# AASB 15 – REVENUE RECOGNITION TO CHANGE FOR TELCOS

This month we take a closer look at the impacts of AASB 15 *Revenue from Contracts with Customers* on the telecommunications industry (telcos). AASB 15 can significantly change the pattern of revenue and profit recognition, as well as affect bank covenants, performance-based compensation (including bonuses and share-based payments), internal budgeting processes, and market and investor communications.

AASB 15 contains more specific guidance on revenue recognition than the current AASB 118 *Revenue* standard.

The following areas are likely to have a significant impact for telcos under AASB 15:

- Selling products/services in a bundle
- Contract renewal options at a discount
- Set-up/installation fees
- Sales commissions.

The effective date of AASB 15 is for annual reporting periods beginning on or after 1 January 2018.

### Selling products/services in a bundle

AASB 15 contains more detailed guidance on separating out (unbundling) contracts into different components if the components are 'distinct'.

A component is 'distinct' if:

- The customer can benefit from goods/services on its own, or together with other resources of the entity, and
- The entity's promise to transfer the goods/services is separately identifiable from other promises in contract.

**Example 1**
Telco Retail Shop sells mobile phones and network access under various different deals.

| | |
|---|---|
| **Deal A** | Latest X-Phone handset can be purchased outright without a network access plan for $700. |
| **Deal B** | 24 months network access for $30 a month (total cost $720), without an X-Phone. |
| **Deal C** | Latest X-Phone handset as well as 24 months network access for $50 per month (total cost $1,200). |

**On 1 June 2018, Customer A signs a contract for Deal C. How should Telco Retail Shop Limited recognise revenue for Deal C under AASB 15?**

There are two performance obligations (i.e. components) in Deal C – handset and network access.

Telco Retail Shop allocates the transaction price of $1,200 to each performance obligation based on the standalone selling prices as follows:

| | Standalone price | Allocated transaction price |
|---|---|---|
| Handset | $700 | $592<br>($700/$1,420X$1,200) |
| Network access | $720 | $608<br>($720/$1,420X$1,200) |
| **Total** | **$1,420** | **$1,200** |

| Components ('performance obligations') | Revenue recognition under AASB 15 | | | |
|---|---|---|---|---|
| | **30 June 2018** | **30 June 2019** | **30 June 2020** | **Total** |
| Handset | $592 | - | - | $592 |
| Network access | $25.33<br>($608/24) | $304<br>($25.33X12) | $278.67<br>($25.33X11) | $608 |
| **Total** | **$617.33** | **$304** | **$278.67** | **$1,200** |

It is likely that many telcos will need to change their current accounting policies and approaches.

Currently, some telcos treat the cost of the handset as a marketing expense, while others defer the cost of the handset and amortise it over the minimum contract period. Other telcos recognise revenue from the sale of the handset, but limit this to its cost.

AASB 15 will result in revenue being allocated to each component (or 'performance obligation'). This means that at the start of each contract, telcos will record revenue and profit that is attributable to the supply of the handset. Compared to current practice, this will typically mean recognising more revenue and profit on inception of contracts, and less revenue and profit over the contract period.

### Contract renewal options at a discount

Standard telecommunications packages may be sold for a specified period (e.g. 12 months), with the customer being given the right to renew the contract on expiry (e.g. for a further 12 months) at a discount from the standard selling price. In these cases, the consideration received for the first 12 months will typically be split between the initial 12 month contract, and the renewal right, with revenue relating to that renewal right being deferred and recognised in a future period.

**Example 2**
On 1 July 2017, Cable Co enters into a contract to provide cable TV services for 12 months for $80 per month. The contract also offers the customer an option to extend the contract for a further 12 months for $60 per month. The standalone selling price for the cable TV services is not expected to change at the end of 12 months. Cable Co estimates that 70% of customers would renew the contract after 12 months.

### How should Cable Co recognise revenue under AASB 15?

Cable Co is regarded as having two performance obligations:

- Provide cable TV services for 12 months, and
- Discounted contract renewal option.

Cable Co accounts for the extension option as a separate 'performance obligation' because the extension option grants the customer a discount (which the customer would not ordinarily have received) without entering into the contract.

The standalone selling price of the 'discount' renewal option is $168 [($80-$60)X12X70%].

| | Standalone price | Allocated transaction price |
|---|---|---|
| 12 month cable TV service | $960 | $817<br>($960/$1,128X$960) |
| Contract renewal option | $168 | $143<br>($168/$1,128X$960) |
| **Total** | **$1,128** | **$960** |

The table below illustrates the different patterns of revenue recognition under AASB 118 and AASB 15.

| | AASB 118 | AASB 15 |
|---|---|---|
| **30 June 2018** | | |
| Revenue – 12 month cable TV service | $960<br>($80X12) | $817 |
| **Total Revenue** | **$960** | **$817** |
| **30 June 2019** | | |
| Revenue – 12 month cable TV service | $720<br>($60X12) | $720 |
| Revenue – Renewal option | | $143 |
| **Total Revenue** | **$720** | **$863** |

### Set-up/installation fees

In some contracts, telcos charge customers a non-refundable upfront activation or installation fee. The fee typically covers, for example, administrative costs of setting up a new customer account, or sending a technician to the customer's premises to activate the service. Under AASB 15, these activities do not result in a transfer of goods or services to the customer and are not separate from the provision of the subscribed services. Under AASB 15, these fees are recognised over the period which the telco expects to provide the service (including any subsequent renewal periods).

**Example 3**
On 1 June 2018, Mr C signs up for cable television for 24 months. To activate the service, Cable Co charges Mr C an upfront, non-refundable fee of $50 to recover the cost of sending a technician to activate the service at Mr C's house. It is expected that Mr C will renew the service for another 12 months.

### How should Cable Co account for the activation fee?

Under AASB 15, the activation fee of $50 is deferred and recognised over three years.

Under AASB 118, the activation fee is recognised as revenue on 1 June 2018.

| | AASB 118 | AASB 15 |
|---|---|---|
| **30 June 2018** | | |
| Revenue – activation fee | $50 | $1.38 ($50/36) |
| **30 June 2019** | | |
| Revenue – activation fee | - | $16.67 ($1.38X12) |
| **30 June 2020** | | |
| Revenue – activation fee | - | $16.67 ($1.38X12) |
| **30 June 2021** | | |
| Revenue – activation fee | - | $15.28 ($1.38X11) |

### Sales commissions

Currently, there is diversity in practice under AASB 118 when accounting for contract acquisition costs such as sales commissions. Some entities capitalise these costs as intangibles and amortise them over the period of the contract, while other entities expense these costs upfront.

AASB 15 contains explicit guidance requiring incremental contracts costs to be capitalised, while non-incremental contract costs are to be expensed. Incremental costs are those costs that would not have been incurred if the contract had not been signed e.g. sales commissions.

**Example 4**

Telco sells mobile phones and provides mobile phone services. During the month, 100 customers signed up for two year service contract. Telco incurs the following expenses for the month:

| Salaries | $10,000 |
|---|---|
| Sales commissions | $2,500 |
| Advertising | $5,000 |
| Cleaning | $1,000 |
| Electricity | $800 |
| Rent | $10,000 |

### How should Telco account for the costs it has incurred during the month under AASB 15?

Telco should capitalise the sales commissions paid to its staff (and amortise it over two years) because these costs would not have been incurred if contracts were not signed. Telco should expense all the other costs (i.e. salaries, advertising, cleaning, electricity and rent) as those costs would have been incurred, regardless of whether or not contracts are signed.

### Practical implications

AASB 15 does not only impact the pattern of revenue and profit recognition as the above examples have shown. AASB 15 will also require changes to systems and processes, which should not be underestimated. In the case of bundling services/products discounts, systems and processes would need to be in place to determine the standalone selling price of each contract component. For contracts with renewal options that are at a discount, systems and processes need to determine the appropriate amount of revenue to be deferred and subsequent recognition. For any activation/installation fees and sales commissions, systems and processes need to be in place to defer the amount of fees received or commission paid, and to track the amortisation of these fees over the expected contract period.