

## TMT Accounting Alert

### Accounting developments affecting the Telecommunications industry



#### Revenue recognition – contract modifications

##### **In a nutshell**

In October 2012 the IASB discussed the topic of contract modifications, which has been a key area of focus for companies in the telecoms industry who are contemplating the impact of the upcoming revenue recognition standard.

Two of the items discussed related to changes in transaction price and the determination of distinct performance obligations. On both topics, we believe the tentative conclusions reached will be welcome news for the telecoms industry.

##### **Background**

The IASB is currently finalising the new standard on revenue recognition which is expected to be issued in the first half of 2013. The effective date has not yet been determined, but at present the requirements are not expected to be effective earlier than for annual reporting periods beginning on or after 1 January 2016.

The November 2011 Exposure Draft provided new guidance on how entities should account for contract modifications, which presented companies in the telecoms industry with a number of challenges including how to interpret and practically implement this guidance (as summarised in our publication *Counting the cost*). Following the large number of comments provided on this subject to the IASB (including several from the telecoms industry) the contract modifications topic was discussed in the IASB's meeting held in October 2012.

##### **Points of focus for the telecoms industry**

Changes in transaction price were addressed separately from the contract modifications guidance and were to be accounted for retrospectively (i.e. the change in the transaction price should be allocated to the separate performance obligations) based on proposals in the 2011 ED. In our comment letter, we suggested that changes in transaction price should be accounted for consistently with other contract modifications as it is difficult to distinguish between a price change representing a modification (e.g. if the entity supplied one extra good or service, however small) and simply a price change.

Accordingly, the IASB has tentatively decided to remove the difference between accounting for changes in transaction price and changes in scope and price and, in effect, treat changes in transaction price in the same way as other contract modifications.

A further difficulty that telecoms companies (amongst other industries) have had in interpreting whether, for the purposes of applying the guidance on contract modifications, a good or service is distinct and, accordingly, whether the modification should be accounted for prospectively rather than as a cumulative catch-up adjustment.

The IASB tentatively clarified that for the modification to be accounted for prospectively the remaining goods or services in the modified contract must be distinct from the goods or services transferred on or before the date of the modification. By focusing the criterion on whether the remaining goods or services are distinct from the goods or services already transferred to the customer, prospective accounting will apply where the performance in the contract to date is separate from its remaining performance. Therefore, if a customer upgrades to a faster download speed halfway through a 2-year broadband contract (for a higher price), the modification would be accounted for prospectively, even if the original 2-year contract was previously treated as a single performance obligation.

Please note that these decisions are not final until the new standard is issued in 2013.

## Resources

IFRS Project Insights on Revenue Recognition at [www.iasplus.com](http://www.iasplus.com) provides an up-to-date overview of the proposals based on the decisions taken at the IASB meetings.



## Contacts

Dave Griffin  
*Director, Technology,  
Media and  
Telecommunications*  
020 7303 8926  
[dgriffin@deloitte.co.uk](mailto:dgriffin@deloitte.co.uk)

Clare Tebbenham  
*Senior Manager,  
Technology, Media and  
Telecommunications*  
020 7303 0623  
[ctebbenham@deloitte.co.uk](mailto:ctebbenham@deloitte.co.uk)

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