IFRS 15 – Implementation in the technology and telecommunication industry

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Deutsche Telekom AG

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Ernst & Young GmbH
## AGENDA

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<tbody>
<tr>
<td>1</td>
<td><strong>Revenue Recognition at Deutsche Telekom AG – background and project milestones</strong></td>
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<td>2</td>
<td>Challenges and questions of interpretation</td>
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</tbody>
</table>
As of 2018, the existing system landscape will not be able to depict revenue according to the new revenue recognition requirements.

The solution design (portfolio approach, contract-by-contract) has significant impact on the cost of implementation.

Corresponding interfaces between CRM* and SAP SD** systems and a “Revenue Engine” as well as between the “Revenue Engine” and SAP FI & CO (general ledger) are needed.

In the pilot project at Telekom Deutschland GmbH it has become evident that cost savings (due to implementation of the portfolio approach) amount up to approximately 95% in comparison to a contract-by-contract solution.

* Customer Relationship Management  ** Sales and Distribution
Customers usually receive subsidised handsets when entering into minimum-term service agreements. From the customer’s perspective, the subsidised handset represents an incentive for (re-)entering into the agreement. In our business model, handset subsidies are viewed as costs of acquiring the customer (SAC*).

ARPU** is applied by users to compare the performance of telecoms regarding the provision of telecommunications services.

* SAC: Subscriber Acquisition Cost
** ARPU: Average (Monthly) Revenue per User
Current Accounting

Billing ➔ Contingent Revenue Cap ➔ Revenue from Multiple Element Arrangements

IFRS 15

Billing ➔ Reallocation ➔ Revenue from Multiple Element Arrangements

- Telecommunications industry held very intensive discussions with IASB to retain the contingent revenue cap.
- IASB’s rationale for eliminating the contingent revenue cap presented in IFRS 15.BC287-293 ‘Contingent revenue cap and the portfolio approach to allocation’.
Major Challenge of the proposed regulations: Cash ≠ Revenue

(1) Segregation of revenue: recognition of a net contract position

(2) Massive impact on KPIs – based on regular subsidised mobile contract
   - Hardware revenue
   - Service revenues
   - ARPU (average revenue per customer) *

* Defined as service revenues divided by the number of subscribers
(1) Identification of the contract with a customer:

A customer enters into a DSL contract with a 6 months contract term. He receives a Wi-Fi router for an amount of 100 € upon contract inception. For voice and internet access the customer pays 50 € on a monthly basis. If the Wi-Fi router was sold separately (non-subsidised), the company would have charged 200 €.

Illustrative example on an individual contract basis

<table>
<thead>
<tr>
<th>Minimum contract term:</th>
<th>6 months</th>
</tr>
</thead>
<tbody>
<tr>
<td>Price for Wi-Fi Router:</td>
<td>100 €</td>
</tr>
<tr>
<td>SSP* for the Wi-Fi router:</td>
<td>200 €</td>
</tr>
<tr>
<td>Monthly price for the service:</td>
<td>50 €</td>
</tr>
<tr>
<td>Monthly SSP for the service:</td>
<td>50 €</td>
</tr>
</tbody>
</table>

* stand-alone selling prices
Background and project milestones at Deutsche Telekom AG
EXAMPLE: SUBSIDY OF A WI-FI ROUTER

<table>
<thead>
<tr>
<th>(2) Identification of separate performance obligations</th>
<th>(3) Determination of the transaction price</th>
<th>(4) Allocation of the transaction price</th>
<th>(5) Revenue recognition</th>
</tr>
</thead>
<tbody>
<tr>
<td>Wi-Fi router</td>
<td>100 €</td>
<td>(4.1) SSP in €</td>
<td>Satisfied at inception</td>
</tr>
<tr>
<td>DSL contract</td>
<td>300 €</td>
<td>(4.2) SSP in %</td>
<td>Satisfied over duration</td>
</tr>
<tr>
<td>-</td>
<td>400 €</td>
<td>(4.3) Relative SSP</td>
<td>-</td>
</tr>
</tbody>
</table>

| Wi-Fi router                                           | 200 €                                     | 160 €                                  |
| DSL contract                                           | 300 €                                     | 240 €*                                 |
| -                                                      | 500 €                                     | 400 €                                  |

* monthly: 240 € / 6 = 40 €
Deutsche Telekom uses an adjustment posting approach on general ledger level.

Amounts from billing are posted on both ledgers – local and IFRS.

Adjustments for IFRS 15 are then posted in IFRS ledger on adjustment accounts.

RevRec adjustment entries and current IFRS ledger entries will be summed up in financial statements to show IFRS 15 revenue amounts.
IFRS 15.4: [...] as a practical expedient, an entity may apply this Standard to a portfolio of contracts (or performance obligations) with similar characteristics if the entity reasonably expects that the effects on the financial statements of applying this Standard to the portfolio would not differ materially from applying this Standard to the individual contracts (or performance obligations) within that portfolio.
Background and project milestones at Deutsche Telekom AG
PORTFOLIO APPROACH - ALLOCATION TRANSACTION PRICE

Relative SSP Router: Conceptional

\[
rel.\, SSP_R = \frac{SSP_R}{(SSP_R + SSP_S)} \times (TP_R + TP_S)
\]

\[
= \frac{(TP_R + TP_S)}{(SSP_R + SSP_S)} \times SSP_R
\]

Relative SSP Router: Example

\[
rel.\, SSP_R = \frac{200}{(200 + 300)} \times (100 + 300)
\]

\[
= \frac{(100 + 300)}{(200 + 300)} \times 200
\]

\[
= 0.8 \times 200
\]

\[
= 160
\]
### Background and project milestones at Deutsche Telekom AG

**PORTFOLIO APPROACH - ALLOCATION TRANSACTION PRICE**

<table>
<thead>
<tr>
<th>固定线私有客户</th>
<th>合同/组合结构</th>
<th>测量SSP交付物</th>
<th>测量考虑</th>
<th>TP分配</th>
<th>收入确认</th>
</tr>
</thead>
<tbody>
<tr>
<td>合同交付物</td>
<td>DSL - 服务</td>
<td>15百万欧元 (50k * (6*50 €))</td>
<td>15百万欧元 (50k * (6*50 €))</td>
<td>12百万欧元 (SSP×0.8)</td>
<td>-3百万欧元</td>
</tr>
<tr>
<td></td>
<td>Wi-Fi 路由器</td>
<td>10百万欧元 (50k * 200 €)</td>
<td>5百万欧元 (50k * 100 €)</td>
<td>8百万欧元 (SSP×0.8)</td>
<td>+3百万欧元</td>
</tr>
<tr>
<td></td>
<td></td>
<td><strong>合计 25百万欧元</strong></td>
<td><strong>总计 20百万欧元</strong></td>
<td></td>
<td><strong>总计 20百万欧元</strong></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>合计 0百万欧元</strong></td>
<td></td>
</tr>
</tbody>
</table>
Divergence from current, well-established revenue recognition model is strongly disapproved by users being surveyed by Telco operators.

Significant ongoing cost of compliance as a result of monitoring tens of millions of customer-specific contracts.

Disconnect between billing and revenue recognition will result in significant one-time cost to adjust/replace IT systems and interfaces.

The new model will be highly sensitive to accounting estimates (e.g. with regard to stand-alone selling prices) and therefore management judgment.

Reduced comparability within the industry for key performance indicators:

- Operators incurring higher costs to connect customers to their network (through higher handset subsidies) will be „rewarded“ by front-loading of revenue.
For each business model, each month, for each contract, one needs to

- Receive data from several systems
- Map contract data across several systems
- Work up data to be at performance obligation/component level
- Determine if adjustment is necessary
- Run through IASB five step approach
  - for each contract
  - each month
- Calculate & post adjustment journal entries

Data processing and mapping is in most cases not feasible!
Triggers:
- Subsidy* of a handset
- Discounts
- Activation fees
- ….

Key figure dimensions:
- Minimum contract duration
- Distribution channel
- New/existing customer

*Subsidy: Transaction price of the handset < SSP
Background and project milestones at Deutsche Telekom AG
ADJUSTMENT VECTOR AND MONTHLY CORRECTION

<table>
<thead>
<tr>
<th>month of the correction vectors</th>
</tr>
</thead>
<tbody>
<tr>
<td>January</td>
</tr>
<tr>
<td>February</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>month where correction applies</th>
</tr>
</thead>
<tbody>
<tr>
<td>J</td>
</tr>
<tr>
<td>---</td>
</tr>
<tr>
<td>60</td>
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<tr>
<td>-10</td>
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<tr>
<td>-30</td>
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<td>5</td>
</tr>
<tr>
<td>...</td>
</tr>
<tr>
<td>72</td>
</tr>
<tr>
<td>-24</td>
</tr>
<tr>
<td>6</td>
</tr>
<tr>
<td>...</td>
</tr>
</tbody>
</table>

**Subsidised Hardware**

**Connection Fee**

**Subsidised Hardware**

**Connection Fee**

January:

- DR: Contract Asset
- CR: Hardware Revenues

\[ \sum (-10-30+5) \cdots \]

**Background and project milestones**

- ADJUSTMENT VECTOR AND MONTHLY CORRECTION
- January:
  - DR: Contract Asset
  - CR: Hardware Revenues
  - DR: Service Revenues
  - CR: Contract Asset

\[ \sum 60 \cdots \]
Mobile private customers: 3 different portfolios 5 different adjustment functions

- Postpaid with hardware
  - Postpaid without hardware
  - Prepaid

- Adjustment Functions:
  - Allocation factor / Cost + Margin
  - Discounts
  - Connection fees
  - Contract modifications
  - Early extension of contracts

- Key Figures:
  - Relative SSP Hardware
  - SAP Billing Revenue Hardware

- Dimensions:
  - Minimum contract term
  - Direct/indirect distribution
  - New/existing customer
  - Sale/Lease

Background and project milestones at Deutsche Telekom AG
EXAMPLE - MOBILE PRIVATE CUSTOMERS
# Background and project milestones at Deutsche Telekom AG

## PROJECT MODEL - OVERVIEW

**Group Rollout Revenue Recognition**

<table>
<thead>
<tr>
<th>Milestones</th>
<th>Deliverables</th>
<th>Auditor provides ongoing assurance activities</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Project Organisation</strong>&lt;sup&gt;1&lt;/sup&gt;</td>
<td><strong>Master Template Impact Study</strong>&lt;sup&gt;β&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Conduction Kick-Off &amp; Coaching</td>
<td><strong>Materiality Log</strong>&lt;sup&gt;β&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Agreed Milestone &amp; Workshop Plan with NatCo</td>
<td><strong>One Pager</strong>&lt;sup&gt;β&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Agreed Milestone &amp; Workshop Plan with NatCo</td>
<td><strong>IT/ Technical Requirements</strong>&lt;sup&gt;β&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Conduction Scoping Workshops</td>
<td><strong>Testing Concept</strong>&lt;sup&gt;β&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Analysis Results and Materiality Log reviewed</td>
<td><strong>Testing Results</strong>&lt;sup&gt;β&lt;/sup&gt;</td>
<td></td>
</tr>
<tr>
<td>Adjustment functions &amp; key figures reviewed</td>
<td><strong>Audit certificate</strong></td>
<td></td>
</tr>
<tr>
<td>Business-requirements reviewed</td>
<td>IT requirements reviewed</td>
<td></td>
</tr>
<tr>
<td>Decision on RevRec-Engine solution</td>
<td>IT Technical solution design reviewed</td>
<td></td>
</tr>
</tbody>
</table>

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**Milestones**

1. Project Organisation
2. Conduction Kick-Off & Coaching
3. Agreed Milestone & Workshop Plan with NatCo
4. Conduction Scoping Workshops
5. Completion Contract Analysis
6. Completion Deliverables
7. Review Deliverables

**Deliverables**

- **Master Template Impact Study**
- **Master Template Business Transaction Matrix**
- **Master Template Accounting Evaluation**
- **Materiality Log**
- **One Pager**
- **IT/ Technical Requirements**
- **Testing Concept**
- **Testing Results**
- **Audit certificate**
# Background and project milestones at Deutsche Telekom AG

## MASTER TEMPLATE IMPACT STUDY

<table>
<thead>
<tr>
<th>Business models</th>
<th>Basic adjustment function</th>
<th>Other portfolio defining aspects</th>
<th>Portfolio</th>
</tr>
</thead>
<tbody>
<tr>
<td>Postpaid with hardware</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
<td>Yes</td>
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<tr>
<td>No</td>
<td>No</td>
<td>No</td>
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<tr>
<td>No</td>
<td>No</td>
<td>No</td>
<td>No</td>
</tr>
</tbody>
</table>

### Detailed Explanation

#### Postpaid with hardware
- **Are service(s) and hardware sold in a bundle?** Yes
- **Is a hardware component sold for a lower price in the bundle as it is sold on a stand-alone basis?** Yes
- **Please describe in detail the rationale for the CPP of the component (please refer to the detailed explanation if necessary).**
- **Detailed Explanation:**

  - In a postpaid contract with hardware, the hardware component is typically subsidized by the service component. The CPP of the hardware component is observable market.

- **Are there any external or internal reporting requirements which lead to portfolio segregation?** Yes
- **Is it possible to internally trace hardware as e.g. hardware provided free of charge for the portfolio?** No

#### Postpaid without hardware (Bill on bill)
- **Are service(s) and hardware sold in a bundle?** No
- **Is a hardware component sold for a lower price in the bundle as it is sold on a stand-alone basis?** No
- **Please describe in detail the rationale for the CPP of the component (please refer to the detailed explanation if necessary).**
- **Detailed Explanation:**

  - A contract without hardware does not contain subsidized components and the CPP is the observable market price of the service.

- **Are there any external or internal reporting requirements which lead to portfolio segregation?** Yes
- **Is it possible to internally trace hardware as e.g. hardware provided free of charge for the portfolio?** No

#### Prepaid
- **Are service(s) and hardware sold in a bundle?** No
- **Is a hardware component sold for a lower price in the bundle as it is sold on a stand-alone basis?** No
- **Please describe in detail the rationale for the CPP of the component (please refer to the detailed explanation if necessary).**
- **Detailed Explanation:**

  - A prepaid bill does not contain subsidized components and the CPP is the observable market price of the service.

- **Are there any external or internal reporting requirements which lead to portfolio segregation?** Yes
- **Is it possible to internally trace hardware as e.g. hardware provided free of charge for the portfolio?** No
Background and project milestones at Deutsche Telekom AG

PILOT PROJECT

<table>
<thead>
<tr>
<th>2012</th>
<th>2013</th>
<th>2014</th>
<th>2015</th>
<th>2016</th>
<th>2017</th>
<th>2018</th>
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</thead>
<tbody>
<tr>
<td>Design and implementation of the solution for customer acquisition cost at TDG</td>
<td>Go live for normal operation „monthly accounts“</td>
<td>Auditor´s report (part 1)</td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Design and implementation of the revenue solution at TDG</td>
<td>Go live for normal operation „monthly accounts“</td>
<td>Auditor´s report (part 2)</td>
<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>= Design of processes and internal controls (ICS)</td>
<td>= Go live for normal operations and significant milestones</td>
<td></td>
<td></td>
<td></td>
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</tr>
</tbody>
</table>

Go Live IFRS 15

Today
### Background and project milestones at Deutsche Telekom AG

#### Group rollout plan (1/2)

<table>
<thead>
<tr>
<th>Quarter</th>
<th>Design</th>
<th>Pre Test</th>
<th>Test &amp; Approval</th>
<th>Additional Scenarios &amp; Fine Tuning</th>
<th>Tuning and Follow up</th>
</tr>
</thead>
<tbody>
<tr>
<td>Q3 2015</td>
<td></td>
<td></td>
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<td></td>
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<tr>
<td>Q4 2015</td>
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<td>Q1 2016</td>
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<tr>
<td>Q2 2016</td>
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<td></td>
<td></td>
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<tr>
<td>Q3 2016</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q4 2016</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q1 2017</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Q2 2017</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

#### Central Engine
- **Design**
- **Pre Test**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### Cosmote/OTE
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### Slovak Telekom
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### Telekom Albania
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### TMNL
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### Magyar Telekom
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### Hrvatski Telekom
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### T-Mobile Poland
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

#### Telekom Romania
- **Design**
- **Build**
- **Test & Approval**
- **Additional Scenarios & Fine Tuning**
- **Tuning and Follow up**

---

**Central**

**EU-Pilot**

**Wave 1**

**Wave 2**

**Group rollout plan (1/2)**
### Group rollout plan (2/2)

#### T-Mobile Austria
- **Design**
- **Build**
- **Test & Approval**
- **Addition al Scenario s & Fine Tuning**
- **Tuning and Follow up**

#### T-Mobile Czech
- **Design**
- **Build**
- **Test & Approval**
- **Addition al Scenario s & Fine Tuning**
- **Tuning and Follow up**

#### Crnogorski Telekom
- **Design**
- **Build**
- **Test & Approval**
- **Addition al Scenario s & Fine Tuning**
- **Tuning and Follow up**

#### Makedonski Tel.
- **Design**
- **Build**
- **Test & Approval**
- **Addition al Scenario s & Fine Tuning**
- **Tuning and Follow up**

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**Background and project milestones at Deutsche Telekom AG**
Background and project milestones at Deutsche Telekom AG

KEY FIGURES OF IFRS 15 PROJECT

KEY FIGURES OF IFRS 15 PROJECT AT DEUTSCHE TELEKOM

- Number of NatCos: 12 EU + TSI +TDG + TMUS = 15
- Number of involved FTE: approx. 50
- Our IT-partners: OTE-IT & Tel-IT & Sopra Steria
- Additional partners: Detecon (PMO) & PwC (assurance services)
<table>
<thead>
<tr>
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<th>Agenda Item</th>
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### Challenges and questions of interpretation

#### AGENDA

<table>
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<tr>
<th></th>
<th>Principal vs. agent accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>2</td>
<td>Significant financing component</td>
</tr>
<tr>
<td>3</td>
<td>Accounting in indirect sales channels</td>
</tr>
<tr>
<td>4</td>
<td>Determining the contract duration</td>
</tr>
<tr>
<td>5</td>
<td>Contract costs</td>
</tr>
</tbody>
</table>
Challenges and questions of interpretation
PRINCIPAL VS. AGENT ACCOUNTING

Example

TelCo

payment

antivirus software

DSL contract

software company

customer

payment
Assessment whether an entity is a principal or an agent is carried out separately for each identified performance obligation.

If a contract contains more than one performance obligation, the entity could be a principal for some and an agent for other goods or services.

Steps in assessment:
- Identifying „specified (= distinct) goods or services“ promised to the customer
- Assessment whether the entity has control according to IFRS 15.33 before goods or services are transferred to the customer:
Challenges and questions of interpretation
PRINCIPAL VS. AGENT ACCOUNTING

Principal vs. agent assessment

Problem occurs when more than one entity is involved in providing goods or services to a customer

Does the entity control the good or service before the customer receives control?

Yes

Substantial

Kind of control?

Momentarily / not clear

Assessment of criteria requires judgement

Principal

Recognise as revenue the „gross“ amount paid by the customer for the good or service (IFRS 15.B35B)

Agent

Recognise as revenue the commission or fee earned for facilitating the transfer of goods or services („net“ amount) (IFRS 15.B36)

It is possible that an entity is an agent and a principal in the same contract for two different performance obligations, because each performance obligation has to be considered separately.

Responsible for fulfillment

Inventory risk

Discretion on pricing

Credit risk

Form of a commission

Recognise as revenue the commission or fee earned for facilitating the transfer of goods or services („net“ amount) (IFRS 15.B36)
<table>
<thead>
<tr>
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</tr>
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</table>
Contracts might contain a financing component because payment by the customer occurs either significantly before or after performance.

Entity shall adjust promised amount of consideration for the effects of the time value of money if contract with customer contains significant financing component (IFRS 15.60).

Entity shall use the discount rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception (IFRS 15.64).

Discount rate shall reflect the customer’s creditworthiness and shall not be adjusted during contract duration.
### Important criteria in determining whether a financing component is significant (IFRS 15.61):

- Expected length of time between when the entity transfers promised goods or services and when customer pays for it
- Whether amount of consideration would differ significantly if customer paid in cash promptly
- Prevailing interest rates in relevant market

**Background**

Challenges and questions of interpretation

**SIGNIFICANT FINANCING COMPONENT**
1. Determining the interest rate:

2. Determining the financing effect:

3. Materiality assessment of the financing effect:

No significant financing component, if the ratio of financing effect and TP < 5% (example)
Challenges and questions of interpretation
SIGNIFICANT FINANCING COMPONENT

Example
► Customer receives handset (SSP 599 €) without upfront payment
► Monthly service fee 49 €
► Minimum contract term: 24 months
► Interest rate: 10% p.a.

View 1: Allocation of financing component solely to handset

<table>
<thead>
<tr>
<th>€</th>
<th>rel. SSP t₀-24</th>
<th>rel. SSP (%)</th>
<th>Interest t₁-24</th>
<th>Σ₀-24</th>
</tr>
</thead>
<tbody>
<tr>
<td>Handset</td>
<td>397</td>
<td>33,8</td>
<td>39</td>
<td>384</td>
</tr>
<tr>
<td>Services</td>
<td>779</td>
<td>66,2</td>
<td>779</td>
<td>753</td>
</tr>
<tr>
<td>Σ revenues</td>
<td>1.137</td>
<td></td>
<td>1.137</td>
<td>1.137</td>
</tr>
<tr>
<td>Σ interest</td>
<td>39</td>
<td></td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td>Σ</td>
<td>1.137</td>
<td></td>
<td>39</td>
<td>1.176</td>
</tr>
</tbody>
</table>

View 2: Allocation of financing component to handset and service

<table>
<thead>
<tr>
<th>€</th>
<th>rel. SSP t₀-24</th>
<th>rel. SSP (%)</th>
<th>Interest t₁-24</th>
<th>Σ₀-24</th>
</tr>
</thead>
<tbody>
<tr>
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<td>1.137</td>
<td>1.137</td>
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<td>39</td>
<td></td>
<td>39</td>
<td>39</td>
</tr>
<tr>
<td>Σ</td>
<td>1.137</td>
<td></td>
<td>39</td>
<td>1.176</td>
</tr>
</tbody>
</table>

SSP = stand-alone selling price
1 599€/1.775€ × 1.176€ (relative SSP handset)
2 1.176€/1.176€ (relative SSP services) * relative SSP

Challenges and questions of interpretation
# Challenges and questions of interpretation

## AGENDA

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
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<tbody>
<tr>
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<td>Principal vs. agent accounting</td>
</tr>
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<td>Significant financing component</td>
</tr>
<tr>
<td>3</td>
<td><strong>Accounting in indirect sales channels</strong></td>
</tr>
<tr>
<td>4</td>
<td>Determining the contract duration</td>
</tr>
<tr>
<td>5</td>
<td>Contract costs</td>
</tr>
</tbody>
</table>
Challenges and questions of interpretation
ACCOUNTING IN INDIRECT SALES

Illustrative Example: Direct versus Indirect Distribution Channel

1. DT purchases a handset for €500.
2. Direct channel: handset sold to customer in T-Shops for €100 (stand-alone selling price SSP: €600) in a bundle with a 24-month service contract at €70/month; same service without subsidised handset is offered for €50/month (“SIM Only”).
3. Indirect channel: handset sold to dealer at a wholesale price of €500; dealer resells handset on his behalf to a customer at €100 in a bundle with a 24-month service contract at €70/month on behalf of DT; same service without subsidised handset is offered for €50/month.
4. Dealer would usually sell the handset at SSP of €600; as he offers the handset for €100 to the customer combined with a DT telecommunication service contract, he receives a subsidy compensation from DT of €500.
5. Dealer receives a total sales commission of €600 including the €500 subsidy compensation and €100 compensation for dealer’s agent services.

Direct Channel:

| Bundle | €100 | Service contract | €70/month |

Indirect Channel:

<table>
<thead>
<tr>
<th>Bundle</th>
<th>Dealer</th>
<th>Service contract</th>
<th>€70/month</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>€500</td>
<td></td>
<td></td>
</tr>
<tr>
<td>€500 dealer’s commission: €500 subsidy compensation + €100 agent service expense</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Current Accounting (IAS 18):

<table>
<thead>
<tr>
<th></th>
<th>DIRECT CHANNEL</th>
<th>INDIRECT CHANNEL</th>
<th>Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Month 1</td>
<td>Months 2-24</td>
<td>Total</td>
</tr>
<tr>
<td>Handset sold to customer</td>
<td>100</td>
<td>0</td>
<td>100</td>
</tr>
<tr>
<td>Service contract</td>
<td>70</td>
<td>70</td>
<td>1.680</td>
</tr>
<tr>
<td><strong>Net Revenues</strong></td>
<td><strong>170</strong></td>
<td><strong>70</strong></td>
<td><strong>1.780</strong></td>
</tr>
</tbody>
</table>

- Total net revenues in indirect channel higher by €400 over the contract term due to higher sales price to dealer.
- **Service revenue/ARPU identical in direct and indirect channel.**
Challenges and questions of interpretation
ACCOUNTING IN INDIRECT SALES

IFRS 15 Accounting:
Direct and indirect channel OPTION A

<table>
<thead>
<tr>
<th>DIRECT CHANNEL</th>
<th>Month 1</th>
<th>Months 2-24</th>
<th>Total</th>
<th>INDIRECT CHANNEL OPTION A</th>
<th>Month 1</th>
<th>Months 2-24</th>
<th>Total</th>
<th>Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Handset sold to customer</td>
<td>593</td>
<td>0</td>
<td>593</td>
<td>Handset sold to dealer</td>
<td>500</td>
<td>0</td>
<td>500</td>
<td>-93</td>
</tr>
<tr>
<td>Service contract</td>
<td>49</td>
<td>49</td>
<td>1.187</td>
<td>Service contract (billing)</td>
<td>70</td>
<td>70</td>
<td>1.680</td>
<td>493</td>
</tr>
<tr>
<td>Net Revenues</td>
<td>643</td>
<td>49</td>
<td>1.780</td>
<td>Net Revenues</td>
<td>570</td>
<td>70</td>
<td>2.180</td>
<td>400</td>
</tr>
</tbody>
</table>

► **Direct channel**: Higher revenue allocated to handset at contract inception and lower monthly service revenue/ARPU over contract term

► **Indirect channel Option A**: Total commission allocated over contract term resulting in lower selling expenses at contract inception; Revenues remain unchanged to current accounting

► Service revenue/ARPU for the same services significantly higher in indirect channel
**Challenges and questions of interpretation**
**ACCOUNTING IN INDIRECT SALES**

**IFRS 15 Accounting:**
Direct and indirect channel OPTION B

<table>
<thead>
<tr>
<th>DIRECT CHANNEL</th>
<th>Month 1</th>
<th>Months 2-24</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Handset sold to customer</td>
<td>593</td>
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<tr>
<td>Service contract</td>
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<td>49</td>
<td>1.187</td>
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<tr>
<td><strong>Net Revenues</strong></td>
<td>643</td>
<td>49</td>
<td>1.780</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>INDIRECT CHANNEL OPTION B</th>
<th>Month 1</th>
<th>Months 2-24</th>
<th>Total</th>
<th>Deviation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Handset sold to dealer</td>
<td>500</td>
<td>0</td>
<td>500</td>
<td>-93</td>
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<td>70</td>
<td>70</td>
<td>1.680</td>
<td>493</td>
</tr>
<tr>
<td>Service contract (subsidy compensation)</td>
<td>-20</td>
<td>-20</td>
<td>-480</td>
<td>-480</td>
</tr>
<tr>
<td><strong>Net Revenues</strong></td>
<td>550</td>
<td>50</td>
<td>1.700</td>
<td>-80</td>
</tr>
</tbody>
</table>

**Direct channel:** Same as Option A (see previous page)

**Indirect channel Option B:** The same service is offered to the customer for €50 (without subsidised handset) and €70 (with subsidised handset sold by the dealer); difference of €20 carved out from selling expenses and deducted from service revenues

**Service revenues/ARPU between direct and indirect channel closely aligned**
Challenges and questions of interpretation
ACCOUNTING IN INDIRECT SALES

IFRS 15: Option A

<table>
<thead>
<tr>
<th>INDIRECT CHANNEL</th>
<th>Month 1</th>
<th>Months 2-24</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Revenues</td>
<td>570</td>
<td>70</td>
<td>2.180</td>
</tr>
<tr>
<td>Service Revenue/ARPU</td>
<td>70</td>
<td>70</td>
<td>1.680</td>
</tr>
</tbody>
</table>

**Option A - focus on formal provisions**
- If the dealer determines the handset price, DT’s subsidy compensation is viewed as part of commission expense.
- Other than in direct channel, handset subsidies do not reduce service revenues. Other than in direct channel, revenue for the same service content will be higher if bundled with a subsidised handset.

IFRS 15: Option B

<table>
<thead>
<tr>
<th>INDIRECT CHANNEL</th>
<th>Month 1</th>
<th>Months 2-24</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net Revenues</td>
<td>550</td>
<td>50</td>
<td>1.700</td>
</tr>
<tr>
<td>Service Revenue/ARPU</td>
<td>50</td>
<td>50</td>
<td>1.200</td>
</tr>
</tbody>
</table>

**Option B - focus on the commercial substance from a customer perspective**
- By paying a price premium for the same service, the customer expects (at least) an equivalent benefit from the dealer (just as if the customer bought those services in direct channel) and if DT (implicitly) compensates the dealer for granting such benefit/discount, this is similar to DT giving handset discounts in direct channel.
- Handset subsidy compensation determined by price premium over comparable “SIM Only” service and netted with service revenue.

**Large audit firms and industry position:**
No alignment (accounting as expense) is a strictly formal interpretation of IFRS 15 but a channel alignment (accounting as revenue reduction) is supported by IFRS Framework. Under the circumstances of the described business model the distribution channels have to be aligned.
Challenges and questions of interpretation

AGENDA

1. Principal vs. agent accounting
2. Significant financing component
3. Accounting in indirect sales channels
4. Determining the contract duration
5. Contract costs
A customer enters into a mobile service contract with a 24 months contract term. He receives a handset for an amount of €100 upon contract inception (SSP = €500). For the mobile services the customer pays €50 on a monthly basis (SSP = €50).

The customer is granted the right to early contract termination (extension) after 18 months of the contract, if he enters into a new mobile service contract (or extends his existing contract), with the right to again receive a subsidised handset, with the outstanding months of the old contract being waived.

Challenges and questions of interpretation
DETERMINING THE CONTRACT DURATION

Example of a contract with a customer in the mobile business area:

What is the relevant service contract duration according to IFRS 15?

A. 18 months

B. 24 months

C. Expected duration, e.g. 21 months
Impact on revenue and contract asset:

What is the difference between using 18 vs. 24 months?

<table>
<thead>
<tr>
<th>A. Contract duration = 18 MONTHS</th>
<th>B. Contract duration = 24 MONTHS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Transaction price = €1,000</td>
<td>Transaction price = €1,300</td>
</tr>
<tr>
<td>Handset revenues = €357</td>
<td>Handset revenues = €382</td>
</tr>
<tr>
<td>Service revenues per month* = €36</td>
<td>Service revenues per month* = €38</td>
</tr>
<tr>
<td>Contract asset after 18 months = €0</td>
<td>Contract asset after 18 months = €71</td>
</tr>
</tbody>
</table>

* Months 1-18 of the contract

Using a longer contract duration leads to:

- Higher handset revenues, as a higher transaction price is used for allocation purposes.
- A contract asset of €71 still being on the balance sheet after 18 months.
  - If customer terminates the contract after 18 months:
    - Impairment of the contract asset?
    - Use contract asset as reduction of the transaction price of the new contract?
Challenges and questions of interpretation
DETERMINING THE CONTRACT DURATION

**IFRS 15.11**: An entity shall apply this Standard to the duration of the contract (i.e. the contractual period) in which parties to the contract have present enforceable rights and obligations.

No change in present enforceable rights and obligations shall be assumed!

However, a renewal or cancellation option included in the contract that provides a material right to the customer represents a present enforceable right.

**IFRS 15.49**: For the purpose of determining the transaction price, an entity shall assume that the goods or services will be transferred to the customer as promised in accordance with the existing contract and that the contract will not be cancelled, renewed or modified.
Challenges and questions of interpretation
DETERMINING THE CONTRACT DURATION

Transaction price:

IFRS 15.47: An entity shall consider the terms of the contract and its customary business practices to determine the transaction price. The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer (...) The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

IFRS 15.B186: The boards clarified that the transaction price should include only amounts (including variable amounts) to which the entity has rights under the present contract. For example, the transaction price does not include estimates of consideration from the future exercise of options for additional goods or services or from future change orders.
Challenges and questions of interpretation
DETERMINING THE CONTRACT DURATION

View A: Minimum enforceable duration (18 months)

TRG Paper 10 (b) + (c)

- If each party can terminate the contract without compensating the other party and the termination right can be exercised only after a specified minimum period, the duration of the contract is up to the point at which the contract can be terminated.

- Example:

  An entity enters into a contract with a customer to supply services for 2 years. Each party can terminate the contract at any time after 15 months from the start of the contract without compensating the other party for the termination.

  Result: The duration of the contract is 15 months.
Challenges and questions of interpretation
DETERMINING THE CONTRACT DURATION

View B: Minimum contract duration (24 months)

TelCo‘s rights and obligations

<table>
<thead>
<tr>
<th>Obligations – Contract 1</th>
<th>Obligations – Contract 2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rights – Contract 1</td>
<td>Rights – Contract 2</td>
</tr>
</tbody>
</table>

Customer‘s rights and obligations

<table>
<thead>
<tr>
<th>Obligations – Contract 1</th>
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</tr>
</thead>
<tbody>
<tr>
<td>Rights – Contract 1</td>
<td>Rights – Contract 2</td>
</tr>
</tbody>
</table>
Challenges and questions of interpretation
DETERMINING THE CONTRACT DURATION

View C: Applying the material right guidance

Big4 Revenue Recognition Guide: “A cancellation option that allows a customer to cancel a multi-year contract after each year might effectively be the same as a renewal option, because a decision is made annually whether to continue under the contract.” (see also IFRS 15.BC391)

Possible assessment:

- Does a material right exist in the contract?
  - Yes, with regard to the cancellation option. Outstanding handset subsidy (months 19-24) is the incremental discount provided to the customer.

- How to account for the contract?
  - Over the expected contract duration (e.g. 21 months).
<p>| | |</p>
<table>
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<td>5</td>
<td>Contract costs</td>
</tr>
</tbody>
</table>
Depending on the use of sales channels (e.g. direct versus indirect channels), telecommunication companies may incur significant costs of obtaining a contract (e.g. sales commissions).

Furthermore, telecommunication companies – especially without own network – are commonly faced with multiple costs to fulfil a contract ([one-time] activation fees, termination fees etc. paid to the network provider).

By applying the current rules and regulations, diverse accounting of contract costs in practice; including recognising expenses when incurred.
### Challenges and questions of interpretation

**CONTRACT COSTS**

<table>
<thead>
<tr>
<th>Costs of obtaining a contract</th>
<th>Costs to fulfil a contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>▶ Incremental costs of obtaining a contract (e.g. sales commissions) are recognised as an asset if the entity expects to recover those costs</td>
<td>▶ Costs of fulfilling a contract that cannot be capitalised under another standard (IAS 2, IAS 16, IAS 38) would be capitalised if they:</td>
</tr>
<tr>
<td>◆ relate directly to a contract;</td>
<td>◆ allocate directly to a contract;</td>
</tr>
<tr>
<td>◆ generate or enhance resources that will be used to satisfy performance obligations in the future; and</td>
<td>◆ are expected to be recovered</td>
</tr>
<tr>
<td>◆ are expected to be recovered</td>
<td></td>
</tr>
<tr>
<td>▶ Practical expedient: recognise as an expense when incurred if the amortisation period would be one year or less</td>
<td></td>
</tr>
<tr>
<td></td>
<td>▶ Amortisation consistent with the pattern of transfer of the related good or service and subject to impairment; potential contract renewals must be considered</td>
</tr>
<tr>
<td></td>
<td>▶ Allocation to different performance obligations in case of diverse patterns of revenue recognition (“over time” versus “point of time”)</td>
</tr>
</tbody>
</table>
### Challenges and questions of interpretation
#### CONTRACT COSTS

<table>
<thead>
<tr>
<th>Estimations and judgements in applying IFRS 15</th>
</tr>
</thead>
<tbody>
<tr>
<td>- Determination of the accounting unit (professional judgement)</td>
</tr>
<tr>
<td>- contract-by-contract versus portfolio approach</td>
</tr>
<tr>
<td>- Requirements concerning the recoverability of contract costs</td>
</tr>
<tr>
<td>- Allocation to different performance obligations in case of diverse patterns of revenue recognition (over time versus point of time)</td>
</tr>
<tr>
<td>- hardware versus service</td>
</tr>
<tr>
<td>- Determination of the amortisation pattern (professional judgement)</td>
</tr>
<tr>
<td>- amortisation method: straight-line versus declining</td>
</tr>
<tr>
<td>- amortisation period: estimation of the contract duration</td>
</tr>
<tr>
<td>- (considering both current and anticipated contracts)</td>
</tr>
<tr>
<td>- consideration of multiple sales commissions</td>
</tr>
<tr>
<td>- Amortisation of contract costs and EBITDA (“Non-GAAP Measure”)</td>
</tr>
<tr>
<td>- Amortisation expenses as part of the operating cycle of the business versus amortisation charge being excluded from EBITDA</td>
</tr>
</tbody>
</table>
AGENDA

1. Revenue Recognition at Deutsche Telekom AG – background and project milestones
2. Challenges and questions of interpretation
3. Disclosure requirements
Disclosure requirements

OVERVIEW

Contracts with customers
- Categorisation of revenue
- Contract balances including significant changes
- Qualitative information concerning performance obligations
- Transaction price allocated to the remaining performance obligations

Significant judgments and estimations
- Determining the timing of satisfaction of performance obligations
- Determining the transaction price and the amounts allocated to performance obligations

Any assets recognised from costs to obtain / fulfill a contract with a customer
Disclosure requirements
REMAINING PERFORMANCE OBLIGATIONS

Background

► Analysis of customer contracts
Multiple types of contracts in the telecommunication industry – for example:
► mobile contracts with a minimum contract term of 24 months including a subsidised handset
► mobile contracts with a minimum contract term of 24 months excluding a subsidised handset
► 2nd life mobile contracts with a minimum contract term of 12 months
► prepaid contracts without a minimum contract term
► (…)

► Issue: Disclosure of (complete) backlog in accordance with IFRS 15 as of the balance sheet date?
Disclosure requirements

REMAINING PERFORMANCE OBLIGATIONS

Disclosure requirements (IFRS 15.120)

► Disclosure of the aggregate amount of the transaction price allocated to the performance obligations that are unsatisfied as of the end of the reporting period (including an explanation of the recognition pattern by using qualitative or quantitative information)
  ► no consideration of renewal options (unless the option provides a material right to the customer)
  ► no consideration of variable consideration (unless the variable consideration is included in the determination of the transaction price)

Practical expedient (IFRS 15.121)

► Optional non-disclosure of the backlog:
  a) contract has an original expected duration of one year or less; or
  b) right of consideration corresponds directly with the value to the customer in accordance with IFRS 15.B16

Example:
Service contracts based on a fixed hourly rate per each hour provided by the service company
Disclosure requirements
REMAINING PERFORMANCE OBLIGATIONS

December 31, 2018
(balance sheet date)

A

B

C

D

Obligatory disclosure of the backlog
Optional disclosure of the backlog
Excluded from the backlog disclosures

A mobile contract as of April 1, 2018:
minimum contract term 24 months; subsidised handset
B mobile contract as of July 1, 2018:
minimum contract term 24 months; no subsidised handset or discounts
C 2nd life contract as of October 1, 2016:
2nd life contract as of October 1, 2018, minimum contract term 12 months
D prepaid contract as of December 1, 2018:
no minimum contract term
Fragen?
Vielen Dank für Ihre Aufmerksamkeit.