed that the second sentence in paragraph 68 be changed to:

For an unconditional right to consideration (ie a receivable), an entity shall account for the receivable in accordance with IFRS 9 except as specified in paragraph *60 and* 69.

In addition, the first sentence of paragraph 69 should be changed as follows: Upon initial recognition of the receivable, any difference between the measurement of the receivable in accordance with IFRS 9, *after considering the practical expedient in paragraph 60*, and the corresponding amount of revenue recognised shall be presented in profit or loss as a separate line item adjacent to the revenue line item.

#### Question 3

Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

# Response to question 3

We propose that paragraph 76 be expanded to cover the recognition of revenue on goods and services in a transaction where the payment for such goods or services is contingent on the provision of related but distinct goods or services. As described earlier, the payment of monthly subscriptions on a bundled transaction that includes a handset may be contingent on the provision of ongoing services with regards to voice, data and SMSs that are distinct from but related to the handset. It will therefore be inappropriate to recognise revenue on delivery of the handset if the consideration relating to the handset is contingent on related future services. The current wording in paragraph 76 only covers consideration contingent on the provision of a good or service and does not contemplate consideration contingent on delivery of a group of goods or services.

We propose that paragraph 76 (b) be removed as it seems to result in a circular reference. We also propose that reference is made to "performance obligations" rather than "good or service" to read consistent with the rest of the Exposure Draft and to include the possibility of a group of performance obligations of which the consideration is contingent on the satisfaction of all components of the group of performance obligations.

# **Question 4**

For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?

# Response to question 4

We welcome the practical expedient of one year, however, this onerous test requires that sophisticated costing models be maintained to determine the direct cost of delivering a service to the level of each performance obligation. The cost of creating and maintaining such a detailed costing system, coupled with significant audit cost to validate the calculations, seems to overshadow the benefits. In addition, the allocation of costs will not be done consistently in practice as different allocation methodologies and bases will be used that will reduce comparability.

For the purposes of testing for onerous performance obligations, entities should be allowed to group performance obligations together that are provided using the same asset or group of assets and recognise an impairment loss on the asset or group of assets as required in terms of IAS 37.69, rather than recognising impairment losses at a performance obligation level. Allocation of costs to a performance obligation level is not considered appropriate where the asset or group of assets used to provide the service is used for numerous performance obligations and incremental revenue contributes to the profitability of the infrastructure as a whole.

7

In addition, to avoid an annual costing and audit of all performance obligations that is known to be profitable, the test for onerous contracts should only be required for contracts if indications exist that a performance obligation or a group of performance obligations is onerous. Where these performance obligations are satisfied through an asset or a group of assets, these assets should be impaired with no further requirement to perform a test for onerous performance obligations.

On a more technical point, we believe paragraph 86 should not only refer to performance obligations satisfied over a period of time but should also include performance obligations satisfied at a point in time in future, more than a year after the contract inception.

#### **Question 5**

The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.

The disclosures that would be required (if material) are:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119–121) In the IASB exposure draft, see paragraph D19 in Appendix D.
- Information on onerous performance obligations and a tabular reconciliation of the movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123).
- A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).

Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.

## Response to question 5

We believe the requirement to provide such detailed reconciliations in interim results announcements is adding clutter to interim reporting and is excessive compared with disclosure required for other items. We propose that qualitative or quantitative information on any significant changes in the recognition, composition or timing of revenue since the publication of the financial statements be disclosed for interim reporting.

#### Question 6

For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset. Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?

## Response to question 6

This is a complex issue that is not adequately addressed by this proposal and it should be dealt with as a separate project as it is not considered to be within the scope of Revenue from Contracts with Customers.

# **Example**

This example illustrates the different accounting consequences of a bundled transaction in the financial records of an individual company compared with that of a group and the complexities resulting from tracking the satisfaction of the performance obligations over time in different entities in a group.

#### Scenario

An agent (MTN 1) acquires handsets from a supplier as well as a bundled product offering from MTN 2 that includes a SIM card, SMSs and airtime.

MTN 1 offers customers who sign a two year contract (that includes the bundled offering above) a free handset and loyalty points.

MTN 1 earns FC 400 commission for each sale made of the bundled product of MTN 2.

MTN 1 acts as a principal for the handset and loyalty points and in an agency capacity with regards to the rest of the bundled offering.

The price charged to the customer is as follows:

Handset – free

SIM card - FC 10

100 SMSs and 120 minutes airtime per month which is carried forward – monthly subscription of FC 120. Assume MTN 2 is not reasonably assured of the unused airtime and SMSs that will expire.

In addition the customer is required to pay a connection fee of FC 10 and will earn 25 free loyalty points. The loyalty points can be redeemed at any MTN 1 store for goods or services of equal value (1 point = FC 1) for up to three months after the points have been awarded. On average, 80% of points are redeemed.

The handset's retail price is FC 350. Other distinct retail prices are as follows SIM – FC 10, 100 SMSs per month– FC 40 per month; 120 minutes airtime per month – FC 100 per month.

MTN 1 and MTN 2 are fellow subsidiaries of MTN Group. The effects of discounting are not considered.

MTN 1: Calculation of fair value and revenue

Item in contract	FC
Fair value of bundle for MTN 1 350+(80%*25)	370
Revenue	
Handset – (350/370) * 400 Recognise when delivered	378
Loyalty awards – (20/370) * 400 Recognise when loyalty awards are claimed	22
Revenue (commission)	400

MTN 2: Determine transaction price

Item in contract	FC
SIM card	10
Connection fee	10
Monthly subscription (120*24)	2 880
Total	2 900

MTN 2: Allocate transaction price to separate performance obligations

Performance obligation	Transaction price (FC)	Stand alone fair value (FC)	Allocated revenue (FC)
SIM card		10	9
SMS (40*24)		960	826
Airtime (100*24)		2 400	2 065
Total	2 900	3 370	2 900

Allocated revenue for SIM card of 9 = 10 / 3370 \* 2900 - same principle applied to other performance obligations (rounded).

The impact of discounting has been ignored for the purposes of this example.

MTN 2: Recognise revenue as performance obligations are satisfied

Performance obligation	Allocated revenue (FC)	Allocated commission paid (FC)	When is revenue recognised*
SIM card	9	1	On transfer to customer
SMS	826	114	FC 0.34 per SMS when used (FC826 / 24/ 100 per month). Recognise 100% when expires.
Airtime	2 065	285	FC 0.72 per minute when used (2 065 / 24 / 120 per month) Recognise 100% when expires
Total	2 900	400	

<sup>\*</sup> Recognise commission paid at the rate applicable to delivery of each performance obligation – SMS = FC 0.0475 per SMS (= 114 / 24 / 100) – same principle for airtime.

# MTN Group: Determine the transaction price

Item in contract	FC
SIM card	10
Connection fee	10
Monthly subscription (120*24)	2 880
Total	2 900

# MTN Group: Allocate transaction price to separate performance obligations

Performance obligation	Transaction price (FC)	Stand alone fair value (FC)	Allocated revenue (FC)
Handset		350	271
SIM card		10	8
SMS (40*24)		960	744
Airtime (100*24)		2 400	1 861
Loyalty awards		20	16
Total	2 900	3 740	2 900

Allocated revenue for handset of 271 = 350 / 3740 \* 2900 - same principle applied to other performance obligations (rounded).

The impact of discounting has been ignored for the purposes of this example.

# MTN Group: Recognise revenue as performance obligations are satisfied

Performance obligation	Allocated revenue (FC)	When is revenue recognised
Handset	271	On transfer to customer
SIM card*	8	On transfer to customer
SMS	744	FC 0.31 per SMS when used (FC744 / 24/ 100 per month). Recognise 100% when expires.
Airtime	1 861	FC 0.65 per minute when used (1 861/ 24 / 120 per month) Recognise 100% when expires
Loyalty awards	16	When loyalty awards are claimed
Total	2 900	

# Summary of different treatment in group

	Group		Group Individual com		ompanies
Performance obligation	Allocated revenue (FC)	Rate per unit of delivery (FC)	Allocated revenue (FC)	Rate per unit of delivery (FC)	
Handset	271		378*		
SIM card	8		9		
SMS	744	0.31	826	0.34	
Airtime	1 861	0.65	2 065	0.72	
Loyalty awards	16		22*		
Total	2 900		(400)* 2 900		
* Intercompany commiss	sion eliminated				

# Further complications at a group level

Issues	Treatment on consolidation
Commission	Intercompany commission will have to be tracked over the contract period and reversed on consolidation.
Discounting of receivables	Further complications exist when discounting is applied if the revenue is different in the group and company.
Credit losses	Credit losses are provided when the revenue is recognised, which will be different for the group and company.
Return of handsets	Accounting for returned goods is complex and, as the values at a group and company level differ for the handsets, this will cause further complications at a consolidated level.
Contract changes	Contract changes – additional goods/services/loyalty awards granted to an existing customer group could trigger a redetermination of the unsatisfied performance obligations at both a company and a group level.
Onerous test	Perform test using company and group revenues and costs as revenue is different and costs for group will exclude commission.