KPMG

Revenue for Telecoms

Issues In-Depth

September 2016

IFRS and US GAAP

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Contents

Facing the challenges

The new revenue standard is having a profound effect across the telecommunications sector.

The past two years have seen telecom companies wrestle with implementation issues. Every day brings new questions and new insights, which are – sometimes quite hotly – discussed and debated in various forums globally.

We are helping our clients to navigate through this period and we've gained extensive experience applying the new revenue standard around the world. And we are delighted to share this experience with you in this publication. It builds on the discussions to provide preparers, users and auditors with a comprehensive and illustrated understanding of how to apply the new standard to common transactions.

Whether you are just starting to assess the impact of the new requirements or are at an advanced stage with your implementation project, this publication will provide you with the insight that you need into the implementation issues that telecom companies are facing.

With the effective date of 2018 rapidly approaching, time is running out. If you have yet to begin your implementation of the new requirements, we urge you to start as a matter of priority and to engage with investors and other stakeholders to build expectations of how your key performance indicators or business practices may change.

Please speak to your usual KPMG contact if you are facing implementation challenges or would like to discuss any other accounting issues.

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Introduction

The new standard will affect the amount, timing and recognition of revenue and some costs for telecom companies. It will also have a follow-on impact to financial reporting, IT systems, internal controls and disclosures related to revenue.

This publication examines how the five steps of the new revenue standard applies to wireless, cable and other telecommunications companies, referred to throughout this publication as telecom entities or telcos. It also covers more advanced topics such as the impact of customer options and material rights in telecom contracts, nonrefundable up-front fees, repurchases, sales through indirect channels, and costs to obtain or fulfill a contract.

This publication does not cover other topics that telecom entities will need to address to ensure their accounting complies with the new standard, including contract modifications, presentation, disclosures and transition. Those topics are covered broadly, in our publications *Revenue Issues-in-Depth*, Edition 2016 (Issues In-Depth, Edition 2016, Guide to annual financial statements – IFRS 15 supplement, Edition 2015 and Illustrative disclosures – Revenue, Edition 2016. We believe that disclosures and transition, in particular, will be challenging for telecom entities to resolve because of the large amount of data required to comply with those provisions of the new standard.

We have illustrated the main points with examples and explained our emerging thinking on key interpretative issues. Also included are comparisons with current IFRS and US GAAP requirements, as well as comparisons between the new IFRS and US GAAP requirements, when relevant.

Key facts

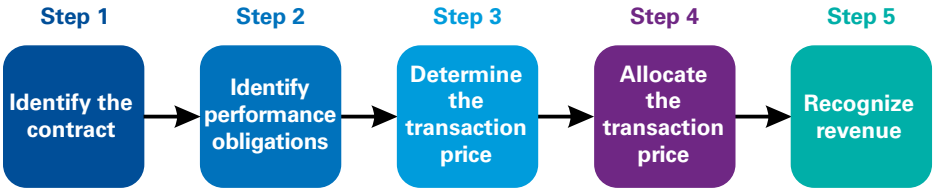
The new standard provides a framework that replaces existing revenue guidance in US GAAP and IFRS, including the contingent cap. It moves away from the industry- and transaction-specific requirements under US GAAP, which are also used by some IFRS preparers in the absence of specific IFRS guidance.

New qualitative and quantitative disclosure requirements aim to enable financial statement users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Entities will apply a five-step model to determine when to recognize revenue, and at what amount. The model specifies that revenue is recognized when or as an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognized:

– over time, in a manner that best reflects the entity's performance; or

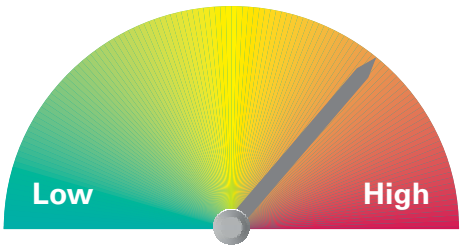
– at a point in time, when control of the goods or services is transferred to the customer.



The new standard provides application guidance on numerous related topics, including principal versus agent arrangements and customer options. It also provides guidance on when to capitalize the costs of obtaining a contract and some costs of fulfilling a contract (specifically those that are not addressed in other relevant authoritative guidance – e.g. for inventory).

The following table lists the mandatory effective date and early adoption provisions of the new standard for IFRS and US GAAP entities.

Type of entity	Annual periods commencing on or after
IFRS entities	January 1, 2018 (with early adoption permitted for any annual period)
Public business entities and certain not-for-profit entities applying US GAAP[1]	December 16, 2017 (with early adoption permitted for annual periods beginning on or after December 16, 2016, the original effective date)
All other US GAAP entities	December 16, 2018 (with early adoption permitted for annual periods beginning on or after December 16, 2016, the original early-adoption date)



Broad impacts for telecom entities

Revenue recognition for handsets may be accelerated

Compared with current accounting, revenue recognition for handsets may be accelerated. This is due to the fact that the new standard removes the contingent cap methodology that many telecom entities have used when accounting for sales of wireless arrangements. The new standard replaces the contingent cap methodology with a requirement that telecom entities determine the amount of revenue for each element in a bundle by allocating the transaction price based on stand-alone selling prices. This change in methodology may also result in a greater amount of revenue being allocated to goods (equipment) and less revenue being allocated to services.

1. 'Public business entity' is defined in ASU 2013-12, *Definition of a Public Business Entity – An Addition to the Master Glossary*, available at www.fasb.org. 'Certain not-for-profit entities' are those that have issued or are a conduit bond obligor for securities that are traded, listed, or quoted on an exchange or an over-the-counter market. All other entities applying US GAAP have the option to defer application of the new guidance for one year for annual reporting purposes.

The acceleration of revenue and the change in allocation between goods and services will have an impact on key performance indicators and ratios, affecting analyst expectations, compensation arrangements and contractual covenants.

Customer options (material rights) require careful analysis

The new standard requires a telecom entity to allocate the transaction price to options to purchase additional goods and services that provide a customer with a material right. Given the breadth of offers provided by telecom entities, this will require careful analysis and may ultimately result in the deferral of revenue, until such options are exercised or they expire.

Accounting for costs to obtain or fulfil a contract may change

Under the new standard, incremental costs to acquire a contract and certain costs to fulfill a contract are capitalized and amortized over the period the goods and services are delivered. This may represent a change in accounting policy for some telecom entities which expense such costs currently. We expect the new standard will reduce some of the diversity in current practice.

Revisions may be needed to tax planning, covenant compliance and sales incentive plans

The timing of tax payments, the ability to pay dividends in some jurisdictions and covenant compliance all may be affected. Tax changes caused by adjustments to the timing and amounts of revenue, expenses and capitalized costs may require revised tax planning. Telecom entities will need to revisit staff bonuses and incentive plans to ensure that they remain aligned with corporate goals.

Sales and contracting processes may be reconsidered

Some entities may wish to reconsider current contract terms and business practices – e.g. distribution channels – to achieve or maintain a particular revenue profile.

IT systems will need to be changed

Telecom entities will need to capture the additional data required under the new standard – e.g. data used to estimate stand-alone selling prices and to support disclosures. Applying the new standard retrospectively likely means the early introduction of new systems and processes, and potentially a need to maintain parallel records during the transition period.

New estimates and judgments will be required

The new standard introduces new estimates and judgmental thresholds that will affect the amount or timing of revenue recognized. Judgments and estimates will need updating, potentially leading to more financial statement adjustments for changes in estimates in subsequent periods.

Accounting processes and internal controls will need to be revised

Telecom entities will need processes to capture new information at its source – e.g. customer service activities, operations, marketing offers and new product introductions – and to document the new processes and information appropriately, particularly as they relate to estimates and judgments. Telecom entities will also need to ensure controls are in place to ensure consistent methodologies for both allocation of the transaction price and accounting for contract modifications. New internal controls will be required to maintain the completeness and accuracy of all of this information.

Extensive new disclosures will be required

Preparing new disclosures may be time-consuming, and capturing the appropriate information may require incremental effort or system changes. There are no exemptions for commercially sensitive information. Telecom entities will also need to consider IFRS, SEC and other regulatory requirements to disclose the effect of recently issued accounting standards on financial statements when adopted.

Entities will need to communicate with stakeholders

Investors and other stakeholders will want to understand the impact of the new standard on the business before it becomes effective. Areas of interest may include the effect on financial results, the costs of implementation, expected changes to business practices and the transition approach selected.

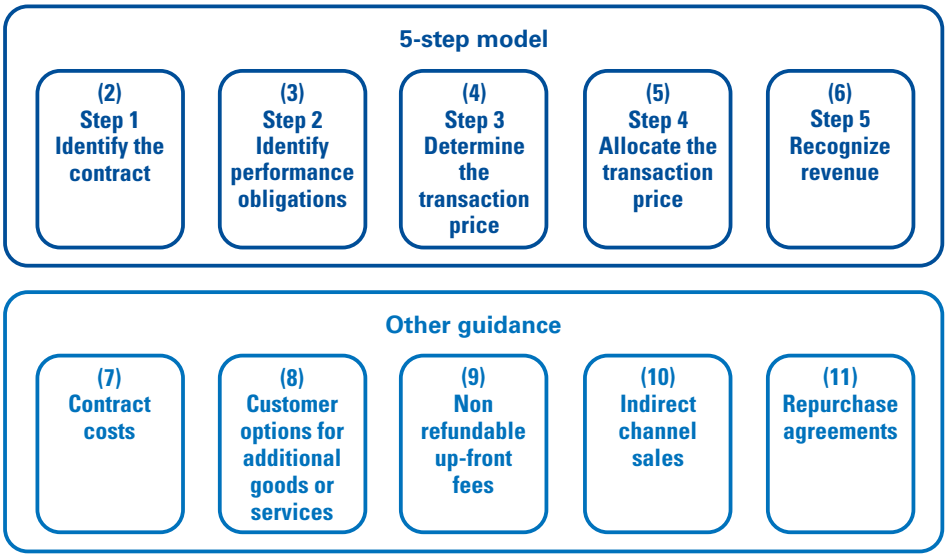
Putting the new standard into context

This publication provides a detailed analysis of the new standard, for those elements that are most relevant to telecom entities and that will result in a change in practice. Examples have also been provided to demonstrate those changes. Further analysis and interpretation will be needed for a telecom entity to apply the requirements to its own facts, circumstances and individual transactions. Furthermore, some of our observations may change and new observations will be made as issues from the implementation of the new guidance arise, and as practice develops.

This section provides important context to the rest of the publication.

Organization of the text

The following diagram highlights how we have organized our discussion of the new standard in this publication. Within each section we generally provide an overview, the requirements of the new standard, examples, our observations, comparisons with current IFRS and US GAAP guidance, and key differences between IFRS and US GAAP, if any.



For those elements of the guidance that are not covered in this publication, such as disclosures, reference is made to Issues In-Depth, Edition 2016.

Guidance referenced in this publication

This publication considers the requirements of IFRS 15 *Revenue from Contracts with Customers* and FASB ASU 2014 09, *Revenue from Contracts with Customers (FASB ASC Topic 606)*, originally published jointly in May 2014, and subsequently amended for clarifications. This publication reflects the amendments to FASB ASC Topic 606 made by ASU 2016-08, *Principal versus Agent Considerations (Reporting Revenue Gross versus Net),* ASU 2016-10, *Identifying Performance Obligations and Licensing*, and ASU 2016-12, *Narrow Scope Improvements and Practical Expedients*. This publication also includes, as Future developments, discussion of other FASB standard-setting projects and technical correction proposals that may further clarify certain requirements.

For specific provisions of the revenue recognition guidance, KPMG *summarizes* the requirements, *identifies* differences between IFRS and US GAAP, and *identifies* KPMG's observations. Neither this publication nor any of KPMG's publications should be used as a substitute for reading the standards and interpretations themselves.

References in the left hand margin of this publication relate to guidance issued as at September 1, 2016. *Future developments* are based on information as at September 1, 2016 and may be subject to changes.

Reference should be made to Issues In-Depth, Edition 2016 for the following information:

- Authoritative portions of the new standard;
- Guidance replaced by the new standard; and
- Summary of key differences between IFRS and US GAAP.

SEC guidance

This publication contains comparisons to current US GAAP, including the SEC's guidance on revenue recognition.[2] Although the new standard supersedes substantially all of the existing revenue recognition guidance issued by the FASB and included in the Codification, it does not supersede the SEC's guidance for registrants. The SEC has rescinded certain observer comments and will continue to evaluate its guidance and determine which guidance may be relevant under the new standard, requires revision or will be rescinded.

2. SEC Staff Accounting Bulletin Topic 13, *Revenue Recognition*, available at www.sec.gov.

Transition Resource Group for revenue recognition

The IASB and the FASB's Joint Transition Resource Group for Revenue Recognition (TRG) was formed for the purpose of:

- soliciting, analyzing and discussing stakeholder issues arising from the implementation of the new standard;
- informing the IASB and the FASB about implementation issues that will help the Boards determine what action, if any, will be needed to address them; and
- providing a forum for stakeholders to learn about the new guidance from others involved with implementation.

The TRG advises the Boards, but does not have standard-setting authority. The members of the TRG include auditors, financial statement preparers and users from various industries and geographies (both United States and international), and both public and private companies and organizations. Others who attend and participate in the meeting as observers include the IASB and FASB Board members and staff, the PCAOB, the SEC, AICPA and IOSCO. The TRG had its first meeting in July 2014 and has held six joint meetings since that time. During these meetings more than 50 issues were addressed, with some resulting in the amendments issued in early 2016 by both the IASB and FASB.

In addition to the TRG, there are various other industry groups – including the Telecommunications Revenue Recognition Task Force formed by the AICPA – that are discussing how to apply the new standard. A telecom entity should actively monitor these activities and consider adjusting its implementation plan if new guidance is developed.

The TRG has discussed a number of issues relevant to telecom entities. The conclusions of the TRG on those issues have been reflected in this publication. Telecom entities are encouraged to review the relevant TRG agenda papers and meeting summaries to ensure the TRG discussions are reflected in their accounting policy choices.

1 Scope

Overview

The new standard applies to contracts to deliver goods or services to a customer. However, if a contract, or part of a contract, is in the scope of other specific requirements, then it falls outside the scope of the new standard. For example, a lease would be in the scope of the leasing standards. This may apply to some equipment provided to customers in a telecom contract.

Furthermore, some non-monetary exchanges may be outside the scope of the new standard, which could potentially apply to exchanges of airtime or network capacity.

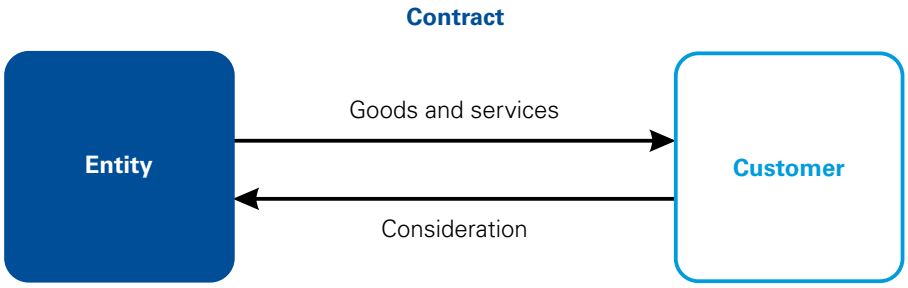
In some cases, the new standard will be applied to part of a contract or to a portfolio of contracts. The new standard provides guidance on when it should or may be applied to these circumstances and how to apply it.

1.1 In scope

Requirements of the new standard

606-10-15-3
[IFRS 15.6]

A 'customer' is a party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration.



Example 1 – In-scope arrangement

Telco X is in the business of constructing networks and associated infrastructure for customers. Telco X enters into a contract with Company C to deliver a call center.

This transaction is in the scope of the new standard, because Company C has entered into a contract to purchase an output of Telco X's ordinary activities and is therefore considered a customer of Telco X.

Example 2 – Out-of-scope arrangement

Telco Y is in the business of providing telecom services to its customers. Telco Y operates several call-centers across various geographic areas. Telco Y decides to reorganize its business and enters into a contract to sell the building and the equipment for one of its call centers to Company D.

This transaction is outside the scope of the new standard. The assets sold are not an output of Telco Y's ordinary activities, and Company D is therefore not considered a customer of Telco Y.

For further discussion on which parts of the model apply to contracts with a noncustomer, see Section 9 in Issues In-Depth, Edition 2016.

Observations

ASU 2014-09.BC52–BC53
[IFRS 15.BC.52–BC53]

Customer defined but ordinary activities not defined

The definition of a customer focuses on an entity's ordinary activities. However, the Boards did not define 'ordinary activities', but referred to the definitions of revenue in their respective conceptual frameworks. The IASB's *Conceptual Framework for Financial Reporting* specifically includes 'ordinary activities of an entity', whereas the FASB's *Statements of Financial Accounting Concepts* refer to the notion of an entity's 'ongoing major or central operations'.

1.2 Out of scope

Requirements of the new standard

606-10-15-2
[IFRS 15.5]

The new standard does not apply to:

- lease contracts;
- insurance contracts (for US GAAP, insurance contracts in the scope of Topic 944);
- financial instruments and other contractual rights or obligations in the scope of other specific guidance (because of the differences between IFRS and US GAAP, the standards that are outside the scope of the new revenue standard are not identical);
- guarantees (other than product or service warranties); and
- non-monetary exchanges between entities in the same line of business that facilitate sales to customers other than the parties to the exchange.

Example 3 – Non-monetary exchanges

Telco A and Telco B provide wireless services such as voice, data and text to their customers. However, they maintain and operate networks in different regions. Telco A and Telco B have agreed to exchange airtime and network capacity to ensure that their customers always have access to wireless services. The exchange is expected to be approximately equal and the contract requires no payment between the entities. Also, the exchange was not assessed as a sale of property, plant and equipment nor a lease.

This transaction is outside the scope of the new standard because Telco A and Telco B have entered into an agreement that is a non-monetary exchange between entities in the same line of business to facilitate sales to their customers. Because this transaction is outside the scope of the new standard for both Telco A and B, it would be excluded from disclosures required by the new standard, including the presentation of revenue from contracts with customers.

Observations

Telecom contracts often contain leased equipment and guarantee provisions

Telecom contracts can be complex and often contain elements that may be scoped out of the new standard, such as leases or some guarantees. However, the remainder of the contract could still be in scope (see 1.3).

Exchanges of airtime and network capacity may be scoped out

606-10-15-2e
[IFRS 15.5(d)]

Telecom entities often exchange network capacity with their peers in different markets or regions. These transactions may be referred to as 'peering' or 'airtime exchange arrangements'. These transactions may take multiple legal forms, such as the exchange of physical network assets, the exchange of rights to use certain network assets or the exchange of airtime or capacity with no reference to particular assets.

Transactions that meet the definition of either a sale of property, plant and equipment or a lease are outside the scope of new standard and therefore not addressed in this publication.

In addition to sales of property, plant and equipment and leases, some non-monetary transactions may also be scoped out of the new standard if they constitute a non-monetary exchange between entities in the same line of business to facilitate sales to their existing or potential customers. When these arrangements include some monetary exchange, an entity would need to consider whether any part of the arrangement is included in the scope of the new standard. If so, these transactions would be reported as other revenue or gain or loss, as appropriate under other applicable guidance, and would be excluded from disclosures required by the new standard.

Payments received from government agencies

Sometimes a telecom entity may receive a grant, subsidy or other payment from a government agency. In accounting for these payments, an entity would first apply any explicit guidance in its accounting framework. In the absence of explicit guidance (assuming the government agency is not making a payment on behalf of a customer or otherwise does not meet the definition of a customer and is thus outside the scope of the new standard), the telecom entity should consider the most appropriate guidance to apply to its specific facts and circumstances. This could include an assessment of whether the principles in the new standard can be applied by analogy.

[IAS 16.24, IAS 18.12, SIC-31]

Comparison with current IFRS

Fewer network capacity exchanges may qualify as revenue transactions

Under current IFRS, certain non-monetary exchanges of network capacity are reported as revenue-generating transactions, if the items exchanged are dissimilar, fair value can be measured reliably and the transaction occurs in the ordinary course of business.

The new standard includes a specific scope exclusion for non-monetary exchanges. That scope exclusion requires a different analysis of non-monetary transactions, specifically whether the exchange involves entities in the same line of business and is completed to facilitate sales to customers. Transactions that meet these criteria will be outside the scope of the new standard, even if they involve dissimilar assets.

Comparison with current US GAAP

Transaction- and industry-specific guidance is eliminated

Topic 922

The new standard eliminates substantially all transaction- and industry-specific guidance and applies to all contracts with customers other than those scoped out as described above. Therefore, entities currently applying transaction- or industry-specific guidance (e.g. the accounting used for cable companies under Topic 922) may find that their revenue recognition and cost policies will change under the new standard (see Section 7).

Minimal change in scope assessment for non-monetary exchanges

845-10-30-1 – 30-4

Existing US GAAP guidance on non-monetary transactions already contains a notion of "exchanges of a product or property held for sale in the ordinary course of business, for a product or property to be sold in the same line of business to facilitate sales to customers other than the parties to the exchange". This notion is similar to that included in the new standard and, therefore, the scope exclusion in the new standard may not result in many changes to existing practice.

However, non-monetary exchanges of network capacity that currently qualify as a real estate transaction may be affected because the specific guidance on real estate is superseded (see 9.3 in Issues In-Depth, Edition 2016, and KPMG's US publication Revenue: Real Estate – Questions and Answers).

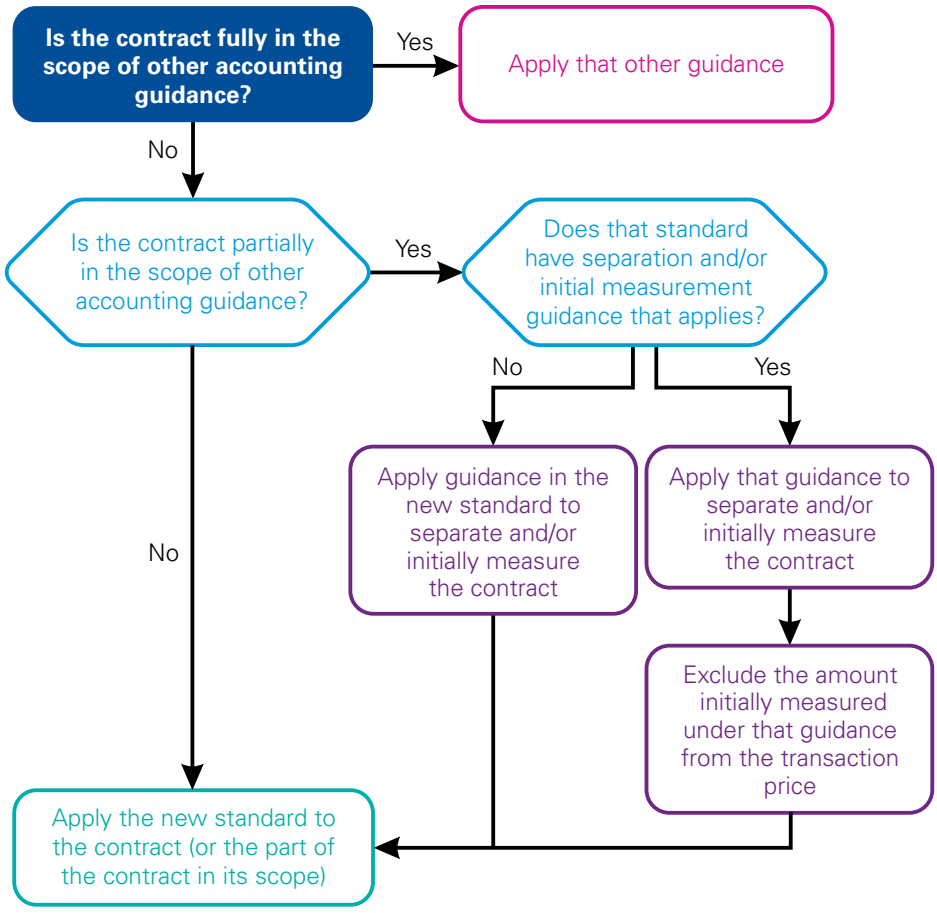
1.3 Partially in scope

Requirements of the new standard

606-10-15-4
[IFRS 15.7]

A contract with a customer may be partially in the scope of the new standard and partially in the scope of other accounting guidance. If the other accounting guidance specifies how to separate and/or initially measure one or more parts of a contract, then an entity first applies those requirements. Otherwise, the entity applies the new standard to separate and/or initially measure the separately identified parts of the contract.

The following flow chart highlights the key considerations when determining the accounting for a contract that is partially in the scope of the new standard.



Topic 460
[IFRS 9, IAS 39]

Difference between IFRS and US GAAP

Guarantee contracts

The new standard scopes out guarantees. The US GAAP version of the new standard specifies that guarantees (other than product and service warranties) are scoped out because they are covered in a stand-alone accounting topic. However, the IFRS version of the new standard scopes out financial guarantees indirectly by scoping out rights and obligations that are in the scope of the financial instruments guidance in IFRS, which includes guidance on financial guarantees.

This difference in scoping may result in certain non-financial guarantees being outside the scope of the new standard for US GAAP but in the scope for IFRS.

Example 4 – Partially in scope transaction

Telco A enters into a contract that includes a promise to provide telecom equipment and services to Customer C. Telco A first applies the leasing standard to assess whether the arrangement contains a lease.

If Telco A concludes that the use of the equipment represents a lease, then the equipment will be accounted for under the leasing standard. Because the leasing standard contains guidance on how to identify a lease component and allocate the transaction price between lease and non-lease components, Telco A first applies that guidance.

If Telco A concludes that the equipment is not leased, then the entire contract would be accounted for under the new standard. In applying the new standard, Telco A would follow all of the relevant guidance, including the requirement to determine whether the equipment is distinct from the service (see Section 3).

Observations

Guidance included for product and service warranties

606-10-55-30 – 55-35
[IFRS 15.B28–B33]

Telecom entities that offer equipment warranties incremental to manufacturers' warranties apply the guidance in the new standard to determine whether these warranties are service warranties. If they are, then they would be accounted for as separate performance obligations under the new guidance. If they are not accounted for as separate performance obligations, then these warranties are generally covered by other guidance and give rise to a cost accrual (see 3.8).

Service contracts often include clauses where the telecom entity guarantees its customer a certain quality of service or performance. These service-level arrangements may increase or decrease the consideration ultimately received by the telecom entity and therefore need to be assessed when determining the transaction price (see 4.2).

Leased equipment accounted for under the leases guidance

Topics 840, 842
[IAS 17, IFRS 16]

When a telecom service contract includes equipment, the telecom entity needs to assess whether that equipment is sold, leased or provided to the customer as part of its service. This assessment is required even if the contract does not explicitly refer to the equipment as leased or the lease payments are not billed separately from other services.

Overall, the telecom entity considers the leases guidance to determine if the transaction includes one or more elements that meet the definition of a lease. In some cases, this conclusion may vary depending on whether the telecom entity applies the current or new leases guidance.

Under the new leases guidance, in practice, a lease may exist when the customer has to return the equipment at the end of the contract and the entity does not have a substantive right to substitute the equipment during the contract term. If the lease criteria are met, then the lease guidance also provides a basis for allocating the overall consideration in the contract between lease and non-lease components.

If the lease criteria are not met, then the whole transaction is in the scope of the new standard.

Parts of the new standard apply to sales of nonfinancial assets

ASU 2014-09.BC57
[IFRS 15.BC57]

Parts of the new standard also apply to sales of intangible assets and property, plant and equipment, including real estate in transactions outside the ordinary course of business (see Section 9 in Issues In-Depth, Edition 2016). For telecom entities that sell network assets, the historical accounting under US GAAP, which was otherwise subject to specific real estate sales accounting guidance, no longer applies.

Comparison with current IFRS

Alternative revenue programs for regulated telecom services

[IFRS 14]

In some jurisdictions, telecom services are subject to rate regulation. Also, some regulators have alternative revenue programs that allow for an adjustment (increase or decrease) to rates charged to customers in the future based on changes in demand and/or if certain objectives are met (e.g. reducing costs, reaching milestones or improving customer service).

Currently, the only specific guidance on the accounting for the effects of rate regulation under IFRS is IFRS 14, an interim standard, which permits – but does not require – first-time adopters of IFRS to continue using previous GAAP to account for regulatory deferral account balances. An entity that applies IFRS 14 will therefore measure movements in regulatory deferral account balances using its previous GAAP. The interim standard requires these movements, as well as the regulatory deferral account balances, to be presented as separate line items in the financial statements, distinguished from assets, liabilities, income and expenses that are recognized under other IFRSs. This is consistent with the new standard's requirement to disclose revenue arising from contracts with customers separately from the entity's other sources of revenue.

Comparison with current US GAAP

Separation and initial measurement

605-25-15-3 – 15-3A, Topics 825, 460

The guidance on separation and measurement for contracts that are partially in the scope of the new standard is consistent with the current guidance on multiple-element arrangements. Examples of guidance in current US GAAP in which an entity first applies that specific separation and measurement guidance before applying the new standard include that on financial instruments and guarantees.

980-605-25-1 – 25-4, 606-10-50-4a

Alternative revenue programs for regulated telecom services

As mentioned above, in some jurisdictions, telecom services are subject to rate regulation. Current US GAAP requirements on the recognition of regulatory assets and liabilities from alternative revenue programs are outside the scope of the new standard. However, the new standard requires revenue arising from regulatory assets and liabilities to be presented separately from revenue arising from contracts with customers in the statement of comprehensive income.

The new standard only applies to the operations of rate-regulated entities for ordinary activities that are not subject to rate regulation. Entities will continue to follow current US GAAP requirements to account for alternative revenue programs, because these contracts are considered to be contracts with a regulator and not with a customer. This may result in a difference for rate-regulated entities with similar alternative revenue programs if they apply IFRS but are not eligible to apply the interim standard on regulatory deferral accounts.

1.4 Portfolio approach

Requirements of the new standard

606-10-10-4
[IFRS 15.4]

The new standard is generally applied to an individual contract with a customer. However, as a practical expedient, an entity may apply the revenue model to a portfolio of contracts with similar characteristics if the entity reasonably expects that the financial statement effects of applying the new standard to the individual contracts within that portfolio would not differ materially.

Example 5 – Portfolio approach applied to costs

In April 20X8, Cable A store sold 100 television cable contracts. The store employs several sales agents who will receive a bonus of 10 for each contract they obtain. Cable A determines that each bonus constitutes a cost of obtaining a contract (see 7.1) and should be capitalized and amortized over the life of that underlying contract and any anticipated renewal that the bonus benefits (see 7.3).

Cable A determines that the portfolio approach is appropriate because the costs are all related to obtaining a contract and the characteristics of the contracts are similar. The amortization period for the asset recognized related to these costs is expected to be similar for the 100 contracts (see 7.3). Additionally, Cable A documents that the portfolio approach does not materially differ from the contract-by-contract approach. Instead of recording and monitoring 100 assets of 10 each, Cable A records a portfolio asset of 1,000 for the month of April 20X8.

Observations

Entities need to consider costs versus benefits of portfolio approach

Although the portfolio approach may be more cost effective than applying the new standard on an individual contract basis, it is not clear how much effort may be needed to:

- evaluate which similar characteristics constitute a portfolio – e.g. the effect of different offerings, periods of time or geographic locations;
- assess when the portfolio approach may be appropriate; and
- develop the process and controls needed to account for the portfolio.

There are many application issues that can arise when applying the portfolio approach for telecom entities, including the initial identification of portfolios, allocation of transaction prices to performance obligations, contract modifications, the effects of the time value of money, contract asset impairments and unique reporting and disclosure requirements.

No specific guidance on assessing whether portfolio approach can be used

606-10-55-202 – 55-207 (Example 22), 55-353 – 55-356 (Example 52)
[IFRS 15.IE110–IE115, IE267–IE270]

The new standard includes illustrative examples in which the portfolio approach is applied, including for rights of return and breakage. However, it does not provide specific guidance on how an entity should assess whether the results of the portfolio approach would differ materially from applying the new standard on a contract-by-contract basis.

Full versus partial portfolio approach

The new standard does not describe if and how the portfolio approach may bring relief to preparers. Some telecom companies may wish to explore the benefits of applying the portfolio approach to all of the aspects of the accounting for a contract with a customer. Others may apply the portfolio approach only for some aspects of the revenue model (e.g. determining some estimates or accounting for some contract costs).

Portfolio accounting may be applied to contract acquisition and fulfillment costs

606-10-10-4, 340-40
[IFRS 15.4, 91–104]

The guidance on costs to obtain and fulfill a contract is included in IFRS 15. Therefore, under IFRS, the portfolio approach can be applied to cost elements of a contract with a customer if the criteria are met.

Under US GAAP, the new costs and revenue guidance have been codified in different subtopics, Topics 340 and 606 respectively. The paragraph describing the portfolio approach, however, has been reproduced only in the revenue subtopic. The portfolio approach can be applied to the costs of a contract, assuming the result of applying it would not differ materially from applying the guidance to the individual contracts within that portfolio.

2 Step 1: Identify the contract with a customer

Overview

A contract with a customer exists under the new standard when the contract is legally enforceable and certain criteria, including collectibility, are met. However, the collectibility threshold at inception will usually be met for telecom consumer contracts.

The more complex issue for telecom entities is determining the contract duration. Although telecom contracts often have a stated term, sometimes the stated term may not be enforceable. In other cases, the term may be implied. In each contract, assessing the contract term is key to determining the contract's transaction price, which, in turn, significantly affects the allocation of that transaction price and therefore the recognition of revenue for each performance obligation (e.g. service and equipment in a bundled arrangement).

Contracts entered into at or near the same time with the same customer (or a related party of the customer) are combined and treated as a single contract when certain criteria are met. Combining telecom contracts results in a single total transaction price that is allocated to all performance obligations in the combined contract.

2.1 Criteria to determine whether a contract exists

Requirements of the new standard

606-10-25-2
[IFRS 15.10]

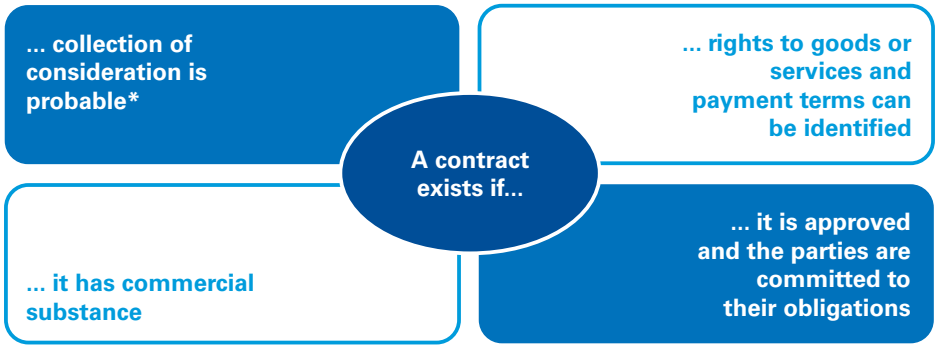
The new standard defines a 'contract' as an agreement between two or more parties that creates enforceable rights and obligations and specifies that enforceability is a matter of law. Contracts can be written, oral or implied by an entity's customary business practices.

606-10-25-4
[IFRS 15.12]

A contract does not exist when each party has the unilateral right to terminate a wholly unperformed contract without compensation.

606-10-25-1
[IFRS 15.9]

A contract with a customer is in the scope of the new standard when it is legally enforceable and it meets all of the following criteria.



* The threshold differs under IFRS and US GAAP due to different meanings of the term 'probable'.

606-10-25-1e
[IFRS 15.9(e)]

In making the collectibility assessment, an entity considers the customer's ability and intention (which includes assessing its creditworthiness) to pay the amount of consideration when it is due. This assessment is made after taking into account any price concessions that the entity may offer to the customer (see 2.1.2).

606-10-25-6
[IFRS 15.14]

If the criteria are not initially met, then an entity continually reassesses the contract against them and applies the requirements of the new standard to the contract from the date on which the criteria are met. Any consideration received for a contract that does not meet the criteria is accounted for under the requirements set out in 2.2.

606-10-25-5
[IFRS 15.13]

If a contract meets all of the above criteria at contract inception, then an entity does not reassess the criteria unless there is an indication of a significant change in the facts and circumstances.

606-10-25-7
[IFRS 15.15]

If on reassessment an entity determines that the criteria are no longer met, then it ceases to apply the new standard to the contract from that date, but does not reverse any revenue previously recognized.

Observations

Most telecom contracts will not be 'wholly unperformed'

605-10-25-4
ASU 2014-09.BC36, BC50
[IFRS 15.12, BC36, BC50]

A contract does not exist if each contracting party has the unilateral right to terminate a wholly unperformed contract without compensating the other party (or parties). However, this guidance will not apply to most typical telecom contracts in which at contract inception (or very shortly thereafter) either the customer performs by paying or the entity performs by transferring a good or service.

Telecom entities will, however, need to consider the remaining criteria when determining whether a contract exists, including the collectibility criterion (see 2.1.2 and 2.2). Entities will also need to determine the contract term (see 2.1.1).

2.1.1 Enforceability and contract term

Requirements of the new standard

606-10-25-3
[IFRS 15.11]

The new standard is applied to the duration of the contract (i.e. the contractual period) in which the parties to the contract have presently enforceable rights and obligations.

Example 6 – 24-month wireless bundle contract with substantive early-termination penalties

Telco A enters into a 24-month wireless contract with Customer C that includes voice and data services for 70 per month and a handset for 200. The services and handset are regularly sold separately for 60 per month and 600, respectively.

Customer C can terminate the contract at any time. In case of early termination, Telco A will charge Customer C an early termination fee (ETF) of 150 plus 20 per month for each of the months remaining in the service term. Telco A has separately concluded that the ETFs are enforceable.

Telco A assesses whether the ETF is substantive and observes that at any point during the contract, the ETF compensates Telco A at an amount greater than the goods and services already transferred. Specifically, the ETF of 150 together with the 20 per month remaining in the contract more than compensates Telco A for the handset already transferred. In addition, at any point during the contract, the ETF is significant, when compared with the monthly service fee. Therefore, Telco A concludes that the ETF is substantive, and that the contract term for the purpose of applying the new standard is 24 months.

Example 7 – 24-month wireless bundle contract that the customer can terminate after Month 12 without penalty

Telco B enters into a 24-month wireless contract with Customer D that includes voice and data services for 90 per month and a handset for 200. The services and handset are regularly sold separately for 60 per month and 600, respectively.

Customer D cannot terminate the contract before Month 12. However, after Month 12, Customer D can terminate the contract without paying any termination fee.

Telco B observes that it has no enforceable rights beyond 12 months. The contract can be terminated after 12 months without compensation; therefore, the contract should not extend beyond the goods and services transferred in those 12 months.

Telco B therefore concludes that the contract term for the purpose of applying the new standard is 12 months.

Example 8 – 24-month wireless bundle contract that the customer can terminate after Month 12 with penalty

Telco E enters into a 24-month wireless contract with Customer F that includes voice and data services for 80 per month and a handset for 200. The services and handset are regularly sold separately for 60 per month and 600, respectively.

Customer F cannot terminate the contract before Month 12. However, after Month 12, the customer can terminate the contract by paying an ETF of 10 per month of remaining service term. Telco E has separately concluded that the ETF is enforceable.

Statistics show that the average contract duration for similar contracts is 18 months.

Telco E observes that the ETF does not fully compensate Telco E for the goods and services already transferred. Specifically, the ETF of 10 per month (after Month 12) is less than the unpaid balance for the handset, calculated as [(600 - 200) - (20 x 12)]. Telco E also observes that the ETF is not significant when compared with the monthly service fee (i.e. 10 compared with 80) and potential offers in the market. Telco E assesses that the ETF in Months 12–24 is not substantive.

Telco E therefore concludes that the contract term for the purpose of applying the new standard is 12 months. For the purpose of this assessment, the average contract duration is not relevant.

Because the accounting assumes a contract term of 12 months and early termination by Customer F, Telco E assesses whether the ETF charged at the end of month 12 can be included in the transaction price at the commencement of the contract (see 4.2).

Example 9 – Month-to-month wireless contract with device installment plan

Telco A enters into a one-month wireless contract with Customer C that includes voice and data services and a handset. The monthly service fee is the same as the price charged to customers that bring their own device (i.e. the monthly service fee is the stand-alone selling price of the service).

Customer C makes no up-front payment for the handset, but will pay the stand-alone selling price of the handset through monthly installments over a 24-month period. Although there is a finance arrangement for the handset, there is no additional interest charged to Customer C. (Telco A operates in a low-interest rate environment.) The remaining balance of installments for the handset becomes immediately due if Customer C fails to renew the monthly service contract. There is no other amount due if Customer C does not renew.

In assessing the enforceability of the contract, Telco A considers the amounts due if Customer C decides not to renew at the end of Month 1. Telco A observes that the requirement to repay the remaining balance of installments for the handset when the service contract is not renewed is an economic incentive for Customer C to renew. That is because by renewing the service contract and extending the financing, Customer C benefits from the ability to 'pay later' and ultimately would pay less for the handset (i.e. because of the time value of money). However, in this circumstance, foregoing this economic incentive is not a substantive termination penalty, but instead is a repayment of a loan for goods already transferred. Because Telco A cannot enforce the service contract for a period longer than one month, Telco A concludes that the contract term is one month.

Telco A then assesses if the installment plan on the handset conveys a significant financing component to Customer C (see 4.4).

Observations

Determining the term of a telecom contract is key for applying the new revenue model

Determining the enforceable contract term is a fundamental step in applying the new standard for telecom entities. The contract term directly affects the calculation of the total transaction price for the contract, the allocation of the transaction price to the distinct goods or services, and the amount of revenue recognized. For example, in a wireless contract sold with a subsidized handset, a shorter contract term may result in a smaller amount being allocated to the handset (depending on the relationship between the stand-alone selling price and the transaction price – see Section 5).

Additionally, the length of the contract term may affect the applicability of certain practical expedients, including those related to identifying significant financing components (see 4.4) and disclosure of the transaction price allocated to the remaining performance obligations (see 12.1.3 in Issues In-Depth, Edition 2016).

The stated telecom contract term may not always be enforceable

606-10-25-3, ASU 2014-09.BC32
[IFRS 15.11, BC32]

Under the new standard, assessing whether a contract exists, and for what duration, requires an entity to focus on the enforceability of rights and obligations. This assessment could result in a term shorter than what is stated in the contract. For example, a telecom contract with a stated term of 24 months could have a term of less than 24 months, if that 24-month term is determined not to be enforceable.

This assessment also requires a telecom to consider relevant laws and regulations. Therefore, this assessment may be affected by customer protection or similar laws that have recently been passed in many jurisdictions. Often these laws allow customers to terminate their telecom contracts before the end of the stated contract term.

Assessing enforceability may require significant judgment – e.g. when the customer can terminate the contract by paying minimal penalties, or when the entity has a practice of not enforcing the termination clauses (further discussed below).

A practice of not enforcing termination clauses generally does not negate the contract's existence

Some telecom entities may not enforce termination clauses or may have a history of not collecting termination penalties. This practice would affect customer behavior and the average contract duration. An entity should assess if it also affects the legal enforceability of the clause (which is determined in relation to the relevant legal environment and may require legal consultation). In such cases, this practice could impact the contract term for the purpose of applying the new standard.

Credits offered by competitors generally do not affect enforceability

Competitors may have an established practice of obtaining customers through the reimbursement of the early termination penalties charged by the customers' current telecom provider. These external factors may affect customers' behavior and encourage early termination. However, they will not generally affect the legal enforceability of the contract with the current telecom provider, which still is entitled to payment of the termination penalties. The entity will still need to assess whether these termination penalties are substantive.

Early termination penalties need to be substantive to support the stated contract term

Termination clauses, when enforceable, may affect the contract term and must be carefully analyzed. The compensation to the entity needs to be substantive to support the stated contract term.

Telecom service contracts frequently include termination penalties if a customer terminates the contract early. However, compensation from the customer is only substantive if it relates to something other than payments due as a result of goods delivered or services transferred up to the termination date.

When assessing termination clauses, a telecom entity considers, among other factors, the:

- contract provisions and all relevant laws and regulations;
- amount due on termination by the customer compared with goods or services already provided); and
- amount due on termination by the customer compared with the amounts otherwise payable.

The historical data on actual terminations may provide evidence that is relevant when assessing whether the termination penalty is substantive. For example, if the data indicate that a significant number of a telecom entity's customers regularly terminate their contract early and pay the early termination fees, then it may suggest that the termination penalties are not substantive.

In situations where the termination penalty is not substantive and is more representative of an administrative termination fee, it may be appropriate to include that amount in the estimate of the transaction price (see Example 8).

Compensation is broader than only termination payments

A payment to compensate the other party on termination is any amount (or other transfer of value – e.g. equity instruments) other than a payment due as a result of goods or services transferred up to the termination date. It is not restricted only to payments explicitly characterized as termination penalties.

The average contract duration may be different from the enforceable contract term

Telecom contracts are often terminated early, subject to promotional offers, or renewed beyond their initial term. Telecom entities usually have detailed customer statistics that may provide evidence that the average contract duration is different from the stated contract term.

When the average contract duration is shorter than the stated contract term, this may indicate that termination penalties are not substantive and entities should therefore make the assessment as described above (also see observation below on upgrade rights).

When the average contract duration is longer than the stated contract term, this may indicate that customers are offered a right to renew at a discount (see Section 8). However, as further discussed below, the customer's ability to renew does not necessarily represent enforceable rights for the entity.

As the new standard focuses on the enforceability of rights and obligations, the average contract duration will generally not be determinative, in itself, of the contract's enforceable term.

Ability of either party to cancel the contract at discrete points in time may limit the term of the contract

If an entity enters into a contract with a customer that can be renewed or cancelled by either party at discrete points in time without significant penalty, then it accounts for its rights and obligations as a separate contract for the period during which the contract cannot be cancelled by either party. On commencement of each service period (e.g. a month in a month-to-month arrangement), where the entity has begun to perform and the customer has not cancelled the contract, the entity normally obtains enforceable rights relative to fees owed for those services and a contract exists.

Evergreen contracts may have an implicit term

For the purpose of assessing contract term, an evergreen contract (i.e. a contract that automatically renews) that is cancellable by either party each period (e.g. on a month-to-month basis) without penalty is no different from a similar contract structured to require the parties to actively elect to renew the contract each period (e.g. place a new order, sign a new contract). In these situations, an entity should not automatically assume a contract period that extends beyond the current period (e.g. the current month).

Therefore, only on the commencement of the next optional service period, when the telecom entity has begun to perform (i.e. provide cable, internet or phone service) and the customer's action of not cancelling the contract provides the entity with legal recourse relative to fees owed for those services, does a contract exist for that period under the new standard.

Contract term assessed considering all promised goods or services

The contract term is assessed for the contract as a whole, considering all goods or services promised in the contract. However, some goods or services can be transferred over a shorter period than the contract term.

Renewal and upgrade rights rarely affect the enforceability of the contract

Telecom contracts often provide customers with the ability to renew contracts at a discount. Other contracts may provide customers with the ability to upgrade to a new handset early (i.e. without paying any termination fees on the current contract) if the customer enters into a new service contract with a specified term (e.g. 24 months). Although these renewal and upgrade rights may affect the duration of the customer relationship, they usually do not affect the enforceability of the termination penalties in the contract if the customer chooses not to renew or upgrade early. Renewal and upgrade rights, however, require additional accounting considerations (see Sections 8 and 9).

Only the customer has a right to terminate the contract

If only the customer has the right to terminate the contract without penalty and the entity is otherwise obligated to continue to perform until the end of a specified period, then the contract is evaluated to determine whether the option gives the customer a material right (see Section 8 for discussion of customer options for additional goods or services).

Comparison with current IFRS

Determining the contract term is not critical under current accounting

[IAS 11, IAS 18]

Current revenue guidance has no explicit contract existence test, though an entity recognizes revenue only if it is probable that it will receive the economic benefits under the contract. Also, determining the contract term has a less significant impact on the accounting outcome for wireless sales under current accounting because most telecom entities do not allocate revenue to the handset (when it is subsidized) beyond the cash payment received at contract inception.

Comparison with current US GAAP

Determining the contract term is not critical under current accounting

Topic 605

Similar to current IFRS, determining the contract term has a less significant effect on the accounting outcome for wireless sales under current accounting. This is because most telecom entities do not generally recognize revenue in advance of cash received under the contingent revenue cap guidance.

2.1.2 Collectibility

Example 10 – Assessing collectibility for individual telecom customers

606-10-25-1e
[IFRS 15.9(e)]

Telco A enters into a 24-month wireless contract with Customer C that includes voice and data services.

Before accepting Customer C, Telco A runs a routine credit check and concludes that Customer C meets the expected credit history requirements to be enrolled. Furthermore, Telco A's historical evidence shows that 98% of the amounts billed will be received. In addition, Telco A observes that it can cancel the service to Customer C at any point if Customer C defaults.

As a result of the evidence received through the credit check, Telco A concludes that it is probable that Customer C will pay the amounts owed for the goods and services to be transferred. Therefore, the contract meets the collectibility threshold. However, any receivable or contract asset should be tested for impairment under relevant guidance.

Example 11 – Implicit price concession

606-10-55-99 – 55-101 (Example 2)
[IFRS 15.IE7–IE9]

Telco B enters a new geographic market and wants to grow its wireless customer base. Telco B is ready to enroll customers with lower credit scores, in contrast to its usual practice. Based on historical data for similar circumstances, Telco B expects that 15% of the amounts billed will not be recovered (i.e. on average, customers will pay 85% of their bill). Based on the assessment of the facts and circumstances related to this market, Telco B determines that it expects to provide a price concession and accept a lower amount of consideration from its customers.

Telco B enters into a 24-month wireless contract with Customer D that includes voice and data services.

Despite its reduction in acceptable creditworthiness, Telco B concludes that it is probable that Customer D will pay the amounts for which Telco B expects to be entitled for goods and services to be transferred. In making that assessment, Telco B uses the lower amount of consideration, reflecting the price concession that it expects to grant. In making this conclusion, Telco B also observes that it can cancel the service if Customer D defaults.

Therefore, the contract meets the collectibility threshold and revenue can be recognized once goods and services are transferred to Customer D. However, Telco B has implicitly granted a price concession and should apply the guidance on variable consideration and the constraint (see 4.2).

Observations

606-10-25-1e
[IFRS 15.9(e)]

Collectibility is only a gating question

Under current requirements, an entity assesses collectibility when determining whether to recognize revenue. Under the new standard, the collectibility criterion is included as a gating question designed to prevent entities from applying the revenue model to problematic contracts and recognizing revenue and a large impairment loss at the same time.

Collectibility is assessed based on the amount the entity expects to receive in exchange for goods or services

The collectibility threshold is applied to the amount to which the entity expects to be entitled in exchange for the goods or services that will be transferred to the customer, which may not be the stated contract price. The assessment considers:

- the entity's legal rights;
- past practice;
- how the entity intends to manage its exposure to credit risk throughout the contract; and
- the customer's ability and intention to pay.

Telecom contracts failing Step 1 should be unusual in practice

606-10-25-1e, 606-10-55-3c, ASU 2014-09.BC46, ASU 2016-12.BC10–BC12
[IFRS 15.9(e), BC46]

When assessing if collectibility is probable, a telecom entity should not consider if all of the consideration under the contract will be recovered. Rather, the entity considers its credit risk exposure in relation to the goods or services that will be transferred to the customer. Therefore, when the telecom entity has received a deposit or advance payment or has the ability to stop providing services as soon as a customer defaults, the collectibility criterion will generally be met.

Generally, telecom entities do not contract for postpaid services with customers with poor credit ratings without a guarantee, such as a deposit or advance payment, that would cover the price of equipment delivered up front. Also, telecom entities generally are able to terminate network services if the customer does not pay. For these reasons, under these circumstances, many telecom contracts would meet the collectibility criterion in Step 1.

'Probable' is a higher threshold under US GAAP than IFRS

Topic 450
[IAS 37]

Although both the IASB and FASB versions of the new standard use the term 'probable' in the collectibility criterion, that term has a different meaning in IFRS and US GAAP. Under IFRS, probable is defined as 'more likely than not' while under US GAAP it indicates a higher threshold of 'likely to occur'. As explained above, this difference is not expected to materially impact telecom entities.

Collectibility is assessed at contract level

606-10-10-4
[IFRS 15.4]

Telecom entities may have historical portfolio data that indicate that a certain percentage of customers are likely to default and therefore not all billed amounts are collectible.

When collectibility has been assessed as probable at the contract level, a contract exists (assuming the other Step 1 criteria are also met). Therefore, revenue is recognized in full, unless historical data suggest that the entity has a history of granting price concessions (see below).

Topic 310
[IAS 39, IFRS 9]

Historical data of defaulting customers by portfolio may be relevant for conducting impairment testing on receivables and contract assets under relevant guidance.

Judgment required to differentiate between a collectibility issue and a price concession

606-10-55-99 – 55-105 (Example 2, Example 3), 606-10-32-7, ASU 2014-09.BC45
[IFRS 15.52, IE7–IE13, BC45]

Judgment will be required in evaluating whether the likelihood that a telecom entity will not receive the full amount of stated consideration in a contract gives rise to a collectibility issue or a price concession. As illustrated in Example 11 above, if the entity concludes that the transaction price is not the stated price or standard rate, then the promised consideration is variable. Consequently, an entity may need to determine the transaction price in Step 3 of the model, including any price concessions (see Section 4), before concluding on the collectibility criterion in Step 1 of the model.

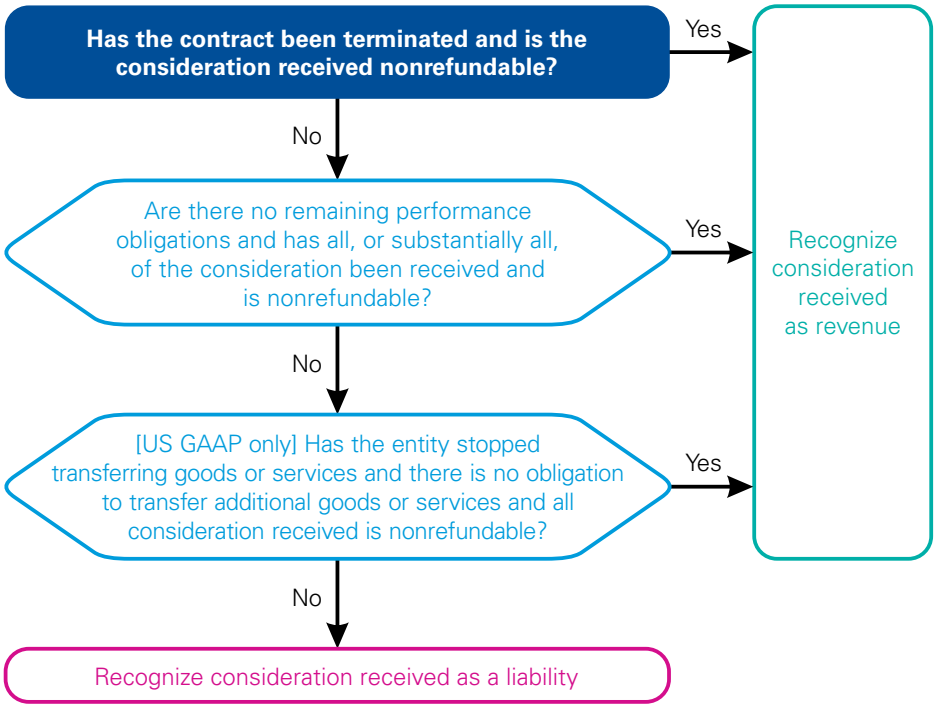
This judgment also affects the income statement presentation. Price concessions are presented as a reduction of revenue. However, collectibility issues arising after contract inception (that do not require a reassessment of the collectibility criterion – see 2.2) will be presented as bad debt expenses.

2.2 Consideration received before concluding that a contract exists

Requirements of the new standard

606-10-25-7 – 25-8
[IFRS 15.15–16]

The following flow chart outlines when consideration received from a contract that is not yet in the scope of the new standard can be recognized.



The entity is, however, required to reassess the arrangement and, if Step 1 of the model is subsequently met, begin applying the revenue model to the arrangement.

606-10-25-7(c), ASU 2016-12.BC24
[IFRS 15.BC45F–BC46H]

⚠ Difference between IFRS and US GAAP

The FASB included an additional step in the requirements to address concerns over potential diversity in the understanding of when a contract is considered terminated, which could have led in some cases to revenue not being recognized even though the entity had stopped delivering goods or services to the customer.

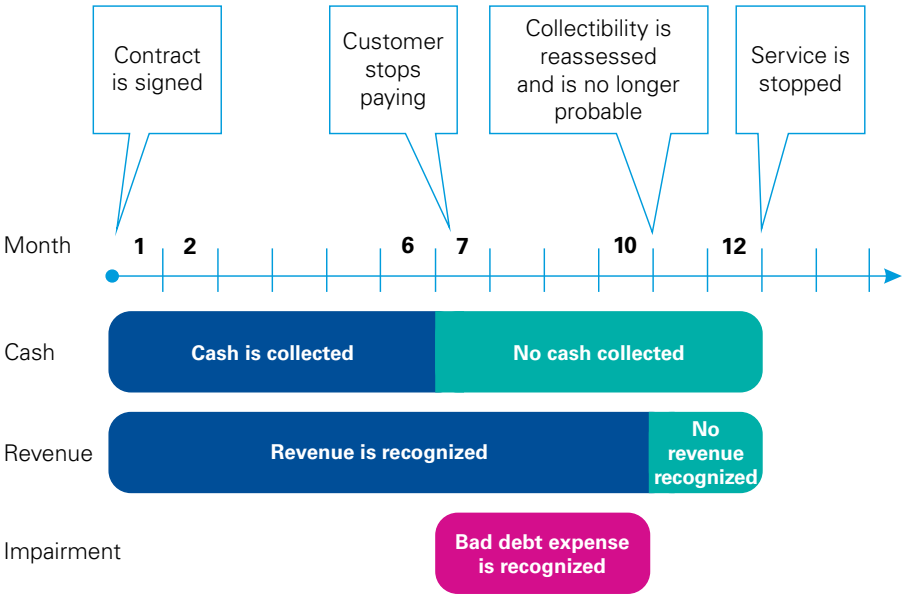
The IASB decided not to add the clarification to IFRS 15. It concluded that the existing guidance in IFRS 15 is sufficient for an entity to conclude that a contract is terminated when it stops providing goods or services to the customer without further clarification.

Example 12 – Customer ceases payment in Month 7 in a 24-month landline voice contract

Telco A enters into a 24-month contract with Customer C to provide landline voice services for a fixed, prepaid monthly fee. At inception, Telco A expects to collect all revenue, and the contract term is assessed as 24 months. Telco A also concludes that it does not provide price concessions on the service.

The bill for Month 7 is unpaid. Routine recovery procedures escalate until Month 12 without further payment from Customer C. According to local regulations, Telco A can only disconnect service to a customer after six months of unpaid services and all legal recovery actions have been performed. At the end of Month 12, Telco A disconnects service to Customer C and has an unpaid account receivable for six months of service.

Telco A has determined that a four-month unpaid service bill constitutes a significant change in circumstances for its prepaid customers. Therefore, at the end of Month 10, Telco A reassesses collectibility for its contract with Customer C. Telco A has historical evidence that only 40% of bills overdue by four months will be recovered and concludes that collectibility is no longer probable and that the contract with Customer C no longer meets the requirements for a contract to exist.



Although Telco A is required by law to continue to provide landline voice services to Customer C for Months 11 to 12 and will issue monthly bills for these services, no revenue (and no receivable) will be recognized beyond Month 10. This means that Telco A will recognize revenue for 10 months and an impairment charge (i.e. bad debt expense) for four months (Months 7 to 10).

Example 13 – Consideration received after a contract ceases to exist

Continuing Example 12, Telco A determines that its contract with Customer C ceases to exist at the end of Month 10. At the end of Month 11, however, Telco A receives payment from Customer C for one month of service. In these circumstances, Telco A is still entitled to terminate the contract at the end of Month 12.

Although some payment has been received, Telco A does not revise its assessment of collectibility and the contract with Customer C still does not exist. Additionally, Telco A has not received substantially all of the consideration promised by the customer and continues to transfer services to Customer C. Therefore, consideration received in Month 11 is not recognized as revenue.

Example 14 – Recognition of a deferred activation fee once a contract ceases to exist

Continuing Example 12, Telco A charged Customer C an up-front nonrefundable activation fee of 60 at contract inception. Telco A determined that activation activities are not a separate performance obligation. It also determined that the activation fee conveys no material right and should be included in the transaction price and recognized over the 24-month contract term. At the end of Month 10, the amount of the activation fee not yet recognized as revenue is 35.

The activation fee is nonrefundable. However, it is consideration received in advance of services to be provided. At the end of Month 10, the contract with Customer C no longer meets the requirements in Step 1 of the new standard for a contract to exist (see Example 12). Therefore, the unrecognized amount of 35 can only be recognized as revenue when the contract is terminated or Telco A has no further service obligation. Telco A still has a legal obligation to continue to provide services for two months after the contract has ceased to exist for accounting purposes. The remaining 35 activation fee will only be recognized as revenue at the end of Month 12.

Observations

Collectibility needs to be monitored throughout the contract term

606-10-25-5
[IFRS 15.13]

If a contract meets the collectibility criterion at contract inception, then the telecom entity does not reassess that criterion unless there is a significant change in facts and circumstances that results in a significant deterioration of the customer's creditworthiness. When the customer's ability to pay deteriorates progressively, judgment is required to determine at what point the collectibility criterion needs to be reassessed and revenue should stop being recognized. It may not be appropriate to wait until service is disconnected to stop recognizing revenue. For example, a significant and repetitive delay in payment may constitute a significant change in the facts and circumstances and require the telecom entity to reassess the collectibility criterion.

Cash basis accounting is not appropriate when consideration is received after a contract ceases to exist

606-10-25-7 – 25-8
[IFRS 15.15–16]

There may be situations where a telecom entity is contractually or legally required to continue providing network services even though collectibility is no longer considered probable. As explained above, if the telecom entity has reassessed the contract and determined that collectibility is no longer probable, then revenue should not be recognized when these services are billed to the customer.

The customer may eventually pay for the services rendered during that period after the contract ceases to exist from an accounting perspective. In this case, the telecom entity needs to assess if collectibility is once again probable. Alternatively, the telecom entity would consider whether one of the following events has occurred in order to recognize revenue:

- the contract has been terminated and the consideration is nonrefundable;
- the entity has no remaining obligation to transfer goods or services or refund the consideration received and all or substantially all of the consideration has been received; or
- (US GAAP only) the entity has stopped providing goods or services and there are no remaining obligations to transfer additional goods or services or refund the consideration received.

Because the legal contract is not terminated, or because the telecom entity is still pursuing collection or is entitled to payment, it may not be clear at what point the above criteria would be met. This is why the FASB added the above third event. As a consequence, under US GAAP, the entity may be able to recognize revenue when it ceases to provide additional goods and services.

[IAS 18]

Comparison with current IFRS

Timing of revenue recognition may change when collectibility is not probable

Under current guidance, collectibility is assessed to determine when revenue can be recognized, rather than when a contract exists. Revenue is recognized if recovery is probable. Some telecom entities may stop recognizing revenue when recovery is no longer probable, even though services are still provided and billed to the customer. However, current guidance does not prevent the recogniton of consideration received as revenue if collectibility of the full contract price is not probable.

SEC SAB Topic 13

Comparison with current US GAAP

Timing of revenue recognition may change when collectibility is not probable

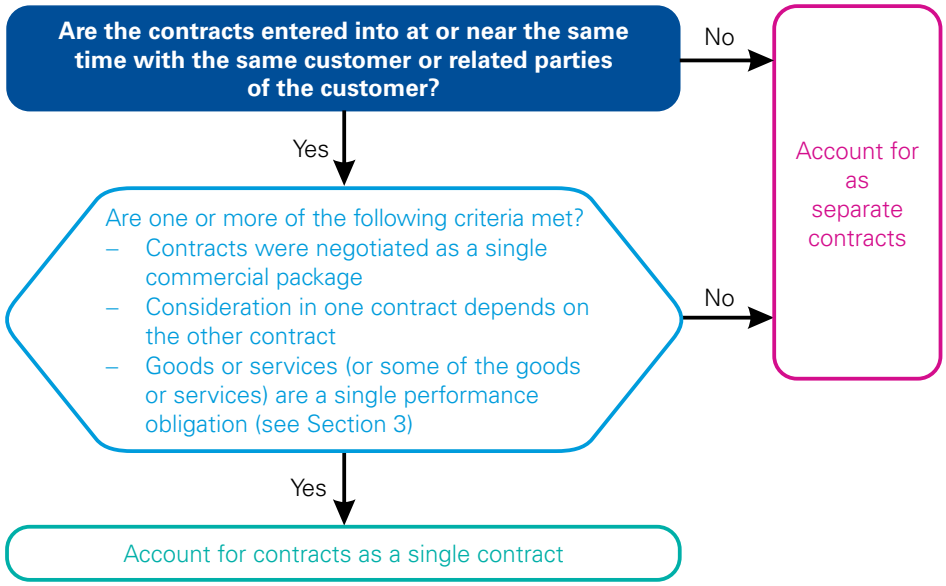
Under current SEC guidance, and similar to current IFRS, collectibility is assessed to determine when revenue can be recognized, rather than when a contract exists. Revenue is recognized if collectibility is reasonably assured. Some telecom entities may stop recognizing revenue when recoverability is no longer reasonably assured, even though services are still provided and billed to the customer. Because the threshold ('reasonably assured' versus 'probable') is stated differently, practice may change.

2.3 Combination of contracts

Requirements of the new standard

606-10-25-9
[IFRS 15.17]

The following flow chart outlines the criteria in the new standard for determining when an entity combines two or more contracts and accounts for them as a single contract.



Example 15 – Combination of contracts in a wireless installment plan

In 20X7, Telco A simultaneously enters into two separate contracts with Customer C.

– Contract 1 is a month-to-month contract for the provision of voice and data services.

– Contract 2 is for the sale of a handset and provides that the contract price of the handset will be paid in full by monthly installments over 24 months. Full repayment of the remaining balance of the handset becomes due as soon as the customer fails to renew its monthly service contract.

Telco A determines that the two contracts should be combined because they were entered into at the same time with the same customer and they are negotiated as a single commercial package. This is evidenced by the fact that the amount and timing of the consideration received for the sale of the handset is impacted by the renewal of the service contract. Telco A still needs to assess whether the combined contract contains one or more performance obligations and the term of the combined contract (see Example 9).

Observations

Evaluating 'at or near the same time' when determining whether contracts should be combined

ASU 2014-09.BC68
[IFRS 15.BC68]

The accounting for a contract depends on an entity's present rights and obligations, rather than on how the entity structures the contract. The new revenue standard does not provide a bright line for evaluating what constitutes 'at or near the same time' to determine whether contracts should be combined for the purpose of applying the standard. Therefore, an entity should evaluate its specific facts and circumstances when analyzing the elapsed period of time.

Specifically, the entity should consider its business practices to determine what represents a period of time that would provide evidence that the contracts were negotiated at or near the same time. Additionally, the entity should evaluate why the arrangements were written as separate contracts and how the contracts were negotiated (e.g. both contracts negotiated with the same parties versus different divisions within the entity negotiating separately with a customer).

An entity needs to establish procedures to identify multiple contracts initiated with the same customer on a timely basis to ensure that these arrangements are evaluated to determine whether they should be combined into a single contract for accounting purposes.

In addition, an entity should consider whether a separate agreement is a modification to the original agreement and whether it should be accounted for as a new contract or as part of the existing contract. For a discussion of contract modifications, see Section 7 in Issues In-Depth, Edition 2016.

Definition of related parties acquires new significance

ASU 2014-09.BC74, 850-10-20
[IFRS 15.BC74, IAS 24]

The new standard specifies that for two or more contracts to be combined, they should be with the same customer or related parties of the customer. The Boards state that the term 'related parties' as used in the new standard has the same meaning as the definition in current related party guidance. This means that the definition originally developed in US GAAP and IFRS for disclosure purposes acquires a new significance, because it can affect the recognition and measurement of revenue transactions.

Criteria for combining contracts are similar but not identical to current guidance for construction contracts

605-35
[IAS 11.8–9]

Both US GAAP and IFRS contain explicit guidance on combining construction contracts. The contracts must be: negotiated as a package; function as a single project; require closely interrelated activities; and performed concurrently or in a continuous sequence), which is sometimes applied by analogy to other contracts to identify different components of a transaction.

The new standard's guidance on combining contracts applies to all contracts in its scope. The approach to combining contracts in the new standard is similar but not identical to that in current US GAAP and IFRS (e.g. the rebuttable presumption under current US GAAP is not present under the new standard), which may result in different outcomes under the new standard as compared with current practice.

Additional complexities for indirect wireless sales

When applying the guidance on combining contracts to indirect sales, a telecom entity needs to determine who its customer is under the contract and when control transfers (see Section 10).

Comparison with current US GAAP

Elimination of rebuttable presumption

605-25-25-3

Current US GAAP on multiple-element arrangements contains a rebuttable presumption that contracts entered into at or near the same time with the same entity or related parties are a single contract. The new standard does not include a similar rebuttable presumption, although it is unclear whether that will affect the analysis in practice.

3 Step 2: Identify the performance obligations in the contract

Overview

The process of identifying performance obligations requires a telecom entity to determine whether it promises to transfer either goods or services that are distinct, or a series of distinct goods or services that meet certain conditions. These promises may not be limited to those explicitly included in written contracts. The new standard provides indicators to help determine when the 'distinct' criteria are met.

Telecom offerings typically bundle equipment (e.g. wireless handset) and various services. Assessing whether these goods and services are distinct is not dependent on whether the goods or services are provided for free or on a heavily discounted basis. Under the new standard, discounted (or free) equipment and other incentives, such as free service periods or gift cards, can be distinct goods or services – i.e. performance obligations – to which revenue needs to be allocated.

3.1 Criteria to identify performance obligations

Requirements of the new standard

606-10-25-14 – 25-15, 25-18
[IFRS 15.22–23, 26]

A 'performance obligation' is the unit of account for revenue recognition. An entity assesses the goods or services promised in a contract with a customer and identifies as a performance obligation either a:

– good or service (or a bundle or goods or services) that is distinct; or

– series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer (i.e. each distinct good or service in the series is satisfied over the time and the same method is used to measure progress).

This includes an assessment of implied promises and administrative tasks. Administrative tasks are not performance obligations (see 3.6).

Observations

Identifying the separate performance obligations is key for telecom entities

Telecom entities evaluate goods and services promised to customers to determine if they are performance obligations that should be accounted for separately. Identifying the performance obligations in the contract is key because it may impact the amount and timing of revenue recognition.

Examples of common telecom offerings and activities that are evaluated to determine whether they are goods or services promised to the customer or merely activities that do not transfer goods or services to the customer, include, but are not limited to:

- equipment – e.g. set-top boxes, wireless handsets, modems, routers, tablets (see 3.3);
- cable services – e.g. basic, premium and pay-per-view services (see 3.4);
- internet services, broadband or other capacity arrangements (see 3.4);
- wireless services – e.g. voice, data and text plans (which may include a SIM card) and various add-on services (see 3.4);
- landline voice services (see 3.4);
- rights to purchase additional goods or services (see 3.4 and Section 8);
- installations for home phone, internet and television, including inside and outside wiring (see 3.5);
- activation of wireless handsets, set-top boxes or other equipment and services (see 3.6);
- other customer services – e.g. support and other activities that may or may not result in fees charged to the customer (see 3.6);
- incentives, including gift cards, or other free goods or services (see 3.7); and
- warranties (see 3.8).

This evaluation is performed for all goods or services promised and activities explicitly stated in arrangements with the customer. The evaluation also takes into account implicit promises arising from customary business practices – e.g. incentives and discounts for early renewal.

Materiality assessment

Under both IFRS and US GAAP, when entities perform their assessment of the performance obligations in the contract, they may consider materiality (that is, whether a performance obligation is immaterial and therefore is not accounted for separately) (see below). The examples in this section illustrate the required analysis to determine whether a promise in a contract represents a performance obligation, without considering the application of materiality.

Differences between IFRS and US GAAP

Promised goods or services that are immaterial in the context of the contract

606-10-25-16A, ASU 2016-10.BC12–BC14
[IFRS 15.BC116A–BC116E]

The FASB decided to permit an entity not to identify promised goods or services that are immaterial in the context of the contract as performance obligations. It reached this decision because it could be unduly burdensome in some circumstances to require an entity to aggregate and determine the effect on its financial statements of those items or activities determined to be immaterial at the contract level.

In contrast, the IASB decided not to include the exception in the IFRS version of the standard, but noted that it did not intend to require an entity to identify every possible promised good or service in the contract individually. The IASB therefore expects that this difference between the IFRS and US GAAP versions of the standard will not give rise to significant differences in practice. However, it remains to be seen whether this really is the case, because the US GAAP version of the standard permits the evaluation at the contract level whereas the IFRS version continues to rely on general materiality guidance, which is viewed from the financial statement level.

Shipping and handling activities

606-10-25-18A – 25-18B
ASU 2016-10.BC20–BC22
[IFRS 15.BC116R–BC116U]

The IFRS version of the standard does not include an accounting policy election to treat shipping and handling activities undertaken by the entity after the customer has obtained control of the related good as a fulfillment activity. The IASB rejected this election because it considered that the election would result in an exception to the revenue model and would make it more difficult for users to compare entities' financial statements.

A difference now exists between IFRS and US GAAP on this point. This will affect the comparability of the financial statements of entities reporting under IFRS and US GAAP that have a significant number of transactions – e.g. telecom equipment sales – in which shipping and handling activities are performed after control of the goods transfers to the customer, and the entity elects to treat the shipping and handling activity as a fulfillment cost under US GAAP.

Comparison with current US GAAP

Approach to determining the accounting is different

Although some of the concepts are similar under the new standard and current US GAAP, an entity's approach to the accounting may be slightly different. Generally, under current US GAAP, an entity determines its accounting by starting at the contract level. An entity determines if the contract can be separated into multiple units of accounting based on whether separation criteria are met or other specific guidance applies. Under the new standard, an entity determines its accounting by beginning at the promise level. An entity identifies all of its promises and then begins combining them if they are determined not to be distinct or are immaterial in the context of the contract.

SEC SAB Topic 13, ASU 2014-09.BC89–BC90

Perfunctory or inconsequential

The FASB emphasized that 'immaterial' in the context of the contract is a qualitative and quantitative assessment based on what may be important to the customer. This concept is expected to be similar to the current US GAAP guidance on inconsequential or perfunctory deliverables.

The current US GAAP guidance states that a performance obligation is inconsequential or perfunctory if it is not essential to the functionality of the delivered products or services. Activities are not inconsequential or perfunctory if failure to complete the activities would result in a full or partial refund or the customer's right to reject the delivered goods or services.

The FASB also specifically noted that customer options to acquire additional goods or services that represent a material right to the customer will need to be identified as a performance obligation even if they might have been considered immaterial in the context of the contract (see Section 8).

Shipping and handling activities

Under the new standard, shipping and handling activities can be accounted for as follows. If they are performed:

– before the customer obtains control of the goods, then they are fulfillment activities; and

– after the customer obtains control of the goods, then:

  - an entity electing to account for shipping and handling as a fulfillment activity accrues the costs of these activities and recognizes all revenue at the point in time at which control of the goods transfers to the customer; or

  - an entity *not* choosing the policy election is likely to conclude that shipping and handling activities that occur after control of the goods transfers to the customer are a performance obligation, and therefore it allocates a portion of the transaction price to the shipping and handling and recognizes revenue as the shipping and handling performance obligation is satisfied.

The accounting policy choice included in the FASB's version of the new standard will allow entities to accrue shipping and handling costs as an expense at the time when revenue is recognized for the delivery of a good, thereby achieving a 'matching' of the revenue and related fulfillment cost.

However, because this is a policy election, entities will not be required to do so, which could result in potential diversity in practice arising both from different:

– economic arrangements (e.g. shipping and handling occur before control of the goods transfers versus occurring after control transfers); and

– policy elections (when control of goods transfers before shipping and handling activities occur).

If the policy election is used under US GAAP, then this could create a difference with IFRS.

3.2 Distinct goods or services

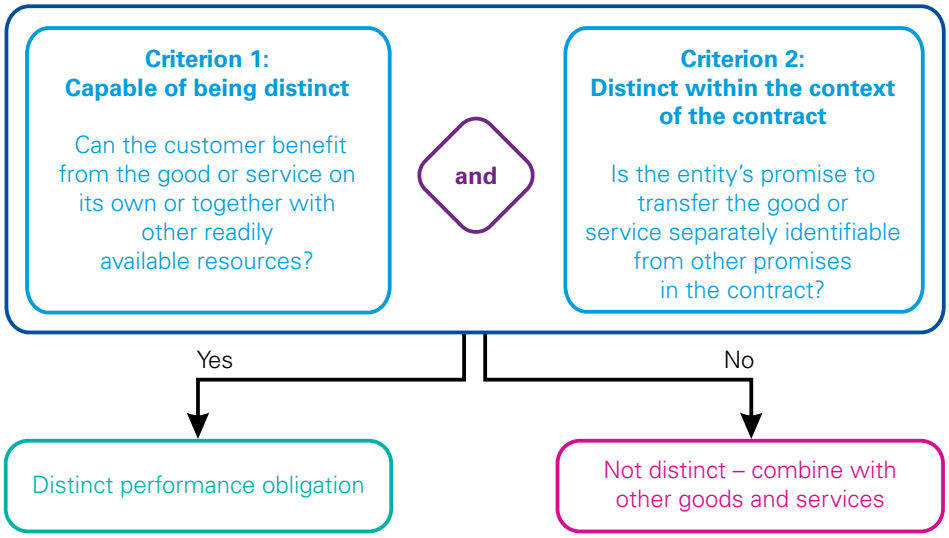
Requirements of the new standard

606-10-25-14
[IFRS 15.22]

A single contract may contain promises to deliver to the customer more than one good or service. At contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and therefore constitute performance obligations.

A good or service is distinct if both of the following criteria are met.

606-10-25-19
[IFRS 15.27]



606-10-25-20
[IFRS 15.28]

Criterion 1	**Good or service is capable of being distinct** A customer can benefit from a good or service if it can be used, consumed, sold for an amount that is greater than scrap value, or otherwise held in a way that generates economic benefits. A customer can benefit from a good or service on its own or in conjunction with: – other readily available resources that are sold separately by the entity, or by another entity; or – resources that the customer has already obtained from the entity – e.g. a good or service delivered up front – or from other transactions or events. The fact that a good or service is regularly sold separately by the entity is an indicator that the customer can benefit from a good or service on its own or with other readily available resources.

606-10-25-21
[IFRS 15.29]

Criterion 2	**Distinct within the context of the contract**
	The objective when assessing whether an entity's promises to transfer goods or services are distinct within the context of the contract is to determine whether the nature of the promise is to transfer each of those goods or services individually, or whether the promise is to transfer a combined item or items to which the promised goods or services are inputs. The new standard provides the following indicators to assist in evaluating whether two or more promises to transfer goods or services to a customer are not separately identifiable: – The entity provides a significant service of integrating the goods or services with other goods or services promised in the contract into a bundle of goods or services that represent the combined output or outputs for which the customer has contracted. This occurs when the entity is using the goods or services as inputs to produce or deliver the output or outputs specified by the customer. A combined output (or outputs) might include more than one phase, element or unit. – One or more of the goods or services significantly modifies or customizes, or is significantly modified or customized by, one or more of the other goods or services promised in the contract. – The goods or services are highly interdependent or highly interrelated, such that each of the goods or services is significantly affected by one or more of the other goods or services. The list of indicators in the new standard is not exhaustive.

606-10-25-22
[IFRS 15.30]

If a promised good or service is determined not to be distinct, then an entity continues to combine it with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, this results in the entity accounting for all of the goods or services promised in a contract as a single performance obligation.

Observations

Applying the indicators will require judgment

The new standard does not include a hierarchy or weighting of the indicators of whether a good or service is separately identifiable from other promised goods or services within the context of the contract. An entity evaluates the specific facts and circumstances of the contract to determine how much emphasis to place on each indicator.

Certain indicators may provide more compelling evidence in the separability analysis than others in different scenarios or types of contracts. For example, factors such as the degree of customization, complexity, customer's motivation for purchasing goods/services, contractual restrictions and the functionality of individual goods/services may have differing effects on the distinct analysis for different types of contracts.

In addition, the relative strength of an indicator, in light of the specific facts and circumstances of a contract, may lead an entity to conclude that two or more promised goods or services are not separable from each other within the context of the contract. This may occur even if the other two indicators might suggest separation.

Applying Criterion 2 requires an entity to assess if there is a transformative relationship between the two items being analyzed

ASU 2016-10.BC30
[IFRS 15.BC116K]

The Boards noted that the evaluation of whether an entity's promise to transfer a good or service is separately identifiable from other promises in the contract considers the relationship between the various goods or services within the contract in the context of the process of fulfilling the contract. An entity should consider the level of integration, interrelation or interdependence among promises to transfer goods or services in evaluating whether the goods or services are distinct.

The Boards also observed that an entity should not merely evaluate whether one item, by its nature, depends on the other (i.e. whether the items have a functional relationship). Instead, an entity should evaluate whether there is a transformative relationship between the two items in the process of fulfilling the contract (see 3.3 and 3.4).

Contractual restrictions may not be determinative

Contracts between an entity and a customer often include contractual limitations or prohibitions. These may include prohibitions on reselling a good in the contract to another third party, or restrictions on using certain readily available resources – e.g. the contract may require a customer to purchase complementary services from the entity in conjunction with its purchase of a good or license.

606-10-55-150E – 55-150F (Example 11D)
[IFRS 15.IE58E–IE58F]

In Example 11D of the new standard, the customer is contractually required to use the seller's installation service to install the purchased good. The example notes that the contractual restriction does not affect the assessment of whether the installation services are considered distinct. Instead, the entity applies Criteria 1 and 2 to assess whether the installation services are distinct. By applying these criteria, Example 11D illustrates that substantive contractual provisions alone do not lead to a conclusion that the goods and services are not distinct. For telecom installation services, see 3.5.

ASU 2014-09.BC100
[IFRS 15.BC100]

A contractual restriction on the customer's ability to resell a good may prohibit an entity from concluding that the customer can benefit from a good or service, because the customer cannot resell the good for more than scrap value in an available market. However, if the customer can benefit from the good together with other readily available resources, even if the contract restricts the customer's access to those resources – e.g. by requiring the customer to use the entity's products or services – then the entity may conclude that the good or service has benefits to the customer and that the customer could purchase or not purchase the entity's products or services without significantly affecting that good.

Comparison with current IFRS

Separately identifiable components

[IAS 18.13, IFRIC 13, IFRIC 15, IFRIC 18]

Current IFRS includes limited guidance on identifying whether a transaction contains separately identifiable components. However, our view is that, based on analogy to the test in IFRIC 18, an entity should consider whether a component has a stand-alone value to the customer and whether the fair value can be reliably measured (see 4.2.50.60 in *Insights into IFRS*, 13th Edition).

The new standard introduces comprehensive guidance on identifying separate components, which applies to all revenue-generating transactions. This could result in telecom goods or services, such as equipment or incentives, being either unbundled or bundled more frequently than under current practice.

605-25-25-5

Comparison with current US GAAP

Benefit to the customer versus stand-alone value

For a promised good or service to be distinct under the new standard, it has to be:

– capable of being distinct (Criterion 1); and

– distinct within the context of the contract (Criterion 2).

Criterion 1 (capable of being distinct) is similar, but not identical, to the stand-alone value criterion required under current US GAAP. Specifically, under current US GAAP a delivered item has value on a stand-alone basis if it is sold separately by any entity or if the customer could resell the delivered item on a stand-alone basis (even in a hypothetical market).

Under the new standard, an entity evaluates whether the customer can benefit from the good or service on its own or together with other readily available resources. This evaluation no longer depends entirely on whether the entity or another entity sells an identical or largely interchangeable good or service separately, or whether the delivered item can be resold by the customer. Rather, in evaluating whether the customer can benefit from the good or service on its own, an entity determines whether the good or service is sold separately (by the entity or another entity) or could be resold for more than scrap value. An entity also considers factors such as a product's stand-alone functional utility.

Therefore, potentially more goods may qualify as distinct under Criterion 1 than under current US GAAP. However, an entity also has to evaluate Criterion 2.

Promised goods or services versus deliverables

There may not be an exact correlation in all cases between what is considered a 'deliverable' under current US GAAP and what is considered a 'promised good or service' under the new standard.

The term 'deliverable' is not defined in current US GAAP. However, in a 2007 speech[3], the SEC staff noted that the following criteria are a helpful starting point in determining whether an item is a deliverable:

– the item is explicitly referred to as an obligation of the entity in a contractual arrangement;

– the item requires a distinct action by the entity;

– if the item is not completed, then the entity will incur a significant contractual penalty; or

– inclusion or exclusion of the item from the arrangement will cause the arrangement fee to vary by more than an insignificant amount.

Under the new standard, promised goods or services are the promised obligations within the contract, which are considered as part of the analysis in Step 1 (see Section 2) and Step 2 (see Section 3).

3. SEC Speech, *"Remarks Before the 2007 AICPA National Conference on Current SEC and PCAOB Developments,"* by Mark Barrysmith, Professional Accounting Fellow at the SEC, available at www.sec.gov.

3.3 Telecom equipment

Consumer and business telecom contracts often include equipment that is provided to the customer. The first step in assessing the accounting for the equipment is to determine whether it is the subject of a lease (see 1.3). When the equipment is not the subject of a lease, the entity assesses whether it is a promised good or service and, if so, if it is distinct from the other goods or services in the contract by applying the criteria in 3.2. Judgment may be required. If the equipment does not transfer to the customer, then the entity considers whether the costs can be capitalized as an asset or as a fulfillment cost (see Section 7).

Example 16 – Wireless contract with handset

TelcoT has a contract with Customer R that includes the delivery of a handset and 24 months of voice and data services. Customer R obtains title to the handset. The handset can be used by Customer R to perform certain functions – e.g. calendar, contacts list, email, internet access, accessing apps via Wi-Fi, and to play music or games.

There is evidence of customers reselling the handset on an online auction site and recapturing a portion of the selling price of the handset. TelcoT regularly sells its voice and data services separately to customers, through renewals or sales to customers who acquire their handset from an alternative vendor – e.g. a retailer.

TelcoT concludes that the handset and the wireless services are two separate performance obligations based on the following evaluation.

Criterion 1	**Capable of being distinct** – Customer R can benefit from the handset either on its own – i.e. because the handset can be resold for more than scrap value and has substantive, although diminished, functionality that is separate from TelcoT's network – or together with its wireless services that are readily available to Customer R, because TelcoT sells those services separately. – Customer R can benefit from the wireless services in conjunction with readily available resources – i.e. either the handset is already delivered at the time of contract set-up, or could be purchased from alternative retail vendors or the wireless service could be used with a different handset.

Criterion 2	**Distinct within the context of the contract**
	– The handset and the wireless services are separable in this contract because they are not inputs to a single asset – i.e. a combined output – which indicates that Telco T is not providing a significant integration service. – Neither the handset nor the wireless service significantly modifies or customizes the other. – Customer R could purchase the handset and the voice/data services from different parties – e.g. Customer R could purchase the handset from a retailer – therefore providing evidence that the handset and voice/data services are not highly dependent on, or highly interrelated with, each other.

Example 17 – Purchased modem and router with internet

Telco A enters into a two-year contract for internet services with Customer C. Customer C also purchases a modem and a router from Telco A and obtains title to the equipment. Telco A does not require customers to purchase its modems and routers and will provide internet services to customers using other equipment that is compatible with Telco A's network. There is a secondary market on which modems and routers can be purchased or sold for amounts greater than scrap value.

Telco A concludes that the modem and router are each distinct and that the arrangement includes three performance obligations (the modem, the router and the internet services) based on the following evaluation.

Criterion 1	**Capable of being distinct**
	– Customer C can benefit from the modem and router on their own as they can be resold for more than scrap value. – Customer C can benefit from the internet services in conjunction with readily available resources – i.e. either the modem and router are already delivered at the time of contract set-up, or could be purchased from alternative retail vendors or the internet service could be used with different equipment.

Criterion 2	**Distinct within the context of the contract**
	– The modem and router are distinct within the context of the contract because Telco A does not provide an integration service. – The modem, router and internet services do not modify or customize one another. – Customer C could benefit from the internet services using routers and modems that are not sold by Telco A. Therefore, the modem, router and internet services are not highly dependent on, or highly interrelated with, each other.

Observations

Telecom equipment may be sold, leased or provided to the customer as part of their service

Topics 840, 842
[IAS 17, IFRS 16]

When a telecom service contract includes equipment, the entity assesses whether that equipment is leased, sold, or provided to the customer as part of its service. This assessment is required even if the contract does not explicitly refer to the equipment as leased or the lease payments are not billed separately from other services. Leased equipment is out of scope of the new standard (see 1.3).

If the entity concludes that the equipment is not leased to the customer, then it needs to analyze the nature of the promise made to the customer. If the equipment transfers to the customer, then it may be distinct and therefore a separate performance obligation.

There may be situations where the telecom entity charges a monthly fee for the use of the equipment that does not represent a lease but is provided to the customer as part of its service. For example, an entity may provide modems or set-top boxes, over which it retains control, because they can be exchanged by the entity as technology changes. In those cases, the equipment remains an asset of the entity. Determining whether the use of the equipment is a service distinct from the network services may not have a significant effect on the timing of revenue recognition because both services are typically provided concurrently. The classification of the revenues received, however, for disaggregated revenue disclosure or segment reporting requirements, as well as management, regulatory and tax reporting, should be considered.

Equipment used to deliver service is often an element of the telecom network (e.g. backbone, cable drops, wireless towers and repeaters). This equipment is typically owned and operated by the telecom entity and is accounted for as an asset/fulfillment cost. These items are not performance obligations because they are not a promised good or service and do not transfer to the customer.

Telecom equipment that transfers to the customer is generally capable of being distinct

Criterion 1 (capable of being distinct) indicates that if an entity regularly sells a good or service separately, then that is an indication that a customer can benefit from the good or service on its own or with other readily available resources. Telecom entities may not regularly sell equipment, such as phones, wireless devices, modems and set-top boxes without network service. Whether the equipment is sold by others is part of the analysis in determining whether it is distinct. The existence of alternative dealers, and secondary markets for telecom equipment, often provides evidence that the equipment is capable of being distinct.

Proprietary or locked telecom equipment can also be distinct

The fact that telecom equipment may be proprietary or locked to the provider's network is not in itself evidence that the customer cannot benefit from the good or service on its own or with other readily available resources. Some telecom equipment has stand-alone functionalities and can be used in a variety of ways by the customer without being connected to the telecom entity's network. For example, wireless handsets can be used with Wi-Fi or as cameras, and set-top boxes may be used to store video content. These factors, in addition to the ability to sell the equipment separately, may provide evidence that the equipment is capable of being distinct.

Assessing whether telecom equipment is distinct in the context of the contract requires judgment

In general, telecom services cannot be provided without the customer having the appropriate telecom equipment. However, this functional dependency is not sufficient to demonstrate that the equipment and services are highly dependent or interrelated with one another. The telecom entity should not merely evaluate whether one item, by its nature, depends on the other (e.g. the service that would never be obtained by a customer without the appropriate equipment). Criterion 2 (distinct in the context of the contract) focuses the analysis on whether the service and the equipment significantly affect or transform each other, rather than on functional dependency. Therefore, if the services and the equipment are functionally dependent but do not transform or affect one another, then they will generally be distinct in the context of the contract and will be accounted for as separate performance obligations (assuming Criterion 1 is also met).

3.4 Telecom services

3.4.1 Network telecom services and add-ons

Once the determination has been made that telecom equipment and services are distinct, the entity determines if the various services are distinct from one another, although they may be provided concurrently. Optional features (referred to in this publication as 'add-ons') may be opted in or out at contract inception or later and will generally represent distinct goods and services. Add-ons are further discussed in Section 8.

Example 18 – Residential triple-play

Telco A contracts with Customer C to provide cable television, internet and landline voice services for a fixed monthly fee for 24 months.

Customer C can benefit from each of the three services on their own (i.e. Customer C can benefit from cable television without either of the other contracted services). None of the three contracted services are highly interrelated or interdependent because Customer C is able to purchase any of the three services separately. Furthermore, Telco A does not provide a significant integration service in the contract as these services are not inputs to a combined service offering that significantly modifies or customizes any of the other stand-alone service offerings.

Telco A concludes that each of the three services is a distinct good or service. However, as a practical matter, because the three services are provided concurrently, Telco A may conclude that it is acceptable to account for the bundle as a single performance obligation, if they have the same pattern of transfer (see 6.3). The classification of the revenues received should be considered, however, for disaggregated revenue disclosure or segment reporting requirements, as well as management, regulatory or tax reporting.

Example 19 – Cable television service and additional premium channel

Cable B contracts with Customer D to provide television services for a fixed monthly fee for 24 months. The base television services package gives Customer D the right to purchase additional premium channels. At contract inception, Customer D adds a premium sports channel for an additional 5 per month.

The premium channel service is capable of being distinct because the customer can benefit from the service together with readily available resources (i.e. the existing base television services). In addition, the premium channel service is distinct in the context of the contract because the premium channel service does not significantly affect, or transform, the base television services and therefore is not highly interrelated with the base television services. Furthermore, the premium channel can be added or dropped by the customer without affecting the base television services. Therefore, Cable B concludes that the premium channel service is a performance obligation. For further considerations, if the premium channel is not added at contract inception, see 8.1, Example 58.

Example 20 – Wireless family plan with shared data

Telco X enters into a contract with Customer C to provide Customer C and his child a family wireless share plan. The plan is comprised of two voice plans, two text plans and 5GB of shared data for a fixed monthly fee. The minutes and texts are not shared. Customer C and his child each have their own wireless handsets.

Customer C and his child are able to benefit from the voice, text and data services individually, together with readily available resources (i.e. the existing handsets). Similarly, the two voice plans and the two text plans do not transform one another and are therefore not highly interrelated. Telco X also promised to provide data services to two users (Customer C and his child), and assesses if this creates two performance obligations. Even though the data is shared between the two users, Telco X determines that the data service is one performance obligation.

Telco X therefore concludes that the contract contains five performance obligations: the two voice plans, the two text plans and the shared data plan.

Similar to the triple-play in Example 18, Telco X may decide as a practical matter that it is acceptable to account for the bundle as a single performance obligation if all performance obligations have the same pattern of transfer (see 6.3).

Observations

Bundled telecom contracts may contain several service performance obligations

A telecom entity typically offers arrangements that can include varying service combinations, such as wireless, internet, television and landline voice. Each service is regularly sold separately, further supporting the conclusion that customers can benefit from each on its own (Criterion 1). Applying Criterion 2, however, requires judgment. The entity should analyze if the services are separately identifiable. The fact that the services are regularly sold separately generally evidences that they do not transform one another. Furthermore, that analysis considers whether there is an interrelationship between the services – e.g. in enterprise contracts where the services are complex.

For practical reasons, dissimilar telecom services delivered concurrently can be treated as one performance obligation when they have the same pattern of transfer

ASU 2014-09.BC116
[IFRS 15.BC116]

606-10-50-5 – 50-6
[IFRS 15.114–115]

Many telecom services are dissimilar (e.g. television, internet, voice) but are delivered concurrently. When performance obligations are dissimilar but have the same pattern of transfer (see 6.3), treating them as one performance obligation may have no effect on the overall pattern of revenue recognition. The classification of the revenues received, however, for disaggregated revenue disclosure or segment reporting requirements, as well as management, regulatory and tax reporting, should be considered.

Optional services will usually be distinct but need to be evaluated for potential material rights

Telecom contracts often include optional features that can be purchased separately – e.g. adding minutes, texts or data to a fixed usage plan, additional bundles of voice, text and data to an existing plan, international roaming plans, additional television channels or pay-per-view movies.

When these add-ons are subscribed to by the customer, either at contract inception or later in the contract, the entity needs to assess whether they are distinct from the other services. As described above, because these add-ons can be purchased separately and can often be opted in to or out of at any time during the contract, they are generally capable of being distinct (Criterion 1). Although the add-ons (e.g. an international wireless voice plan) are typically not offered to a customer that has not subscribed to a base service plan (e.g. a wireless voice plan), the add-ons do not generally transform the base service and therefore meet Criterion 2 (distinct in the context of the contract).

When these add-ons are available to the customer but the customer has not yet subscribed to them, the telecom entity should consider the guidance on options and material rights (see Section 8).

Share plans add complexity

Share plans add complexity when identifying the performance obligations in a contract. Their specific facts and circumstances may vary and need to be analyzed carefully. In addition, share plans may be entered into through several contracts with different users. The telecom entity should therefore determine who its customer is, which may include assessing who is responsible for payment. It should also consider the contract combination guidance (see 2.3).

3.4.2 The series guidance applied to telecom services

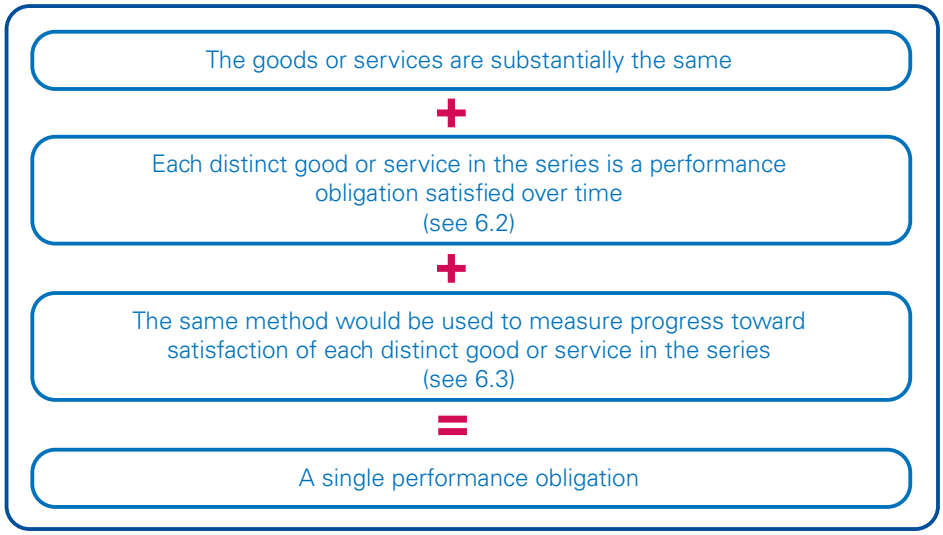
Telecom entities need to define the nature of their promise to the customer, which may be a promise to deliver time increments of network service (minute, day etc.) or other service units (text, data gigabyte etc.). In many cases, telecom services will meet the criteria to be accounted for as a series because each time increment or service unit is distinct, similar and delivered over time. If so, the telecom service is accounted for as one performance obligation. This may have follow-on consequences when determining the pattern of transfer (see 6.3) and accounting for contract modifications. The practical outcome of accounting for the services as a series is a simplified approach to what the new standard otherwise would require.

Requirements of the new standard

606-10-25-14b
[IFRS 15.22(b)]

A contract may contain promises to deliver a distinct series of goods or services that are substantially the same. At contract inception, an entity assesses the goods or services promised in the contract and determines whether the series is a single performance obligation. This is the case when it meets the following criteria.

606-10-25-15
[IFRS 15.23]



Example 21 – Term cable television contract with fixed fee and unlimited usage

Cable Company R enters into a two-year service contract with Customer M to provide cable television services for a fixed fee of 100 per month. Cable Company R has concluded that its cable television services are satisfied over time because Customer M receives and consumes the benefit from the services as they are provided – e.g. customers generally benefit from each day that they receive Cable Company R's services.

Cable Company R determines that each increment of its services – e.g. day or month – is distinct because Customer M benefits from that period of service on its own and each increment of service is separately identifiable from those preceding and following it – i.e. one service period does not significantly affect, modify or customize another.

However, Cable Company R applies the series guidance and concludes that its contract with Customer M is a single performance obligation to provide two years of cable television service because each of the distinct increments of services is satisfied over time and the same method would be used to measure progress (see 6.3 for a discussion of measure of progress).

Example 22 – Term wireless service contract with fixed fee and limited usage

Telco A enters into a two-year wireless contract with Customer C to provide 120 minutes of voice service for a fixed fee of 20 per month. The voice plan includes both incoming and outgoing calls. The voice plan allows the customer to use 120 minutes each month for incoming and outgoing calls and the handset will not function for voice purposes once the minutes are used. The 120 minutes expire at the end of every month. Telco A concludes that the voice services are satisfied over time because Customer C receives and consumes the benefit from the services as they are provided – e.g. customers generally benefit from each minute that they receive Telco A's services.

Telco A determines that each minute is distinct because Customer C benefits from that minute of service on its own. Additionally, each minute is separable from those preceding and following it – i.e. one service period does not significantly affect, modify or customize another.

However, Telco A applies the series guidance and concludes that its contract with Customer C is a single performance obligation to provide 2,880 minutes (120 x 24 months) of wireless service. Telco A determines that each of the distinct minutes of voice is satisfied over time, and the same method would be used to measure progress (see 6.3 for a discussion of measure of progress).

Observations

Determining the nature of the telecom entity's promise to the customer is the first step in applying the series guidance

Determining the nature of the telecom entity's promise is the first step in determining whether the criteria to account for the services as a series are met. For example, if the nature of the promise is the delivery of a specified quantity of a good or service, then the evaluation should consider whether each good or service is distinct and substantially the same.

Conversely, if the nature of the telecom entity's promise is to stand ready to provide a single service for a period of time (i.e. there is not a specified quantity to be delivered), then the evaluation would likely focus on whether each time increment, rather than the underlying activities, is distinct and substantially the same.

Telecom services generally meet the criteria to be accounted for as a series but determining the nature of the service obligation may require judgment

606-10-25-14b
[IFRS 15.22(b)]

606-10-25-15
[IFRS 15.23]

Generally, telecom network services represent a promise to deliver time increments of network services (minute, day, month etc.). Alternatively, they may represent the promise to deliver a specific amount of service units (text, data gigabyte etc.). In either case, those services generally meet the criteria to be accounted for as a series. This is because each time increment or service unit is distinct but similar. Additionally, the customer receives and consumes the benefit from the services as they are provided; therefore, services are satisfied over time (see 6.2). When the series criteria are met, the network services are accounted for as one performance obligation, rather than as distinct service units.

Accounting for the services as a series usually brings relief to the application of the revenue model

In a telecom environment, the series guidance can simplify the application of the five-step revenue model because monthly network services are accounted for as a single performance obligation. Therefore, a telecom entity does not need to determine the individual stand-alone selling prices for each time increment or service unit promised. However, the telecom entity still needs to carefully assess the nature of its promise to the customer (time increments versus service units etc.) because this will impact the pattern of revenue recognition (see 6.3).

606-10-25-12 – 25-13
[IFRS 15.20–21]

When a contract is modified and a telecom entity accounts for the services as a series, it accounts for the change prospectively because the underlying services in the series are distinct from one another and some of the monthly performance obligations will have been satisfied when the contract modification or change in price occurred (see Section 7 in Issues In-Depth, Edition 2016 for the accounting for contract modifications).

606-10-32-44
[IFRS 15.89]

Furthermore, if a contract includes variable consideration, then a change in the measurement of that variable consideration can be applied to one or more of the distinct services, rather than to the overall performance obligation when applying the series guidance, if certain criteria are met (see 5.4.2.2 in Issues In-Depth, Edition 2016).

3.5 Installations

Many telecom entities offer residential and business installation services that need to be carefully evaluated to determine if they transfer a distinct service to the customer and are separate performance obligations. In many cases, judgment is required.

Example 23 – Residential installation services

A new residential customer purchases television services from Telco A under a three-year contract. The contract requires that Telco A perform certain installation activities, including connecting Telco A's network to the customer's house and wiring the inside of the house so that set-top boxes can be connected. The customer could have selected a third party to perform the inside wiring services.

Under the terms and conditions of the contract, the connection to the customer's home belongs to Telco A and it is responsible for any repairs or maintenance. Telco A concludes that connecting the network to the customer's house results in an extension of its own network, does not transfer a good or service to the customer and is not a performance obligation. Telco A then considers whether any of the installation costs qualify to be capitalized as property, plant and equipment or costs of fulfilling a contract (see Section 7).

Since the terms and conditions of the contract indicate that the inside wiring is the responsibility of the customer, Telco A needs to determine if this service is distinct from other goods and services in the contract. Telco A notes that the customer can benefit from the inside wiring on its own because this service is sold separately, which is evidenced by the fact that the customer could have obtained the service from a third party. The promise related to the inside wiring is separately identifiable – Telco A does not provide a service of integrating the inside wiring with other services to create a combined output, the inside wiring does not modify or customize another good or service, and the inside wiring is not highly dependent on or interrelated with the television services. Thus, Telco A concludes that the inside wiring is distinct and constitutes a separate performance obligation.

Example 24 – Business installation services

Business Customer Y purchases a customized telecommunications package from Telco Z that requires Telco Z to make a significant network investment. Customer Y enters into a 10-year network services contract and pays 500,000 up front (to compensate Telco Z for its network investment costs) and 10,000 per month for the services. The network subject to the contract is not transferred to the customer but is used and managed by Telco Z to deliver the specific network services.

The activities related to the network investment do not result in the transfer of goods or services to Customer Y. Telco Z concludes that the activities are set-up activities. Accordingly, there is only one activity that transfers a good or service to the customer (i.e. network services). Therefore, revenue will not be recognized until the network services begin to be provided. Telco Z also considers the guidance on nonrefundable up-front fees (see Section 9).

Because the network assets are owned by Telco Z but used to satisfy this contract, Telco Z also may assess if the contract includes a lease. If Telco Z concludes that the equipment is subject to a lease, then Telco Z would account for that lease under the appropriate guidance and the remainder of the contract would be accounted for under the new standard.

Observations

Installation and activation fees do not necessarily mean that the underlying activities are distinct

Whether an activity is referred to as an 'activation' or 'installation', and whether a fee is charged to a customer are not determinative factors in assessing whether the activity is a separate performance obligation. A telecom entity needs to consider the specific facts of the arrangement to understand the nature of the activation or installation activities performed and whether they transfer control of a distinct good or service to the customer. Any up-front fee would be included in the transaction price and allocated to the performance obligations identified in the contract (see Section 9).

Activities that improve the telecom's network do not transfer a good or service to the customer

Telecom entities may incur up-front costs for improvements to their networks to set up, install or hookup a customer's services. The fact that these costs may be significant is not sufficient to conclude that the related activities transfer a good or service to the customer, even if the telecom entity is able to recover those costs from the customer.

When assessing if installation activities are distinct, a telecom entity first needs to determine whether these activities are an improvement to or extension of its network, rather than a transfer of a service or good to the customer. Technologies change rapidly in the telecom industry and, therefore, appropriately identifying all of the activities related to an installation will require careful consideration.

If installation and other related activities do not transfer a good or service to the customer, then the costs should be analyzed to determine if they qualify to be capitalized as property, plant and equipment or as a cost of fulfilling the contract (see Section 7).

Assessing whether installation activities are distinct requires judgment

For those installation activities that transfer a good or service to a customer – e.g. those that are not improving or extending its network – the telecom entity needs to assess if the installation services are capable of being distinct (Criterion 1) and are distinct in the context of the contract (Criterion 2). Determining whether installation activities are a performance obligation will require judgment.

For example, the customer may have the option to self-install its equipment and wiring, or to select another provider to do so, rather than purchasing the installation from the entity. This would generally evidence both that the customer can benefit from the installation on its own and that the network services and the installation are not highly interdependent. However, if the installation is performed by a third party, then this in itself may not be sufficient to conclude that the installation brings benefit to the customer on its own – e.g. if the telecom entity has simply subcontracted the installation activity to a third party. The entity also considers whether the installation would need to be reperformed if the customer changes service providers or renews or upgrades its service contract.

Comparison with current US GAAP

Hookup revenue guidance for cable/satellite entities is superseded

922-430-25-1, 35-1, 922-605-25-3

Under current guidance for cable television providers, hookup revenue (i.e. fees that customers pay for the installation/set-up of their cable/satellite television services) is recognized up front to the extent of direct selling costs, with the remainder deferred over the expected customer relationship period. This guidance will be withdrawn when the new standard becomes effective. However, some of the guidance on costs for cable companies has not been withdrawn (see Section 7).

There is no industry-specific revenue recognition guidance under the new standard. Therefore, whether a portion of any up-front fee for an installation will be recognized at contract inception under the new standard depends on the specific facts and whether the installation activities meet the definition of a performance obligation.

3.6 Other telecom services, fees and administrative tasks

Requirements of the new standard

606-10-25-16 – 25-17
[IFRS 15.24–25]

Promises to transfer a good or service can be explicitly stated in the contract, or be implicit based on established business practices or published policies that create a valid ('reasonable' under US GAAP) expectation that the entity will transfer the good or service to the customer.

Conversely, administrative tasks do not transfer a good or service to the customer and are not performance obligations – e.g. administrative tasks to set up a contract.

Example 25 – Activation fee in a wireless contract

Telco A charges a one-time activation fee of 25 to Customer C when Customer C enters into a wireless contract for a voice and data plan. The activation of a new wireless customer to the network requires various administrative tasks, including setting up the wireless service, processing a new customer in the billing system, and credit checks.

Telco A determines that activation activities are administrative in nature and therefore do not constitute a separate promise to the customer to be assessed as a separate performance obligation. Because the activation fee is charged at contract inception and is not refundable, Telco A applies the guidance on nonrefundable up-front fees (see Section 9).

Example 26 – Wi-Fi hotspot access

Telco A offers a premium internet package that includes, among other services, access to Wi-Fi hotspots with the advantage to customers that they are able to save on their data usage. Alternatively, Telco A offers a basic internet package which allows, for an additional fee, the same access to Wi-Fi hotspots as the premium package.

Telco A determines that the access to the Wi-Fi hotspots is distinct from the other network services. This is because the customer can benefit from the Wi-Fi hotspot access on its own (i.e. it is sold separately). Furthermore, this service is distinct in the context of the contract because the Wi-Fi hotspot access is not highly interrelated with the network services. This is because the customer could choose not to take Wi-Fi hotspot access and the network services would not be significantly affected.

Observations

Administrative activities are not performance obligations

Telecom entities charge a number of fees to their customers at inception or during the contract term. These fees cover activities that should be evaluated to determine if they are distinct goods or services and therefore accounted for as separate performance obligations.

Fees such as wireless activation fees, credit check fees, service level change fees (sometimes referred to as 'service upgrade' or 'downgrade fees') and early contract termination fees are generally charged to recover the cost of administrative activities. Therefore, they would not typically give rise to performance obligations.

Fees for administrative tasks that are charged at contract inception or upon contract modification, if they are nonrefundable, are assessed further under the guidance on nonrefundable up-front fees (see Section 9).

Optional services may represent separate performance obligations

Some telecom entities offer optional services, such as help desk support, to their customers. Judgment is needed to determine if the optional services are promises made to the customer and represent separate performance obligations. If they are included in all network service bundles, then they may still meet the criteria for being distinct. For practical purposes, in these circumstances, these optional services can however be accounted for as part of the same bundle, as a single performance obligation, if all services are provided concurrently and have the same pattern of transfer.

Comparison with current US GAAP

Administrative tasks

SEC SAB Topic 13

The notion of an administrative task exists in current SEC guidance and refers to activities that do not represent discrete earnings events – i.e. selling a membership, signing a contract, enrolling a customer, activating telecommunications services or providing initial set-up services. Current SEC guidance distinguishes between deliverables and these activities. It states that activities that do not represent discrete earnings events are typically negotiated in conjunction with the pricing of the deliverables to the contract, and that the customer generally views these types of non-deliverable activities as having significantly lower or no value separate from the entity's overall performance under the contract.

In general, entities are unlikely to reach a substantially different conclusion under the new standard when they attempt to identify administrative tasks from that reached under current SEC guidance in identifying activities that do not represent discrete earnings events.

3.7 Incentives and promotional giveaways

Incentives and promotional giveaways are performance obligations if they meet the 'distinct' criteria. Even if the intent of the entity in offering the incentive is solely to entice customers to subscribe to a telecom service by, for example, giving free equipment or gift cards, that does not negate the requirement to evaluate whether the incentives are performance obligations (see 3.1).

Example 27 – Free handset case and gift card

Customer C purchases a wireless handset and a two-year service contract (both identified as separate performance obligations) from Telco A. Telco A offers Customer C a free handset case and a gift card for a local electronics store. These items are not typically included at contract inception.

Telco A determines that, although the handset case and gift card are incremental goods provided to Customer C as a marketing incentive to enter the wireless contract, they represent promises made by Telco A to Customer C. Therefore, there are four promised goods and services, as follows:

- wireless handset;
- handset case;
- gift card; and
- service contract.

Telco A concludes that the handset case and gift card are distinct because Customer C could have purchased them separately, can benefit from these items separately and they are not highly interrelated with the handset and wireless services. Therefore, Telco A accounts for four performance obligations.

Observations

Judgment is required to evaluate which guidance applies to telecom customer incentives

Telecom incentives may be offered in many different forms. Some may be performance obligations, while others may raise accounting issues addressed in other sections of the new standard.

Incentive	Accounting issue and applicable guidance	Examples
Free or discounted good or service	Assess if the good or service is distinct (Step 2) and allocate the transaction price (Step 4 – see Section 5)	Free charger, free premium television services for two months, gift card
Discount or bill credit	Estimate the transaction price (Step 3 – see Section 4)	Handset subsidy, bundle discount, goodwill credit, volume rebate
Up-front payment to customer	Estimate the transaction price (Step 3 – see Section 4)	Port-in credit, debit card
Options for additional discounted goods or services	Assess if a material right exists (see Section 8)	Option to renew a service contract at a discounted price

Due to the inherent promise included in customer incentives (e.g. a free good or service offered if the customer signs a contract), many incentives will be considered performance obligations, rather than a marketing expense.

Additional complexities in accounting for gift cards

Determining the proper accounting for gift cards given as incentives to a telecom customer requires judgment. The telecom entity needs to consider whether a gift card represents a performance obligation or consideration payable to a customer (see 4.3).

When the entity sells or offers third-party gift cards, it also needs to evaluate if it acts as a principal or an agent (see 10.3 in Issues In-Depth, Edition 2016).

End customer incentives in indirect channels

Telecom entities that have dealer or reseller networks should consider the proper accounting for incentives or payments made to the dealer (see Section 10).

Comparison with current US GAAP

Significant change for many entities that provide sales incentives

The new standard could result in a significant change in practice for entities that provide sales incentives, such as free goods or services, to their customers or to their customers' customers in a distribution chain. It will generally result in those goods or services being identified as promised goods or services in the entity's contract with its customer when the sales incentives are put in place before the sale to the customer. Existing practice when the sales incentive is a free product or service is mixed, with many entities accruing the cost of the free product or service and recognizing all of the revenue when the original good is sold to the customer.

3.8 Warranties

Requirements of the new standard

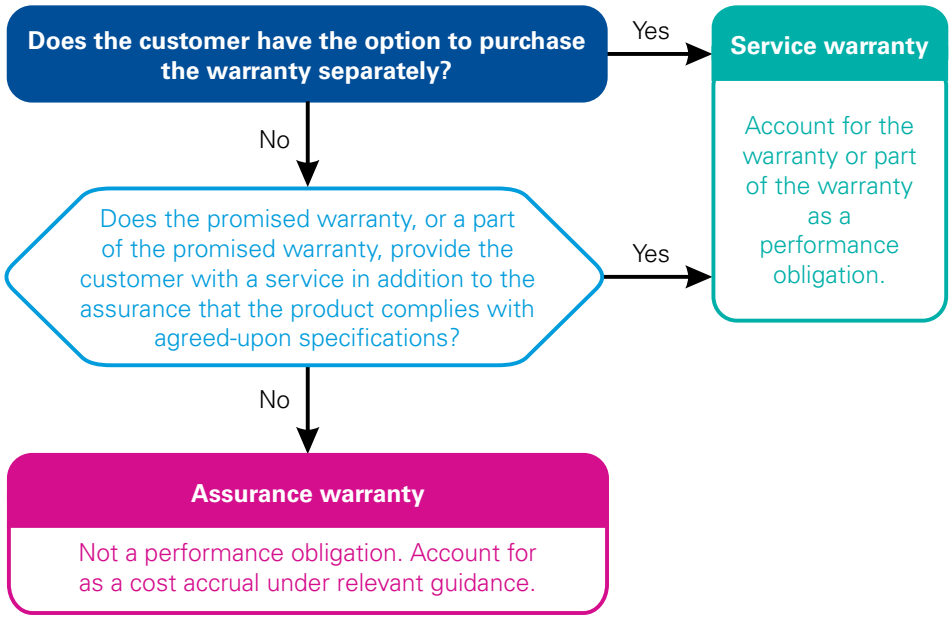
606-10-55-31
[IFRS 15.B29]

Under the new standard, a warranty is considered a performance obligation if it is distinct under the Step 2 criteria (see 3.2). If the customer has an option to purchase the good or service with or without the warranty, then the warranty is a distinct service. If the warranty includes a service beyond assuring that the good complies with agreed-upon specifications, then it is distinct.

606-10-55-31 – 55-32, Topic 450
[IFRS 15.B29–B30, IAS 37]

When a warranty is not sold separately, it or part of it may still be a performance obligation if it provides the customer with a service in addition to the assurance that the product complies with agreed-upon specifications. A warranty that only covers a product's compliance with agreed-upon specifications (an 'assurance warranty') is accounted for under other guidance.

An entity distinguishes between the types of warranties as follows.



606-10-55-33
[IFRS 15.B31]

To assess whether a warranty provides a customer with an additional service, an entity considers factors such as:

- *whether the warranty is required by law:* because such requirements typically exist to protect customers from the risk of purchasing defective products;
- *the length of the warranty coverage period:* because the longer the coverage period, the more likely it is that the entity is providing a service, rather than just guaranteeing compliance with an agreed-upon specification; and
- *the nature of the tasks* that the entity promises to perform.

606-10-55-31
[IFRS 15.B29]

If the warranty – or part of it – is considered to be a performance obligation, then the entity allocates a portion of the transaction price to the service performance obligation by applying the requirements in Step 4 of the model (see Section 5).

606-10-55-34
[IFRS 15.B32]

If an entity provides a warranty that includes both an assurance element and a service element and the entity cannot reasonably account for them separately, then it accounts for both of the warranties together as a single performance obligation.

606-10-55-35, 450-20
[IFRS 15.B33, IAS 37]

A legal requirement to pay compensation or other damages if products cause damage is not a performance obligation, and is accounted for under other relevant guidance.

Example 28 – Wireless handset extended warranty

Customer C purchases a wireless handset and a two-year service contract from Telco B. Customer C has the option, and chooses to purchase, a one-year extended warranty to cover the operation of the handset for the second year of the two-year contract.

As Customer C has the option to purchase the extended one-year warranty, Telco B identifies this warranty as a separate performance obligation.

Observations

Wireless handset warranties

Wireless customers can often purchase separate warranty coverage for their wireless handset from their telecom provider. This coverage may guarantee that the handset will continue to function properly after the manufacturer's warranty has expired. It may also provide additional coverage during the manufacturer's warranty period, such as the loan of a handset during the repair period, or the replacement of a broken, lost or stolen handset. Whether the warranty is separately priced is not determinative of whether a separate performance obligation exists and these warranty plans will typically represent separate performance obligations.

Additionally, if the warranty activities are performed by a third party, then the entity considers the principal versus agent guidance (see 10.3 in Issues In-Depth, Edition 2016). Under IFRS, the entity also considers any interaction with the insurance guidance.

Service level guarantees

The term 'service level guarantee' is used in some telecom contracts to require an entity to meet a minimum service level – e.g. having the network available to transport data for 95 percent of the time. When the minimum service level is not met, adjustments to the transaction price occur, typically through penalties that reduce the consideration paid to the telecom entity. These service level guarantees are not a performance obligation but, instead, generally result in variable consideration and affect the transaction price (see 4.2).

Comparison with current IFRS

Presence of warranty clause does not preclude recognition of revenue

[IAS 18.16(a), 17, IAS 37.C4]

Under IAS 18, a standard warranty clause in a sales contract that does not result in the seller retaining significant risks does not preclude revenue recognition at the date of sale of the product. In this case, the telecom entity recognizes a warranty provision under IAS 37 at the date of sale, for the best estimate of the costs to be incurred for repairing or replacing the defective products.

However, an abnormal warranty obligation could indicate that the significant risks and rewards of ownership have not been passed to the buyer, and that revenue should therefore be deferred.

Unlike current IFRS, the new standard does not envisage that the presence of a warranty would ever preclude the recognition of all of the revenue associated with the sale of the product. This could accelerate revenue recognition in some cases compared to current IFRS.

Comparison with current US GAAP

Entities will be required to consider factors in addition to considering whether a warranty is separately priced

Topics 450, 460

Under current US GAAP, warranties that are not separately priced are accounted for when the goods are delivered, by recognizing the full revenue on the product and accruing the estimated costs of the warranty obligation. The warranty is only treated as a separate unit of account under current US GAAP if it is separately priced.

Under the new standard, an entity evaluates whether the warranty provides a service regardless of whether it is separately priced – and, if it does, assesses whether it (or part of it) is a separate performance obligation.

Topic 460, 605-20-25-1 – 25-6

Amount of revenue allocated to a separately priced warranty may change

The amount of revenue recognized for some separately priced extended warranties and product maintenance contracts may change when the transaction price is allocated on a relative stand-alone selling-price basis, rather than by deferring the contractually stated amount of the warranty, as required under current US GAAP.

460-10-15-7(i)

Service level agreement

Contracts may guarantee an entity's performance through a service level agreement (SLA) under which an entity is required to pay compensation to a customer if it fails to provide the required level of service. Because these guarantees relate to an entity's own performance, they are not accounted for under the guidance on guarantees but under the new revenue standard.

There is diversity in practice in the accounting for an SLA under current US GAAP, including whether compensation payments are recorded as an expense or a reduction of revenue.

However, under the new standard an SLA that provides the customer with consideration if performance conditions are not met is accounted for as variable consideration (see 4.2). This may require an entity to estimate the anticipated pay-outs under its SLAs for the contractual period and include those estimated payments as a reduction of the transaction price and revenue.

4 Step 3: Determine the transaction price

Overview

606-10-32-2
[IFRS 15.47]

The 'transaction price', determined at contract inception, is the amount of consideration to which an entity expects to be entitled in exchange for transferring goods or services to a customer. The transaction price excludes amounts collected on behalf of third parties – e.g. some sales taxes or some telecom regulatory fees. Conversely, nonrefundable up-front fees, such as activation fees or set-up fees, are included in the transaction price (see Section 9).

606-10-32-4
[IFRS 15.49]

In determining the transaction price, the entity considers its enforceable rights and obligations within the contract. It does not consider the possibility of a contract being cancelled, renewed or modified. As seen in 2.1.1, the contract term is key to defining the transaction price. Additionally, telecom contracts often permit customers to navigate through service levels or add and remove optional services. Therefore, determining the enforceable rights and obligations may require judgment.

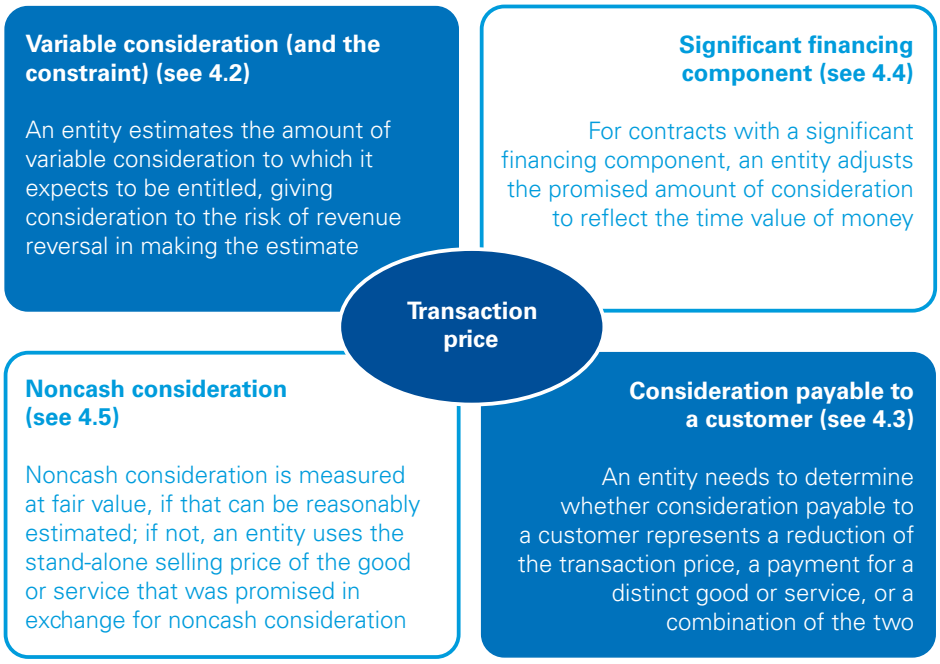
The transaction price also considers variable consideration (and the constraint), consideration payable to a customer and noncash consideration. Telecom entities need to analyze their contractual and business practices of offering incentives, rebates, goodwill and port-in credits etc., as those may affect the transaction price and need to be estimated at contract inception. Usage-based charges may represent a customer option (see Section 8), but in certain circumstances may constitute variable consideration and need to be analyzed.

Finally, at contract inception, the transaction price is adjusted for any significant financing component. Many wireless customers receive a handset at contract inception, which is ultimately paid for over time. In other situations, a nonrefundable fee is often paid at the beginning. Telecom entities therefore need to determine if such arrangements contain a significant financing component.

Requirements of the new standard

In determining the transaction price, an entity considers the following components.

606-10-32-3
[IFRS 15.48]



Customer credit risk is not considered when determining the amount to which an entity expects to be entitled – instead, credit risk is considered when assessing the existence of a contract (see Section 2). However, if the contract includes a significant financing component provided to the customer, then the entity considers credit risk in determining the appropriate discount rate to use (see 4.4).

Practical expedient for sales taxes (US GAAP only)

606-10-32-2A

An entity applying US GAAP may elect to exclude from the measurement of the transaction price all taxes assessed by a government authority that are both imposed on and concurrent with the specific revenue-producing transaction and collected by the entity from a customer – e.g. sales, use, value added and some excise taxes. Taxes assessed on an entity's total gross receipts or imposed during the inventory procurement process are not included in the scope of this election.

An entity that applies the election is required to exclude from the transaction price all taxes in the scope of the election and comply with accounting policy disclosure requirements. Entities not adopting this policy need to evaluate whether they are principal or agent for each transaction/jurisdiction.

Difference between IFRS and US GAAP

Sales and other similar taxes

605-45-15-2e
[IAS 18.8, IFRS 15.BC188A–188D]

The policy election available under US GAAP for the treatment of sales taxes is similar to the one that is currently available under US GAAP. The IASB decided not to provide a similar exception because it would reduce comparability and an analysis similar to that required under the new standard is required under current IFRS revenue requirements.

Therefore, consistent with current IFRS requirements, telecom entities applying IFRS assess taxes and regulatory fees and determine if they are collected on behalf of third parties to conclude whether they should be excluded from the transaction price. This would require an entity to consider whether it is acting in a manner similar to that of an agent or a principal with respect to such sales taxes (see 4.2.700 in *Insights into IFRS*, 13th Edition).

Observations

The treatment of sales taxes is an accounting policy choice under US GAAP

606-10-32-2A

Under US GAAP, entities are permitted to exclude amounts collected from customers for all sales and other similar taxes from the transaction price, as an accounting policy choice. This policy choice has to be applied consistently to all sales taxes. Telecom entities that make this election are also required to assess other sundry amounts billed to the customer to determine whether they represent a sales tax and are eligible to the practical expedient.

Changes in transaction price can be contract modifications

606-10-32-42 – 32-45
[IFRS 15.87–90]

The transaction price can change for various reasons. If the change arises as a result of a contract modification, then the entity applies the guidance on contract modifications (see Section 7 in Issues In-Depth, Edition 2016). For other changes in the transaction price, an entity applies the guidance described in 5.3.

4.1 Contractual minimum commitment or contracted service amount?

Requirements of the new standard

606-10-25-2, 32-4
[IFRS 15.10, 49]

A contract is an agreement between two or more parties that creates enforceable rights and obligations. The terms of the contract (including the period over which the contract is enforceable, see 2.1.1) and an entity's customary business practices are considered in determining the transaction price. Furthermore, in determining the transaction price, the entity assumes that the goods or services will be transferred to the customer as promised in the existing contract and that the contract will not be cancelled, renewed or modified.

Observations

Careful analysis of enforceable rights and obligations and customary business practices

Many contracts in the telecom industry require a customer to commit to a specified term (duration). In addition, these contracts often implicitly or explicitly require the customer to commit to a minimum level of service or a minimum monthly payment amount that cannot be decreased without terminating the contract and incurring termination penalties. In conjunction with this minimum commitment over the specified term, telecom entities may provide the customer with discounted goods or services (e.g. handsets or installation) that are typically delivered up front.

However, at the outset of the contract, or during the term of the contract, customers sometimes select (and the contract specifies) a level of service or monthly payment amount that may be higher than the minimum amount.

Such contractual terms raise a question about the enforceable rights and obligations of the telecom entity that have to be considered when determining the transaction price at contract inception. That is, the amount that a telecom entity "expects to be entitled in exchange for transferring the service" is either:

- the minimum amount to which the customer has committed for the contract term (the 'contractual minimum commitment'); or
- the actual amount for which the customer has contracted at contract inception (the 'contracted service amount').

Careful analysis of the facts and circumstances is required to determine the transaction price.

Example 29 – Determining the transaction price: Contractual minimum commitment

Telco T enters into a 24-month wireless voice and data services contract with Customer C. At contract inception, Telco T transfers a handset to Customer C, and Customer C pays 200 to Telco T, which is less than the stand-alone selling price of the handset.

The 24-month contract includes 1,000 monthly minutes of voice and 1GB of data usage for a monthly fee of 80 (Service Package A). During the two-year term, Customer C may decrease the service package to 500 monthly minutes of voice and 500MB of data usage for a monthly fee of 60 (Service Package B). (In other contracts, Telco T also offers an 'add-on' package of 500 minutes of voice and 500MB of data usage that can be added or dropped monthly at the customer's option.)

Customer C cannot reduce the service package below 60 without terminating the contract and incurring substantive termination penalties. In addition, Customer C can only reduce the service package in the month following that in which he provides notice.

Note that this example does not assess whether the contract includes a significant financing component.

After analyzing the terms and conditions of the contract, Telco T concludes that using the contractual minimum commitment approach to determine the transaction price would be appropriate.

Following this approach, the transaction price for the service is 1,460, calculated using one month at the contracted amount of 80 and 23 months at 60 per month for Service Package B, which is the minimum amount to which Customer C can reduce his service package without incurring penalties.

Thus, following this approach, the total transaction price is 1,660 (200 promised consideration for the handset and 1,460 promised consideration for the services).

See 5.2, Example 41 for allocating the transaction price.

Example 30 – Determining the transaction price: Contracted service approach

Telco X enters into a 24-month wireless voice and data services contract with Customer F. At contract inception, Telco X transfers a handset to Customer F, and Customer F pays 200 to Telco X, which is less than the stand-alone selling price of the handset.

The 24-month contract includes 800 monthly minutes of voice and 1GB of data usage for a monthly fee of 70. During the two-year term, Customer F cannot change the service package without terminating the contract and incurring substantive termination penalties.

However, Telco X has in limited circumstances allowed customers to downgrade their service without paying a termination penalty.

Note that this example does not assess whether the contract includes a significant financing component.

After analyzing the terms and conditions of the contract, Telco X concludes that using the contracted service approach to determine the transaction price would be appropriate.

Following this approach, the transaction price for the service is 1,680 (24 months at 70 per month), which is the amount specified in the contract.

Thus, the total transaction price for this contract is 1,880 (200 promised consideration for the handset and 1,680 promised consideration for the services).

See 5.2, Example 42 for allocating the transaction price.

Observations

Consider enforceable rights and obligations when determining the transaction price

In determining which approach is the more appropriate, telecom entities will need to carefully analyze all of the facts and circumstances, including the relevant contractual terms. After analyzing those facts, the approach that reflects the rights and obligations of the entity will be used to determine the transaction price.

The following explains the key difference between the approaches.

– The *contractual minimum commitment approach* accounts for any rights to obtain services above the contractual minimum commitment as an option to acquire additional goods or services, typically at their stand-alone selling prices. The transaction price includes the contracted amount in the first month and the contractual minimum amounts for the remaining months of the contract. (This approach also intersects with the guidance on customer options and material rights. See Section 8).

– In contrast, the *contracted service approach* accounts for the customer's initial commitment throughout the term of the contract and therefore any changes in those rights would be accounted for as a contract modification when they occur.

One example of a contractual right that may determine the accounting for the contract is the existence of a substantive penalty to move from a higher service package to a lower service package. That might suggest that there are enforceable rights and obligations relating to the higher service level. However, all of the contractual rights and obligations need to be considered in determining the appropriate accounting.

Practical implications of the contractual minimum commitment approach or the contracted service approach

Each approach has different practical implications for data requirements and on the accounting required by other parts of the new standard. For example, using the contractual minimum commitment requires an entity to gather data to determine the minimum amount for each service plan. However, there may be fewer implications for the future accounting if a customer changes the service plan to the minimum amount.

In contrast, if a customer makes a change to the service plan, under the contracted service approach, then the change will be accounted for as a contract modification, which could create complexity in the future accounting for the contract with commensurate system implications (see Section 7 in Issues In-Depth, Edition 2016 on contract modifications).

4.2 Variable consideration (and the constraint)

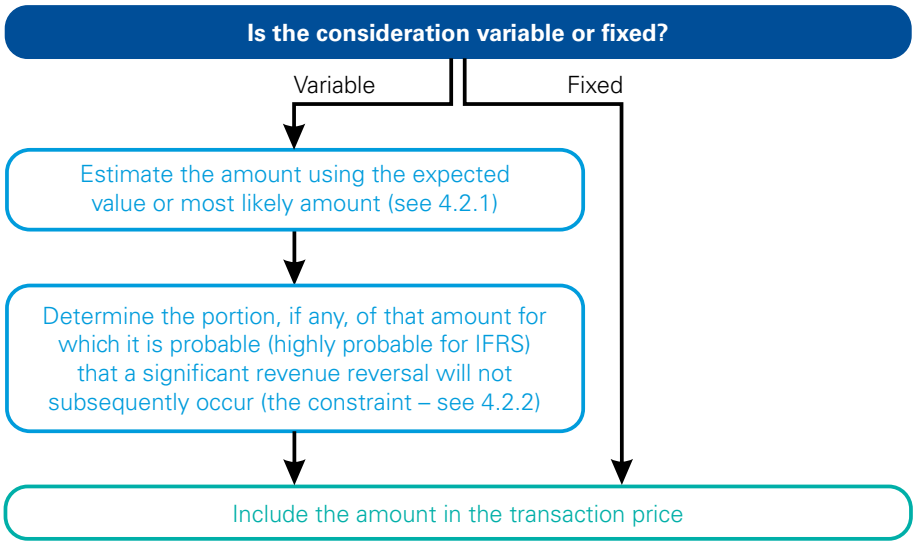
Requirements of the new standard

606-10-32-6 – 32-7
[IFRS 15.51–52]

Items such as discounts, rebates, refunds, rights of return, credits, price concessions, incentives, performance bonuses, penalties or similar items may result in variable consideration. Promised consideration also can vary if it is contingent on the occurrence or non-occurrence of a future event. Variability may be explicit or implicit, arising from customary business practices, published policies or specific statements, or any other facts and circumstances that would create a valid expectation by the customer.

606-10-32-8, 32-11, 32-13
[IFRS 15.53, 56, 58]

An entity assesses whether, and to what extent, it can include an amount of variable consideration in the transaction price at contract inception. The following flow chart sets out how an entity determines the amount of variable consideration in the transaction price, except for sales- or usage-based royalties from licenses of intellectual property.



Example 31 – Enterprise service contract with usage fee treated as variable consideration

Telco A enters into a contract with enterprise Customer C to provide call center services. These services include providing dedicated infrastructure and staff to stand ready to answer calls. Telco A receives consideration of 0.50 per minute for each call answered.

Telco A observes that Customer C does not make separate purchasing decisions every time a user places a call to the center. Therefore, Telco concludes that its performance obligation is the overall service of standing ready to provide call-center services, rather than each call answered being the promised deliverable. It therefore concludes that the per-minute fee is variable consideration.

The accounting for this contract, including measurement of progress, is further discussed in Example 50 (see 6.3).

Observations

Consideration can be deemed to be variable even if the price stated in the contract is fixed

ASU 2014-09.BC190–BC194
[IFRS 15.BC190–BC194]

The guidance on variable consideration may apply to a wide variety of circumstances in the telecom industry. The promised consideration may be variable if an entity's customary business practices and relevant facts and circumstances indicate that the entity may accept a price lower than that stated in the contract – i.e. the contract contains an implicit price concession, or the entity has a history of providing price concessions or price support to its customers.

In these cases, it may be difficult to determine whether the entity has implicitly offered a price concession, or whether it has chosen to accept the risk of default by the customer of the contractually agreed-upon consideration (customer credit risk). Entities need to exercise judgment and consider all of the relevant facts and circumstances in making this determination.

Telecom entities may provide other credits that may be viewed as variable consideration, including one-time credits such as goodwill or retention credits (see 4.3).

A fixed rate per unit of output may be variable consideration

When an entity enters into a contract with a customer for an undefined quantity of output at a fixed contractual rate per unit of output, the consideration may be variable. In some cases there may be substantive contractual terms that indicate a portion of the consideration is fixed – e.g. contractual minimums.

For contracts with undefined quantities, it is important to appropriately evaluate the entity's underlying promise to determine how the variability created by the unknown quantity should be treated under the new standard. For example, the entity's underlying promise could be a series of distinct goods or services (see 3.4.2), an obligation to provide the specified goods or services, or a stand-ready obligation (see Example 31). Unknown quantities could also represent customer options for which the entity will need to consider whether a material right exists (see Section 8).

Some charges that depend on usage are not considered to be variable consideration

606-10-55-340 – 55-342 (Example 50)
[IFRS 15.IE254–IE256]

Many telecom consumer contracts allow the customer to elect to purchase usage in excess of the contractual network service amounts. The price for the excess usage is specified in the contract. When the amounts charged for the excess usage are based on the stand-alone selling price of that usage, the amounts are not estimated and are not included in the determination of the transaction price. This is because they represent an option to purchase additional distinct goods or services at their stand-alone selling price (see Section 8).

Volume discounts or rebates may be variable consideration or may convey a material right

Some large business telecom contracts may include volume-based or other discounts. Different structures of discounts and rebates may have a different effect on the transaction price. For example, some agreements provide a discount or rebate that applies to all purchases made under the agreement – i.e. the discount or rebate applies on a retrospective basis once a volume threshold is met. In other cases, the discounted purchase price may only apply to future purchases once a minimum volume threshold has been met.

If a discount applies retrospectively to all purchases under the contract once the threshold is achieved, then it represents variable consideration. In this case, the entity estimates the volumes to be purchased and the resulting discount in determining the transaction price and updates that estimate throughout the term of the contract.

However, if a tiered pricing structure provides discounts for future purchases only after volume thresholds are met, then the entity evaluates the arrangement to determine whether the arrangement conveys a material right to the customer (see Section 8). If a material right exists, then this is a separate performance obligation, to which the entity allocates a portion of the transaction price. If a material right does not exist, then there are no accounting implications for the transactions completed before the volume threshold is met, and purchases after the threshold has been met are accounted for at the discounted price.

Termination penalties

606-10-32-4
[IFRS 15.49]

When determining the transaction price, a telecom entity assumes that the contract will not be cancelled, renewed or modified. Therefore, termination penalties should not be included in the determination of the transaction price. However, when the termination penalties are not substantive, and as a result the contract term is assessed as less than the stated term (see 2.1.1), it is necessary to assess if the termination penalty should be included in the transaction price. In all cases, the treatment of a termination penalty should be consistent with the assessment of the contract term.

Example 32 – Enterprise contract with SLA penalties

Telco B enters into an agreement to provide data hosting services to a large business customer, C, for a period of five years. Certain SLAs are agreed to by Telco B as part of the contract with Customer C. Specifically, the SLAs will result in a reduction of consideration paid by Customer C to Telco B, if Telco B does not meet a specified level of service. Because the SLAs are part of the contract with Customer C, the SLA penalties create variable consideration.

Therefore, Telco B estimates the amount of the penalties at contract inception in determining the transaction price.

Observations

SLA penalties can represent variable consideration or a product warranty

606-10-32-6
[IFRS 15.51]

Some telecom entities may enter into SLAs that result in penalties if the entity's performance fails to achieve certain specifications. Penalties are explicitly referred to in the new standard as an example of variable consideration. However, in some circumstances these provisions may be similar to a warranty on the promised goods and services (see 3.8).

4.2.1 Estimate the amount of variable consideration

Requirements of the new standard

606-10-32-8
[IFRS 15.53]

When estimating the transaction price for a contract with variable consideration, an entity's initial measurement objective is to determine which of the following methods better predicts the consideration to which the entity will be entitled.

Expected value	The entity considers the sum of probability-weighted amounts for a range of possible consideration amounts. This may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.
Most likely amount	The entity considers the single most likely amount from a range of possible consideration amounts. This may be an appropriate estimate of the amount of variable consideration if the contract has only two (or perhaps a few) possible outcomes.

606-10-32-9
[IFRS 15.54]

ASU 2014-09.BC195
[IFRS 15.BC195]

The method selected is applied consistently throughout the contract and to similar types of contracts when estimating the effect of uncertainty on the amount of variable consideration to which the entity will be entitled.

Example 33 – Estimate of variable consideration: Expected value

Telco A agrees to sell to Business C, its customer, voice minutes over a period of one year. Business C promises to pay 0.15 per minute for the first 100,000 minutes. If minutes purchased exceed 100,000 minutes, then the price falls to 0.12 per minute for all minutes purchased (i.e. the price is reduced retrospectively). If the minutes purchased exceed 150,000, then the price falls to 0.10 per minute for all minutes purchased (i.e. the price is reduced retrospectively). Based on Telco A's experience with similar arrangements, it estimates the following outcomes.

Minutes used	Probability
Less than 100,000	70%
100,000 to 150,000	20%
Over 150,000	10%

Telco A determines that the expected value method provides the better prediction of the amount of consideration to which it expects to be entitled. As a result, it estimates the transaction price to be 0.14 per minute (i.e. (0.15 × 70%) + (0.12 × 20%) + (0.10 × 10%)).

Example 34 – Estimate of variable consideration: Most likely amount

Telco B enters into a contract with a customer to build a call center. Depending on when the asset is completed, Telco B will receive either 110,000 or 130,000.

Outcome	Consideration	Probability
Call center is completed on time	130,000	90%
Call center is delayed	110,000	10%

Because there are only two possible outcomes under the contract, Telco B determines that using the most likely amount provides the better prediction of the amount of consideration to which it expects to be entitled. Telco B estimates the transaction price to be 130,000, which is the single most likely amount.

Observations

All facts and circumstances are considered when selecting estimation method

ASU 2014-09.BC200
[IFRS 15.BC200]

The use of a probability-weighted estimate, especially when there are binary outcomes, could result in revenue being recognized at an amount that is not a possible outcome under the contract. In such situations, using the most likely amount may be more appropriate. However, all facts and circumstances need to be considered when selecting the method that best predicts the amount of consideration to which a telecom entity will be entitled.

606-10-32-8, 32-11, 32-34a, ASU 2014-09.BC200
[IFRS 15.53, 56, 79(a), BC200]

Historical experience may be a source of evidence

An entity may use a group of similar transactions as a source of evidence when estimating variable consideration, particularly under the expected value method. The estimates using the expected value method are generally made at the contract level, not at the portfolio level. Using a group as a source of evidence in this way is not itself an application of the portfolio approach (see 1.4).

For example, an entity may enter into a large number of similar contracts whose terms include a performance bonus. Depending on the outcome of each contract, the entity will either receive a bonus of 100 or will not receive any bonus. Based on its historical experience, the entity expects to receive a bonus of 100 in 60 percent of such contracts. To estimate the transaction price for future individual contracts of this nature, the entity considers its historical experience and estimates that the expected value of the bonus is 60. This example illustrates that when an entity uses the expected value method, the transaction price may be an amount that is not a possible outcome of an individual contract.

The entity needs to use judgment to determine whether the number of similar transactions is sufficient to develop an expected value that is the best estimate of the transaction price for the contract and whether the constraint (see 4.2.2) should be applied.

4.2.2 Determine the amount for which it is probable (highly probable for IFRS) that a significant reversal will not occur ('the constraint')

Requirements of the new standard

606-10-32-11
[IFRS 15.56]

After estimating the variable consideration, an entity may include some or all of it in the transaction price – but only to the extent that it is probable (highly probable for IFRS) that a significant reversal in the amount of cumulative revenue will not occur when the uncertainty associated with the variable consideration is subsequently resolved.

606-10-32-12
[IFRS 15.57]

To assess whether – and to what extent – it should apply this constraint, an entity considers both the:

- likelihood of a revenue reversal arising from an uncertain future event; and
- potential magnitude of the revenue reversal when the uncertainty related to the variable consideration has been resolved.

In making this assessment, the entity uses judgment, giving consideration to all facts and circumstances – including the following factors, which could increase the likelihood or magnitude of a revenue reversal.

- The amount of consideration is highly susceptible to factors outside of the entity's influence – e.g. volatility in a market, the judgment or actions of third parties, weather conditions and a high risk of obsolescence.
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- The entity's experience with (or other evidence from) similar types of contracts is limited, or has limited predictive value.
- The entity has a practice of either offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances.
- The contract has a large number and a broad range of possible consideration amounts.

606-10-32-14
[IFRS 15.59]

This assessment needs to be updated at each reporting date.

Difference between IFRS and US GAAP

Level of confidence – A difference in wording only

ASU 2014-09.BC208–BC212
[IFRS 15.BC208–BC212]

The term 'highly probable' in the IFRS version of the new standard has been used with the intention of converging with the term 'probable' as used in the US GAAP version of the new standard. The IASB took a similar approach in IFRS 5.

Observations

Constraint assessment made against cumulative revenue

When constraining its estimate of variable consideration, a telecom entity assesses the potential magnitude of a significant revenue reversal relative to the cumulative revenue recognized – i.e. for both variable and fixed consideration, rather than on a reversal of only the variable consideration. The assessment of magnitude is relative to the transaction price for the contract, rather than the amount allocated to the specific performance obligation.

Specified level of confidence included in constraint requirements

ASU 2014-09.BC209
[IFRS 15.BC209]

The inclusion of a specified level of confidence – 'probable' ('highly probable' under IFRS) – clarifies the notion of whether a telecom entity *expects* a significant revenue reversal. The use of existing defined terms should improve consistency in application between preparers, and reduce concerns about how regulators and users will interpret the requirement. This is an area of significant judgment, and entities will need to align their judgmental thresholds, processes and internal controls with these new requirements. Documenting these judgments will also be critical.

ASU 2014-09.BC207
[IFRS 15.BC207]

Constraint introduces an element of prudence

The constraint introduces a downward bias into estimates, requiring entities to exercise prudence before they recognize revenue – i.e. they have to make a non-neutral estimate. This exception to the revenue recognition model, and to the Boards' respective conceptual frameworks' requirement to make neutral estimates, reflects the particular sensitivity with which revenue reversals are viewed by many users and regulators.

Comparison with current IFRS

Estimation uncertainty limits rather than precludes revenue recognition

[IAS 18.14(c)]

The constraint is a significant change in accounting for revenue under IFRS.

Under current IFRS, an entity recognizes revenue only if it can reliably estimate the amount – so uncertainty over the outcome may preclude revenue recognition. By contrast, the constraint sets a ceiling – it limits rather than precludes revenue recognition.

Comparison with current US GAAP

Applying the constraint

SEC SAB Topic 13

Unlike current US GAAP, the new standard requires an entity to estimate variable consideration and apply the constraint in determining the transaction price, rather than assessing whether the amount is fixed or determinable. This will result in earlier revenue recognition in a number of circumstances.

4.3 Consideration payable to a customer

Requirements of the new standard

606-10-32-25
[IFRS 15.70]

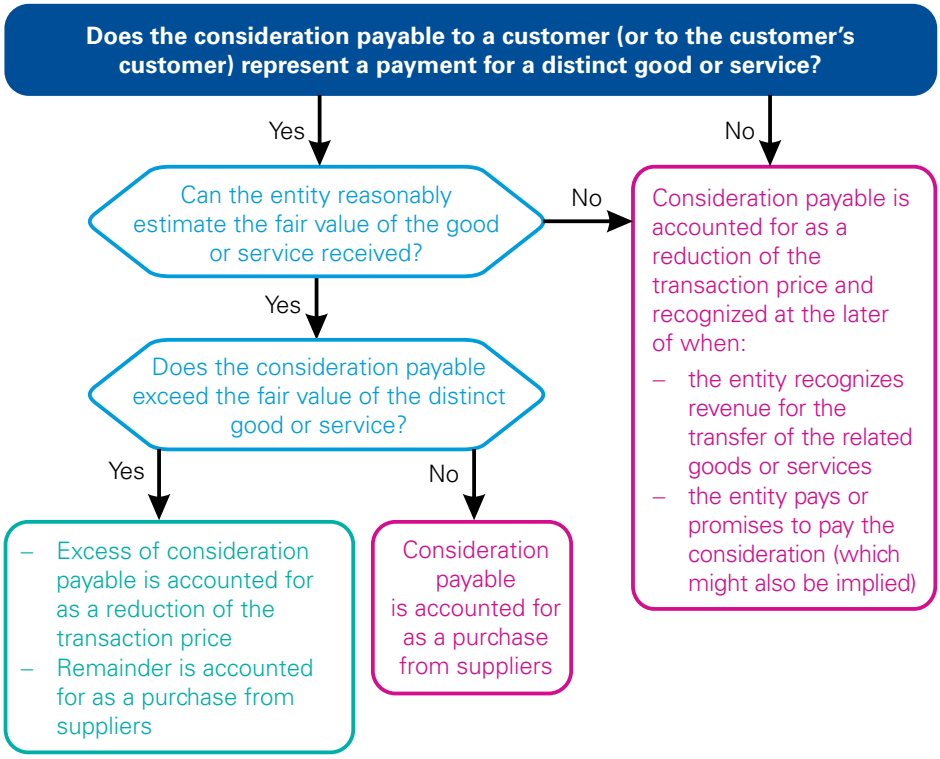
Consideration payable to a customer includes cash amounts that an entity pays or expects to pay to the customer, or to other parties that purchase the entity's goods or services from the customer. Consideration payable to a customer also includes credits or other items – e.g. a coupon or voucher – that can be applied by the customer against the amount owed to the entity or to other parties that purchase the entity's goods or services from the customer.

An entity evaluates the consideration payable to a customer to determine whether the amount represents a reduction of the transaction price, a payment for distinct goods or services, or a combination of the two.

606-10-32-26
[IFRS 15.71]

If the entity cannot reasonably estimate the fair value of the good or service received from the customer, then it accounts for all of the consideration payable to the customer as a reduction of the transaction price.

606-10-32-25 – 32-27
[IFRS 15.70–72]



Example 35 – Goodwill credits

Customer C has a two-year network service contract with Telco A. In Month 6, Telco A experiences two-days of service quality issues. Past experience indicates that service quality issues are infrequent for Telco A.

In Month 7, Customer C receives a bill of 100 for Month 6 services. On receiving the bill, Customer C calls Telco A and requests a credit for the service outage. Telco A grants Customer C a credit of 5.

Because the credit can be applied against amounts owed to Telco A, it should be accounted for as consideration payable to the customer. And, because the payment is not in exchange for a distinct good or service, the consideration is accounted for as a reduction of the transaction price.

Telco A considers whether the credit could have been considered to be akin to a discount or a price concession and therefore within the definition of variable consideration to be estimated at the time of entering into the contract with Customer C (i.e. at the beginning of Month 1). However, Telco A notes that service quality issues are infrequent. When they do occur, Telco A generally does not provide credits to customers. Furthermore, customers do not have an expectation that they will receive such credits at contract inception. Thus, the goodwill credit is not considered to be variable consideration to be estimated at contract inception.

Telco A considers the guidance on allocating the change in transaction price (see 5.3) and concludes that the credit is recognized as a reduction of revenue to be estimated at contract inception only when Telco A grants Customer C the credit (i.e. when Telco A promises to pay the consideration), which occurs in Month 7.

Example 36 – Credits to a new customer

Customer C is currently in the middle of a two-year contract with Telco B, his current wireless service provider, and would be required to pay an early termination penalty if he terminated the contract today.

If Customer C cancels the existing contract with Telco B and signs a two-year contract with Telco D for 80 per month, then Telco D promises at contract inception to give Customer C a one-time credit of 200 (referred to as a 'port-in credit'). The amount of the port-in credit does not depend on the volume of service subsequently purchased by Customer C, during the two-year contract.

Telco D determines that it should account for the port-in credit as consideration payable to a customer. This is because the credit will be applied against amounts owing to Telco D. Because Telco D does not receive any distinct goods or services in exchange for this credit, it will account for it as a reduction of the transaction price (i.e. 80 × 24 – 200). In this case, Telco D has promised the credit at contract inception; therefore, the timing of actual payment is not relevant for the purpose of determining the transaction price. Therefore, Telco D will recognize the reduction in the transaction price as the promised goods or services are transferred.

Observations

Amounts payable to a customer may be either variable consideration or consideration payable to a customer

Telecom entities provide credits to customers for a variety of reasons – e.g. goodwill credits, port-in-credits, and credits resulting from pricing or billing disputes. Many of these credits may be consideration payable to the customer.

The new standard states that consideration payable to a customer includes amounts that a telecom entity pays, or expects to pay, to a customer or to other parties that purchase the telecom entity's goods or services from the customer. The guidance on consideration payable to a customer states that it is recognized at the later of when the telecom entity recognizes revenue or when the telecom entity pays or promises to pay the consideration. However, because consideration payable to a customer can be included in the transaction price, it can also be a form of variable consideration.

Variable consideration is estimated and included in the transaction price at contract inception, and remeasured at each subsequent financial reporting date. This is different from the guidance on when to recognize consideration payable to a customer.

This discrepancy puts pressure on the determination, at contract inception, of whether the telecom entity intends to provide an incentive or the customer has a reasonable expectation that an incentive will be provided.

This evaluation includes an assessment of the telecom entity's past practice and other activities that could give rise to an expectation at contract inception that the transaction price includes a variable component. The consideration payable to a customer guidance is used only when an entity has not promised a payment to the customer at contract inception, either implicitly (including through its customary business practice) or explicitly.

Guidance on consideration payable to a customer may apply to handset trade-in programs

Telecom entities may purchase a new customer's existing handset, when entering a new wireless contract. In these cases, the telecom entity purchases a distinct good from the customer, which is recorded in accordance with the applicable inventory guidance. Accordingly, if the fair value of the handset is less than its cost, then the difference is consideration payable to a customer and reduces the transaction price.

See Section 11 for repurchases or trade-in of handsets sold by the telecom entity.

Scope of consideration payable to a customer is wider than payments made under the contract

Payments made to a customer that are not specified in the contract may still represent consideration payable to a customer. A telecom entity will need to develop a process for evaluating whether any other payments made to a customer are consideration payable that requires further evaluation under the new standard.

The determination of how broadly payments within a distribution chain should be evaluated requires judgment. However, a telecom entity need not always identify and assess all amounts ever paid to a customer to determine if they represent consideration payable to a customer.

Payments through indirect channels require analysis

Many telecom entities enter into contractual arrangements with third-party distributors or retailers that sell the entity's equipment and services (often referred to as an 'indirect channel sale'). These arrangements often require telecom entities to make payments to those third parties, which are sometimes passed on to the end customer (see Section 10).

Comparison with current IFRS

Customer incentives

[IFRIC 13]

Accounting for customer incentives and similar items is a complex area for which there is limited guidance under current IFRS, other than specific guidance on customer loyalty programs (see 10.4.2 in Issues In-Depth, Edition 2016). Customer incentives take many forms, including cash incentives, discounts and volume rebates, free or discounted goods or services, customer loyalty programs, loyalty cards and vouchers.

Currently, there is some diversity in practice over whether incentives are accounted for as a reduction in revenue, an expense or a separate deliverable (as in the case of customer loyalty programs), depending on the type of incentive. The requirements of the new standard may change the accounting for some telecom entities.

Comparison with current US GAAP

No rebuttable presumption

605-50-45-2

Under current US GAAP, cash payments made from an entity to a customer are presumed to be a reduction of revenue. This presumption can be overcome if the entity receives an identifiable benefit in exchange for the cash payment and the fair value of the benefit can be reasonably estimated.

Unlike current US GAAP, the new standard requires an entity to evaluate whether it receives distinct goods or services in exchange for its payment to a customer, instead of whether the entity has received an identifiable benefit. Although these concepts appear to be similar, the new standard does not contain the rebuttable presumption that the payment is a reduction of revenue, which exists under current US GAAP.

Other parties in the distribution chain

605-50-15-2

Similar to current US GAAP, the new standard requires an entity to consider other parties in the distribution chain that purchase the entity's goods or services from the entity's customer when applying the guidance on consideration payable to the customer. However, judgment needs to be applied to evaluate the nature of the transaction with a customer's customer in order to conclude whether the transaction should be included in the determination of the transaction price (see Section 10).

Reduction of revenue may be recognized earlier in some cases

605-50-25-3

The new standard indicates that consideration payable to a customer might be implied by the entity's customary business practices. Under current US GAAP, consideration payable to a customer is recognized at the later of when revenue is recognized and when an offer is made to a customer – which some have interpreted to be when an explicit offer is made to the customer. When an entity's promise to pay the consideration is implied by its customary business practices, the consideration payable to a customer that is accounted for as a reduction of revenue could be recognized earlier under the new standard than under current US GAAP.

4.4 Significant financing component

Requirements of the new standard

606-10-32-15
[IFRS 15.60]

To estimate the transaction price in a contract, an entity adjusts the promised amount of consideration for the time value of money if that contract contains a significant financing component.

606-10-32-16
[IFRS 15.61]

The objective when adjusting the promised amount of consideration for a significant financing component is to recognize revenue at an amount that reflects what the cash selling price of the promised good or service would have been if the customer had paid cash at the same time as control of that good or service transferred to the customer. The discount rate used is the rate that would be reflected in a separate financing transaction between the entity and the customer at contract inception.

To make this assessment, an entity considers all relevant factors – in particular the:

- difference, if any, between the amount of promised consideration and the cash selling price of the promised goods or services;
- combined effect of the expected length of time between the entity transferring the promised goods or services to the customer and the customer paying for those goods or services; and
- prevailing interest rates in the relevant market.

606-10-32-17
[IFRS 15.62]

A contract does not have a significant financing component if any of the following factors exists.

Factor	Example
An entity receives an advance payment and the timing of the transfer of goods or services to a customer is at the discretion of the customer	A prepaid phone card or customer loyalty points
A substantial portion of the consideration is variable, and the amount or timing of the consideration is outside the customer's or entity's control	A transaction whose consideration is a sales-based royalty
The difference between the amount of promised consideration and the cash selling price of the promised goods or services arises for non-finance reasons	Protection from the counterparty not completing its obligations under the contract

606-10-32-19
[IFRS 15.64]

The new standard indicates that:

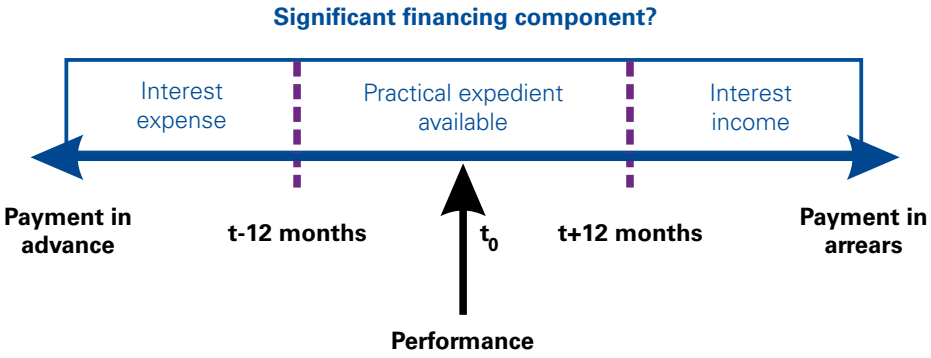
– an entity should determine the discount rate at contract inception, reflecting the credit characteristics of the party receiving credit; and

– the discount rate should not generally be updated for a change in circumstances.

606-10-32-18
[IFRS 15.63]

As a practical expedient, an entity is not required to adjust the transaction price for the effects of a significant financing component if, at contract inception, the entity expects the period between customer payment and the transfer of goods or services to be one year or less.

For contracts with an overall duration greater than one year, the practical expedient applies if the period between performance and payment for that performance is one year or less.



606-10-32-20
[IFRS 15.65]

The financing component is recognized as interest expense (when the customer pays in advance) or interest income (when the customer pays in arrears), and is presented separately from revenue from customers.

Observations

Assessment is undertaken at the individual contract level

ASU 2014-09.BC234
[IFRS 15.BC234]

A telecom entity determines the significance of the financing component at an individual contract level, rather than at a performance obligation or portfolio level. The individual contract level for a particular customer could consist of more than one contract if the contract combination criteria in the new standard are met. However, the Boards believe that it would be unduly burdensome to require an entity to account for a financing component if the effects of the financing component are not material to the individual contract, but the combined effects for a portfolio of similar contracts would be material to the entity as a whole. An entity should apply judgment in evaluating whether a financing component is significant to the contract.

As a practical matter, it may be appropriate to perform the assessment for each type of telecom offering rather than for each individual contract.

Example 37 – Wireless installment plan with a two-year service contract

Telco M enters into a contract with Customer J for a two-year wireless service plan at 125 per month (which also represents its stand-alone selling price). In the same contract, Customer J also purchases a handset and selects from the following two payment options:

– up front for a price of 600, which is its stand-alone selling price; or

– 30 per month over the two-year contract term (i.e. an installment plan).

Telco M does not charge a stated interest rate to the customer for selecting an installment plan for the handset. Telco M determines that the contract term for accounting purposes is two years.

Does the installment plan include a significant financing component?

	Total consideration paid if installment plan is selected	Total consideration paid if installment plan is NOT selected
Wireless service	3,000 (125 x 24 months)	3,000 (125 x 24 months)
Handset	720 (30 x 24 months)	600
Total	**3,720**	**3,600**

The installment plan creates a difference in timing between performance and payment, because the handset is delivered on day one and its payment occurs over 24 months. Consequently, the installment plan represents a financing transaction.

The contract does not specify an interest rate. However, there is a 120 difference between the 'cash selling price' (i.e. 600) of the handset and the sum of the payments under the installment plan (i.e. 720). Telco M therefore uses this difference and the payment of 30 per month for 24 months to determine the implicit interest rate in the contract, which is 19.7%. Telco M also concludes that this rate reflects the rate that would be used by Telco M and Customer J in a separate financing transaction.

Therefore, Telco M uses the financing component of 120, calculated above, to determine if it is significant. Telco M determines that the relative value of the financing component of 120 to the total contract price is approximately 3%. Telco M concludes that a financing component that represents 3% of the contract price is not significant to the contract as a whole and does not account for a financing component for this contract.

Example 38 – Wireless subsidized handset with a two-year service contract

Telco R enters into a contract with Customer S for a two-year wireless service plan at 85 per month (stand-alone selling price is 65 per month). In the same contract, Customer S also purchases a handset for 130 (stand-alone selling price is 630). Telco R determines that the contract term for accounting purposes is two years.

The transaction price and stand-alone selling prices in the contract are summarized as follows.

	Transaction price	Stand-alone selling price
Wireless service	2,040 (85 x 24 months)	1,560 (65 x 24 months)
Handset	130	630
Total	**2,170**	**2,190**

There is a difference in timing between performance and payment because the handset is delivered on day one and payment for at least a portion of that handset occurs over 24 months. Consequently, the contract includes a financing transaction.

However, because there is an overall discount on the bundle (2,170 transaction price versus 2,190 stand-alone selling price), Telco R needs to allocate that discount before determining whether the financing component is significant. This is because it is necessary to determine the cash flows that relate specifically to the handset. To allocate that discount, Telco R allocates the transaction price based on relative stand-alone selling prices (see Section 5). This results in an allocation of 624 to the handset and 1,546 to the wireless service.

The contract does not specify an interest rate. Telco R concludes that 7% reflects the rate that would be used by Telco R and Customer S in a separate financing transaction. (This rate is assessed as reasonable given the customer's facts and circumstances). Telco R then calculates the present value of the payment stream related to the handset (i.e. 624 less 130 repaid over 24 months) using the discount rate of 7%, which results in an imputed interest component of 33. The relative value of the financing component of 33, compared with the total contract price, is less than 2%. Telco R concludes that a financing component that represents less than 2% of the contract is not significant and does not account for a financing component in this contract.

Example 39 – Month-to-month wireless contract with handset installment plan

Continuing Example 9 in Step 1 (see 2.1.1). The facts of that example are repeated here for convenience.

- Telco A enters into a one-month wireless contract with Customer C that includes voice and data services and a handset. The monthly service fee represents the price charged to customers that bring their own device (i.e. it is the stand-alone selling price of the service). After Month 1, the service fee is the then stand-alone selling price for that plan.
- Customer C makes no up-front payment for the phone but will pay its stand-alone selling price by monthly installments over 24 months. There is no additional interest charge for the financing. Full repayment of the remaining balance of the phone becomes due if Customer C fails to renew the monthly service contract. There is no other amount due if Customer C does not renew.

In Example 9, it was concluded that the term of the contract is one month. Telco A then needs to assess if the installment plan on the handset conveys a significant financing component to the customer.

In making that assessment, Telco A observes that installment payments are due immediately if the service contract is not renewed. Thinking about this conditionality and the contract term together, Telco A may conclude that either the financing component may not be significant or the practical expedient applies. In such cases, Telco A would not adjust the transaction price for the financing component. Telco A also needs to consider the applicable financial instrument guidance in the measurement of any receivable resulting from the installment plan.

Observations

No significant financing component if the timing of transfer of goods or services is at customer's discretion

ASU 2014-09.BC233a
[IFRS 15.BC233(a)]

Customers pay for some types of goods or services in advance – e.g. prepaid phone cards, gift cards and customer loyalty points – and the transfer of the related goods or services to the customer is at the customer's discretion. In these cases, the contracts do not include a significant financing component, because the payment term does not relate to a financing arrangement. Also, the Boards believe that the costs of requiring an entity to account for the financing component in these situations would outweigh any perceived benefits, because the entity would not know – and would therefore have to continually estimate – when the goods or services will transfer to the customer.

Using an interest rate that is explicitly specified in the contract may not always be appropriate

ASU 2014-09.BC239–BC241
[IFRS 15.BC239–BC241]

It may not always be appropriate to use an interest rate that is explicitly specified in the contract, because the entity might offer below-market financing as a marketing incentive. Consequently, an entity applies the rate that would be used in a separate financing transaction between the entity and its customer that does not involve the provision of goods or services.

This can lead to practical difficulties for telecom entities with large volumes of customer contracts and/or multinational operations, because they will have to determine a specific discount rate for each customer, class of customer or geographic region of customer.

A contract with an implied interest rate of zero may contain a financing component

When the consideration to be received for a good or service with extended payment terms is the same as the cash selling price, the implied interest rate is zero. However, a significant financing component may still exist.

For example, telecom entities sometimes offer a promotional incentive that allows customers to buy handsets and pay the cash selling price over two years after delivery. Judgment is required to evaluate whether in these circumstances an entity is offering a discount or other promotional incentive for customers who pay the cash selling price at the end of the promotional period equal to the financing charge that would otherwise have been charged in exchange for financing the purchase.

If the telecom entity concludes that financing has been provided to the customer, then the transaction price is reduced by the implicit financing amount and interest income is accreted. The implicit financing amount is calculated using the rate that would be used in a separate financing transaction between the telecom entity and its customer.

Presentation of interest income as revenue is not precluded

ASU 2014-09.BC247
[IFRS 15.BC247]

The new standard does not preclude a telecom entity from presenting interest income (when it has provided financing to the customer) as a type of revenue if the interest represents income arising from ordinary activities – e.g. entities that have significant lending operations.

Comparison with current IFRS

No specific guidance for advance payments

[IAS 18.11]

Under current IFRS, an entity discounts consideration to a present value if payment is deferred and the arrangement effectively constitutes a finance transaction. However, current IFRS is silent on whether an entity adjusts consideration if payment is received in advance.

Comparison with current US GAAP

Advance payments

835-30-15-3b

Amounts that do not require repayment in the future, but that will instead be applied to the purchase price of the property, goods or services involved, are currently excluded from the requirement to impute interest. This is because the liability – i.e. deferred revenue – is not a financial liability.

The requirements under the new standard are a change from current practice and may particularly impact contracts in which payment is received significantly earlier than the transfer of control of goods or services.

When the financing component is significant to a contract, an entity increases the contract liability and recognizes a corresponding interest expense for customer payments received before the delivery of the good or service. When it satisfies its performance obligation, the entity recognizes more revenue than the cash received from the customer, because the contract liability has been increased by the interest expense that has accreted.

4.5 Noncash consideration

Requirements of the new standard

606-10-32-21 – 32-22
[IFRS 15.66–67]

Noncash consideration received from a customer is measured at fair value. If an entity cannot make a reasonable estimate of the fair value, then it refers to the estimated selling price of the promised goods or services.

606-10-32-23
[IFRS 15.68]

Estimates of the fair value of noncash consideration may vary. Although this may be due to the occurrence or non-occurrence of a future event, it can also vary due to the form of the consideration – e.g. variations due to changes in the price per share if the noncash consideration is an equity instrument.

When the fair value of noncash consideration varies for reasons other than the form of the consideration, those changes are reflected in the transaction price and are subject to the guidance on constraining variable consideration.

US GAAP only

606-10-32-21

Noncash consideration is measured at contract inception.

Comparison with current IFRS

Changes in the measurement threshold

[IAS 18.12, IFRS 2]

The requirement to measure noncash consideration at fair value is broadly similar to the current IFRS requirements. However, under current IFRS, when the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by any cash transferred. By contrast, under the new standard, the entity measures the transaction price at the stand-alone selling price of the goods or services transferred.

Furthermore, the threshold for using the fair value of the noncash consideration as the measurement basis is that the entity can 'reliably measure' the fair value, not 'reasonably estimate' it.

Barter transactions involving advertising services

[SIC-31]

Currently, revenue from advertising barter transactions is measured at the fair value of the advertisement services given, if their fair value can be measured reliably. Furthermore, an exchange of similar advertisement services is not a transaction that generates revenue under current IFRS.

The new standard does not contain any specific guidance on the accounting for barter transactions involving advertising services; therefore, the general principles for measuring consideration apply.

Transfer of assets from customers

[IFRIC 18]

Unlike current IFRS, the new standard does not contain any specific guidance on transfers of items of property, plant and equipment that entities receive from their customers. However, if a telecom entity recognizes revenue on the transfer, then there is no change in the measurement attribute, and the entity continues to measure revenue at the fair value of the item transferred.

Comparison with current US GAAP

Exchanges of non-monetary assets

845-10-30-3 – 30-4

The accounting for non-monetary transactions based on fair value under the new standard is broadly consistent with the current US GAAP on non-monetary transactions, except for those in which the consideration received from the customer is a share-based payment.

One of the requirements for a contract to exist under the new standard is that it has commercial substance, which would result in non-monetary exchanges being accounted for at fair value. Under the new standard, if an entity cannot reasonably estimate the fair value of the noncash consideration received, then it looks to the estimated selling price of the promised goods or services.

However, under current US GAAP, rather than looking to the estimated selling price of the promised goods or services, the telecom entity uses the fair value of either the assets received or the assets relinquished in the exchange – unless the fair value of the assets cannot be determined within reasonable limits, or the transaction lacks commercial substance.

Topic 845, 605-20-25-14 – 25-18

Use of the estimated selling price

The alternative of using the estimated selling price of the promised goods or services if the fair value of the noncash consideration cannot be reasonably estimated may result in differences from current practice if an entity uses the stand-alone selling price rather than following the guidance for other fair value measurements.

In addition, the new standard eliminates the specific requirements on determining whether sufficient evidence exists – including prescriptive guidance requiring sufficient recent cash transactions to support the selling price – when recognizing revenue on exchanges of advertising space and exchanges involving barter credit transactions. Rather, under the new standard a telecom entity recognizes revenue based on the fair value of the services received if that fair value can be reasonably estimated in a barter transaction involving advertising services. If not, the entity recognizes revenue based on the estimated stand-alone selling price of the services provided.

However, a telecom entity will need to conclude that the contract has commercial substance – i.e. that it will change the amount, timing or uncertainty of the contract's future cash flows – in order to conclude that a contract exists; otherwise, no revenue is recognized because the requirements for a contract under the new standard are not met.

5 Step 4: Allocate the transaction price to the performance obligations in the contract

Overview

606-10-32-28, 32-30
[IFRS 15.73, 75]

The transaction price is allocated to each performance obligation – generally each distinct good or service – to depict the amount of consideration to which a telecom entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

606-10-32-29
[IFRS 15.74]

A telecom entity generally allocates the transaction price to each performance obligation in proportion to its stand-alone selling price. However, when specified criteria are met, a discount or variable consideration is allocated to one or more, but not all, performance obligations.

In wireless transactions, when subsidized handsets are bundled with service plans, the new allocation requirements will often result in higher equipment revenue and lower service revenue compared with existing practices.

The telecom industry also may face challenges in determining stand-alone selling prices due to variations in plans and fast-changing conditions in the market.

606-10-32-31
[IFRS 15.76]

This step of the revenue model comprises two sub-steps that a telecom entity performs at contract inception.

Determine stand-alone selling prices (see 5.1) → **Allocate the transaction price (see 5.2)**

5.1 Determine stand-alone selling prices

Requirements of the new standard

606-10-32-32
[IFRS 15.77]

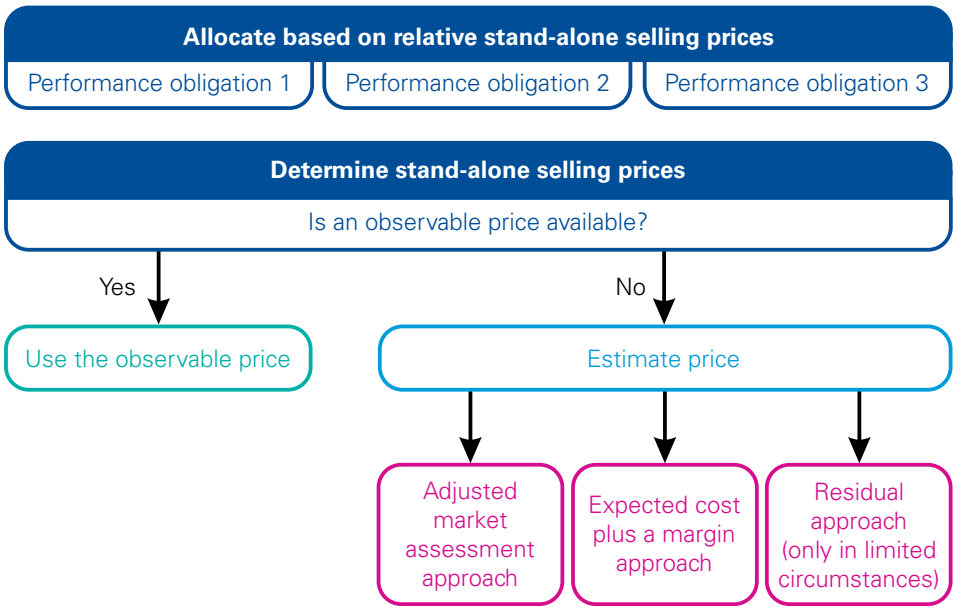
The 'stand-alone selling price' is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of this is an observable price from stand-alone sales of the good or service to similarly situated customers.

A contractually stated price or list price may be the stand-alone selling price of that good or service, but this is not presumed to be the case.

606-10-32-33
[IFRS 15.78]

If the stand-alone selling price is not directly observable, then the entity estimates the amount using a suitable method, as illustrated below. In limited circumstances, an entity may estimate the amount using the residual approach.

606-10-32-34
[IFRS 15.79]



606-10-32-33
[IFRS 15.78]

An entity considers all information that is reasonably available when estimating a stand-alone selling price – e.g. market conditions, entity-specific factors and information about the customer or class of customer. It also maximizes the use of observable inputs and applies consistent methods to estimate the stand-alone selling price of other goods or services with similar characteristics.

606-10-32-34
[IFRS 15.79]

The new standard does not preclude or prescribe any particular method for estimating the stand-alone selling price for a good or service when observable prices are not available, but describes the following estimation methods as possible approaches.

Adjusted market assessment approach	Evaluate the market in which goods or services are sold and estimate the price that customers in the market would be willing to pay
Expected cost plus a margin approach	Forecast the expected costs of satisfying a performance obligation and then add an appropriate margin for that good or service
Residual approach (limited circumstances)	Subtract the sum of the observable stand-alone selling prices of other goods or services promised in the contract from the total transaction price

606-10-32-43
[IFRS 15.88]

After contract inception, an entity does not reallocate the transaction price to reflect subsequent changes in stand-alone selling prices.

Observations

New standard does not contain a reliability threshold

Under the new standard, the stand-alone selling price is determined at contract inception for each performance obligation. There are no circumstances in which revenue recognition is postponed because it is difficult to determine a stand-alone selling price.

If an observable price is available, then it is used to determine the stand-alone selling price; if not, then the telecom entity is required to estimate the amount.

The new standard does not require that the amount can be 'reliably' estimated, nor does it prescribe another threshold. A telecom entity is required to maximize the use of observable inputs, but in all circumstances will need to arrive at a stand-alone selling price and allocate the transaction price to each performance obligation in the contract.

Observable prices may often be available for consumer telecom contracts

In a number of cases, observable prices will be available for telecom goods and services, and there will be no need to estimate their stand-alone selling price. Examples of observable prices can include published prices for equipment sold separately (either by the telecom entity or third parties) or 'bring your own device' or 'SIM only' prices for comparable network service plans.

Observable prices may also be different by class of customer (see 8.1). For example, telecom entities may segment their customer base in various ways, such as consumer or enterprise, multi-line users or single-line users, or according to other factors such as geography or distribution channel.

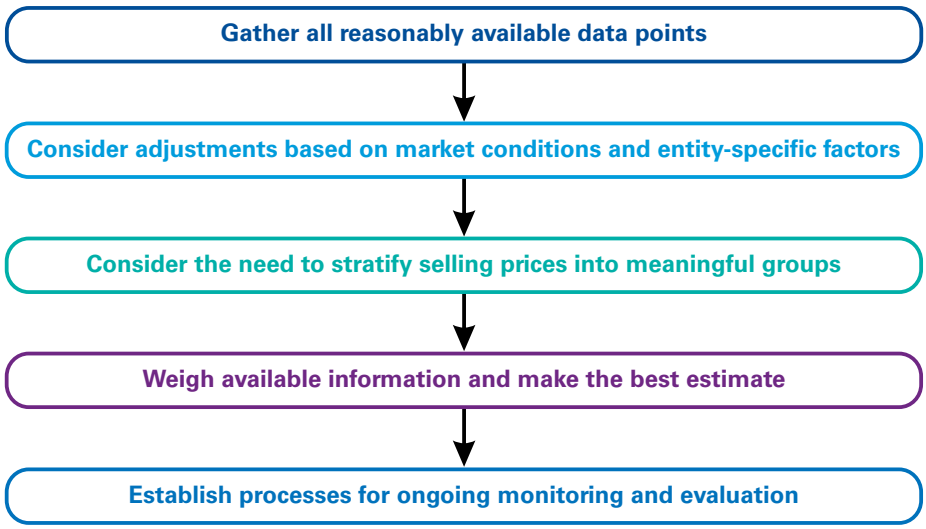
ASU 2014-09.BC269
[IFRS 15.BC269]

Judgment may be required for more complex telecom contracts

Prices may not always be observable, particularly for enterprise and wholesale contracts. This is because many contracts are priced based on individual customer needs rather than standard pricing. In addition, there can be a significant variation in price for a good or service between customers. In these case, judgment will be required in estimating the stand-alone selling price.

Some telecom entities may already have robust processes in place to determine selling prices, including vendor-specific objective evidence (VSOE). However, others will need to develop new processes with appropriate internal controls for documenting observable selling prices, and estimating stand-alone selling prices of goods or services that are not typically sold separately or for which there is significant price variation.

The following framework may be a useful tool for estimating and documenting the stand-alone selling price and for establishing internal controls over the estimation process.



If there is a range of observable prices, then a stated contract price within the range may be an acceptable stand-alone selling price

In some cases, a telecom entity may sell a good or service separately for a range of observable prices. When this is the case and the stated contract price is within a sufficiently narrow range of observable selling prices, it may be appropriate to use a stated contract price as the estimated stand-alone selling price of a good or service.

To determine whether this is appropriate, a telecom entity assesses whether an allocation of the transaction price based on such an estimate would meet the allocation objective (see 5.2). As part of this assessment, a telecom entity considers all information that is reasonably available (including market conditions, entity-specific factors, information about the customer or class of customer, how wide the range of observable selling prices is and where the stated price falls within the observable range).

Using a range to estimate stand-alone selling prices

When estimating stand-alone selling prices, it may be acceptable to select from a range of prices, particularly when stand-alone selling prices would be expected to vary for similar types for customers. A range has to be narrow and based on an analysis that maximizes observable inputs and supports an assertion that any price within that range would be a valid pricing point if the performance obligation were sold on a stand-alone basis.

It would not be appropriate to establish a range by determining an estimated stand-alone selling price and then arbitrarily adding a range of a certain percentage on either side of the point estimate to create a reasonable range of estimated selling prices.

Some techniques for estimating the stand-alone selling price of telecom goods and services may not be appropriate

The residual approach for determining the stand-alone selling price is generally not appropriate for telecom goods and services. This is because observable prices are usually available. Although observable prices may change rapidly, they are not highly variable or uncertain when comparing similar goods and services.

Furthermore, when observable prices are not available, the cost plus margin approach is likely to be appropriate only in cases where the expected costs of satisfying the performance obligation are identifiable. This may apply to some enterprise and wholesale landline and internet contracts.

Stand-alone selling prices of telecom services and equipment may need to be reassessed frequently

Stand-alone selling prices for a particular good or service may change over time due to changes in market conditions and entity-specific factors. Although the estimated stand-alone selling prices for previously allocated arrangements are not revised, new arrangements should reflect current, reasonably available information, including changes in pricing, customer base or product offerings.

The extent of the monitoring process and the frequency of necessary changes to estimated stand-alone selling prices will vary based on the nature of the performance obligations, the markets in which they are being sold and various entity-specific factors.

Given the frequency and magnitude of rate plan price changes, particularly in consumer markets, the process for reviewing and updating stand-alone selling prices will require careful planning and implementation.

Regulatory and other fees

Many telecom entities itemize and bill customers for regulatory and other government fees. If the telecom entity concludes that these fees are part of the transaction price (see Section 4), then it should also determine whether they should be included in the stand-alone selling price of the relevant service.

Comparison with current IFRS

Introduction of specific guidance

[IFRIC 12.13, IFRIC 13.5–7, IFRIC 15.8]

Current IFRS is largely silent on the allocation of consideration to components of a transaction. However, recent interpretations include guidance on allocation for service concession arrangements, customer loyalty programs, and agreements for the sale of real estate. Under these interpretations, consideration can be allocated to:

- components with reference to the relative fair values of the different components (relative fair value method); or
- the undelivered components measured at their fair value, with the remainder of the balance allocated to components that were delivered up front (residual method).

The new standard introduces guidance applicable to all in-scope contracts with customers. It therefore enhances comparability and brings more rigor and discipline to the process of allocating the transaction price.

Similar emphasis on use of observable inputs

[IAS 18.IE11, IFRIC 13.AG3]

Under current IFRS, our view is that a cost plus a margin approach should generally be applied only when it is difficult to measure the fair value of a component based on market inputs because there are few inputs (see 4.2.60.110 of *Insights into IFRS*, 13th Edition). This emphasis on the use of available market inputs – e.g. sales prices for homogeneous or similar products – is consistent with the new standard's requirement to maximize the use of observable inputs.

Comparison with current US GAAP

No specified hierarchy for non-observable inputs

605-25, ASU 2014-09.BC274–BC276

Currently, arrangement consideration is allocated to all deliverables meeting the separation criteria on the basis of their relative selling price, unless some other specific guidance is applicable – e.g. software arrangements and separately priced warranty contracts. In addition, selling prices are currently determined using a specified hierarchy of evidence as follows:

- VSOE of the selling price, if it exists;
- third-party evidence of the selling price, if VSOE does not exist; or
- the best estimate of the selling price, if neither VSOE nor third-party evidence exists.

However, the new standard does not prescribe a hierarchical order or a particular method for estimating the stand-alone selling price when observable prices are not available. For example, even when observable prices are not consistent enough to constitute VSOE, a telecom entity will still consider those observable transactions in estimating the stand-alone selling price of the good or service. Furthermore, a telecom entity may be able to use an alternative estimation method, even if third-party evidence of the selling price is available, as long as the approach taken maximizes the use of observable inputs.

The new standard applies the same approach regardless of the type of transaction or industry, and therefore differs from certain transaction- and industry-specific guidance in US GAAP.

5.2 Allocate the transaction price

Requirements of the new standard

606-10-32-31
[IFRS 15.76]

At contract inception, the transaction price is generally allocated to each performance obligation on the basis of relative stand-alone selling prices. However, when specified criteria are met, a discount (see 5.2.1) or variable consideration (see 5.4.2.2 in Issues In-Depth, Edition 2016) is allocated to one or more, but not all, of the performance obligations in the contract.

606-10-32-43 – 32-44
[IFRS 15.88–89]

After initial allocation, changes in the transaction price are allocated to satisfied and unsatisfied performance obligations on the same basis as at contract inception, subject to certain limited exceptions (see 5.3).

Example 40 – Allocation of the transaction price

Telco A enters into a 12-month wireless contract in which Customer C is provided with a handset and a voice and data plan (the wireless plan) for a price of 35 per month. Telco A has identified the handset and the wireless plan as separate performance obligations.

Telco A sells the handset separately for a price of 200, which provides observable evidence of a stand-alone selling price. Telco A also offers a 12-month service plan without a phone that includes the same level of services for a price of 25 per month. This pricing is used to determine the stand-alone selling price of the wireless plan as 300 (25 x 12 months).

The transaction price of 420 (35 x 12 months)[a] is allocated to the performance obligations based on their relative stand-alone selling prices as follows.

Performance obligation	Stand-alone selling prices	Selling price ratio	Transaction price allocation	Calculation
Handset	200	40%	168	(420 x 40%)
Wireless plan	300	60%	252	(420 x 60%)
Total	**500**	**100%**	**420**	

At the inception of the contract, the following accounting entry is made.

	Debit	Credit
Contract asset	168	
Equipment revenue		168

The difference between the revenue recognized and the transaction price is recorded as a contract asset because Telco A does not have the legal right to invoice the amount at contract inception.

When the monthly service fee is billed, this entry is made.

	Debit	Credit
Receivable	35	
Service revenue (252 ÷12)		21
Contract asset (168 ÷12)		14

Note

a. In this example, Telco A does not adjust the consideration to reflect the time value of money. This means Telco A concluded that the transaction price does not include a significant financing component or Telco A elected to use the practical expedient (see 4.4).

Example 41 – Allocation of the transaction price in a wireless contract: Minimum commitment approach

Continuing Example 29 in Step 3 (see 4.1). The fact pattern is repeated here for convenience.

Telco T enters into a 24-month wireless voice and data services contract with Customer C. At contract inception, Telco T transfers a handset to Customer C and Customer C pays 200 to Telco T, which is less than the stand-alone selling price of the handset.

The 24-month contract includes 1,000 monthly minutes of voice and 1GB of data usage for a monthly fee of 80 (Service Package A). During the two-year term, Customer C may decrease the service package to 500 monthly minutes of voice and 500MB of data usage for a monthly fee of 60 (Service Package B). Telco T also sells an 'add-on' package of 500 minutes of voice and 500MB of data usage for 20 per month that can be added or dropped monthly at the customer's option.

Customer C cannot reduce the service package below 60 without terminating the contract and incurring substantive termination penalties. In addition, Customer C can only reduce the service package in the month following that in which he provides notice.

Note that this example does not assess whether the contract includes a significant financing component.

The stand-alone selling prices of the handset and the service packages are as follows.

Performance obligation	Stand-alone selling prices
Handset	600
Service Package A (monthly fee) (1,000 monthly minutes of voice; 1GB of data usage)	75
Service Package B (monthly fee) (500 monthly minutes of voice; 500MB of data usage)	55

After analyzing the terms and conditions of the contract, Telco T concludes that using the contractual minimum commitment to determine the transaction price would be appropriate.

Using this approach, the transaction price is determined using 80 for Package A in the first month, then 60 per month for Service Package B. Therefore, the transaction price is 1,660 (200 for the handset; 1,460 (80 + 60 x 23 months) for the services). This amount is allocated to the handset and the service as follows.

Performance obligation	Stand-alone selling prices	Transaction price allocation	Calculation
Handset	600	513	[(600 ÷ 1,940) x 1,660]
Service in Month 1 (based on Service Package A)	75	64	[(75 ÷ 1,940) x 1,660]
Service in remaining 23 months (based on Service Package B)	1,265	1,083 (approx 47 per month)	[(1,265 ÷ 1,940) x 1,660]
Total (for purposes of allocation)	**1,940**	**1,660**	

This approach views the ability to upgrade to Service Package A as a customer option or right to purchase additional distinct services for 20 per month (see Section 8). Accordingly, assuming no change to the plan, service revenue recognized in Month 2 is 67 (47 + 20).

Example 42 – Allocation of the transaction price in a wireless contract: Contracted service amount

Continuing Example 30 in Step 3 (see 4.1). Fact pattern is repeated here for convenience.

Telco X enters into a 24-month wireless voice and data services contract with Customer F. At contract inception, Telco X transfers a handset to Customer F, and Customer F pays 200 to Telco X, which is less than the stand-alone selling price of the handset.

The 24-month contract includes 800 monthly minutes of voice and 1 GB of data usage for a monthly fee of 70. During the two-year term, Customer F cannot change the service package without terminating the contract and incurring substantive termination penalties.

However, Telco X has in limited circumstances allowed customers to downgrade their service without paying a termination penalty.

Note that this example does not assess whether the contract includes a significant financing component.

The stand-alone selling prices of the handset and the service packages are as follows.

Performance obligation	Stand-alone selling prices
Handset	600
Wireless service (1,000 monthly minutes of voice; 1GB of data usage)	65

After analyzing the terms and conditions of the contract, Telco X concludes that using the contracted service amount to determine the transaction price would be appropriate.

Using this approach, the transaction price is determined using 70 per month for the service. Therefore, the transaction price is 1,880 (200 for the handset; 1,680 (70 x 24 months) for the services). This amount is allocated to the handset and the service as follows.

Performance obligation	Stand-alone selling prices	Transaction price allocation	Calculation
Handset	600	522	[(600 ÷ 2,160) x 1,880]
Service (24 months)	1,560	1,358 (or 56.58 per month)	[(1,560 ÷ 2,160) x 1,880]
Total (for purposes of allocation)	**2,160**	**1,880**	

606-10-25-12 – 25-13
[IFRS 15.20–21]

If changes to this plan do not result in a contract termination but instead in a contract modification, then the telecom entity should consider the guidance on contract modifications (see Section 7 in Issues In-Depth, Edition 2016).

Comparison with current IFRS

Removal of the contingent cap

[IFRS 15.BC287–BC293]

Under current IFRS, many telecom entities have analogized the contingent cap approach in current US GAAP when accounting for bundled arrangements that include subsidized handsets. For those entities, the effect of the new requirements on allocating the transaction price will be the same as under US GAAP (see below).

Comparison with current US GAAP

Removal of the contingent cap

ASU 2014-09.BC287–BC293, 605-25-30

The allocation of arrangement consideration to delivered items is currently limited to amounts of revenue that are not contingent on a telecom entity's future performance (often referred to as 'the contingent cap'). Currently, many wireless contracts are subject to the contingent cap methodology. That methodology limits the amount of revenue recognized for handsets that are delivered at the beginning of the contract to the amount of cash received when the remaining payments under the arrangement are contingent on the ongoing network service.

The new standard does not have such a limitation: the full estimated transaction price – which includes all amounts, including contingent amounts, to which the telecom entity expects to be entitled – is allocated on a relative stand-alone selling price basis to each separate performance obligation.

However, the recognition of variable consideration may be constrained (see 4.2). Nevertheless, the new standard's removal of the contingent cap may accelerate the recognition of contingent or variable consideration. In previously constrained arrangements, telecom entities will allocate more transaction price to the handset, which will ultimately result in more revenue being recognized when the handset is transferred to the customer. This allocation will also reduce the amount of monthly service revenue recognized in bundled arrangements.

5.2.1 Allocating a discount

Requirements of the new standard

606-10-32-36
[IFRS 15.81]

If the sum of the stand-alone selling prices of a bundle of goods or services exceeds the promised consideration in a contract, then the discount is generally allocated proportionately to all of the performance obligations in the contract. However, this does not apply if there is observable evidence that the entire discount relates to only one or more of the performance obligations.

606-10-32-37
[IFRS 15.82]

This evidence exists, and a discount is allocated entirely to one or more, but not all, of the performance obligations, if the following criteria are met:

- the entity regularly sells each distinct good or service, or each bundle of distinct goods or services, in the contract on a stand-alone basis;
- the entity also regularly sells, on a stand-alone basis, a bundle (or bundles) of some of those distinct goods or services at a discount to the stand-alone selling prices of the goods or services in each bundle; and
- the discount attributable to each bundle of goods or services is substantially the same as the discount in the contract, and an analysis of the goods or services in each bundle provides observable evidence of the performance obligation(s) to which the entire discount in the contract belongs.

606-10-32-37
[IFRS 15.82]

Example 43 – Bundle discount allocated to all performance obligations in a contract

Telco B offers phone, internet and television services to residential customers, at 20, 30 and 40 per month, respectively. If a customer contracts for either phone and internet or internet and television services, a discount of 5 is given by Telco B. If the customer takes all three services, then Telco B gives a discount of 10. Because the discount attributable to each bundle is not the same and the analysis of the services in each bundle does not provide observable evidence that the discount relates to just one or two services, the discount of 10 is allocated to all three services as shown below.

Performance obligation	Stand-alone selling prices	Allocation of discount	Price allocation
Phone	20	10 x 20 ÷ 90	18
Internet	30	10 x 30 ÷ 90	27
Television	40	10 x 40 ÷ 90	35

606-10-55-259 – 55-264
[IFRS 15.IE167–IE172]

Example 44 – Discount allocated entirely to one or more, but not all, performance obligations in a contract

Telco C enters into a contract with a residential customer to sell phone, internet and television services for a total amount of 120. Telco C regularly sells the products individually for the following prices.

Product	Stand-alone selling prices
Phone	40
Internet	55
Television	45
Total	**140**

Telco C also regularly sells phone and internet services together for 75.

The contract includes a discount of 20 on the overall transaction (140 - 120), which is allocated proportionately to the three services in the contract when applying the relative stand-alone selling price method. However, because Telco C regularly sells phone and internet services as a bundle for 75 (at a 20 discount compared with their total selling price of 95 (55 + 40)) and television services for 45, it has evidence that the entire discount should be allocated to the phone and internet services.

The discount of 20 is individually allocated to those two services with reference to their relative stand-alone selling prices as follows.

Performance obligation	Stand-alone selling prices	Selling price ratio	Price allocation	Calculation
Phone	40	42%	32	(75 x 42%)
Internet	55	58%	43	(75 x 58%)
Total	**95**	**100%**	**75**	

Telco C will recognize revenue of 32 for phone, 43 for internet and 45 for television services.

Observations

Analysis required when a large number of goods or services are bundled in various ways

Some arrangements involve several different goods or services that may be sold in various bundles. In this case, a telecom entity may need to consider numerous possible combinations of products to determine whether the entire discount in the contract can be allocated to a particular bundle. This may represent a challenge for telecom entities, given the number of marketing offers and the frequency with which they are changed.

However, this analysis is required only if the telecom entity regularly sells each good or service – or bundle of goods or services – on a stand-alone basis. Therefore, if the telecom entity regularly sells only some of the goods or services in the contract on a stand-alone basis, then the criteria for allocating the discount entirely to one or more, but not all, of the performance obligations are not met and further analysis is not required.

Determination of 'regularly sells' will be a key judgment

Under the guidance on allocating a discount entirely to one or more performance obligations, a bundle of goods or services has to be regularly sold on a stand-alone basis. A telecom entity may need to establish a policy to define 'regularly sells'. This may include considering volume and frequency.

The telecom entity will need processes and related controls to monitor sales transactions and determine which bundles are regularly sold.

Discounts can impact the stand-alone selling price

The telecom entity should consider the number and regularity of discounts offered to customers to determine if some of those discounts should reduce the stand-alone selling price of a specific product or service in the bundle.

Guidance on allocating a discount will typically apply to contracts with at least three performance obligations

ASU 2014-09.BC283
[IFRS 15.BC283]

Also, the discount in the contract has to be substantially the same as the discount attributable to the bundle of goods or services under the guidance on allocating a discount entirely to one or more performance obligations. As a result, a telecom entity will typically be able to demonstrate that the discount relates to two or more performance obligations, but it will be difficult to have sufficient evidence to allocate the discount entirely to a single performance obligation. Therefore, this provision is not likely to apply to arrangements with fewer than three performance obligations.

Comparison with current IFRS

New prescriptive guidance

There is no specific guidance on allocating a discount in current IFRS. If a telecom entity allocates consideration according to the relative fair value of components, then it effectively allocates a discount to all components in the arrangement. If a telecom entity uses the residual method to allocate consideration, then it effectively allocates the discount to the delivered component. The new standard introduces specific guidance on allocating discounts.

Comparison with current US GAAP

Discount may be allocated to undelivered items

Generally, a telecom entity cannot attribute a discount in a contract to one or more separate deliverables, other than when the residual method is used – e.g. in software arrangements – and the entire discount is attributed to the delivered items. However, the allocation of a discount under the new standard is not restricted to particular industries or circumstances – so if the criteria are met, a discount is allocated entirely to one or more performance obligations in a contract, regardless of whether they are delivered or undelivered items.

5.3 Changes in the transaction price

Requirements of the new standard

606-10-32-42 – 32-45
[IFRS 15.87–90]

After contract inception, the transaction price may change for various reasons – including the resolution of uncertain events or other changes in circumstances that affect the amount of consideration to which an entity expects to be entitled.

In most cases, these changes are allocated to performance obligations on the same basis as at contract inception; however, changes in the transaction price resulting from a contract modification are accounted for under the new standard's contract modifications guidance (see Section 7 in Issues In-Depth, Edition 2016). If a change in the transaction price occurs after a contract modification, then it is allocated to the performance obligations in the modified contract – i.e. those that were unsatisfied or partially unsatisfied immediately after the modification – unless the:

- change is attributable to an amount of variable consideration that was promised before the modification; and
- modification was accounted for as a termination of the existing contract and creation of a new contract.

606-10-32-44
[IFRS 15.89]

A change in the transaction price is allocated to one or more distinct goods or services only if specified criteria are met (see 5.4.2.2 in Issues In-Depth, Edition 2016).

606-10-32-43
[IFRS 15.88]

Any portion of a change in transaction price that is allocated to a satisfied performance obligation is recognized as revenue – or as a reduction in revenue – in the period of the transaction price change.

Example 45 – Discretionary credit: Service quality issue

Telco F provides a customer with a credit in the current month due to a short period of service quality issues experienced in the prior month (often referred to as a 'goodwill credit'). Telco F determines that this results in a change in the transaction price, rather than variable consideration (see 4.2). Because the goodwill credit relates to a satisfied performance obligation, the credit is recognized in its entirety in the month in which it is granted (i.e. when Telco F promises to pay the consideration).

Example 46 – Discretionary credit: Retention

Telco G grants a one-time credit of 50 to a customer in Month 14 of a two-year contract. The credit is discretionary and is granted as a commercial gesture, not in response to prior service issues (often referred to as a 'retention credit'). The contract includes a subsidized handset and a voice and data plan.

Telco G does not regularly provide those credits and therefore customers do not expect them to be granted. Therefore, Telco G concludes that this is a change in the transaction price and not variable consideration (see 4.2). Because the credit does not relate to a satisfied performance obligation, the change in transaction price resulting from the credit is accounted for as a contract modification and recognized over the remaining term of the contract (see Section 7 in Issues In-Depth, Edition 2016).

If, in this example, rather than providing a one-time credit, Telco G grants a discount of 5 per month for the remaining contract term, Telco G would also conclude that it is a change in the transaction price. It would apply the contract modification guidance and recognize the credit over the remaining term of the contract (see Section 7 in Issues In-Depth, Edition 2016).

Observations

Change in transaction prices may also be assessed as variable consideration

Judgment is required at contract inception to determine if customer credits constitute variable consideration (see 4.2). Customer credits that are not variable consideration constitute a change to the transaction price and are accounted for under the contract modification guidance. The accounting varies depending on whether the credit relates to satisfied or unsatisfied performance obligations, such as telecom services, at the time the credit is granted.

Comparison with current IFRS

Introduction of guidance on reallocation

Current IFRS is largely silent on the allocation of revenue to components, and is therefore silent on the reallocation of revenue. Under the new standard, if some of the performance obligations to which the transaction price was initially allocated have already been satisfied when the change in transaction price takes place, then this results in an adjustment to the amount of revenue recognized to date – including revenue on completed performance obligations.

Comparison with current US GAAP

Introduction of guidance on reallocation

ASU 2014-09.BC287–BC293, 605-25-30

The allocation of arrangement consideration to delivered items is currently limited to amounts of revenue that are not contingent on a telecom entity's future performance. Therefore, there is limited current guidance on changes in contingent amounts. The new standard introduces more discipline around the accounting for changes in transaction price.

6 Step 5: Recognize revenue when or as the entity satisfies a performance obligation

Overview

A telecom entity recognizes revenue when or as it satisfies a performance obligation by transferring a good or service to a customer, either at a point in time (when) or over time (as).

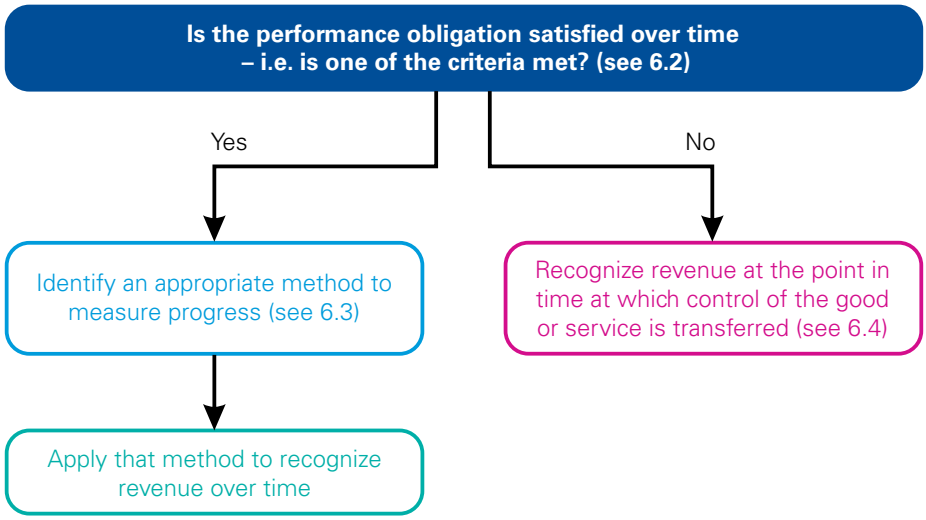
Generally, a telecom entity recognizes revenue for equipment sales at a point in time, usually at contract inception, when control of the equipment is transferred to the customer. Service revenue is recognized over time as the services are provided. This is not in itself a change from current practice. However, the allocation methodology in the new standard (see Section 5) is a change in practice. This change will often increase the amount of revenue allocated to, and accelerate revenue recognition on, the equipment, particularly for subsidized wireless handsets.

Options for additional services, such as usage, generally result in revenue recognition only once the customer exercises the option (see Section 8).

Requirements of the new standard

606-10-25-24
[IFRS 15.32]

At contract inception, an entity first evaluates whether it transfers control of the good or service over time – if not, then it transfers control at a point in time.



Comparison with current IFRS

Over-time recognition retained, but with new criteria

[IAS 11, IAS 18.21]

Construction contracts, and some contracts for the rendering of services, are currently accounted for under the stage-of-completion method – e.g. some telecom enterprise contracts that include the construction of networks or facilities that will be owned by the customer. The new standard may result in a broadly similar profile of revenue to that under current stage-of-completion accounting, but introduces new criteria to determine when revenue should be recognized over time.

Some contracts that are currently accounted for under the stage-of-completion method may now require revenue to be recognized on contract completion. However, for other contracts, over-time recognition may be required for the first time under the model.

Comparison with current US GAAP

Over-time recognition retained, but with criteria rather than guidance based on type of activity

605-35-25-57

Currently, construction-type contracts in the scope of Subtopic 605-35 are generally accounted for under the percentage-of-completion method and, although service contracts do not fall in the scope of Subtopic 605-35, revenue from services is generally recognized under the proportional performance or straight-line method.

Under the new standard, a telecom entity currently applying these methods can continue to recognize revenue over time only if one or more of three criteria are met (see 6.2). Unlike current industry- and transaction-specific guidance, the requirements in Step 5 of the model are not a matter of scope, but rather are applied consistently to each performance obligation in a contract. When applying the new criteria, some telecom entities may determine that revenue currently recognized at a point in time should be recognized over time, or vice versa.

6.1 Transfer of control

Requirements of the new standard

606-10-25-23 – 25-24
[IFRS 15.31–32]

A good or service is transferred to a customer when the customer obtains control of it. 'Control' refers to the customer's ability to direct the use of, and obtain substantially all of the remaining benefits from, an asset. It also includes the ability to prevent other entities from directing the use of, and obtaining the benefits from, an asset. Potential cash flows that are obtained either directly or indirectly – e.g. from the use, consumption, sale or exchange of an asset – are benefits of an asset.

Control is …	
the ability	– the customer has a present right
to direct the use of	– the right enables the customer to: - deploy the asset in its activities - allow another entity to deploy the asset in its activities - prevent another entity from deploying the asset
and obtain the remaining benefits from	– the right also enables the customer to obtain potential cash flows directly or indirectly – for example, through: - use of the asset - consumption of the asset - sale or exchange of the asset - pledging the asset - holding the asset
… an asset.	

ASU 2014-09.BC118
[IFRS 15.BC118]

Observations

Use of control concept to recognize revenue aligns with the accounting for assets

The new standard is a control-based model. First, a telecom entity determines whether control of the good or service transfers to the customer over time based on the criteria in the new standard and, if it does, the pattern of that transfer. If it does not, then control of the good or service transfers to the customer at a point in time, with the notion of risks and rewards being retained only as an indicator of the transfer of control (see 6.4).

Assessing the transfer of goods or services by considering when the customer obtains control may result in different outcomes – and therefore significant differences in the timing of revenue recognition. The Boards believe that it can be difficult to judge whether the risks and rewards of ownership have been transferred to a customer, so applying a control-based model may result in more consistent decisions about the timing of revenue recognition.

The new standard extends a control-based approach to all arrangements, including service contracts. The Boards believe that goods and services are assets – even if only momentarily – when they are received and used by the customer. The new standard's use of control to determine when a good or service is transferred to a customer is consistent with the current definitions of an asset under both US GAAP and IFRS, which principally use control to determine when an asset is recognized or derecognized.

New conceptual basis for revenue recognition

The new standard takes a conceptually different approach to revenue recognition from current US GAAP and IFRS. Although the basic accounting outcomes – recognition of revenue at a point in time or over time – are similar, they may apply in different circumstances. However, this change is not expected to have a significant effect for most telecom arrangements because telecom services are consumed as they are provided, and revenue is currently recognized when the services are provided.

[IAS 11.23, IAS 18.14, 20, IFRS 15.BC118, IFRIC 15]

Comparison with current IFRS

Move away from a risk-and-reward approach

Currently, revenue from the sale of goods that are in the scope of IAS 18 is recognized based on when, among other criteria, the telecom entity has transferred to the buyer the significant risks and rewards of ownership. Under this approach, which is unlike the new standard, revenue is typically recognized at the point in time at which risks and rewards pass, rather than control transfers.

IFRIC 15 introduced the notion that the criteria for recognizing a sale of goods could also be met progressively over time, resulting in the recognition of revenue over time. However, this approach is not generally applied, except in the specific circumstances envisaged in IFRIC 15.

For contracts for the rendering of services that meet the over-time criteria in the new standard, revenue is recognized with reference to the stage of completion of the transaction at the reporting date – i.e. measuring the telecom entity's performance in satisfying its performance obligation.

The new standard applies a control-based approach (whereby control can be transferred either over time or at a point in time) to all arrangements, regardless of transaction or industry type.

Comparison with current US GAAP

Move away from a risk-and-reward approach

SEC SAB Topic 13, ASU 2014-09.BC118, 605-35-25

Unlike the new standard, revenue from the sale of goods is currently recognized when the telecom entity has transferred the significant risks and rewards of ownership to the buyer. This is evidenced by:

- persuasive evidence of an arrangement;
- the occurrence of delivery or performance;
- a fixed or determinable sales price; and
- reasonable assurance of collectibility.

Under current US GAAP, revenue from service contracts is generally recognized under the proportional performance or straight-line method. The new standard applies a control-based approach to all arrangements, regardless of transaction or industry type.

6.2 Performance obligations satisfied over time

Requirements of the new standard

606-10-25-24, 25-27
[IFRS 15.32, 35]

For each performance obligation in a contract, an entity first determines whether the performance obligation is satisfied over time – i.e. control of the good or service transfers to the customer over time – using the following criteria.

	Criterion	Example
1	The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs	Routine or recurring telecom services – e.g. network services
2	The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced	Building a telecom network on a customer's premises
3	The entity's performance does not create an asset with an alternative use to the entity (see 5.5.2.1 in Issues In-Depth, Edition 2016) and the entity has an enforceable right to payment for performance completed to date (see 5.5.2.2 in Issues In-Depth, Edition 2016)	Building an asset to a customer's specifications, such as a call center built on the telecom entity's premises

606-10-25-27, 25-30 – 25-31
[IFRS 15.35, 38–39]

If one or more of these criteria are met, then the entity recognizes revenue over time, using a method that depicts its performance – i.e. the pattern of transfer of control of the good or service to the customer. If none of the criteria is met, then control transfers to the customer at a point in time and the entity recognizes revenue at that point in time (see 6.4).

Criterion 1

606-10-55-5 – 55-6, ASU 2014-09.BC125–BC128
[IFRS 15.B3–B4, BC125–BC128]

A customer simultaneously receives and consumes the benefits of the entity's performance as the entity performs if another entity would not need to substantially reperform the work that the entity has completed to date.

When determining whether another party would not need to substantially reperform, the entity also presumes that another party would not have the benefit of any asset that the entity presently controls and would continue to control if that other party took over the performance obligation.

Criterion 2

606-10-55-7
[IFRS 15.B5]

In evaluating whether a customer controls an asset as it is created or enhanced, an entity considers the guidance on control in the new standard, including the indicators of the transfer of control (see 6.4).

Criterion 3

606-10-25-28
[IFRS 15.36]

In assessing whether an asset has an alternative use, at contract inception an entity considers its ability to readily direct that asset in its completed state for another use, such as selling it to a different customer.

606-10-55-6, 55-8 – 55-10, ASU 2014-09.BC127
[IFRS 15.B4, B6–B8, BC127]

Applying Criteria 1 and 3

Potential contractual restrictions or practical restrictions may prevent the entity from transferring the remaining performance obligation to another entity (Criterion 1) or directing the asset for another use (Criterion 3). The new standard provides guidance on whether these facts or possible termination impact the assessment of those criteria. It provides the following guidance on the assumptions that an entity should make when applying Criteria 1 and 3.

Determining whether…	Consider contractual restrictions?	Consider practical limitations?	Consider possible termination?
… another entity would not need to substantially reperform (Criterion 1)	No	No	Yes
… the entity's performance does not create an asset with an alternative use (Criterion 3)	Yes	Yes	No

Example 47 – Assessing whether telecom network services meet the over-time criteria

ASU 2014-09.BC126
[IFRS 15.BC126]

Telco M enters into a contract to provide network services to Customer C. Telco M needs to assess whether the network service revenue should be recognized at a point in time or over time. Telco M first considers whether the network services meet Criterion 1 and notes that:

- Customer C will receive and consume the benefits of the network services as they are delivered; and
- if Customer C changed service providers, then the new service provider would not need to reperform the work performed to date by Telco M.

Since it is necessary to meet only one of the criteria to recognize revenue over time, Telco M concludes that it should recognize revenue for the network services over time.

Observations

Telecom network services typically meet Criterion 1 and are satisfied over time

Telecom network services, such as wireless, landline, cable or internet, typically meet Criterion 1 because the customer simultaneously receives and consumes the benefits provided by the telecom entity. Therefore, telecom network services are satisfied over time.

For telecom services other than network services, a telecom entity should consider whether another provider taking over the contract would need to reperform past services.

Criterion 1 involves a hypothetical assessment of what another telecom entity would need to do if it took over the remaining performance obligation. Accordingly, contractual restrictions or practical limitations, which would otherwise prevent the telecom entity from transferring the performance obligation to another telecom entity, are not relevant when assessing whether the telecom entity has transferred control of the goods or services provided to date.

Enterprise contracts require careful assessment of all over-time criteria

Enterprise contracts are complex and a careful analysis of all over-time criteria is required. For instance, the construction of networks or call centers for customers will require detailed analysis to determine if either Criterion 2 or 3 are met. Once that analysis is complete, telecom entities can determine if the performance obligation is satisfied over time or at a point in time. Criteria 2 and 3 are not discussed further in this publication. See 5.5.2 in Issues In-Depth, Edition 2016, for further detail on applying Criteria 2 and 3.

Comparison with current IFRS

Applying the new criteria may alter the timing of revenue recognition

[IAS 11, IAS 18, IFRIC 15]

Under current IFRS, there are three circumstances in which revenue is recognized over time:

- the contract is a construction contract in the scope of IAS 11; this is the case when, and only when, the contract has been specifically negotiated for the construction of an asset or assets;
- the contract is for the sale of goods under IAS 18, and the conditions for the recognition of a sale of goods are met progressively over time; and
- the contract is for the rendering of services.

By contrast, the new standard introduces new concepts and uses new wording that telecom entities need to apply to the specific facts and circumstances of individual performance obligations. Subtle differences in contract terms could result in different assessment outcomes – and therefore significant differences in the timing of revenue recognition compared with current practice.

Comparison with current US GAAP

Some similarities, but new concepts to be applied

Criteria 1 and 3 of the new standard will require telecom entities to think differently about the satisfaction of performance obligations. In general, the impact of applying the criteria will vary depending on relevant facts and circumstances, and subtle differences in contract terms could result in different assessment outcomes. These different assessments could create significant differences in the timing or pattern of revenue recognition.

6.3 Measuring progress toward complete satisfaction of a performance obligation

Requirements of the new standard

606-10-25-31 – 25-35, 55-17 – 55-21
[IFRS 15.39–43, B15–B19]

For each performance obligation that is satisfied over time, an entity applies a single method of measuring progress toward complete satisfaction of the obligation. The objective is to depict the transfer of control of the goods or services to the customer. To do this, an entity selects an appropriate output or input method. It then applies that method consistently to similar performance obligations and in similar circumstances.

Method	Description	Examples
Output	Based on direct measurements of the value to the customer of goods or services transferred to date, relative to the remaining goods or services promised under the contract	– Surveys of performance to date – Appraisals of results achieved – Milestones reached – Time elapsed
Input	Based on an entity's efforts or inputs toward satisfying a performance obligation, relative to the total expected inputs to the satisfaction of that performance obligation	– Resources consumed – Costs incurred – Time elapsed – Labor hours expended

606-10-55-18
[IFRS 15.B16]

As a practical expedient, if an entity has a right to invoice a customer at an amount that corresponds directly with its performance to date, then it can recognize revenue at that amount. For example, in a services contract an entity may have the right to bill a fixed amount for each unit of service provided or for each time period (e.g. each month).

606-10-25-36 – 25-37
[IFRS 15.44–45]

An entity recognizes revenue over time only if it can reasonably measure its progress toward complete satisfaction of the performance obligation. However, if the entity cannot reasonably measure the outcome but expects to recover the costs incurred in satisfying the performance obligation, then it recognizes revenue to the extent of the costs incurred.

The new standard contains guidance on measuring and adjusting measures of progress when input methods are used – e.g. uninstalled materials. See 5.5.3.3 in Issues In-Depth, Edition 2016 for further information.

Example 48 – Monthly prepaid wireless contract

Telco M enters into a monthly prepaid contract with wireless Customer B for 200 minutes per month of voice services. Customer B pays 30 per month in advance. Customer B can use the minutes at any time during the month. Once the 200 minutes are used, the handset remains connected to the network and can accept calls. That is, incoming calls are not included in the 200 minutes per month.

Telco M first concludes that Customer B simultaneously receives and consumes the benefits from the services as it is provided and thus the performance obligation is satisfied over time. Furthermore, Telco M determines that the nature of its promise is to provide network services to Customer B throughout the month because incoming calls are not included in the 200 minutes. Consequently, the number of minutes used does not appear to appropriately depict the satisfaction of that promise. Instead, the more appropriate measure of progress appears to be time elapsed. Telco M therefore recognizes revenue of 30 evenly throughout the month.

Example 49 – Wireless service contract with rollover minutes feature

Telco N enters into a two-year wireless contract with Customer C for prepaid voice services. The voice plan allows the Customer C to use 600 minutes each month for incoming and outgoing calls. After the 600 minutes are used, the handset can no longer be used to make or receive calls during that month. If Customer C does not use all of the minutes, then Customer C is able to roll over the unused minutes to the subsequent month. For the purposes of this example, breakage is ignored.

Telco N concludes that Customer C simultaneously receives and consumes the benefits of the minutes, and thus the performance obligation is satisfied over time. Due to the ability of the customer to roll over the unused minutes each month, progress toward complete satisfaction of the performance obligation is measured based on the number of minutes used each month.

Any minutes that are unused at the end of each month will be accounted for as a contract liability because Customer C pays in advance for the following month's 600 minutes.

Example 50 – Enterprise service contract with usage fee treated as variable consideration

Continuing Example 31 in Step 3 (see 4.2). Fact pattern is repeated here for convenience.

Telco A enters into a contract with enterprise Customer C to provide call center services. These services include providing dedicated infrastructure and staff to stand ready to answer calls. Telco A receives consideration of 0.50 per minute for each call answered.

Telco A has separately concluded that its performance obligation is the overall service of standing ready to provide call center services each day, rather than each call answered. Furthermore, Telco A has concluded that the per-minute fee is variable consideration. In assessing the appropriate pattern of transfer (i.e. measure of progress in satisfying the performance obligation), Telco A considers whether the variable consideration needs to be estimated at contract inception.

Because Customer C simultaneously receives and consumes the benefits of the service of standing ready each day the service is provided, the performance obligation is satisfied over time. Telco A also observes that the arrangement meets the series guidance because each day (or each month) of standing ready to provide call center services is distinct, is essentially the same and has the same pattern of transfer.

Telco A expects its performance to be fairly consistent during the contract and observes that the pricing in this contract is consistent with pricing in similar contracts with similar customers. Telco A also observes that the variable consideration for each day (i.e. the per-minute fee) relates to the entity's effort to satisfy the promise of standing ready each day. Furthermore, Telco A observes that it has a right to consideration from the customer for each day of minutes used (for practical reasons these amounts may be invoiced on a monthly basis). In addition, Telco A concludes that the per-minute usage corresponds directly with the value to the customer of the service provided by Telco A (i.e. the service of standing ready). Therefore, Telco A concludes that revenue can likely be recognized based on the contractual right to bill.

ASU 2014-09.BC159
[IFRS 15.BC159]

606-10-55-18
[IFRS 15.B16]

Observations

Determining which measure of progress to apply is not a free choice

The new standard requires a telecom entity to select a method that is consistent with the objective of depicting its performance. A telecom entity therefore does not have a free choice of which method to apply to a given performance obligation – it needs to consider the nature of the good or service that it promised to transfer to the customer (see 3.4.2). Accordingly, judgment is required when identifying an appropriate method of measuring progress.

Most telecom network services will be recognized using an output measure

Output measures such as minutes, texts, amount of data consumed or time elapsed will usually prove to be appropriate measures of progress for telecom network services. Telecom entities need to consider carefully the nature of the promises in the contract – e.g. those promises made in prepaid contracts or contracts with rollover minutes. When the billing to the customer does not directly correspond to the telecom entity's performance in these types of plans, the telecom entity may need to adjust any contract assets, contract liabilities or accounts receivable related to the contract.

Some telecom network services may be recognized as they are billed

Telecom services billings are often based on output measures, as described above. However, as a practical expedient, a telecom entity may recognize revenue using the amount that it has the right to invoice, if this amount directly corresponds with the value that is transferred to the customer. The amount that the telecom entity has the right to invoice does not need to be based on a fixed amount per unit for this practical expedient to be applied.

If a contract includes fixed fees in addition to per-unit invoicing, substantive contractual minimums or payments to the customer such as rebates, discounts or signing bonuses, then the use of the practical expedient may be precluded because the invoiced amounts do not correspond to the value that the customer receives. Furthermore, to apply the practical expedient to a contract, all goods and services in the contract will need to qualify.

When the practical expedient is used, the telecom entity is not required to disclose the remaining transaction price to be received under the contract. See 12.1.3 in Issues In-Depth, Edition 2016 for further details on disclosures required by the new revenue standard.

606-10-55-46 – 55-49
[IFRS 15.B44–B47]

Customers' unexercised rights (breakage)

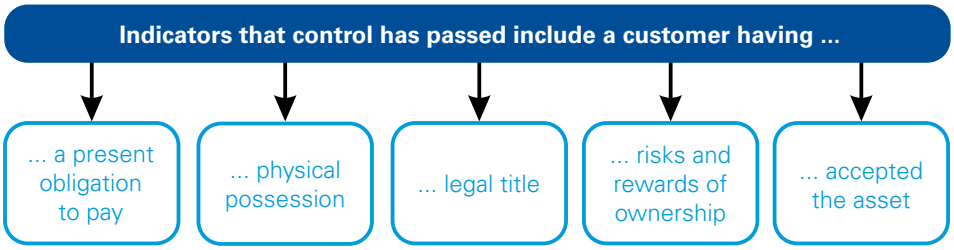
Telecom entities may receive a nonrefundable prepayment from a customer that gives the customer the right to receive goods or services in the future. Common telecom examples include rollover minutes (see Example 49) or prepaid phone cards. Typically, some customers do not exercise their right – this is referred to as 'breakage'. The new standard contains guidance to determine the timing of revenue related to breakage (see 10.5 in Issues In-Depth, Edition 2016 for further discussion).

6.4 Performance obligations satisfied at a point in time

Requirements of the new standard

606-10-25-30
[IFRS 15.38]

If a performance obligation is not satisfied over time, then an entity recognizes revenue at the point in time at which it transfers control of the good or service to the customer. The new standard includes indicators of when the transfer of control occurs.



Relevant considerations include the following.

- In some cases, possession of legal title is a protective right and may not coincide with the transfer of control of the goods or services to a customer – e.g. when a seller retains title solely as protection against the customer's failure to pay.
- In consignment arrangements (see Section 10 and 5.5.6 in Issues In-Depth, Edition 2016) and some repurchase arrangements (see Section 11), an entity may have transferred physical possession but still retain control. Conversely, in bill-and-hold arrangements (see 6.5 and 5.5.7 in Issues In-Depth, Edition 2016), an entity may have physical possession of an asset that the customer controls.
- When evaluating the risks and rewards of ownership, an entity excludes any risks that give rise to a separate performance obligation in addition to the performance obligation to transfer the asset.
- An entity needs to assess whether it can objectively determine that a good or service provided to a customer conforms to the specifications agreed in a contract (see 6.5 and 5.5.8 in Issues In-Depth, Edition 2016).

Example 51 – Determining when control transfers

On the last day of Month 1, Customer L enters into a two-year contract with Telco M for internet protocol television (IPTV) service. Customer L also purchases a set-top box and installation services from Telco M. Telco M has determined that the IPTV service, the set-top box and the installation are three separate performance obligations (see Section 3).

The installation will be performed in Month 2, and IPTV service will commence on that date. Customer L pays for and takes the set-top box on the day on which he entered into the arrangement (i.e. on the last day of Month 1).

Revenue for the set-top box is recognized in Month 1 because Customer L has obtained control of the box on the day the arrangement is agreed to by both parties. Telco M would consider whether there are any rights of return when determining the amount of revenue to be recognized for the set-top box. Revenue from the installation service is recognized in Month 2 and revenue from the IPTV service is recognized over the two-year period commencing in Month 2 (assuming the services are provided) because that is when the performance obligation is satisfied.

Observations

Judgment may be required to determine the point in time at which control transfers

ASU 2014-09.BC155
[IFRS 15.BC155]

The indicators of transfer of control are factors that are often present if a customer has control of an asset; however, they are not individually determinative, nor are they a list of conditions that have to be met. The new standard does not suggest that certain indicators should be weighted more heavily than others, nor does it establish a hierarchy that applies if only some of the indicators are present. However, it remains possible that in some facts and circumstances certain indicators will be more relevant than others and so carry greater weight in the analysis.

Judgment may be required to determine the point in time at which control transfers. This determination may be particularly challenging when there are indicators that control has transferred alongside 'negative' indicators suggesting that the telecom entity has not satisfied its performance obligation.

Potential challenges may exist in determining the accounting for some delivery arrangements

SEC SAB Topic 13
[IAS 18.14]

Revenue is not currently recognized if a telecom entity has not transferred to the customer the significant risks and rewards of ownership. For product sales, the risks and rewards are generally considered to be transferred when a product is delivered to the customer's site – i.e. if the terms of the sale are 'free-on-board' (FOB) destination, then legal title to the product passes to the customer when the product is handed over to the customer. When a product is shipped to the customer FOB shipping point, legal title passes and the risks and rewards are generally considered to have transferred to the customer when the product is handed over to the carrier. However, careful analysis of facts and circumstances is required.

Indirect channels

Many telecom entities sell through distributors and resellers. These transactions will require judgment to determine if the transfer of control occurs on delivery to the intermediary or when the good is resold to the end customer (see Section 10).

6.5 Enterprise contracts – Bill-and-hold and customer acceptance

Observation

606-10-55-81
[IFRS 15.B79]

Large enterprise telecom contracts often include bill-and-hold arrangements and the related issues around customer acceptance, usually for equipment sales.

Bill-and-hold arrangements occur when a telecom entity bills a customer for a product that it transfers at a point in time, but retains physical possession of the product until it is transferred to the customer at a future point in time – e.g. due to a customer's lack of available space for the product or delays in production schedules.

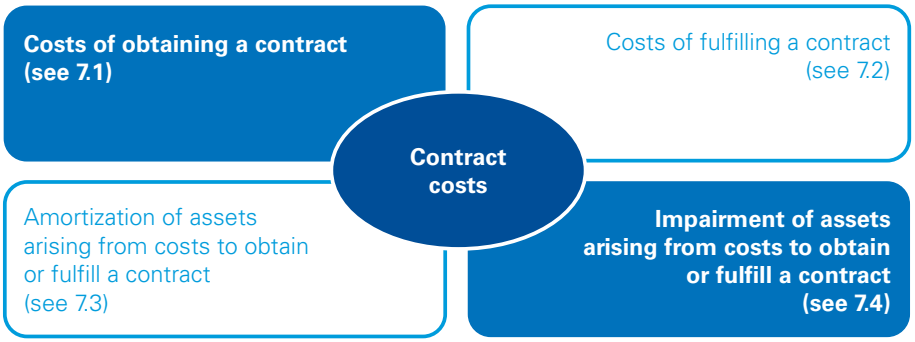
606-10-55-82 – 55-83
[IFRS 15.B80–B81]

To determine the point in time at which a customer obtains control and therefore the point in time at which the performance obligation is satisfied, the telecom entity considers several indicators of the transfer of control, including whether the customer has accepted the goods or services (see 5.5.8 in Issues In-Depth, Edition 2016). For further guidance on bill-and-hold criteria, see 5.5.7 in Issues In-Depth, Edition 2016).

7 Contract costs

Overview

The new standard does not seek to provide comprehensive guidance on the accounting for contract costs. In many cases, telecom entities continue to apply existing cost guidance under US GAAP and IFRS. The new standard includes specific guidance in the following areas.



Telecom entities incur a number of different customer acquisition costs when a customer enters into a contract. Some of these costs – e.g. sales commissions – meet the criteria for recognition as an asset as a cost to obtain a contract.

For costs capitalized under the new standard, telecom entities are also required to determine the appropriate amortization period, taking into account expectations about the renewal of contracts.

7.1 Costs of obtaining a contract

Requirements of the new standard

340-40-25-1 – 25-2
[IFRS 15.91–92]

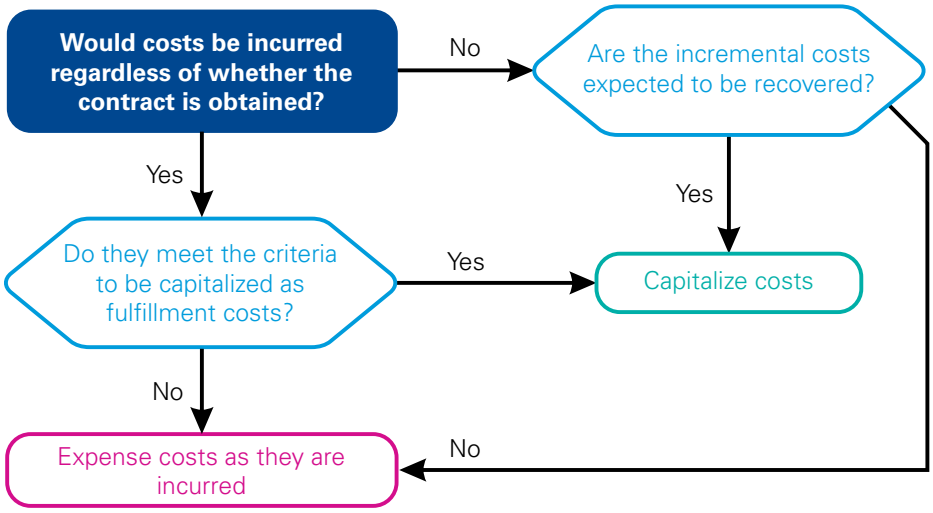
An entity capitalizes incremental costs to obtain a contract with a customer – e.g. sales commissions – if it expects to recover those costs.

340-40-25-4
[IFRS 15.94]

However, as a practical expedient, an entity is not required to capitalize the incremental costs to obtain a contract if the amortization period for the asset is one year or less. The costs of fulfilling a contract that meet the capitalization criteria are not eligible for the practical expedient, which can only be applied to the costs of obtaining a contract.

340-40-25-3
[IFRS 15.93]

Costs that will be incurred regardless of whether the contract is obtained – including costs that are incremental to *trying* to obtain a contract, are expensed as they are incurred, unless they meet the criteria to be capitalized as fulfillment costs (see 7.2). An example of such costs are costs to prepare a bid, which are incurred even if the entity does not obtain the contract.



Example 52 – Costs incurred to obtain a contract

Telco E enters into a two-year wireless contract with Customer C that includes voice and data services. The contract is signed at one of Telco E's stores and the sales employee receives a commission of 30 when the customer signs the contract. Telco E has also incurred costs related to a two-week advertising campaign. On signing the contract, the customer indicates that he came into the store in response to this advertising campaign.

The commission paid to the sales employee is an incremental cost to obtain the contract with the customer because it is payable only on successfully obtaining the contract. Because the contract term is more than 12 months, the practical expedient does not apply. Telco E therefore capitalizes the sales commission of 30 as a cost of obtaining the contract. For discussion of the amortization period, see 7.3.

In contrast, the advertising costs, although they are associated with *trying* to obtain the contract, are not incremental costs of obtaining the contract. That is, the advertising costs would have been incurred even if no new customer contracts were acquired. Consequently, Telco E expenses the advertising costs as they are incurred.

Example 53 – Dealer commission with clawback provision

Telco E enters into a month-to-month wireless contract with Customer C that includes voice and data services. The contract is obtained through Dealer D, who is entitled to a commission of 20 from Telco E. The commission is paid on contract commencement but is clawed back and refunded to Telco E if the customer cancels the service within the first three months.

Telco E concludes that Dealer D has completed its obligation, which is to sign the customer up for the service, even though the customer must continue to receive the service until the end of Month 3 for the commission to be fully earned. Dealer D's commission is an incremental cost to obtain the contract with Customer C. Therefore, Telco E recognizes the commission of 20 as an asset at contract inception. For discussion of the amortization period and the application of practical expedient, see 7.3.

Telco E assesses the contract cost asset for impairment together with its right to a refund on the commission paid to Dealer D.

Example 54 – Commission paid on renewals after the initial contract is obtained

Telco A pays its sales employees a commission of 30 for each new two-year wireless contract entered into with a customer. Telco A also pays 10 to sales employees each time the customer renews a contract for an additional two years. Telco A needs to assess if and when these commissions should be capitalized as costs to obtain a contract.

At contract inception, Telco A concludes that the commission of 30 is an incremental cost of obtaining the initial contract because the cost would not have been incurred if the contract had not been obtained. The contract between Telco A and the customer creates no enforceable rights and obligations beyond the initial two-year period. Because there is no contract beyond the two-year period, Telco A does not capitalize at contract inception future commissions that may be payable on renewal (i.e. the renewal commission of 10).

On contract renewal, Telco A incurs an additional commission of 10. This commission of 10 is an incremental cost of obtaining the second contract because the cost would not have been incurred if the contract had not been renewed.

Telco A therefore capitalizes both commissions when they are incurred. For discussion of the amortization period, see 7.3 and Example 57.

Observations

New requirement to capitalize costs of obtaining a contract creates a change in practice

The requirement to capitalize the incremental costs of obtaining a contract, such as employee and dealer commissions, will be a change in practice for many telecom entities that currently expense those costs as they are incurred.

Similarly, telecom entities that currently capitalize the costs to obtain a contract will need to assess whether their current capitalization policy is consistent with the new requirements, particularly for enterprise contracts.

Costs incurred before or at contract inception that do not qualify as costs to obtain a contract may, however, meet the criteria to be capitalized as fulfillment costs (see 7.2).

Not all subscriber acquisition and retention costs qualify for capitalization

Although many telecom entities track subscriber acquisition and retention costs, not all of these costs will qualify for capitalization as costs to obtain a contract.

Costs to obtain a contract must be incremental. This is the case if those costs would not have been incurred unless the contract was obtained. Costs incurred in trying to obtain the contract should be expensed. For example, a telecom entity will need to identify bid costs that are incremental to obtaining the contract and exclude bid costs that are incurred regardless of whether the contract is obtained. Likewise, a telecom entity that capitalizes both incremental and allocable costs of obtaining a contract will need to revise its accounting policy to capitalize only the incremental costs of obtaining a contract.

Discounts or other items provided to the customer in obtaining a contract are not capitalized under the cost guidance. For example, handset subsidies or free goods and services provided to the customer should be accounted for as either a reduction of the transaction price (see Section 4) or a separate performance obligation (see Section 3).

Limited use of the practical expedient in the telecom sector

The capitalization of costs to obtain a contract is required under the new standard unless the amortization period of the asset is one year or less. Because the amortization period typically includes specific anticipated renewals (see 7.3), it is likely that telecom entities will not be able to apply the practical expedient to expense costs of obtaining a contract as they are incurred.

Capitalizing commission when associated liability is accrued

In some cases, an additional commission may be payable, or the original commission amount adjusted, at a future date. Examples include commissions:

- paid for renewal of the contract;
- earned on contract modifications;
- contingent on future events;
- subject to clawback; and
- that are tiered, subject to a threshold.

In these cases, a telecom entity considers the enforceable rights and obligations created by the arrangement to determine when the liability is accrued and whether to capitalize a commission, and in what amount.

In more complex scenarios, a telecom entity focuses on whether its obligation to pay a commission meets the definition of a liability. This is particularly important when considering commission structures that include thresholds – e.g. a commission amount is payable only if cumulative sales within a given period exceed a specified amount, or the commission rate varies with cumulative sales.

In general, if a telecom entity recognizes a liability to pay commission that qualifies for recognition as the cost of obtaining a contract, then the entity recognizes an asset at the same time.

270-10-45
[IAS 34.29, IFRIC 21.12, 13(a)]

This focus on whether the obligation to pay commission meets the definition of a liability may result in differences between IFRS and US GAAP, due to underlying differences in liability accounting in the two frameworks. Differences may also occur in interim financial statements because IFRS generally takes a discrete approach to interim reporting (with some exceptions). However, US GAAP views the interim period as a portion of the annual period. This can potentially result in different liability recognition and measurement at interim reporting dates.

For example, a commission payable on reaching a specified threshold for which the threshold is expected to be met only in the third quarter is not recognized at the end of the first quarter under IFRS, because the entity does not have a present obligation at that date. Conversely, under US GAAP a portion of the expected commission is recognized as an expense in the first quarter to reflect the portion of the expense that relates to that period.

Judgment required for multiple-tier commissions

Some telecom entities pay sales commissions on a multiple-tier system, whereby the salespersons receive commission on all contracts executed with customers, and their direct supervisor receives commission based on the sales of the employees that report to them. Alternatively, commission structures may have thresholds, where the commission increases depending on the number or dollar value of contracts signed. Telecom entities should use judgment when determining whether the supervisor's commission is incremental to obtaining a specific contract or contracts. The incremental cost is the amount of acquisition cost that can be directly attributable to an identified contract or contracts.

Many sales commission models are based on multiple criteria, not just the acquisition of an individual contract – e.g. overall contract performance. It will require careful analysis to determine what portion of the supervisor's commission is an acquisition cost that is directly related to a specific contract or contracts.

Benefits paid on employee commissions require analysis

To the extent that commissions generate fringe benefits, such as pension benefits or other bonuses, telecom entities need to determine if these costs should be capitalized as part of the commission cost. Some fringe benefits cannot be capitalized because they are not incremental – e.g. car allowances – because they are incurred regardless of the contracts obtained. However, to the extent that fringe benefits are incremental – e.g. employer pension contributions or payroll taxes calculated on the employee's commission – that amount is included in the capitalized cost.

Portfolio approach may be useful in accounting for contract acquisition costs

Many telecom entities have a high volume of low-value commission costs that may be difficult to account for on an individual basis. In those situations, it may be helpful to adopt a portfolio approach for those costs if the criteria for the portfolio approach are met (see 1.4). A telecom entity needs to consider the guidance on amortization of those costs when defining the portfolios.

Comparison with current IFRS

Capitalizing costs to obtain a contract

[IAS 38, IU 05-09]

There is no specific guidance on the accounting for the costs to obtain a contract with a customer in current IFRS. The IFRS Interpretations Committee discussed the treatment of selling costs and noted that only in limited circumstances will direct and incremental recoverable costs to obtain a specifically identifiable contract with a customer qualify for recognition as an intangible asset in the scope of IAS 38.

[IAS 11.21]

In addition, when a contract is in the scope of IAS 11, costs that relate directly to the contract and are incurred in securing it are included as part of the contract costs if they can be separately identified and reliably measured, and it is probable that the contract will be obtained.

[IAS 38]

The new standard therefore brings clarity to this topic. It also introduces a new cost category – an asset arising from the capitalization of the incremental costs to obtain a contract – which is in the scope of the new standard and not in the scope of IAS 38.

Comparison with current US GAAP

Policy election

SEC SAB Topic 13

Under current SEC guidance, a telecom entity can elect to capitalize direct and incremental contract acquisition costs – e.g. sales commissions – in certain circumstances. Under the new standard, a telecom entity capitalizes costs that are incremental to obtaining a contract if it expects to recover them – unless it elects the practical expedient for costs with amortization periods of one year or less. This may affect those telecom entities that currently elect to expense contract acquisition costs, because they will now be required to capitalize them if the anticipated amortization period for such costs is greater than one year.

310-20-25-6 – 25-7

Currently, some telecom entities capitalize a portion of an employee's compensation directly relating to origination activities by analogy to current US GAAP on loan origination fees. This is not permitted under the new standard, because these costs are not incremental to a specific contract – i.e. an employee's salary and benefits are paid whether or not they successfully solicit a sale.

Direct-response advertising costs

340-20-25-4, 720-35-25-5, 944-30-25-1AA

The new standard amends existing cost-capitalization guidance to require the costs of direct-response advertising (except for insurance contracts) to be expensed as they are incurred, because they are not incremental costs to obtain a specific contract.

7.2 Costs of fulfilling a contract

Requirements of the new standard

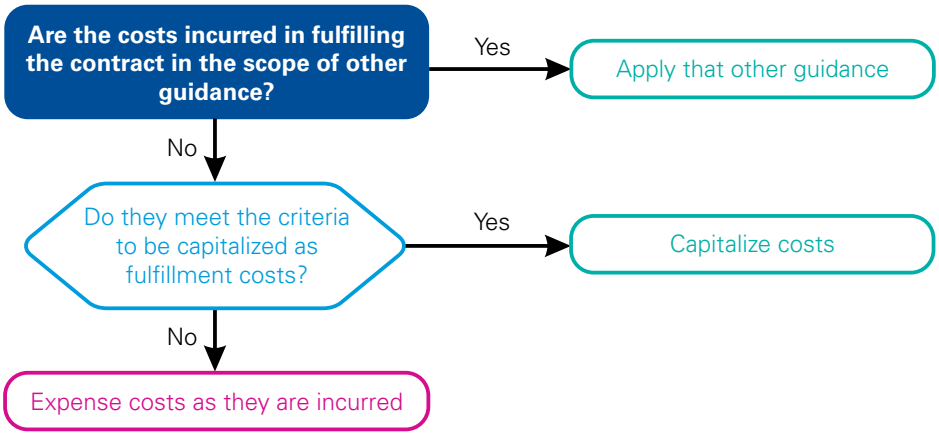
340-40-25-5, ASU 2014-09.BC308
[IFRS 15.95, BC308]

If the costs incurred in fulfilling a contract with a customer are not in the scope of other guidance – e.g. inventory, intangibles or property, plant and equipment – then an entity recognizes an asset only if the fulfillment costs meet the following criteria:

- relate directly to an existing contract or specific anticipated contract;
- generate or enhance resources of the entity that will be used to satisfy performance obligations in the future; and
- are expected to be recovered.

340-40-25-6
[IFRS 15.96]

If the costs incurred to fulfill a contract are in the scope of other guidance, then the entity accounts for them using the other guidance.



340-40-25-7 – 25-8
[IFRS 15.97–98]

The following are examples of costs that are capitalized when the specified criteria are met and of costs that cannot be capitalized.

Direct costs that are eligible for capitalization if other criteria are met ✓	**Costs required to be expensed when they are incurred** ✗
– **Direct labor** – e.g. employee wages – **Direct materials** – e.g. supplies – **Allocation of costs that relate directly to the contract** – e.g. depreciation and amortization – **Costs that are explicitly chargeable to the customer under the contract** – **Other costs that were incurred only because the entity entered into the contract** – e.g. subcontractor costs	– **General and administrative costs** – unless explicitly chargeable under the contract – **Costs that relate to satisfied performance obligations** – **Costs of wasted materials, labor or other contract costs** – **Costs that do not clearly relate to unsatisfied or partially satisfied performance obligations**

340-40-55-5 – 55-9
[IFRS 15.IE192–IE196]

Example 55 – Set-up costs incurred to fulfill a contract

Telco M enters into a contract to manage Customer Y's IT data center for five years, for a fixed monthly fee. Before providing the services, Telco M designs and builds a technology platform to migrate and test Customer Y's data. This platform is not transferred to Customer Y and is not considered a separate performance obligation. The initial costs incurred to set up the platform are as follows.

Design services	40
Hardware and software	210
Migration and testing	100
Total	**350**

These set-up costs relate primarily to activities to fulfill the contract, but do not transfer goods or services to Customer Y. Telco M accounts for them as follows.

Type of cost	Accounting treatment
Hardware	Accounted for under guidance for property, plant and equipment
Software	Accounted for under guidance for internal-use software development/intangible assets
Design, migration and testing of the data center	Capitalized under the new standard because these costs: – relate directly to the contract – generate or enhance resources of Telco M that will be used to satisfy performance obligations in the future – are expected to be recovered over the five-year contract period

The capitalized hardware and software costs are subsequently measured in accordance with other applicable guidance. The costs capitalized under the new standard are subject to its amortization and impairment requirements (see 7.3 and 7.4).

Observations

Contract fulfillment costs will require careful analysis

340-40-25-5
[IFRS 15.95]

The new standard provides additional guidance that may require telecom entities to capitalize some costs incurred in relation to a contract with the customer, if those costs create a resource for the telecom entity and are not covered by other guidance. Therefore, telecom entities should carefully consider costs incurred in relation to a contract, in particular those incurred at the inception of a contract as follows.

- Do the costs relate to a good or service that has been transferred to the customer (see Section 3)? If so, these costs are expensed as they are incurred.
- Does other guidance in IFRS or US GAAP apply? If so, that guidance applies. In particular, if other guidance specifically requires that certain costs be expensed as they are incurred (e.g. advertising costs), then costs in the scope of that guidance continue to be expensed.
- Does the cost guidance in the new standard apply? To the extent that any costs remaining meet the capitalization criteria, they are capitalized as costs to fulfill a contract.

Capitalization is not an accounting policy choice

The new standard requires the capitalization of costs to fulfill a contract that meet the specified criteria. Additionally, unlike the costs to obtain a contract, there is no practical expedient permitting these costs to be expensed if the amortization period would be less than one year. Current GAAP is not specific about the accounting for those costs and telecom entities have made an accounting policy choice to capitalize or expense. The new standard may therefore result in a change in practice.

Telecom entities will need to analyze costs carefully to determine which are now subject to capitalization. Telecom entities that capitalized costs previously also need to determine if their accounting policy complies with the new requirements.

Comparison with current IFRS

Capitalizing costs to fulfill an anticipated contract

[IAS 11]

The new standard requires a telecom entity to capitalize the costs of fulfilling an *anticipated* contract, if the other conditions are met. This is similar to the notion in IAS 11 that costs incurred before a contract is obtained are recognized as contract costs if it is 'probable' that the contract will be obtained. It is not clear whether the Boards intend 'anticipated' to imply the same degree of confidence that a contract will be obtained as 'probable'.

[IAS 2, IAS 18]

IAS 2 will remain relevant for many contracts for the sale of goods that are currently accounted for under IAS 18.

Comparison with current US GAAP

Policy election

SEC SAB Topic 13

Although there is no specific authoritative guidance under current US GAAP, fulfillment costs are generally expensed as they are incurred. For certain set-up costs, however, telecom entities may make an accounting policy election under current SEC guidance to either expense or capitalize these costs. Telecom entities that currently expense these costs will be required to capitalize them under the new standard if certain criteria are met.

Costs in excess of transaction price

In limited circumstances under current US GAAP, the SEC concluded that an entity should not necessarily recognize a loss on a delivered item in a multiple-element revenue arrangement – i.e. not recognize the full costs of a delivered good or service.

Under the new standard, a telecom entity may similarly deliver a good or provide a service, and all or a portion of the transaction price relating to that good or service may be constrained from revenue recognition otherwise the amount of transaction price allocated to the performance obligation may not exceed the cost. There is no provision in the new standard that is similar to the current SEC guidance for situations in which applying the variable consideration constraint or the new standard's allocation guidance results in an up-front loss on the delivered good or service. As a result, in certain circumstances a telecom entity may be required to recognize costs before recognizing expected revenue on satisfied performance obligations.

Cable-specific guidance

922-360-25-7, 922-720-25-3

The general guidance on costs incurred by entities in the cable television industry (cable entities) was not superseded by the new standard. However, we believe that accounting for the costs of reconnections will be impacted by the new standard's requirement to capitalize costs to fulfill a contract.

Under current US GAAP, reconnection costs are expensed as they are incurred. However, in practice, cable entities historically defined reconnections differently. For example, some cable entities defined reconnections broadly to apply to the premise, such that the costs associated with installing a new customer at a previously connected premise are expensed as they are incurred. Other cable entities defined reconnections narrowly to include only situations where the same individual customer reconnected services at the same premise. Consequently, those cable entities capitalized the cost of reconnecting any other customer or the cost of connecting the same customer to a new service at that premise.

Outside of the industry guidance above, existing US GAAP includes a policy choice for costs of obtaining a contract (see 7.1). That policy choice led to a practice in the cable industry related to the costs of reconnections in that certain of the same activities were either expensed or capitalized based on an interpretation of the specific guidance related to reconnections. The new standard changes US GAAP and requires costs of fulfilling a contract that meet certain criteria are to be recognized as an asset. We believe that cable entities that applied a broad definition of a reconnection should look to the guidance in the new standard to account for fulfillment costs and should capitalize costs (e.g. the costs of installing/setting up a new customer or service at a previously connected premise) if the criteria in the new standard are met. As a result of applying the guidance in the new standard, the diversity in this specific practice for cable entities, resulting from the different definitions of a reconnection, should be narrowed.

Costs that are capitalized as a cost of fulfilling a contract should be amortized to cost of sales under the new standard.

7.3 Amortization

Requirements of the new standard

340-40-35-1
[IFRS 15.99]

An entity amortizes the asset recognized for the costs to obtain and/or fulfill a contract on a systematic basis, consistent with the pattern of transfer of the good or service to which the asset relates. This can include the goods or services in an existing contract, as well as those to be transferred under a specific anticipated contract – e.g. goods or services to be provided following the renewal of an existing contract.

Example 56 – Amortization of acquisition costs for month-to-month contracts

Telco E enters into a month-to-month wireless contract with Customer C that includes voice and data services. The dealer is paid a commission of 20 at the time of sale. Telco E does not pay commissions on renewals of month-to-month contracts. Based on historical experience and customer analysis, Telco E expects Customer C to renew the contract for 36 months (i.e. three years).

Telco E recognizes an asset of 20 for the commission paid and amortizes that asset over the three-year period – i.e. on a systematic basis consistent with the pattern of satisfaction of the performance obligation, and including specifically anticipated renewals.

Example 57 – Commission paid on renewals after the initial contract is obtained

Continuing Example 54 (see 7.1). Fact pattern is repeated here for convenience.

Telco A pays its sales employees a commission of 30 for each new two-year wireless contract entered into with a customer. Telco A also pays 10 to sales employees each time a customer renews a contract for an additional two years. Telco A previously concluded that both commissions qualify as a cost to obtain a contract and are capitalized when they are incurred.

Based on historical experience and customer analysis, Telco A expects the customer to renew for an additional two years for a total of four years. Telco A further observes that the 10 renewal commission is not commensurate with the 30 paid at the inception of the contract.

Telco A concludes that the first commission relates to a longer period than the initial two-year contract term. The commission should therefore be amortized over four years – i.e. on a systematic basis consistent with the pattern of satisfaction of the performance obligation, and including the specifically anticipated renewal period. The renewal commission, however, is amortized over two years, being the period to which the commission relates. In this fact pattern, the amortization expense would therefore be higher during the renewal period than during the initial contract period.

Observations

Amortization period may need to include anticipated contracts

Under the new standard, a capitalized contract cost asset is amortized based on the transfer of goods or services to which the asset relates. In making this determination, the new standard notes that those goods or services could be provided under an anticipated contract that the telecom entity can specifically identify.

The new standard does not prescribe how a telecom entity should determine whether one or more anticipated contracts are specifically identifiable, so practice is likely to develop over time. Relevant factors to consider may include the telecom entity's history with that customer class, and predictive evidence derived from substantially similar contracts. In addition, a telecom entity may consider the available information about the market for its goods or services beyond the initial contract term – e.g. whether it expects the service still to be in demand when renewal would otherwise be anticipated. Judgment will be involved in determining the amortization period of contract cost assets, but telecom entities should apply consistent estimates and judgments across similar contracts, based on relevant experience and other objective evidence.

Anticipated contracts included when determining whether practical expedient applies

Under the new standard, a telecom entity assesses the amortization period to determine whether it is eligible to apply the practical expedient not to recognize an asset for the incremental costs to obtain a contract (costs to fulfill a contract are not eligible for the practical expedient). For example, a cable television company incurs incremental costs to obtain contracts with customers that have an initial term of one year. However, a significant proportion of customers renew the contracts at the end of the initial term. In this case, the company cannot assume that it is eligible for the practical expedient, but instead has to determine the amortization period.

Judgment is required when contracts include recurring commissions

Many telecom entities pay sales commissions on all contracts executed with customers, including new contracts – i.e. new services and/or new customers – and renewal or extension contracts. If the commission paid by a telecom entity on a new contract will be followed by corresponding commissions for each renewal period – i.e. the salesperson will receive an incremental commission each time the customer renews the contract, or does not cancel it – then the telecom entity applies judgment to determine whether the original commission on the new contract should be amortized only over the initial contract term, or over a longer period.

The capitalized asset is generally recognized over the period covered by the commission. If the renewal commission is commensurate with the initial commission, then the initial commission is amortized over the original contract term and the renewal commission is amortized over the renewal period. Commissions are generally considered commensurate with each other when they are reasonably proportional to the respective contract value.

Systematic amortization for contract assets related to multiple performance obligations

The new standard requires the asset to be amortized on a systematic basis (which might not be on a straight-line basis) that is consistent with the transfer to the customer of the goods or services to which the asset relates. When the contract contains multiple performance obligations satisfied at different points in time – e.g. in complex enterprise arrangements – the telecom entity takes this into account when determining the appropriate amortization period and pattern.

No correlation with the accounting for nonrefundable up-front fees

The amortization pattern for capitalized contract costs (i.e. including the term of specific anticipated contracts) and the revenue recognition pattern for nonrefundable up-front fees (i.e. the existing contract plus any renewals for which the initial payment of the up-front fee provides a material right to the customer) are not symmetrical under the new standard (see 9.1). Therefore, there is no requirement under the new standard for the recognition pattern of these two periods to align, even if contract costs and nonrefundable up-front fees on the same contract are both deferred.

Presentation of amortization costs

If a telecom entity chooses to present its expenses by nature, then judgment will be required to determine the nature of the expenses arising from the amortization of capitalized contract costs. In all cases, a telecom entity is subject to the general requirement to ensure that its presentation is not misleading and is relevant to an understanding of its financial statements.

Comparison with current US GAAP

No correlation with the accounting for nonrefundable up-front fees

SEC SAB Topic 13

Current SEC guidance on revenue recognition indicates that registrants are required to defer nonrefundable up-front fees if they are not in exchange for goods delivered or services performed that represent the culmination of a separate earnings process. These fees are deferred and recognized as revenue over the expected period of performance, which may include expected renewal periods if the expected life of the contract extends beyond the initial period. Similarly, the guidance states that a telecom entity may elect an accounting policy of deferring certain set-up costs or customer acquisition costs.

If the amount of deferred up-front fees exceeds the deferred costs, then these two amounts are recognized over the same period and in the same manner. However, if the amount of deferred costs exceeds the deferred revenue from any up-front fees, then current practice is somewhat mixed and some telecom entities may amortize the net deferred costs over the shorter of the estimated customer life and the stated contract period.

The new standard effectively decouples the amortization of contract fulfillment costs from that for any nonrefundable up-front fees in the contract (see 9.1). The capitalization of qualifying fulfillment costs is not a policy election (see 7.2). The amortization period for contract cost assets is determined in a manner substantially similar to that under current guidance when up-front fees result in an equal or greater amount of deferred revenue – i.e. the existing contract plus any anticipated renewals that the telecom entity can specifically identify. However, contract costs that were previously deferred without any corresponding deferred revenue may be amortized over a longer period under the new standard than under current US GAAP.

S-X Rule 5-03(b)

Presentation of costs similar to current SEC guidance

SEC guidance on income statement classification requires costs and expenses applicable to sales and revenues to be separately stated from selling, general and administrative expenses. The new standard does not change this guidance. A telecom entity may have costs that are required to be capitalized under the new standard that are expensed as they are incurred under current US GAAP. The classification of the amortization cost will be treated the same as the current classification of the expense. Amortization of costs to obtain a contract will generally be classified as selling, general and administrative expenses. A telecom entity will determine the appropriate costs of sales category in which to classify amortization of its costs to fulfill a contract.

7.4 Impairment

Requirements of the new standard

340-40-35-3
[IFRS 15.101]

An entity recognizes an impairment loss to the extent that the carrying amount of the asset exceeds the recoverable amount. The 'recoverable amount' is defined as:

- the remaining expected amount of consideration to be received in exchange for the goods or services to which the asset relates; *less*
- the costs that relate directly to providing those goods or services and that have not been recognized as expenses.

340-40-35-4
[IFRS 15.102]

When assessing an asset for impairment, the amount of consideration included in the impairment test is based on an estimate of the amounts that the entity expects to receive. To estimate this amount, the entity uses the principles for determining the transaction price, with two key differences:

- it does not constrain its estimate of variable consideration – i.e. it includes its estimate of variable consideration, regardless of whether the inclusion of this amount could result in a significant revenue reversal if it is adjusted; and
- it adjusts the amount to reflect the effects of the customer's credit risk.

Observations

New impairment model for capitalized contract costs

Topics 330, 360
[IAS 2, IAS 36]

The new standard introduces a new impairment model that applies specifically to assets that are recognized for the costs to obtain and/or fulfill a contract. The Boards chose not to apply the existing impairment models in US GAAP or IFRS, in order to have an impairment model that focuses on contracts with customers. A telecom entity applies this model in addition to the existing impairment models.

350-20-35-31 – 35-32, Topics 350, 360
[IAS 36.22]

The telecom entity applies, in the following order:

- any existing asset-specific impairment guidance (e.g. for inventory);
- the impairment guidance on contract costs under the new standard; and
- the impairment model for cash-generating units (IFRS) or for asset groups or reporting units (US GAAP).

For example, if a telecom entity recognizes an impairment loss under the new standard, then it is still required to include the impaired amount of the asset in the carrying amount of the relevant cash-generating unit or asset group/reporting unit if it also performs an impairment test under IAS 36, or in applying current property, plant and equipment, intangibles or goodwill impairment guidance under US GAAP.

Specific anticipated contracts are considered in impairment test

The new standard specifies that an asset is impaired if its carrying amount exceeds the remaining amount of consideration that a telecom entity expects to receive, less the costs that relate directly to providing those goods or services that have not been recognized as expenses.

Under the new standard, a telecom entity considers specific anticipated contracts when capitalizing contract costs. Consequently, the telecom entity includes cash flows from both existing contracts and specific anticipated contracts when determining the consideration expected to be received in the contract costs impairment analysis. However, the telecom entity excludes from the amount of consideration the portion that it does not expect to collect, based on an assessment of the customer's credit risk.

Future development in US GAAP

Consideration received but not recognized as revenue

340-40-35-4

When assessing a contract asset for impairment, a telecom entity determines the consideration that it expects to receive. This amount includes both the amount of consideration that it has already received, but has not recognized as revenue, and the amount that it expects to receive in exchange for the goods or services to which the contract asset relates. The FASB proposes to clarify this point. As of the date of this publication, the FASB has not finalized this proposal.

340-40-35-6
[IFRS 15.104]

Differences between IFRS and US GAAP

Reversal of an impairment loss

The requirements on a reversal of an impairment loss are different under the US GAAP and IFRS versions of the new standard, to maintain consistency with the existing models. Under US GAAP, a telecom entity does not recognize a reversal of an impairment loss that has previously been recognized.

By contrast, under IFRS a telecom entity recognizes a reversal of an impairment loss that has previously been recognized when the impairment conditions cease to exist. Any reversal of the impairment loss is limited to the carrying amount, net of amortization, that would have been determined if no impairment loss had been recognized.

8 Customer options for additional goods or services

Overview

Customer options to acquire additional goods or services come in many forms, including sales incentives, customer credits, contract renewal options or other discounts on future goods or services. A telecom entity accounts for a customer option to acquire additional goods or services as a performance obligation if the option provides the customer with a material right. Telecom customers often have the ability to acquire additional goods or services (add-ons), and are offered a wide range of significant discounts and other marketing offers. Consequently, identifying customer options and whether they provide a material right to the customer may be particularly challenging for telecom entities and will often require significant judgment.

Nonrefundable up-front fees that may convey material rights are addressed in Section 9.

8.1 Determining if a material right is created by contract options

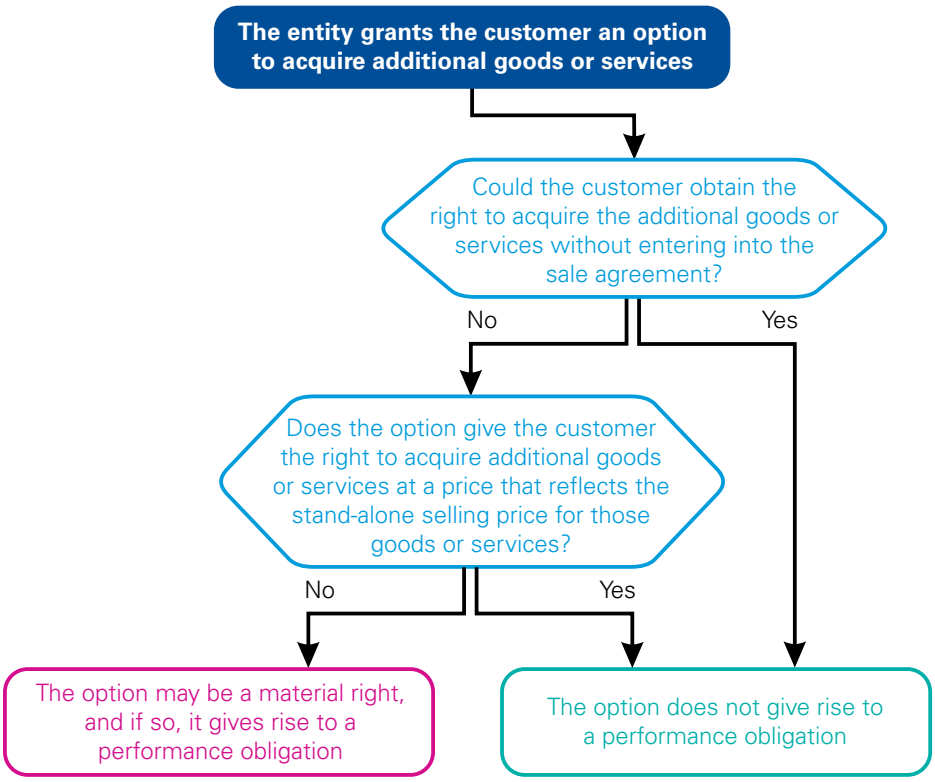
Requirements of the new standard

606-10-55-42
[IFRS 15.B40]

When an entity grants the customer an option to acquire additional goods or services, the option is a performance obligation under the contract if it provides a material right that the customer would not receive without entering into that contract.

606-10-55-42 – 55-43
[IFRS 15.B40–B41]

The following flow chart helps analyze whether a customer option is a performance obligation.



Example 58 – Cable television service and additional premium channels

Cable B contracts with Customer D to provide television services for a fixed monthly fee for 24 months. The base television services package gives Customer D the right to purchase additional premium channels. In Month 3, Customer D adds a premium sports channel for an additional 5 per month, which is the price that all customers pay for the premium sports channel (i.e. it is priced at its stand-alone selling price).

The premium channel can be added or dropped by the customer without affecting the base cable television service. Therefore, the premium channel represents an option to purchase additional goods or services.

At contract inception, Cable B concludes that because the option to purchase the premium channel is priced at its stand-alone selling price, the option is not a material right. Therefore, the option is not identified as a performance obligation at contract inception. Cable B will recognize revenue for the premium channel in Month 3 when it provides the services.

Example 59 – Wireless contract with option for data

Telco B contracts with Customer C to provide wireless voice, text messaging and data services for 24 months for a monthly fee of 100. The customer can purchase additional data for 2 per megabyte, which is the price for all additional data (i.e. it is the stand-alone selling price).

The additional data can be added or dropped by the customer without affecting the wireless service. Therefore, the additional data represent an option to purchase additional goods or services.

Telco B concludes that because the option to purchase additional data is priced at its stand-alone selling price, it is not a material right. Therefore, the option is not identified as a performance obligation at contract inception. Telco B will recognize revenue for the additional data when it provides the services.

Example 60 – Optional added shared wireless lines

Telco C contracts with Customer D for a wireless plan that provides unlimited voice and 10GB of data for 80 per month. Telco C permits Customer D to add up to three additional lines of service and share the 10GB of data included in the first wireless plan. Telco C sells each additional line for 30 per month, which is the price for all individual unlimited voice plans with access to shared data (i.e. it is the stand-alone selling price).

Each additional line is priced at a lower amount than the first individual line as the addition of each line provides unlimited voice and the ability to share the same data, rather than conveying another 10GB of data.

The additional lines represent an option to purchase additional goods or services.

Telco C concludes that because the option to purchase additional lines is priced at its stand-alone selling price, it is not a material right. Therefore, the option is not identified as a performance obligation at contract inception. Telco C will recognize revenue for the additional lines when it provides the services.

Example 61 – Wireless with global add-on

Customer C signs an agreement with Telco D for voice, text and data services for 24 months. All services are unlimited and are provided on a monthly basis. During Month 6 of the contract, the customer adds an optional global rate plan for 25 a month, which is the price for all global rate plans (i.e. it is the stand-alone selling price).

The customer can remove or add the global rate plan as needed, without affecting the wireless service. Therefore, the global rate plan represents an option to purchase additional goods or services.

Telco D concludes that because the option to purchase the global rate plan is priced at its stand-alone selling price, it is not a material right. Therefore, the option is not identified as a performance obligation at contract inception. Telco D will recognize revenue for the global rate plan when it provides the services.

Observations

Determining whether a material right exists requires an evaluation of both quantitative and qualitative factors

A telecom entity considers whether a customer option for additional goods or services is a material right at contract inception based on both quantitative and qualitative factors. Although that evaluation is judgmental and no specific criteria exist for an evaluation, the telecom entity considers whether it would likely impact the customer's decision on whether to exercise the option to continue buying the telecom entity's product or service. This is consistent with the notion that an entity considers valid expectations of the customer when identifying promised goods or services. For example, an arrangement that allows the customer to renew services at a significant discount that is incremental to other discounts typically provided and in which the telecom entity expects customers to renew primarily as a result of the discount itself would generally be considered a material right.

A telecom entity will need to carefully evaluate the specifics of its contracts to determine whether the terms convey rights that are significant to the customer. Material rights are separate performance obligations to which a portion of the contract's transaction price is allocated at contract inception (see 8.2).

Options available only because a contract was previously entered into are not always material rights

606-10-55-43
[IFRS 15.B41]

A customer may be able to exercise an option in a contract solely as a result of having entered into a contract. An option exercisable at its stand-alone selling price does not convey a material right, but rather is a marketing offer that does not constitute a separate performance obligation. Commonly, additional services or features offered by a telecom entity will not be material rights because the additional services or features are priced at their stand-alone selling prices.

Upgrade rights require careful evaluation

A telecom entity often sells a handset for less than the stand-alone selling price when it is bundled with a term (e.g. 24 months) service plan. Some telecom entities also include in the contract, or have a customary business practice of providing, a promise that after a certain period of time the customer can upgrade its handset by entering into another term plan at the current stand-alone selling price. In these cases, rights to the remaining consideration under the initial contract, including any early termination penalties, are waived.

These promises require careful analysis of the terms and conditions to determine the appropriate accounting. Because the waiver is provided on the condition that the customer enters into a new contract, some view the waiver as an incentive (akin to a discount) offered as part of the new contract. Therefore, the promise or right to upgrade at a discount could be accounted for as a material right. However, others believe that the waiver of the early termination penalties affects the transaction price of the initial contract. In these cases, the promise or right to early upgrade with some waived fees would result in less expected consideration on the first handset and thus would require an estimate of the variable consideration. However, the consideration of the contract only would vary if the renewal option is exercised and an additional service plan is agreed to. Accordingly, the exercise of the early upgrade option also affects both the scope of the goods and services, as well as the price, and therefore some believe the option is not variable consideration. Whether the promise or right is accounted for as a material right or variable consideration, the amount and timing of the revenue recognized for the handset and service may be similar.

When the contract does not explicitly include the promise to upgrade and this is not implied by customary business practices, a contract asset would remain at the time of early upgrade. If the telecom entity concludes that the contract modification guidance applies, then the contract asset may be rolled into the new contract and derecognized prospectively as a reduction of the revenue recognized under the new contract.

Determining the class of customer when assessing options requires careful consideration

When assessing whether an option grants a material right to the customer, a telecom entity assesses whether the discount provided is incremental to the range of discounts typically given for those goods or services to that *class* of customer. In determining the appropriate class of customer, a telecom entity considers a number of factors, such as geography or market. For example, enterprise customers may be a different class of customer from individual consumers.

However, a class of customer is not determined by the customer's prior purchasing history. For example, a customer who has already purchased goods or services from the telecom entity (i.e. an 'existing' customer) is not necessarily (if all other factors are the same) in a different class from those customers who have not already purchased goods or services from the telecom entity (i.e. 'new' customers).

Customer loyalty arrangements may convey material rights

Customer loyalty arrangements that allow customers to accrue points, or similar benefits, through purchases over time may convey material rights. See 10.4 in Issues In-Depth, Edition 2016 for additional guidance.

8.2 Measuring and accounting for material rights

Requirements of the new standard

606-10-55-44
[IFRS 15.B42]

If the stand-alone selling price of a customer's option to acquire additional goods or services that is a material right is not directly observable, then an entity needs to estimate it. This estimate reflects the discount that the customer would obtain when exercising the option, adjusted for:

– any discount that the customer would receive without exercising the option; and

– the likelihood that the option will be exercised.

606-10-55-45
[IFRS 15.B43]

If the goods or services that the customer has a material right to acquire are similar to the original goods or services in the contract – e.g. when the customer has an option to renew the contract – then an entity may allocate the transaction price to the optional goods or services by reference to the goods or services expected to be provided and the corresponding consideration expected to be received.

Example 62 – Fixed price guarantee on renewal of service

A customer enters into a one-year service contract with Telco B. The customer agrees to pay 50 per month. The contract gives the customer the right to renew the contract for an additional year for 50 monthly. Telco B estimates that prices charged to customers in the same class will increase to 56 per month in the next year and that 75% of customers will renew.

In these specific circumstances, based on quantitative and qualitative factors, Telco B concludes that the renewal option is a material right because the expected discount on renewal is sufficient to influence the customer's behavior, and the customer is likely to renew. Therefore, there are two performance obligations in the contract: the first year of service and the material right to renew the contract at a discount.

Telco B allocates the transaction price of 600 (12 x 50) to the performance obligations based on their relative stand-alone selling prices. Telco B determines that the stand-alone selling price of the current-year service is 600.

Telco B estimates the stand-alone selling price of the material right at 54 by multiplying the estimated monthly discount by the expected likelihood of exercise ((56 less 50) x 12 months x 75%).

Telco B allocates the transaction price as follows.

	Stand-alone selling prices	Relative %	Allocation
Service	600	92%	552
Material right	54	8%	48
	654	**100%**	**600**

In Year 1, Telco B recognizes revenue of 46 per month (552 ÷ 12 months). In Year 2, assuming exercise of the option to renew, Telco B recognizes revenue of 54 per month ((48 allocated to the material right + 50 per month x 12) ÷ 12 months). If the customer does not renew the contract, then Telco B recognizes the 48 allocated to the material right as revenue when the right expires – i.e. at the end of the first year of service, in this example.

Example 63 – Fixed price guarantee on renewal of service: Applying the practical alternative

Using the same facts as Example 62, Telco B determines that instead of estimating the stand-alone selling price of the material right, it could use a practical alternative to allocate the transaction price. The practical alternative can be used in this case because the customer has a material right to acquire goods or services that are similar to the original goods or services. Therefore, Telco B allocates the transaction price to the optional goods and services with reference to the goods or services expected to be provided and the expected consideration as follows.

Expected consideration: 50 x 12 (Year 1) + 75% x 50 x 12 (Year 2) = 1,050

Goods or services expected to be provided: 50 x 12 (Year 1) + 75% x 56 x 12 (Year 2) = 1,104

In Year 1, Telco B recognizes revenue of approximately 47 for each month in the first year (600 ÷ 1,104 x 1,050 ÷ 12 = 47). Consequently, Telco B allocates 36 (600 - (47 x 12)) to the option to renew at the end of Year 1. Therefore, Telco B recognizes approximately 53 in each month during Year 2 (600 + 36 allocated to the material right) if the option is exercised.

If the option is not exercised, then the remaining 36 would be recognized when the option expires. The outcome of this approach results in the effective discount on renewal being allocated to the periods consistent with Telco B's expectation that prices will increase.

Observations

Options to purchase additional goods and services at their stand-alone selling prices do not represent a material right

606-10-55-43
[IFRS 15.B41]

Generally, options to purchase goods or services at their stand-alone selling prices do not represent a material right and are not accounted for as a performance obligation at contract inception. This is an important distinction that will impact the allocation of the transaction price.

Telecom entities need to estimate the stand-alone selling price of an option that represents a material right

606-10-55-44 – 55-45
[IFRS 15.B42–B43]

Telecom entities typically do not sell 'options' that represent a material right separately. Therefore, the stand-alone selling prices of these types of options may not be readily observable and may need to be estimated. That estimate should reflect the discount that the customer would obtain when exercising the option, adjusted for any discount that the customer could receive without exercising the option, and the likelihood that the option will be exercised.

If the material right is to acquire future goods or services that are similar to the original goods or services in the contract and are provided based on the terms of the original contract, then a telecom entity may use a practical alternative to estimating the stand-alone selling price of the option. Under this practical alternative, the telecom entity allocates the transaction price to the optional goods or services with reference to the goods or services expected to be provided and the expected consideration. A telecom entity needs to evaluate its specific facts, and the potential impact of the likelihood that the option will be exercised, to determine the proper accounting and apply the approach consistently.

Estimate of the likelihood of exercise of an option is not revised

606-10-32-43
[IFRS 15.88]

When determining the stand-alone selling price of a customer option for additional goods or services a telecom entity estimates the likelihood that the customer will exercise the option. This initial estimate is not subsequently revised because it is an input into the estimate of the stand-alone selling price of the option. Under the new standard, a telecom entity does not reallocate the transaction price to reflect changes in stand-alone selling prices after contract inception.

The customer's decision to exercise the option or allow the option to expire affects the timing of recognition of the amount allocated to the option but it does not result in reallocation of the transaction price.

Exercise of a material right

When a customer exercises a material right for additional goods and services, a telecom entity may account for it using one of the following approaches.

– *Continuation of the original contract:* Under this approach, a telecom entity treats the consideration allocated to the material right as an addition to the consideration for the goods or services under the contract option – i.e. as a change in the transaction price.

– *Contract modification:* Under this approach, a telecom entity applies the contract modification guidance to evaluate whether the goods or services transferred on exercise of the option are distinct from the other goods or services in the contract. The outcome of this evaluation will determine whether the modification is accounted for prospectively or with a cumulative catch-up adjustment.

In telecom consumer contracts, the optional goods or services would typically be distinct from those promised in the original contract. Therefore, the outcome under either approach will be similar and prospective.

Material rights do not extend the term of a contract

A right to renew a contract may create a material right (i.e. because there is an incentive for the customer to renew the contract). This material right may be recognized in a period beyond the contract's initial term. However, the existence of a material right does not extend the term of the contract, which is defined by the enforceable rights and obligations (see Section 2).

Comparison with current IFRS

Treatment of customer loyalty programs broadly similar to current practice

[IFRIC 13]

The current IFRS guidance on customer loyalty programs is broadly similar to the guidance in the new standard.

However, a telecom entity needs to consider whether the allocation method that it currently applies remains acceptable under the new standard. Under current IFRS, a telecom entity can choose which method it wants to use to allocate the consideration between the sales transaction and the award credits, and many use the residual method to estimate the stand-alone selling price of award credits. By contrast, under the new standard the residual approach can only be applied if certain criteria are met.

605-25, 985-605-55-82 – 55-85

Comparison with current US GAAP

Stand-alone selling price of a customer option

The new revenue standard requires an entity to establish either an observable or an estimated stand-alone selling price for a customer option that provides the customer with a material right. This is not a requirement under current US GAAP. There are two approaches to accounting for a significant incremental discount under current US GAAP.

- *Apply general multiple element accounting guidance:* An entity may account for the option as a separate deliverable under general multiple element accounting guidance. This practice is similar to the accounting required under the new standard.
- *Apply software revenue recognition guidance:* Although this guidance applies to software arrangements, it is sometimes analogized to in the accounting for significant incremental discounts in non-software arrangements. This approach generally results in accounting that is different from the new standard and typically results in a greater amount allocated to the future discount than under the new standard.

Under the software guidance, if an arrangement includes a right to a significant incremental discount on a customer's future purchase of products or services, then a proportionate amount of that significant incremental discount is applied to each element based on its fair value (selling price) without regard to the significant incremental discount. For example, a 35% discount on future purchases would result in each element in the arrangement being recognized at a 35% discount to its fair value (selling price). This approach does not require an estimate of the selling price for that customer option. This is different from the new revenue standard's requirement to establish either an observable or an estimated stand-alone selling price for a customer option that is a material right.

In addition, if the products to which the discount applies are not specified or the fair value of the future purchases cannot be determined but the maximum discount is quantifiable, then under current guidance it is allocated to the elements assuming that the customer will purchase the minimum amount necessary to receive the maximum discount. This approach is inconsistent with the new standard's guidance on estimating the selling price of an option, which inherently includes an estimate of breakage.

These changes may increase the need to establish estimates, and related internal processes and controls, when customer options for the future purchase of goods or services are included in contracts.

9 Nonrefundable up-front fees

Overview

Many telecom contracts include nonrefundable up-front fees that are paid at or near contract inception – e.g. activation fees, set-up fees or other payments made at contract inception. The new standard provides guidance on determining the timing of recognition for these fees, which may vary depending on whether goods or services are transferred to the customer at the beginning of the contract and whether those goods or services are distinct, and on the nature of the contract (month-to-month versus a term contract). Some nonrefundable up-front fees may also convey a material right to the customer – e.g. for future renewals of service at a discount.

Requirements of the new standard

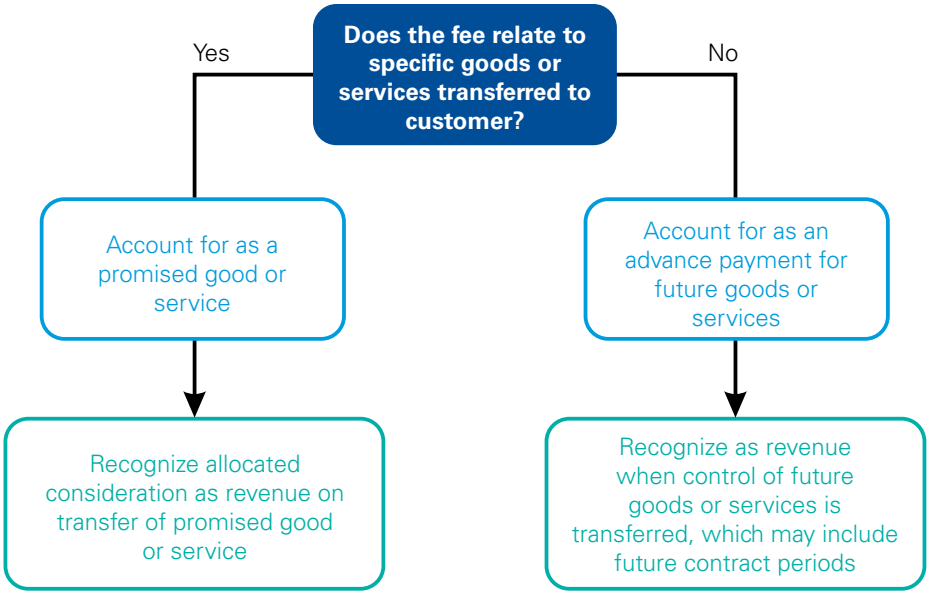
606-10-55-42, 55-50 – 55-53
[IFRS 15.B40, B48–B51]

An entity assesses whether the nonrefundable up-front fee relates to the transfer of a promised good or service to the customer.

In many cases, even though a nonrefundable up-front fee relates to an activity that the entity is required to undertake in order to fulfill the contract, that activity does not result in the transfer of a promised good or service to the customer. Instead, it is an administrative task. For further discussion on identifying performance obligations, see Section 3.

If the up-front fee gives rise to a material right for future goods or services, then the entity attributes all of the goods and services to be transferred, including the material right associated with the up-front payment (see 9.1).

If the activity does not result in the transfer of a promised good or service to the customer, then the up-front fee is an advance payment for performance obligations to be satisfied in the future and is recognized as revenue when those future goods or services are provided (see 9.2).



Observations

Up-front fee may need to be allocated

A nonrefundable up-front fee forms part of the transaction price of the contract and is allocated to performance obligations, including any material right, under the new standard.

Even when a nonrefundable up-front fee relates to a promised good or service, the amount of the fee may not equal the relative stand-alone selling price of that promised good or service; therefore, some of the nonrefundable up-front fee may need to be allocated to other performance obligations (see 5.2).

Telecom entities also consider how the up-front fee affects the determination of the stand-alone selling price of the goods or services promised in the arrangement because, in some cases, it may be appropriate to add it to the stand-alone selling price of just one of the performance obligations (see Example 66 in 9.2).

Consideration of whether a nonrefundable up-front fee gives rise to a significant financing component

606-10-32-15
[IFRS 15.60]

A telecom entity will need to consider whether the receipt of an up-front payment gives rise to a significant financing component within the contract. An up-front fee may not result in a significant financing component when, for example, the fee is small or the contract term is month-to-month. This may commonly occur in consumer contracts.

However, assessing whether a nonrefundable up-front fee gives rise to a significant financing component may be relevant for certain enterprise and network capacity contracts. All relevant facts and circumstances need to be evaluated, and a telecom entity may need to apply significant judgment in determining whether a significant financing component exists (see 4.4).

9.1 Assessing if nonrefundable up-front fees convey a material right

Example 64 – Nonrefundable up-front fees: Annual contract

Cable A enters into a one-year contract to provide cable television to Customer C. In addition to a monthly service fee of 100, Cable A charges a one-time up-front fee of 50. Cable A has determined that the up-front activity does not transfer a promised good or service to Customer C, but is instead an administrative task.

At the end of the year, Customer C can renew the contract on a month-to-month basis at the then-current monthly rate, or can commit to another one-year contract at the then-current annual rate. In either case, Customer C will not be charged another fee on renewal. The average customer life for customers entering into similar contracts is three years.

Cable A considers both quantitative and qualitative factors to determine whether the up-front fee provides an incentive for Customer C to renew the contract beyond the stated contract term to avoid the up-front fee. If the incentive is important to Customer C's decision to enter into the contract, then there is a material right.

First, Cable A compares the up-front fee of 50 with the total transaction price of 1,250 (the up-front fee plus the service fee of 1,200 (12 x 100)). It concludes that the nonrefundable up-front fee is not quantitatively material.

Second, Cable A considers the qualitative reasons Customer C might renew. These include, but are not limited to, the overall quality of the service provided, the services and related pricing provided by competitors, and the inconvenience to Customer C of changing service providers (e.g. returning equipment to Cable A, scheduling installation by the new provider).

Cable A concludes that, although the avoidance of the up-front fee on renewal is a consideration to Customer C, this factor alone does not influence Customer C's decision whether to renew the service. Cable A concludes based on its customer satisfaction research data that the quality of service provided and its competitive pricing are the key factors underpinning the average customer life of three years.

Overall, Cable A concludes that the up-front fee of 50 does not convey a material right to Customer C.

As a result, the up-front fee is treated as an advance payment on the contracted one-year cable services and is recognized as revenue over the one-year contract term. This results in monthly revenue of 104 (1,250 ÷ 12) for the one-year contract.

Conversely, if Cable A determined that the up-front fee results in a contract that includes a customer option that is a material right, then it would allocate the total transaction price including the up-front fee between the one-year cable service and the material right to renew the contract. The consideration allocated to the material right would be recognized as revenue when that right is exercised or expires (see 8.2).

Example 65 – Activation fee in a month-to-month wireless contract

Telco B charges a one-time activation fee of 25 when Customer D enters into a month-to-month contract for a voice and data plan that costs 50 per month. Customer D has no obligation to renew the contract in the subsequent month. If Customer D does renew, then no activation fee will be charged in the second or subsequent months. Telco B's average customer life for month-to-month contracts is two years.

606-10-55-51
[IFRS 15.B49]

Telco B concludes that there are no goods or services transferred to Customer D on activation. Therefore, the up-front fee does not relate to a good or service and the only performance obligation in the arrangement is the voice and data plan. The activation is merely an administrative activity that Telco B must perform to allow Customer D to access its network.

The activation fee is considered an advance payment for future goods or services and included in the transaction price in Month 1.

606-10-55-42
[IFRS 15.B40]

Telco B then assesses whether the option to renew the contract without paying the activation fee on renewal represents a material right for Customer D. Telco B considers both qualitative and quantitative factors in determining whether Customer D has a material right to renew at a discount.

Customer D pays 75 in Month 1 and would pay 50 in each subsequent month for which renewal occurs. Therefore, the 'discount' on the renewal rate is quantitatively material. Telco B also notes that Customer D is likely to renew the contract beyond the first month, and that his decision to renew is affected significantly by the up-front fee.

Therefore, Telco B concludes that the activation fee is a prepayment for future goods and services and represents a material right. The activation fee will be recognized over the period for which Customer D consumes the services that give rise to the material right. This period is often shorter than the average customer life.

Observations

The activation fee does not always convey a material right to the customer

In some cases, the activation fee may not convey a material right to the customer. This would occur when, after considering both qualitative and quantitative factors, a telecom entity concludes that a customer's decision to renew a contract is not significantly affected by the up-front fee. Qualitative factors could include the quality of the service provided, increasing ease associated with changing service providers or promotional offers by competitors that do not include an activation fee.

However, this assessment may be different for longer-term contracts, where the qualitative factors may be very uncertain. For example, in a 10-year service contract, it may be difficult to know what may influence the customer's decision to renew when the contract is completed. In these cases, an assessment of quantitative factors may be more relevant.

Judgment will be required when assessing the qualitative and quantitative factors to determine whether an up-front fee gives rise to a material right.

Determining the period of recognition of the material right requires judgment

If the payment of an up-front fee provides a material right to the customer, then the fee is recognized over the period for which the payment provides the customer with a material right. Determining that period will require significant judgment, because it may not align with the stated contractual term or other information historically maintained by the entity – e.g. the average customer relationship period.

A telecom entity should also consider quantitative and qualitative factors in the assessment of whether there is a material right. These additional factors may often result in the recognition of the material right over a period that is shorter than the average customer life.

9.2 Accounting for nonrefundable up-front fees that do not convey a material right

Example 66 – Allocation of the transaction price, including a nonrefundable up-front fee

TelcoT enters into a one-year wireless contract to provide Customer E with a handset and a voice and data plan (the wireless plan) for a price of 35 per month. TelcoT charges an activation fee of 25, which represents an administrative activity and not a performance obligation. This fee is waived only in unusual circumstances. TelcoT has identified the handset and the wireless plan as separate performance obligations. TelcoT considered quantitative and qualitative factors and concluded that the activation fee does not convey a material right to Customer E.

TelcoT sells the handset separately for a price of 200, which provides observable evidence of a stand-alone selling price. TelcoT also offers a one-year plan without a phone that includes the same level of data/calls/texts for a price of 25 per month, with an activation fee of 25 (also concluded not to include a material right). This pricing, including the activation fee, is used to determine the stand-alone selling price of the wireless plan of 325 (25 x 12 months + 25).

The transaction price of 445 (35 x 12 months + activation fee of 25)[a] is allocated to the performance obligations based on their relative stand-alone selling prices as follows.

Performance obligation	Stand-alone selling prices	Transaction price	Price allocation	Calculation
Handset	200	-	170	(445 x 38%)
Wireless plan	325	420	275	(445 x 62%)
Activation fee	-	25		
Total	**525**	**445**	**445**	

Note

a. For purposes of this example, Telco T did not adjust the consideration to reflect the time value of money because Telco T applied the practical expedient. See 4.4 for details on accounting for a significant financing component.

Observations

Nonrefundable up-front fees can affect the stand-alone selling price of the performance obligations

An up-front fee may affect the determination of the stand-alone selling price of the goods or services promised in the arrangement. For example, if a telecom entity regularly requires a customer to pay an activation fee with a wireless service plan, then this activation fee may be considered when determining the stand-alone selling price for that wireless service plan. The fact that the activation fee is separately itemized on the customer bill does not affect the conclusion of whether the fee relates solely to one or more but not all goods and services sold to the customer.

However, if a telecom entity regularly waives activation or other up-front fees for a significant proportion of its customers, then it may not be included in the stand-alone selling price of the ongoing service.

Ultimately, the inclusion of the up-front fee in the stand-alone selling price of a good or service in the arrangement may affect the allocation of the transaction price that will include that up-front fee.

Comparison with current IFRS

Accounting for nonrefundable up-front fees

[IAS 18.IE17]

Under current IFRS, any initial or entrance fee (e.g. an activation fee in the telecom industry) is recognized as revenue when there is no significant uncertainty over its collection and the entity has no further obligation to perform any continuing services. It is recognized on a basis that reflects the timing, nature and value of the benefits provided. In our experience, such fees may be recognized totally or partially up front or over the contractual or customer relationship period, depending on the facts and circumstances. Under the new standard, a telecom entity needs to assess whether a nonrefundable, up-front fee relates to a specific good or service transferred to the customer – and if not, whether it gives rise to a material right to determine the timing of revenue recognition.

Comparison with current US GAAP

Accounting for nonrefundable up-front fees as a separate performance obligation

SEC SAB Topic 13

Concluding whether a nonrefundable up-front fee represents a payment for a promised good or service under the new standard may involve an analysis similar to current US GAAP to determine whether the up-front fee is payment for delivery of a good or service that represents the culmination of a separate earnings process. In practice, outside of specific guidance for the cable industry (see below), these fees are rarely recognized when they are invoiced. When performing the analysis under the new standard, a telecom entity considers the integration guidance in Step 2 of the model, which is not necessarily the same as current US GAAP.

Initial hookup fees in the cable television industry

922-430, 922-605

Under current industry-specific US GAAP, initial hookup fees in the cable television industry are recognized as revenue to the extent of the direct selling costs incurred. The new standard has no industry-specific revenue recognition guidance, and so hookup fees are treated like any other nonrefundable up-front fees.

In addition, the costs associated with the hookup activity need to be evaluated separately under the new standard's cost guidance. For further discussion on contract costs, see Section 7.

SEC SAB Topic 13

Deferral period when nonrefundable up-front fee is recognized as advance payment

Under current SEC guidance, the up-front fee is deferred and recognized over the expected period of performance, which can extend beyond the initial contract period. In our experience, this has often resulted in an entity recognizing nonrefundable up-front fees over the average customer relationship period.

Under the new standard, an entity assesses the up-front fee to determine whether it provides the customer with a material right – and, if so, for how long. This means that an entity no longer defaults to an average customer relationship period, which may be driven by factors other than the payment of an initial up-front fee. These factors may include the availability of viable alternatives, the entity's customer service, the inconvenience of changing service providers or the quality of the product or service offering.

10 Indirect channel sales

Overview

Telecom entities sell goods and services to end customers through various distribution networks that typically include corporate-owned stores (the 'direct channel') and third-party resellers (the 'indirect channel'). The resellers are independent dealers (referred to as the 'dealer' throughout this section).

Accounting for sales through indirect channels requires the telecom entity to carefully analyze the specific facts of the dealer arrangement and common business practices. Contractual arrangements can vary significantly between dealers and telecom entities.

Because the telecom entity typically transfers equipment – e.g. handsets – to the dealer, the telecom entity needs to determine who its customer is (the dealer or the end customer) in the equipment sale and whether the dealer obtains control of the equipment before the equipment is transferred to the end customer. This involves assessing whether the arrangement is a consignment sale and whether the dealer is acting as an agent or a principal.

Telecom entities also need to analyze the sale of network service arrangements through the dealer, which will also include a principal versus agent analysis. Furthermore, telecom entities will need to assess the payments related to these arrangements to determine if they are a cost of obtaining a contract or consideration payable to a customer.

The ultimate conclusions on these issues will affect the timing and amount of revenue recognized for goods and services sold through the indirect channel. These conclusions may also create differences in the accounting for revenues and costs, depending on whether the sale is made by a direct or indirect channel.

10.1 Determining who the customer is and when control transfers

Requirements of the new standard

When providing goods or services that will be sold through an indirect channel, an entity first determines who the customer is in the arrangement – i.e. the dealer or the end customer. It then determines when control of those goods or services is transferred to that customer.

606-10-25-25
[IFRS 15.33]

Section 6 illustrates the requirements of the new standard related to the transfer of control. 'Control' is the ability to direct the use of, and obtain substantially all of the remaining benefits from, the goods or services (including preventing others from doing so).

In addition to the general guidance on determining when control transfers to customers in the distribution channel, entities also need to consider the application guidance on:

– consignment arrangements; and

– principal versus agent considerations (from the dealer's perspective) to determine who is the customer.

Observations

Determining who the customer is for each dealer arrangement is key

Indirect channel arrangements will need to be analyzed carefully to determine whether the dealer or the end customer is the customer of the telecom entity for the relevant goods or services (i.e. the handset and the network service). That analysis can be performed using either the principal versus agent or the consignment arrangement guidance, depending on the specific facts and circumstances of the agreement with the indirect channel. Regardless of which guidance is used, we expect that the accounting outcome would generally be the same.

10.1.1 Consignment arrangements

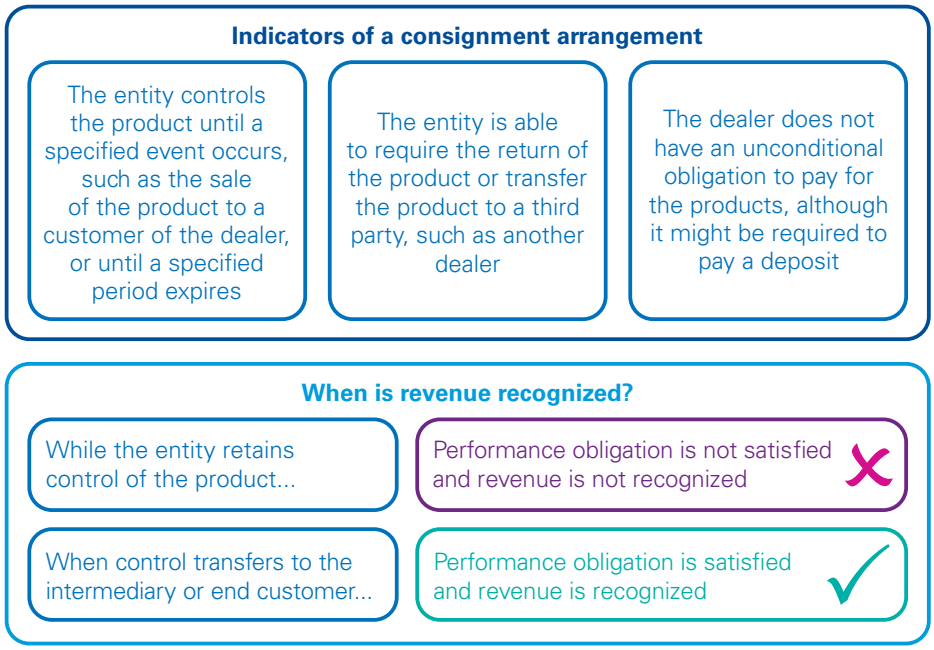
Requirements of the new standard

606-10-55-79
[IFRS 15.B77]

An entity may deliver goods to another party but retain control of those goods – e.g. it may deliver a product to a dealer or distributor for sale to an end customer. These types of arrangements are called 'consignment arrangements' and do not allow the entity to recognize revenue on delivery of the products to the intermediary.

606-10-55-80
[IFRS 15.B78]

The new standard provides indicators that an arrangement is a consignment arrangement, as follows.



Example 67 – Consignment arrangement

Telco C enters into a contract with Retail Store T, an independent dealer. Specifically, Telco C agrees to deliver handsets to Retail Store T. The terms of the arrangement are as follows.

- Retail Store T pays Telco C only on sale of the handsets to the end customer.
- Telco C has the ability to require Retail Store T to transfer the handsets to other dealers in the distribution network, or return the handsets to Telco C.
- Telco C has agreed to accept the return of any handsets from Retail Store T.

Telco C concludes that it does not transfer control of the handsets to Retail Store T. Instead, Telco C has entered into a consignment arrangement with Retail Store T. Therefore, Telco C concludes that it should recognize revenue for the sale of the handset when it is sold to the end customer.

Observations

Move away from a risk-and-reward approach

Under the new standard, a telecom entity typically considers contract-specific factors to determine whether revenue should be recognized on sale into the distribution channel or whether the telecom entity should wait until the product is sold by the dealer to its customer.

SEC SAB Topic 13
[IAS 18.16, IE2(c), IE6]

This assessment may differ from current IFRS and US GAAP as a result of the shift from a risk-and-reward approach to a transfer of control approach. However, consideration of whether the significant risks and rewards of ownership have been transferred is an indicator of the transfer of control under the new standard (see 6.1) and conclusions about when control of handsets has passed to the dealer or the end customer are generally expected to stay the same.

10.1.2 Principal versus agent considerations

Requirements of the new standard

606-10-55-36 – 55-36A
[IFRS 15.B34–B34A]

When other parties are involved in providing goods or services to an entity's customer, the entity determines whether the nature of its promise is a performance obligation to provide the specified goods or services itself, or to arrange for them to be provided by another party – i.e. whether it is a principal or an agent. This determination is made by identifying each specified good or service promised to the customer in the contract and evaluating whether the entity obtains control of the specified good or service before it is transferred to the customer.

Because an entity evaluates whether it is a principal or an agent for each good or service to be transferred to the customer, it is possible for the entity to be a principal for one or more goods or services and an agent for others in the same contract.

606-10-55-37 – 55-38
[IFRS 15.B35–B36]

An entity is a 'principal' if it controls the specified good or service that is promised to the customer before it is transferred to the customer.

When another party is involved, an entity that is a principal obtains control of:

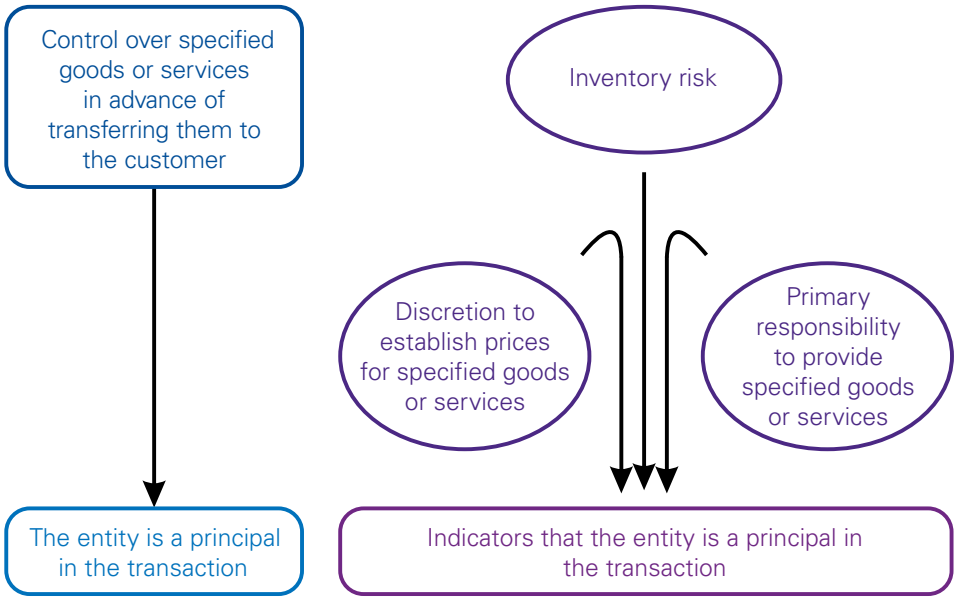
- a good from another party that it then transfers to the customer;
- a right to a service that will be performed by another party, which gives the entity the ability to direct that party to provide the service on the entity's behalf; or
- a good or a service from another party that it combines with other goods or services to produce the specified good or service promised to the customer.

If the entity is a principal, then revenue is recognized on a gross basis – corresponding to the consideration to which the entity expects to be entitled. If the entity is an agent, then revenue is recognized on a net basis – corresponding to any fee or commission to which the entity expects to be entitled. An entity's fee or commission might be the net amount of consideration that the entity retains after paying other parties (see 10.3).

606-10-55-39
[IFRS 15.B37]

The new standard includes the indicators listed below to assist an entity in evaluating whether it controls a specified good or service before it is transferred to the customer.

These indicators may be more or less relevant to the assessment of control, depending on the nature of the specified goods or services and the terms and conditions of the contract. In addition, different indicators may provide more persuasive evidence in different contracts.



If an entity does not obtain control of the goods or the right to the services in advance of transferring them to the customer, then it is an agent for those goods or services.

Example 68 – Determining when control transfers

Telco A enters into a contract with Retail Store X, an independent dealer. The contract requires Telco A to provide Retail Store X with handsets. The contract also allows Retail Store X to sell Telco A's wireless service plans to end customers.

The wireless service plans are never transferred to Retail Store X. Rather, Telco A contracts with and provides the service to the end customer directly. Telco A sets the price and characteristics of each service plan. Service plans can only be sold to end customers approved by Telco A, based on credit scores. In addition, service plans can be sold either with the handsets that Telco A has previously sold to Retail Store X or on their own. When a service is sold with a handset, Retail Store X has no discretion in setting the price of the handset.

Additional facts related to the arrangement are:

– Retail Store X must pay Telco A for handsets when they are delivered to Retail Store X;

– Telco A cannot require Retail Store X to return any handsets;

– Retail Store X does not have a right to return handsets and, further, Retail Store X must manage and insure its own inventory and bears the risk for any inventory obsolescence, shrinkage and overstocking; and

– Telco A is solely responsible for providing network services to the end customer, under the wireless service plans.

Telco A first analyzes whether the dealer is agent or principal in reselling the wireless service plans. Retail Store X does not obtain the benefits from the service, nor does Retail Store X obtain a right to the service. Telco A contracts with the end customer directly and is responsible for satisfying the network service performance obligation. Therefore, Telco A concludes that the dealer is acting as an agent. Therefore, Telco A recognizes revenue for the network services when (or as) those services are provided.

Telco A then analyzes whether the dealer is agent or principal in reselling the handsets. Telco A first considers whether control of the handsets transfers to Retail Store X. If that is unclear, then Telco A considers the principal versus agent indicators from the perspective of Retail Store X.

Consideration	Assessment
Does Retail Store X control the handset before transferring it to the end customer?	Unclear. Retail Store X obtains legal title to the handsets. However, because the answer is unclear given the other terms and conditions of the arrangement with the dealer, the following indicators should be considered.
Is Retail Store X primarily responsible for fulfilling the promise to provide the handset to the end customer?	Retail Store X provides the handsets to the end customer and can resell the handsets with or without service plans. Telco A cannot recall the handsets. However, any issues related to the handset are corrected by the manufacturer.
Does Retail Store X have inventory risk?	Retail Store X takes legal title and insures the inventory. Retail Store X is also responsible for maintaining the appropriate inventory levels and for inventory obsolescence. Telco A does not accept returns of handsets.
Does Retail Store X have discretion in establishing prices?	Retail Store X has no discretion in setting the prices of the handsets when they are sold with a service. It has pricing discretion if the handsets are sold stand-alone.

On balance, and after applying judgment, the analysis above indicates that Retail Store X is acting as a principal in the sale of the handsets, primarily because Retail Store X takes legal title and bears the inventory risk. This means that Telco A transfers control of the handset to Retail Store X at the time of delivery. Therefore, Telco A recognizes the sale of the handset at the time control transfers to Retail Store X.

Observations

The agent versus principal analysis is performed from the dealer's perspective

In distribution networks, the telecom entity will typically be acting as principal in the transfer of goods or services to the dealer. Therefore, the principal versus agent analysis is applied to the dealer, to determine if the dealer takes control of the goods or services before they are resold to the end customer, and if the dealer is the agent or the customer of the telecom entity.

606-10-55-36, ASU 2016-08.BC29
[IFRS 15.B34, BC385Q]

Unit of account is the specific good or service

The evaluation focuses on the promise to the customer, and the unit of account is the specified good or service. A 'specified good or service' is a distinct good or service (or a distinct bundle of goods or services) to be provided to the customer. For telecom entities, the specified good or service would be the handset or the network service. If individual goods and services are not distinct from one another, then they represent inputs into a combined promise that is the specified good or service that the telecom entity assesses.

Control of the good or service is the focus of the analysis

The telecom entity needs to determine if and when control of the goods and services transfers to the dealer before transferring to the end customer. This analysis is key for the telecom entity to identify its customer and determine the amount and timing of its revenue. Generally, the dealer does not take control of the telecom network services, or the right to those services; therefore, the emphasis of the control analysis is on the equipment, such as handsets in wireless sales.

When it is clear that the dealer obtains control of the goods or services (e.g. the handsets) before transferring them to the end customer, no further analysis is required. However, if it is unclear if control transfers, then the telecom entity should consider the new standard's indicators in the agent versus principal guidance.

If the dealer obtains legal title to a good or service only momentarily before legal title transfers to the end customer, then obtaining that legal title is not in itself determinative. However, if the dealer has substantive inventory risk, for example, then this may indicate that the dealer obtains control of the goods or services. In performing the analysis of whether the dealer has substantive inventory risk, telecom entities consider to what extent the dealer is exposed to technological obsolescence, shrinkage and changes in market price, and whether the dealer can return the inventory to the telecom entity (for any reason other than non-working according to specifications).

606-10-55-39
[IFRS 15.B37]

No specified hierarchy for the indicators

There is no specific hierarchy for the indicators and all of the indicators are considered in making the assessment. However, depending on the facts and circumstances, one or more indicators may be more relevant to the specific contract. Assessing the relevance of the indicators may be challenging when it is unclear whether the telecom entity or the dealer bears the responsibility, or when there are shared responsibilities between the telecom entity and the dealer.

Equipment financing or lease plans may add further complexity to the analysis

ASU 2014-09.BC423
[IFRS 15.BC423]

Telecom entities may offer finance or lease plans to their customers for the purchase of handsets and other equipment. These plans are also offered through indirect channels and may involve repurchasing the handset or the receivable from either the dealer or the end customer. These finance offerings do not necessarily preclude the transfer of control of the handset to the dealer. Judgment will be required to consider the specific facts and circumstances of the arrangement.

Comparison with current IFRS

From risks and rewards to transfer of control

[IFRS 15.BC382, IAS 18.8, IE21]

There is a similar principle in current IFRS that amounts collected on behalf of a third party are not accounted for as revenue. However, determining whether the dealer is acting as an agent or a principal under the new standard differs from current IFRS, as a result of the shift from the risk-and-reward approach to the transfer of control approach. Under current IFRS, the dealer is a principal in the transaction when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. The Boards noted that the indicators serve a different purpose from those in current IFRS, reflecting the overall change in approach.

Comparison with current US GAAP

Less guidance under new standard

605-45

Many of the indicators in current US GAAP for assessing whether a party is a principal or an agent are not included in the new standard – e.g. discretion in supplier selection, involvement in determining the product or service specifications or customer credit risk. Based on the changes to the principal versus agent guidance introduced by the new standard, telecom entities will need to reconsider their conclusions. Also, the new standard does not identify any of the indicators as being more important than others, while current US GAAP specifies that the primary obligor and general inventory risk are strong indicators.

10.2 Combining contracts in the indirect channel

Section 2.3 discusses the requirements of the new standard on when contracts are combined. That guidance should also be applied to sales through distribution channels.

Observations

The service and the handset sale contracts may not always be combined in the indirect channel

When selling goods and services through a distribution channel, telecom entities often enter into multiple contracts with multiple parties. The telecom entity needs to assess if these contracts should be combined and therefore accounted for as one contract. One condition for combining contracts is that the contracts are with the same customer (or related parties of the customer). It is therefore key that a telecom entity determines who the customer is under the contracts (see 10.1).

For example, in an indirect sale of a wireless handset and service plan, the customer for the sale of the handset could be the dealer (i.e. when the dealer is acting as a principal), while the customer in the network service contract is the end customer. In this case, because the dealer and the end customer are not related parties, these contracts (the initial sales contract for the handset to the dealer and the subsequent network service contract with the end customer) are not combined. These contracts are therefore treated as separate contracts for the purposes of the remainder of the analysis under the new standard. Accounting for these contracts separately may lead to differences in the amount and timing of revenue recognition in the indirect and the direct channel. However, this will depend on the specific facts and circumstances and conclusions related to the accounting for any payments in the indirect channel (see 10.3).

Alternatively, if the dealer is the agent in the resale of the handset, then the end customer is considered the customer for both sales and the contracts are combined (provided the other criteria for combination are met). In this case, combining the contracts implies that the combined transaction price, including any discount, will be allocated to the performance obligations (handset and network service) in the combined contract, as explained in Step 4 (see 5.2). Therefore, the accounting for this indirect channel arrangement could be closer, if not similar, to the accounting for the same arrangement in a direct channel sale.

10.3 Accounting for payments in the indirect channel

Requirements of the new standard

The new standard includes guidance on the accounting for payments related to contracts with a customer as follows:

– consideration payable to a customer (see 4.3); and

– costs of obtaining a contract (see 7.1).

Example 69 – Payments in the indirect channel: Dealer commission versus discount to the end customer

Continuing Example 68, Retail Store X acts as a principal in the sale of handsets to end customers.

The agreement between Telco A and Retail Store X also specifies that Telco A will make certain payments to Retail Store X. Specifically, Telco A agrees to pay Retail Store X a commission when Retail Store X sells a network service plan to a customer, whether it is bundled with a handset or sold on its own.

Retail Store X has no discretion to set prices in a bundled arrangement that includes a handset provided by Telco A and Telco A's service plan. In addition, Telco A will reimburse Retail Store X for discounts from the stand-alone selling prices of the handsets provided to the end customer. The reimbursement of the discount is payable only when the end customer activates the service plan and is limited to the amount of the discount provided to the end customer, for which Retail Store X must provide evidence.

Commission

Telco A concludes that the commission paid to Retail Store X is paid in Retail Store X's capacity as an agent in the sale of the network service plan, not as a customer. This is because the commission is only payable when Retail Store X sells a network service plan to an end customer (which, in the case of service plans, is Telco A's customer). Thus, Telco A concludes that the commission represents an incremental cost of obtaining a contract with a customer. Therefore, Telco A follows the guidance on accounting for costs incurred to obtain a contract with a customer (see 7.1). Specifically, Telco A recognizes those costs as an asset and amortizes that asset on a systematic basis (see 7.3).

Handset discount reimbursement

Telco A observes that the reimbursement related to the handset is ultimately a discount provided to the end customer. This is because there is a direct correlation between the amount paid to Retail Store X and the discount provided by Retail Store X to the end customer; the amount is only paid to Retail Store X when the customer activates the service plan, and Retail Store X provides evidence of the discount provided to Telco A's customer. In this arrangement, Retail Store X passes through a discount to the end customer that is funded by Telco A. Consequently, Telco A concludes that the reimbursement is consideration payable to a customer (i.e. the end customer). Telco A recognizes the reimbursement to Retail Store X as a reduction of the service transaction price.

Example 70 – Payments in the indirect channel: When judgment is required

Continuing Example 68, Retail Store X acts as a principal in the sale of handsets to end customers.

The agreement between Telco A and Retail Store X also specifies that Telco A will make certain payments to Retail Store X when Retail Store X sells a service plan to a customer. The agreement specifies that the payment is 500 when Retail Store X sells a service plan with a handset and 100 when Retail Store X sells the same service plan alone.

Telco A determines that the amount paid to Retail Store X is paid in Retail Store X's capacity as an agent, not a customer. This is because the payment is only payable when Retail Store X sells a service plan to an end customer which, in the case of service plans, is Telco A's customer.

Before concluding that the full payment of 500 should be capitalized as a cost to obtain the service contract, Telco A observes that the difference in the amount paid between types of contracts sold by Retail Store X may require additional analysis. In particular, the higher amount paid to Retail Store X when it sells a handset and a service plan suggests that the amount paid may be something other than a commission and may represent a reimbursement of discounts commonly provided to end customers in the purchase of handset and service arrangements. In assessing whether the payment should be accounted for as something other than a commission, Telco A considers the difference in the commission payments and the typical discounts provided to end customers in the purchase of handset when it is bundled with a service contract. Telco A also considers other in-market offerings that provide a significant discount on the handset when it is bundled with a service offering.

Observations

No specific guidance on allocating a discount when dealer is principal for part of the arrangement and agent for the other part of the arrangement

The new standard does not include specific guidance on how a telecom entity allocates a discount in an arrangement in which it is a principal for some goods or services and an agent for others. This may apply to telecom entities selling through a distribution channel when the dealer acts as a principal in the sale of the handset and an agent in the sale of the service (see 10.1). In these arrangements, a telecom entity needs to consider the guidance on determining and allocating the transaction price (see Sections 4 and 5).

Payments in the indirect channel may be accounted for differently

Arrangements with dealers for sales in the indirect channel often include a number of different payments. When the dealer is acting as a principal in the sale of handsets, the accounting for these payments may vary, depending on the terms and conditions related to the payments.

For example, if payments are not directly linked to the discount provided to the end customer, then it may be difficult to conclude that the payments are something other than a commission paid to the dealer and therefore should be accounted for as a cost of obtaining a contract. However, in determining the accounting for these payments, telecom entities also should consider the guidance on consideration payable to a customer, as well as other factors, such as a comparison of cash flows between the direct and indirect channel and differences in payments when the dealer sells only a service plan, as compared with when the dealer sells a handset and a service plan.

In addition, telecom entities may need to consider whether the payments to dealers effectively represent a subsequent discount on the handset. In this case, the discount would represent variable consideration and would need to be estimated at the time the handset is delivered.

Determining the appropriate accounting for these payments requires judgment.

11 Repurchase agreements

Overview

A telecom entity has executed a repurchase agreement if it sells an asset to a customer and promises, or has the option, to repurchase it. If the repurchase agreement meets the definition of a financial instrument, then it is outside the scope of the new standard. If not, then the repurchase agreement is in the scope of the new standard and the accounting for it depends on its type – e.g. a forward, call option or put option – and on the repurchase price.

Given the rapid change in technology, telecom entities commonly offer their customers upgrades or trade-ins on their equipment – e.g. their wireless handsets. Indirect channel sales may also give the telecom entity the right or obligation to buy back the equipment from the dealer. These arrangements may fall under the repurchase guidance and should be analyzed with care.

Requirements of the new standard

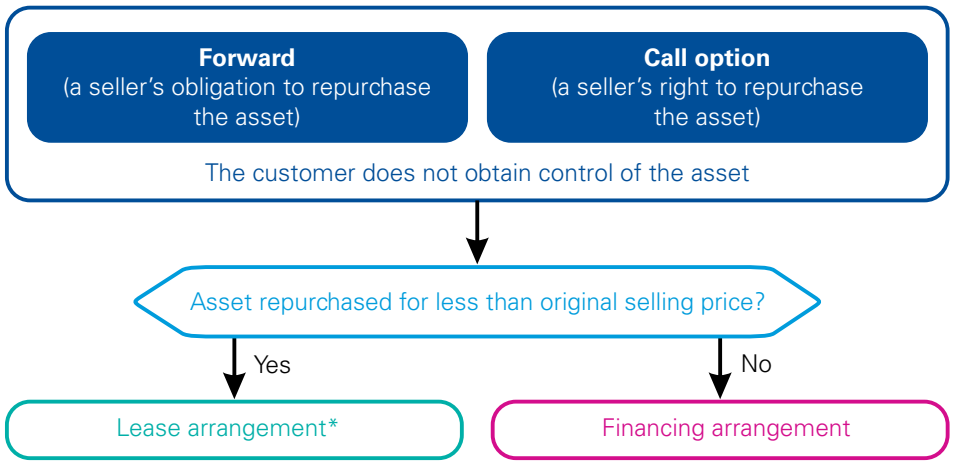
A forward or a call option

606-10-55-68 – 55-69
[IFRS 15.B66–B67]

If an entity has an obligation (a forward) or a right (a call option) to repurchase an asset, then a customer does not have control of the asset. This is because the customer is limited in its ability to direct the use of and obtain the benefits from the asset, despite its physical possession. If the entity expects to repurchase the asset for less than its original sales price, then it accounts for the entire agreement as a lease. Conversely, if the entity expects to repurchase the asset for an amount that is greater than or equal to the original sales price, then it accounts for the transaction as a financing arrangement. When comparing the repurchase price with the selling price, the entity considers the time value of money.

606-10-55-70 – 55-71, 55-78
[IFRS 15.B68–B69, B75]

In a financing arrangement, the entity continues to recognize the asset and recognizes a financial liability for any consideration received. The difference between the consideration received from the customer and the amount of consideration to be paid to the customer is recognized as interest, and processing or holding costs if applicable. If the option expires unexercised, then the entity derecognizes the liability and the related asset, and recognizes revenue.



* Under US GAAP, if the contract is part of a sale-leaseback transaction then it is accounted for as a financing arrangement.

A put option

606-10-55-72 – 55-73
[IFRS 15.B70–B71]

If a customer has a right to require the entity to repurchase the asset (a put option) at a price that is lower than the original selling price, then at contract inception the entity assesses whether the customer has a significant economic incentive to exercise the right. To make this assessment, an entity considers factors including the:

- relationship of the repurchase price to the expected market value of the asset at the date of repurchase; and
- amount of time until the right expires.

606-10-55-72, 55-74
[IFRS 15.B70, B72]

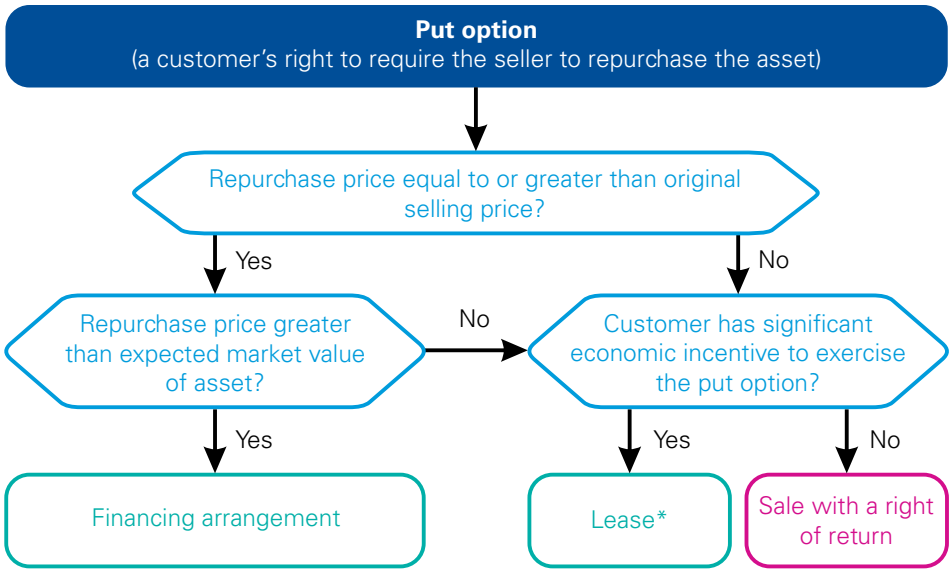
If the customer has a significant economic incentive to exercise the put option, then the entity accounts for the agreement as a lease. Conversely, if the customer does not have a significant economic incentive, then the entity accounts for the agreement as the sale of a product with a right of return (see 10.1 in Issues In-Depth, Edition 2016).

606-10-55-75, 55-78
[IFRS 15.B73, B76]

If the repurchase price of the asset is equal to or greater than the original selling price and is more than the expected market value of the asset, then the contract is accounted for as a financing arrangement. In this case, if the option expires unexercised, then the entity derecognizes the liability and the related asset and recognizes revenue at the date on which the option expires.

606-10-55-77
[IFRS 15.B75]

When comparing the repurchase price with the selling price, the entity considers the time value of money.



* Under US GAAP, if the contract is part of a sale-leaseback transaction then it is accounted for as a financing arrangement.

Example 71 – Handset trade-in

TelcoT enters into a 24-month wireless service contract with Customer C. At contract inception, TelcoT transfers to Customer C a handset for 600, together with a right to trade in that handset for 100, at the end of the service contract. The stand-alone selling price of the handset at contract inception is 600. TelcoT expects the handset market value to be 150 in 24 months.

TelcoT's obligation to repurchase the handset at the customer's option is a put option. TelcoT assesses, at contract inception, whether Customer C has a significant economic incentive to exercise the put option, to determine the accounting for the transfer of the handset.

TelcoT concludes that Customer C does not have a significant economic incentive to exercise the put option because the repurchase price of 100 is lower than the expected market value of 150. Additionally, customers usually have easy access to the second-hand market to resell similar phones. TelcoT determines that there are no other relevant factors to consider when assessing whether Customer C has a significant economic incentive to exercise the put option. Consequently, TelcoT concludes that control of the handset transfers to Customer C because Customer C is not limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the handset.

TelcoT therefore accounts for the transaction as a sale with a right of return (see 10.1 in Issues In-Depth, Edition 2016).

Observations

A revised approach that focuses on the repurchase price

The new standard includes guidance on the nature of the repurchase right or obligation and the repurchase price relative to the original selling price. In contrast, the current accounting focuses on whether the risks and rewards of ownership have been transferred. As a result, determining the accounting treatment for repurchase agreements may, in some cases, be more straightforward under the new standard, but differ from current practice.

However, judgment will be required to determine whether a customer with a put option has a significant economic incentive to exercise its right. This determination is made at contract inception and is not updated for subsequent changes in asset prices. Historical customer behavior in similar arrangements will be relevant to this determination.

It is common for telecom entities, in several jurisdictions or markets, to include handset trade-in rights in their wireless contracts. Consequently, they will need to analyze the contract conditions carefully to determine whether the guidance related to repurchase agreements should be applied and, if so, whether the arrangement is accounted for as a lease or a sale with a right of return.

Trade-in offers after contract inception

Telecom entities may make offers after contract inception that provide customers with an option to trade in their handsets. These subsequent offers require careful analysis to determine the nature of the offer and any accounting consequences.

Often, these offers are widely provided, made for a limited time and can be retracted at any time. If these offers are frequently provided after contract inception, then they may constitute customary business practices and thus represent an implied promise at contract inception. In those cases, the telecom entity needs to determine if the guidance on repurchase agreements or variable consideration applies. When they are not assessed as the telecom entity's customary business practice, the offers may be viewed as marketing offers.

Repurchase agreements in indirect channels

In the indirect channels, there could be situations where the telecom entity repurchases the equipment from the dealer. The telecom entity should assess whether the repurchase guidance applies. Repurchase agreements do not necessarily preclude transfer of control but facts and circumstances should be considered.

Sale-leaseback transactions

The accounting for sale-leaseback transactions differs between US GAAP and IFRS (see 5.5.5 in Issues In-Depth, Edition 2016).

Comparison with current IFRS

Introduction of more prescriptive guidance

[IAS 18.IE5]

The limited guidance on repurchase agreements in current IFRS focuses on whether the seller has transferred the risks and rewards of ownership to the buyer. The new standard introduces explicit guidance that requires telecom entities to apply a conceptually different approach when accounting for repurchase arrangements, and may result in differences from current practice.

[IAS 17, IAS 18]

In addition, under current IFRS, guaranteed residual amounts offered by a telecom entity to the customer may preclude revenue recognition if significant risks are retained. By contrast, the specific guidance in the new standard on repurchase arrangements focuses on whether the telecom entity retains control of the asset.

Comparison with current US GAAP

Change in practice for guarantees of resale value

840-10-55-10 – 55-25, 460-10

Under current US GAAP, if a telecom entity guarantees the resale value of an asset, then the arrangement is accounted for as a lease. Under the new standard, the guarantee is evaluated to determine if it is in the scope of the revenue standard (see Section 1) and, if so, revenue is recognized at the point in time at which the customer obtains control of the asset, which may result in a significant change in practice for some telecom entities.

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