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Mr. Hans Hoogervorst
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Your reference
Our contact Michael Brücks
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Date 2 March 2012
Subject

Exposure Draft ED/2011/6 “Revenue from Contracts with Customers”

Dear Mr. Hoogervorst,

We appreciate the opportunity to respond to the International Accounting Standards Board’s revised Exposure Draft “Revenue from Contracts with Customers” issued by the IASB in November 2011. This letter represents the view of Deutsche Telekom AG, one of the world's leading integrated telecommunications companies with over 129 million mobile customers, around 34 million fixed-network lines and nearly 17 million broadband lines (as of December 31, 2011). The Group provides fixed-network, mobile communications, Internet and IPTV products and services for consumers, as well as ICT solutions for business and corporate customers.

In our Comment Letter on the original ED submitted to the IASB in October 2010, we have expressed our concerns with several provisions of the proposed revenue recognition model. From the perspective of the telecommunications sector, the abandonment of the Contingent Revenue Cap was the crucial concern that we have expressed. In our Comment Letter, as well as during follow-up discussions with IASB, we have substantiated those concerns conceptually and practically in depth.

First of all, we welcome the Board’s decision to re-expose the original ED and appreciate the several improvements to the proposals. Furthermore, we would like to once again thank the Board and the IASB staff for their willingness to discuss with us our concerns. We believe that discussions held with the IASB staff in March 2011, as well as the Educational Session held with IASB and FASB Board members in May 2011, have significantly increased the understanding of each others position. We also appreciate that several Board members have voted for the adjustment of the proposals, to consider the concerns of the telecom operators.

Given that, it is extremely disappointing to us to find that the results of our comments and discussions with the IASB have not been addressed by the principles presented in the new ED. We have carefully studied the reasons for the IASB not to consider our concerns, which are described in BC193-197.

We understand that the objective of the IASB is the improvement of financial reporting by creating a revenue recognition standard that can be applied consistently across various transactions, industries and capital markets. We have strong doubts whether the model proposed in the ED will ultimately improve the quality of information provided in financial statements of telecom operators. To verify our doubts, we surveyed analysts on the desirability of the proposed changes for our industry. We would like to point out that over 90% of respondents actively disagreed with the changes.

We further participated in a field-testing organised by EFRAG to test the practical implementation impacts and to identify application difficulties. As a result of the field-testing we feel justified in our concerns that the proposed model will be impossible to apply for telecom operators, given the tremendous volume of transactions we face every day.

Although we appreciate the Board's clarification on the application of a portfolio approach, we are still firmly convinced that applying this practical expedient would not be feasible. Because of the differences in individual customer contracts we feature in our industry, the model, as proposed, would require us to account separately for tens of millions of contracts. This would require telecom operators to implement new IT systems, solely for the purpose of revenue recognition, with an estimated implementation cost amounting to at least hundreds of millions of Euros for each company. In addition, the restriction that the results of using a portfolio approach should not materially differ can hardly be seen as a facilitation.

As a result, we adhere to our firm conviction that, with regard to our industry, the proposed model on revenue recognition will deteriorate the quality of information provided to users and simultaneously increase costs extremely, both for users and preparers of financial statements of telecom operators.

Please find our responses to the questions 1-6 raised in the ED in Appendix 1 to this letter. We included additional comments to the ED in Appendix 2. We would be pleased to discuss them with you at your convenience.

Yours sincerely,

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Appendix 1
Responses to the questions raised in the ED/2011/6
“Revenue from Contracts with Customers”
by Deutsche Telekom AG

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?

Response:

1 We appreciate that new guidance on performance obligations satisfied over time has been included in the ED and consider it to be an improvement compared to the previous proposals. However, for the sake of conceptual clarity, we think that a further differentiation should been made between continuing obligations and “single” obligations with fulfilment extending over a certain period of time. We believe that such necessary distinction would be easier to draw if two separate revenue recognition principles were provided, one for the sale of goods and one for the rendering of services, accompanied by a clear distinction as to what a good and what a service is.

2 For example, consider wireless telecommunication services being provided over a period of two years, consulting services, a health club membership or any other continuing obligations which, as IAS 18.25 describes it “are performed by an indeterminate number of acts over a specified period of time.” While the contract period for these services often encompasses a certain time frame, the “service” during that period is characterized by a sequence of either definite or indefinite “single” services which only happen to be arbitrarily combined by the contract term. For example, in a wireless contract this could technically be any day, hour or minute of access service which the customer can take advantage of. By contrast, there are service contracts where an entity owes a final result to the customer which can only be achieved over a certain time period. These are the typical “work-in-progress” contracts which the Board obviously had in mind when conceiving paragraphs 35 and 36. Unfortunately, the Board did not draw a clear distinction between these two types of contracts which both extend over a time period but have completely different economic characteristics.

3 We appreciate that the Board confirmed that each increment of service within a continuing obligation is considered distinct (BC81, IE12). Paragraph 27 indicates that each distinct good or service represents a separate performance obligation. Paragraph 30 suggests that, as a practical expedient, two or more distinct services having the same pattern of transfer may be accounted for as a single performance obligation. Now the question is what this means for distinguishing between

performance obligations satisfied over time and performance obligations satisfied at a point in time. Does the “practical expedient” determine the classification of a sequence of distinct obligations as **one** obligation satisfied over time? Or is the fact that each individual service is distinct the relevant criterion, leading to numerous performance obligations each being satisfied at a point in time?

4 In addition, the differentiation between performance obligations satisfied over time and performance obligations satisfied at a point in time lacks conceptual clarity. As an example for the application of paragraph 35 (b) (i) the Board mentions an entity’s obligation to process several transactions on behalf of a customer. As the entity’s processing of each transaction does not create an asset with an alternative use to the entity and the customer consumes a benefit as each transaction is fulfilled, the criterion is met and the entity satisfies its obligation over time as those transactions are processed (BC96). As each transaction is distinct and therefore represents a separate performance obligation, we find this result conceptually questionable. In any case, the criterion under 35 (b) (i) would also be fulfilled if the entity promised to process **only one** single transaction. As a consequence, the satisfaction of a single, one-time transaction would be considered a performance obligation satisfied over time instead of a performance obligation satisfied at a point in time. This seems conceptually questionable and counter-intuitive to us.

5 In our Comment Letter to the original ED, we have advised the Board to maintain the risks and rewards approach. We have expressed our general doubts about the principle of transfer of control being more conducive. Notwithstanding that, we appreciate that the Board included risks and rewards of ownership and customer’s acceptance to the indicators of control in paragraph 37.

6 Unfortunately the new proposals are, from a theoretical point of view, very sophisticated and difficult to apply. They are neither based on a convincing concept of control nor on a straightforward risks and rewards approach. It is also questionable, whether the guidance of the ED can be assessed to be principle-based, when reading the comprehensive Basis of Conclusions which highlights aspects that are impossible to depict from the “principle” stated in the ED.

7 We therefore stay with our recommendation to the Board to develop two principles for the transfer of control – for goods and services, and provide guidance on the continuous transfer of control for both – goods and services. With regard to services, a further differentiation between single and continuing obligations would also be helpful.

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?

Response:

8 First of all, we support the Board's decision not to distinguish between receivables (i.e. unconditional rights to consideration) and contract assets. We acknowledge the different characteristics of contract assets as they do not fall under the financial instruments' definition and in fact, we are of the opinion that such "assets" do not meet the Conceptual Framework's asset criteria as their future economic benefits do not result from past events but from fulfilling future performance obligations. Nevertheless, if the Board requires the capitalisation of these "assets", we believe that the impact of impairment losses on a company's performance and financial position should be the same for both receivables and contract assets. Accordingly, any differentiation in income statement presentation for impairment losses between those two categories would be arbitrary from an economic point of view and therefore not useful information for users of financial statements.

9 We further support the Board's view that any loss arising on initial recognition should be presented under the same line item as (future) impairment losses. In our opinion, in many mass-market business operations such distinction would be somewhat clouded anyway. For example, on initial recognition of a large portfolio of customer receivables historical data often suggest that a certain default rate is inherent even if there is not yet any indication of an individual customer receivable being impaired. While it could be argued that a resulting impairment loss on a portfolio basis is still considered a subsequent measurement following immediately after initial recognition, users of financial statements will probably rather view this as a technicality which does not justify a different income statement presentation compared to initial losses.

10 However, we do not agree with the presentation of uncollectible amounts as a separate line item adjacent to revenue. As the Board noted in BC172: *"A consequence of that decision is that impairment losses…may relate to amounts of uncollectible consideration that was recognised as revenue in previous reporting periods."* Nevertheless, while the Board acknowledges the missing connection between impairment losses and revenue recognised in a given period, it still believes that this presentation *"…facilitates users' understanding of the amounts that an entity ultimately expects to receive from the customer."* However, the point is that a mismatch between revenues and impairment losses presented in the income statement does **not** provide accurate information on "ultimately" collectible amounts. As a result, we do not see how a separate presentation of impairment

losses adjacent to revenue would result in any benefit for users of financial statements.

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?

Response:

11 We agree with the notion that the amount of consideration allocated to satisfied performance obligations should be reasonably assured in order to prevent an overstatement or premature recognition of revenue. However, we believe that the restrictive requirement of the amount of consideration being "variable" is far too narrow and should be abandoned. There is not any reason why a fixed consideration should not also be reasonably assured to justify revenue recognition for a satisfied performance obligation. After all, such consideration is still contingent on the entity satisfying its promised future performance obligations. Frankly, we wonder why this fact seems to be just taken for granted by the Board.

12 Among items such as discounts, credits, penalties or performance bonuses, paragraph 53 also defines contingencies as being included in the term "variable consideration". At first glance, this might indicate that uncertainties with regard to a fixed consideration would be covered by the guidance in paragraph 81, too. However, IAS 37.10 defines contingent assets/liabilities as assets/obligations depending on uncertain future events "not wholly within the control of the entity". As a result, the term "contingency" does not refer to a potential failure to satisfy a performance obligation which is due to factors within the entity's influence.

13 We find it somewhat inconsistent that, on the one hand, the Board takes a more conservative approach in paragraphs 47 and 48 regarding the partial revenue recognition for performance obligations satisfied over time, stating that an entity must be able to reasonably measure progress, regardless of whether any

uncertainties lie within or outside the sphere of the company. On the other hand, the constraints in paragraphs 81-82 shall only apply if the consideration is variable or contingent on factors outside the entity's influence. For example, assume that an inexperienced start-up company enters into a multiple-element arrangement comprising a heavily subsidized up-front hardware delivery and a subsequent service, both charged at a fixed price. Even if there were significant internal risks with regard to the company being able to satisfy the service obligation, this would not limit the revenue recognised for the hardware since the outstanding consideration is not variable. We cannot imagine that such a result would be consistent with the Board's objective in adding the constraint in paragraph 81.

14 In summary, we oppose any limitation of paragraph 81 to amounts of consideration being variable or uncertain in any way. While we agree that uncertainty is a factor to be considered when determining whether the amount of consideration is reasonably assured, it should not be an explicit requirement for applying paragraph 81 in the first place. Otherwise preparers might only examine the constraint if a variable or contingent consideration is explicitly mentioned in the customer contract. This approach, however, would ignore the fact that all considerations are eventually contingent, namely contingent on the company providing the promised service and thereby satisfying its future performance obligation.

15 We agree with the rationale in paragraph 85. However, we think that the guidance should be formulated more broadly instead of making a rule-based exception for intellectual property licences.

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?

Response:

16 As already stated in our Comment Letter to the original ED, we do not agree with the proposal to identify and account for onerous performance obligations within an overall profitable contract. We believe that the verification whether the lower of the direct costs to satisfy the obligation(s) and the exit price exceeds the amount of transaction price should be provided on a contract level only. Further, we do not agree on limiting the application of the onerous test to performance obligations that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year.

17 We do not share the Board's – unsubstantiated – assumption in BC207 that an onerous test on contract level would add complexity. On the contrary, conducting an onerous test on a performance obligation level would require entities to estimate expected costs of settling every single performance obligation, which we consider rather more than less complex. Unfortunately, this argument provides further evidence for the Board's missing understanding for practical matters.

18 Further, we believe that the provision is inconsistent with the requirement to combine contracts specified in the ED. It is not unusual that entities sign contracts with customers which are interdependent with other contracts. The idea behind the requirement of combining contracts is to eliminate inappropriate accounting and allocate consideration from customer appropriately to all deliverables. The outcome of the allocation of the transaction price depends on several factors (the overall discount, estimates of the stand-alone selling price etc.). Identifying onerous performance obligations in an overall profitable contract or a combination of overall profitable contracts and recognising liabilities for them would not reflect the economic substance of the transaction. That being said, we do not understand why the Board believes that an onerous test on contract level would lead to arbitrary results, depending on whether goods or services are being provided in one or more than one contract. If two contracts are interdependent, they would be combined in accordance with paragraph 17 for revenue recognition purposes, thereby justifying an onerous test at the (combined) contract level. If they are not interdependent, they would of course be treated separately both for revenue recognition and onerous test purposes. This is not an arbitrary distinction but a distinction based on different facts and circumstances which are supported by objective evidence.

19 We also do not understand the rationale behind limiting the application of the onerous test to performance obligations that an entity satisfies over time and expects at contract inception to satisfy over a period of time greater than one year. The Board refers to this guidance as a "practical expedient". However, it is not clear to us why the Board sees a (questionable) benefit in recognising liabilities for onerous performance obligations within an overall profitable contract, while, on the other hand, a large number of "loss-making" performance obligations are excluded from the onerous test just because they are satisfied at a point in time or within one year. In our opinion, **this** seems to be indeed an arbitrary distinction. We propose that the scope of the onerous test is not limited and applies to all contracts with customers, irrespective whether performance obligations are satisfied over time or at a point in time in the future.

20 Overall, the guidance in paragraph 86 totally contradicts the provisions for onerous contracts under IAS 37, both with regard to the unit of account (contract as a whole vs. performance obligation) and the time frame (any contract vs. contract being satisfied over more than one year).

21 We also wonder how the guidance in paragraph 86 should be incorporated into a portfolio approach in accordance with paragraph 6. For obvious reasons, it seems easier to apply such approach if an entity only has to assess whether each contract (as a whole) within the portfolio is not deemed onerous.

22 As a consequence, it seems questionable whether it is reasonable to incorporate an onerous test into the new ED on revenue recognition. We believe that the guidance of IAS 37 is sufficient to account for liabilities for onerous contracts.

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:

(a) The disaggregation of revenue (paragraphs 114 and 115);

(b) A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117);

(c) An analysis of the entity's remaining performance obligations (paragraphs 119–121);

(d) 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);

(e) 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.

Response:

23 We strongly disagree with the Board's proposal to extend the comprehensive disclosure requirements of the ED to interim financial statements. In our opinion, this would be inconsistent with IAS 34's objective to present condensed information of major items along with an explanation of significant events and transactions in the given period. By contrast, the level of detail which the ED requires in terms of disaggregation and reconciliation disclosures would significantly exceed the explanatory information being presented for other financial statements items within interim reporting. Additionally, we believe that the impacts on costs and timeliness would by far outweigh any potential benefits to users of financial statements.

24 We think that the disclosure requirements on revenue under IAS 34.16A represent an appropriate balance between benefits and costs and should not be amended.

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?

Response:

25 We agree with the Board's proposal to apply the proposed control and measurement requirements of the ED to account for the transfer of non-financial assets that are not an output of an entity's ordinary activities.

26 However, we would like to point out that the amendments to paragraph 72 of IAS 16, paragraph 116 of IAS 38 and paragraph 70 of IAS 40 restrict the amount of consideration to be included in the gain of loss from derecognition to the amount to which the entity is reasonably assured to be entitled. By contrast, when accounting for transfers in connection with an entity's ordinary activities this constraint shall only apply when the amount of consideration is variable.

27 We recommend removing this inconsistency by deleting the requirement of consideration being "variable" under paragraph 81. Please refer to Question 3 where we laid out our arguments against this provision.

Appendix 2
Additional comments to the ED/2011/6 "Revenue from Contracts with Customers" by Deutsche Telekom AG

28 In addition to responding to the questions raised in the ED, we would like to comment on the following issues:

A. Contingent Revenue Cap
- General concerns
- Analysts' survey

B. EFRAG's field-testing activities

C. Contract modifications

D. Time value of money

E. Disclosures

F. Retrospective application

A. Contingent Revenue Cap

General concerns

29 In our Comment Letter to the original ED we have explained in detail why we believe that the so-called contingent revenue cap is consistent with core accounting principles as laid out in the IASB's Conceptual Framework. Our main arguments for introducing the contingent revenue cap into the proposed model were the following:

- The contract asset recognised for the amount exceeding the non-contingent amount does not fulfil the definition of an asset according to the Conceptual Framework.
- Without contingent revenue cap, comparability within the telecom industry becomes distorted. Companies which need to sell higher subsidised handsets to attract customers will be able to recognise more revenue upfront.
- Without contingent revenue cap, disconnect between accounting and billing systems leads to tremendous implementation issues in a mass-market industry.
- Contingent revenue cap reflects the economic reality that discounts on upfront hardware deliveries tend to be in fact customer acquisition cost.

30 The Board decided not to include the contingent revenue cap in the revised ED. The reasons for this decision are described in BC193-197. We would like to

comment on these explanations.

31 In BC193 it is stated that some respondents "disagree with the boards' proposal that the transaction price should be allocated on a relative stand-alone selling price basis. Those respondents (primarily from the telecommunications and cable television industry) requested that, instead, the boards carry forward the contingent revenue allocation guidance from ASC Subtopic 605-25 (often described as the contingent revenue cap)." We would like to point out that the statement of BC193 is misleading. The principle of the ASC Subtopic 605-25 is not an opposite model to the revenue model proposed in the ED, as it is similarly based on the allocation of customer's consideration to the separate units of accounting on a relative stand-alone selling price basis. The contingent revenue cap is an additional constraint on revenue recognition for contingent amounts in ASC Subtopic 605-25.

32 Beside that, please consider the response to Question 7 in our Comment Letter on the original ED, where we explicitly expressed our agreement with the proposed principle of allocating the transaction price on a relative stand-alone selling price basis, taking into regard two constraints:

- Additionally considering the contingent revenue cap;
- Using only observable stand-alone selling prices.

33 BC195 summarises the two main reasons, why telecommunications industry doesn't believe that the proposed model – without the contingent revenue cap – would be appropriate:

a. The recognised contract asset **would not meet the definition of an asset**, as the entity would only be entitled to collect the excess amount when it provides network services;

b. The proposed model would be **complex and costly to apply** because of the high volume of contracts that telecommunications entities have to manage.

34 **Ad a):** The Board argues that the contract asset represents a "valuable contractual right" to the entity and it therefore meets the definition of an asset (BC196 (c)). We have already commented on this argument in our Comment Letter on the original ED:

Excerpt from our Comment Letter on the original ED, submitted on October 19, 2010 (Page 13):

"The Boards state that in such situation an entity "clearly has a valuable contractual right as a result of satisfying performance obligations" (BC95), which in our example would be the delivery of the handset. In our opinion, while the entity may have "valuable contractual rights", such rights are the result of the underlying contract irrespective of the previously satisfied performance obligation. For example, the right to receive CU1,000 as a return for rendering wireless services already existed at contract inception (providing that the entity would deliver its promised services). However, the Boards precluded the recognition of revenue at that point of time (BC29). That being said, the delivery of a subsidised handset

does not change the entity's rights with regard to compensation for future wireless services. The mere contractual right to receive compensation already existed at contract inception while an unconditional right to such consideration (that is, a receivable) only arises upon performing the promised wireless services. It is therefore not clear how the delivery of a subsidised handset can be viewed as a past transaction which gives rise to any "valuable contractual rights" between those points of time. It would therefore be consequent to defer recognition until the entity performs the services which, pursuant to the contract, give rise to the right to receive compensation. In our view, these are the transactions eventually resulting in the future economic benefits which give rise to an asset."

We would like to add that we agree with the Board's remark that an entity would be compensated for its past performance, i.e. for the costs already incurred, if it were to transfer the remaining rights and obligations to a third party. Therefore we would support a capitalisation of these costs as costs to fulfil a contract in accordance with paragraph 91. However, the fact that costs will be recoverable in the event of transferring the remaining contract rights and obligations does not trigger recognition of revenue.

We simply do not understand how a contract position can change by delivering a free-of-charge handset to a customer. Referring to our example, the entity has the right to receive CU 1,000 as a return for providing wireless services. Prior to providing these services, rights and obligations for this unit of account are equally unperformed. The delivery of the free handset does not change that position.

35 **Ad b)**: We miss any comments on this issue. We understand that the implementation costs are not the Board's concern. However we appeal to you to at least consider that the new revenue model would either force a whole industry incurring tremendous costs to implement new accounting systems and interfaces or changing its long-time business model which has been established in the market and has been appreciated by customers. To assess and demonstrate the complexity and needs to adjust internal processes we have participated in a field-testing initiated by EFRAG. Please consider our findings in section B. hereunder.

36 With regard to BC196 (a), we would further like to point out, that applying the contingent revenue cap is not tantamount to cash-basis accounting. Depending on the specific contractual agreement, the non-contingent amount is not automatically the amount of cash received from the customer. We would like to ask the Board to consider the conceptual difference between the cash amount and the non-contingent amount, as we do this when currently accounting for multiple-element arrangements by using the guidance of ASC Subtopic 605-25. The fact, that in our business the non-contingent amount predominantly equals the cash amount received from the customer, is a business-model driven effect, which offers us the advantage of using billing systems as a basis for deriving revenues. This advantage is further very much appreciated by users of financial statements, as it is understandable and has strong predictive value. We know that users of financial statements strongly appreciate and support this fact as it limits impact of management judgement and, in addition, firmly links revenue recognised in a

period to the amounts billed to the customer and, eventually, to cash received for that period. Please refer to the results of our analysts' survey below.

37 We agree with the Board's argument of BC196 (b) that the upfront recognition of losses as a result of the contingent revenue cap is an unfavourable side effect. We concede that under the current IFRS standards the costs relating to a good already transferred to the customer would not give rise to an asset. However, we would support a capitalisation under a new revenue model, similar to the amendment regarding the capitalisation of incremental costs of obtaining a contract. In any case, we believe that such capitalisation would not contradict the Framework's asset definition.

38 We do not agree with the argumentation of BC196 (d) and (e). When bringing forward the argument that the distinction between "limiting the amount allocated to satisfied separate performance obligations (rather than limiting the amount allocated to a satisfied portion of a single performance obligation) … would create an arbitrary distinction and put additional pressure on the criteria for identifying separate performance obligations", the Board in fact admits its own uncertainty with regard to the consistency of the proposed criteria for identifying separate performance obligations. As the criteria for identifying separate performance obligations is a completely different issue, we would like to ask the Boards to solve those expressed uncertainties regardless of our request to introduce the contingent revenue cap.

39 Besides, we do not understand why the Board views our proposed distinction between amounts allocated to satisfied performance obligations and amounts allocated to partially satisfied performance obligations as arbitrary. For example, look at a construction contract for which an entity is promised a consideration of CU 1,000 upon completing the performance obligation. Even if a contract milestone and, as a result, an unconditional right to payment has not been reached, the entity has put effort in partially satisfying the obligation for which it will receive the consideration upon completion. Accordingly, providing one of the criteria in paragraph 35 is met, the entity has transferred control over time. By contrast, if you look at the telecommunications contract, at the time of delivery of the free handset the entity has not even started to satisfy the promised performance obligation for which it is entitled to receive CU 1,000 on a monthly basis. Granted, there has been a transfer of control over the handset. However, in our opinion, what matters is whether an entity has transferred control over an asset for which it is contractually entitled to receive a consideration. This demonstrates that our proposed distinction has indeed an economic substance.

40 Regarding the argument under BC196 (f) we see the Board's point. Please refer to our proposal in our answer to Question 3 to amend the guidance in paragraph 81.

Analysts' survey

41 Together with our peers Vodafone, France Télécom and Telefónica we have obtained feedback from 22 telecommunications analysts on the desirability of the proposed changes for our industry. The outcome of the analysts survey showed that

- None of the respondents supported the changes;
- Over 90% of respondents actively disagreed with the changes.

We have provided the results in a letter to the Board on February 29, 2012.

B. EFRAG's field-testing activities

42 We would like to inform the Board that Deutsche Telekom has participated in a field-testing on the ED organised by EFRAG. The purpose of the field-testing was to:

a. Identify potential implementation and application difficulties;

b. Assess the directions of any changes in elements of entities' financial position and performance;

c. Estimate the effort required to implement and apply the proposals.

43 Our approach for the field-testing was to apply the ED to a simple contract from our mobile business, including a handset and an airtime service with a minimum contract term of 24 months. We considered in our example determining and accounting for the time value of money. We presented the journal entries and disclosure notes. Further, we accounted for a subsequent change in the transaction price and presented the impact of diminishing the stand-alone selling price of the service with regard to the effect on the amount of revenue allocated to the handset and recognised up-front.

44 We concentrated in our analysis on assessing the challenges that the implementation of the ED would bring up with regard to a possible IT solution. The conclusion that we reached is the following:

Implementing the ED would require us to build a new, highly complex IT system connected to several data basis (performance obligations data base, stand-alone selling prices data base, tool for determining the transaction price etc). Furthermore, operating this IT system would require a huge manpower with regard to permanent monitoring, data update, making assessments and estimates etc. This connection between a complex IT solution and permanent manual assistance will inevitably cause tremendous costs which we estimate to amount at least hundreds of millions of Euros.

45 Providing an example for the complexity of an IT solution, please consider the stand-alone selling price data base which we will need to implement and

permanently monitor within an IT solution for revenue recognition. This data base would need to be connected to the contract data base, where all contracts with our customers are stored. For each separate performance obligation defined in the performance obligation data base, a current stand-alone selling price would need to be maintained in the stand-alone selling price data base. If a performance obligation is not defined in the data base, processing of the contract would cause an error. Besides the current stand-alone selling prices, the data base would need to store all historical stand-alone selling prices at each point in time in the past, in order to account for a contract modification / change in the transaction price leading to a catch-up journal entry. A huge manpower will be required to maintain, assist and update the data base. From systems' and processes' view it is a tremendous challenge to create interfaces for connecting the stand-alone selling price data base to the contract data base, the performance obligations data base, the tool determining the transaction price, the software allocating the transaction price to all separate performance obligations etc.

46 Another tremendous challenge to telecom operators is determining and accounting for time value of money. Please consider that our contracts lead to a series of payments over a period of 24 months or more. To determine the effect of time value of money we need to simulate the revenue stream according to the ED at contract inception and compare it with the billing stream. Doing this for all of our tens of millions of contracts will not be feasible. In addition, we would have to permanently adjust impairment losses on contract assets whenever the contract asset is accreted by using the credit risk adjusted discount rate (note that we have not considered these effects in our field-testing). Please refer to our comment on time value of money below under D.

47 Apart from these practical concerns, there are still several conceptual concerns that we have identified when applying the ED, like:

- **a.** The conditions to apply the portfolio approach;
- **b.** Evaluating the criterion of § 28(b) for distinct goods or services, if those goods or services can only be used in connection with other goods or services solely offered by DT;
- **c.** Determining whether an add-on flat-rate represents a separate performance obligation or a contractual specification with regard to the transaction price;
- **d.** Applying the criteria on satisfaction of performance obligations: Does the airtime service represent (a) a separate performance obligation satisfied over time; or (b) an indefinite number of separate performance obligations satisfied at a point in time?;
- **e.** The requirements to account for contract modifications.

48 Ultimately, the field-testing has confirmed our position that the proposed model is impractical to apply within our industry.

C. Contract modifications

49 We disagree with the proposals on contract modifications. The guidance is extremely complex and sophisticated and, as a result, impracticable to apply. We kindly ask you to consider that the guidance is not only to be applied by construction companies with a few major orders but also by companies operating in mass-market such as telecommunications industry with hundreds of possible modifications to consider. In addition, these modifications may vary seasonally or by region. The guidance on paragraphs 18-22 requires such fine differentiations with a significant degree of judgement that it will be impossible to be applied in practice.

50 Frankly, the whole rationale for differentiating between modifications as separate contracts or as amendments to the original contract is totally incomprehensible to us. Besides, we simply do not see the need why contract modifications should lead to reallocations and catch-up entries for an existing contract. If an option being granted to a customer at contract inception represents a material right, such right has to be considered in determining the transaction price of the contract right from the beginning (B20-24). Conversely, this means that all future modifications which did not represent material rights in the first place are somewhat distinct and should be accounted for as a separate contract.

D. Time value of money

51 Adjusting a net contract position for the time value of money would be extremely burdensome for wireless operators due to the continuous changes of the position in line with the revenue stream. For a mass-market industry with millions of customer contracts and thousands of different combinations of handsets, rate plans, discounts and add-ons, this will be practically impossible to implement. The assessment of significance in paragraph 59 is highly judgemental and could drive different evaluations between operators.

52 In addition, while we understand the Board's rationale for applying a credit risk adjusted discount rate, we would like to point to the inevitable interactions with the collectability assessment and resulting impairment losses. As we have explained in our answer to Question 2, based on historical data a certain receivable default rate is inherent in a mass-market business. Accordingly, by using a portfolio approach an impairment loss has actually already incurred at initial recognition or, if you will, immediately afterwards. However, in order to avoid recognising the same credit risk twice, an impairment loss can only be recognised to the extent that the contract asset has not already been reduced by discounting the nominal amount with the credit risk adjusted interest rate. In future periods, however, the contract asset will be accreted again through interest income, thereby implying that the credit risk has been diminished (which, from a portfolio perspective, is not true). As a result, over the contract period a constant adjustment of impairment expense will be necessary to compensate for the contract asset's accretion.

E. Disclosures

53 We believe that the disclosure requirements are overly excessive, especially for companies operating in mass-market industries rather then providing construction or other services for a selected number of customers. For example, if you look at the requirement in paragraph 119, the aggregate amount of the transaction price allocated to remaining performance operations of a wireless operator refers to millions of customer contracts which have been entered into at different times and, as a result, will be recognized as revenue at different times over a (generally) two-year contract period. The Board conceded in paragraph 121 that quantitative information on timing of revenue recognition need not be disclosed if revenue will be recognized as billed in accordance with paragraph 42. Unfortunately, this practical expedient cannot be applied as a result of the transaction price being allocated based on relative fair value. As a consequence, we would have to present extensive disclosures for fairly common, run-of-the-mill customer contracts. From a cost/benefit point of view, we recommend to consider further facilitations.

F. Retrospective application

54 We do not agree with the proposal of a retrospective application of the proposed model. We would like to point out that a retrospective application of the revenue recognition model as presented in the Exposure Draft is not possible for telecommunications companies.

55 In order to make a retrospective application of the new Standard feasible, the proposed model would have to be modified, especially considering our concerns regarding the retention of the contingent revenue cap or any alternative provision which would allow us to avoid incurring significant implementation efforts.