12 March 2012

Mr Hans Hoogervorst
Chairman
International Accounting Standards Board
c/o: commentletters|@ifrs.org

Exposure Draft "Revenue from Contracts with Customers"

Dear Mr Hoogervorst,

We are responding to your request for feedback to the second Exposure Draft 'Revenue from Contracts with Customers' (the 'Exposure Draft'). Vodafone Group Plc is one of the world's largest mobile communications companies; we have interests in over 30 countries across Europe, Africa, Asia-Pacific and the United States and over half a billion customers through our subsidiaries, joint ventures and equity accounted interests.

In our response, we have not confined our comments to the specific questions included in the Exposure Draft. For Vodafone, and most other mobile telecommunications operators ('telecom operators'), the revised model requires a reallocation of revenue for some transactions such that ongoing charges for airtime are, in part, recognised up-front as equipment revenue. This does not reflect our business model and results in a number of undesirable effects:

(i) Inconsistent accounting for similar transactions.
(ii) Revenue and profit figures that are highly susceptible to management judgements and estimates.
(iii) A cost accounting model that is likely to drive changes to sales and remuneration structures.
(iv) A reduction in the comparability of financial reporting for our industry.
(v) A very complex accounting model that is not supported by our current accounting systems. It is uncertain that we will be able to implement systems to reliably account for revenue in the way envisaged. Furthermore if we are able to install systems and processes to perform the necessary accounting, this would be extremely costly and time consuming to implement, whether accounting is performed on a contract or a portfolio basis.
(vi) Revenue that no longer equates to income from the customer.
(vii) The need for a long implementation timeline; and
(viii) Very high implementation costs with no discernible benefit.

In conjunction with several other large European mobile telecoms operators, we have obtained feedback from users of our accounts. None of the users that provided feedback supported the requirements of the Exposure Draft as they apply to telecom operators. We provided a summary of the feedback received to the IASB members on 29 February.

We believe that the impact of the proposed standard for our industry will result in IFRS accounts that do not reflect the majority of the qualitative characteristics of useful information under the Conceptual Framework, as they do under the current accounting model and the Boards should give priority to ensuring that the revenue standard can

be applied by preparers and provides information that users want, rather than insisting on a pure conceptual approach regardless of the outcome.

We believe that a restriction on revenue akin to the contingent revenue cap remains the best solution and addresses each of the adverse effects noted above. Further it would best reflect our business model and is fundamentally more appropriate when an entity has no legal right to receive further consideration from the customer unless further performance obligations are delivered.

Please refer to our comments on specific aspects of the proposed requirements and responses to the questions asked in the Exposure Draft on the following pages.

Yours faithfully

/s/ Andy Halford
Chief Financial Officer

Copies to: Henry Rees, Associate Director, International Accounting Standards Board.
Glenn Brady, Senior Technical Manager, International Accounting Standards Board.
European Financial Reporting Advisory Group

Primary issues for telecom operators

(i) Inconsistent accounting for similar transactions

In common with other telecom operators, Vodafone sells airtime contracts to customers through its own shops and distribution channels (the 'direct' channel') and via third party dealers (the 'indirect' channel).

Key performance indicators for users of our accounts, particularly service revenue and EBITDA, will be materially different for the same customer airtime tariffs, depending on whether customer contracts are acquired through the direct channel or the indirect channel.

Since the proportion of direct and indirect channel sales can vary significantly between operators, countries and reporting periods, we believe this will materially undermine the usefulness and comparability of telecom operators' financial statements.

When airtime contracts are sold via the direct channel, customers are often incentivised to enter into airtime agreements through the offer of a discounted or free handset.

When airtime contracts are sold via the indirect channel, Vodafone typically pays a connection commission to the dealer which the dealer may use to fund customer incentives such as discounted handsets or other goods and services. The value of the commission depends on the value of the tariff sold, i.e. it is typically independent of whether the dealer provides an incentive to the customer. Generally Vodafone does not have visibility of the nature or value of any customer incentives provided by dealers.

Example[1]

An entity enters into a contract with a customer for a handset and 24 months of airtime services. Key terms are as follows:

- Customer pays: -
    - CU100 up-front for the handset
    - CU20 per month for 24 months.
    - CU20 per month after the 24 month term until the contract is cancelled or replaced
- Standalone selling prices:
    - CU250 for handset
    - CU20 per month for airtime services
- Costs incurred:
    - CU230 handset cost (direct channel only)
    - CU20 overheads (direct channel only)
    - CU150 commission (indirect channel only)

[1] Simplified example assumes full availability of contract data and ignores adjustments for the time value of money.

For a given tariff, current accounting practice results in the same service revenue and similar up-front recognition of direct costs (handset discounts in the direct channel and commission costs in the indirect channel) regardless of sales channel.

The proposed accounting results in inconsistent accounting for the two key performance indicators for telecom operators, service revenue and EBITDA:

	Current accounting		*Proposed accounting*	
	Direct channel	*Indirect channel*	*Direct channel*	*Indirect channel*
Service revenue	480	480	381	480
EBITDA	330	330	330	480

A summary of how these figures are derived is provided below.

Direct channel – current accounting - handset discounts expensed up-front:

	T_0	T_{1-2}	Total
Handset revenue	100	-	100
Service revenue	-	480	480
Total revenue	100	480	580
Handset cost	(230)	-	(230)
Other direct costs	(20)	-	(20)
EBITDA	(150)	480	330

Indirect channel – current accounting - commission payable expensed up-front:

	T_0	T_{1-24}	Total
Handset revenue	-	-	-
Service revenue	-	480	480
Total revenue	-	480	480
Handset cost	-	-	-
Incremental commission	(150)	-	(150)
EBITDA	(150)	480	330

Under the proposed accounting the up-front accounting charge for handset discounts will be reduced; other incremental customer acquisition costs will be capitalised. Thus up-front losses will be reduced or eliminated for both direct and indirect channel sales.

Since contract acquisition costs will be amortised, service revenue and EBITDA will be higher for indirect channel sales:

Direct channel – proposed accounting (assumes no incremental commission costs):

	T_0	$T_{1\text{-}2}$	Total
Handset revenue	199	-	199
Service revenue	-	381	381
Total revenue	199	381	580
Handset cost	(230)	-	(230)
Other direct costs	(20)	-	(20)
EBITDA	(51)	381	330

Indirect channel – proposed accounting (assumes incremental commission costs are amortised during the contract term):

	T_0	$T_{1\text{-}24}$	Total
Handset revenue	-	-	-
Service revenue	-	480	480
Total revenue	-	480	480
Handset cost	-	-	-
EBITDA	-	480	480
Commission amortisation	-	(150)	(150)
Net income	-	330	330

(ii) Revenue and profit figures that are highly susceptible to management judgement

In addition to the different accounting for direct and indirect channels sales, the proposed accounting model is very sensitive to data that is determined by management estimates and judgements, such as estimated contract term, standalone selling prices, the basis of amortising commission and discount rates.

Currently, management estimates and judgement have a little impact on revenue recognised for telecom operators, whereas during our field-testing for EFRAG we confirmed that even small movements in estimates and judgements, singly and combined, can materially affect recognised revenue and/or profit.

Under the proposals, the usefulness of service revenue and EBITDA, which are key performance indicators for our industry that internal and external users of our accounts analyse changes in to fractions of one percentage point, would be significantly impaired.

Key estimates and judgements that are likely to impact results under the proposed accounting model are discussed below.

Expected term

Customers are frequently allowed to replace their contracts prior to completing the contractual term; in some markets this is allowed just 18 months into a 24 month contract. The expected term may therefore be shorter than the contractual term.

The expected term determines the total expected consideration at contract inception, which in turn impacts the allocation of consideration between handset and service revenue and thus the timing of revenue recognition.

In addition, the expected contract term impacts the amortisation of the accrued handset revenue and the total imputed interest income recognised, which impacts total revenue recognised.

Our EFRAG user testing demonstrated that modest changes in expected term can materially impact EBITDA and net income during the life of a contract.

Standalone selling prices

The standalone selling prices ('SASPs') of both handsets and airtime impacts the allocation of consideration between handsets and service revenue and thus also impacts the timing of revenue recognition.

The SASPs of handsets and airtime can be subject to rapid changes and can be validly determined in different ways:

- The consumer market for standalone handsets is small and handset prices can fall very quickly when new models are released or if technical issues occur. Valuation bases could validly include observable standalone sales (although transaction volumes may be low), cost-plus, 'the adjusted market assessment approach' or the residual approach. Each method may yield different values.
- The value of airtime can be very difficult to determine in most markets. Airtime services are typically sold in bundles, often including significant voice minutes, messaging and data entitlements. Although 'SIM only' tariffs, which are airtime bundles without handsets, are sold in some markets, these are generally for shorter terms or for different airtime entitlements to airtime bundles sold with handsets.

  A broad range of values for the SASP of airtime can potentially be determined regardless of whether the adjusted market approach is used based on the most similar SIM only tariffs or the residual approach is used based on the assumption that the standalone selling prices of handsets can be more clearly determined.

Our EFRAG user testing demonstrated that standalone selling prices can materially impact the timing and amounts of service revenue, EBITDA and net income recognised during the life of a contract.

Commission

The method of amortising the incremental costs of acquisition, such as commission, also has the potential to significantly impact profitability during the contract term.

It is arguable that commission should be amortised over the expected contract term, rather than customer life, on the basis that if customer life extends beyond the expected contract term then more commission will be payable. However, this approach will not necessarily be universally adopted.

Furthermore, for direct channel sales, if commission is amortised against total revenue (i.e. amortised against both handset and service revenue), then up-front profitability would be reduced compared to amortising solely against service revenue.

Discount rate

Since handset revenue would be accrued up-front and recovered during the expected contract term, it is likely that the up-front amount recognised will have to be discounted using an appropriate discount rate and that imputed interest will be recognised during the expected term.

Monthly agreements with customers are only for the provision of airtime, customers do not sign up to any type of handset finance agreement, consequently there is no explicit or implicit contractual finance rate. The discount rate must therefore be determined from market rates, however the spread of observable consumer interest rates is very broad; in the UK rates range from approximately 20% to nil.

A large number of factors can significantly impact an 'appropriate' rate, the determination of which will be very subjective. Overall, a high rate will reduce up-front equipment revenue and overall revenue, since it is proposed that such imputed interest income will be recognised outside revenue.

(iii) A cost accounting model that is likely to drive changes to sales and remuneration structures

We do not believe that it is appropriate that the proposed standard should mandate the recognition of the incremental costs of acquiring a contract as an asset.

The proposals will incentivise entities to sell goods and services through third parties for the following reasons:

- **Fixed costs incurred by third parties, such as salaries and property-related overheads can be reimbursed by the entity through the payment of incremental commissions that can be recognised as an asset, whereas such costs incurred by an entity in its own sales channels will be expensed as incurred;**
- **Assuming such assets are classified as intangible assets, the charge will ultimately be realised as amortisation and thus EBITDA will depend on the mix of sales channel used and usefulness and comparability of this key measure will be significantly reduced; and**
- **Entities will have increased scope to manage reported profits through altering sales structures.**

Entities will also be compelled to redesign remuneration structures.

Furthermore, we believe that the proposed exemption from the requirement to recognise an asset where the amortisation period would be one year or less is arbitrary and inappropriate; the amortisation period is not necessarily indicative of materiality and realised profit may be materially impacted by management judgements or contractual constructs impacting whether the relevant amortisation term is greater or less than one year.

(iv) Reduction in the comparability of financial reporting for telecom operators

We believe that the following, singly and combined, are likely to materially impair the comparability of reporting between different countries, periods and entities for telecom operators:

- **Inconsistent accounting for airtime contracts sold in different channels, discussed in (i), above;**
- **The susceptibility of revenue and profit measures to management estimates and judgements, discussed in (ii), above; and**
- **Existing differences between, and future changes in, sales and remuneration structures, discussed in (iii), above.**

We believe that this will be severely detrimental for users of our accounts.

(v) A very complex accounting model that is not supported by our current accounting systems and may not be possible to apply at all, whether accounting is performed on a contract or portfolio basis.

Complex accounting steps

Under the proposed model, contract accounting, particularly for airtime contracts obtained through the direct channel, requires an excessive number of complex accounting steps even for straightforward contracts that are not amended by customer actions during the contract term.

We believe that this form of accounting is unduly onerous in an environment with hundreds of millions of customers.

Certain key calculation steps will be required for all direct channel sourced contracts. The detailed workings required are very convoluted, even for a single contract in its most basic form:

- Determination of key contract information.

  Significant contract data is needed to be able to perform the required accounting. Our IT systems and processes are not designed to retain or facilitate harvesting of this data. See 'data availability' section, below.

- Calculation of expected term.

  Although typical airtime agreements are for fixed terms, such as 24 months, customers are typically allowed to take out replacement contracts some months prior to completion of the initial contract term. The expected term of the contract must therefore be determined excluding the impact of expected defaults.

- Calculation of expected contract consideration and allocation between handset and services.

  The total expected contract consideration must be calculated, taking into account the expected contract term. The consideration is then allocated between the handset and the airtime according to relative standalone selling prices that are likely to have to be estimated.

Allocation of the monthly fee between the handset and airtime.

The allocation of expected consideration must be used to determine the split of the monthly service fees between the handset and airtime, taking into account the value of any up-front payment for the handset.

- Calculation of imputed interest on the handset receivable.

  The present value of the payments allocated to the handset must be calculated using a discount rate estimated by management. From this the implicit value of interest must be derived.

- Allocation of interest during the expected contract term.

  Interest must be allocated to accrued handset revenue during the expected contract term. The allocation needs to reflect higher interest in the early stages of the contracts when accrued handset income is at its highest. An appropriate allocation methodology must be determined.

- Deferral of incremental contract acquisition costs.

  Incremental contract acquisition costs must be identified and the basis of amortisation determined.

- Detailed accounting entries must be determined and recorded.

- Contract balances must remain under ongoing review in reaction to customer actions; for example. Contract balances must be written off in the event of earlier than expected contract termination or a default.

- Accounting forecasts must be maintained, and contract balances must be reconciled to debtor and cash movements, for all contracts, for disclosure purposes.

Data availability

Currently, minimal contract data is required to account for airtime bundles provided with discounted handsets. Consequently, in most countries in which we operate, we do not have integrated systems that allow the easy collection or extraction of the extensive contract data needed to comply with the proposed accounting requirements.

Field-testing performed for EFRAG within one of our subsidiaries confirmed that certain key contract information necessary to implement the proposed accounting is either not retained or is retained in peripheral IT systems where the data is difficult to extract and sometimes lacks common references required to link data to core customer records.

IT implementation issues

We are undertaking a high level assessment of the IT infrastructure investment required to comply with the proposed accounting requirements. This is complex since our subsidiaries, joint ventures and equity accounted interests typically have multiple bespoke billing and related platforms; consequently a single IT solution is not feasible.

As the final accounting requirements are uncertain and small amendments to the requirements can fundamentally affect system requirements, we are unable to meaningfully progress an implementation project design until a final standard is issued, particularly since the costs incurred for such a project are expected to be high.

A key decision to be made would be whether the proposed accounting would be performed on a per contract or on a portfolio basis. A per contract basis of accounting is expected to be preferable in nearly all respects; however it is doubtful whether this is possible given the vast data volumes generated by over half a billion customers and the complexity of existing IT infrastructure. However, it is equally uncertain whether portfolio accounting can be applied in a sufficient level of detail to ensure the reliability of revenue and to provide the required accounting disclosures.

We remain concerned that even with huge investment , it may not be possible to develop reliable and stable systems to practically apply the proposed accounting.

Accounting on a per contract basis would potentially allow more accurate and auditable revenue accounting compared to accounting on a portfolio basis. However, as discussed above, it is uncertain that per contract accounting is possible. We believe that the number of customers, combined with a uniquely high number of contract variations that are constantly changing, means that such an IT implementation would likely require data processing and storage capabilities of huge capacity and complexity..

Accounting on a portfolio basis would reduce data volumes but is likely to require a very large number of portfolios to achieve sufficient accuracy – for example, separate portfolios per tariff type, per start month and per handset supplied. This may result in thousands of separately accounted portfolios.

We also believe that it may be difficult to demonstrate that portfolio accounting will result in materially the same results as a per contract basis, that recorded revenue will be even more dependent on management assumptions and that the link between revenue recognised on a portfolio basis and actual customer billings and cash receipts will be very marginal, potentially inhibiting the ability to reconcile movements in contract balances.

(vi) Revenue that no longer equates to income from the customer

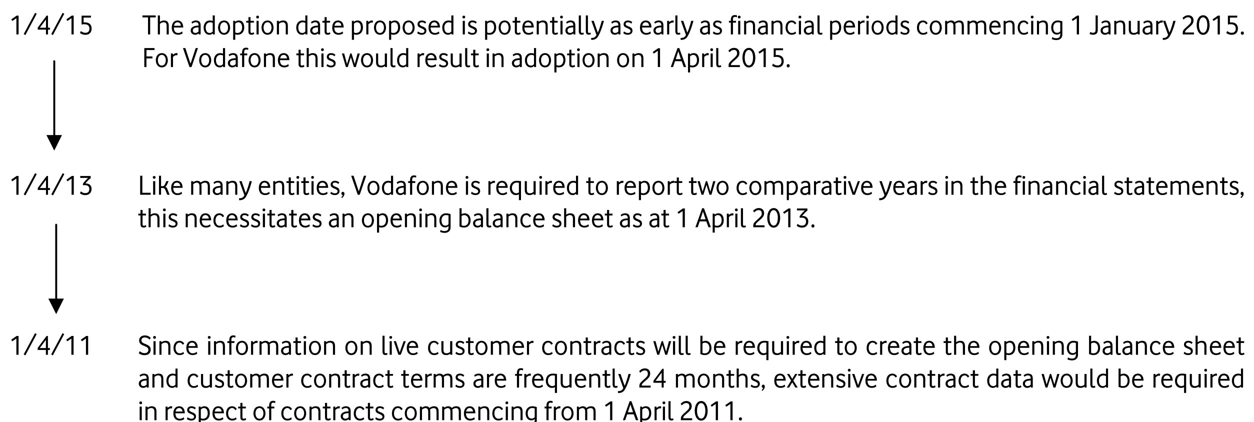
The exposure draft requires the up-front accrual of revenue against handsets. In turn, this will likely require the accrued amount to be discounted and imputed interest to be recognised on the balance.

Since the proposed requirements require an entity to treat transactions in the ordinary course of its activities as if it has provided vendor finance, the related imputed interest income meets the definition of revenue in Appendix A of the Exposure Draft and should be recognised as revenue.

We believe the requirement of paragraph 62 to recognise such customer income as interest income does not reflect the substance of such transactions, being income generated directly by sales to customers. Excluding such income from revenue will further incentivise preparers to minimise discount rates used.

(vii) A long implementation timeline

We believe that the proposed adoption timetable does not allow reasonable time for telecom operators to transition to the new standard if it remains in its current form and would increase the risk of error. Mandatory adoption should be deferred and required for accounting periods commencing on or after 1 January 2019.



The proposed standard would have a substantive impact of the accounting requirements on systems and processes and the need for historic data that is not currently obtained or retained. Furthermore, as discussed above, we are unable to meaningfully progress an implementation project until a final standard is issued.

To avoid the potentially significant risk of errors on adoption, we believe the Boards must allow sufficient time for preparers to plan for adoption:

1/1/13 We understand the Boards are intending to issue the standard in late 2012 or early 2013.

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1/4/17 As explained above, we would require four years' of contract data in order to adopt the proposed standard and restate revenue for comparative periods.

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1/4/19 Given the complexity of system and process changes required in our subsidiaries, joint ventures and associates, we believe an additional two year implementation term is appropriate.

We believe that the potential timing of implementation is unrealistic and that mandatory adoption should be deferred and required for accounting periods commencing on or after 1 January 2019.

(viii) Very high implementation costs with no discernible benefit

Until a final standard is issued, we are unable to meaningfully progress an implementation project as the final accounting requirements are uncertain and small amendments to the requirements can fundamentally affect system requirements and design. Furthermore, costs incurred for such a project are likely to be very high.

The Group has subsidiaries, joint ventures and associates with over half a billion customers in over 30 countries, frequently operating multiple bespoke billing systems and related IT systems in each location.

It frequently costs tens of millions of euros to implement a new billing system or data warehouse in a single country; the cost of compliance for the proposed standard is likely to be huge.

We believe the impact of the proposed standard is overwhelmingly negative for telecom operators and that there is no cost/benefit justification for the proposals.

Responses to questions in the Exposure Draft

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?*

We agree in principle that charges for uncollectible amounts should be presented adjacent to revenue.

However, in certain circumstances, invoices may be raised to customers for which payment is rarely received; for example penalties may be invoiced to customers for default or other breach of contract but collection rates can be very low.

In these circumstances, we believe 'gross' recognition will overstate revenue and related impairment charges. Furthermore, where entities introduce or revoke such charges the resulting impact on impairment charges in the income statement may present users with a misleading view regarding the entity's credit control performance.

We believe that for revenue to be recognised, collection should be probable.

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?*

We do not believe that the requirements of the exposure draft are appropriate:

- The onerous test should be applied at a contract and not a performance obligation level. If high margin and low margin goods and services are provided together in a contract that incorporates a discount, applying the test at a performance obligation level may result in the recognition of an onerous performance obligation liability for the low margin good or service, even if the overall contract is profitable. In such circumstance, recognition of a liability under the onerous test would be arbitrary and misleading.

  Furthermore, we do not agree with the premise in BC207 that performing the 'onerous test' at a contract level would add complexity. We believe that performing the test at a performance obligation level will be more complex since it requires the estimation of expected costs for each undelivered performance obligation even when an overall contract is known to be profitable.

  We believe that existing guidance in IAS 37 is sufficient in determining and providing for loss-making contracts.

- We do not believe that it is appropriate to restrict the onerous test to performance obligations to be satisfied over a period greater than one year. We believe this may result in:
  - Non-recognition of material obligations as the timing of delivery is not necessarily indicative of value.
  - Manipulation of contractual delivery terms to avoid liability recognition, particularly if the test is required to be performed at a performance obligation level such that entities are required to recognise liabilities on an arbitrary basis that do not reflect economic reality.
  - Uncertainty over whether obligations should be recorded when the timing of delivery is at the customer's option.

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)*
- *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.

** In the IASB exposure draft, see paragraph D19 in Appendix D.*

The disaggregation of revenue should be disclosed in interim financial reports.

However, we believe that all the other proposed disclosure will entail an unnecessary level of cost and effort that will outweigh any potential benefits to users.