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IMPLEMENTATION OF THE NEW INTERNATIONAL ACCOUNTING STANDARD ON REVENUE RECOGNITION IN THE TELECOMMUNICATIONS INDUSTRY

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EN – **ABSTRACT**

Bachelor's Degree Final Project *Implementation of the new international accounting standard on revenue recognition in the telecommunications industry*

For several years now, the IASB (international accounting regulatory body) had been working on a project to improve and deepen on the requirements to recognize revenue, due to inconsistencies and divergence regarding different regulation and also due to the lacking detailed guidance of the previous standards. Therefore, on May 2014, IFRS 15 was issued: "*Revenue from Contracts with Customers*", which includes more information and requirements and which brings old regulation together, resulting in a new analysis approach. It is expected that the adoption of the new revenue standard will entail a significant impact on the financial information for those companies that apply IFRS.

In this project, the requirements of IFRS 15 are studied in detail, its implementation project and its impact on a chosen industry: telecommunications. Based on the consolidated annual accounts of three listed telecommunications companies (MásMóvil Ibercom, Orange and Telefónica), changes and new requirements of the transition from the former revenue standard to current IFRS 15 are studied, exposing the primary reasons of the alteration on the financial information and comparing the results obtained with the three companies, in order to ascertain whether the impact has been the same.

Thus, it has been concluded that the impact of IFRS 15 has not been really significant in numerical terms, that is to say, quantitative information has not been significantly altered. However, the adoption of the new standard has given rise to considerable changes in the way of presenting financial information.

Keywords *IFRS 15, IAS 18, performance obligation, telecommunications, consolidated financial statements.*

ES – **RESUMEN**

Trabajo de Fin de Grado *Implementación de la nueva norma contable internacional sobre reconocimiento de ingresos ordinarios en la industria de las telecomunicaciones*

Ya desde hace varios años, el IASB (organismo regulador de la contabilidad a nivel internacional) estuvo trabajando en un proyecto para mejorar y profundizar en los requerimientos de reconocimiento de ingresos ordinarios, debido a inconsistencias y discrepancias entre diferente normativa y debido también a la falta de información detallada de la anterior norma. Por ello, en mayo de 2014, se emitió la NIIF 15: "*Ingresos de Actividades Ordinarias procedentes de Contratos con Clientes*", la cual incluye más información y requerimientos y aglutina toda la normativa anterior, lo que da lugar a un nuevo enfoque de análisis respecto de la antigua norma. Se espera que la adopción de esta nueva norma suponga un impacto significativo en la información financiera de entidades que aplican NIIF.

En este trabajo, se analizan detalladamente los requerimientos de la NIIF 15, su proyecto de implementación y el impacto en una industria concreto: el de las telecomunicaciones. Tomando como base las cuentas anuales consolidadas de tres empresas de telecomunicaciones cotizadas (Orange, MásMóvil Ibercom y Telefónica), se han analizado los cambios y requerimientos de transición de la anterior norma de ingresos a la NIIF 15, exponiendo las principales causas de la alteración de la información financiera y comparando los resultados obtenidos del análisis de las tres empresas, para así comprobar si el impacto ha sido el mismo.

Se ha concluido, así, que el impacto de la NIIF 15 no ha sido realmente significativo en términos numéricos, es decir, la información cuantitativa que las empresas presentan no se ha visto significativamente alterada. No obstante, la adopción de la nueva norma ha supuesto cambios notables en la manera de presentar la información financiera.

Palabras clave *NIIF 15, NIC 18, obligación de desempeño, telecomunicaciones, cuentas anuales consolidadas.*

EU – **LABURPENA**

Gradu Amaierako Lana *Ohiko sarreren onarpeneko nazioarteko kontabilitate-arau berriaren ezarpena telekomunikazioen industrian*

Duela zenbait urte, IASB erakundea (nazioarte-mailan kontabilitatearen arautzeaz arduratzen dena) ohiko sarreren onarpeneko eskakizunak hobetzeko eta sakontzeko, proiektu batean murgiltzen hasi zen, arau ezberdinen funsgabetasun, xehetasun falta eta beren artean zeuden kontraesanengatik. Hortaz, 2014ko maiatzean, 15. FINA igorri zen: "*Bezeroen Kontratuetatiko Ohiko Jardueren Sarrerak*", informazio eta eskakizun gehiago barneratzen duena eta aurreko araudi guztia bateratzen duena. Horrek, aurreko arauarekin alderatuta, analisi-ikuspuntu ezberdina dakar. Arau berriaren ezarpenak FINA aplikatzen duten erakundeen finantza-informazioan eragin nabarmena izango duela espero da.

Lan honetan, 15. FINAren eskakizunak xehetasunez aztertzen dira, bere inplementazio-proiektua eta baita industria konkretu batean izandako eragina; gure kasuan, telekomunikazioena. Kotizatzen duten hiru telekomunikazio-enpresetako (MásMóvil Ibercom, Orange eta Telefónica) urteko kontu bateratuak oinarritzat hartuz, aurreko sarreren arautik 15. FINArako trantsizioaren aldaketak eta betekizunak aztertu dira, finantza-informazioaren aldaketaren arrazoi nagusiak azalduz eta hiru enpresen analisitik lortutako emaitzak alderatuz, eragina berdina izan den ala ez frogatzeko.

Horrenbestez, zenbakizko terminoetan, 15. FINAren eragina ez dela benetan esanguratsua izan ondorioztatu da, hau da, enpresek aurkezten duten informazio kuantitatiboa ez da nabarmen aldatu. Hala ere, arau berriak finantza-informazioa aurkezteko era nabarmenki aldatzea eragin du.

Hitz gakoak *15. FINA, 18. KNA, betetze-obligazio, telekomunikazio, urteko kontu bateratuak.*

Index of abbreviations

BOICAC. Boletín Oficial del Instituto de Contabilidad y Auditoría de Cuentas (in English, Official Journal of the Accouting and Accounts Auditing Institute)
CFS. Consolidated Financial Statements
CNMC. Comisión Nacional de los Mercados y la Competencia (in English, National Markets and Competition Commission)
EFRAG. European Financial Reporting Advisory Group
EU. European Union
FASB. Financial Accounting Standards Board
IAS. International Accounting Standard
IASB. International Accounting Standards Board
IASCF. International Accounting Standards Committee Foundation
ICAC. Instituto de Contabilidad y Auditoría de Cuentas (in English, Institute of Accouting and Accounts Auditing)
IFRS. International Financial Reporting Standard
IFT. Instituto Federal de Telecomunicaciones (in English, Federal Institute of Telecommunications)
PGC. Plan General de Contabilidad (in English, *Spanish* General Accounting Plan)
PwC. Price Waterhouse Coopers (auditing firm)
SFP. Statement of Financial Position
SME. Small and Medium Enterprise
US. United States *of America*
US GAAP. *United States* Generally Accepted Accounting Principles

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Chapter 1 Introduction

1.1. Relevance of the chosen topic

Revenue, as it is one of the main indicators of a company's financial situation, is key when analyzing financial information. It is important to determine how much and to what extent financial information changes after the issuance of a new standard and what the companies expected with respect to former standards: additional information, new itemizations in annual accounts, difficulty on the application, etc.

On account of the existing differences and discrepancies on international revenue regulation, one of the international accounting regulatory bodies, the IASB, initiated a study on the needs that companies and diverse industries presented on revenue recognition. In this context, the IASB started a joint project with the American FASB, the regulatory body of the United States, because previous revenue requirements in IFRS and US GAAP (accounting standards of the US) made it difficult for investors and analysts to understand and compare a company's revenue (IFRS Foundation, 2014). The project underwent a very long process over time, which gave rise to the international standard IFRS 15, effective as of January 1, 2018. The new Standard repeals all the former revenue standards and it includes much more requirements.

IAS 18 to IFRS 15 transition supposes a great change for many industries and companies, as in many of them the moment or way to recognize revenue is significantly altered. Telecommunications industry is one of the industries that is affected by this new Standard. As will be shown during this project, the expected impact on these types of companies is significant, due to the different moment of recognizing revenue which, in theory, would suppose an increase on consolidated reserves.

The reason to choose this project is to complement my skills in accounting obtained during the degree. I wanted to "become a professional" in standards interpretation, so I chose to analyze an IFRS and its impact on a specific industry. I thought it could be interesting to research on the ordinary activity of a company: the revenue recognition process, as it is fundamental indicator of a company's economic health. I also wanted to see how differently revenue was measured between PGC (*Spanish* General Accounting Plan) and international standards (IFRS) – as in the degree we only went through national regulation – and know more about accounting standardization.

1.2. Context

Market globalization and the increasing international economic activity have led to a greater interdependence amongst countries and, at the same time, a reduction in the distance perceived by economic agents. The difficulty to compare financial information provided by companies from different countries conducts to undesirable situations, such as economic and financial information's trustworthiness being questioned if a company presents different results in different countries for a same group of transactions. As a result, there is a need to create a common language that enables mutual understanding between agents all over the world: accounting harmonization and normalization.

The International Accounting Standards Board (hereinafter IASB) is one of the organizations in charge of issuing and promoting the use and application of standards for the accounting harmonization and normalization. It attempts to develop a set of high-quality, easy to understand and of compulsory compliance accounting standards, as well as the alignment of national and international standards. This organization issues what we know as International Financial Reporting Standards (IFRS), which is the international accounting framework applicable to report financial information.

1.2.1. Accounting harmonization in the European Union and Spain

The European Union (hereinafter EU) also followed a lengthy process of harmonization. In its case, accounting harmonization aims to reinforce the comparability of the financial information of the companies of the Member States. We ought to take into account that the change of the Treaty of Europe of 1986 stated that there would be a single European market by the end of 1992, which meant a free flow of labor and capital within the European borders (Single European Act, 1987). For that reason, the influence of the EU on the accounting processes is clear: grow and develop the Single Market, where companies operate under equal circumstances. Since 2005, that resulted in companies, whose securities are publicly traded on the financial markets, applying IFRS (or in its case IAS) for their consolidated statements. This advancement has had an accurate impact on the comparability of the financial information provided by Member States companies in Europe, which can now be compared with companies outside EU (Regulation No. 1606/2002 of the European Parliament and of the Council, 2002).

There is a private association in the EU named EFRAG (European Financial Reporting Advisory Group) that aims to serve the European public interest by promoting European views in the field of financial reporting (EFRAG, 2019); in other words, a technical committee that provides advice on the process of IFRS standards adoption. When the IASB issues a standard, EFRAG conducts consultations with its Member Organizations (European stakeholders and National Organizations) to provide advice to the European Commission on determining whether the issued standard complies with the IAS Regulation for endorsement for use in the EU, as well as the contribution to the efficiency of capital markets (EFRAG, 2019).

Regarding Spain, the harmonizing process started around year 2001, when accounting experts gave their opinion on the impact the harmonizing movement could have on the country.

For that purpose, an Experts Commission was constituted to diagnose the progress of Spanish accounting and, if it came to that, to tackle a reform. The experts expressed their ideas on a document called *Libro Blanco*[1], where the most important recommendation was to homogenize the financial information of Spanish group of companies listed on regulated markets, as many other countries were doing (Martínez-Pina, 2014). These companies should apply the same group of accounting standards, rather, IAS or IFRS endorsed by the Commission. And, as for the individual financial statements, companies would still be governed by national regulation, that is to say, by the Spanish accounting law, complying with international harmonization based on the regulation of the EU, adopting accounting criteria emanating from IAS or IFRS.

Aforesaid regulation or law is basically the 2007 PGC. It comprises a set of standards that are adapted from the international regulation to be applicable in the state. There have been various versions of the PGC: the former one was published in 1990 and the most recent in 2007, both of which have undergone some changes and adaptations, arising from international changes, as well as sectorial adjustments of the plan itself. 1514/2007 Royal Decree[2] delegates ICAC (Spanish accounting institute) the power of passing, by means of Resolutions, compulsory compliance standards that develop the PGC and complementary regulation.

Lastly, it should be noted that regulation carried out these years has been a fundamental complement to all the existing normative; ICAC has issued interpretations of the PGC from 1990 and 2007 and also consults –published in the official journal of ICAC, that is, in BOICAC– dealing with important matters that are of general concern (Martínez-Pina, 2014).

1.2.2. Revenue recognition and its importance

Among the IFRS, there are standards that regulate a company's operating activity, which is the most important existing reason of companies themselves. These activities are meant to be resources deriving from a company's main pursuit – main source of ordinary revenue – that originate income in form or revenue from the receipt of goods and rendering of services to customers.

According to the Accounting Conceptual Framework: "revenue or income is increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, except for contributions of equity-participants". Revenue should be recorded when the revenue generating act or process has been completed, or when it has been earned, rather than when the payment of revenue is actually received (FASB, 2019). It is recognized in the income statement when an increase in future economic benefit related to an increase in an assets or a decrease of a liability has arisen that can be measured reliably.

Concerning accounting and tax obligations, the size of the company plays a very relevant role. In the table below it is shown when Spanish companies must prepare normal or abbreviated

[1] Informe sobre la situación actual de la contabilidad en España y líneas básicas para abordar su reforma (ICAC, 2002). *White Book – Report on the current situation of accounting in Spain and the basic lines to tackle a reform.*
[2] 1514/2007 Royal Decree, 16th November, by which Spanish General Accounting Plan is approved.

models of financial statements in accordance with total assets, revenue and average number of workers.

Table 1. *Accounting and tax obligations by company size*

	SME MODEL		ABBREVIATED MODEL		NORMAL MODEL	
	Micro-enterprise	**Remaining SME**	Balance sheet and explanatory notes	Profit and loss statement	Balance sheet, statement of changes in equity, statement of cash flows and explanatory notes	Profit and loss statement
	Balance sheet, profit and loss statement and explanatory notes					
Conditions	During two consecutive tax years, at the year-end close date, shall the entity, at least, meet two of the following conditions:		During two consecutive tax years, at the year-end close date, shall the entity, at least, meet two of the following conditions:		N/A	
Total Assets (€)	< 1,000,000	< 4,000,000	< 4,000,000	< 11,400,000	Rest	Rest
Revenue (€)	< 2,000,000	< 8,000,000	< 8,000,000	< 22,800,000	Rest	Rest
Average No. of workers	< 10	< 50	< 50	< 250	Rest	Rest

SOURCE: Self-made based on Orden JUS/471/2017, de 19 de mayo (2017)

As can be seen in the table above, Spanish companies can apply different models of annual accounts depending on their size, regarding the three criteria explained. For instance, in order to know whether a company can apply SME General Plan or whether it has advantages for being a micro-entity or whether it is a small-dimension company with regard to the corporate tax, it needs to know how big it is.

One of the key aspects to measure size is the revenue from operating activities. Sometimes the amount of revenue can be confusing, because a company can sell a lot and have a big number of revenue and be a small company with few workers and little assets; or the opposite way, a company with a big number of workers and assets and with low revenue. Therefore, revenue is not a warranty of liquidity and profitability (Martínez, 2017). Besides, in accounting terms, these numbers indicate if an entity has audit requirement.

In short, stakeholders put their eye on revenue when deciding to invest in a company, as it is the tool that generates profits and increases equity and value; the key to measure the financial performance of a company. Moreover, it should be noted that stakeholders and potential investors will not only be interested in the revenue shown in the income statement, but also by what means and to what extent the company has been accurate measuring it, to then calculate operating profits, net income and cash flow, among others (McManamon & Co., 2018).

1.3. Objectives and project's structure

The main objective of the project is to analyze the requirements of the new revenue standard, IFRS 15, and study the impact of its application on an industry. Likewise, the specific objectives are explained as follows:

- Research the reasons to issue a new revenue recognition standard. In other words, the background of IFRS 15.
- Understand in detail the new requirements of IFRS 15 in comparison to the former revenue standards.

- Study the complexity of the application and the transition from IFRS 15 to IAS 18 on the telecommunications industry.
- Make a comparison between a sample of three telecommunications companies to determine:
  - what the impact has been and to what extent it has been significant;
  - if the adoption of IFRS 15 has had the same consequences on the three companies; and
  - the way of presenting financial information.

This project will be composed of three main parts:

- **Theoretical**. This will be the first part of the project, where we will study the background of the new revenue standard – the reasons to be issued and the project behind –, IFRS 15 itself and the telecommunications industry (the main characteristics and the situation in Spain).
- **Empirical**. It is the essential part of the project, as it deals with the impacts of the application of IFRS 15 on the telecommunications industry, taking a sample of three companies, based on the information on their consolidated annual accounts.
- **Conclusions**. Final analysis of the carried out research.

1.4. Methodology

The methodology used during this project is mainly a literature review of official sources, such as IFRS, consolidated financial statements and other regulation or documents. Firstly, the relevance of the topic to be discussed is analyzed, such as the international accounting harmonization process, in the European Union and in Spain, to be able to understand the possible reasons to have issued IFRS 15. Throughout the project, documents, regulations and other utilized sources are cited.

Next, the reasons of the issuance of IFRS 15 is studied, consulting official web pages of IFRS Foundation and FASB, that is to say, why IASB, just as other regulatory bodies, saw the need to replace the revenue standards that were in force in its day. As the investigation requires, revenue recognition standards is analyzed: IAS 18, which was the standard principally applied to recognize revenue, and IAS 11, about construction contracts. Once known and interpreted, the new IFRS is studied in depth. The *Illustrative Examples* and the *Basis for Conclusions* issued by IASB have been used for a better understanding and to explain certain parts of the standard by means of simple examples. The reading also allows making a brief comparison of the analysis approach proposed by the two standards (IAS 18 and IFRS 15). Every updated document has been retrieved from the official web page of this regulatory body.

Before starting the empirical analysis, a quick review of the telecommunications industry is made: understand what they are and what elements they are composed of in order to be able to master the most technical issues when it comes to conducting the analysis of the annual accounts. Furthermore, based on the economic report of the National Markets and Competition Commission on audiovisual and telecommunications industry, the situation of the Spanish telecoms market is described.

Lastly, with the aforementioned sample, an empirical analysis is presented. For that purpose, the information stemming from the financial annual reports of these companies has been used. Financial statements have been gathered from the corporative official websites of each company. With the goal of studying the expected and real impact of the application of IFRS 15, annual reports corresponding to 2018 and 2017 have been used and, in some cases, also 2016. With the available reports, the offered information on the adoption of the new standard is critically examined, particularly, the Statement of Financial Position, the Consolidated Income Statement, the Statement of Changes in Equity and the Explanatory Notes on their corresponding sections.

Chapter 2 Theoretical Framework

This chapter will be focused fundamentally on theoretical aspects. First of all, we will analyze the background of the new revenue recognition standard, that is, the project behind. Then, we will have a look at the Standard itself, showing the principal requirements of each step, special guidance for contract costs and some differences between former revenue standards and IFRS 15.

2.1. Background

2.1.1. IASB's IFRS 15 implementation project

Since long time ago, in June 2002, the IASB added to its agenda a project on revenue. It was considered that there was a need to create a new standard that increased and deepened the revenue recognition requirements arising from contracts with customers, due to lacking detailed guidelines of the standards in force in its day, as well as limitations on their application (Bejarano, 2016). Moreover, the differences between the regulation in the US and the IASB's standards gave rise to a joint project between the two accounting organizations (IASB and FASB[3]), also because the American standardization had particular Standards that comprised broader concepts on the recognition of revenue, sometimes contradictory to each other.

In that joint project, the main objectives were to create a standard that would eliminate the inconsistencies and weaknesses of all the former regulation, provide a unique revenue recognition model for all industries, companies and geographic areas, improve and simplify the elaboration of financial statements, as well as strengthen the Accounting Conceptual Framework (Deloitte, 2019).

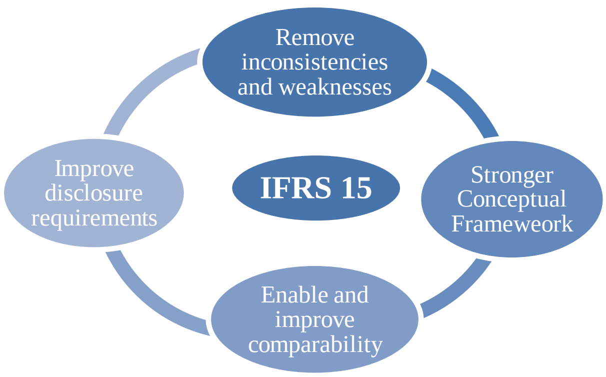

ILLUSTRATION 1: *IFRS 15 improvements*
Source: Self-made based on Deloitte (2019)

The project underwent an extensive due process. It started with the two organizations

[3] Financial Accounting Standards Board.

having more than 650 meetings all over the world, where stakeholders such as academics, accountancy bodies, auditors and accounting firms, governments, investors and analysists and so on participated. Furthermore, they also regularly consulted with advisory groups such as IFRS Advisory Council.

IASB and FASB went beyond the normal due process requirements by publishing a revised Exposure Draft after previously publishing both a Discussion Paper and an initial Exposure Draft (IFRS Foundation, 2014). During the process, over 1,500 comment letters in total were gathered, among which EFRAG's comment letters were included. To supplement them, some meetings with several types of users of financial statements were held. The organizations also carried out outreach with investors in particular industries, for example, in the industry of telecommunications, whose aim was to understand how analysts used revenue information to assess financial performance.

Throughout the project, both organizations took part in workshops, where preparers tested the applications of the proposals in the Exposure Drafts. The objective of the workshops was to identify the possible difficulties on the application of the Standard. Finally, the findings were considered during the redeliberations of the 2011 Exposure Draft.

After the dilated process to improve and converge with the financial information requirements of both IFRS and GAAP (accounting framework of the US) regulations, the organizations came to the same conclusions on the necessity for accounting revenue, creating a unique way of revenue recognition. The final Standard was published on May 28, 2014, which is very similar to GAAP Topic 606 (revenue standard published the same day as IFRS 15), although there are some small differences.

2.1.2. Adoption in the EU and Spain

European Union. The implementation of IFRS 15 has also been part of EFRAG's agenda. Since the publication of the first Exposure Draft by the boards (IASB and FASB) on June 24, 2010, for public discussion, the European association started working on the adoption project. The illustration below summarizes the process.

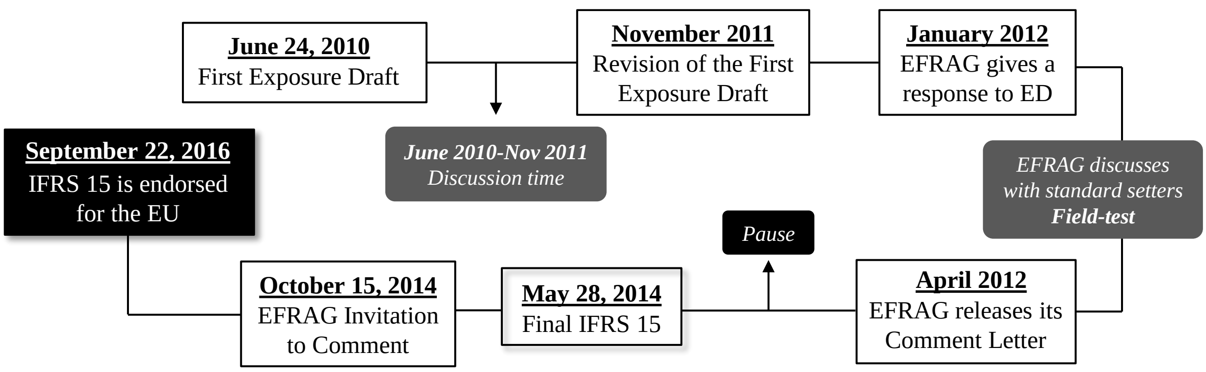

ILLUSTRATION 2: *IFRS 15 implementation process in the EU*
Source: Self-made

After discussions by different associations, the IASB published in November 2011 a revision of the first exposure draft. EFRAG responded to the new publication of the IASB in January 2012 and until April of the same year – when it released the Comment Letter – continued its discussion with national standard setters. The European association carried out field-test to European companies that consisted of identifying potential implementation and application difficulties (EFRAG, 2012).

On 28 May 2014, the IASB released the final Standard and some months later, in October, issued an Invitation to Comment related with the endorsement of IFRS 15 in the EU. It mainly attempted to assess the technical criteria for the adoption of the Standard and the costs and benefits that could arise from its application. The initial assessment was that IFRS 15 satisfied the technical criteria for EU endorsement. Finally, it was endorsed on September 22, 2016 by *Commission Regulation 2016/1905* and published in the Official Journal of the European Union on October 29, 2016.

Spain. In 2018, ICAC issued a Resolution Project[4] (adapted to Spanish companies and their situation), by which the rules for recognition, valuation and presentation and disclosure of annual accounts from the recognition of ordinary revenue are established. The Project modifies the current recognition and measurement standard No. 14 of the PGC about revenue recognition and it proposes to set as an effective date economic years beginning on January 1, 2020 for all those companies, regardless of their legal form, that apply PGC. Companies that apply SME-PGC can also make a subsidiary use of this regulation. Note that the Spanish standard is very similar to the international standard issued by the IASB and adopted by the EU.

2.2. IFRS 15 overview

In this part of the project, we will **briefly** analyze the requirements to recognize revenue under IFRS 15. As we have mentioned, the standard gives guidance on how to recognize revenue from contracts with customers in a 5-step model. This standard becomes effective for economic years beginning on January 1, 2018.

2.2.1. Objective

The objective of this standard is to set and specify the basis to recognize revenue from a contract with a customer, who is the party that has agreed on obtaining goods and/or services with an entity, which are a result of the ordinary activities of the entity itself, in exchange of a compensation (from now on consideration).

The new revenue recognition standard specifies how an entity ought to deal with accounting for an individual good or service provided to a customer. Nevertheless, the standard can also be applied to a portfolio of contracts (or performance obligations, about which we will

[4] Proyecto de Resolución del Instituto de Contabilidad y Auditoría de Cuentas por la que se dictan normas de registro, valoración y elaboración de las cuentas anuales para el reconocimiento de ingresos por la entrega de bienes y la prestación de servicios (ICAC, 2018).

soon talk). If the entity decides to apply the standard to a portfolio of contracts, it should take into account the fact that the goods or services need to be similar and the effect of applying the standard to a group of goods or services is minimum on the financial statements of the company; rather, there is little difference on the financial statements when applying this standard to an individual contract or a portfolio of contracts.

2.2.2. Scope

This standard regulates everything related with a contract with a customer. Anything out of that topic is outside the scope of the standard.

Table 2. *Scope of IFRS 15*

IFRS 15	OTHERS
☑ Contracts with a customer based on performance obligations satisfied. ☑ Only when the counterparty to the contract is a customer, who will never collaborate or participate in the activity of the company, sharing risks and benefits.	☒ Leases contracts (under IAS 17: *Leases*) ☒ Insurance contracts (IFRS 4: *Insurance Contracts*) ☒ Financial instruments and other contractual rights or obligations within IFRS 9, 10 and 11 and IAS 27 and 28. ☒ Non-monetary exchanges between entities.

SOURCE: Self-made

IAS 18 and 11 were the main or principal antecessors to this standard. The picture below shows a graphical representation of the scope of revenue recognition standards.

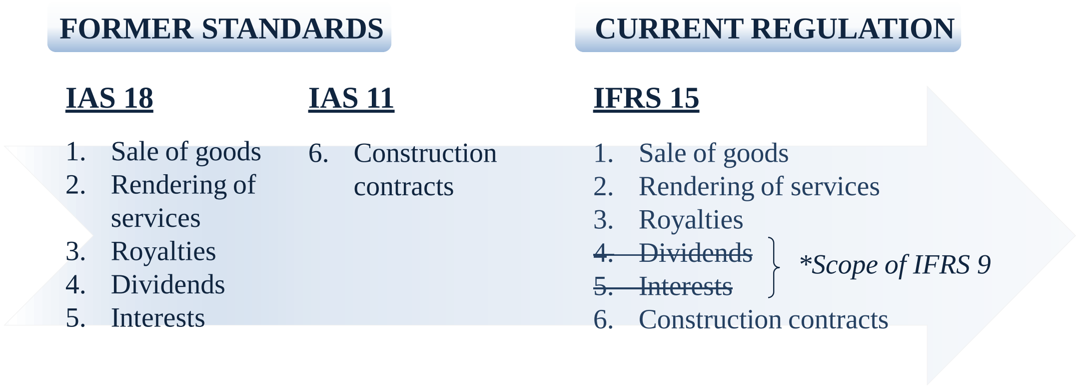

ILLUSTRATION 3: *Scope of revenue recognition standards*
Source: Self-made based on PwC (2017)

IAS 18 regulated sale of goods, rendering of services, royalties, dividends and interests, whereas IAS 11 regulated construction contracts. In contrast, IFRS 15 does not distinguish between sale of goods, rendering of services and construction contracts, but it defines performance obligations for a transaction, which are satisfied over time (typical on services) or at a point in time (typical on goods cessions). Additionally, dividends and interests are now within the scope of IFRS 9, about financial instruments.

2.2.3. Revenue recognition process: the 5-step model

This part of the section will focus on the process to recognize revenue under the 5-step model. The recognition of revenue arising from a contract with a customer is based on satisfying performance obligations at a point in time or over time. At contract inception, all the steps need to be fully understood and analyzed and provided that any of the criteria change during the contract, it shall be reassessed.

ILLUSTRATION 4: *5-step revenue recognition process*
Source: Self-made

Let us start the analysis, identifying the main aspects and ideas of each step. It should be noted that all the examples shown next are gathered from the "*Illustrative Examples*" of the IASB (IASB, 2014).

Table 3. *Step 1: Identification of the contract*

STEP 1. Identification of the contract with the customer
Overview
To assess whether we have a contract with a customer, first of all, we shall ask the following question: does a contract with a customer exist? If it does, is it within the scope of IFRS 15? We need to remember that only topics related with customers are within the scope of the standard at issue.
Definition of contract
A contract is an agreement, which can be written, oral or implied by an entity's customary business practices, between two or more parties that creates enforceable rights and obligations. The **entity**, on the one hand, will be obliged to give the customer the promised good or services and it will have the right to receive a consideration from the customer. On the other hand, the **customer** will have the obligation to give the entity the amount of consideration stated in the contract and will have the right to receive the goods or services promised.
Criteria that indicate there is a contract with a customer
There are some criteria that indicate the existence of a contract with a customer, next explained: (a) The contract is **approved by both parties**, which totally agree on fulfilling the obligations stated. (b) Each party knows what its **rights and obligations** are. (c) **Payment terms** can be easily identified. (d) The contract has **commercial substance**.

(e) High **probability** the entity will **collect** the **consideration** to which it will be entitled if it fulfills the obligations.

Combination of contracts

Sometimes, the accounting treatment of contracts can be eased by combining them. That combination needs to follow some **criteria** that companies ought to satisfy in order to be able to have a single contract amongst a group of contracts. The most important issue to be taken into account is that the contracts must be related to the same party, that is, the **same customer**. Additionally, the contracts need to be negotiated as a **package**, are **interrelated** one with each other – the amount to be paid in one contract depends on the price or performance of the other contract – and there is a **unique performance obligation**.

Contract modifications

A contract modification should change its **scope, price or both**. As the creation of the contract, the change in the scope, price or both can be done written, orally or by business practices. The change, to be considered as such, has to create new or change existing enforceable rights and obligations. We may find three possible situations:

- **Modification of the contract that results in a new separate contract**
    - The scope of the contract increases because new distinct goods or services are added.
    - The price of the contract increases by an amount of consideration that reflects the individual selling prices of the additional promised good or services.
        - e.g. if an entity promised, at contract inception, to transfer to the customer 100 products at 1,000 m.u. – 10 m.u. per product – uniformly during 5 months and after 2 months both parties agree upon adding 20 new identical products, not included in the initial contract, for 400 m.u. (whose individual selling prices are 20 m.u. each), the entity will create a new contract for the additional promised goods, due to having already transferred part of the promised goods. As we see, the amount of money of the new product reflects the individual selling prices of the additional promised goods (400 m.u. / 20 products = 20 m.u./product). And, as the additional products' price differs with the initial one, the entity shall account for a separate contract, recognizing revenue from the initial products by 10 m.u. per product (1,000 m.u) and the additional products by 20 m.u. per each (400 m.u.). Then, total contract revenue would sum up to 1,400 m.u. with no change in the prices of the already transferred products.
- **Modification of the contract that terminates the existing contract and creates a new one.** For the case when there is a change in the price of the remaining goods or services are distinct from the goods or services transferred. Oppositely, the amount of consideration receivable does not reflect the individual selling prices of the additional promised good or services.
    - e.g. retrieving the former example, with the initial contract terms, the entity transfers goods corresponding the first two months but the customer claims the goods (40 units) were in bad condition; therefore, both parties agree on lowering the price of the additional goods (20 units). The price for the new products will no longer be 20 m.u./unit; the entity will give a credit to the customer on the 20 additional products, resulting in a total price of 280 m.u. (40 faulty products × 3 m.u.), which means the price of each additional good is 14 m.u. (280 ÷ 20). As a result, the individual selling prices of the additional goods do not fit in with the original prices (14 ≠ 20). The company, then, will terminate the existing contract and create a new one.
    - Thus, what is the effect on revenue? The company's operating revenue will diminish by the amount of credit given to the customer, rather, in 120 m.u., as there is a reduction in the transaction price. The revenue of the remaining goods would be a mixture of prices: initial 60 products to be transferred at a price of 10 m.u. and the additional 20 products at a price of 14 m.u. would make a final combined price of 11 m.u. [(60 × 10 + 20 × 14) ÷ 80]. Revenue pending of recording would sum up to 880 m.u. (11 m.u. × 80 products), instead of 1,000 m.u. (12.5 m.u.[5] × 80 products). Total contract revenue would be equal to 1,280 m.u. (880 + 400), instead of 1,400 m.u. (1,000 + 400).
- **Modification of the contract as if it were part of the existing contract.** For the case when there is a change in the price of the remaining goods or services that are similar or the same (not distinct) to the original ones, and so they form a single performance obligation. Revenue already recorded is modified in a catch-up basis.

SOURCE: Self-made based on IFRS 15

[5] Price not taking the change into account [(60 × 10 + 20 × 20) ÷ 80].

Table 4. *Step 2: Identification of performance obligations*

STEP 2. Identification of performance obligations

Concept

A performance obligation can be defined as the **promise** to transfer to the customer the goods and/or services stated in the contract.

Single performance obligation or a series of performance obligations

At contract inception, the entity shall assess the goods or services in question to determine a:

- **single performance obligation:** the goods or services in the contract are the same or substantially the same and have the same pattern of transfer to the customer, which appears to be a performance obligation satisfied over time and the use of the same method to measure the progress toward complete satisfaction of the performance obligation (see *step 5*); or
- **series of performance obligations:** if there is a bundle of goods and/or services within a contract, for the case of distinct goods or services (see row below) that are separately identifiable and not interrelated one with each other.

Distinct goods or services and determination of performance obligations

There are two very important criteria that need to be fulfilled to determine whether we have a distinct good or service:

(1) <u>Capable of being distinct.</u> The customer can **benefit** – the good or service can be used, consumed or sold for a greater amount that its residual value – from the good or service either on **its own** or **together with** other resources readily available to the customer.

(2) <u>Distinct within the context of the contract</u>. The entity's **promise** to transfer the good or service to the customer is **separately identifiable from other promises** in the contract, that is, there are different promises in the contract so that the goods or services can be identified clearly from other promises.

Additionally, there are also some <u>indicators</u> that tell if a good or service <u>are not separately identifiable</u> one from each other:

i. when there is a series of goods or services within a contract that are highly related; that is to say, when there is a need to use one or some of the goods or services as an input to perform other goods or services in the contract (output).

ii. when the entity cannot transfer goods or services promised in the contract independently (need to be transferred altogether).

iii. when the use of the good or service modifies or customizes other goods or services promised in the contract.

If the first two criteria are met, the goods and/or services will be distinct, and so the entity will account for as a separate/single performance obligation. If the criteria are not met, then, the goods and/or services will not be distinct and will need to be grouped with other goods or services in the contract. The entity may use the remaining criteria (i., ii., iii.) to assess whether the goods and services are distinct.

e.g. Suppose that an entity that develops software conducts a contract with a customer to transfer a software license, offer an installation service, and provide updates to the software and technical support for a period of two years. The entity sells the license, the installation service and the technical support separately. The installation service can be made by other entities and does not significantly modify the software itself. Moreover, the software remains functional without the need of updates. The entity observes that the software is delivered before the other services are performed and it is functional without the updates and technical support. The entity also takes the three aforementioned additional criteria (i., ii., iii.) into account and determines that the obligation to transfer each good and service to the customer is separately identifiable from each of the other obligations. The installation service does not modify nor personalize the software itself but it is a separate service added to the contract.

Therefore the entity concludes, in accordance with the criteria and indicators above explained, that:

- the customer can benefit from each of the goods and services individually or together with others already available;
- the entity can transfer the software without the need of transferring other service; and
- the installation service does not significantly affect the use of the software.

All in all, there are four identifiable performance obligations: software license; the installation service; updates of the software; and the technical support.

SOURCE: Self-made based on IFRS 15

Table 5. *Step 3: Determine the transaction price*

STEP 3. Determination of the transaction price

Concept

The transaction price is the amount of **consideration** that the **entity** expects to **receive** in exchange of transferring the goods or services to the customer. Consideration in a contract can be fixed, variable or both.

Fixed consideration

Fixed consideration is an **exact amount** of money, or other type of consideration measurable in cash, that does not vary within the operating life of the contract; for instance, if there is a contract with a unique performance obligation to transfer a handset (good) to a customer, a fixed price would be a single price (e.g. 500 m.u.) that is not dependent on other factors or variables that can alter it.

Variable consideration

When there is consideration promised in the contract that can **vary due to some items**, such as discounts, rebates, credits, price concessions, incentives and others, **or events**, such as future or contingent events, we have a contract that includes variable amounts of consideration.

The entity needs to state the variable consideration in the contract and so it needs to make some **estimations** to set the price, which will be updated at the end of each reporting period to represent faithfully the change in the circumstances that alter the price. The estimated amounts cannot be recognized as revenue if there is a high probability that a reversal in cumulative revenue may happen.

- **Expected value.** This method consists of summing probability-weighted amounts in a range of possible consideration amounts. Appropriate for a large number of contracts.
  - e.g. an entity conducts a contract with another entity (customer) to offer a service of optical fiber with a fixed duration of 18 months. If the customer terminates the contract before the stated date (after 18 months), the company will charge a penalty of 80 m.u. per month. The customer can stay with the Wi-Fi device installed at contract inception (with no payment initially done), which can be used for other purposes, at the end of the contract if it pays a reduced price of 29.99 m.u.
  - Therefore, the entity uses the expected value to estimate the price the customer will pay if it terminates the contract before the date set: (monthly price × 18) + 80 m.u. per month of contract termination in advance.
- **Most likely amount.** This method consists of allocating the single most likely amount in a range of possible consideration amounts. Appropriate when there is a contract with two possible outcomes.
  - e.g. with the former information, the customer might stay with the Wi-Fi device or it might not. There are two possible outcomes for this aspect of the contract; therefore, the entity concludes it is appropriate to use the most likely amount method (29.99 or 0 m.u. receivable).

Existence of a significant financing component in the contract

The existence of a significant financing component can be **explicitly** (it is stated that the entity finances the payments receivable from the customer with a rate of interest that reflects the effects of the time value of money) or **implicitly** (implied in the payment terms agreed upon the parties) stated in the contract.

The entity has to **assess** whether there is a significant financing component in the operation. If the duration of the contract is less than a year, no adjustments will be done (no financing component present).

The existence of a significant financing component means both the **customer** and the **entity can benefit** from the time: the customer has more time to pay and the entity can charge a higher price. There is a **special accounting treatment** for a financing component, explained as it follows (*see more in the case study*):

- the entity will recognize revenue at the moment of the transfer of the goods or rendering of services for an amount that reflects what the customer would have paid in cash at the moment of the cession;
- the entity will use the discount rate that would be reflected in a separate financing transaction between the entity and its customer. That is, the rate would reflect the difference between what the customer pays and what it would pay if it were paid in cash; and
- interests arising from the financing are accounted for finance revenue in the statement of comprehensive income.

Non-cash consideration

When the customer does not pay in cash (money), there is consideration regarded as “non-cash”. It shall be measured at **fair value**, that is to say, the sale price agreed upon by a willing buyer and seller, assuming both parties enter the transaction freely and knowledgeably (Investopedia, 2018). If the fair value cannot be measured (reliably), individual selling prices of the goods or services should be taken into account to estimate it.

Consideration payable to the customer

Consideration payable to the customer includes cash amounts that an entity pays or expects to pay to the customer. In this case, the transaction price would be reduced by the amount the entity pays or expects to pay to the customer unless it is an exchange of distinct goods or services from the customer, in which case the entity will have to account for a purchase to suppliers. Examples could be coupons/vouchers, volume discounts, payments for publicity shelving (for instance, a company says to its customer that it has to use certain types of shelves to promote the products the company sells, so the entity pays the customer for that), etc.

SOURCE: Self-made based on IFRS 15

Table 6. *Step 4: Allocate the price to performance obligations*

STEP 4. Allocation of the determined transaction price to performance obligations

Concept

As the name says, it consists of allocating the price already determined to performance obligations in the contract or, in its case, to the distinct goods and/or services within the contract. The aim is to show what each performance obligation will **provide** the entity with in terms of **consideration**.

Allocation based on individual selling prices

The individual selling prices of the promised good or services are regarded to **proportionally allocate** the price to each performance obligation of the contract. However, what if an individual selling price is not directly observable? The entity shall estimate it in accordance with the objective already explained. There are various **estimation methods**, which are the following:

- **Adjusted market assessment approach**. In this method, the market is analyzed: buyers' willingness to pay and competitors' prices for same or similar goods or services.
- **Expected cost plus a margin approach**. This method consists of forecasting the costs that each performance obligation satisfaction may mean for the entity and then adding a profit margin.
- **Residual approach**. This method may be used when the entity knows what the prices of other goods or services promised in the contract are, so that it can estimate the price(s) of the lacking good(s) or service(s). It is calculated as the total transaction price minus the sum of the observable individual selling prices of the other goods or services (TTP[6] – ∑ ISP[7]). Nonetheless, this method can only be used when the entity sells the same good or service to different customers for a broad range of amounts and when it has not established a price for that good or service and the good or service has not been yet sold individually.

In addition, a combination of methods can be used when the individual selling prices of two or more goods or services are highly uncertain. As a conclusion, an entity may use the method it thinks it is best.

Allocation of variable consideration

Variable consideration may be allocated to the **whole contract or to a specific part**. If it is only applied to a part, it can be applicable to one or more, but not all, performance obligations or inside a (or some) performance obligation(s) only to some of the goods or services if there is a series of goods or services.
Also an entity shall allocate a variable amount to what we have explained above when the terms of a variable payment relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service; in other words, an event is dependent on the entity's efforts to satisfy a (or some) performance obligation(s) in a contract.

Allocation of discounts

[6] Total Transaction Price
[7] Individual Selling Price

There is a discount applied to the customer when the sum of the individual selling prices of a good or service is greater than the promised consideration in the contract (∑ ISP[7] > PC[8]). If an entity has observable evidence that it only applies a discount to one or more, but not all, performance obligations in a contract, it shall apply the discount proportionately to all affected performance obligations.

e.g. Suppose an entity sells three individual products: iPhone X, Samsung S10 and Huawei P20. Their individual selling prices are the following:

iPhone X	Samsung S10	Huawei P20
895 m.u.	1,060 m.u.	500 m.u.

The entity offers the iPhone and the Samsung altogether for a price of 1,795 m.u. The entity signs a contract to sell the three products jointly to an entity for a total price of 2,295 m.u. The entity transfers each good at a specific date.
Therefore, as we can see: ∑ ISP = 2,455 > PC = 2,295; the discount is worth 160 m.u. If we realize, the discount is applied to two performance obligations (iPhone X and Samsung S10), because they have the discount implied (the individual original selling prices jointly is 1,955 m.u. and the entity offers a joint price of 1,795 m.u. (discount = 160 m.u.). Consequently, the entity shall allocate the discount proportionately to both performance obligations, recognizing the amount proportionally allocated at different points in time, as it follows:

$$iPhone\ X = \frac{\text{Individual original selling price}}{\text{Original joint selling price}} \times \text{ Offered joint selling price} = \frac{895}{1{,}955} \times 1{,}795 = 821.75$$

$$Samsung\ S10 = \frac{\text{Individual original selling price}}{\text{Original joint selling price}} \times \text{ Offered joint selling price} = \frac{1{,}060}{1{,}955} \times 1{,}795 = 973.25$$

If the entity transfers these two terminals at the same time, it could recognize revenue directly for an amount of 1,795 m.u. with no need of allocating discounts proportionately to both performance obligations.

What happens if the transaction price changes?

When a transaction price changes, the entity expects to be entitled a different amount from the one at contract inception. We may have two possible scenarios in this case:

- **Not to reallocate transaction prices**. When there are changes in individual selling prices of a good or service within a performance obligation, the entity will not alter the transaction price nor the contract itself, but will it attribute as an increase or a reduction of revenue at the year of the event occurred.
- **Reallocate transaction prices.** If there is a modification of the contract according to contract modifications in *Step* 1. However, if the transaction price changes after a contract modification, an entity shall apply the requirements explained above.

SOURCE: Self-made based on IFRS 15

Table 7. *Step 5. Recognize revenue*

STEP 5. Satisfaction of performance obligations: Revenue recognition

General rule

As a general rule, an entity will recognize revenue as it **satisfies performance obligations**, rather, when the service is rendered or the asset transferred. The asset is transferred when the customer obtains **control** over it, that is to say, when the entity does not control the asset anymore (does not obtain economic benefits from it) and when the customer has direct use and can obtain benefits from it.

Performance obligations can be satisfied **over time** (typical on render of services) or **at a point in time** (typical on goods cessions), explained in the following two rows.

Satisfaction over time

There are **three criteria** that indicate a good or service is transferred or rendered over time. One of the following criteria shall be met to determine a performance obligation is satisfied over time:

- When the entity satisfies a performance obligation and the customer receives and consumes the benefits provided by the satisfaction all at once. When another entity needs not re-carry out the work already done by the entity is also an indicator of a performance obligation satisfied over time (see case study).
- When the entity creates or improves and asset and the customer can control it directly as it is created or improved (for example, the construction of a building – work in progress –: as soon as the entity finishes the construction, the customer can benefit from its use).
- When (a) the satisfaction of the performance obligation does not create an asset with an alternative use to the

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[8] Promised Consideration

entity and (b) the entity has enforceable right to payment for the satisfaction that is completed to date.

- e.g. (a) an entity conducts a contract with another entity (customer) to design a specific software. The entity is an expert in creating new specific software for companies. Each software design differs really significantly because it is based on the needs of each customer. As all software is different one from another, the entity concludes it does not have an alternative use and, provided it had it, the entity would have to incur high costs to modify the software so that it could be offered to a new customer.
- e.g.(b) retrieving the former example, the entity sees that the contract claims: "*In the event of the user cancelling the contract for a reason other than the performance of the entity, shall it compensate the entity with the costs incurred and a 20% margin over the costs*". The margin approximates to the benefit the entity would earn with this transaction. Therefore, if the customer would terminate the contract for a reason distinct to the performance of the entity, it would have to compensate the entity with the above mentioned. But what would happen if the contract said that the entity would only have right to receive the costs incurred? As the margin is the tool to approximate to the benefit the entity would earn with the transaction (and compulsory condition to have enforceable right to payment), the compensation received would be less than the benefit, so that the entity would not be able to call the performance obligation as satisfied over time nor have to assess whether the software has an alternative use to the entity. Consequently, it would be a performance obligation satisfied at a point in time (next explained).

Satisfaction at a point in time

An entity satisfies a performance obligation at a point in time when it does not satisfy it over time. It is typically related with the transfer of goods, rather, with the **transfer of control**. There are various indicators of control, which are explained as it follows (there are more):

- **The entity has a present right to payment for the asset.** When the customer is obliged to pay for the assets, it may indicate it can obtain the remaining benefits from it.
- **The customer has legal title to the asset.** Has direct use of, obtains the remaining benefits from the assets and other entities cannot access to those benefits.
- **The entity has transferred physical possession of the asset.** It is understood that there has been a transfer of control. But in some cases (consignments or bill-and-hold arrangements[9]) the asset(s) is (are) still property of the entity or already of a customer.
- **The customer has the significant risks and rewards of ownership of the asset.** However, an entity shall exclude risks or obligations of an additional performance obligation to be satisfied, such as an additional service of maintenance of the asset.
- **The customer has accepted the asset.** The customer has direct use of and can obtain substantially all of the remaining benefits from the asset.

Methods to recognize revenue of a performance obligation satisfied over time

An entity will choose what method it will apply to a performance obligation satisfied over time. The method chosen shall be the same for similar performance obligations or for similar circumstances within a contract.

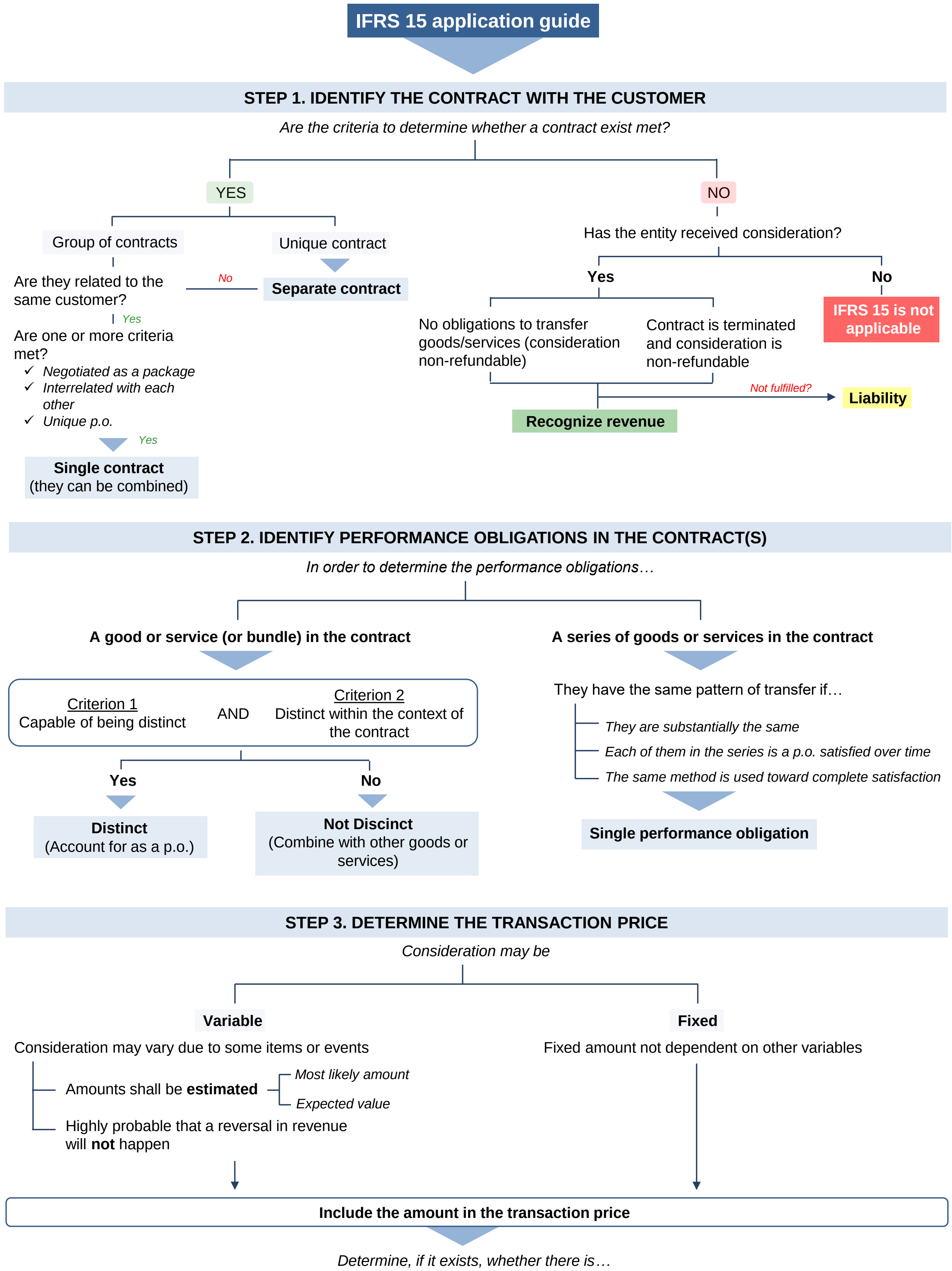
To determine what method to use, the entity will consider the nature of the goods or services in question. There are two methods that can be used to measure progress toward complete satisfaction of a performance obligation:

- **Output method.** This method consists of analyzing the value of the goods or services transferred to the customer in relation with the ones pending of transfer. It includes analysis of performance completed to date, time elapsed, produced and delivered units…
  An entity shall assess whether an output method would faithfully represent the progress of a performance. For example, if an entity builds a 10-hallway edifice and 2 of the hallways are ready to be used, if the entity can reasonably measure the transfer of control, it is accurate to use this method. Nevertheless, if the entity cannot reasonably measure the transfer of control, this method is not effective when recognizing revenue and, therefore, it shall use the input method.
- **Input method.** As for this method, it focuses on the inside of the company. It takes into account the efforts or resources of satisfying performance obligations in relation with all the resources needed to satisfy the performance obligation. The efforts and resources include: consumed resources (such as machines), labor-hours, costs incurred, time elapsed, and so on.

SOURCE: Self-made based on IFRS 15

[9] Form of sales arrangement in which a seller of a good bills a customer for products but does not ship the product until a later date (Investopedia).

2.2.4. Analysis approach in a concept map



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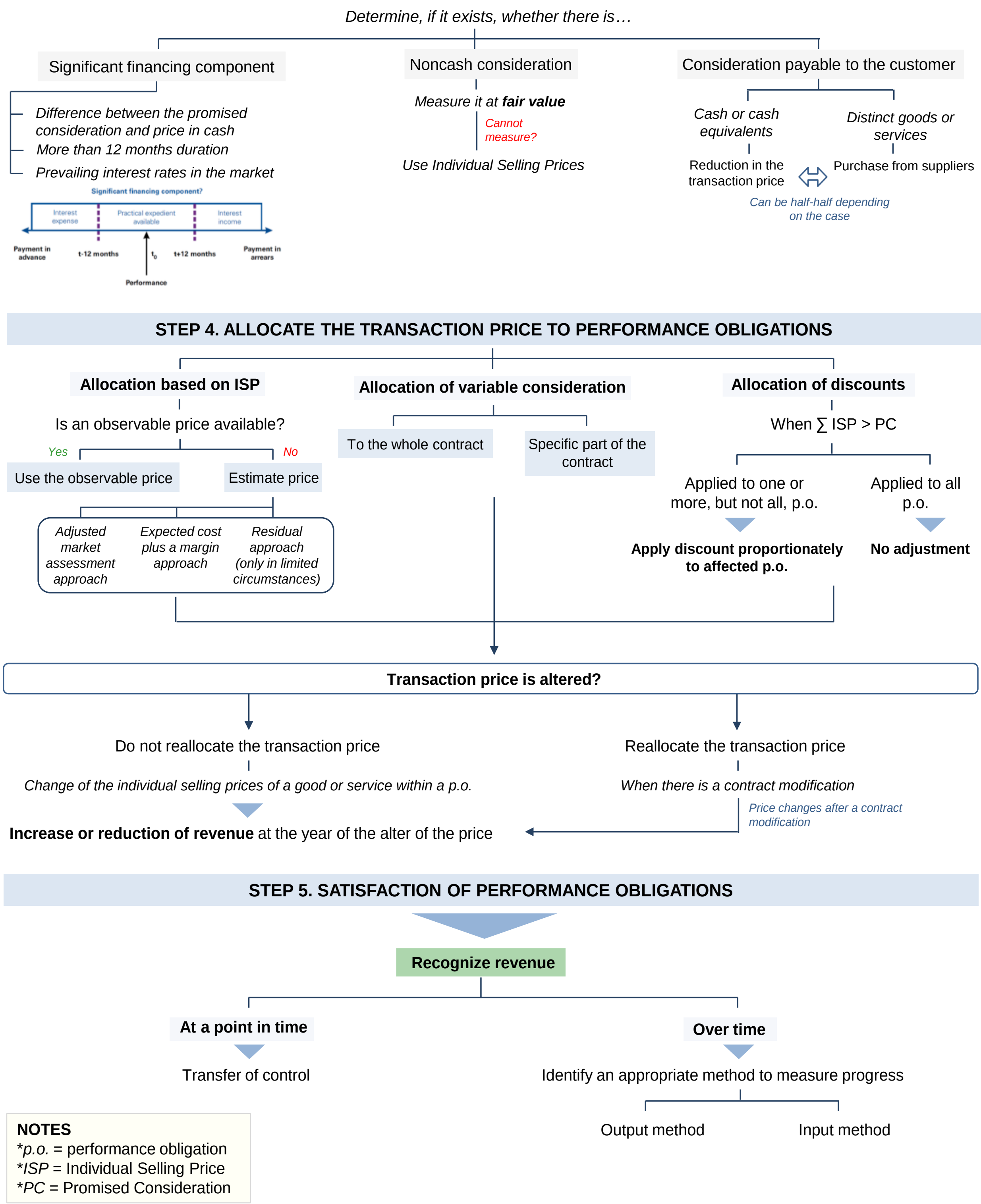

ILLUSTRATION 5: *Concept map of IFRS 15 analysis approach*
Source: Self-made based on KPMG (2016)

2.2.5. Accounting treatment of contract costs

Incremental costs of obtaining a contract

- <u>Recognize an asset</u> An entity will recognize as an asset the incremental costs incurred to obtain a contract with a customer if it has made efforts to obtain it (that is, if it did not make the efforts, the contract would not exist) and if it expects that it can recover the costs by the satisfaction of performance obligations.
- <u>Recognize costs as expenses</u> An entity will recognize as an expense the costs of the contract if it need not make efforts to obtain the contract (regardless of the efforts made, the contract exists) and/or if the amortization period of recognizing an asset would be less than one year.

Costs to fulfill a contract

When there are costs to fulfill a contract, an entity will **only recognize** an **asset** if the following criteria are met:

- the costs relate directly to a contract or to a future contract;
- the costs relate with an entity's efforts to satisfy performance obligations; and
- the entity expects to recover the costs

2.2.6. Transition from IAS 18 to IFRS 15

When an entity applies firstly IFRS 15, it shall disclose the fact in the Explanatory Notes. An entity shall apply this new Standard using one of the following two methods:

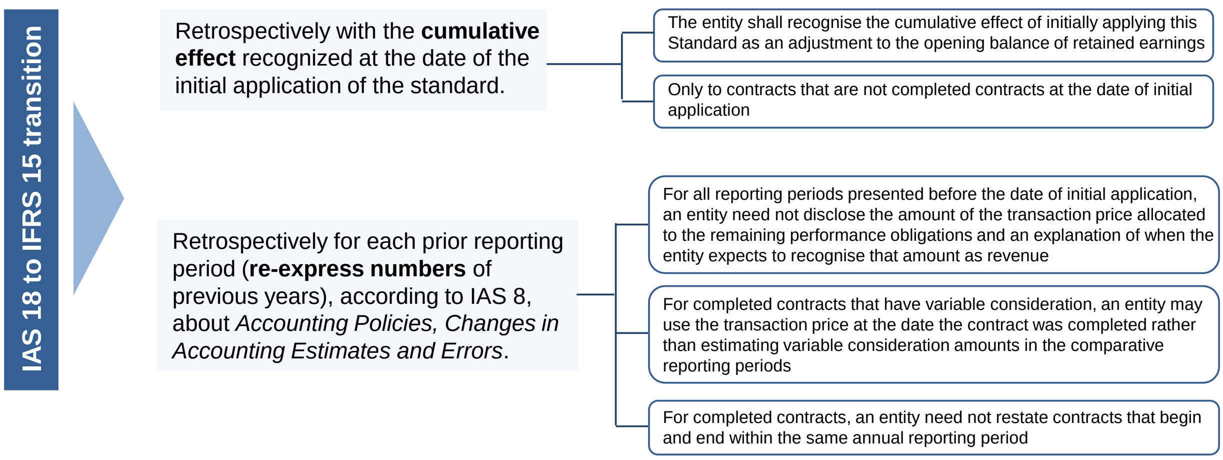

ILLUSTRATION 6: *Transition methods*
Source: Self-made from IFRS 15 Appendix C "Effective date and transition"

2.2.7. Key differences between IAS 18 and IFRS 15

In the table below, the most relevant differences between current revenue standards and IFRS 15 can be seen. It is mainly analyzed the differences between IAS 18 (about revenue) and IFRS 15, but sometimes other standards, such as IAS 11 (about construction contracts), are mentioned.

Table 8. *Main differences between revenue accounting standards*

IAS 18	IFRS 15
Transfer of risks and rewards Vs. transfer of control	
Revenue is recognized when the company transfers significant risks and rewards of ownership to the customer (**goods**).	Revenue is recognized when the company transfers control (the customer has enforceable right to payment for the performance) of **goods and services** to the customers. It may change the pace of revenue recognition regarding IAS 18 criteria.
Distinction between goods and services	
This Standard differentiates and separates accounting for goods and services.	Under IFRS 15, there is no distinction between goods and services but a unique revenue recognition process based on identification of performance obligations.
Scope	
See illustration 3.	See illustration 3.
Combination of contracts	
IAS 18 does not concretely specify when contracts can be combined. However, IAS 11 requires contracts be combined if they are performed simultaneously or in a continuous sequence.	Contracts can be combined if the goods and/or services promised in the contract comprise a single performance obligation and if the effect on the financial statements in minimum or insignificant.
Performance obligations and distinct goods and services	
Not included in IAS 18. This Standard gives guidance on **separately identifiable components** and when they shall be recognized together or separately, to reflect the substance of the transaction.	Specific and more detailed guidance to determine whether goods and services are **distinct** and so to determine performance obligation of the contract (new concept introduced) and their moment to recognize revenue.
Amounts to recognize revenue	
An entity will only recognize revenue if it can **estimate** the amount **reliably**, so uncertainty over the outcome may preclude revenue recognition.	It does not preclude amounts, but limit them. This Standard states that revenue will be recognized when a **performance obligation is satisfied**; therefore, contingent amounts can be recognized as revenue.
Fair Value Vs. Stand-alone selling prices	
Revenue is measured under the **fair value** of the goods given or services rendered.	The entity measures the transaction price based on **stand-alone** (individual) selling prices of the goods or services within the contract.
Allocation of discounts	
Not included in IAS 18.	Specific guidance to allocate discounts. They will be applied to all performance obligations proportionally, unless there is evidence that it only relates to one or more, but not all, performance obligations in the contract.
Over time recognition of revenue	
Revenue is recognized over time if the contract is a construction contract within the scope of IAS 11; sales of goods whose revenue recognition is met progressively; when it is a services rendered contract.	Detailed instructions and different criteria to determine a performance obligation is satisfied over time (revenue over time). In some cases, it may differ from the criteria applied with IAS 18.

Costs of obtaining a contract	
IAS 18 does not specify anything related with costs to obtain a contract with a customer. However, IAS 38 (about intangible assets) states that certain costs can be recognized as intangible assets in limited circumstances, that is, direct and incremental recoverable costs to obtain an identifiable contract.	Incremental costs to obtain a contract are those costs incurred in obtaining a contract that would not have been incurred had that individual contract not been obtained. They would then be recognized as a contract asset.
Costs to fulfill a contract	
IAS 18 does not include this consideration. Anyhow, IAS 11 states that costs incurred before a contract is obtained are recognized as contract costs if it is probable that the contract will exist.	Requires an entity to capitalize the costs of fulfilling an anticipated contract if certain conditions are met.
Presentation in financial statements	
Diversity when presenting assets and liabilities. Amounts from contracts with customers can be presented in items such as receivables, deferred revenue, payments received, advances…	It does not distinguish between different types of contracts with customers. The amounts are included in items such as contract assets/liabilities, receivables…

SOURCE: Self-made based on BDO (2017)

2.3. Expected impact of IFRS 15 on each industry

The adoption of IFRS 15 will not affect the entire industries to the same extent. The expected impact varies by industry, mainly as follows (Cabaleiro, 2018):

- Technological, engineering and software companies (those which offer integrated solutions, that is, software together with adaptation or integration services).
- Pharmaceutical companies.
- Construction and real estate companies.

Those companies will above all be affected by the stage of completion for the recognition of revenue, that is to say, the moment to recognize revenue.

- Licenses and intellectual property companies. The recognition of revenue for the sale of licenses and intellectual property is now subject to new criteria that differ significantly from the criteria applied before.
- Companies that offer packages with different products and services (e.g. telecommunications companies). The new requirements to consider as separate obligations goods or services from which the customer can benefit separately might have consequences in diverse industries (Grant Thornton, 2017).

The table in the next page summarizes, by principally affected industry, the steps of the IFRS 15 model that are most likely to affect the current practice of certain industries. We can see that telecommunications industry is mostly affected in steps 2 and 4, as we will see in the next chapter.

Industry	Step				
	1	2	3	4	5
Aerospace and defense	✓	✓	✓		✓
Asset managers			✓		
Building and construction			✓		✓
Contract manufacturers					✓
Health care (US)	✓		✓		
Licensors (media, life sciences, franchisors)	✓*	✓	✓		✓
Real estate	✓	✓			✓
Software		✓	✓	✓	✓
Telecommunications (mobile networks, cable)		✓		✓	

* In particular, life sciences.

ILLUSTRATION 7: *Principally affected industries by IFRS 15*
Source: KPMG (2016)

Chapter 3 Overview to the telecommunications industry

The aim of this chapter is to introduce the telecommunications industry. In Chapter 4, we will analyze the impact of IFRS 15 on the telecommunications industry companies, so it is important to give an overview to the industry and see characteristics relevant for the application of the revenue Standard.

It is noted that the reason to have chosen this industry is the significant impact that IFRS 15 has had on it (*see next section*). In addition, it is an industry whose products and services are well-known, as we are daily users of them. Therefore, the most relevant operations that take place in this industry can be understood.

3.1. About the telecommunications industry

Before starting to analyze the main characteristics and situation of this industry, we shall clarify concept of *telecommunications*. They are communications in the long distance, rather, tools that make us able to communicate with each other without the need of being face-to-face. More concretely, it is the exchange of information over significant distances using electronic means and refers to all types of voice, data and video transmission (Rose, 2016); in other words, the process of sending or receiving information by telephone, TV, Internet, etc.

This type of companies generally offer services of fixed and wireless telephony, broadband, Internet, data traffic, payment TV and diverse telecommunications products, such as cellphones. Wholesalers mainly rent optical fiber networks and technical locations and spaces for hosting customers' telecommunications equipment (REE, 2019).

Thanks to telecommunications (IFT, 2018), we can **access and consult** Internet webpages, educational contents, social networks, national and international news, and so on. We are able to **transmit** signs, signals and data, in other words, emails, text messages, photos, videos, music, among others. We **receive** phone calls, TV channels – free of charge or via payment – radio stations, emails, photos and whatever transmissible. Lastly, TV- or radio-signals can be **broadcast**.

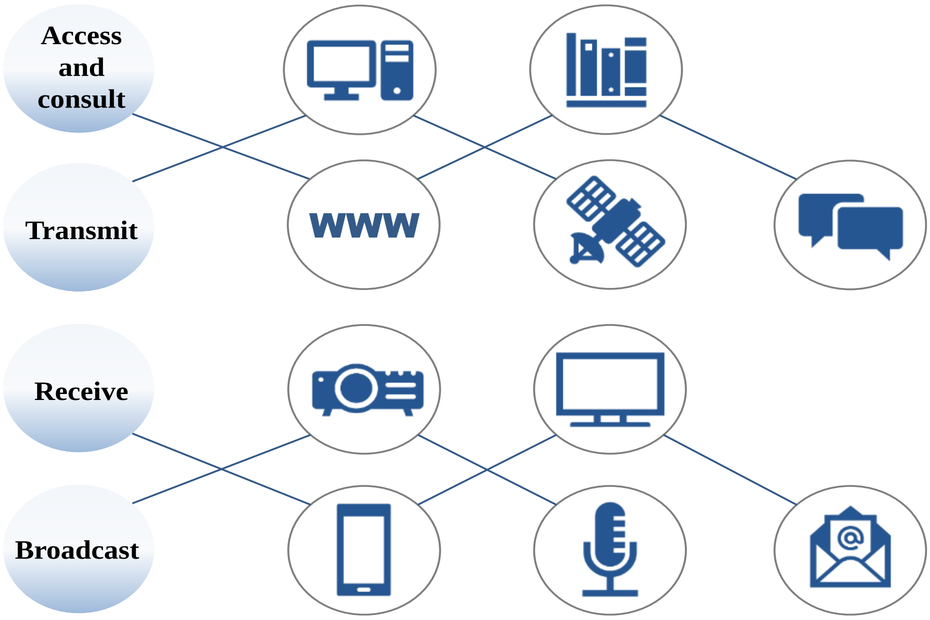

ILLUSTRATION 8: *Telecommunications*
Source: Self-made based on IFT (2018)

3.2. Situation in Spain

The Spanish telecommunications industry has undergone vast changes in the last years. Those changes have been consequence of technological development and the success of the European regulatory model, which have managed to ease the penetration of the broadband[10] with mobility and the high-speed broadband to a great part of the European population. For instance, in Spain, since 2007, fixed broadband market has doubled its size, reaching a result of 14.6 million lines in 2017. Additionally, mobile broadband has obtained very good data since its commercialization in 2010, with a penetration of 93.8%.

The Spanish market is characterized for being highly concentrated. Telecommunications markets are usually oligopolies, where a few companies satisfy the demand and gain the largest share of sales. However, in recent years, there are increasing agreements between teleoperators; for example, collaboration agreements between Movistar and Jazztel in 2012 or Vodafone and Orange in 2013 to share infrastructures, or the agreement between Movistar and Vodafone, in which Movistar offered Vodafone a wholesale access to its fiber network in exchange of rental commitments for a minimum period of five years.

Revenue

With regard to retailers' revenue, there was a change in the trend of the last years and started to slightly grow, while wholesalers' revenue was still increasing for the third consecutive year (2017). The concentration process that the industry was experiencing since 2014, ended up

[10] System that makes it possible for many messages or large amounts of information to be sent at the same time and very quickly between computers or other electronic devices (Cambridge Dictionary).

with consolidations in Euskaltel and MASMÓV!L Group. Euskaltel, for its part, acquired R (cable operator) in 2015 and TeleCable in 2017 and MASMÓV!L Group set itself the aim of being the fourth operator in Spain and opted for offering quadruple voice and broadband packages (fixed telephony, Internet access, digital television and mobile telephony) for very competitive prices. The three main operators, rather, Telefónica-Movistar, Orange and Vodafone, got a joint revenue of 77.5% of total market share (downward trend regarding 2016) whereas MASMÓV!L Group and Euskaltel achieved a 4.6% and 2.6% respectively.

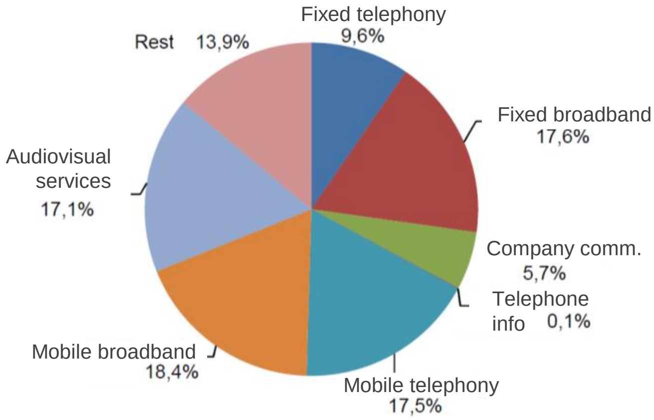

ILLUSTRATION 9: *Distribution by revenue from retail services in 2017*
Source: CNMC (2018)

The graph on the left shows how revenue was shared between the main telecoms services in 2017. This year was much the same as the year before, where voice services – both for fixed and mobile network – showed a decreasing trend, while broadband services continued to increasingly contribute to total industry revenue. Broadband represented the majority of revenue for the companies (8.5% more than 2016), almost the half of telecommunications service revenue and exceeded in 9 percent points the voice service ones. It should be pointed out that for the third consecutive year, mobile broadband services exceeded, in absolute terms, the fixed broadband services.

If we analyze retailers' revenue more deeply, Orange was the only one of the three main operators that increased its revenue in a 6.5%, whilst Movistar and Vodafone maintained their results from 2016. Movistar saw its revenue fall in a 1% due to a 3.1% reduction of mobile business; meanwhile, fixed business kept its revenue levels. MASMÓV!L Group placed itself in fourth position, achieving the objective set. Lastly, Euskaltel, after the acquisition of TeleCable, got the same numbers as the previous year.

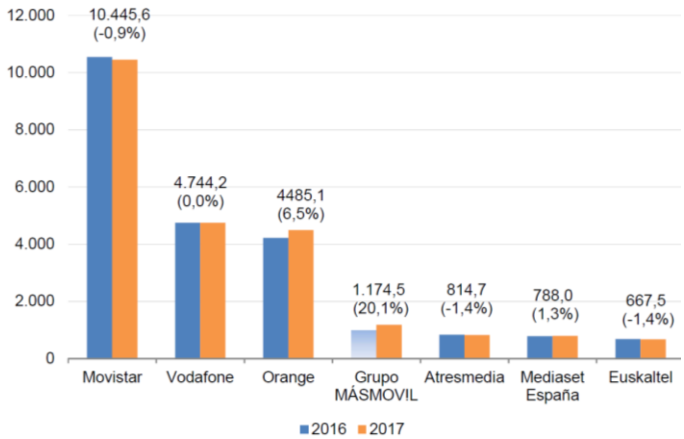

ILLUSTRATION 10: *Retail revenue per operator in millions of euros*
Source: CNMC (2018)

Bundling: packages of products and services

The Spanish market distinguishes itself by the high number of bundling (that is, combined telecommunications services). Till year 2012, the key service was fixed broadband and the sort of service most hired was the combination of that key service with fixed telephony. Nevertheless, from 2012 on, Telefónica-Movistar launched "*Movistar Fusión*". With this launch, fixed and mobile telephony and broadband, called "quadruple bundling", became very popular among users. But that did not end there: Movistar bet for quintuple bundling in 2014, which included payment television to the aforementioned four services. Heretofore, these joint services have been constantly growing, and more and more companies have started to offer it, as we can see in the graph above.

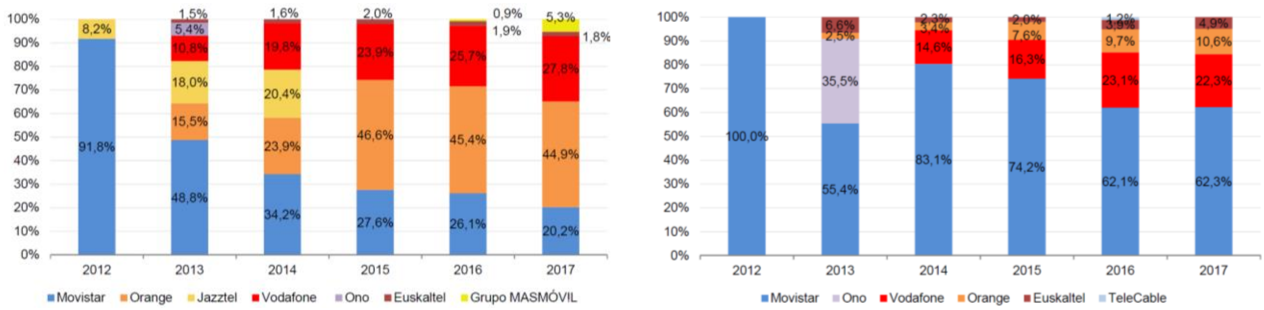

ILLUSTRATION 11: *Quadruple and quintuple bundling (from left to right) by operator*
Source: CNMC (2018)

As we can see in the graph, the bundling that most grew is the quintuple package, for the fourth consecutive year. The quadruple package kept its results from 2016, at 6.2 millions of packages. Double (fixed telephony and broadband) and triple (plus payment TV) packages showed again their decreasing trend, 6% and 13% respectively, due to the appearance of the famous mentioned packages.

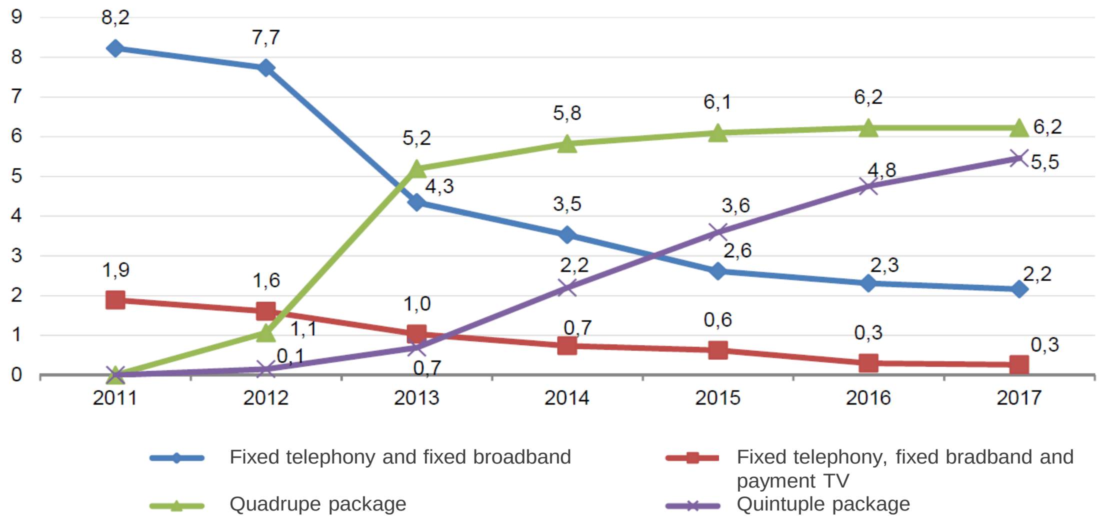

ILLUSTRATION 12: *Most hired bundling evolution (millions of packages)*
Source: CNMC (2018)

Chapter 4 Empirical evidence

The purpose of this chapter is to analyze the practical implementation of the new revenue recognition Standard, IFRS 15, on the telecommunications industry, in order to know the impact on the financial statements of listed entities. We will analyze a sample of three telecommunications companies: *Orange, MásMóvil Ibercom* and *Telefónica*, European companies that offer similar telecommunications products and services. They are companies that are well-known in the Spanish telecom industry and the information provided on their financial statements is extensive and understandable. The three companies have firstly applied the Standard on January 1, 2018. Orange and Telefónica are among the three big corporations in the Spanish industry (the first one French and the second Spanish). MásMóvil (also a Spanish company), on its side, is a smaller company. All of them present their consolidated financial statements under IFRS.

We will focus on the effect that IFRS 15 has had on the Consolidated Statement of Financial Position, the Consolidated Income Statement (for the case of Telefónica) and the Consolidated Explanatory Notes of the last period, that is, the year ended on 31st December 2018. We expect to be able to determine if the three companies present the same impact on the application of the Standard.

4.1. Companies under analysis

Firstly, *Orange* is a French listed parent company that has a great history behind. It was created in 1879 known as *Postes, télégraphes et téléphones*, later took the name of *France Télécom* and in 2013 *Orange*. It is a Public Limited Company with headquarters in Paris (France). The company provides consumers, businesses and other telecommunications operators with a wide range of services including fixed telephony and mobile telecommunications, data transmissions and other value-added services, mainly in Europe, Africa and Middle East. Additionally, the Group is developing its

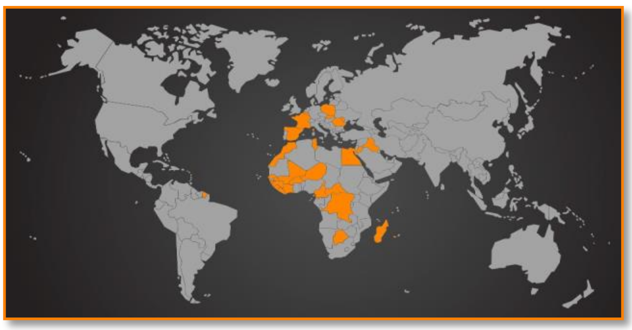

ILLUSTRATION 13: *Orange's operating area*
Source: www.orange.com

activity in the mobile financial services (*Orange Bank*).

Secondly, *Telefónica*, is a Spanish listed parent company within a group of companies located in Madrid (Spain), founded in 1924 as a Public Limited Company. The company's main pursuit or activity is centered on services of fixed and wireless telephony, broadband, Internet, data traffic, Payment TV and other digital services (Telefónica, 2019). Telefónica is a multinational telecommunications company, operating in 16 countries with presence in 24, mainly in Europe and South America, as can be seen in the picture at the right.

ILLUSTRATION 14: *Telefónica's operating area*
Source: www.telefonica.com

The third and last company chosen, *MásMóvil Ibercom* (hereinafter, simply, MásMóvil or MásMóvil Group), is a Spanish listed parent company located in Donostia-San Sebastián (Spain) that was founded in 1997 as a Limited Liability Company. In 2011, the legal form changed to Public Limited Company. In 2014, MásMóvil merged with Ibercom, a company listed in MAB (Mercado Alternativo Bursátil[11]); as a result, MásMóvil's shareholders ended up with the 45% capital of Ibercom. In 2019, the company joins IBEX 35, the benchmark stock index of the Spanish stock market, which measures the joint behavior of the 35 most traded companies (Banco Santander, 2019).

Nowadays, it is one of the most consolidated operators of Spain. In 2016, the group acquired Yoigo and Pepephone, two Spanish telecom companies. Amongst the offers, we can find fixed and mobile telephony services, as well as Internet service for residential customers, companies and Wholesale, through its principal brands Yoigo, Pepephone, MásMóvil and Llamaya (Grupo MásMóvil, 2019).

The table below shows certain size data that have been gathered from the Consolidated Financial Statements (CFS) of the three companies. The data may help determining whether the impact of the adoption of IFRS 15 depends on size.

Table 9. *Size data by company in 2018*

	No. of workers	Total assets	Total revenue	Net equity
ORANGE	151,000	96,592,000,000	41,381,000,000	33,249,000,000
TELEFÓNICA	120,318	114,047,000,000	48,693,000,000	26,980,000,000
MÁSMÓVIL	> 500	2,653,049,000	1,450,866,000	475,883,000

SOURCE: Self-made, based on information gathered from each company's website and CFS

[11] MaB is a market for small companies looking to expand, with a special set of regulations, designed specifically for them with costs and processes tailored to their particular characteristics (BME – Bolsas y Mercados Españoles, 2019).

4.2. Impacts of IFRS 15 on the financial information

This section will introduce the quantitative and qualitative changes that the new revenue recognition standard has entailed on the financial statements of the three listed entities under study. Depending on the information that each company provides us with in the CFS under IFRS, we will analyze the impact of the Standard on the **annual accounts of the last period 2018**, seeing the retrospective approach that companies explain (year 2017 for Telefónica and MásMóvil and 2016 and 2017 for Orange). The information is gathered from the Consolidated Financial Statements of these three companies.

We will look at the information in the Statement of Financial Position all the items related with the application of IFRS 15, such as trade receivables, deferred revenue, contract assets and liabilities etc.; in the Statement of Changes in Equity, we will be able to see the impact on retained earnings; lastly, in the Explanatory Notes we will center on details that companies offer, like transfers, impacts, and also qualitative information. It shall be highlighted that we will only analyze the Consolidated Income Statement of Telefónica, because the information Orange provides is scarce and MásMóvil does not show any impact on its Consolidated Income Statement.

Orange, MásMóvil Group and Telefónica expected this impact on their financial statements on the year ended December 31, 2017:

Table 10. *Type of adjustment and expected impact of IFRS 15 on each company*

	Adjustment	Impact
orange	Retrospectively for its prior reporting period, for periods 2016 and 2017	Δ Net equity in **0.8 billion** euros after taxes, mainly for recognition of contract assets
Telefónica	Mainly retrospectively[12] with the cumulative effect recognized at the date of the initial application of the standard, for the last period of 2017	Δ Net equity in **0.95-1.1 billion** euros before taxes, mainly for recognition of contract assets
GRUPO MASMOVIL	Retrospectively with the cumulative effect recognized at the date of the initial application of the standard, for the last period of 2017	Δ Net equity in **0.11 billion** euros before taxes, mainly from contract assets

SOURCE: Self-made, based on each company's CFS

Before analyzing each company individually, it is prominent that these three companies show similar data on some aspects. As IFRS 15 includes new and special guidance on **contract assets**, the three companies under analysis have explained the impact in a much related way. For example, one of the key impacts is the allocation of revenue to bundled offers which offer a mobile handset at a discounted price with a telecom service attached. Under IAS 18, when companies transferred the mobile handset to their customers, the amount of revenue recognized

[12] Except for contracts completed at January 1, 2018 and contract modifications that result in a separate contract, in which case a prospective method would be applied.

was the contractual amount, generally the amount of money the customer paid at the moment of the transfer or installments to discounted amounts payable over 12-24 months.

Opposite to the former standard, IFRS 15 allocates the transaction price based on individual selling prices of the elements that comprise the contract, rather, both the handset and the service. There is a change in the pace of recognition of revenue when the equipment is sold at a discounted price, as the price of the transaction has been allocated based on individual selling prices, so that the revenue recognized at the moment of the transfer is higher with regard to the remaining revenue to be recognized for the rendering of services (accelerated recognition of revenue), because there is a reallocation of a portion of amounts invoiced for the telecom services to the supply of the mobile phone.

The IASB mentions in its *Basis for Conclusions* that entities that satisfy a performance obligation but, for example, have not satisfied another performance obligation that is linked to the already satisfied obligation, shall recognize an asset which shows a conditional (e.g. satisfaction of a performance obligation) right to payment that will be then settled against a receivable as the telecom service is rendered. To the extent revenue for services is recognized, assets are credited while service revenue is lower, as can be seen in the accounting entry below:

DATE	DESCRIPTION	DEBIT	CREDIT
Contract inception	Cash and cash equivalents	Consideration invoiced	
	Customer contract assets	Excess of amount	
	Revenue from equipment sale		Higher revenue than IAS 18
Service invoicing	Trade receivable	Real amount invoiced	
	Revenue from services rendered		Lower revenue than IAS 18
	Customer contract assets		Proportional part that corresponds to the service

ILLUSTRATION 15: *Example of an accounting entry for the accelerated recognition of revenue*
Source: Self-made

Consequently, the overall recognition of revenue does not change (same amount of revenue will be recognized during the contract's life), but the moment of recognition does change, which makes the company's revenue increase or fall depending on time, the number of contracts signed and their intrinsic characteristics.

Lastly it should be highlighted that other quantitative and qualitative changes have taken place but each company has applied its own method and way to disclose the information. Those are, mainly, costs of obtaining a contract and costs to fulfill a contract, although other aspects are explained.

4.2.1. Orange

The application of IFRS 15 in this company's CFS has supposed an increment of 815 million euros of retained earnings or reserves (674 million attributable to owners of the parent), which arise mainly from recognition of contract assets, assets related to deferred acquisition costs and changes in deferred tax assets. This company opted for a retrospective application of the Standard, that is, re-express numbers since January 1, 2016 for contracts with customers not completed before its first application (January 1, 2018).

The net effect of the application is summarized as follows:

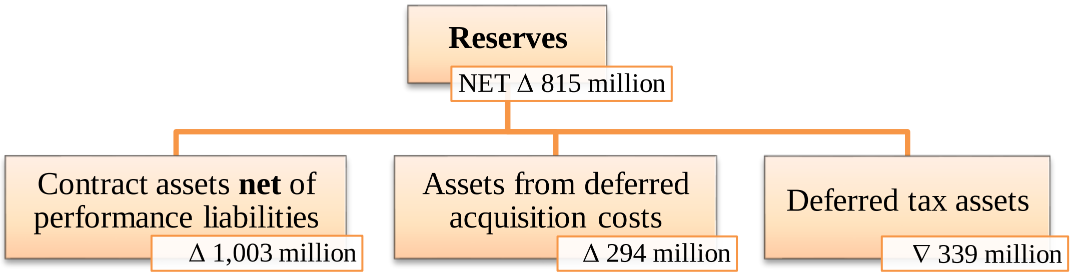

ILLUSTRATION 16: *Net impact of IFRS 15 on Orange's retained earnings*
Source: Self-made

Contract assets and liabilities are new items that appear as a consequence of the new Standard. In the table below, the retrospective approach for these two elements is shown.

Table 11. *Retrospective approach of Orange's contract assets and liabilities*

millions of euros	*Dec 31, 2015*	*IFRS 15 effect*	*January 1, 2016*	*December 31, 2016*	*IFRS 15 effect*	*January 1, 2017*	*December 31, 2017*	*IFRS 15 effect*	*January 1, 2018*
(a) Other customer contract assets	-	**1,442**	**1,442**	-	**1,335**	**1,335**	-	**1,204**	**1,204**
Customer contract assets (1)	-	*1,027*	*1,027*	-	*916*	*916*	-	*815*	*815*
Costs of obtaining a contract (2)	-	*294*	*294*	-	*273*	*273*	-	*250*	*250*
Costs to fulfill a contract (3)	-	*121*	*121*	-	*146*	*146*	-	*139*	*139*
(b) Prepaid expenses	**495**	**(122)**	**373**	**540**	**(146)**	**394**	**594**	**(139)**	**455**
(c) Customer contract liabilities	-	**2,121**	**2,121**	-	**2,071**	**2,071**	-	**2,021**	**2,021**
(d) Deferred income	**2,136**	**(2,097)**	**39**	**2,134**	**(2,050)**	**84**	**2,081**	**(2,005)**	**76**

SOURCE: Orange 2018 CFS

As it can be seen in the columns in white, the company did not show contract assets and liabilities before December 1, 2018, as the previous standard did not require separate disclosure neither recognizing distinct assets and liabilities related to customers. The re-expressed numbers are shown in columns in gray and the impact of IFRS 15 in columns in orange.

(a) Within **other customer contract assets**, the company has classified the item in three categories, which are explained as follows, exposing the main causes of their emergence.

a.1. Customer contract assets

The company states that this type of contract asset arises mainly from bundled equipment and service offering. Usually, Orange sells a mobile handset together with a telecommunication service. As we have said in the introduction of this section, when there is a handset sold at a discounted price, the pace of recognition of revenue changes and an asset is created (contract asset).

Hence, Orange has recognized the asset for those bundled offers which comprise a mobile handset at a discounted price and a telecom service, which show the accelerated recognition of revenue from the sale of the equipment. Those assets are each year lower, because as the telecom service is performed, the proportional part is credited and the receivable is created (the *unconditional right to payment*). We can conclude, then, that the company signed more contracts with this offer the first years of the retrospective application of the Standard and less the last years, because it can be seen that the asset is amortized and decreases somewhat in the same amount. On the contrary, assets could even be higher each year.

a.2. Costs of obtaining a contract

IFRS 15 requires that those costs to obtain a contract with a customer shall be capitalized if they can be amortized over a period of more than one year and if there is enough evidence that they have been incurred to obtain the contract with the customer. Orange has identified commissions paid to distributors, which were previously booked in expenses when incurred (Orange, 2019); those incremental commissions are regarded as costs to obtain a contract because if they had not been paid, the contract would not have existed.

The company names these kinds of assets as *assets related to deferred acquisition costs*. The costs of obtaining a fixed-period mobile service contracts are capitalized and released to profit or loss on a straight-line over the enforceable contract term (Orange, 2019); that is to say, when a contract with a customer is signed and the commissions paid to distributors (costs to obtain a contract) are estimated, the company creates an asset and it will be expensed as the product or service of the contract is invoiced or, in other words, performance obligations satisfied. Therefore, companies delay expense allocation to profit or loss, which makes their income higher at the beginning of the contract's life, in return to higher costs and lower assets as time passes (see table below).

Table 12. *Comparison in CFS of the costs of obtaining a contract*

	DECEMBER 31, 2017			**DECEMBER 31, 2016**		
ASSETS	Historical data	IFRS15 effect	Restated data	Historical data	IFRS15 effect	Restated data
Costs of obtaining a contract	-	250	250	-	273	273
INCOME Capitalized costs **expensed**	-	(28)	-	-	(17)	-

SOURCE: Self-made based on Orange 2018 CFS *a.3. Costs to fulfill a contract*

Costs to fulfill a contract consist of all the initial contractual costs necessary to fulfill one or more performance obligations of a contract (Orange, 2019). According to the company, these costs mainly concern contract for Corporate customers with design, installation, connection and migration fees that relate to a future performance obligation of the contract.

In this case, the company does not identify new costs of fulfilling a contract that must be deferred under IFRS 15. These costs are now reclassified from (b) **prepaid expenses** to contract assets.

(c) **Customer contract liabilities** relate to reclassifications that the company has done by virtue of IFRS 15, from the item (d) **deferred income**. This line in the balance sheet represents amounts paid by customers for services or products that are not transferred yet (or performance obligation not satisfied). In Table 11, we can see the reclassifications mentioned; note that remaining deferred income not reclassified lies beyond the scope of IFRS 15.

The company has identified requirements that **have not actually had a significant impact** on the financial information. On the one hand, the identification of a *significant financing component* in the transaction. IAS 18 did state that a transaction which had a significant financing component should be accounted for separately from the element to which it was attached; nonetheless, IFRS 15 gives more detailed guidance on so doing. Orange indicates that the financing component is likely to be found on offerings combining the sale of a mobile terminal and a fixed-term service. Anyhow, due to the low level of interest rates, the company has not recognized revenue from such transactions separately.

On the other hand, the new revenue recognition standard changed the indicators to determine whether an entity acts as *a principal* or *an agent*. The company has not been affected by this change, because with regard to the agreements with its distributors, it acts as a principal, as it has full responsibility on the mobile phones sold. The revenue recognized from the sale of a mobile and the connection service is identical irrespective of the distribution channel (Orange, 2019).

Conclusion

The effect of the application of IFRS 15 has led to significant quantitative and qualitative changes in the Consolidated Financial Statements of the company. The most important quantitative modification has been reflected on contract assets, where the accelerated recognition of revenue from equipment sales has meant the creation of assets that will lead to a lower recognition of revenue for services rendered. And qualitative alterations have been mainly seen in reclassifications and the creation of new items in the statement of financial position.

The total effect of shareholders' equity can be seen in the Consolidated Statement of Changes in Equity. Total assets increased 888 million euros – net effect from goodwill, deferred tax assets, all customer contract assets, and prepaid expenses – while liabilities increased 73 million euros – deferred tax liabilities, customer contract assets and trade payables –, resulting in an increase on consolidated reserves of 815 million euros (888 – 73). This result coincides with what Orange had expected in 2017 (an increase of net equity of 800 million euros).

(in millions of euros)	Note	Attributable to owners of the parent company: Number of issued shares	Share capital	Share premiums and statutory reserve	Subor-dinated notes	Reserves	Other compre-hensive income	Total	Attributable to non-controlling interests: Reserves	Other compre-hensive income	Total	Total equity
Balance at January 1, 2016		**2,648,885,383**	**10,596**	**16,790**	**5,803**	**(3,144)**	**862**	**30,907**	**2,085**	**275**	**2,360**	**33,267**
Effect of IFRS 15 application [(1)]		-	-	-	-	674	-	674	141	-	141	815
Balance at January 1, 2016 after effect of IFRS 15 application		**2,648,885,383**	**10,596**	**16,790**	**5,803**	**(2,470)**	**862**	**31,581**	**2,226**	**275**	**2,501**	**34,082**
Consolidated comprehensive income		**-**	**-**	**-**	**-**	**2,813**	**(1,265)**	**1,548**	**309**	**(20)**	**289**	**1,837**

ILLUSTRATION 17: *Extract from Orange's Statement of Changes in Equity*
Source: Orange 2018 CFS

4.2.2. *Telefónica*

Telefónica has applied the new revenue recognition Standard on January 1, 2018 and it has supposed an increment of reserves of 743 million euros, which 654 million are attributable to owners of the parent company. It is noteworthy that Telefónica has not included new itemizations in the SFP (which does not have restated data from the previous year) at December 31, 2018; conversely, the already existing lines in the balance sheet do comprise the new amounts arising from the application of the Standard.

The net effect of the application is summarized as follows:

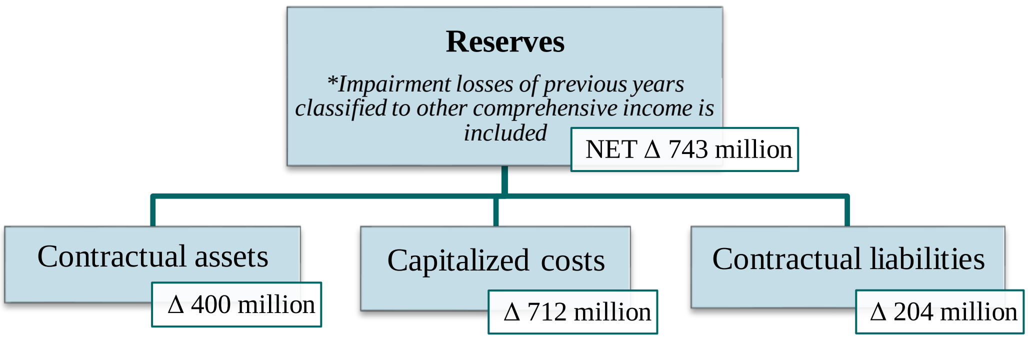

ILLUSTRATION 18: *Net impact of IFRS 15 on Telefónica's retained earnings*
Source: Self-made

One of the key aspects when analyzing this company's financial statements is that it does not show the Statement of Financial Position with comparative figures with restated data at January 1, 2018 but it compares the application of IFRS 15 with IAS 18 at December 1, 2018. Thus, there is a change in the analysis approach, because the impact explained in the Statement of Changes in Equity does not coincide with the numbers shown in the aforementioned Statement of Financial Position. Even so, the Explanatory Notes of the Group contain a breakdown of contractual assets and liabilities and capitalized costs (which are the most important for our analysis) with the impact of the application of the Standard at January 1, 2018.

The balance that corresponds to these assets and liabilities is presented in the lines "financial assets and other non-current assets", "accounts receivable and other current assets" and "accounts payable and other current liabilities".

(a) Contractual assets

Table 13. *Breakdown of contractual assets*

Millions of euros	Balance at 12/31/2017	IFRS 15 application	Additions	Disposals	Transfers	Translation dif. and hyperinflation adj.	Balance at 12/31/2018
Long-term contractual assets	**-**	**68**	**153**	**-2**	**-110**	**-1**	**108**
Contractual assets	-	71	156	-2	-110	-1	114
Impairment losses	-	-3	-3	-	-	-	-6
Short-term contractual assets	**-**	**332**	**761**	**-856**	**113**	**-9**	**341**
Contractual assets	-	354	764	-857	113	-10	364
Impairment losses	-	-22	-3	1	-	1	-23
Total	**-**	**400**	**914**	**-858**	**3**	**-10**	**449**

SOURCE: Telefónica 2018 CFS

Contract assets from the accelerated recognition of revenue arising from discounts offered to customers have increased the Group's assets in 400 million euros before taxes at January 1, 2018. The amount includes contract modifications with a retrospective effect; that is, the company has calculated the impact that IFRS 15 would have had if it were applied before only for contracts that are not terminated before the initial application of the Standard.

Once the amounts recognized as contract assets become receivables, which normally occurs when they are invoiced, they are transferred to the "Trade receivables" heading. In this regard, the balance of the contract assets account represents amounts not yet due (Telefónica, 2019). That is shown in the column "transfers", which represent a significant amount of the account's balance.

(b) Capitalized costs

Table 14. *Breakdown of capitalized costs*

Millions of euros	Balance at 12/31/2017	IFRS 15 application	Additions	Disposals	Transfers	Translation dif. and hyperinflation adj.	Balance at 12/31/2018
Non-current capitalized costs	**-**	**172**	**366**	**-1**	**-343**	**-3**	**191**
Of obtaining a contract		**170**	**349**	**-1**	**-338**	**-2**	**178**
Of fulfilling a contract	-	2	17	-	-5	-1	13
Impairment losses	-	-	-	-	-	-	-
Current capitalized costs	**-**	**540**	**437**	**-746**	**342**	**-7**	**566**
Of obtaining a contract		**522**	**400**	**-713**	**337**	**-5**	**541**
Of fulfilling a contract	-	18	37	-33	5	-2	25
Impairment losses	-	-	-	-	-	-	-
Total	**-**	**712**	**803**	**-747**	**-1**	**-10**	**757**

SOURCE: Telefónica 2018 CFS

With regard to deferred expenses, Telefónica has capitalized those costs that are expected to be recoverable, mainly, from the rendering of services. Unlike the other two companies under analysis, the annual accounts only provide us with quantitative information, so the conclusions have to be drawn by pure numerical interpretation.

On the one hand, the most important costs are those that are incurred to obtain a contract with a customer. In the adjustment, Telefónica includes the costs incurred for contracts not terminated before December 31, 2017 and which have a due date beyond December 31, 2018. It seems that the Group signs contracts for more than a year and most of the contracts have a due date in the next 12 months of the initial application of the Standard (see the analysis of *Income Statement* explained next). On the other hand, costs to fulfill a contract do not show a very significant impact on the assets of the Group.

(c) Contractual liabilities

Table 15. *Breakdown of contractual liabilities*

Millions of euros	Balance at 12/31/2017	IFRS 15 application	Additions	Disposals	Transfers	Translation dif. and hyperinflation adj.	Balance at 12/31/2018
Long-term contractual liabilities	-	106	558	-295	240	4	613
Short-term contractual liabilities	-	98	7561	-7631	1317	-10	1335
Total	**-**	**204**	**8119**	**-7926**	**1557**	**-6**	**1948**

SOURCE: Telefónica 2018 CFS

This is also a new item that appears from the application of IFRS 15. Contract liabilities, as for Telefónica, represent unperformed performance obligations mainly referred to IRU[13] contracts, prepaid airtime, set up fees and other prepaid services (Telefónica, 2019).

In this new line inside "Payables and other (non-)current liabilities", we mainly find reclassifications to reflect the new terminology of IFRS 15, by which there is a briefer and clearer way to present the information. The reclassifications arise from "Deferred revenue" both in the long- and short-term. In the table below we can see the balance for each account.

Table 16. *Transfers to Contractual Liabilities*

	NON-CURRENT		CURRENT	
Millions of euros	**12/31/2018**	**12/31/2017**	**12/31/2018**	**12/31/2017**
Contractual liabilities	613	-	1335	-
Deferred revenue	283	774	106	1387

SOURCE: Telefónica 2018 CFS

If we compare the data from these last two tables, we can see that mostly all the balance of deferred revenue is transferred to contractual liabilities, above all in the short-term. According to the Financial Statements, non-current deferred revenue primarily included revenue from rights of use on the cable network and activation fees not yet recognized in the income statement. In the

[13] An IRU is a contractual agreement that confers an indefeasible and exclusive right of access to equipment, fibers or network capacity on a telecommunications system to another telecom operator for an agreed-upon period in return for upfront or recurring payments (EY, 2015).

short-run, the account primarily included the amount of deferred revenue from sales of prepay cards (the company does not have the obligation to perform a service 365 days after the money deposit), handsets transferred to the distributor, and also the aforementioned rights of use and activation fees. Both amounts are now included within non-current and current contractual liabilities and the remaining amounts of the account "Deferred revenue" lie beyond the scope of IFRS 15.

(d) Income Statement

Table 17. *Impact of IFRS 15 on the Income Statement*

Millions of euros	2018 IFRS 15	2018 IAS 18	2018 Impact IFRS 15
Sales and services rendered	48,693	48,728	-35
OPERATING RESULT BEFORE AMORTIZATIONS	15,751	15,495	76
Amortizations	-9,049	-9,049 -	
OPERATIING RESULT	6,522	6,446	76
Finance net result	-955	-944	-11
RESULT BEFORE TAXES	5,571	5,506	65
Income tax	-1,621	-1,609	-12
NET INCOME	**3,950**	**3,897**	**53**

SOURCE: Adjusted from Telefónica 2018 CFS

As we can see, Telefónica has shown a comparison of the numbers if IAS 18 was applied this year (2018). If the new Standard had not been applied, revenue would have been 35 million euros higher. The reason for which revenue is lower can emerge from the accelerated recognition of revenue: as there is lower revenue in this case, more contracts will be in the stage of service providing, because we know that the accounted revenue is lower with regard to the initial stage. Finally, although the impact has not been significant (lower than 1%) and revenue has diminished, the net income has increased.

Conclusion

As the other two companies, the application of IFRS 15 has supposed both quantitative and qualitative alterations. As for Telefónica, the main change has also derived from capitalized costs and contractual assets. Qualitative changes are not shown in the Statement of Financial Position but the Group includes breakdowns in its Explanatory Notes. Furthermore, it is the only company that has revealed information taking into account the effects of not having applied the new Standard.

Lastly, if we regard the Statement of Changes in Equity, we can see the effect of the application of IFRS 15. As total assets increased 1,112 million euros and liabilities 240 million euros **before taxes**, the overall impact on retained earnings (reserves) results in an increase of 743 million euros. However, the line in the Statement below, total equity is affected in 578 million euros; the datum comprises the effect of applying IFRS 9 and IFRS 15 (743 – 165 = 578). In gross terms, there is an increase of 1,006 million euros (including impairment losses of previous years classified to other comprehensive income), which is what the Group had expected before the application of the Standard.

	Attributable to equity holders of the parent and other holders of equity instruments											Non-controlling interests (Note 15)	Total equity
Millions of euros	Share capital	Share premium	Treasury Shares	Other equity instruments	Legal reserve	Retained earnings	Fair value financial assets	Hedges	Equity of associates and others	Translation differences	Total		
Financial position at December 31, 2017 (*)	**5,192**	**4,538**	**(688)**	**7,518**	**987**	**14,732**	**74**	**384**	**37**	**(15,854)**	**16,920**	**9,698**	**26,618**
Adjustment on initial application of new reporting (Note 15)	—	—	—	—	—	817	(305)	—	—	—	512	66	578
Initial impact of hyperinflation in Argentina	—	—	—	—	—	(1,114)	—	—	—	3,147	2,033	—	2,033
Financial position at January 1, 2018	**5,192**	**4,538**	**(688)**	**7,518**	**987**	**14,435**	**(231)**	**384**	**37**	**(12,707)**	**19,465**	**9,764**	**29,229**

ILLUSTRATION 19: *Extract from Telefónica's Statement of Changes in Equity*
Source: Telefónica 2018 CFS

4.2.3. *MásMóvil Ibercom*

The application of IFRS 15 for this company has supposed an increment of 81,317 thousand euros of retained earnings or reserves, which arise mainly from recognition of contract assets, provision related to "*Cuota 25*" (next explained) and changes in deferred tax liabilities. This company opted for a modified retrospective application of the Standard, that is, the recognition of the cumulative effects of the adoption of the Standard in the opening Statement of Financial Position at January 1, 2018 are shown in the Explanatory Notes, but the information presented in respect of the comparative figures for 2017 has not been restated and is presented under the previously applied standard, rather, IAS 18 (Grupo MásMóvil, 2019).

The net effect of the application is summarized as follows:

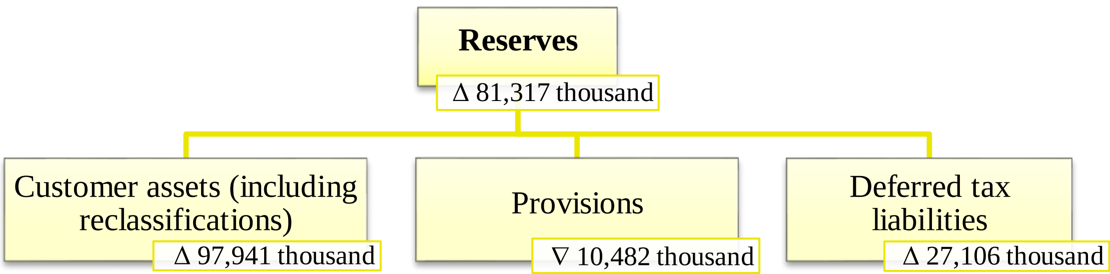

ILLUSTRATION 20: *Net impact of IFRS 15 on MásMóvil's retained earnings*
Source: Self-made

The itemization of the impact IFRS 15 has had on the Statement of Financial Position is shown in the table below. It is adapted only to the impact of IFRS 15, so the data shown in the Explanatory Notes of the Group may vary because the impact of IFRS 9 is not taken into account.

Table 18. *Extract from the impact on the Group's SFP*[14] *at January 1, 2018*

Thousand Euros	**12/31/2017**	**IFRS 15**	**01/01/2018**
ASSETS	**2,093,398**	**97,941**	**2,191,339**
Non-current assets		**1,179**	
(a) Intangible assets	434,225	(40,597)	393,628
(b) Contract costs	-	41,776	41,776
Current assets		**96,762**	
(b) Contract costs	-	96,762	96,762

[14] Statement of Financial Position

EQUITY AND LIABILITIES	**2,093,398**	**97,941**	**2,191,339**
Equity		**81,317**	
(c) Retained earnings and other reserves	(165,874)	81,317	(84,557)
Non-current liabilities		**20,266**	
(d) Provisions	89,408	(6,840)	82,568
Deferred tax liabilities	28,875	27,106	55,981
Current liabilities		**(3,642)**	
(d) Provisions	7,071	(3,642)	3,429

SOURCE: Self-made adapted from MásMóvil 2018 CFS

(a) **Intangible assets**. Within this item, the Group capitalized the costs of obtaining customers attributable to certain convergent[15] products until the adoption of the new Standard. Although before the application of IFRS 15 the costs of obtaining contracts with customers were not capitalized, MásMóvil created assets related to certain products sold to customers and they were amortized during their operating life. These costs were taken to results under fixed assets amortization or depreciation. The convergent products mainly were customer portfolios received through business combinations and the costs of accessing other operator's ADSL (Asymmetric Digital Subscriber Line) network (Grupo MásMóvil, 2019).

With the implementation of IFRS 15, the assessment to capitalize the costs of obtaining contracts with customers changed and so the presentation in the Consolidated Financial Statements. As a result, the Group reclassified the amounts inside "other intangible assets" to the item *costs of obtaining a contract* within "contract costs". This qualitative change led to a transfer of 40,597 thousand euros in favor of the new heading *contract costs* (see table below).

(b) **Contract costs.**

Table 19. *Changes in contract costs*

Thousand Euro	**Non-current**	**Current**
Adjusted balance on 01/01/2018		
Application of IFRS 15 at 1 January 2018	41,776	96,762
During 2018		
Additions	65,724	148,865
Taken to income statement	-	(152,205)
Transfers	(41,776)	41,776
Balance at 31 December 2018 (in SFP)	**65,724**	**135,198**

SOURCE: MásMóvil 2018 CFS

Inside contract costs, MásMóvil encompasses various assets related with customers:

b.1. Customer contract assets

They correspond to the already mentioned discounts for contracts with permanence obligations. The assets are recognized in the income statement on a straight-line basis over the term of the contract with the customer. With IFRS 15, the Group states that there is an increase in revenue recognized in the **first month** of the contract and a decrease over its remaining estimated

[15] It refers to the provision of telephone, video and data communication services within a single network.

life. Notwithstanding, until the adoption of the Standard, discounts were recognized as a decrease in revenue when customers were invoiced, that is, lower revenue in all the operating life of the contract, without the creation of an asset; and the subsidies were recognized as an expense in respect of "merchandise, raw materials and consumables used" when contracts were arranged with customers (Grupo MásMóvil, 2019).

Additions. Inside the amount, discounts for early recognition of revenue are included, that is, the difference between the recorded revenue and the received consideration.

Taken to income statement. The proportional part of the discount is taken to the income statement as the telecommunication service is provided.

b.2. Costs of obtaining a contract

Inside this item we can find the part of the balance transferred from **intangible assets** due to the application of IFRS 15. Most of the costs related are classified as non-current assets at the beginning of the year, that is, as they are fixed intangible assets, the company directly classifies them in the long-run. However, they are reclassified as current assets at the end of the year (December 2018), because the remaining operating life of the contracts to which these costs are related will be of less than one year.

According to MásMóvil, the incremental costs that are directly attributable to securing contracts with customer for both convergent and non-convergent products and retention activities which may be individually identified, reliably measured and for which recovery is expected are recognized as assets at inception and taken to income statement under "Merchandise, raw materials and consumables used" if the amortization period is greater than 12 months. At 1 January 2018 the Group identified commissions paid to distributors and different sales platforms for securing contracts with customers (Grupo MásMóvil, 2019).

Additions. Capitalized costs, which means that the recognition of expenses is delayed.

Taken to income statement. Amortization during the operating life of the contract, that is, they are expensed over time.

b.3. Costs to fulfill a contract

Consolidated Financial Statements do not clarify whether MásMóvil identified costs to fulfill a contract. As a result, it cannot be concluded if these costs are a significant impact for the Group's results.

Transfers. Lastly, transfers refer mainly to costs of obtaining a contract that are reclassified from intangible assets, as mentioned before, and the remaining sum may apply to costs to fulfill a contract. The amount created at the beginning of the year (January 1, 2018) is short-term at the end of the year, so it is reclassified as a current asset.

(d) **Provisions**. One of the subsidiaries within the Group, Xfera Móviles, S.A.U. (whose commercial brand is MásMóvil), offers to customers who purchase a terminal the option to finance the terminal for a duration of 24 months. The customers pay monthly instalments and a final instalment called *Cuota 25*. When the contract ends, the customer has the option to pay the so-called final *Cuota 25* to the company or to sell the terminal to the company, which is committed to acquire it and would pay the same amount the customer would pay for it (the *Cuota 25*).

Until the application of the Standard, Xfera Móviles recognized the contractual liability fully at contract inception (under *Provisions for commercial transactions*) for an amount that reflected the market value of the terminal and it was taken to the income statement as an expense in respect of "Merchandise, raw materials and consumables used". However, with the application of IFRS 15, the provision is not created at the sign-up of the contract but monthly, showing a decrease on revenue from services rendered. That is to say, when the company creates the provision, the expense related is not accounted for; conversely, a reduction of revenue is recognized. Moreover, it should be noted that the amount for which the company creates the provision reflects the difference between the promised amount under *Cuota 25* plan and the expected market value of the terminal after 24 months (Grupo MásMóvil, 2019).

Everything results in a decrease of provisions for commercial transactions of 2017, as these types of provisions under IFRS 15 are recognized monthly and not fully at the beginning of the contract. Until 2017, the accounting for provisions arising from *Cuota 25* did not alter *Revenue* in the income statement, as new criteria do. As the provision is taken to income statement at a slower pace, the result for the period increases, so that the company adjusted reserves (or retained earnings) positively. Therefore, as we can see in the picture below, the Group has modified data from 2017 showing a decrease of 10,482 thousand euros in provisions.

Thousand Euro	Provision for unfavorable/ onerous contracts	Provision for comm-ercial trans-actions	Decom-miss-ioning prov-ision	Provision for employee benefits	Prov-isions for other liabilities	Other provisions	Total
Balance at 31 December 2016	**95,391**	**29,354**	**8,374**	**2,470**	**1,273**	**3,561**	**140,423**
Charge for the year	-	4,656	-	-	-	-	4,656
Business combinations (note 4)	-	7,774	209	9,366	1,200	132	18,681
Applications	(37,894)	(6,342)	-	(2,470)	(1,273)	(445)	(48,424)
Reversals	(4,108)	(11,153)	(610)	-	-	(2,986)	(18,857)
Balance at 31 December 2017	**53,389**	**24,289**	**7,973**	**9,366**	**1,200**	**262**	**96,479**
Application of IFRS 15 at 1 January 2018 (note 2 (g))	-	(10,482)	-	-	-	-	(10,482)
Balance at 1 January 2018	**53,389**	**13,807**	**7,973**	**9,366**	**1,200**	**262**	**96,479**

ILLUSTRATION 21: *MásMóvil's adjustment of provisions due to IFRS 15*
Source: MásMóvil 2018 CFS

Conclusion

The application of IFRS 15 has also resulted in quantitative and qualitative changes. In this company, the most important change has arisen from contract costs (which include contract assets for the accelerated recognition of revenue) and the most relevant reclassifications from intangible assets to contract costs and the apparition of new items in the Statement of Financial Position, such as contract costs (qualitative changes).

(c) **Retained earnings.** The total effect of shareholders' equity can be seen in the Consolidated Statement of Changes in Equity. Total assets increased 97,941 thousand euros while liabilities increased 16,624 euros, resulting in an increase on consolidated reserves of 81,317 thousand euros (97,941 – 16,624). The Group expected an increase on consolidated reserves of 110 million euros before taxes, so the result approximates to the estimation.

Thousand Euro	Capital	Share Premium	Other reserves	Retained earnings	Treasury shares	Translation differences	Other equity instruments	Total equity
Balance at 1 January 2017	**1,995**	**246,652**	**(4,594)**	**(58,051)**	**(375)**	**(44)**	**70,022**	**255,605**
Loss for the year	-	-	-	(102,759)	-	-	-	**(102,759)**
Other comprehensive income	-	-	-	-	-	243	-	**243**
Total comprehensive income for the year	**-**	**-**	**-**	**(102,759)**	**-**	**243**	**-**	**(102,516)**
Treasury shares (note 11 (d))	-	-	672	-	(7,598)	-	-	**(6,926)**
Other instruments (note 11 (e))	-	-	-	-	-	-	151,982	**151,982**
Issue of share-based payments (note 21)	-	-	-	-	-	-	6,082	**6,082**
Application of loss for the year	-	-	(58,051)	58,051	-	-	-	-
Other movements (note 11)	-	-	(1,142)	-	-	-	-	**(1,142)**
Balance at 31 of December 2017	**1,995**	**246,652**	**(63,115)**	**(102,759)**	**(7,973)**	**199**	**228,086**	**303,085**
Impact of adopting IFRS 15, neto net of taxes (note 2 (g))	-	-	81,317	-	-	-	-	**81,317**
Impact of adopting IFRS 9, neto net of taxes (note 2 (g))	-	-	(8,239)	-	-	-	-	**(8,239)**
Balance at 1 of January 2018	**1,995**	**246,652**	**9,963**	**(102,759)**	**(7,973)**	**199**	**228,086**	**376,163**

ILLUSTRATION 22: *Extract from MásMóvil's Statement of Changes in Equity*
Source: MásMóvil 2018 CFS

4.3. IFRS 15 implementation impact on financial indicators

In the table below we can see some chosen ratios. Data corresponding IAS 18 have been compiled from Telefónica's "Note 2. *Basis of presentation of the consolidated financial statements*" from its financial statements (available in the appendix). Note that numbers in the formulas are expressed in million euros.

Table 20. *Financial Ratios*

RATIO	FORMULA	IFRS 15	IAS 18
PROFITABILITY			
Return On Assets (ROA)	$\frac{\text{Net Income}}{\text{Average Total Assets}}$	$\frac{3{,}950}{\left(\frac{115{,}066+114{,}047}{2}\right)}=0.03448$	$\frac{3{,}897}{\left(\frac{115{,}066+112{,}898}{2}\right)}=0.03418$
Return On Equity (ROE)	$\frac{\text{Net Income}}{\text{Shareholders' Equity}}$	$\frac{3{,}950}{26{,}980}=0.1464$	$\frac{3{,}897}{26{,}193}=0.1488$
EBITDA	Net income ± Interests + Taxes + Depreciation + Amortization	3,950 + 955 + 1,621 + 9,049 = 15,575 million euros	3,897 + 944 + 1,609 + 9,049 = 15,499 million euros
LIQUIDITY			
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	$\frac{23{,}340}{29{,}649}=0.7872$	$\frac{22{,}540}{29{,}528}=0.7633$
Acid-test Ratio	$\frac{\text{Current Assets} - \text{Inventories}}{\text{Current Liabilities}}$	$\frac{23{,}340-1{,}692}{29{,}649}=0.7301$	$\frac{22{,}540-1{,}692}{29{,}528}=0.7060$
LEVERAGE FINANCIAL RATIOS			
Debt-to-equity Ratio	$\frac{\text{Total Liabilities}}{\text{Shareholders' Equity}}$	$\frac{87{,}067}{26{,}980}=3.2270$	$\frac{86{,}795}{26{,}193}=3.3137$
Debt Ratio	$\frac{\text{Total Liabilities}}{\text{Total Assets}}$	$\frac{87{,}067}{114{,}047}=0.7634$	$\frac{86{,}795}{112{,}988}=0.7682$

Financial Autonomy Ratio	$\frac{\text{Shareholders' Equity}}{\text{Total Liabilities}}$	$\frac{26{,}980}{87{,}067} = 0.3099$	$\frac{26{,}193}{86{,}795} = 0.3018$

SOURCE: Self-made, based on data from Telefónica's 2018 CFS

We have proceeded to calculate basic ratios to determine to what extent IFRS 15 has impacted financial indicators. We have only analyzed Telefónica's results because it is the unique company that has offered data on the hypothetical application of IAS 18 this last period (January-December 2018). Nevertheless, as Telefónica's and Orange's data are similar, it is applicable to both companies.

The results show that regardless of the application of IFRS 15, data would have been almost the same, the change is insignificant. This means that the adoption of the new revenue recognition standard does not impact financial ratios. As a result, the company will give an identical view of the business, regardless of what method is used to recognize revenue, IAS 18 or IFRS 15.

4.4. Results analysis

Each company has different ways of expressing the impact of the new revenue recognition standard on their Financial Statements. Some companies offer more detailed information that eases the understandability over the provided information, so that it is more effortless for stakeholders to make economic decisions.

We can draw some conclusion from this empirical analysis:

1. The most **significant change** has resulted in the creation of **contract assets** due to the accelerated recognition of revenue.
2. **Size is a relevant factor** to determine the impact of IFRS 15. In our sample, the smallest company is greater affected, especially with regard to total equity, as it increases a 26 % with the application of this Standard. Therefore, the bigger the company is, the less affected it is. See table below.

Table 21. *Relationship of the increase in reserves with equity, revenue and total assets, due to IFRS 15 application*

	ORANGE	MÁSMÓVIL	TELEFÓNICA
Net Equity (2017)[16]	33,845 million	303 million	26,618 million
Revenue (2018)	41,381 million	1,451 million	48,693 million
Total Assets (2018)	96,592 million	2,653 million	114,047 million
Δ Reserves	815 million	81 million	743 million
Δ Reserves / Equity	**2.41 %**	**26.83 %**	**2.79 %**
Δ Reserves / Revenue	**1.97 %**	**5.60 %**	**1.53 %**
Δ Reserves / Total Assets	**0.84 %**	**3.07 %**	**0.65 %**

SOURCE: Self-made, based on information gathered from each company's CFS

[16] Orange's data corresponds to 2016.

3. Orange shows the retrospective effect **until 2016**, while MásMóvil and Telefónica **only 2017**. **Orange** is the only company that **re-expresses numbers** of the Financial Statements.
4. When it comes to interpreting **financial information**, although there has been a significant impact on companies' consolidated reserves, their solvency, leverage and profitability and so on, **remains unchanged**. Therefore, the view of the business toward investors and stakeholders is the same.
5. Orange's and MásMóvil's Financial Statements show **new itemizations** after the application of IFRS 15; however, Telefónica opted for including the new items in the already existing lines in the Statement of Financial Position.
6. The first mentioned two companies offer more explanations on the impact, that is, more **qualitative information** than quantitative, which is more useful. The information that **Telefónica** offers is **tougher to analyze**, because the qualitative information is much more succinct. Although Telefónica does not deepen enough on explaining the quantitative data (does not give many explanations) it is the only company that has shown the **effect of applying IAS 18** during 2018, which is an interesting perspective to consider.

Chapter 5 Conclusion

Quite a long time ago, the IASB had been working on the modification of the way to recognize revenue, due to inconsistencies on international regulation and disagreements between several international regulatory bodies and stakeholders. The prior standard in force **generated debates** because of the lacking detailed guidance and because it differed significantly with other international regulation. All of that led, after the joint project between the American FASB and the IASB, to the issuance of the new IFRS 15, in order to **eliminate the inconsistencies and discrepancies** between the regulations, which has supposed a great change for many companies. Therefore and definitively, a **unique way to recognize revenue** for all industries was created.

The adoption of **IFRS 15** has supposed a **change in the analysis approach** to recognize revenue. As already mentioned the new standard is much more extensive and gives more detailed guidance on many aspects; its structure is completely different. Firstly, this standard only applies to contracts with customers, leaving out any other contract or agreement. Secondly, the revenue recognition process changes and is based on a 5-step model, which needs to be followed step by step successively. Thirdly, there is no distinction between goods and services under this standard; it is only based on the transfer of control to the customer. Fourthly, the transaction price is measured under the individual selling prices and not fair value, which gives a better view of the transaction prices. Lastly, IFRS 15 includes new requirement for contract costs, which usually delays the expense allocation to profit and loss statement due to the recognition of assets. In conclusion, in some industries the amount and moment to recognize revenue differs significantly with the former IAS 18.

During this project, an empirical analysis has been conducted to determine the impacts of the adoption of IFRS 15 on the telecommunications industry. Taking the sample of three Companies (Orange, MásMóvil and Telefónica) and analyzing their financial information in their consolidated Financial Statements, we have concluded that the **impact, in numerical terms, has not been *really* significant** for some reasons next explained. However, the application of IFRS 15 has impacted ***significantly*** the **way of presenting the financial information**.

The implementation of IFRS 15 in the telecommunications industry has supposed some changes when recognizing revenue. The **most affected steps** in the process have been *Step 2* (determining performance obligations) and *Step 4* (allocating the transaction price to performance obligations). On the one hand, as for step 2, bundled offers that comprised some goods and services needed to be assessed to determine if they were distinct and not distinct goods or services. In this aspect, companies expressed their difficulty on applying the criteria. On the other hand, the allocation of the transaction price to the performance obligations changed the pace of recognition of revenue when there is a discount. In this case, revenue recognized at the beginning of the contract is greater than revenue accounted for during contract's life, due to the guidance of IFRS 15 on the application of discounts.

The three companies have **disclosed information properly**, that is, the information provided on their Consolidated Financial Statements is sufficient and accurate, so that the nature, amount, timing and uncertainty of revenue and cash flows can be well-understood. The companies have included new itemizations in the Statement of Financial Position, responding to the requirements of disclosure of IFRS 15. Telefónica, for its part, disclosed the information regarding revenue in the already existing lines of its Statement of Financial Position, as the Standard does not prohibit entities from using alternative descriptions to name these types of accounts.

Another relevant aspect that was found out during the research was that the increment in retained earnings mainly arose from the **creation of contract assets**. Those contract assets made reference to the already mentioned allocation of discounts, where an asset was created when revenue was recognized in full without taking into account the discount, and the excess of amount recognized was booked in the mentioned contractual asset. Additionally, the new guidance for costs of obtaining a contract also supposed creations of new assets and helped in the increase of consolidated reserves.

Generally, **every company** has shown the **same affected items** on the application of IFRS 15. However, one of the questions of the empirical analysis was to determine whether the impact has been the same depending on size, taking into account variables such as revenue, equity and total assets. We have realized that the smaller the company is, the greater affected it is; that is to say, the increase in reserves is more significant with respect to the variables mentioned, if we compare with bigger companies such as Orange and Telefónica.

Anyway, although there is a significant increase in reserves, the **financial information** in **numerical** terms is **not altered at all**. If IAS 18 had been applied in the last year (2018), data would have been almost the same, so the view that the company gives to its potential investors and financial information users would be much the same. We should highlight that the analysis of the financial ratios carried out refer only to Telefónica. Thus, we cannot warranty that the impact on Orange's and MásMóvil's financial indicators is the same; conversely, we can only suppose that these two company's ratios may be alike because of the very similar available information on the impact of IFRS 15.

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Appendix

In this appendix, Consolidated Financial Statements of *MásMóvil Ibercom*, *Orange* and *Telefónica* are presented: the Statement of Financial Position and the Income Statement. The rows in color in the Statement of Financial Position indicate the items affected by IFRS 15. For further information or clarifications, each company's corporate website can be consulted.

STATEMENT OF FINANCIAL POSITION

Expressed in millions of euros

ASSETS	2018	2017	2016
(A) NON-CURRENT ASSETS	**74,701**	**73,612**	**74,373**
Goodwill	27,174	26,911	26,979
Other intangible assets	14,073	14,339	14,602
Property, plant and equipment	27,693	26,665	25,912
Interests in associates and joint ventures	104	77	130
Non-current financial assets related to Orange Bank activities	1,617	1,464	1,523
Non-current financial assets	2,282	2,247	2,359
Non-current derivatives assets	263	213	915
Other non-current assets	129	110	106
Deferred tax assets	1,366	1,586	1,847
(B) CURRENT ASSETS	**21,891**	**21,737**	**21,038**
Inventories	965	827	819
Trade receivables	5,295	5,175	4,964
Other customer contract assets	1,166	1,204	1,335
Current financial assets related to Orange Bank activities	3,075	3,275	3,336
Current financial assets	2,748	2,686	1,617
Current derivatives assets	139	34	57
Other current assets	1,152	1,094	1,073
Operating taxes and levies receivables	1,027	1,045	918
Current tax assets	119	132	170
Prepaid expenses	571	455	394

Cash and cash equivalents	5,634	5,810	6,355
TOTAL ASSETS (A+B)	**96,592**	**95,349**	**95,411**

EQUITY AND LIABILITIES

(A) EQUITY	**33,249**	**33,512**	**33,845**
Share capital	10,640	10,640	10,640
Share premiums and statutory reserve	16,859	16,859	16,859
Subordinated notes	5,803	5,803	5,803
Retained earnings	(2,633)	(2,327)	(2,061)
Equity attributable to owners of the parent	**30,669**	**30,975**	**31,241**
Equity attributable to non-controlling interests	2,580	2,537	2,604
(B) NON-CURRENT LIABILITIES	**33,047**	**32,780**	**35,638**
Non-current financial liabilities	26,749	26,293	28,908
Non-current derivatives liabilities	775	1,002	578
Non-current fixed assets payables	612	610	907
Non-current financial liabilities related to Orange Bank activities	0	0	1
Non-current employee benefits	2,823	2,674	3,029
Non-current provision for dismantling	765	774	716
Non-current restructuring provision	230	251	185
Other non-current liabilities	462	521	608
Deferred tax liabilities	631	655	706
(C) CURRENT LIABILITIES	**30,296**	**29,057**	**25,928**
Current financial liabilities	7,270	6,030	4,616
Current derivatives liabilities	133	34	50
Current fixed assets payables	2,835	3,046	2,800
Trade payables	6,736	6,527	6,214
Customer contract liabilities	2,002	2,021	2,071
Current financial liabilities related to Orange Bank activities	4,835	4,941	4,507
Current employee benefits	2,392	2,448	2,266
Current provision dismantling	11	15	21
Current restructuring provision	159	126	190
Other current liabilities	1,788	1,935	1,530
Operating taxes and levies payables	1,322	1,262	1,241
Current tax payables	755	596	338
Deferred income	58	76	84
TOTAL EQUITY AND LIABILITIES (A+B+C)	**96,592**	**95,349**	**95,411**

STATEMENT OF FINANCIAL POSITION

Expressed in thousands of euros

GRUPOMASMOVIL

ASSETS	**2018**	**2017**
(A) NON CURRENT ASSETS	**2,172,314**	**1,566,178**
Goodwill	508,281	389,380
Intangible assets	703,549	434,225
Property, plant and equipment	610,123	462,903
Contracts costs	65,724	-
Other investments	7,734	6,404
Prepayment for non-current assets	30,835	28,876
Deferred tax assets	246,068	244,390
(B) CURRENT ASSETS	**480,735**	**527,220**
Inventory	1,239	448
Trade and other receivables	237,674	198,441
Contracts costs	135,198	-
Current tax assets	71	1,995
Other investments	4,532	3,493
Prepayment for current-assets	3,816	2,751
Cash and cash equivalents	98,205	320,092
TOTAL ASSETS (A+B)	**2,653,049**	**2,093,398**

EQUITY AND LIABILITIES		
(A) EQUITY	**475,883**	**303,085**
Capital	2,404	1,995
Share premium	616,269	246,652
Retained earnings and other reserves	(207,085)	(165,874)
Treasury shares	(2,020)	(7,973)
Other equity Instruments	66,253	228,086
Translation differences	62	199
(B) NON CURRENT LIABILITIES	**1,257,266**	**1,069,914**
Loans and borrowings	738,591	499,274
Derivative financial instruments	589	3,123
Other payables	8,094	4,296
Finance lease payables	21,720	27,718
Other financial liabilities	177,510	298,260
Provisions	105,155	89,408
Government grants	10,865	11,791
Deferred tax liabilities	61,013	28,875
Other non-current liabilities	133,729	107,169
(C) CURRENT LIABILITIES	**919,900**	**720,399**
Loans and borrowings	80,262	24,055
Current income tax liabilities	2,334	-

Other payables	233,400	31,952
Finance lease payables	6,009	6,412
Other financial liabilities	12,759	41,517
Trade and other payables	553,579	609,392
Provisions	31,557	7,071
TOTAL EQUITY AND LIABILITIES (A+B+C)	**2,653,049**	**2,093,398**

STATEMENT OF FINANCIAL POSITION
Expressed in millons of euros

ASSETS	**2018**	**2017**
(A) NON-CURRENT ASSETS	**90,707**	**95,135**
Intangibles	16,856	18,005
Goodwill	25,748	26,841
Tangible fixed assets	33,295	34,225
Investments in associates and joint ventures	68	77
Financial assets and other non-current assets	7,109	8,167
Deferred tax assets	7,631	7,820
(B) CURRENT ASSETS	**23,340**	**19,931**
Inventories	1,692	1,117
Accounts receivables and other current assets	10,579	10,093
Taxation authorities, receivables	1,676	1,375
Other current financial assets	2,209	2,154
Cash and cash equivalents	5,692	5,192
Non-current assets held for sale	1,492	-
TOTAL ASSETS (A+B)	**114,047**	**115,066**

EQUITY AND LIABILITIES

(A) EQUITY	**26,980**	**26,618**
Equity attributable to owners of the parent and other equity holders	17,947	16,920
Equity attributable to non-controlling interests	9,033	9,698
(B) NON-CURRENT LIABILITIES	**57,418**	**59,382**
Non-current financial liabilities	45,334	46,332
Accounts payables and other non-current liabilities	1,890	1,687
Deferred tax liabilities	2,674	2,145
Long-term provisions	7,520	9,218

(C) CURRENT LIABILITIES	**29,649**	**29,066**
Current financial liabilities	9,368	9,414
Accounts payables and other current liabilities	15,485	15,095
Taxation authorities, payables	2,047	2,341
Short-term provisions	1,912	2,216
Liabilities held for sale	837	-
TOTAL EQUITY AND LIABILITIES (A+B+C)	**114,047**	**115,066**

CONSOLIDATED INCOME STATEMENT

Expressed in millions of euros	2018	2017	2016
Revenue	**41,381**	**40,859**	**40,708**
External purchases	(18,563)	(18,381)	(18,186)
Other operating income	760	701	739
Other operating expenses	(505)	(724)	(546)
Labor expenses	(9,074)	(8,574)	(8,866)
Operating taxes and levies	(1,840)	(1,846)	(1,808)
Gains (losses) on disposal of investment and activities	17	(5)	59
Restructuring and integration costs	(199)	(167)	(499)
Depreciation and amortization	(7,047)	(6,846)	(6,728)
Effects resulting from business combinations	-	(27)	97
Reclassification of translation adjustment from liquidated entities	1	(8)	14
Impairment of goodwill	(56)	(20)	(814)
Impairment of fixed assets	(49)	(190)	(207)
Share of profits (losses) of associates and joint ventures	3	6	(46)
OPERATING INCOME	**4,829**	**4,778**	**3,917**
Costs of gross financial debt	(1,341)	(1,274)	(1,407)
Gains (losses) on assets contributing to net financial debt	9	11	23
Foreign exchanges gain (loss)	(4)	(63)	(149)
Other net financial expenses	25	(17)	(31)
Effects resulting from BT stake	(51)	(372)	(533)
Net finance expense	**(1,362)**	**(1,715)**	**(2,097)**
INCOME BEFORE TAXES	**3,467**	**3,063**	**1,820**
Income tax	(1,309)	(1,052)	(951)
NET INCOME FOR CONTINUING OPERATIONS	**2,158**	**2,011**	**869**

NET INCOME FOR DISCONTINUED OPERATIONS (EE)	0	29	2,253
NET INCOME	**2,158**	**2,040**	**3,122**
Attributable to owners of the parent	1,954	1,843	2,813
Attributable to non-controlling interests	204	197	309
Earnings per share (euros)			
Basic	0.63	0.59	0.95
Diluted	0.62	0.59	0.95

Effect of IFRS 15 and 9 present

CONSOLIDATED INCOME STATEMENT

GRUPOMASMOVIL

Expressed in thousands of euros	**2018**	**2017**
Revenue	**1,450,866**	**1,301,032**
Merchandise, Raw materials and consumables used	(724,150)	(712,843)
Other operating income	47,348	49,727
Other operating expenses	(411,124)	(375,679)
Employee benefits expenses	(50,390)	(46,652)
Depreciation and amortization	(160,753)	(123,567)
OPERATING INCOME	**151,797**	**92,018**
Financial income	958	1,912
Financial expenses	(104,066)	(232,742)
Change in fair value of financial instruments	486	906
Exchange differences	(137)	(326)
Impairment and result from disposals of financial instruments	28,666	(3,612)
Net finance expense	**(74,093)**	**(233,862)**
INCOME BEFORE TAXES	**77,704**	**(141,844)**
Income tax	(7,161)	39,085
NET INCOME	**70,543**	**(102,759)**
OTHER COMPREHENSIVE INCOME		
Items to be reclassified to profit or loss		
Translation differences of financial statements of foreign operations	(137)	243
Other comprehensive income for the year, net of tax	(137)	243
Total comprehensive income for the year	**70,406**	**(102,516)**
Earnings per share (euros)		

Basic	2.764	(4.308)
Diluted	1.287	0.675

CONSOLIDATED INCOME STATEMENT

Expressed in millions of euros	2018	2017	2016
Sales and services rendered	48,693	52,008	52,036
Other income	1,622	1,489	1,763
Supplies	(14,013)	(15,022)	(15,242)
Personnel expenses	(6,332)	(6,862)	(8,098)
Other expenses	(14,399)	(15,426)	(15,341)
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION	**15,571**	**16,187**	**15,118**
Amortization and depreciation	(9,049)	(9,396)	(9,649)
OPERATING INCOME	**6,522**	**6,791**	**5,469**
Share of results of equity accounted associates and joint ventures	**4**	5	(5)
Finance income	1,458	1,073	1,770
Exchange gains	3,389	3,958	5,489
Finance expenses	(2,690)	(3,363)	(4,476)
Exchange losses	(3,112)	(3,867)	(5,002)
Net finance expense	**(955)**	**(2,199)**	**(2,219)**
INCOME BEFORE TAXES	**5,571**	**4,597**	**3,245**
Income tax	(1,621)	(1,219)	(846)
NET INCOME	**3,950**	**3,378**	**2,399**
Attributable to owners of the parent	3,331	3,132	2,369
Attributable to non-controlling interests	619	246	30
Earnings per share, basic and diluted, attributable to owners of the parent (euros)	**0,57**	**0,56**	**0,42**

STATEMENT OF FINANCIAL POSITION 2018: Impact of IFRS 15

Expressed in millons of euros

ASSETS	**IFRS 15**	**IAS 18**	**Impact**
(A) NON-CURRENT ASSETS	**90,707**	**90,448**	**259**
Intangibles	16,856	16,856	0
Goodwill	25,748	25,748	0
Tangible fixed assets	33,295	33,295	0

Investments in associates and joint ventures	68	68	0
Financial assets and other non-current assets	7,109	6,823	286
Deferred tax assets	7,631	7,658	-27
(B) CURRENT ASSETS	**23,340**	**22,540**	**800**
Inventories	1,692	1,692	0
Accounts receivables and other current assets	10,579	9,789	790
Taxation authorities, receivables	1,676	1,666	10
Other current financial assets	2,209	2,209	0
Cash and cash equivalents	5,692	5,692	0
Non-current assets held for sale	1,492	1,492	0
TOTAL ASSETS (A+B)	**114,047**	**112,988**	**1,059**

EQUITY AND LIABILITIES

(A) EQUITY	**26,980**	**26,193**	**787**
Equity attributable to owners of the parent and other equity holders	17,947	17,262	685
Equity attributable to non-controlling interests	9,033	8,931	102
(B) NON-CURRENT LIABILITIES	**57,418**	**57,267**	**151**
Non-current financial liabilities	45,334	45,334	0
Accounts payables and other non-current liabilities	1,890	1,903	-13
Deferred tax liabilities	2,674	2,510	164
Long-term provisions	7,520	7,520	0
(C) CURRENT LIABILITIES	**29,649**	**29,528**	**121**
Current financial liabilities	9,368	9,368	0
Accounts payables and other current liabilities	15,485	15,460	25
Taxation authorities, payables	2,047	1,951	96
Short-term provisions	1,912	1,912	0
Liabilities held for sale	837	837	0
TOTAL EQUITY AND LIABILITIES (A+B+C)	**114,047**	**112,988**	**1,059**

CONSOLIDATED INCOME STATEMENT 2018: Impact of IFRS 15

Expressed in millions of euros	**IFRS 15**	**IAS 18**	**Impact**
Sales and services rendered	48,693	48,728	(35)
OPERATING INCOME BEFORE DEPRECIATION AND AMORTIZATION	**15,571**	**15,495**	**76**
Amortization and depreciation	(9,049)	(9,049)	0

OPERATING INCOME	**6,522**	**6,446**	**76**
Share of results of equity accounted associates and joint ventures	**4**	**4**	**0**
Net finance expense	**(955)**	**(944)**	**(11)**
INCOME BEFORE TAXES	**5,571**	**5,506**	**65**
Income tax	(1,621)	(1,609)	(12)
NET INCOME	**3,950**	**3,897**	**53**
Attributable to owners of the parent	3,331	3,291	40
Attributable to non-controlling interests	619	606	13
Earnings per share, basic and diluted, attributable to owners of the parent (euros)	**0,57**	**0,56**	**0,01**