



Madrid, 13 March 2012

Mr Hans Hoogervorst  
Chairman  
International Accounting Standards Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

**Re: ED 2011/6 *Revenue from Contracts with Customers***

Dear Mr Hoogervorst,

I am writing on behalf of Telefónica, S.A. one of the world's largest integrated telecommunications companies by market cap. It operates in 25 countries and its customer base exceeds 307 million globally (as of December 31, 2011). Telefónica's growth strategy is focused on the markets in which it has a strong foothold: Europe and Latin America. Further information about the Telefónica Group and its activities is available on our website: [www.telefonica.com](http://www.telefonica.com)

Telefónica is very pleased to provide comments to the International Accounting Standards Board on its revised Exposure Draft Revenue from Contracts with Customers (the "ED") issued by the IASB in November 2011.

Telefónica supports the joint work carried out by the IASB and the FASB to develop a single revenue standard. Also, we would like to thank the Board members and Staff for engaging in discussions with the telecommunications industry and appreciate their willingness in this respect. As you know, the impacts of the Board's proposals and the significant industry challenges that would arise from their implementation have been addressed in previous correspondence and discussed in several meetings and conference calls held between Board members and Staff and us and other relevant companies on the telecommunications sector over the last years, and more recently, during the EFRAG's field testing of the ED, where we have demonstrated with real examples the concerns expressed to date.

Those concerns were also communicated to the IASB in our comment letter to the original ED issued on October 2010 where we highlighted that the main issue for our company was the proposed allocation method, which has been maintained in the new ED, and our proposed alternative solution was to add a limitation in the transaction price allocation method such as the following: "The amount allocable to a performance obligation should be limited to the amount that is not contingent upon the future satisfaction of additional performance

obligations (the non-contingent amount)", meaning that the transaction price allocated to performance obligations that have been satisfied, should be deferred to the extent that there are unperformed obligations in the contract that need to be satisfied in order to earn the amounts allocated to satisfied performance obligations. We hereby confirm that we maintain these same views which were expressed in our previous comment letter.

In this respect, we are quite disappointed by the fact that our main concerns expressed by us in all our comments and discussions with the IASB have not been dealt with in the new ED. Nevertheless, we expect that the final standard will deal with our concerns and will include a solution for the particularities of our industry. In this sense, we still believe that our proposed solution described above would reflect the economic substance of the transactions carried out by our company. In addition, we remain at your disposal to work in finding a suitable solution for all parties involved.

We further insist in the extreme difficulties in the practical application of the new ED given that our IT systems do not have all the necessary information to apply the proposed method. In particular there is no link between the handset and the contract for services sold together to a customer, and IT systems don't contain information on "standalone selling prices" of all elements of contracts.

Furthermore, the proposed model involves the use of estimations to a greater extent thereby increasing complexity and potentially decreasing reliability and comparability of the information. This high degree of estimations affects not only to accounting but to internal control as well, since entities will have to ensure that estimation techniques are used consistently throughout the entities composing the Group. In addition, this will make it impossible to compare consistently financial information of the companies operating in our industry, resulting in no improvement of quality of financial information. In this context, we have performed a telecommunication analysts survey together with Deutsche Telekom, France Telecom and Vodafone, which has been shared with the Board members. The results showed that none of the respondents supported the changes and over 90% actively disagreed with the changes.

In addition to the answer to the questions raised by the Board in the ED, we include additional comments on other issues.



If you would like to discuss any of the issues described herein, please do not hesitate to contact Marta Soto, Head of Accounting Practice, at +34914828534 or by e-mail to [marta.sotobodi@telefonica.es](mailto:marta.sotobodi@telefonica.es).

Thank you for your attention and we look forward to your reaction on the concerns raised in this letter.

Yours sincerely,

Marta Soto

Copies to: Henry Rees, Associate Director, International Accounting Standards Board.  
Glenn Brady, Senior Technical Manager, International Accounting Standards Board.  
European Financial Reporting Advisory Group

## **Telefónica's responses to the questions asked in ED 2011/6 *Revenue from Contracts with Customers***

**Question 1 — Paragraphs 35 and 36 specify when an entity transfers control of a good or service over time and, hence, when an entity satisfies a performance obligation and recognises revenue over time. Do you agree with that proposal? If not, what alternative do you recommend for determining when a good or service is transferred over time and why?**

Telefónica has concerns about the application of the proposed guidance to the rendering of services transactions. There is no distinction between the transfer of goods and the rendering of services, although they have different features. We think that par. 35 and 36 were written bearing in mind construction type contracts, but are also be applicable to utility companies that render services continuously over time. In fact, when discussing performance obligations satisfied at a point in time, it is only mentioned the transfer of assets. In this sense we have implied that services are always treated as performance obligations satisfied over time. We think that the proposed treatment is quite confusing because the Board has tried to include only one treatment that could be applied at the same time to goods and services, although they are different.

We would, therefore, propose the Board to include different criteria for the transfer of control of goods and of services.

In relation to the above, in our industry the transfer of control of telecommunication services could be seen as one performance obligation satisfied over time, but also as multiple performance obligations that are satisfied at points in time that could be "infinitesimal", for example any day, minute or second in which the customer is connected to our network and is able to use our service.

Currently we recognise revenue in a linear way. Provided our service is understood as a performance obligation satisfied over time, we consider that p.42 of the ED could be applied to our flat rate contracts and, as a consequence, it would be allowed to recognise revenue in the amount we have the right to invoice, i.e. in a linear way. However, as stated above it is not clear from the wording of the ED that this is the correct answer / interpretation. That is why we believe that clarification is needed.

**Question 2 — Paragraphs 68 and 69 state that an entity would apply IFRS 9 (or IAS 39, if the entity has not yet adopted IFRS 9) or ASC Topic 310 to account for amounts of promised consideration that the entity assesses to be uncollectible because of a customer's credit risk. The corresponding amounts in profit or loss would be presented as a separate line item adjacent to the revenue line item. Do you agree with those proposals? If not, what alternative do you recommend to account for the effects of a**

**customer's credit risk and why?**

Telefónica agrees with applying the same accounting treatment to potential impairment of receivables and contract assets, although we believe that there are many conceptual differences between them, as we believe that a contract asset does not meet the asset definition of the Framework.

Telefónica does not agree with the proposal that requires an entity to present in a line adjacent to revenue the amount of estimated uncollectibility. We would rather prefer to keep current practice of presenting uncollectibility as an operating expense. There are several reasons behind:

- Timing: impairment due to credit risk may not arise in the same period as the corresponding revenue. This means that there is no a direct relation between the revenues recognised in one period and impairment recognised in that same period, which can easily be related to revenue recognised in prior periods.
- Amount: the amount of receivables from customers is not the same as the corresponding revenue figure, as this does not include VAT whereby receivables do include VAT. Therefore, amounts are not directly comparable-
- Additions together with reversals: the line item corresponding to uncollectibility might include in the same period additions and reversals, so this is another reason why we believe that the proposed presentation might end up with conclusions far from reality.

Accordingly, considering the facts above, presenting both concepts in adjacent lines might give a misleading view of the entity's performance on credit risk control, with no benefit for users. We propose to keep current practice in this respect.

We believe that users of financial statements normally consider credit losses on receivables separately, given that they represent estimations which involve more level of judgment and do not refer to the revenue transaction itself.

**Question 3 — Paragraph 81 states that if the amount of consideration to which an entity will be entitled is variable, the cumulative amount of revenue the entity recognises to date should not exceed the amount to which the entity is reasonably assured to be entitled. An entity is reasonably assured to be entitled to the amount allocated to satisfied performance obligations only if the entity has experience with similar performance obligations and that experience is predictive of the amount of consideration to which the entity will be entitled. Paragraph 82 lists indicators of when an entity's experience may not be predictive of the amount of consideration to which the entity will be entitled in exchange for satisfying those performance obligations. Do you agree with the proposed constraint on the amount of revenue that an entity would recognise for satisfied performance obligations? If not, what alternative constraint do you recommend and why?**

Telefónica supports that revenue on satisfied performance obligations should only be recognised for the allocated amount that is reasonably assured. The same treatment should be given to variable amounts and to fixed amounts, being the key factor the “reasonably assured” criterion.

The proposed model results, at least in our industry, in recognising contract assets on satisfied performance obligations which is still contingent on future events, i.e. the entity satisfying the remaining performance obligations of the contract. Therefore, a similar constraint should be included for any kind of consideration, as all could be potentially contingent.

**Question 4 — For a performance obligation that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year, paragraph 86 states that the entity should recognise a liability and a corresponding expense if the performance obligation is onerous. Do you agree with the proposed scope of the onerous test? If not, what alternative scope do you recommend and why?**

Telefónica does not agree with the proposal to require the “onerous test” at a performance obligation level rather than at contract level, as this could result in the recognition of a provision for an onerous performance obligation within a contract that is profitable as a whole, which we believe is not reasonable. Rather, and in consistency with IAS 37, we believe that a provision for an onerous contract should be recognised only if the entire contract is onerous, i.e. according to the approach in IAS 37, an entity should consider the unavoidable costs of meeting the obligations and the economic benefits expected to be received under the contract as a whole. As a matter of fact, in our industry it is very common that, for commercial reasons, an entity enters into a contract where some performance obligations are onerous but the contract as a whole is profitable.

Besides, we don't understand why the onerous test is proposed only in certain circumstances. It should be applied in any case.

In addition to this, we believe that IAS 37 already covers any kind of contract that could be onerous, therefore there is no need to include any onerous test in the final standard as it would be under the scope of IAS 37.

**Question 5 — The boards propose to amend IAS 34 and ASC Topic 270 to specify the disclosures about revenue and contracts with customers that an entity should include in its interim financial reports.\* The disclosures that would be required (if material) are:**

- **The disaggregation of revenue (paragraphs 114 and 115)**
  - **A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)**
  - **An analysis of the entity's remaining performance obligations (paragraphs 119–121)**
- Information on onerous performance obligations and a tabular reconciliation of the**

movements in the corresponding onerous liability for the current reporting period (paragraphs 122 and 123)

- A tabular reconciliation of the movements of the assets recognised from the costs to obtain or fulfil a contract with a customer (paragraph 128).

**Do you agree that an entity should be required to provide each of those disclosures in its interim financial reports? In your response, please comment on whether those proposed disclosures achieve an appropriate balance between the benefits to users of having that information and the costs to entities to prepare and audit that information. If you think that the proposed disclosures do not appropriately balance those benefits and costs, please identify the disclosures that an entity should be required to include in its interim financial reports.**

Telefónica disagrees with the proposed disclosure requirements for interim financial reports, as they are excessive when compared with the general principles of IAS 34 to present condensed financial information and explanations of significant events and transactions for the period.

In addition to this, Telefónica is highly concerned about the cost of preparing all the disclosures required by the ED. The process to obtain the information required by these disclosures could be very costly to implement in the telecommunication services industry and it will outweigh any potential benefit for users.

**Question 6 — For the transfer of a non-financial asset that is not an output of an entity's ordinary activities (for example, property, plant and equipment within the scope of IAS 16 or IAS 40, or ASC Topic 360), the boards propose amending other standards to require that an entity apply (a) the proposed requirements on control to determine when to derecognise the asset, and (b) the proposed measurement requirements to determine the amount of gain or loss to recognise upon derecognition of the asset.\* Do you agree that an entity should apply the proposed control and measurement requirements to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities? If not, what alternative do you recommend and why?**

Telefónica agrees in amending consequently other standards that deal with the transfer of non-financial assets that are not an output of an entity's ordinary activities. In addition, the proposed wording of the consequential amendments restricts the amount of consideration to be recognised as gain or loss on derecognition to the amount which is reasonably assured to be entitled, regardless if the consideration is variable or not, as opposed to the scope of paragraph 81. We therefore suggest consistency in both treatments by amending the scope of par. 81 to eliminate the requirement for the consideration of being variable.

## **Telefónica's additional comments on several issues**

We would also like to comment on the following areas of concern:

1. Allocation of the transaction price
2. Contract modifications
3. Incremental costs
4. IT investments
5. Tax & Regulatory issues
6. Portfolio approach
7. Implementation timetable

### **1. Allocation of the transaction price**

Telefónica does not agree that the initial (estimated) transaction price should be allocated to all separate performance obligations in a contract in proportion to the stand-alone selling price. Our main concern relates to the proposed transaction price allocation method, that would result in a shift from ongoing service revenue to the devices we provide to customers to allow them to access our services. We use the devices as marketing tools in order to attract new customers. This does not mean that we do not give any value to the handsets; in fact, because we know that customers give so much value to the devices, we try to sell them at important discounts so that customers are willing to join our company rather than one of our competitors. Almost all telecom companies do the same. For our business what is most relevant is the service we provide, as it is our primary activity and the means we have to recover our investment in the network.

In a bundle arrangement of a handset and airtime service where the handset is generally sold with an important discount as a means to acquire future service revenues, the proposed allocation method would result in a significant amount of service fees being accounted for as equipment revenue upfront, in advance of billings, and would lead to an asset which is not legally enforceable if the operator does not fulfil its contractual obligation to provide future airtime services to the customer.

#### 1.a) Contract asset.

The following Example 1 illustrates the contractual asset that typically would arise in a standard wireless contract:

#### *Example 1*



Customer A enters into a wireless service contract over 18 months with a tariff plan of CU30 per month and a free handset (the contract amounting to CU540 in its total term). For the purposes of this Example, assume that the handset has a standalone selling price of CU200. Under the proposed model, CU146 would be allocated to the handset and CU394 would be allocated to the service (i.e. CU22 per month). This would give rise to a contract asset of CU146, amount that will only be earned if the company performs its services, i.e. it depends on the occurrence of a future event.

The Framework defines an asset as “a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity” (FW par. 49). In this context, the point of discussion would be determining which is the “past event” that gives rise to that contract asset. We also disagree with the argument in BC 196c because, although the entity could have a “valuable contractual right”, it is the result of the underlying contract, rather than the result of the delivery of the handset, i.e. the previously satisfied performance obligation. The mere contractual right to receive compensation already exists at contract inception while an unconditional right to such consideration (that is, a receivable) only arises upon performing the promised wireless services. In other words, the delivery of a free or subsidised handset does not change the entity’s rights concerning the compensation for future wireless services and therefore cannot be viewed as the “past transaction” that gives rise to “valuable contractual rights”. In our view, the event that eventually generates future economic benefits which give rise to an asset for the company is the wireless service contract, rather than the sale of the handset. Therefore we think that it would be appropriate to defer recognition until the entity performs the services that, pursuant to the contract, give rise to the right to receive compensation.

Furthermore, we have reviewed the definition of contract asset in the ED and noted that it is a right to consideration for goods or services transferred to the customer when that right is conditioned on something other than the passage of time (for example, the entity’s future performance). It is hardly for us to differentiate this concept from contingent assets, as these assets depend on the occurrence or non-occurrence of uncertain future events not wholly within the control of the entity. We think that contingent assets would fall within the definition of “contract assets” as they are conditioned on “something other than the passage of time” (i.e. occurrence or non-occurrence of future events), however they are not recognised in the statement of financial position.

Therefore, there is an inconsistency between the treatment of those types of assets which is not supported by any conceptual basis.

## 1.b) Benefits for users

Furthermore, the shift of revenues between service revenues and equipment revenues would produce a significant difference between our revenue figure for reporting purposes and the way our management, our investors, our analysts and other users of financial information view our business. Cash inflows are closely linked to revenues in our industry and users consider cash flow generation as a key indicator for their performance analysis. Under the proposed model,

however, cash would deviate significantly from revenues and so the information provided by reported revenues would be less representative and less relevant for users. As a result, in our view the proposed allocation method would not provide decision-useful information in our business, nor would it depict the economic substance of our business.

This argument is supported by the survey made among users of our financial information whose summary was sent to the IASB members on 29 of February of 2012.

In order to avoid the inconsistencies described above regarding the recognition of handset and service revenues in our industry we suggest that the amount allocable to a satisfied performance obligation should be limited to the amount that is not contingent upon the fulfilment of additional future performance obligations ("contingent revenue cap"). For bundled arrangements including performance obligations that are fulfilled at different moments in time, revenue should only be allocated to those obligations to the extent that the allocated revenue does not exceed the legally enforceable payments due from the customer under the terms of the contract without the delivery of future services. We consider that applying the contingent revenue cap would result in financial information that better reflects the economics of this type of transactions. Such limitation would entail the deferral of the transaction price allocated to the unperformed obligations. Accordingly, in the example of a bundled offer (discounted handset plus airtime service), the equipment revenue would be recognised at its discounted price, and the service revenue would be recognised at its selling price as agreed in the contract, and, therefore, as billed and collected from the customer. This would provide more useful information to users enhancing the predictability of future revenue streams from services.

## 1.c) Inconsistencies of proposed model

- *Same service with different handsets*

Based on the same facts considered in Example 1 above, the following illustrates the inconsistencies of the proposed model in our business. The company has the right to receive CU540 for the services billed on a monthly basis over an 18-month period if and when such services are performed. According to the ED, the entity would have to allocate part of the CU540 consideration to the handset and recognise this amount as a contract asset and revenue at the time of delivery. Besides, an entity could offer different handset models, which would have different stand-alone selling prices, together with the same CU540 wireless contract. The future economic benefits, i.e. the cash flows resulting from performing the telecommunications services, remain the same, i.e. CU540 over a period of 18 months. However, the "contract assets" would be measured differently, depending on the varying equipment discount or if we offer or not a free or subsidized handset together with the service offer as compared to the stand-alone selling price of the future services. The outcome would be two contract assets valued differently while the future economic benefits of the contract from which they result are exactly the same. Example 2 below illustrates this.

### *Example 2*

A telecom operator offers a wireless & data service plan for CU432 over an 18-month contract period, a connection fee of CU25 plus a free or discounted handset supplied when a customer enters into the contract. The total price of the bundled offer depends finally on the handset model that the customer decides to choose, which is entirely at his own discretion. For the purposes of this Example, assume the standalone selling price of the wireless & data service plan is CU24/month. The standalone selling price of Handset A is CU559, and it is offered at a CU349 discounted price when a customer enters into the contract. The standalone selling price of Handset B is CU549, and it is supplied at a CU219 discounted price together with the same wireless & data service contract. The variable discount for the different handset models is due to promotions and marketing strategies. In summary:

	Price Offer		Standalone Selling Price	
	Handset A	Handset B	Handset A	Handset B
Wireless & Data Services	CU 432	CU 432	CU 432	CU 432
Connection fee	CU 25	CU 25	N/A	N/A
Equipment	CU 349	CU 219	CU 559	CU 549
<b>Total Offer</b>	<b>CU 806</b>	<b>CU 676</b>	<b>CU 991</b>	<b>CU 981</b>

The plan is cancellable subject to a penalty that decreases pro rata over the contract term.

	Current		Proposed	
	Handset A	Handset B	Handset A	Handset B
Contract Asset (Day1)	0	0	CU 81	CU 134
Equipment Revenue	CU 374	CU 244	CU 455	CU 378
Wireless & Data Services Revenue	CU 432	CU 432	CU 351	CU 298
<b>Total Revenues</b>	<b>CU 806</b>	<b>CU 676</b>	<b>CU 806</b>	<b>CU 676</b>
<b>Monthly revenues</b>	<b>CU 24.00</b>	<b>CU 24.00</b>	<b>CU 19.52</b>	<b>CU 16.54</b>
Wireless & Data Services	CU 24.00	CU 24.00	CU 19.52	CU 16.54

This Example illustrates how the requirement to use a relative standalone selling price method will result in different accounting for economically identical transactions (wireless and data services) depending on which handset model the customer decides to buy. This argument has been considered by the Board in its Basis for Conclusions as a reason to reject the so called "contingent revenue cap" (BC 196a), therefore it should also be considered when analysing the current proposals. We therefore do not believe that the proposed model on revenue recognition will improve the quality of information provided to users. In fact, the information provided by reported revenues under the proposed model is misleading; in this Example leading users to believe that Company A could be performing better (lower upfront revenues but higher ongoing services revenues) if the customer chooses Handset A than if he elects Handset B, whereas exactly the same service is provided in both cases, being the only difference the discount offered for each handset because of the marketing strategy existing at the time of the contract.

In contrast, the application of a contingent revenue cap would lead to the reporting of limited equipment revenue upfront, also providing users the information that reported service revenues are equal for both contracts and depicting the marketing tools applied by the company at contract inception.

- *Same contract, different sales channel*

In addition to such inconsistency, in our industry the proposed model would also lead to a significantly different recognition of reported revenue depending on the sales channel used, despite the fact that in the direct channel transactions the economic substance is not different from the indirect channel transactions (i.e. through dealers that purchase handsets and then sell them to customers together with service contracts). The sale of long-term service contracts entails certain costs in the form of commission payments (indirect channel) or handset subsidies (direct channel). According to the proposals in the ED (par. 95), dealers' commissions should be capitalized, in contrast with subsidies (discounts) in the direct sale of handsets that are expensed as incurred although they follow the same economic rationale. As a result, selling customer contracts via the direct channel entails the recognition of upfront losses, while selling the same contracts via the indirect channel does not. In our view, the proposals do not meet the objective of providing useful and relevant information to readers of financial statements in our industry, as it results in different accounting outcome for economically identical transactions.

In our view, all these issues should be taken into consideration in the final standard by adding a limitation in the transaction price allocation method requiring that the transaction price allocated to performance obligations that have been satisfied, should be deferred to the extent that there are unperformed obligations in the contract that need to be satisfied in order to earn the amounts allocated to satisfied performance obligations. We believe that this approach would avoid the accrual of material amounts of revenue which will only be received if and when future services are provided.

## **2. Contract modifications**

In the telecommunication sector, the tariff plan modifications are very frequent and the number of changes and tariff combinations are very wide. The question is whether each new tariff plan is a separate contract every time the new tariff plan (price) and the services are different from the previous plan. In that sense, Telefónica considers each change to be a new contract because it would accomplish with the fact that is regularly sold separately and it is a distinct service. If the client upgrades the plan, the product and services would be distinct from the originals. In this case, the contract modification treatment would be as a termination of the old contract and a creation of a new contract. However the wording of the ED it is not that clear and might lead to different interpretations. This has occurred among audit firms.

In relation to consumptions above the minimum contracted in a package of services, they would be a new contract provided they comply with p. 21 conditions. It is not straightforward to conclude in this respect. We think that further clarification is needed.

In addition, in relation to the “standalone selling price” concept within par. 21, there is not a single stand-alone price for each minute/sms/data consumed above the minimum contracted because the price is linked to the tariff plan. So, if we take into account only the customers of the specific tariff plan, the price would be the same and it reflects the standalone selling price, but if we consider all our customers it is difficult to conclude about the selling price condition, because there would be cheaper and more expensive prices for the same service, depending on the tariff plan. In this respect, we have interpreted that we are charging the standalone selling price adjusted to consider the circumstances and rest of features of the specific tariff plan. In fact, the prices for additional services to those included in the flat rate, are established taking into consideration the rest of features of the tariff plan.

We believe that the treatment for contract modifications should be better developed, specifically with regard to the connection between contract modifications and subsequent changes in the transaction price. For instance introducing clear guidance regarding the connection between contract modifications and the subsequent exercise of a contractual option that did not qualify as a material right at contract inception (B21). We believe that the subsequent exercise of such option should always be considered as a new contract, therefore eliminating the requirement for subsequent assessment each time a customer exercises an option already included in the contract. Otherwise the model is not feasible within our industry for application on a contract-by-contract basis. We manage a very large number of customers and an extremely large possible combinations of pricing, price changes and other contractual changes (e.g., changes in rate plans, adding on or removal of certain features or services such as data plans, international calling flat rates, Consumption of services beyond those included in a flat rate tariff plan) which depend solely on our customers’ decisions. If we consider these as contract modifications, the proposed model would require constant revisions to update for new products and offers and changes in stand-alone selling prices in order to appropriately allocate considerations for new contracts, and at the same time maintain documentation of historical information for existing contracts.

Telefónica assumes these modifications as different contracts but considers that the wording of the final standard should clarify this.

In relation to contract modifications that do not provide a material right, Telecom operators frequently offer the option of adding additional services to a contract at a price slightly below stand-alone selling prices due to the fact that the discounted price reflects the adjustment to stand-alone selling price because it is not necessary for the operator to incur in the related selling costs. In order to demonstrate this fact, it is difficult to obtain and manage data around discounts and selling costs which, furthermore, are not the same for sales through direct and indirect channels. So, we think the concept of material right should also be clarified.

### **3. Incremental costs**

The draft proposal requires the incremental costs to obtain a contract (such as sales commissions) to be capitalized. In the case of telecom operators this will cause inconsistency in the accounting for “customer acquisition costs” related to sales through direct and indirect

channels, in addition to those that arise in the allocation of the transaction price, as we commented above in point 1.

In addition to this, it is almost impossible to follow the amortization of these costs on a contract by contract basis provided the amortization period is the minimum term of the contracts. Furthermore, a question arises around the depreciation period of these assets which could be understood to be either the contract period or average life of a customer. If it is the customer life a portfolio approach would be needed. It would also be necessary to update the estimation of customer life considering churn rates. This is a model itself and this calculation might differ from one company to another.

We believe that the intended treatment proposed by the Board regarding these issues is not clearly understood; therefore we suggest clarifying in the final standard.

#### **4. IT investments**

Provided the final standard remains as it is, we would need to implement systems capable to support the methodology of the ED. The application of the new standard would force us to follow up case by case in order to comply with the new principles of recognition, measurement and disclosure of income. The amount of data to be managed and estimates to be made would require very significant investments in IT systems and allocation of specific personnel to control the information. Currently, multiple billing systems hold much of the individual contract information. That information is often transferred to the accounting systems at an aggregated level. Consequently, at present our accounting systems do not have the capability to account for millions of individual contracts nor have been designed to handle this volume of data. Additionally, some of the information required by the proposal is not tracked in the current systems. To accurately account for individual contracts under the proposal, billing and accounting systems require extensive and costly changes that would take a considerable period of time to implement.

At present, current systems do not have all the necessary information to apply the proposed method. In particular there is no link between the handset and the contract for services sold together to a customer, and IT systems don't contain information on "standalone selling prices" of all elements of contracts.

We also think that the application of the draft standard will require significant amount of judgment and bring worse alignment between revenue and cash flow generation. This fact will affect the comparability between telecom operator's financial statements and make more difficult our communication with analysts and other users. We consider that the information produced will not be useful for internal business decision making and will not serve as basis for meaningful KPIs. We would be required by internal and external users to keep current accounting methodology in addition to the proposed model in the ED.

This is the reason why we believe that the implementation of new IT systems would result in an excessive cost that would not give rise to any additional benefit for users of financial

statements and for management of our company for their decision making process. In addition, no cost savings are expected.

## 5. Tax and regulatory issues

In some countries, the different telecom services are taxed at different VAT rates. Any alteration of revenue allocated to different performance obligations could result in higher or lower taxes than currently.

In addition to this, in many countries, the prices of different telecom services are regulated by establishing maximum prices. Any alteration of revenue allocated to different performance obligations could result in contradictions with applicable law and/or reporting requirements to regulators. (e.g. Universal Service Obligation)

## 6. Portfolio approach

The practical portfolio approach included in the ED will not alleviate the concerns of our industry due to the great variety and flexibility of our offers. As an example of the magnitude of offers, one of the operating companies in our Group has the following outstanding offers, apart from old offers which are still in place as customers have not changed them:

- Number of tariff plans: 185.
- Modules that can be combined with each tariff plan: 19!

Therefore, the result would be a high amount of portfolios that would not solve the concerns expressed by our industry.

## 7. Implementation timetable

The adoption of the ED requires extensive and costly changes that would take a considerable period of time to implement. The proposed timetable does not allow reasonable time for telecom operators to transition to the new standard. According to our estimations (see below) mandatory adoption should be deferred at least for accounting periods commencing on or after 1 January 2020.

Relevant dates	Remarks
01/01/2015	The adoption date proposed is not before financial periods commencing 1 January 2015.
01/01/2013	Telefónica reports three comparative years in the financial statements, this needs an opening balance sheet as at 1 January 2013.
01/01/2011	Since information on live customer contracts will be required to create the opening balance sheet and customer contract terms are generally between 18 and 24 months, extensive contract data would be required in respect of contracts commencing from 1 January 2011.

The accounting requirements under the proposed standard would have a substantive impact on current systems, in many areas such as financial, accounting and operational systems

enhancements, like billing systems, commercial systems, logistics, etc, provided such modification is feasible. If not, new systems would be required. Also, a complete integration of all of them with accounting systems. In addition to those mentioned, we will also have to perform internal training for related departments such as controlling, investor relations, finance, commercial people, etc. It is difficult to determine the timing required for this implementation, but we assume we would need at least three years provided we had enough resources, apart from those required for the business itself, which are very limited in these days, when, due to the world crisis, costs have been dramatically reduced and controlled.

Our estimated timetable to avoid potential risks on adoption of the new standard would be as follows:

Relevant dates	Remarks
01/01/2013	The Boards estimate to issue the final standard in late 2012 or early 2013.
01/01/2018	We would require five years of contract data in order to adopt the proposed standard (2 years) and restate revenue for comparative periods (3 years).
01/01/2021	Given the complexity of changes in systems and processes required in operating companies within our Group we estimate an additional three year implementation term.