

Accounting for revenue is changing

What's the impact on telecommunication companies?



Have you planned for the effects on:

- subsidised handsets?
- portfolio accounting?
- multiple-user plans?
- early upgrade rights?
- non-refundable fees for set-up or installation services?
- one-off credits and customer retention-type discounts?
- contracts paid over a period of more than one year?
- indirect channel sales?
- commissions and other contract costs?
- transition options?

How could your business be affected?

Now that the IASB and FASB have published a new joint standard on revenue recognition, the real work for telecommunication companies is just beginning. IFRS 15 and FASB ASC Topic 606 *Revenue from Contracts with Customers* were issued in May 2014, replacing the existing IFRS and US GAAP revenue guidance, and introducing a new revenue recognition model.

The new standard will result in significant impacts across the telecommunications sector, requiring companies to assess how their financial reporting, information systems and processes will be affected. In particular, some revenue may be recognised earlier than today whilst some costs may be deferred. In addition, the new disclosure requirements are extensive and might require changes to systems and processes to collect the necessary data. Companies will need to ensure that any judgements and policy choices made comply with the new standard and it will be crucial to remain aware of the trends developing as acceptable practice within the sector. In addition, companies will need to engage with their investors and other stakeholders to build up expectations of how their key performance indicators or business practices may change as a result of the new standard.

The new standard takes effect in January 2017, although IFRS preparers can choose to apply it earlier. While the effective date may seem a long way off, decisions need to be made soon – namely, when and how to transition to the new standard. An early decision will allow companies to develop an efficient implementation plan and inform their key stakeholders.

Determining the impact

	Potential impact	Actions to consider
Subsidised handsets	<ul style="list-style-type: none"> Companies will need to allocate a contract's transaction price based on each performance obligation's relative stand-alone selling price. Previously, revenue recognised on handset sales that were subsidised by the ongoing service fees in a contract was usually limited to the amount of cash received (based on the contingent revenue cap approach or application of the residual method). As a result of allocating revenue to handsets based on their stand-alone selling price, companies will recognise a greater amount of revenue up-front. This will result in a disconnect between the reported revenue and the amount billed. This will decrease the average revenue per user for ongoing services. 	<ul style="list-style-type: none"> Develop new processes and adjust systems to capture, estimate and monitor stand-alone selling prices to allocate the transaction price to the performance obligations in the contract. Assess whether billing management systems are capable of supporting the allocation methodology and generation of journals to allocate revenue. Identify commercial opportunities by reconsidering whether any contract terms or business practices should be modified for the impact of the new standard.
Portfolio accounting	<ul style="list-style-type: none"> A practical expedient allows a company to apply the new standard's requirements to a portfolio of contracts or performance obligations with similar characteristics if the company does not expect the outcome to be materially different from accounting for those individually. It is not clear how much effort and cost may be needed to: <ul style="list-style-type: none"> evaluate which items constitute a portfolio considering, for example, the impact of different offerings, periods of time, geographic locations and contract modifications; and assess, on an ongoing basis, whether the portfolio approach gives a materially different result than the contract-by-contract approach. 	<ul style="list-style-type: none"> Exercise judgement in determining when the portfolio approach may be appropriate, including considering whether any customer-specific agreements would be eligible for the portfolio approach. Develop the record keeping necessary to track and compare contract terms over large numbers of individual contracts. Develop the process and controls needed for accounting and monitoring portfolios over time through contract events such as repricing, changes in scope or duration.
Multiple-user plans	<ul style="list-style-type: none"> Many companies offer multiple-user plans under which individuals can share services – e.g. data or minutes – among themselves at discounted prices. Companies will need to determine the appropriate unit of account for these types of arrangements – i.e. is there one contract or multiple individual contracts? If they are accounted for on a combined basis, then companies will need to consider the implications of contract modifications to an individual's specific plan. Companies may also need to estimate the stand-alone selling price of each user's plan to allocate the transaction price. 	<ul style="list-style-type: none"> Review the contractual terms and business practices related to multiple-user plans and determine the appropriate unit of account – either as individual contracts or as a combined contract. Assess how modifications to the goods or services in an individual's plan within a multiple-user contract will be accounted for. Develop valuation models or processes to estimate stand-alone selling prices.
Early upgrade rights	<ul style="list-style-type: none"> Companies that offer early upgrade rights to customers – e.g. handset upgrade offers – will need to determine the appropriate accounting, including whether a material right has been granted to the customer or if modification accounting applies. A material right is an option to acquire additional goods or services at a price that does not reflect the good's or service's stand-alone selling price, and is considered a separate performance obligation. 	<ul style="list-style-type: none"> Review all arrangements and business practices for early upgrade rights and exercise judgement in assessing if a material right exists and should be separated. Develop new processes and adjust systems to track and monitor separate components in a contract, including upgrade rights.
Non-refundable fees for set-up or installation services	<ul style="list-style-type: none"> The majority of up-front set-up or installation services facilitate the customer's access to the network, and are bundled with a future period of ongoing services. Companies will need to evaluate whether these types of up-front services are separate performance obligations. In many cases, even though a non-refundable fee charged for up-front services relates to an activity that a company is required to fulfil – e.g. switching on access to the network – the activity does not result in the transfer of a promised good or service to the customer. Instead, the up-front fee is recognised as revenue when the future services are provided. The revenue recognition period for the non-refundable fee may not necessarily be consistent with the initial contractual period – e.g. the period could extend beyond the initial contractual period if the company grants the customer the option to renew the contract. 	<ul style="list-style-type: none"> Review all arrangements with non-refundable up-front fees and exercise judgement in assessing when to bundle or unbundle them. For contracts with renewal options, exercise judgement in evaluating whether a material right has been granted to the customer or whether the future optionality is a marketing promotion. Assess the revenue recognition period for non-refundable up-front fees, especially in relation to renewal options and early termination practices.

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One-off credits and customer retention-type discounts	<ul style="list-style-type: none"> Companies may offer one-off credits and customer retention-type discounts throughout the life of a contract. Although these discounts may not be explicit in the contract, this part of the fixed consideration could be considered variable based on customer expectation, or if the company's customary business practice indicates the intention to offer a price concession to the customer. Alternatively, these types of discounts could be considered to be contract modifications. Whether the discount is variable consideration or a contract modification will require judgement and may impact the timing of revenue recognition – i.e. recognised over the contract term or recognised prospectively over the remaining term. Some companies also issue promotional offers to current customers subsequent to the contract inception. Companies will need to assess whether these types of offers are contract modifications or separate marketing transactions. 	<ul style="list-style-type: none"> Assess whether processes and systems are capable of tracking and monitoring all discounts, concessions and promotional offers granted to customers. Review customer care retention and pricing policies. Review current business practices in identifying any implicit promised consideration. Exercise judgement to assess whether these types of discounts are variable consideration and, if so, determine how to apply the constraint in estimating whether a significant revenue reversal is expected.
Contracts paid over a period of more than one year	<ul style="list-style-type: none"> Many companies offer contracts that provide for instalment payments for up-front purchases of equipment when coupled with ongoing services – e.g. a customer can pay for purchased equipment over a two-year period provided that ongoing network services are purchased for the same period. If the contract is deemed to include a significant financing component, then the company will need to adjust the transaction price to reflect the time value of money. 	<ul style="list-style-type: none"> Review all contracts that span a period longer than one year and exercise judgement in assessing whether a significant financing component exists. Determine processes for estimating discount rates and ensure that systems can handle the complex calculation that will be needed in certain cases.
Indirect channel sales	<ul style="list-style-type: none"> Companies whose business model includes sales through indirect sales channels (dealers) could transfer a handset to the dealer. The dealer is then responsible for selling that handset to the end customer, who simultaneously enters into a contract with the company for future ongoing services. The timing and presentation of handset sales could be affected as well as the accounting for reimbursements to the dealer for equipment subsidies when customers sign up for future services. 	<ul style="list-style-type: none"> Review the contractual terms and business practices of arrangements with dealers. Exercise judgement in determining how to account for reimbursements – e.g. commissions and handset subsidies – and whether to recognise revenue on a gross or a net basis.
Commissions and other contract costs	<ul style="list-style-type: none"> Companies are required to capitalise incremental contract acquisition costs – e.g. sales commissions – and other contract fulfilment costs if they are expected to recover these costs. However, a practical expedient allows a company to expense as incurred the incremental costs of obtaining a contract if the amortisation period of the asset arising would be one year or less. Companies will need to exercise judgement in distinguishing between incremental costs incurred as a result of obtaining a contract and those that relate to satisfying a performance obligation. 	<ul style="list-style-type: none"> Assess any required changes to existing systems to capture incremental costs and processes to determine and monitor the amortisation periods. Analyse any impacts on key performance indicators such as subscriber acquisition costs and subscriber retention costs. Exercise judgement in determining appropriate amortisation periods and in assessing whether the practical expedient is available when there is a possibility of contract renewals.
Transition options ¹	<ul style="list-style-type: none"> Although the effective date of January 2017 may seem a long way off, decisions need to be made soon – i.e. when and how to transition to the new standard. The new standard may be adopted retrospectively, or as of the application date by adjusting retained earnings at that date and disclosing the effect of adoption on each line of profit or loss (the cumulative effect approach). 	<ul style="list-style-type: none"> Quantify and evaluate the effects of the different transition options, including the available practical expedients under the retrospective approach. Perform a historical analysis of your contracts. Develop a transition plan for parallel runs, including reconciliations, to track the data needed to provide comparative information.

1 Our forthcoming publication *Transition Options* will outline the options available and factors to consider when selecting a transition option.

How we can help

KPMG's Telecommunications practice

KPMG's Telecommunications practice is dedicated to supporting telecommunications carriers globally in understanding industry trends and business issues. Member firms offer customised, industry-tailored services that can lead to value-added assistance for your most pressing business requirements. At KPMG, our extensive network of professionals experienced in telecommunication practice combines global perspective with in-depth industry knowledge to help companies adjust to today's rapidly changing market.

For those affected by the new revenue recognition requirements, the impact will be felt far beyond accounting change. The following are just a few examples of how our cross-functional team of experts has helped clients across various sectors – including telecommunications – with the accounting and operational challenges.

- Developing an accounting diagnostic to identify and prioritise the impacts on accounting policies and disclosures including information gaps.
- Identifying and analysing contract attributes that impact revenue.
- Identifying the impacts to internal management reporting including key financial measures and ratios.
- Helping to automate the stand-alone selling price allocation.
- Implementing a portfolio approach methodology, where appropriate.
- Implementing automated solutions around the decoupling of revenue from billing.
- Mapping information requirements to existing sources and defining required information that is not currently available in your existing systems.
- Assisting in redrafting contracts and remodelling goods and services offerings.
- Identifying corporate and indirect tax implications.

Starting now will allow you to assess the impact and design an appropriate implementation plan that allows time for unanticipated complexity.



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