Global Communications
GAAP Summit 2013
Sheraton Golf, Rome
17-18 June
Workshop 1: The new revenue standard
Revenue, what’s going on?

- Single comprehensive model applicable to all entities and industries
- Standard expected in Q3, 2013

Methods of transition:
- Retrospective restatement
- Simplified transition method (similar to cumulative catch up approach)
Revenue Recognition – The Five Step Approach

Step 1: Identify the contract(s) with the customer

Step 2: Identify the separate performance obligations

Step 3: Determine the transaction price

Step 4: Allocate the transaction price

Step 5: Recognise revenue when, or as, a performance obligation is satisfied
# What to expect in the standard?

## November 2011 Exposure Draft

- Distinct devices (e.g. mobile phone) are a **separate performance obligation**
- **Collectability** is not a recognition criterion
- **Bad debt** is a reduction to revenue
- **Stand-alone selling price (SSP)** must be estimated if a market for the item does not exist
- **Contract modification** can result in a cumulative catch-up
- **Costs to acquire customer** contracts to be capitalised
- Revenue should be **discounted** if the contract includes a significant financing element

## Still relevant?

- ✓
- ✓
- ×
- ✓
- ✓
- ✓
Have you considered the impact on your business of the proposed revenue standard?

1) Yes - assessing the specific accounting and systems impact
2) Yes - implementing process and system changes
3) No - waiting to see what others do
4) Not sure
Meet FAT
Further-Afield Telecom

FAT is a rapidly expanding global communications company providing fixed and mobile services to consumer, enterprise and wholesale customers.

FAT currently offers the following bundles of products and services to its customers:

• Mobile *handset with a service* contract;
• *Set-top box with a TV* subscription; and
• *Special discounts to existing customers*.

FAT also *provides dedicated CPE* as part of its networked IT contracts to global enterprise customers.

Mr Networker (CFO) is keen to understand the impact of the proposed revenue standard on the numbers......
Question time: handset and service

- FATconnect (FC), FAT’s mobile business, offers a mobile handset for an up-front charge of €100 and a 2 year service tariff with a monthly fee €50 (total cash consideration of €1,300).
- The mobile phone could be sold separately (not subsidized or bundled) for €300.

How much revenue should FAT recognise for the handset?

1) €nil – FAT is not in the business of selling handsets
2) €100 – the amount paid by the customer
3) €260 – the relative portion of the overall contract value
4) €300 – the stand-alone selling price
5) I am not sure
## Solution: handset and service

### Separate performance obligation

<table>
<thead>
<tr>
<th></th>
<th>(1) Cash paid €</th>
<th>(2) Stand-alone selling price of performance obligation €</th>
<th>(3) Relative value %</th>
<th>(4) Relative stand-alone selling price €</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mobile phone</td>
<td>100</td>
<td>300</td>
<td>20</td>
<td>260</td>
</tr>
<tr>
<td>Service contract (24 x €50)</td>
<td>1,200</td>
<td>1,200</td>
<td>80</td>
<td>1,040</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>1,300</strong></td>
<td><strong>1,500</strong></td>
<td><strong>100</strong></td>
<td><strong>1,300</strong></td>
</tr>
</tbody>
</table>

**Revenue recognition:**

- Handset revenue (non-recurring) of €260 (instead of €100)
- ARPU of €43.33/month (1,040/24) (instead of €50) from service
Question time: Stand-alone selling price

How would you determine the stand-alone selling price?

1) The price at which you sell the handset separately
2) The price at which the handset is sold separately by competitors in your market
3) With reference to a similar product (adjusting for functionality)
4) Cost plus a reasonable profit margin
5) Other
**Question time: Other services**

- *FATmedia*, FAT’s broadcast and TV business, also provides the *FATVIEW* set-top box with its IPTV subscriptions.

- The *FATVIEW* is designed for FATmedia’s IPTV platform and is not capable of operating on other TV platforms.

Is the *FATVIEW* set-top box a performance obligation?

1) Yes
2) No
3) I am not sure
Question time: Family line

• FATline, FAT’s fixed line business, offers its consumer customers fixed line rental for €20 per month when customer signs up for 24 months
• Customers on this tariff have an option to purchase a secondary family line for a monthly line rental of €1.
• About 80% of FATline’s customers take up this offer

Is the family line a performance obligation?

1) Yes
2) No
3) I am not sure
Question time: Family line

• FATline, FAT’s fixed line business, offers its consumer customers fixed line rental for €20 per month when customer signs up for 24 months
• Customers on this tariff have an option to purchase a secondary family line for a monthly line rental of €1.
• About 80% of FATline’s customers take up this offer

How should FAT recognise revenue on the family line?

1) Prospectively when the customer exercises the option
2) Calculate the relative SSP of the two lines
3) Calculate the relative SSP based on an assumption that 80% of customers will exercise the option
4) I am not sure
## Illustrative impact on FAT’s KPIs

<table>
<thead>
<tr>
<th>€</th>
<th>Old Standard</th>
<th>New Standard</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenue:</td>
<td>11,000</td>
<td>11,000</td>
</tr>
<tr>
<td>services</td>
<td>10,000</td>
<td>7,000</td>
</tr>
<tr>
<td>equipment (non-recurring)</td>
<td>1,000</td>
<td>4,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>KPIs</th>
<th>Old (€)</th>
<th>New (€)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Service revenue (ARPU)</td>
<td>10,000</td>
<td><strong>down</strong></td>
</tr>
<tr>
<td>OFCF</td>
<td>2,500</td>
<td><strong>up</strong></td>
</tr>
<tr>
<td>EBITDA</td>
<td>3,000</td>
<td><strong>up</strong></td>
</tr>
<tr>
<td>ROCE (return on capital employed)</td>
<td><strong>12 %</strong></td>
<td><strong>up</strong></td>
</tr>
</tbody>
</table>
ED.6: This [draft] IFRS specifies the accounting for an individual contract with a customer. However, as a practical expedient, an entity may apply this [draft] IFRS to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the result of doing so would not differ materially from the result of applying this [draft] IFRS to the individual contracts (or performance obligations).

Deutsche Telekom will share their perspectives on the practical challenges of implementing the proposals in the next session.
Could the lease exposure draft impact revenue recognition?

• FATline enters into a 10 year contract to provide global managed services. Under the contract FATline must deploy CPE in over 1,000 client sites in 90 countries.

• The CPE typically has an economic life of 5 years. The customer has exclusive use of the CPE during that time.

• FATline must replace the equipment after the initial 5 years.

• FATline can choose which CPE is deployed and under the terms of the contract could change the equipment with the customers consent.

Has FATline sold or leased the CPE to its customer?

1) Sold
2) Leased
3) Does it matter
Which standard am I in?

Managed service (non-leasing component)  CPE (embedded lease)

Allocate consideration based on the relative SSP guidance in the Revenue ED

Revenue ED for service revenue recognition  Lease ED for lessor accounting on Type A lease

Lease ED says ...
Disclosure considerations

The exposure draft calls for a significant increase in the volume of disclosures related to revenue, including:

- Disaggregation of revenue
- Reconciliation of contract balances
- Remaining performance obligations
- Costs to obtain or fulfill contracts
- Other qualitative disclosures
- Interim period disclosures
# Disclosure considerations

Reconciliation of contract balances

<table>
<thead>
<tr>
<th>Unbilled receivables</th>
<th>Ref</th>
</tr>
</thead>
<tbody>
<tr>
<td>Opening balance</td>
<td>X</td>
</tr>
<tr>
<td>Additional services rendered</td>
<td>a)</td>
</tr>
<tr>
<td>Subsequent billing</td>
<td>b)</td>
</tr>
<tr>
<td>Amounts credited</td>
<td>c)</td>
</tr>
<tr>
<td>Closing balance</td>
<td></td>
</tr>
</tbody>
</table>

a) Represents the value of services that have been provided to clients during the year but not yet billed. The revenue associated with these services has been recognised in line with FAT’s accounting policies.

b) Represents the amounts that have been billed during the year.

c) Represents unbilled receivables subsequently reversed.
## Industry investment analyst views

<table>
<thead>
<tr>
<th>Boards' Rationale</th>
<th>Risks and Concerns</th>
</tr>
</thead>
<tbody>
<tr>
<td>Better information for investors</td>
<td>• Mismatch between revenue and cash flows</td>
</tr>
<tr>
<td></td>
<td>• Complexity and risk of error</td>
</tr>
<tr>
<td></td>
<td>• Inconsistency between direct and indirect sales channels</td>
</tr>
<tr>
<td></td>
<td>• Distortion of key metrics</td>
</tr>
<tr>
<td>Accounting ‘sees through’ company and market specific differences</td>
<td>• Could encourage uneconomic behaviour</td>
</tr>
<tr>
<td>Removal of industry specific rules</td>
<td>• No pricing interdependency between mobile phones and service plans</td>
</tr>
</tbody>
</table>

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Slide 19
Question time: What do you think?

After the workshop today, in which area will the proposed revenue standard have the largest impact for you?

1) Systems and processes
2) Financial metrics
3) Marketing department
4) IT department
5) Sales tax
6) Other
Thank you