

## Telecoms Revenue Recognition Survey June 2013



Understanding operators' issues and how  
they are responding

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# Foreword and key findings

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A new revenue recognition standard has been in joint development by the International Accounting Standards Board (“IASB”) and United States Financial Accounting Standards Board (“FASB”) for many years with the first discussion paper published in December 2008. We are now approaching the finalisation of the standard and the challenges facing telecoms operators are becoming clearer.

We have undertaken a survey of the telecoms industry and have gathered the thoughts of over 40 operators in relation to key questions on the understanding of the proposals and their concerns from an operational, commercial and accounting methodology perspective.

## Key findings

Our survey findings highlight that operators have significant concerns around stakeholder awareness of the proposals and the impact on comparability between peers, particularly within the investor and analyst community, with work to be done to also educate key stakeholders at Board and Audit Committee level.

Unsurprisingly perhaps, our survey indicates operators’ biggest concerns relate to their systems rather than the availability of data required to comply with the proposals. Changes to such systems will be costly and time consuming and are likely to require the input and approval of those outside of finance.

From our experience and as supported by the results of the survey, the responsibility for understanding the impact of these proposals and taking ownership to formulate a response rests with finance (typically the head of external reporting or financial controller). However, the ability to implement a portfolio approach will require much more input from the custodians of customer data (who typically sit outside of finance) and a strong data analytics capability to provide insight into the customer contract population and assurance that the accounting estimates are reasonable.

Our survey findings indicate a wide-ranging series of actions that telecoms operators have undertaken to date as well as a differing level of progress in responding to the proposals. We believe that this is both symptomatic of the appetite to implement change and the ability to respond. To address the latter point, a critical success factor will be identifying who in the business is tasked with responding to the challenges posed by the standard and leading the compliance programme. As suggested by our survey, we believe that some uncertainty exists about where the responsibility for compliance lies within organisations (particularly large groups). Whilst central or head office finance functions have traditionally led the adoption of new accounting standards, telecoms operators need to be confident that adopting the same approach for revenue recognition will be the most effective approach given the system and data complexities involved.

# 1. Background

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New revenue recognition standards have been in development by the IASB and FASB for many years with the first discussion paper published in December 2008.

For some time operators have been reflecting on the impact that the proposals would have on their reported results as well as the significant challenges and costs associated with the system and process re-engineering required to comply with the proposals.

## **Our survey**

We have undertaken this survey in order to help operators in the telecoms industry better understand the size and scale of the impact of the proposed changes as well as enabling industry participants to compare their own thoughts and challenges against their peer group.

We are confident that the information gathered from the survey will be useful in assisting the industry to plan and prepare for the adoption of the new revenue standard.

## **Latest developments**

In December 2012, the Boards finalised their conclusions following consideration of the views of the telecoms industry regarding the much debated issue of accounting for bundled arrangements and concluded that they would not be modifying the proposals.

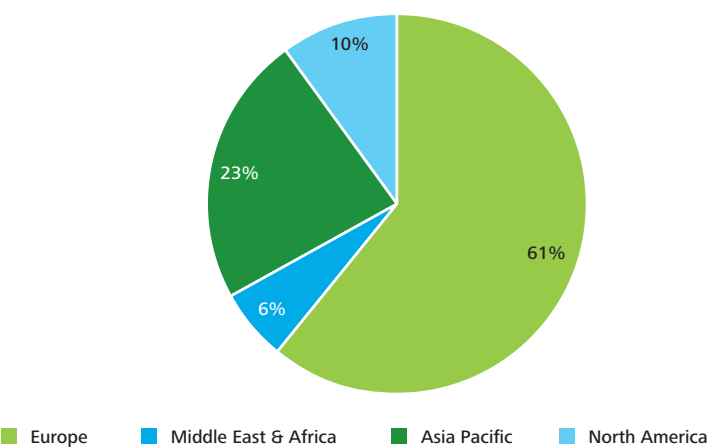
However, the Boards acknowledged that when applying the proposed revenue recognition model, entities may use a portfolio technique to aggregate contracts with customers that exhibit similar characteristics. The Boards therefore tentatively agreed to add clarifying language to the final standard to emphasise that it is acceptable for all industries, including the telecoms industry, to use a portfolio technique as long as it yields results that are similar to those the entity would have obtained if it had applied the revenue model to an individual contract.

The Boards are expected to publish the proposed final standard in the third quarter of 2013.

# 2. About the respondents

We have sought to achieve global coverage with this survey by seeking responses from a number of major telecoms operators who cover a broad range of geographies (see Figure 1). Feedback was received from over 40 operators with 61% relating to operators headquartered in Europe, which is somewhat reflective of the global telecoms industry market fragmentation. In most cases, responses were submitted by individuals working in head office finance teams (69%) with the remainder from local operating companies' finance and systems finance teams.

Figure 1. Global composition of respondents



*We have sought to achieve global coverage with this survey by seeking responses from a number of major telecoms operators who cover a broad range of geographies.*

The respondents represented a range of operators. 42% of respondents were wireless operators, a further 42% offering both fixed and wireless services with the remainder representing cable operators and managed service/solutions businesses.

The vast majority of respondents currently report under IFRS (78%) with the remainder reporting under US GAAP (6%) or seeking to adopt IFRS in the next five years.

# 3. Awareness of the proposals

There has been a high level of engagement between certain operators and Boards during the four years since the first exposure draft was published and industry focus groups have been active.

The survey evidences the high level of interest of the telecoms community. The revenue recognition proposals have generated particularly strong feelings within the industry: 42% of those surveyed have voiced their views through the submission of comment letters on the discussion paper and exposure drafts, roundtable discussions with the IASB/FASB or lobbying through an industry focus group.

Of those who have actively responded to the proposals 85% have used more than one of these routes to make their opinions heard. We found that the majority of the companies responding were businesses offering a combination of fixed and wireless services.

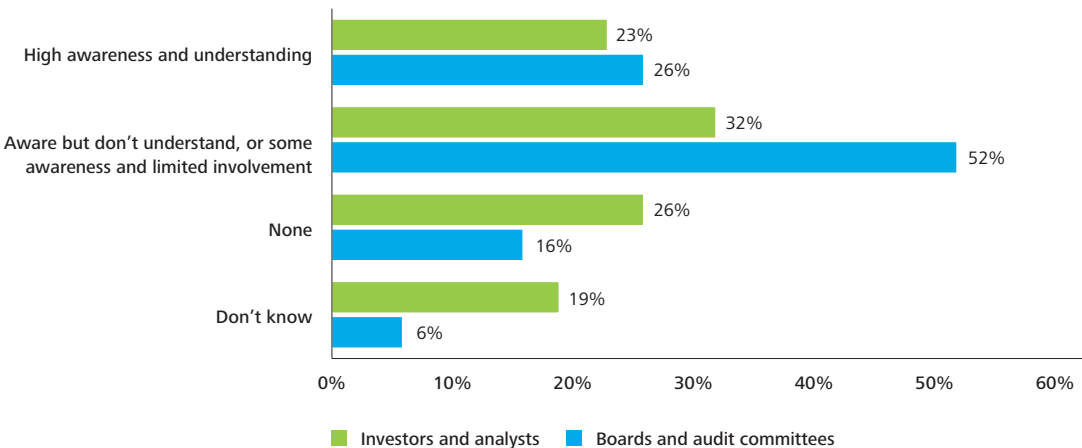
## Extent of Board and Audit Committee understanding and involvement

Awareness of the proposals at executive and audit committee levels within telecoms companies is good, 78% of companies surveyed consider there is some awareness or involvement.

This is in contrast to the perceived awareness and understanding of the likely impact of the proposals within the investor and analyst community with only 23% of companies believing that investors and analysts are aware of the proposals and also understand the likely impact on the report results and 45% of survey respondents either don't know or think investors and analysts have little or no understanding of the impact.

We have summarised the overall views of operators of the awareness of proposals in Figure 2.

Figure 2. Awareness of the proposals

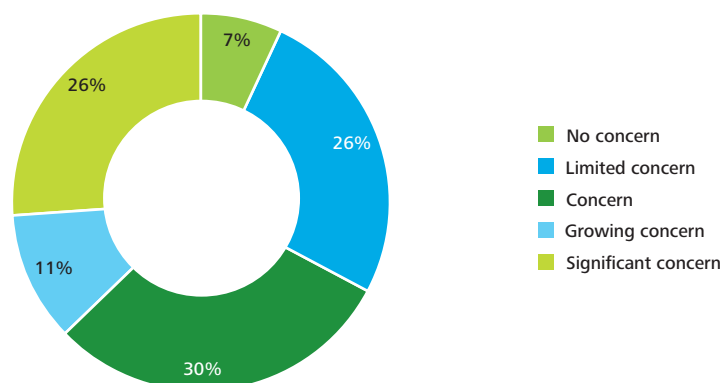


This potential lack of awareness and understanding within the investor and analyst community is a challenge that will need to be addressed. It is clear that there is work for the operators to do to begin to better educate investors and analysts as to the likely changes and how these would be presented and there is likely to be a need to focus resources on evaluating the required communications to explain the changes and the impact on the results presented.

The need for communication is even more critical in light of the concerns that telecoms operators have around the impact of the proposals on the ability to compare results between peers which we highlight in Figure 3. The concern around comparability is as a result of the levels of judgement and estimation which operators consider may be required within the application of a new standard.

*It is clear that there is work for the operators to do to begin to better educate investors and analysts as to the likely changes.*

**Figure 3. Level of concern in relation to comparability of results between peers**



In situations with significant changes in accounting, companies may choose to continue to present their results under their previous model of accounting on a proforma basis in their management reporting, segmental analysis or analyst communication so that it is simple for users of the information to continue to evaluate performance in the same way. However, this would also potentially create another layer of complexity to an already challenging situation given there may be significant changes in accounting for some telecoms operators.

There are established forums within the telecoms industry which have been used to voice their views in relation to the proposals. There may now be an opportunity to leverage this community to drive comparability within the industry. This may be either through evaluating whether there is a common approach to be taken by operators in relation to judgements, or through the telecoms community as a whole communicating more widely the impact of the changes.

#### **Deloitte Bottom Line**

The survey findings highlight that operators have significant concerns around awareness of the proposals and the impact on comparability between peers particularly the understandability for the investor and analyst community.

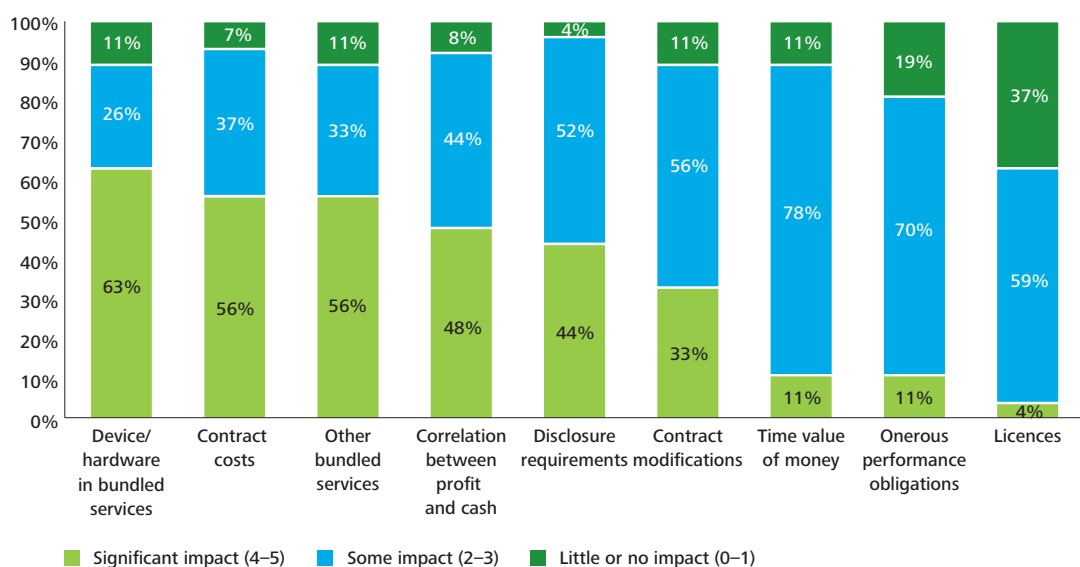
We believe there is more work to do to continue to educate key stakeholders at Audit Committee level, and in the investor and analyst communities. The existing industry forums not only offer an opportunity for the industry to provide this education and create consistency in communications to these groups but also to work closely together to drive greater comparability between them.

## 4. Understanding the impact of the proposals

At a high level, the majority of respondents believe that the proposals will result in a material (21%) or significant (57%) change to their reported results with only 7% of respondents not expecting the proposals to result in a change to their reported results (none of which were wireless operators).

In terms of specific areas of impact, respondents were asked what level of impact (on a scale of 0-5) a number of specific topics associated with the proposals would have on their financial statements. The findings are summarised in Figure 4 below (we discuss the impact on IT systems in Section 5).

**Figure 4. Expected impact of proposals**



Unsurprisingly, the most significant impact is anticipated in respect of accounting for services which are bundled with a device or hardware. Those who reported the most significant impact were wireless and cable operators who operate predominantly in mature markets. Wireless operators in the Far East and emerging markets reported a less pronounced impact in comparison to their Western European and US counterparts. Interestingly, it wasn't just wireless operators who expect to be affected by this point as a number of fixed operators also reported a mid to high level of expected impact. These results were similar for the impact of other bundled services.

For contract costs, 56% of respondents expect a significant level of impact with Western European and Far East wireless operators expecting the most significant impact, perhaps reflective of the high level of commissions paid to indirect sales channels in these highly competitive markets. Cable operators and emerging market wireless operators expect a less pronounced impact.

60% of the respondents reported that the change in accounting relating to bundled devices and hardware will have the same degree of impact in respect of the correlation of cash to profit in their reported results. The majority of the remaining respondents concluded that the correlation between reported profits and cash will be less pronounced than the impact of the change in accounting for bundled services. As expected, the most significant impact in correlation between cash and profit was reported by those respondents who would be affected by changes to accounting for bundled services and contract costs (primarily Western European and North American wireless operators).



One-third of respondents expect that the proposed guidance on contract modifications will have a significant impact. The proposed guidance is that a contract modification is accounted for as a separate contract when it results in a separate performance obligation that is “distinct” and the additional price for that modification reflects the stand-alone selling price of that separate performance obligation. Otherwise, the entity treats the modification as an adjustment to the original contract by allocating the remaining transaction price to the remaining performance obligations in the contract prospectively or for certain performance obligations being satisfied over time, updates the performance obligation’s measure of progress toward completion (which could result in a cumulative catch up of revenue).

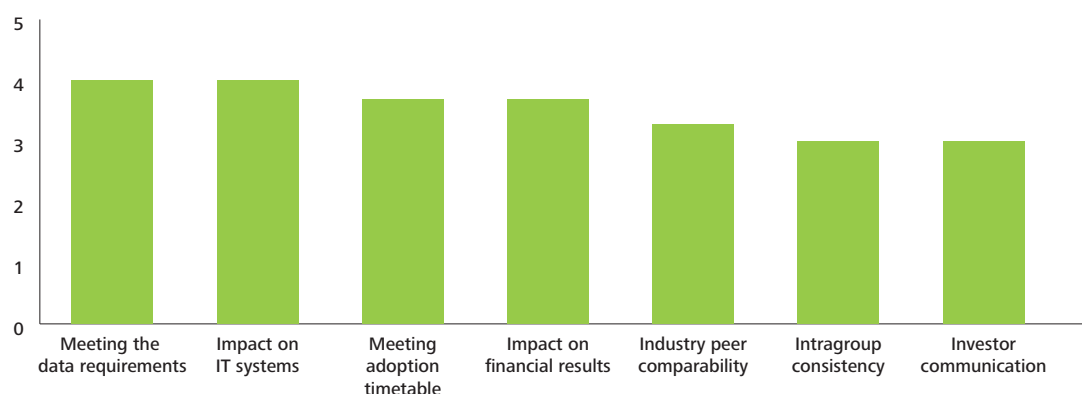
However, it is not known to what extent these respondents are aware of the tentative decisions taken by the Boards subsequent to the publication of the revised Exposure Draft, which are expected to reduce the level of impact on telecoms operators. Consensus of the impact was split amongst Western European operators, perhaps symptomatic of this point.

The vast majority of respondents (78% and 77% respectively) believed that the proposed changes to accounting for the time value of money and the changes to onerous performance obligations would have some impact on their reported financials but few (11%) would be significant. Interestingly 37% of operators thought there would be little or no impact in relation to accounting for licences.

### Operational concerns

In addition to the impact of the technical accounting changes, respondents expressed concern in a number of other areas. We asked those surveyed to state their level of concern relating on a scale of 1–5 (no impact – significant impact) in respect of these areas, which is summarised in Figure 5.

**Figure 5. Impact assessment – average score**



The most significant concern for respondents was in meeting the data and information requirements that the proposed accounting will require, closely followed by the impact that this will have on IT systems. Irrespective of geography or market segment the majority of respondents indicated a significant level of concern. Those less concerned revealed no clear geographical or market pattern, presumably reflective of their individual IT and data infrastructure.

Although adoption of the new standard is not anticipated until 2017 there was still a significant level of concern around meeting the anticipated timetable for implementation with only less than 5% of respondents having little or no concern that they would meet the required adoption timetable.

There were mixed levels of concern relating to the impact of peer comparability with 37% of respondents expressing significant concern. Whilst there was little geographic or market segment trend around the level of concern on this point the results clearly suggest that there is a high level of concern overall.

*The most significant concern for respondents was in meeting the data and information requirements that the proposed accounting will require, closely followed by the impact that this will have on IT systems.*

Given the inherent level of judgement required by entities adopting the new proposals, it's unsurprising to see that most operators have some concern over whether the new standard will be applied consistently between entities within the same corporate group. The survey results evidence a strong correlation between degree of concern and diversity of the group's operations.

### Commercial impact

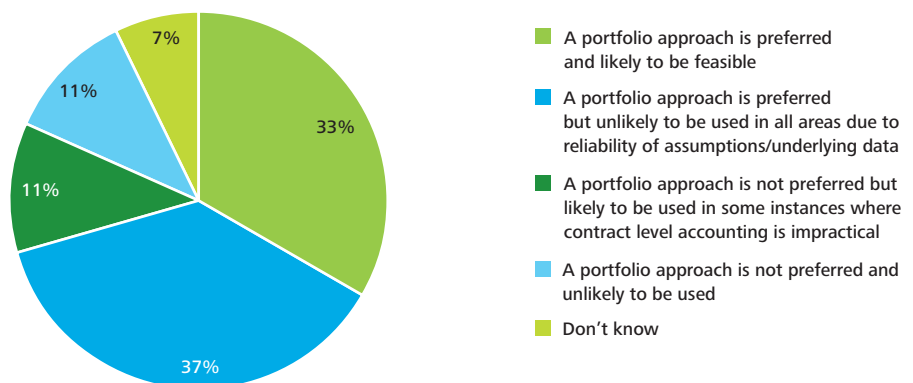
Given the complexities associated with accounting for certain products 43% of respondents believe that the proposals are likely (or very likely) to impact the commercial terms of their products and services with a further 32% believing that such an impact is possible. Given that the responses to the survey were almost exclusively provided by people working within finance, it would be interesting to observe whether the same views would be shared by the commercial teams in those organisations.

### Methodology concerns

It is fairly certain that final standard will allow companies to adopt a portfolio approach to accounting for revenues based on the published comments from the December meetings of the Board however, it is not yet clear what the detail of allowable approaches will be.

The Boards have noted the concerns expressed by the telecoms industry and noted that the characteristics of customer contracts in the telecoms industry may lend themselves to the use of a portfolio approach. However, they also acknowledged that the relief afforded by this opportunity would be minimal given the level of diversity in contract populations.

**Figure 6. Respondent views on use of portfolio approach**



As summarised in Figure 6, our survey revealed that 70% of respondents favoured using a portfolio approach but over half of those are unlikely to be able to use it due to the reliability of assumptions and underlying data that would be required to support such an approach.

### Deloitte Bottom Line

From our experience and as supported by the results of the survey, the responsibility for understanding the impact of these proposals and taking ownership to formulate a response rests with finance (typically the Head of External Reporting or Financial Controller). However, the ability to implement a portfolio approach will require much more input from the custodians of customer data (who invariably sit outside of finance) and a strong data analytics capability to provide insight into the customer contract population and assurance that the accounting estimates are reasonable.

# 5. Impact on systems

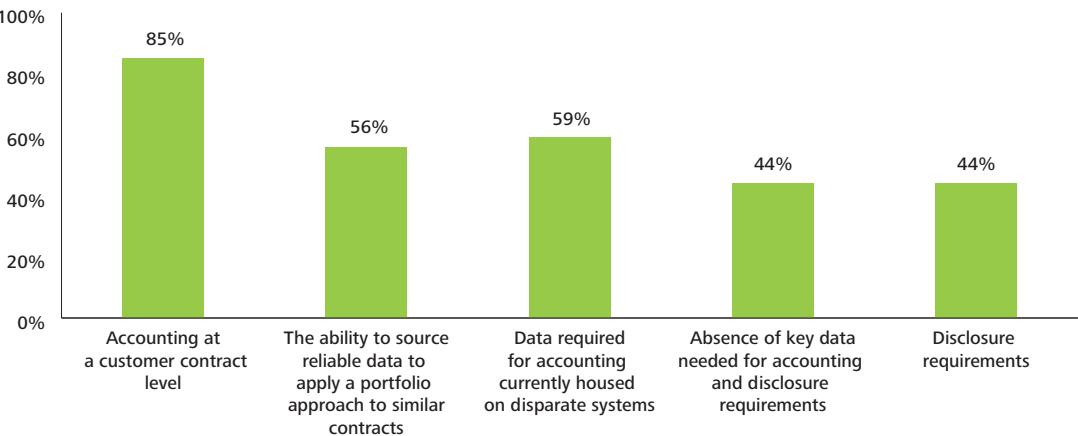
One of the primary concerns telecoms operators have had from the outset of the proposals has been the impact of systems from both a technical feasibility and a potential cost perspective. This remains an area which is likely to have significant impact and our survey indicates companies have yet to fully understand the challenges they may face.

It is clear from our survey that there are a number of common themes in the areas which cause telecoms companies the greatest concern in terms of their ability to implement and operate modified systems and processes.

In our survey, the biggest concern (with 85% of operators stating so) is the ability of the systems to allow accounting at a customer contract level (see Figure 7). The concern is driven from the very high volumes of customer contracts which are typical of a telecoms business. However a number of other IT issues are still considered a concern to large numbers of operators.

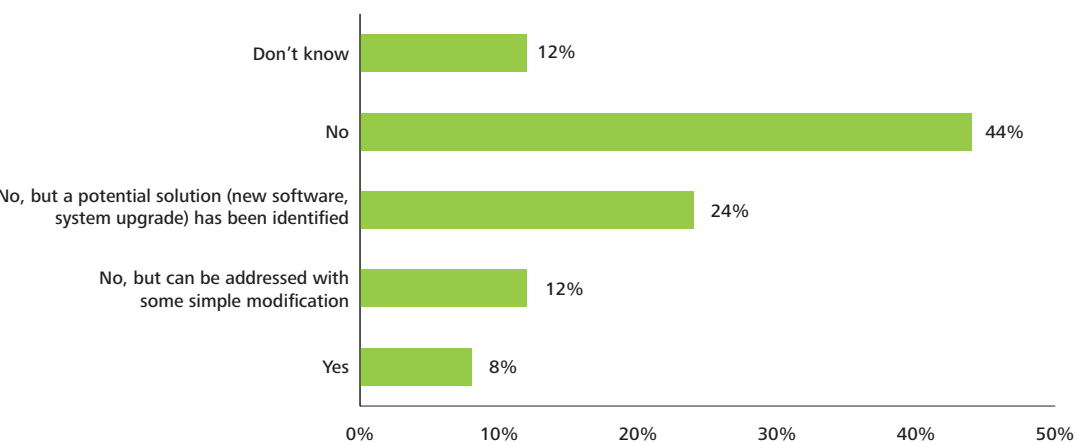
*It is clear from our survey that there are a number of common themes in the areas which cause telecoms companies the greatest concern in terms of their ability to implement and operate modified systems and processes.*

Figure 7. IT related concerns



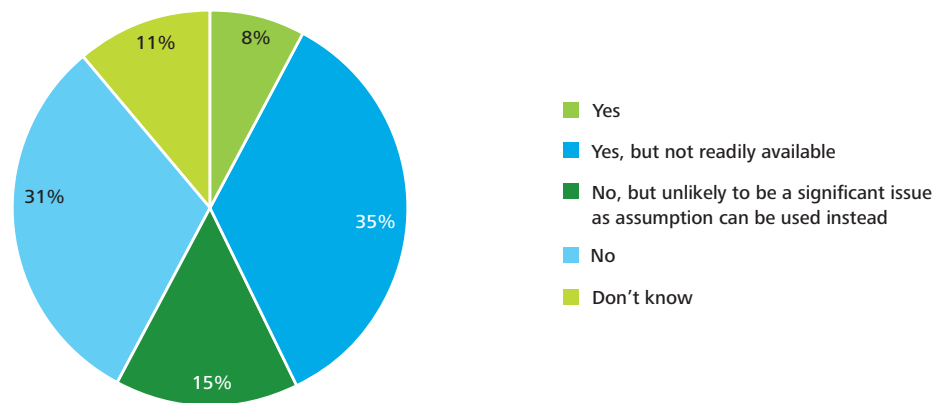
We asked companies whether they felt their current systems could meet the likely requirements of the standard. It is surprising to see that 44% of companies don't currently believe their systems could supply the required data. And a further 12% have not at this time evaluated whether their IT systems are capable of supplying the data. Figure 8 shows the operator's views on the ability of their IT systems to supply the data.

Figure 8. Capability of IT systems to meet the requirements of the standard



In our survey we also asked whether respondents would have the data available to apply the standard and the responses indicate that concerns are much greater around systems than data (see Figure 9).

**Figure 9. Operators assessment of whether they have the data availability to meet the likely requirements**



As explained in Section 4 it is fairly certain that final standard will allow companies to adopt a portfolio approach. In our survey only 8% of companies stated that they currently have the data available to implement the likely requirements. However, in the event that the standard allows a portfolio approach our survey indicates that nearly 60% of companies would already have the ability to extract the data required, or could apply assumptions to generate this.

However 44% of companies have not identified an IT solution to address the likely requirements. Implementing a new solution will likely be costly and could have a significant lead time, and there may also only be a limited number of offerings in the market to deal with the requirements of the new standard.

#### **Deloitte Bottom Line**

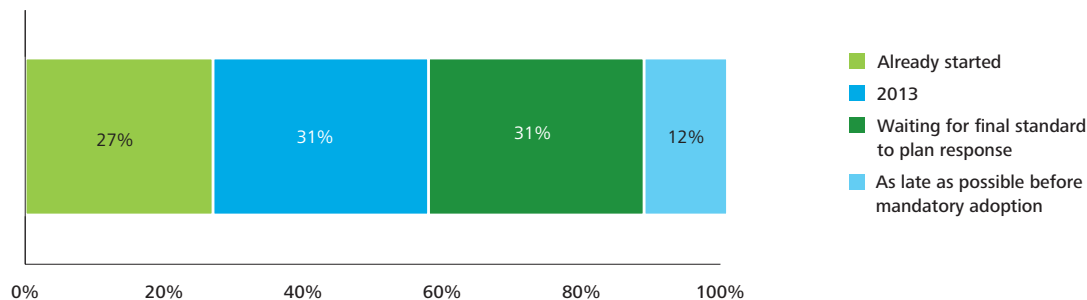
Our survey indicates operators have their biggest concerns around their systems rather than the data required. Changes to such systems will be costly and time consuming and are likely to require the input and approvals of those outside of finance functions. It will important for telecoms operators to include these considerations in existing ERP/IT programmes.

As telecoms operators continue to reduce cost by reducing operational complexity, the new revenue recognition standard is a key requirement of those systems and not factoring this in early could result in more costs being incurred in the future to address it.

## 6. Implementing change

As illustrated in Figure 10 the respondents are at different stages of initiating a project or response to the proposals. 58% of respondents have already started some sort of initiative or will commence in 2013. A further 31% are waiting for the publication of the final standard before commencing a response (which therefore should mean starting in 2013). No pattern emerged from the results that correlated the timing of response and nature of the respondent's operations.

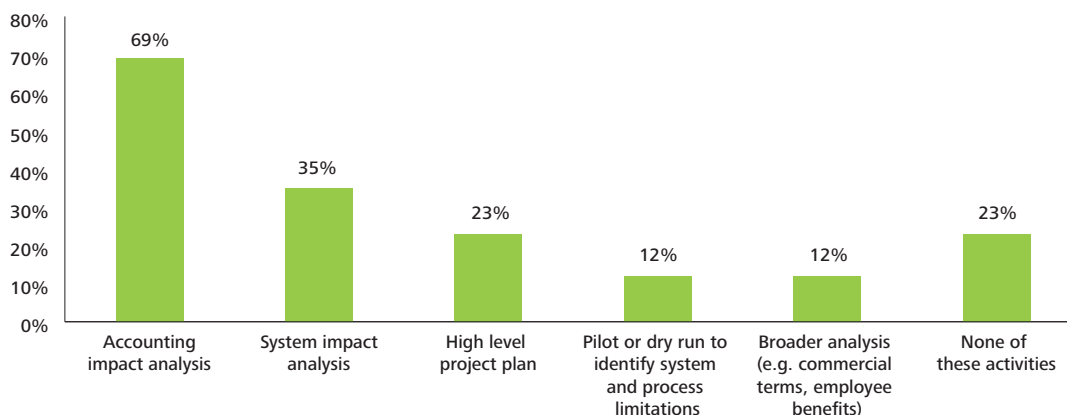
**Figure 10. Status of projects in response to proposals**



On average, respondents believe that it will take them 1.7 years to be ready to report under the new revenue standard (20% believe it will take less than one year, 46% between 1–2 years, 27% more than 2 years and 7% don't know).

In seeking to understand the impact of the proposals, respondents have undertaken a range of activities, as summarised below.

**Figure 11. Activities undertaken**



The results reveal that the majority of respondents had undertaken some sort of accounting impact analysis, a population which includes all of the large Western European wireless operators. 35% of respondents have undertaken a system impact analysis, which primarily constituted wireless operators outside of Western Europe. As expected, most of the 23% of respondents who have developed a project plan have done so on the back of a system impact analysis.

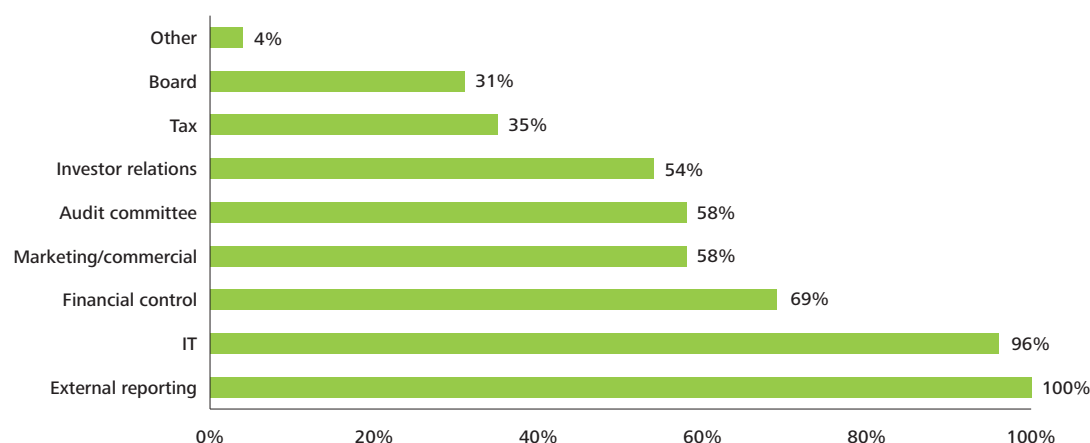
There is no pattern amongst those respondents who have not undertaken any of the activities suggested by the survey.

*77% of respondents expect their group or head office finance function to lead the response and implementation programme with the majority of the remainder being led by divisional or local finance teams. None of the respondents suggested that IT would lead the response.*

77% of respondents expect their group or head office finance function to lead the response and implementation programme with the majority of the remainder being led by divisional or local finance teams. None of the respondents suggested that IT would lead the response. It is interesting to note that, in general, those respondents who believe that the implementation programme will be led by divisional teams are themselves divisions of a larger group and those who responded on behalf of groups suggesting that group finance would be leading the programme. These findings highlight the importance of understanding who is responsible for leading a response to these proposals.

Responding to the proposals will require a significant level of interaction and buy-in across their organisation. Figure 12 summarises areas of the business that will be involved in planning the response to the new standard.

**Figure 12. Areas of the business involved in planning the response**



The survey reveals that a high level of buy-in will be required across a broad range of areas with areas such as legal and Financial Planning & Analysis also suggested as functions that will require some degree of input.

The level of resource required to respond to the proposals was also subject to different opinion amongst respondents. Opinion was split evenly between the suggested levels of resource (less than 10 FTEs, 11–25 and over 25) with a further 23% responding that they don't know how much resource will be required. Whilst this level of differing opinion is consistent with the finding that few respondents have a plan in place to respond to the proposals it may also indicate a level of uncertainty of the cost of compliance. This is further evidenced by the fact that nearly 40% of companies do not know (roughly) how much it will cost them to comply. Of those who provided an estimate, most (27%) believed that their compliance programme would cost between \$0.5 million and \$5.0 million with 12% predicting a cost of over \$5.0 million.

#### **Deloitte Bottom Line**

The survey findings indicate a wide-ranging series of actions that telcos have undertaken to date as well as a differing level of progress in responding to the proposals. We believe that this is both symptomatic of the appetite to implement change and the ability to respond. To address the latter point, a critical success factor will be identifying who in the business will be tasked with responding to the challenges posed by the standard and leading the compliance programme. As suggested by our survey, we believe that some uncertainty exists within organisations (particularly large groups) around where the responsibility for compliance lies. Whilst central or head office finance functions have traditionally led the adoption of new accounting standards, telcos need to be confident that adopting the same approach for revenue recognition will be the most effective response given the system and data complexities involved.

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