PARTICULARTS REGARDING THE ACCOUNTING RECOGNITION OF REVENUE – THE CASE OF MOBILE OPERATORS

Iuliana Oana Mihai  
oana.anghel@ugal.ro  
Riana Iren Radu  
raduriana@yahoo.com  
“Dunarea de Jos” University of Galati, Romania

For the current economy, the sector of telecommunications which includes mobile telephony is one of the most important worldwide. World leaders of this sector are among the companies present in Romania, in terms of income and as financial performance. The range of services offered by mobile operators diversified and greatly increased in recent years, so that there are a wide variety of business models, which are subject to different policies. Experts in the field have hoped that the adoption of IFRS will help increase clarity in the sector, but the results so far are uncertain. The overall objective of this paper focuses on the analysis of the telecommunications industry accounting practices, focusing on specific issues of the mobile market. To this end we intend to analyze aspects of the history and evolution of mobile telephony market, national and international accounting regulations applied to the mobile operators, and evaluating accounting practices applied in the mobile telephony companies.

Keywords: income, mobile, IFRS

Introduction

Communications industry encompasses traditional fixed telephony services, but also mobile telephony, data transmission, Internet, television, etc. From an accounting perspective, companies in the communications industry face a number of challenges resulting from the continuous and accelerated development of technologies. The overall objective of this paper focuses on the analysis of the telecommunications industry accounting practices, focusing on specific issues of the mobile market. To this end we intend to analyze aspects of the history and evolution of mobile telephony market, national and international accounting regulations applied to the mobile operators, and evaluating accounting practices applied in the mobile companies.

The services provided by mobile operators on the Romanian market have evolved to an amazing pace in the past decade. Important companies in the field are trying to expand operations in areas "related" to those in which they have a tradition or were originally released. The offer has diversified greatly and customers are provided with services such as games, music, internet and the latest innovation in the field, 4G technology. The mobile phone industry has grown dramatically in recent years, in such a way that it is estimated that at the end of 2013, globally, there were 7.1 billion mobile phone users.

Thanks to this diversified offer and the rapid development of mobile telephony industry, there were specific accounting issues that have been addressed in national regulations and international standards.

History and evolution of the mobile market in Romania

Human needs represent people's desire to have, to know, to believe and to acquire goods (Angelescu, et al., 2009). They are divided into basic needs and luxury needs. Shortly after the appearance of mobile phones, they were a necessary luxury because their prices were pretty high compared to incomes of the population and not everyone could afford one. From an enviable luxury, mobile telephony has become in more than a decade the most common method of communication in Romania and almost worldwide. From the first "brick" in the '90s to the most intelligent touchscreen and from the expensive minute conversation to thousands of minutes included in your subscription, mobile development is outstanding. With the development of mobile telephony market, they have become more accessible and people's need to communicate with distant anywhere and anytime has become a vital one. Mobile telephony has gained more ground both globally and nationally.
It can be seen from the chart above that the mobile phone industry has conquered the world, quickly and securely, starting from 23,482 users in 1980 and reached towards the end of 2013 a surprising number of users, 7.1 billion respectively.

In Romania, the first reference to the number of users dates back to 1993 when we started from a number of 800 Romanian using a mobile phone, and in the end of 2013 it was reached the number of 22.6 billion. The evolution of the number of Romanian graphics that were used throughout history telecommunications mobile phones in Romania is shown in Fig. 2:

At the end of 2013, the world had over 7.1 billion people and about the same number of mobile phone users at the end of 2013. The country with the largest number of users of mobile services is China56 (over 1.2 billion users), which is explained mainly by the fact that this country is one of the leading manufacturers of mobile phones and specific accessories.

For the current economy, the sector of telecommunications including mobile telephony is one of the most important worldwide. World leaders of this sector are among the companies present in Romania, in terms of income and as financial performance.

The large number of potential users, as well as the high degree of acceptance of new technologies, shows great potential for growth of the mobile telephony market. In other words, there will be an increasingly greater demand for quality products with a design of increasingly sophisticated facilities becoming more and more complex. The Romanian mobile market is characterized by strong competition between the three mobile operators Vodafone, Orange and Cosmote. Statistically, Orange has a larger number of customers, due to its almost monopolistic presence on poorer markets where Vodafone and Cosmote are less present.

The extraordinary impact of digital mobile telephony in Romania is now both an economic and financial phenomenon and a social phenomenon.

The fact that the mobile industry is an important sector that affect GDP growth is no secret, given the importance of this market.

In recent years, the percentage of mobile telecommunications sector at a global level has undergone large swings, ranging from 5.6% in 2009 and 3% in 2013. In terms of GDP in Romania and

56 Source: geocurrents.info
the percentage of mobile industry, this sector registered percentages between 7% in 2009 and 2.5% in 2013 \(^57\) (fig. nr. 4).

![Fig. nr. 4 – Evolution of the mobile telephony in global GDP and national Source: www.business.ro](image)

Literature Review

In literature there are few studies on the impact of IFRS on companies in the telecommunications industry (Alsuhaibani, 2012). The few existing studies on this topic have focused on the impact of mandatory adoption of IFRS rules on the quality of accounting information. Accounting information quality can be affected positively and negatively by the mandatory adoption of IFRS and is influenced primarily by reporting earnings and therefore income and expenses. In this context revenue recognition accounting policies becomes crucial (Nulla, 2014).

Busaca and Maccarone (2008) studied whether and to what extent the adoption of IFRS improves the quality of accounting information, especially on intangible assets. They analyzed the application of key elements related to intangible assets in accordance with IFRS on the company Telecom Italia. Their conclusion was that the use of indicators based on value improves the overall quality of accounting information.

Mario et al. (2010) studied the compliance of accounting policies relating to business combinations and goodwill depreciation with the rules IAS / IFRS, for a total of eight European companies in the telecommunications industry. Their conclusion was that the mandatory adoption of IFRS by listed companies in Europe has generated challenges regarding the accounting and reporting of information on those aspects. On the other hand, globalization has generated impressive growth of international mergers and acquisitions of companies. Multinational companies, particularly in the telecommunications sector, are using international acquisitions and mergers as quick and practical way of entering foreign countries, and the telecommunications sector was marked by significant transactions of this kind. In this context, for the multinational companies in the telecommunications sector, goodwill is the most important asset reported in the financial statements.

Several studies developed by the 4 audit and accounting firms, KPMG (2010), (2014), PricewaterhouseCoopers, Ernst & Young (2009) and (2012) and Deloitte analyzed a number of important accounting issues for companies in the telecommunications sector intending to adopt IFRS, such as the recognition of internally developed intangible assets, licenses, revenue recognition, customer loyalty programs, impairment of assets, etc.

The accounting treatment of revenue recognition on mobile operators

Rapid and profound changes taking place in the telecommunications industry generated by technological developments, call for major changes and how operators measure and report accounting information. The range of services offered by mobile operators and diversified greatly increased in recent years, so that there are a wide variety of business models in use in different countries. Experts in the field have hoped that the adoption of IFRS will help increase clarity in the sector, but the results so far are uncertain. IFRS do not provide clues regarding the accounting treatment of mobile or subscriber acquisition costs and industry practices diverge.

\(^57\) National Institute of Statistics; www.insse.ro
One of the most delicate and challenging aspects in the accounting domain which mobile operators are facing is the recognition of revenue. Combinations of service delivery, packet fixed telephony, mobile telephony, television and Internet create challenges for determining income in each period and for each category.

Until recently, IAS 18 - "Income" was the main accounting standard that could be used by telecom operators in accounting for their wide range of revenue generating transactions. Despite various changes over the years, the basic framework of IAS 18 has been in effect since 1993, but while the standard contains general principles related to revenue recognition, lack of guidance in its application has led to a degree of inconsistency in the recognition revenues for companies in this sector.

In 2006, the Committee on International Financial Reporting Interpretations (IFRIC) refused to take on its agenda the accounting of phone sales with a contract for services. Although the issue was directly relevant to telecommunications, the Committee noted that there is a wide range of contracts on the market and that any guidelines should be based on professional judgment. In the absence of specific instructions, many telecommunications companies have turned to the detailed guidance in US GAAP in establishing appropriate accounting policies for revenue recognition.

However, recently, the IASB published a series of IFRIC interpretations that provide a well defined framework for recognizing revenue according to IFRS as they deal with revenue generating operations, which have more than one component. These interpretations now serve as a starting point in developing appropriate accounting policies, even if they are not necessarily specific to the telecommunications sector: IFRIC 13, IFRIC 15, IFRIC 18.

In the telecommunications sector, the suppliers usually provide customers with equipment when signing a contract for services. The operator may charge the customer the full price for the equipment, a subsidized price, or sometimes, there will be no separate fee. It is unlikely that sales of equipment such as mobile phones, modems, represent the main operating activity in telecommunications, but they can be a significant revenue stream for the company.

IAS 18 does not provide detailed guidance on how the components should be identified separately in such contracts.

However, the following separation criteria are recently included in policies issued by IFRIC 18 and, by analogy we consider them relevant for operators of mobile services:

- component has independent value for the customer; and
- the fair value of the component can be measured reliably.

If an item which is part of a transaction is not a separately identifiable component, then it is an integral part of the remaining components of the transaction.

The second step in the recognition of revenue is to assign them for the components that have been identified separately, looking at them as a whole under the arrangement.

While the greater part of IAS 18 does not refer to the allocation of income for each component there are no specific allocation instructions included in interpretations such as IFRIC 13 in terms of
customer loyalty programs and IFRIC 15 in terms of sales of real estate. In this interpretation, the income may be distributed by components using any of these methods:

- the relative fair value (fair value method)
- the fair value of the undelivered component (residual method).

Using relative fair values, the total amount is allocated to the various components based on ratio between the fair value of the components, while in the case of the residual method, the undelivered components are measured at fair value, and the remaining consideration is allocated to the components delivered.

IAS 18 also refers to the allocation of income for undelivered components based on the expected cost plus a reasonable margin (cost-plus-margin method).

Revenue is measured at the fair value of the consideration received, taking into account any trade discounts and volume. The amount of revenue recognized is updated to present value. After identifying the separate components in an arrangement and the consideration of income allocated to each of these components, revenues are recognized when the relevant criteria are met for each component. There are a number of criteria to be met for revenue to be recognized, for the sale of goods and services:

- As regards the sale of goods, the key requirement for mobile operator services is that risk and ownership have been transferred; usually this happens at a single point in time. Thus, for example, revenue earmarked for sale in advance of a receiver is recognized when the equipment was delivered to the customer and has been activated, if necessary.
- In terms of services, a key requirement for a mobile service operator is to analyze the time when the service is provided. Therefore, revenue is recognized based on the time to complete the transaction. For example, a fixed fee in advance to provide a service in progress is recognized on a straight-line basis over the contract period.

**Fair value method**

There is no requirement under IFRS for the fair value of the separately identifiable components of an agreement which are to be determined solely by reference to an active market.

The best assessment of fair value is the price charged by telecommunications when an identical product or service is sold independently. This was, in fact, the model illustrated in the following example, in which there is presented an assumption that both the components delivered (phone) and the undelivered component (monthly subscription) could be measured by reference to the agreements with one component concluded by the telecommunications.

If the company is unable to determine fair value by reference to its own products and services, the following relevant benchmark is the price of a similar product or service sold by a competitor, adjusted for significant differences between products or services.

Operators of mobile services generally charge lower fees for service packages than the costs that would be entailed by each separate component. Fair value method allocates this reduction for all separately identifiable components. In total, revenue is allocated based on the relative fair values of all deliverable components of the engagement.

**The residual method**

The residual method is to evaluate components delivered and undelivered at the retail price according to the agreement. In our opinion, the fair value method, in which the components supplied are measured at fair value and the discount granted is allocated proportionally for the components of the commitment is not an adequate basis for the income distribution. Applying the fair value can lead to excessive income distributed to the components delivered in a transaction by applying all cuts. One of the criteria that must be met before revenue recognition is specified in IAS 18 which states that "it is probable that the economic benefits associated with the transaction will flow to the entity".

In some cases, this condition can be met, because:

1. The contract includes a cancellation fee which, together with any money received or receivable, relates to revenues recognized in advance; and
2. The company intends and is able to apply the cancellation fee.

However, IAS 18 does not require such a strict interpretation to be applied, and a company should assess the probability based on its expectations from the contract as a whole; usually this can be achieved based on previous experience with similar customers and contracts.
We chose to exemplify the parallel between the two methods of revenue recognition for a better synthesis, understanding and highlighting the characteristics of each method.

A practical example of revenue recognition accounting policies

A mobile operator launched a promotional campaign, according to which new customers who sign a contract for 12 months receive a Blackberry at a price of 150 lei, VAT included, with a monthly subscription of 40 lei, VAT included. The operator does not sell the Blackberry phone without a contract, but the phone is available for sale to retailers at a price of 450 lei.

The revenue recognition plan is as follows:

a) *fair value method*

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b) *the residual method*

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Conclusions

Mobile service operators continuously reassess their business model, constantly renewing the range of services and devices offered to the customers. The assessment of the impact of these new accounting services brings new challenges for the accounting professionals in the sector.

Revenue recognition is a complex issue for the communications industry. This complexity arises from the different types of services. On the other hand, the domain is continuously developing and new business models will probably be adopted by operators, especially converged services. Differences between radio and telecommunications, including fixed-line and wireless, will fade in the coming years, and this will bring new challenges in the field of revenue recognition accounting.

References