

Turin, March 13, 2012

Mr. Hans Hoogervorst, Chairman  
International Accounting Standards  
Board  
30 Cannon Street  
London EC4M 6XH  
United Kingdom

**Ref.: Exposure Draft ED/2011/6 “Revenue from Contracts with Customers”**

Dear Mr. Hoogervorst,

we are writing in response to your invitation to comment the last version of the Exposure Draft *Revenue from Contracts with Customers* published by the IASB in November 2011 (the “New ED”).

During last three years the main European telecommunication operators, including Telecom Italia, have been engaged in discussions with the IASB staff and IASB members regarding the possible impact on the telecommunications (“TLC”) industry of the new model on revenue recognition.

With reference to the New ED, we confirm once again the most part of the concerns and critical issues raised in the above mentioned discussions even if we continue to support the Boards (IASB and FASB) objective of a single revenue standard.

Hence, please find enclosed herewith our comments together with a brief introduction of the Telecom Italia Group and our industry background.

We thank you for the opportunity to submit our contribution on this topic.

Best regards,

Stefano De Angelis  
Chief Accounting Officer

## APPENDIX

### 1. PROFILE OF TELECOM ITALIA GROUP AND INDUSTRY BACKGROUND

Telecom Italia S.p.A. and its subsidiaries operate mainly in Europe, the Mediterranean Basin and South America, with around 115 million of mobile-lines, around 21 million fixed-lines network connections, and more than 10 millions of broadband accesses as of December 31, 2011. In 2011, the Telecom Italia Group recorded revenues for approximately 30 billion euros (source: 2011 Preliminary Results approved by the Telecom Italia Board of Directors held in February 24, 2012).

The Telecom Italia Group is engaged principally in the communications sector and, particularly, the fixed and mobile national and international telecommunications sector, the television sector and the office products sector.

The business of telecommunications industry is mainly represented by services. Products are sold separately or in combination with services primarily in order to:

- enable customers to use TLC services (e.g. mobile phone, modem, etc.);
- simplify the customer experience with TLC services, especially when the service fruition requires a combination of different technologies (e.g. in the ICT services: netbook, software, remote data-servers, etc.).

### 2. PRELIMINARY COMMENTS

#### 2.1. The current accounting model

The accounting model used, till now, by the major telecommunications entities in Europe and the United States is the **relative fair value model**, with a **“contingent revenue cap” applied to up-front equipment** provided as a **contract incentive**.

So the **Equipment revenue** is typically the **price paid up-front** by the customer; service revenue is dependent upon the future provision of services and on future customer purchase decisions and is recognised as services are delivered. We believe that the current model:

- results in accounting that better depicts the underlying nature of the business as viewed by management, investors, analysts and other users of financial statements;
- leads to reliable revenue information despite large customer numbers and near-infinite contract variability;
- provides good comparability between telecommunications entities;
- is not unduly sensitive to management estimation;
- avoids the accrual of revenue which will only be received if future services are provided;
- allows the recognition of revenue that correlates closely to the cash flows generated from customers; and

- provides strong predictive information regarding the likely value of future cash flows.

## 2.2. Specific issues to be addressed

The implementation of the new model of revenue recognition in its current shape mainly entails as follows:

- the proposed accounting for *Revenue Recognition* generates a **mismatch between cash flows and revenues streams** during the contract period that concurrently affects the working capital and makes more difficult to understand the cash generation arising from operating activities. This fact is particular evident in case of bundle offers (i.e. sale of handset at discounted price plus future rendering of TLC services); in such situation, the application of the New ED will result, due to the allocation of the transaction price, in an anticipation of revenue in comparison with the current practice. This gives rise to a particular concern if we consider that the higher accrual in revenue is dependent on the future performance of services;
- an increase in the **complexity** of revenue accounting that undermines the **understandability of the financial information** (including Key Performance Indicators) making also more difficult the evaluation of the companies' performances by the stakeholders (i.e., analysts, investors,...);
- the **estimate of the transaction price** (using the expected value or the most likely amount) and **its allocation** to the performance obligations that **involve practical difficulties**. This is due to the large customer number (millions) and near-infinite contract variability;
- the **availability of a powerful information system**, that requires a relevant modification of both the current information system's architecture and the current operating procedures, **that implies the incurrence of material costs and capital expenditures and commits the entities for several years**;
- the processing of information that is subject to a **higher degree of judgment** that, among other things, could materially **affect the comparability of the financial statement key figures** between the telecommunications entities;
- the new proposed model could materially **influence the commercial policies** of the telecommunications entities leading to effects other than those that normally a standard pursues.

## 2.3. Balance between complying costs and benefits for users of financial statements

As said before, in the telecommunications industry the application of the proposed model could result complex or even not practicable due to the features of our industry. In particular the telecommunications industry is characterised by millions of customers, thousands of products, services and offers, several tariffs (regulated and not), different country markets, and different terms of payment (e.g. pre-paid, post-paid). This means a huge number of combinations of contracts with customers.

Based on the foregoing, the application of the new model **on a contract-by-contract basis** would result almost impossible to manage without the incurrence of significant expenditures for the upgrading of the information technology systems, the operational procedures, and the internal control / reporting systems.

Finally, **we believe that the costs to comply with the new standard outweighs the benefits for users and therefore we invite the IASB to revise the proposed model** before the issuance of the final version of the standard.

**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?

As already indicated in our comment letter to the June 2010 ED, it is firstly necessary to consider that the proposed definition of control seems to be more relevant for the sale of goods than for the rendering of services. In particular, the indicators provided by the New ED are not clearly referable to services and therefore we believe that the assessment of the transfer of control in case of services would need additional guidance (including the transfer of control over time). Furthermore, due to the fact that the concept of control is currently addressed by various IFRSs, we believe that, in order to assure consistency across the standards, the concept of control should be defined at the conceptual framework level.

**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?

In principle, we agree with the proposals. However, we believe that the impairment losses, included in the separate line item adjacent to revenue, related to uncollectible considerations that were recognised as revenue in previous reporting periods, should be disclosed separately in the related Note to the financial statements, if material.

**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?

In principle, we agree with the proposed constraint.

**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?

As already indicated in our comment letter to the June 2010 ED, we do not agree with the requirement of identifying an onerous position at the level of each performance obligation within the contract. In fact, in case of an overall profitable contract the proposal of the New ED to account for onerous performance obligations within the contract, results in a misrepresentation of the position of the entity with respect to the related contract with a customer. We believe that the test whether the costs exceed the transaction price should be conducted on a contract level only.

**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:

- The disaggregation of revenue (paragraphs 114 and 115)
- A tabular reconciliation of the movements in the aggregate balance of contract assets and contract liabilities for the current reporting period (paragraph 117)
- An analysis of the entity's remaining performance obligations (paragraphs 119–121)
- 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)
- A tabular reconciliation of the movements of the assets recognized 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.

\* In the IASB exposure draft, see paragraph D19 in Appendix D.

With reference to the proposed disclosures, we believe that it is disproportionate with respect to the information requested by IAS 34 for the other financial statement line items within the interim financial reporting. Furthermore, we believe that the cost to comply with such additional disclosures outweighs the

related benefits for users. In fact, due to the large customer numbers and near-infinite contract variability the proposed disclosures seems to be very burdensome and challenging for the preparers.

**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?

\* In the IASB exposure draft, see paragraphs D17, D22 and D26 in Appendix D.

Yes, we agree with the proposal because this approach leads to a grater consistency in the accounting of similar phenomena.