

March 13, 2012

Hans Hoogervorst
International Accounting Standards Board
1st Floor
30 Cannon Street
London EC4M 6XH
United Kingdom

Delivered via email to commentletters@ifrs.org

Re: TELUS Corporation Inc. reply to request for comments – Exposure Draft Revenue from Contracts with Customers

Dear ladies and gentlemen:

TELUS Corporation Inc. ("TELUS") is pleased to provide comment on the November 2011 Exposure Draft (ED) *Revenue from Contracts with Customers*.

TELUS is a leading national telecommunications company in Canada, with over \$10billion of annual revenue and 13 million customer connections, including 7 million wireless subscribers, 4 million wireline network access lines, 1.3 million internet subscribers, and over half a million television customers. TELUS provides a wide range of communications products and services, including data, internet protocol (IP), voice, entertainment and video.

TELUS is a reporting issuer in both Canada and the U.S., and adopted IFRS effective January 1 2011. TELUS has been recognized by the Canadian Institute of Chartered Accountants for Corporate Reporting, capturing top honours with the Overall Excellence in Financial Reporting Award for the last two years. TELUS has also been recognized for the last eight years by enterprise.com's *Annual Report on Annual Reports*, a global survey of annual reports drawn from a sample of approximately 1,500 companie, placing in the top 10 in the world across all industries. The TELUS team strives to improve the quality and value of our stakeholder disclosures each year and is firmly committed to providing full and fair financial disclosure for the benefit of our investors and many stakeholders.

TELUS supports the IASB and FASB efforts to develop a common revenue standard, and we appreciate the significant efforts that have been invested in advancing the proposal to its current state. In our remarks below, we have first identified our main concerns regarding certain aspects of the proposal and suggestions for improvement or implementation, followed by our responses to some of the specific questions posed by the boards.

### **Kev Areas of Concern:**

1. Removal of the contingent cap: The elimination of the revenue constraint to the amount that is not contingent on delivery of undelivered items (i.e. the contingent cap), and the restrictions on the use of residual technique will have an enormous impact; not only to TELUS, but to substantially all North American telecommunications companies and a significant portion of the global telecom industry. Our position since the 2010 ED is unchanged; we do not support removal of the contingent cap and do not agree with the narrow application of residual technique. We believe this will ultimately result in less relevant financial statement results, and loss of a high degree of comparability and consistency in accounting practices within our industry. Consequently, financial statement users will place more reliance on non-GAAP measures for decision making, as there will be a material disconnect between key operating indicators, cash flows, and financial statements. We expect that users will be required to rely on cash based non-GAAP metrics to be reported in the Management Discussion and Analysis (MD&A) in order to obtain a true and accurate picture of economics and performance trends that will no longer be evident in the financial statements. This will also require extensive reconciliations between non-GAAP measures and the financial statements.

It is evident that the board have already considered and deliberated on the telecommunication industry's position, and have confirmed the decision to eliminate the contingent cap. We respectfully request that, at minimum, the boards reconsider expanding or modifying the circumstances under which the residual technique may be applied, to include situations where there is high variability in the up-front selling price of an item sold as part of a bundle.

We wish to convey to the boards the magnitude of impact to our organization and to the telecommunications industry as a consequence of removing the contingent cap and limiting applicability of the residual technique, and question whether the benefits of such changes really justify the economic costs as outlined in our Summary of Key Concerns and Recommendations below.

2. Variable consideration impractical to apply as it requires extensive estimation of future outcomes: Determination of transaction price is overly complicated by the proposal to include variable consideration that may or may not materialize in the future. The proposal requires that management estimate variable consideration at contract inception and at each reporting period over the contract life. This would necessitate that management predict multiple outcomes and assess probability of occurrence, which is extremely subjective and open to manipulation. The probabilityweighted approach will be difficult to apply other than to the most basic of contract portfolios, and results would be highly sensitive to changes in management's judgment. For example, in our sector it would be difficult to predict at what point in time a customer will achieve volume pricing thresholds in a long-term contract (e.g. 5 to 10 years), or whether any service level penalties will be incurred over a 10-year contract. In addition, future contract terms for many large or complex arrangements is not contained within our billing systems due to the complexity and variability of future options, and a vast volume of possible permutations that are not known at contract inception. A more objective approach would be to include only consideration that has been contractually committed to, and account for other contingent variable consideration on a prospective basis only when the contingency has been resolved. When an item is contingent upon the occurrence of a future event it would be accounted for when that event occurs. Such application is consistent with IAS 37 which would not account for a transaction until an obligating event has occurred. We suggest that the ED proposal as drafted is far too subjective, leading to an increased risk for manipulation, It is

also difficult to apply on a portfolio basis, while still not feasible to apply to contracts on an individual basis, and will lead to a lack of industry comparability; therefore, we suggest a more simplified and practical approach is warranted.

- 3. Contract modification guidance is overly complex and impractical to apply: The proposal for accounting for contract modifications is unnecessarily complex and will present practical difficulties when combined with the mechanics of portfolio accounting. In the telecommunication sector, contract modifications are extremely common. In many of our product lines, customers have the ability to change service plans, add or remove services and features, or choose to upgrade part way through a contract. At TELUS, we have 13 million customer connections across a myriad of product lines. The proposal would require us to assess literally millions of possible permutations to determine the appropriate accounting. The quantification and allocation of the revenue impact resulting from modifications will have significant calculation complexities that our systems cannot perform, and we believe the cost associated with changing systems or developing new systems would far exceed the benefits. In addition, it is not clear how to apply a modification when using the portfolio accounting approach. That is, would the contract modification guidance be applied to material modifications to individual contracts, or alternatively to material modifications at the portfolio level? If applied at the portfolio level and all the contracts in the portfolio do not change at the same time, then you could have variability in the application of the rules based on an entity's definition of portfolios. We propose that contract modifications, including transaction price changes, should be accounted for on a prospective basis only (i.e. account for the modification as a termination of the original contract and creation of a new contract), with no requirement to recognize the effect of the modification on a cumulative catch-up basis. We have provided additional context to item 2 and 3 through illustrative examples in Appendix attached to this letter.
- 4. Guidance on accounting for costs to acquire or fulfill a contract should not be included in a revenue recognition standard: In regard to the ED proposal to capitalize certain contract acquisition and fulfillment costs, we feel that that the proposal lacks clarity as to what types of costs should be capitalized and question why the scope of the revenue guidance would extend to the accounting for costs when there is existing guidance such as that contained in IAS 2, IAS 16, and IAS 38. We believe that the proposal may be subject to significant interpretation or inconsistent application, potentially reducing comparability of companies' financial results both across and within industries. If this guidance remains in scope, we suggest the boards provide significantly more specific guidance and examples of contract acquisition and contract fulfillment costs that should be capitalized. Further clarification is required on the nature and timing of application of this guidance (i.e. would costs throughout a 10 year contract period continue to be eligible for capitalization or only at contract inception). Guidance is also required on classification of the contract acquisition and fulfillment assets, and amortization in the financial statements (i.e. would the assets be grouped with other capital assets like PP&E and Intangibles with amortization included in Depreciation and Amortization line item, or a new separate asset line item and amortized to operating expenses)? If the boards intend for the amortization to be included in Depreciation and Amortization, this adds to our concerns as the consequence is a smoothing of financial results that hides true economic activity, and in a capital intensive industry such as telecommunications, these costs will be buried in a very large depreciation and amortization category.
- 5. Disclosure guidance is impractical to apply as it requires estimation of future outcomes: Certain disclosures required by the ED should be eliminated as they are onerous from a cost

perspective, subject to considerable judgment as they are dependent on future customer choices, and will not deliver sufficient benefits to warrant the associated cost and effort. In particular, the requirement to disclose information about remaining performance obligations is difficult to apply in practice as our existing systems do not have the capability to track and accumulate the various types of data that would be required to quantify transaction price allocated to remaining performance obligations, or to identify the timing of when such performance obligations would be recognized. In addition, due to the considerable variability of future performance obligations, we do not feel this information would contribute to helping financial statement users as the requirements would not provide a comprehensive view of the amount, timing and uncertainty of revenue and cash flows. We are supportive of the other disclosure requirements; however, we respectfully request that disclosures on remaining performance obligations be removed.

# **Summary of Key Concerns and Recommendations:**

The effects of the proposed ED on TELUS will be of greater significance than that of our recent transition from Canadian GAAP to IFRS. The new ED, as drafted, will result in significant changes to our financial statements which will materially disconnect reported results from cash flows and other key industry operating metrics. This will drive financial statement users to rely more on non-GAAP measures than on financial statements for assessing the financial performance of our organization relative to competitors as well as other investment opportunities across industries. This will dramatically impact our financial statement users; and extensive communication and education will be required to adequately inform our shareholders, the investment community and other stakeholders of the pending changes, both internally for TELUS and across the telecommunications industry. Implementation of the final standard will be an enormous task; involving significant time, effort and cost with no related benefit as we will be required to provide our financial statement users with non-GAAP measures so that they may assess the economic performance of our organization. Furthermore, we are concerned with the degree of subjectivity that this guidance permits, which in turn opens the door to the increased possibility for manipulation of results.

Although the boards have provided some relief in the form of a practical expedient to allow application of the (draft) IFRS to a portfolio of contracts with similar characteristics, this is not enough to alleviate what we anticipate to be a massive implementation burden. Our initial assessment is that the portfolio approach will be helpful when assessing the most basic consumer type contracts that contain a limited number of performance obligations; however that addresses only a portion of our contracts and revenues. For the more complex contracts associated with our business and government customers, the portfolio approach will present challenges due to the vast array of products and services that customers can choose from; the number of different product and service bundles is virtually infinite. Definition of business contract portfolios and their boundaries will be a considerable undertaking. It is important to note that we expect that it will not be possible to account for all contracts on a portfolio basis, particularly those related to our very large enterprise and government customers who have customized contracts; we therefore anticipate that we will be required to apply the ED proposals to a substantial number of contracts on an individual basis. Given the extensive data collection efforts required to implement the proposal, system changes, interfaces or new systems will be required to address the proposed revenue recognition requirements. Even where a portfolio basis is utilized, systems work will be required at a transactional level to identify, categorize, and accumulate the data. In our sector, billing and accounting systems are extremely complex, and any changes will be costly and will require a lengthy development period.

As outlined in our key concerns above, we recommend the following modifications to the exposure draft to provide practical expedients for implementation:

- At a minimum, as an alternative to the contingent cap, consider expanding or modifying the circumstances under which the residual technique is applied to include situations where there is high variability in the selling price of an item.
- Variable consideration should include contractually committed consideration only. Other
  contingent variable consideration should be accounted for on a prospective basis only when
  the contingency is resolved (please refer to Appendix for illustrative examples for which we
  are seeking further clarification).
- Contract modifications should be accounted for on a prospective basis with no requirement to recognize the effect of modifications on a cumulative catch-up basis (please refer to Appendix for illustrative examples for which we are seeking further clarifications).
- The disclosures on remaining performance obligations should be removed (item 5 above).

Without the above recommended modifications, due to the immense effort and significant incremental costs associated with implementing this standard, we respectfully request that the boards consider a mandatory effective date no earlier than **1 January 2017**. Assuming a final standard issued in late 2012, that will allow adequate time to assess impacts, evaluate alternatives, build and test processes and make system changes, educate both internal and external stakeholders, and accumulate adequate data to provide accurate comparatives (as many of our customer contracts are three years or more in duration). We believe it is practically impossible to be able to apply this guidance retrospectively starting in 2011 when a final standard has not yet been issued for comparative reporting on contracts of three or more years. A shorter implementation period would be onerous, if not impossible, to apply and may put TELUS' world class standing for financial reporting at risk. Shorter implementation would also require management to make material estimates based on broad assumptions that will be difficult to audit.

## **ED Questions:**

## **Question 2**

Paragraphs 68 and 69 state than 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 alternatives do you recommend to account for the effects of a customer's credit risk and why?

TELUS agrees with the proposal to apply IFRS 9 (or IAS 39 if the entity has not yet adopted IFRS 9) to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. However, TELUS disagrees with the proposal to present the corresponding amounts in profit or loss as a separate line item adjacent to the revenue line item. Disclosure of credit losses is adequately addressed in IFRS 7, and we see no benefit to presenting this amount on the face of the financial statements. If the proposal proceeds as drafted, we suggest that it would be appropriate to provide clarification regarding how this proposal interacts with IAS 1

on Financial Statement presentation which indicates that an entity would display only material line items. We suggest that the ED be amended as follows:

"Upon initial recognition of the receivable, any difference between the measurement of the receivable in accordance with IFRS 9 and the corresponding amount of revenue shall be presented in profit or loss as a separate line time in adjacent to the revenue, *if material*."

#### **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 recognizes to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonable 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 recognize for satisfied performance obligations? If not, what alternative constraint do you recommend and why?

TELUS disagrees with the proposed constraint due to the inherent difficulties in the proposed methods for estimating the amount of variable consideration as discussed above in point 2. We believe the constraint on the cumulative amount of revenue recognized should be the amount to which an entity is legally entitled. This constraint or threshold is far more verifiable and reliable than an estimated amount subject to significant management judgment that would lack industry comparability.

#### **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 recognized from the costs to obtain or fulfill 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 approximately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial statements.

TELUS does not agree that an entity should be required to provide each of those disclosures in its interim financial reports due to the considerable variability in their predictive nature as discussed above in point 5. In particular, TELUS doesn't believe that an entity should be required to disclose an analysis of its remaining performance obligations in our interim or annual financial reports. The analysis does not provide a comprehensive, complete view of the amount, timing or uncertainty of revenue and is therefore not meaningful to financial statement users. In addition, disclosure of revenue amounts associated with outstanding performance obligations is akin to forward-looking prospective estimates that are more appropriately addressed in the Management Discussion and Analysis. Costs to produce such disclosure would be significant and would require new systems or system changes; and such excessive cost is not warranted by such limited benefit.

#### Conclusion:

We are pleased to have had this opportunity to submit our comments on the revised ED Revenue from Contracts with Customers. We recognize that this is a tremendously difficult topic, and applaud the boards for their commitment demonstrated by the extensive outreach activities conducted and the decision to reexpose for public comment, all in the interests of achieving an improved final global standard. TELUS is similarly committed to 'best in class' financial reporting, and again we respectfully request that the boards carefully consider providing adequate implementation time for this important standard, and delay the mandatory effective date to **1 January 2017**. For the Canadian Telecommunication Industry, this standard will be the most impactful change to generally accepted accounting principles in the last decade, fundamentally changing how we account for both revenue and costs, necessitating a lengthy transition. This will result in greater reliance by financial statement users on non-GAAP metrics for measuring performance, and therefore extensive education and communication will be required.

If you require further clarification regarding our response, I would be pleased, along with our TELUS team, to discuss our comments further or to provide you with any additional information.

Sincerely,

Doug French

Vice-President Corporate Accounting and Financial Reporting

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### Appendix (note amounts and examples are for illustrative purposes only)

We believe the guidance lacks clarity and in some cases appears inconsistent or contradictory, and suggest that additional application guidance and/or more comprehensive illustrative examples are required. Below is a description of a very simple contract and a few common scenarios. We have provided our comments and questions as to the various ways the proposed guidance could be interpreted and applied to the various scenarios, and hope this may aid the boards in understanding our desire for more specific guidance.

- 1. An entity enters into a 3 year contract with a customer to sell wireless telecommunication service. The customer receives a handset at contract inception. The customer chooses a 3 year wireless service plan that includes a maximum of 200 airtime minutes, and 3 features (Caller ID, Voice Mail, Call Waiting) for a base monthly contract cost of \$40. The contract states that if the customer uses more than the maximum 200 airtime minutes, all excess minutes will be billed at \$0.25 per minute. Additional minutes are utilized solely at the customer's discretion, and currently the entity accounts for excess airtime minutes only if and when the customer actually uses them.
  - Is the potential provision of additional airtime minutes a distinct performance obligation (assuming sold at stand alone selling price)?
  - Historical experience indicates that similar customer contracts are billed, on average, an additional \$5 per month for excess airtime minutes. To determine transaction price, does the entity include an estimate of the potential airtime minute overages? More specifically, is the consideration associated with providing additional optional services (that are same as other committed contract services) to be included as Variable Consideration (i.e. \$45 \* 36 = \$1,620)? Or is the transaction price based only on the contractual committed amount (i.e. \$40 \* 36 = \$1,440)?
  - Using the above example what would be the difference between the transaction price, the amount an entity is reasonably assured to be entitled to, and the amount an entity is legally entitled to?? At month 24 of the contract, the customer observes that the entity is offering a substantially similar plan to new customers for only \$36 per month (10% lower monthly price). Customer requests that he be moved to the lower cost plan for the last 12 months of his contract, and the entity obliges to prevent the customer from cancelling his contract. The price of the contract has changed to a current market price that is available to all contract customers. In this case, as the contract modification includes no scope change and the price change is at market, would this preclude retroactive reallocation of adjusted transaction price (i.e. would the price reduction be accounted for on a prospective basis)?
  - In the preceding example, if the price change must be accounted for on a retroactive basis (i.e. reallocation of price change to delivered performance obligations), is it appropriate to assess materiality at a portfolio level? For example, assume that an entity has a portfolio of 1 million contracts, and 10% of the contracts are adjusted by moving customers from a \$40 per month service plan to a \$36 per month service plan. For the total portfolio, the monthly consideration will decline by \$400 thousand from \$40 million per month to \$39.6 million per month (900,000 contracts \* \$40 + 100,000 contracts \* \$36). On a total portfolio basis, this 1% decline seems immaterial and we would consider it appropriate to account for the price reduction on a prospective basis only, even though on an individual contract basis, the

monthly revenue reduction is more material at 10%. Additional guidance is requested in regard to whether such assessment of materiality at a portfolio level is appropriate.

2. In regard to Illustrative Example 10, if the entity was unable to estimate how many units would be purchased by the customer, and there is no contractual commitment for the customer to purchase any units, could this result in a different accounting outcome? For example, would you account for unit sales at \$100 per unit until such time that it is probable that the customer will exceed the 1000 unit threshold? The tiered pricing example results in revenue recognition based on blended average rates throughout the contract, while it appears that options to purchase additional distinct goods or services may be contract modifications that are accounted for prospectively. As tiered pricing in a contract with no purchase commitment is not substantially different than an option to purchase additional goods or services (assuming at market prices for similar volumes), this appears to be a contradiction.