IFRS 15, *Revenue from Contracts with Customers* is applicable for accounting periods beginning on or after 1 January 2018. Ind AS 115 being the equivalent standard to IFRS 15, is expected to become effective for accounting periods beginning on or after 1 April 2018. This necessitates companies to look at their revenue recognition policies and practices and do a complete evaluation of the impact of the new standard since accounting as per Ind AS 115 is expected to bring about significant changes in the way companies recognise, present and disclose their revenue.

Ind AS 115 provides guidance on modification of contracts, capitalisation of contract costs, repurchase agreements, etc. for which adequate guidance was not available under current accounting standards. Ind AS 115 also provides certain transition options and practical expedients to transition from the existing revenue recognition standard to Ind AS 115. Each transition option and practical expedient would have different financial implications, reporting and system requirements. Therefore, careful evaluation of each option and practical expedient is required.

Accounting under Ind AS 115 and changes from existing practice would be critical for telecommunication companies considering the dynamics in which these companies operate with varied products and services and different possible combinations thereof. Hence, many telecommunication companies around the world started preparing for the standard well in advance for implementation of this standard. Certain Ind AS 115 implementation issues that require careful consideration by telecommunication companies have been discussed in this article.
Key considerations for telecommunication companies

1. Bundled arrangements

Telecommunication companies often come out with arrangements where two or more products are sold together for a bundled price. For example, telecommunication plan with a commitment period would be provided to a customer along with any or combination of following: handset, pocket router, set-top boxes, premium number, free value added services, shopping vouchers, fixed line internet, extended warranty, etc.

Ind AS 115 requires an entity to identify the Performance Obligations (PO) in a contract whereas current accounting standards contain limited guidance on identifying whether a transaction contains separately identifiable components. 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 (given in the diagram below).

Example

A telecommunication company T enters into a contract with customer R that includes the delivery of a handset and 24 months of voice and data services for a monthly consideration of INR5,000. The contract does not require any payment of consideration upfront as long as the customer commits to a 24 months contract. 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 applications via Wi-Fi, and to play music or games.

Company T concludes that the handset and the wireless services are two separate performance obligations based on the evaluation that the customer can benefit from the handset on its own and both handset and wireless services are also separate in the context of the contract as a whole.

Currently there are wide practices of revenue recognition for bundled arrangements. Few telecommunication companies do not recognise handset revenue when handsets are given free along with the wireless plan, whereas few companies allocate revenue to both components using the residual approach. Ind AS 115 provides accounting at the performance obligation level based on their respective stand-alone selling prices and therefore, there would be an impact on financial statements based on the current practice followed for revenue recognition for such arrangements.

Although the analysis can be straightforward in certain cases, in other cases, the analysis of whether equipment can be assessed as a separate PO may not be straightforward. This is due to the fact that telecommunication entities may not regularly sell equipment, such as phones, wireless devices, modems and set-top boxes without its own network service. Also, much of the equipment may be proprietary and locked to the telecommunication company’s network. In such cases, analysis may require careful consideration of factors such as existence of secondary markets and alternative dealers, other add-on functionalities of the equipment such as storage facilities in set-top boxes, etc. and require application of significant judgement.
2. Identification of performance obligations within telecommunication services

A telecommunication entity typically offers arrangements that can include varying service combinations, such as wireless, internet, television and landline voice. Further, telecommunication offer various sign-on offers such as free talktime, free data, etc. to induce new customers to subscribe or migrate to their network. After determining whether telecommunication equipment is distinct in context of the telecommunication contract, telecommunication companies may have to determine if the various services are distinct from one another, although they may be provided concurrently.

For example:

Telecommunication company 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, company 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 customises any of the other stand-alone service offerings.

The company 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, company 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. 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.

Another consideration in this matter is determining a measure of progress required at Step 5 – Revenue recognition. For example, certain telecommunication companies allow rollover of unutilised allowances to the next month and allow accumulation until a certain limit. Currently many telecommunication companies recognise wireless services revenue on pro-rata monthly basis i.e. ignoring rollover feature. Under Ind AS 115, telecommunication companies will have to carefully evaluate the substance of roll over feature and if it is substantive, telecommunication companies may not be able to recognise revenue on pro-rata basis. Instead telecommunication companies would have recognised revenue as and when the performance obligations are satisfied i.e. on utilisation of rolled over allowances.

Hence, in such cases, telecommunication entities may end up having different measures of progress for various POs.

3. Variable consideration

Telecommunication companies provide various credits and incentives to the subscribers such as goodwill credits, cashbacks for the renewal, waivers of charges, etc. to maintain their customer base. Many telecommunication companies may opt to currently recognise the credits as and when these are provided to the subscribers in absence of clear guidance under the current accounting standards.

Ind AS 115 recognises these credits as variable consideration and also explains that variability may be either 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. As per Ind AS 115, variable amounts are estimated and included in the transaction price using either the expected value method or the most likely amount method. 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 selected method should be applied consistently throughout the contract and update the estimated transaction price at the end of each reporting period.

This requirement may pose significant challenges for many telecommunication companies due to the sheer volume of contracts and the variety of possibilities across all contracts.

Example

A telecommunication company A agrees to sell to business C, its customer, voice minutes over a period of one year. Business C promises to pay INR0.15 per minute for the first 100,000 minutes. If minutes purchased exceed 100,000 minutes, then the price falls to INR0.12 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 INR0.10 per minute for all minutes purchased (i.e. the price is reduced retrospectively). Based on company A's experience with similar arrangements, it estimates the following outcomes.

<table>
<thead>
<tr>
<th>Minutes used</th>
<th>Probability</th>
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<tbody>
<tr>
<td>Less than 100,000</td>
<td>70%</td>
</tr>
<tr>
<td>100,000 to 150,000</td>
<td>20%</td>
</tr>
<tr>
<td>Over 150,000</td>
<td>10%</td>
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</tbody>
</table>
Company 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 INR0.14 per minute (i.e. \((0.15 \times 70\%) + (0.12 \times 20\%) + (0.10 \times 10\%))

4. Significant financing component

It is quite common for telecommunication companies to provide interest free instalment plan for a handset when a customer enters into a contract for telecommunication service. Customers normally receive a price discount in relation to the services provided by the telecommunication companies in return for agreeing to an instalment plan for purchase of handsets from such telecommunication companies. Such handset plans may be for varied terms such as 12 months, 18 months, 24 months, etc. Also, telecommunication companies sometimes enter into long-term capacity sharing arrangements where consideration in many cases is received in advance.

Under Ind AS 115, while determining the transaction price, an entity would need to adjust the promised amount of consideration for the effects of time value of money, if the timing of payments agreed upon by the parties to the contract (either explicitly or implicitly) provides the customer or the entity with a significant financing benefit. Determination of the significance of the financing component is assessed at each individual contract level. An entity should apply judgement when evaluating whether a financing component is significant to the contract. A practical expedient with Ind AS 115 allows entities not 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.

Telecommunication companies would have to therefore analyse bundled arrangements and long-term contracts where there is a time lag between transfer of goods and services and payment for such goods and services and assess whether financing component, if any is significant.

If significant financing component is present, interest expense or income will have to be recognised with corresponding increase or decrease in telecommunication revenue depending on the nature of financing. Recognition of interest expenses and interest income may significantly affect the measurement and classification of these items in the statement of profit and loss.

5. Material rights

The costs involved in acquiring new customers is high and therefore, telecommunication companies, as in many other industries, seek to reduce customer churn by offering incentives and options. For example, a telecommunication company may award points for an amount spent on airtime and a customer could redeem those points for money off their monthly bill or obtain a handset upgrade or it may provide a substantial discount on renewal of contracts.

Ind AS 115 introduces a concept of material right in application guidance and requires entities to evaluate whether options provide material rights to customers and treat them as separate POs.
The following flow chart helps analyse whether a customer option is a performance obligation:

For example:

A customer enters into a one-year service contract with telecommunication company B. The customer agrees to pay INR50 per month. The contract gives the customer the right to renew the contract for an additional year for INR50 per month. Company B estimates that prices charged to customers in the same class will increase to INR56 per month in the next year and that 75 per cent of customers will renew.

In these specific circumstances, based on quantitative and qualitative factors, company B concludes that the renewal option is a material right because the expected discount on renewal is sufficient to influence the customer’s behaviour, 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.

In Year 1, company B recognises revenue of INR46 per month (552 ÷ 12 months). In Year 2, assuming exercise of the option to renew, company B recognises revenue of INR54 per month ((INR48 allocated to the material right + INR50 per month x 12) ÷ 12 months). If the customer does not renew the contract, then company B recognises 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.

Identification of options provided in the contracts and assessing whether it is a material right could be very judgemental especially because telecommunication companies are dynamic with new products being regularly launched and little historical data being available with companies to assess if options would be exercised by customers for the new products.

(Source: Revenue for Telecoms, Issues In-depth, KPMG IFRG Ltd’s publication dated September 2016)
6. Non-refundable upfront fees

Many telecommunication contracts include non-refundable 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. Many telecommunication companies recognise revenue upfront for such non-refundable fees. The new standard provides guidance on determining the timing of recognition for these fees i.e. whether upfront fees is an amount collected for administrative activities which should be recognised over the period of material right or it is an advance received for future goods or services which should be recognised as and when goods and services are provided.

Example

A telecommunication company 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 INR50 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. Company B’s average customer life for month-to-month contracts is two years.

Company B concludes that there are no goods or services transferred to customer D on activation. Therefore, the up-front 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 company B must perform to allow customer D to access its network. The activation fee is considered as an advance payment for future goods or services and included in the transaction price in month 1.

Company B then assesses whether the option to renew the contract without paying the activation fee on renewal represents a material right for customer D by considering all factors.

Customer D pays INR75 in month 1 and would pay INR50 in each subsequent month for which renewal occurs. Therefore, the ‘discount’ on the renewal rate is quantitatively material. Company 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, company B concludes that the activation fee is a prepayment for future goods and services and represents a material right. The activation fee will be recognised over the period for which customer D consumes the services that give rise to the material right.

7. Contract costs

Ind AS 115 requires an entity to capitalise incremental costs to obtaining a contract and costs to fulfil a contract that are not in the scope of another Ind AS.

Costs to obtain

Costs to obtain a contract, generally understood as customer acquisition (or origination) costs, are the directly attributable costs incurred in signing up a new customer. Many telecommunication companies are presently expensing the commission immediately while the standard would require companies to capitalise incremental costs of obtaining a contract (internal and external costs) which could be a significant change. 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 capitalised as fulfilment costs. However, as a practical expedient, an entity is not required to capitalise the incremental costs to obtain a contract if the amortisation period for the asset is one year or less.

For example:

A telecommunication company E enters into a two-year wireless contract with Customer C that includes voice and data services. The contract is signed at one of E’s stores and the sales employee receives a commission of INR30 when the customer signs the contract. 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. E, therefore, capitalises the sales commission of INR30 as a cost of obtaining the contract.

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, E expenses the advertising costs as they are incurred.

E is required to determine the appropriate period to amortise capitalised cost of INR30 taking into account expectations about the renewal of contracts. This would require E to maintain detailed customer history which may be onerous considering the huge customer base that telecommunication companies have.
The costs of adding subscribers to an entity’s customer base can be substantial and complicated by the type of costs involved, including incentives to retailers, commissions paid to external dealers or agents, and sales commissions to the telecommunication company’s staff. Identifying the amount eligible to be capitalised could be complicated where terms of commission pay out are complex e.g. commission paid on renewal, commissions earned on contract modifications, commission contingent on future events, commissions subject to clawback, tiered commission structure, etc.

Costs to fulfil

Costs to fulfil are capitalised only if certain criteria are met and the costs are not in scope of other guidance. Some examples with respect to the cost to fulfil a contract could be the set-up, activation and installation costs (including equipments given to customers that may not be separate performance obligation) incurred by telecommunication companies for setting up a new customer. Companies may allocate direct labour, material and even supervision and depreciation costs towards the cost to fulfil a contract. However, costs to fulfil does not include general and administrative costs unless explicitly chargeable under the contract, costs of wasted materials, labour, etc. This may have significant impact on financial statements as capitalising such costs is not an accounting policy choice. Telecommunication entities that capitalised costs previously also need to determine if their accounting policy complies with the new requirements. Practical expedient discussed above for costs to obtain a contract is not available for costs to fulfil.

8. Other issues

Gross vs net presentation

In many services such as content provision like music, videos, etc. and mobile payments one or more parties are involved with the telecommunication company to provide the service to the customer. Several issues arise in determining which party in the chain should report the transaction on a gross or net basis.

Ind AS 115 provides specific guidance to assess whether an entity is acting as an agent (net revenue presentation) or principal (gross revenue presentation) in a contract. The focus for such an assessment is shifted to a transfer of control approach from the existing risks and rewards approach. If an entity obtains control of another party’s goods or services before transferring control to the customer, then the entity’s promise is to provide the goods or services itself and hence, it is a principal. However, if an entity does not control the good or service before it is transferred to the customer, then the entity is acting as an agent and arranges for that good or service to be provided by another party.

Assessing who controls the delivery of services could be very critical with contracts containing multiple performance obligations. This requires detailed evaluation of terms and conditions agreed by the company with the customer and inter se amongst the company and the third parties involved in providing the services. Presentation of revenue gross or net may impact revenue based licence fees payable to government.

Repurchase agreements

Given the rapid change in technology, telecommunication entities commonly offer their customers upgrades or trade-ins on their equipment – e.g. their wireless handsets. Indirect channel sales may also give the telecommunication entity the right or obligation to buy back the equipment from the dealer. These arrangements may fall under the repurchase guidance, if they do not fall under Ind AS 109, Financial Instruments and should be analysed with care.

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. In such cases the arrangement may be accounted either as a lease or a financing arrangement depending on the comparison between the original selling price and the repurchase price. Similarly, if a customer has a right to require the entity to repurchase the asset (a put option), then arrangement may be accounted either as a lease or a financing arrangement or a sale with a right of return depending on the facts and circumstances i.e. comparison between the original selling price and the repurchase price, economic incentive to exercise the put option, etc.

IT system impacts and processes

Telecommunication companies in their day to day operation make use of many IT systems like billing systems, customer databases, Enterprise Resource Planning (ERP), interface systems, etc. to track end to end transactions with customers. Since principles of Ind AS 115 would change the revenue recognition at the transaction level, appropriate changes would have to be carried out in all the systems to capture the additional information required to recognise and disclose revenue as per Ind AS 115. Considering the volume of transactions, number of IT systems and integration between IT systems, making suitable changes to reflect revenue recognition as per Ind AS 115 would be a key challenge.
Next steps

Telecommunication companies would face significant challenges in transitioning to new revenue recognition standards considering the number of impacted areas, volume of transactions, frequent tweaking of plans to tackle the competition and changes in IT systems to process and report revenues in real time. Any changes from the current practice of revenue recognition would have direct impact on the Average Revenue Per User, commonly referred as ARPU which is a key metric of performance of telecommunication entities. Following are potentially the next steps that telecommunication companies may have to consider:

- In-depth analysis of product offerings and current revenue recognition practices in light of Ind AS 115 principles to assess the accounting impact areas. As changes in accounting policies and data availability are identified in the gap analysis, the areas that will require new judgements, estimates, and calculations will need to be identified.
- Analysis of change in disclosure requirements to identify the incremental disclosures.
- Assess transition options, including the relevant practical expedients and apply an option which is most appropriate considering the reporting objectives, system feasibility, availability of time, etc.
- Assess potential tax, systems and processes and internal control aspects of implementation.
- Managements may consider broader impacts such as reviewing the terms and conditions of existing contracts to renegotiate, train, change management, investor relations, impact on management metrics, changes required to forecasting and budgeting processes, etc.