New IASB/FASB Revenue Recognition Requirements

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Industry perspective

TELECOMS OPERATORS ARE FACED WITH THE CHALLENGE OF COMPLYING WITH A FORTHCOMING IFRS THAT WILL ALTER HOW THEY RECOGNIZE REVENUE. THE REGULATION IS SOON TO BE RATIFIED AND WILL COME INTO EFFECT IN 2017 SO OPERATORS FACE REAL URGENCY IN ESTABLISHING SYSTEMS AND APPROACHES TO ACHIEVE COMPLIANCE.

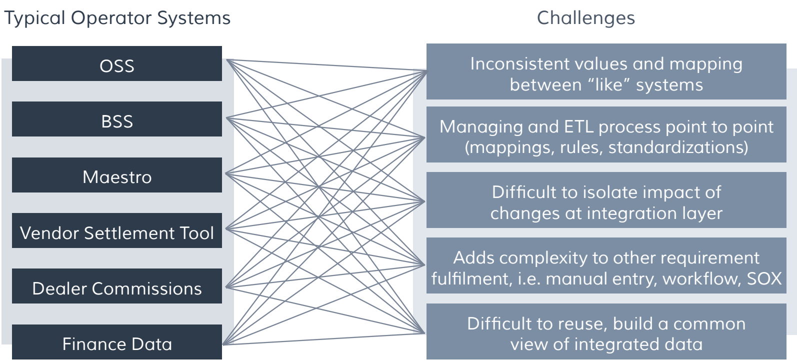
That will not be easy to achieve. The new FASB/IFRS revenue recognition rules presents a distraction for operators from managing their day-to-day business that they can ill afford given the competitive environment they operate in.

Operators have complex business models that rely on delivering multiple service and product components that are bundled together in packages and delivered to users over a life of a contract, which can last 24 months or longer.

Operators' worries

Operators current systems are not flexible enough to handle these changes. It will require significant investment to deploy new, compliant processes at a time when operator's investment is committed to rolling out 4G wireless and superfast fixed broadband networks.

The complex IT and back office architectures of operators mean that ripping out and replacing systems is unworkable because of how this impacts the running of the business and the length of time it would take.



It is not uncommon for replacement of a single system to take more than two years and, with the regulation coming into force in 2017, it's clear there simply won't be enough time to complete a multi-system transformation project of this magnitude.

In order to achieve compliance, operators need to change processes for accounting, including identifying individual performance obligations and calculating proper transaction prices. This requires determining and storing the fair value of handsets and having the ability to manage lifecycle events such as contract modifications.

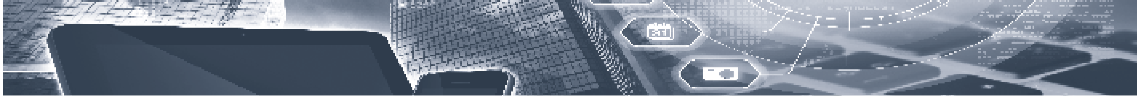
> *"If the proposed IFRS are issued as previously exposed, we would have serious concerns over the ability of our industry to implement required changes in a suitable time frame."*
>
> *– Open letter from a group of operators to the Accounting Standards Board on effective dates and transition methods.*

Accounting for millions of contracts

AS WITH ANY ACCOUNTING STANDARD, THERE IS A BURDEN TO PROVE COMPLIANCE. THAT IS DIFFICULT FOR SMALLER BUSINESSES. THIS IS PARTICULARLY DIFFICULT FOR OPERATORS BECAUSE THEY HAVE MILLIONS OF CUSTOMERS AND LARGE PRODUCT PORTFOLIOS.

Some of the largest operators have noted the multi-million dollar investment burden that might be required and made representations to the IASB emphasising the specific challenges of the regulation to a telecoms operator. In an open letter, operators stated it could cost about €20m to change each and every billing system and possibly take 10 years to implement.

These representations have been unsuccessful, and the standard sets out that operators must account revenue for each performance obligation within a contract – or contract portfolio.



To explain the complexity, consider how an operator must account for the revenue associated with providing an individual subscriber with an iPhone on a 24 month contract. If the customer alters their plan or decides to cancel in month 16, the operator will have accounted for only two-thirds of the cost of the device against the revenue from the service it has provided. This will require calculating the correct adjustments for not only the contract asset accounts (associated with the iPhone) but also to those for the related voice and data plans.

It is easy to see how accounting for revenue under the new rules will be difficult to manage across millions of contracts, each with a handful of individual performance obligations and each subject to lifecycle events such as contract modifications, terminations and bolt-ons.

1 JANUARY 2017

The IASB is currently suggesting an adoption date that is potentially as early as financial periods commencing 1 January 2017

1 JANUARY 2015

For entities with two comparative years in the financial statements, this implies an opening balance sheet as of 1 January 2015.

1 JANUARY 2013

Since information on open contracts will be required to create the opening balance sheet and contract terms might typically be considered to be 24 months, this implies enhanced information would be required in respect of contracts from 1 January 2013.

The time to act is now

OPERATORS MUST REPORT USING THE NEW RULES BY 1 JANUARY 2017 SO THERE IS NOT MUCH TIME LEFT FOR OPERATORS TO ACT.

As resistant operators have consistently pointed out, a two-year timeframe is insufficient for an operator group to re-engineer existing systems to address the requirements of the standard. Many large operators have experience with large scale ERP projects, and know the cost and time to implement large-scale projects.

Further time pressure exists because, in order to ensure investors receive meaningful metrics on business performance, operators will need to continue to report in traditional ways alongside the new method. A period of one to two years of reporting in dual standards will be necessary to effect a smooth transition to the new standard. That effectively brings the deadline forward to 2015.

CASE STUDY

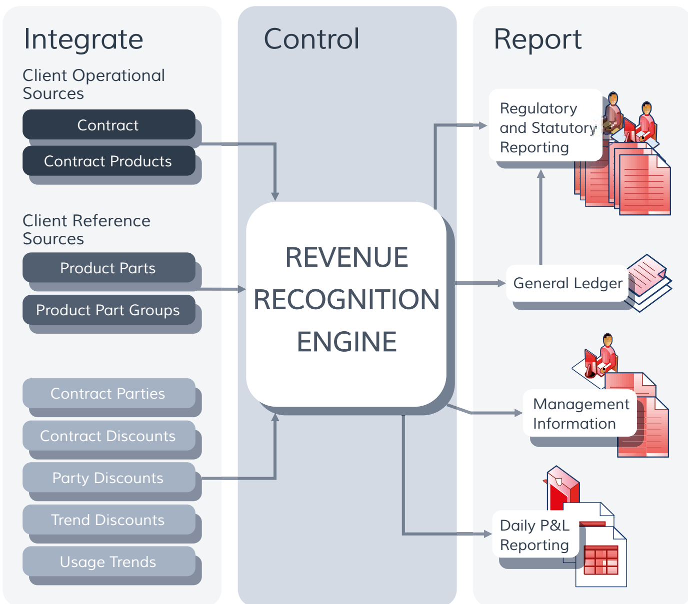
A proactive operator’s chosen approach

Most operators have spent the last year or two studying and thinking about the issue, with few taking definite action so far. However, one leading North American wireless voice and data communications service provider has decided to get ahead of the game, working with Aptitude Software, even before the standard was ratified.

This operator, like many others, was worried about the ability to change existing OSS/BSS systems and bring together all of the necessary data such as data on individual performance obligations or transaction prices. The team spent months debating whether they should develop representative portfolios or whether it was feasible to track individual contracts and performance obligations. Ultimately the operator realized that regardless of which model they pursued, it would be necessary to track the individual obligations and transaction prices associated with contracts or contract portfolios.

Over
9m
subscribers

- Track contracts including individual performance obligations
- Integrate data with single sourcing layer
- Manage revenue recognition rules and lifecycle events like contract modifications
- Model revenue recognition events



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CASE STUDY (continued)

Key to the group's progress was the decision to separate the choice of what system they would use to calculate revenue recognition adjustments from the wider data integration projects. The Aptitude Software platform provides the opportunity to track and model contracts, implement revenue recognition rules and manage lifecycle events. They plan to test a revenue recognition rules engine with representative data as a sub-team progresses with the data integration project.

Ultimately, the team will connect the new revenue recognition engine with a range of data sources – integrating granular contract-level data as well as existing accounting systems.

The outcome is that the North American operator will be able to address the new standard without ripping out or replacing existing back office infrastructure. Deployment can happen in a phased approach and the new system can be adapted for any new rules or requirements.

Lead the charge

ALTHOUGH THE CHALLENGE OF COMPLIANCE MIGHT SEEM OVERWHELMING AND UTTERLY TRANSFORMATIVE IT IS FUNDAMENTALLY A DATA ISSUE.

Leading companies in many other industries, such as financial services, digital media and retail, are characterised by a high volume of complex contracts and have faced similar reporting issues. These firms are also subject to the new IFRS.

Online digital media businesses for example, have had to build systems to account for millions of transactions and complex, multi-part product bundles.

The rise of high-volume digital businesses has brought new enterprise software providers to the fore with the dual capabilities of handling massive volumes of data and delivering finance-accurate accounting outputs.

"We have been working with large and leading firms in all of these industries to deploy systems to streamline financial accounting and add much needed flexibility to effectively address new reporting requirements. Addressing the new IFRS standards is similar in nature to what large investment banks have faced with regards to increased regulatory reporting in the banking sector."

Explains Tom Crawford, President of Aptitude Software.

Who can help?

"Handling data in such high volumes along with complex contracts is nothing new...addressing the new IFRS standards is similar to what large investment banks have faced in regard to changed regulatory reporting."

Tom Crawford,
President of Aptitude Software

Many operators have started to consider their choices for implementing a solution, including getting quotations from internal development teams and hearing pitches from large ERP vendors and specialist software providers.

However, regardless of the direction of travel, each approach will be challenged by the technological and cultural disconnects that exist between telecoms-specific back office systems – or OSS/BSS. OSS/BSS often don't speak each other's language and use different data models and are therefore hard, expensive or risky to change.

Some new software products, such as Aptitude Software's Revenue Recognition Engine, represent a less invasive approach, providing operators with the ability to slot new logic into existing architectures.

These systems can draw cleansed and formatted data from existing billing, customer and reference data systems and fluidly connect to existing General Ledgers and financial reporting systems, acting as a middle layer and minimizing the impact on an operator's existing architecture.

This is of immense importance because these existing systems are often mission critical for operators' continued operations. A further benefit of the less invasive approach is accelerated time to operation – critical because, now the standard is ratified, the clock is ticking on the 2017 deadline for compliance.

Conclusion

Operators are challenged to achieve compliance with new revenue recognition rules within a tight timeframe. However, at heart, this is a data issue and one that is well understood by large companies in other industries. By adopting a centralised approach of bringing all the outputs required from disparate systems into a single point of control, operators can meet the compliance deadline without disrupting their core IT systems.

For more information email info@aptitudesoftware.com

About Aptitude Software

Aptitude Software provides finance applications to many of the world's leading firms. Customers use our software to achieve financial insight, control and transparency. We believe the ability to access and analyze granular, finance-accurate data is the missing ingredient in the analytics infrastructure of many large companies.

Uniquely, Aptitude Software enables enterprises to build applications around their data, often leveraging the processing and data handling capabilities of the enterprise data warehouse.

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