Relationship between AASB Interpretation 1042 *Subscriber Costs in the Telecommunications Industry* and IFRS 15 *Revenue from Contracts with Customers.*

AASB Staff Issues Paper

Introduction

1 The purpose of this paper is to determine whether:

(a) the requirements of AASB Interpretation 1042 Subscriber Acquisition Costs in the Telecommunications Industry (Interpretation 1042) are within the scope of the contract costs requirements in IFRS 15 Revenue from Contracts with Customers (which is expected to be issued in Australia as AASB 15 Revenue from Contracts with Customers); and

(b) if so, whether that Interpretation should be withdrawn, amended or retained.

Background

AASB 1042 *Subscriber Acquisition Costs in the Telecommunications Industry*

2 Interpretation 1042 was originally issued as UIG Abstract 42 Subscriber Acquisition Costs in the Telecommunications Industry in October 2001 because concern had been expressed that, in the absence of authoritative guidance, diverse or unacceptable practices in accounting for customer acquisition costs in the telecommunications industry may occur or develop. As part of the transition to International Financial Reporting Standards, the Urgent Issues Group decided in December 2004 to retain this guidance and replace Abstract 42 with Interpretation 1042.

3 The issues addressed in Interpretation 1042 are:

(a) should subscriber acquisition costs incurred by entities in the telecommunications industry be capitalised as an asset;

(b) if so, what costs should be recognised as part of the cost of the asset; and

(c) if subscriber acquisition costs are capitalised should they be amortised and if so on what basis?

4 Interpretation 1042 (at paragraph 4) states:

> **Subscriber acquisition costs** are costs incurred in obtaining and recording telecommunications services contracts with subscribers. **Direct subscriber acquisition costs** are those incremental subscriber acquisition costs that are directly attributable to establishing specific subscriber contracts and would not have been incurred had those contracts not been entered into [emphasis added].

5 The requirements of Interpretation 1042 are provided in the attached Appendix.

IFRS 15 *Revenue from Contracts with Customers*

6 Paragraphs 91-104 of IFRS 15 include requirements on the following:

(a) recognising the incremental costs of obtaining a contract as an asset;

(b) recognising the costs to fulfil a contract as an asset; and

(c) the amortisation or impairment of those assets.

7 These requirements are also provided in the attached Appendix.

Comparing the scopes of Interpretation 1042 and IFRS 15

8 Both Interpretation 1042 and IFRS 15 specify requirements for accounting for contract acquisition costs. Both pronouncements also similarly identify contact acquisition costs that are capable of being recognised as an asset (in accordance with the specific recognition requirements in each pronouncement) as being the incremental costs incurred to obtain a contract. Specifically:

(a) Interpretation 1042 describes those costs as "those incremental subscriber acquisition costs that are directly attributable to establishing specific subscriber contracts and would not have been incurred had those contracts not been entered into" (paragraph 4); and

(b) IFRS 15 describes those costs as "those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract has not been obtained" (paragraph 92).

9 The requirements in IFRS 15 apply to costs to obtain any type of contract with a customer that is within the scope of IFRS 15. In contrast, the requirements in Interpretation 1042 apply only to subscriber (i.e. customer) contracts in the telecommunications industry. Consequently, the requirements overlap because the costs to obtain a contract with a subscriber in the telecommunications industry would be within the broader scope of IFRS 15.

Differences between Interpretation 1042 and IFRS 15

10 The main differences between Interpretation 1042 and IFRS 15 include:

(a) Asset recognition – although it may not have a significant practical effect, the asset recognition criteria are described differently in Interpretation 1042 and IFRS 15. In addition, paragraph 16 of Interpretation 1042 states that examples of directly attributable costs include the costs of recording subscriber and contract information in relation to contracts entered into. Under IFRS 15, those costs could be included in the asset only if the incurrence of those costs is incremental to obtaining the contract.

(b) Practical expedient – IFRS 15 includes a practical expedient for an entity to recognise the incremental costs of obtaining the contract as an expense when incurred if the amortisation period of the asset that would otherwise be recognised is one year or less. Interpretation 1042 does not provide entities with a similar option.

(c) Amortisation – Interpretation 1042 states that the period for amortising the asset cannot extend beyond the stated period of the contract. In contrast, IFRS 15 states that the asset is amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates, and thus may include anticipated renewals of the contract.

(d) Impairment – Interpretation 1042 requires that impairment of the asset is determined in accordance with AASB 136 *Impairment of Assets*. In contrast, IFRS 15 has developed a specific impairment test for these assets.

Should Interpretation 1042 be withdrawn, amended or retained?

11 Given that IFRS 15 will apply to account for contract acquisition costs in the telecommunications industry, the staff recommend that Interpretation 1042 should be withdrawn when AASB 15 becomes effective. Withdrawing Interpretation 1042 is recommended for the following reasons:

(a) it would be consistent with the Board's policy of not providing unnecessary local guidance on matters covered by International Financial Reporting Standards; and

(b) several aspects of the requirements in Interpretation 1042 are not consistent with the requirements in IFRS 15 (as outlined in paragraph 10 above).

12 Staff have informally reached out to two technical experts in practice who have both indicated that they consider that IFRS 15 addresses the issues in Interpretation 1042 and that Interpretation 1042 could be withdrawn.

Question 1 to the Board

Does the Board agree with the staff recommendation in paragraph 11 above that AASB Interpretation 1042 *Subscriber Acquisition Costs in the Telecommunications Industry* be withdrawn when AASB 15 *Revenue from Contracts with Customers* becomes effective?

Next steps

13 Although the withdrawal, amendment or retention of Interpretation 1042 was not specifically addressed in either of the Exposure Drafts (EDs) on revenue that the Board issued for comment, both EDs indicated that other Australian Accounting Standards and Interpretations (in addition to those standards and Interpretation identified by the IASB) might be subject to consequential amendments. Therefore, if the Board agrees with the staff recommendation to withdraw Interpretation 1042, staff consider that it would be necessary to issue an ED seeking comments from constituents.

14 Staff recommend that this ED be issued as an 'adverse comment' ED1 whereby constituents are only asked to comment if they disagree with withdrawing Interpretation 1042. Staff recommended that the ED is issued with a comment period of 30 days.

Question 2 to the Board

Does the Board agree with the staff recommendation made in paragraph 14 that the intention to withdraw AASB Interpretation 1042 *Subscriber Acquisition Costs in the Telecommunications Industry* be exposed by way of an adverse comment ED?

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[1] The AASB has previously issued an 'adverse comment' ED for Tier 2 Supplement to ED 206 *Severe Hyperinflation* and ED 218 *Presentation of Items of Other Comprehensive Income: Tier 2 Proposals*.

Extract from AASB Interpretation 1042 Subscriber Acquisition Cost in the Telecommunications Industry

<u>Consensus</u>

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4 **For the purposes of this Interpretation, subscriber acquisition costs are costs incurred in obtaining and recording telecommunications service contracts with subscribers. Direct subscriber acquisition costs are those incremental subscriber acquisition costs that are directly attributable to establishing specific subscriber contracts and would not have been incurred had those contracts not been entered into. Those costs do not include the cost of telephones provided to subscribers.**

5 **Direct subscriber acquisition costs shall be recognised as expenses as incurred, except that they shall be recognised as an asset when, and only when, the costs can be identified separately and:**

(a) the entity controls future economic benefits as a result of the costs incurred;

(b) it is probable that those future economic benefits will flow to the entity; and

(c) the costs can be measured reliably.

6 **Subscriber acquisition costs other than those dealt with in paragraph 5 shall be recognised as expenses as incurred.**

7 **Subscriber acquisition costs recognised as an asset in accordance with paragraph 5 shall be amortised from the inception of the contract over the lesser of:**

(a) the stated period of the contract; and

(b) the period during which the future economic benefits are expected to be obtained.

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28 **Where an asset is recognised in accordance with this Interpretation, and measured on the cost basis, it is written down to recoverable amount when its carrying amount is greater than the recoverable amount, in accordance with AASB 136 Impairment of Assets. For example, if contracts are terminated during the contract period, unamortised subscriber acquisition costs attributable to terminations in excess of estimated levels already reflected in the amortisation of acquisition costs are written off as an expense.**

Extract from IFRS 15 *Revenue from Contracts with Customers* – Contract Costs

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Contract costs

Incremental costs of obtaining a contract

91 **An entity shall recognise as an asset the incremental costs of obtaining a contract with a customer if the entity expects to recover those costs.**

92 The incremental costs of obtaining a contract are those costs that an entity incurs to obtain a contract with a customer that it would not have incurred if the contract had not been obtained (for example, a sales commission).

93 Costs to obtain a contract that would have been incurred regardless of whether the contract was obtained shall be recognised as an expense when incurred, unless those costs are explicitly chargeable to the customer regardless of whether the contract is obtained.

94 As a practical expedient, an entity may recognise the incremental costs of obtaining a contract as an expense when incurred if the amortisation period of the asset that the entity otherwise would have recognised is one year or less.

Costs to fulfil a contract

95 If the costs incurred in fulfilling a contract with a customer are not within the scope of another Standard (for example, IAS 2 *Inventories*, IAS 16 *Property, Plant and Equipment* or IAS 38 *Intangible Assets*), an entity shall recognise an asset from the costs incurred to fulfil a contract only if those costs meet all of the following criteria:

(a) the costs relate directly to a contract or to an anticipated contract that the entity can specifically identify (for example, costs relating to services to be provided under renewal of an existing contract or costs of designing an asset to be transferred under a specific contract that has not yet been approved);

(b) the costs generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and

(c) the costs are expected to be recovered.

96 For costs incurred in fulfilling a contract with a customer that are within the scope of another Standard, an entity shall account for those costs in accordance with those other Standards.

97 Costs that relate directly to a contract (or a specific anticipated contract) include any of the following:

(a) direct labour (for example, salaries and wages of employees who provide the promised services directly to the customer);

(b) direct materials (for example, supplies used in providing the promised services to a customer);

(c) allocations of costs that relate directly to the contract or to contract activities (for example, costs of contract management and supervision, insurance and depreciation of tools and equipment used in fulfilling the contract);

(d) costs that are explicitly chargeable to the customer under the contract; and

(e) other costs that are incurred only because an entity entered into the contract (for example, payments to subcontractors).

98 An entity shall recognise the following costs as expenses when incurred:

general and administrative costs (unless those costs are explicitly chargeable to the customer under the contract, in which case an entity shall evaluate those costs in accordance with paragraph 97);

(b) costs of wasted materials, labour or other resources to fulfil the contract that were not reflected in the price of the contract;

(c) costs that relate to satisfied performance obligations (or partially satisfied performance obligations) in the contract (ie costs that relate to past performance); and

(d) costs for which an entity cannot distinguish whether the costs relate to unsatisfied performance obligations or to satisfied performance obligations (or partially satisfied performance obligations).

Amortisation and impairment

99 An asset recognised in accordance with paragraph 91 or 95 shall be amortised on a systematic basis that is consistent with the transfer to the customer of the goods or services to which the asset relates. The asset may relate to goods or services to be transferred under a specific anticipated contract (as described in paragraph 95(a)).

100 An entity shall update the amortisation to reflect a significant change in the entity's expected timing of transfer to the customer of the goods or services to which the asset relates. Such a change shall be accounted for as a change in accounting estimate in accordance with IAS 8.

101 An entity shall recognise an impairment loss in profit or loss to the extent that the carrying amount of an asset recognised in accordance with paragraph 91 or 95 exceeds:

(a) the remaining amount of consideration that the entity expects to receive in exchange for the goods or services to which the asset relates; less

(b) the costs that relate directly to providing those goods or services and that have not been recognised as expenses (see paragraph 97).

102 For the purposes of applying paragraph 101 to determine the amount of consideration that an entity expects to receive, an entity shall use the principles for determining the transaction price (except for the requirements in paragraphs 56–58 on constraining estimates of variable consideration) and adjust that amount to reflect the effects of the customer's credit risk.

103 Before an entity recognises an impairment loss for an asset recognised in accordance with paragraph 91 or 95, the entity shall recognise any impairment loss for assets related to the contract that are recognised in accordance with another Standard (for example, IAS 2, IAS 16 and IAS 38). After applying the impairment test in paragraph 101, an entity shall include the resulting carrying amount of the asset recognised in accordance with paragraph 91 or 95 in the carrying amount of the cash-generating unit to which it belongs for the purpose of applying IAS 36 *Impairment of Assets* to that cash-generating unit.

104 An entity shall recognise in profit or loss a reversal of some or all of an impairment loss previously recognised in accordance with paragraph 101 when the impairment conditions no longer exist or have improved. The increased carrying amount of the asset shall not exceed the amount that would have been determined (net of amortisation) if no impairment loss had been recognised previously.

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