Working Draft:

Telecommunications Revenue Recognition Implementation Issue

Issue #15-1– Portfolio Accounting

Expected Overall Level of Impact to Industry Accounting:
Significant

Wording to be Included in the Revenue Recognition Guide:

Introduction

1. Per FASB ASC 606-10-10-4, the portfolio approach is a practical expedient that an entity may choose in accounting for a group of contracts collectively as opposed to individually if the entity reasonably expects the impact would not differ materially. This approach was suggested as an alternative for entities that have a large volume of similar contracts with similar classes of customer (based on BC488(a) of ASU 2014-09) to reduce the complexity and cost of applying the new standard.

2. Discussed below are various factors to be considered when determining the appropriate composition of a portfolio as it relates specifically to the telecommunications industry.

3. There are a number of application issues that can arise when applying the portfolio method of accounting for telecommunication companies. Initial identification of portfolios, allocation of transaction prices to performance obligations, contract modifications, the effects of time value of money, contract asset impairments and unique reporting and disclosure requirements are addressed in this section. In the end, for portfolios of revenue, given the large volume of contract types and performance obligations, significant promotions and the number of contract modifications that occur for telecommunication contracts, companies should consider the various challenges in meeting the requirements set forth for applying a portfolio approach, particularly resulting from the nature of the telecommunications plans and pricing conventions in the United States, including, but not limited to, single service plans, multiple services plans, group/family plans and frequent contract modifications. For other companies, and for portfolios of costs, the challenges may not be as significant. In all cases, the application of the portfolio approach requires the determination of whether the accounting results of a portfolio differ materially from applying the guidance to the individual contracts within that portfolio. There are no specific criteria provided in FASB ASC 606 to assist financial statement preparers with making that conclusion, so judgment will be required to evaluate whether the challenges associated with the portfolio approach outweigh the benefits. Given these

complexities, practical examples that address the comprehensive application of the portfolio approach are beyond the scope of this publication.

Definitions/Scoping

4. The portfolio approach may be applied to all contracts within the scope of FASB ASC 606. Whether the individual contract approach is applied or the portfolio approach, the results should not yield materially different results to the financial statements of the entity.

5. The guidance allows the entity to exercise judgment when creating the portfolios. BC69 of ASU 2014-09, discusses the need for "similar characteristics" among the contracts (or performance obligations) to be grouped together, but permits the application of a "reasonable approach to determine the portfolios that would be appropriate for these types of contracts".

6. FASB ASC 606-10-10-4 permits a company to create portfolios of either performance obligations or contracts as long as they have similar characteristics and the expected outcome of the accounting for the portfolio is not materially different from the individual contract approach. For example, assume an entity sells bundled services including equipment (e.g., a wireless handset, a wireline phone, a cable set-top box, etc.) and network services. That entity may wish to apply the portfolio approach at the contract level. This approach could for instance provide a practical expedient in allocating transaction prices to dissimilar performance obligations (e.g., handset vs. service) within similar contract portfolios (e.g., bundled wireless contracts for 24-month terms entered into in the month of January) or in determining variable consideration (see paragraphs 22 to 36). Alternatively, an entity is permitted to create separate portfolios comprising the performance obligations, for example, a portfolio group of sold wireless handsets and another portfolio group comprised of separate wireless services for similar contracts that contain both performance obligations. In the case of portfolios of performance obligations, the entity would first have to determine and allocate the transaction price to each of the performance obligations in the contract, either at the individual contract level or at the portfolio contract level.

7. FinREC believes that the portfolio approach may be applied to some, but not all, of a company's revenue streams. For example, a company could apply a portfolio approach to its residential customer contracts and apply an individual contract approach to its business customers. The Boards did not provide specific guidance for the criteria to be used in the creation of the portfolios. There is no requirement that a single accounting policy decision be made. For example, a company may have one revenue stream that involves complex installation and sales of components that are uniquely designed to meet the various customers' needs and another revenue stream that comprises homogenous equipment and services. In this case, it would be acceptable to create a portfolio for homogenous equipment and service contracts and account for the unique customer contracts at the individual contract level. FASB ASC 606-10-10-3 does state that an entity must apply the new guidance, along with any practical expedients, "consistently to contracts with similar characteristics and in similar circumstances." A company must adhere to this principle when developing their portfolios to ensure consistent treatment across similar revenue streams. In all cases, the results of the practical expedient must not materially differ from applying the guidance to the individual contracts (FASB ASC 606-10-10-4).

8. FinREC believes that the portfolio approach may be applied to certain aspects only of accounting for a contract with a customer (i.e., "partial" vs. "full" portfolio approach). This view is supported by Example 22 of FASB ASC 606 (FASB ASC 606-10-55-202 to 55-207) that provides an illustration of a partial use of the portfolio approach. In this example, a portfolio approach is followed for estimating the rate of returns (i.e. measuring the transaction price and variable consideration). However, other aspects of the revenue guidance, such as timing of recognition for instance, are applied at an individual contract level in this example.

9. Since the portfolio method was designed as a practical expedient, an entity should use its own discretion and judgment in applying it to some or all of the requirements of FASB ASC 606. For example, some telecommunication entities may want to use a portfolio approach to measure only the transaction price, estimate variable consideration or allocate the transaction price to performance obligations in a contract, while still assessing contract existence and recognition criteria at an individual contract basis. Some implementation issues of applying a "full" vs. "partial" portfolio approach are further discussed in paragraphs 22 through 36.

10. The guidance in FASB ASC 606-10-10-4 does not specifically apply to the cost elements of a contract. Further, the portfolio approach is not specifically mentioned in FASB ASC Subtopic 340-40 – "Other Assets and Deferred Costs – Contracts with Customers." However, the Boards developed the guidance on contract revenue and costs as part of a unique project with an overall objective. As a result, IFRS 15 includes the revenue and cost guidance in one place and the Boards have not discussed or noted the scope of the portfolio practical expedient to be a difference between IFRS and US GAAP. FASB ASC 606-10-10-4 states an entity may apply "this guidance" to a portfolio of contracts and the ASC's (inclusive of the Board's guidance set forth in Subtopic 340) changed existing practice with respect to contract acquisition and fulfillment costs. Therefore, FinREC believes that the portfolio approach can be applied to the costs of a contract as well as the revenue, assuming the result of applying the portfolio method would not differ materially from applying the guidance to the individual contracts within that portfolio.

11. FinREC also believes that the portfolio approach can be applied only to the cost elements of a contract while the revenues are accounted for on a contract by contract basis. There is no requirement to apply the portfolio method to all elements of a contract. For example, assume a company sold multiple types of three-year maintenance agreements related to the purchase of varying types of phone systems. The contract types may include significant contract acquisition and fulfillment costs due to complex installation or provisioning, and the allocation and attribution of the overall transaction price may vary given the allocation requirements under the relative selling price approach of the standard. Accordingly, the company may choose to account for the contract acquisition and fulfillment costs in a single portfolio and separately account for the attribution of the contract's revenue on an individual contract basis. Such an approach may; however, result in the loss of the ability to accurately track and monitor each contract's margins.

12. Based on the views set forth in paragraphs 10 and 11, FinREC also believes that an entity could account for the costs to obtain and fulfill a contract using different methods (i.e., portfolio approach for one and individual contract approach for the other). One example that may give a company a reason to do so is a situation whereby the contract acquisition costs have a determined life commensurate with the stated contract life (a sales commission is paid for the original acquisition of a contract and a separate commission is paid for a renewal of that contract), but the fulfillment costs have a life longer than the contract life, due to expected renewals. In another example, a company may include the costs to fulfill a contract (e.g., direct labor, direct materials, etc.) as a part of its internal overall margin analysis of the contract and, so, contract-level accounting for contract specific costs is necessary. However if the costs of obtaining a contract (e.g., sales commissions) on an individual contract basis is less important for internally evaluating contract profitability, a portfolio approach for accounting for those costs would be acceptable and may be consistent with the company's internal reporting needs. In this situation, a company could choose to create a portfolio for the contract acquisition costs while individually accounting for the costs to fulfill a contract. While the guidance permits such an approach when the accounting for items at the contract level would not materially differ from a portfolio approach, a company does need to apply that approach consistently to all contracts with "similar characteristics."

Evaluating the concept of "similar characteristics"

13. The phrase "similar characteristics" as used in FASB ASC 606-10-10-4 is not explicitly defined. The Boards explained their rationale for including FASB ASC 606-10-10-4 in BC69-BC70 of ASU 2014-09 noting they did not believe that it was their place to specify how an entity applied the guidance to their contracts but based upon feedback from constituents decided to include the practical expedient to acknowledge that a portfolio approach would be a practical way to apply the guidance. The Boards specifically stated that an entity's judgment would be required in selecting the size and composition of the portfolio such that the entity would not expect the portfolio results to differ materially from the application of the standard to each specific contract.

14. Determining whether a portfolio of contracts or performance obligations have similar characteristics requires judgment. FinREC recommends that telecommunications companies consider the following when determining whether certain contracts have similar characteristics:

    a. Customer contracts comprise performance obligations with a similar pattern of recognition (for example, (1) a portfolio of contracts comprised only of performance obligations satisfied over-time or (2) a portfolio of "bundled" contracts, (i.e., contracts including a performance obligation satisfied over time and a performance obligation satisfied at a point in time such as a sale of a wireless phone combined with a wireless service agreement).

b. Customer contracts comprise similar goods or services within each contract. Characteristics to consider for a wireless company's service plans may include, for example, (1) only single-line plans; (2) only multi-line or family plans; (3) only voice plans; (4) only data plans; and (5) for contracts with hardware sales, plans that comprise simple or economy handsets vs. plans that comprise smart phone handsets. There may be a series of combinations of the above that may be similar based on a company's specific facts.
c. Customer contract terms show similarities, such as same contract duration (a portfolio of one-year contracts), same payment terms, same termination features, etc.
d. Customer contracts are within one reportable segment (for example, the same geographic location or same product grouping: for instance consumer/ business/ wholesale or wireless/ wire line).
e. Customer contracts are procured through the same sales channels (all direct or indirect sales, for example) or have the same credit profiles, for example, all prime/ sub-prime sales.
f. Customer contracts offer similar upfront discounts or other customer promotions.
g. Customer contracts generally are not modified or when modified result in prospective accounting.
h. Customer contracts are entered into at or near the same time (for example, the same month and possibly the same quarter).
i. For customer contracts with more than one performance obligation, ratios of the relative selling prices to the transaction prices are within the same range.
j. Customer contracts are managed on the same business system (for example, the billing system), which may indicate that they have similar characteristics.
k. When considering portfolios for accounting for contract costs: the expected duration of customer relationship and churn rates are close.

15. FASB ASC 280 "Segment Reporting" contains guidance on the aggregation of two or more operating segments into one reportable segment if the segments have "similar economic characteristics" and meet additional requirements. This phrase "similar economic characteristics" has been stringently applied in the aggregation of segments. FASB ASC 606 does not explicitly reference FASB ASC 280's criteria and therefore is not required to be considered. However, FinREC believes that considering FASB ASC 280 may be helpful in evaluating whether a portfolio has "similar characteristics."

16. A portfolio of contracts (or performance obligations) may include contracts (or performance obligations) that are reported in different reportable segments. This question may, for instance, arise when the company reports on a geographical basis. However, if portfolios cross segments, FinREC recommends carefully considering whether the principles set forth in determining that contracts have similar characteristics are met. Further, such a conclusion may impact the required disclosures and other allocations required in applying the segment guidance.

17. Some contracts with customers may be partially in the scope of FASB ASC 606 (for example, contracts that contain a lease element), such as managed services agreements that include a lease of equipment as well as telecommunications services. FinREC believes that an entity may apply the portfolio method to those contracts, for the elements of the contract that are in the scope of FASB ASC 606. The company would follow the guidance in FASB ASC 840 "Leases" to distinguish between lease and non-lease components and allocate the contract consideration according to the FASB ASC 840 requirements. The portfolio guidance then would explicitly apply to the non-lease components required to be accounted for under FASB ASC 606.

18. FinREC believes that a portfolio may consist of contracts with performance obligations that are delivered at a point in time and performance obligations that are delivered over time, as long as the portfolio consists of contracts that have similar multiple product or service offerings. For instance, a portfolio could consist of cellular phone service contracts that include both the sale of a handset and the provision of voice and data services over a period of time. The transaction price would still need to be allocated to each performance obligation in the contract.

19. FinREC believes that contracts that contain performance obligations with dissimilar patterns of revenue recognition would not typically be expected to meet the "similar characteristics" concept. For example, a 24-month contract with both a handset and voice and data services typically would not be grouped with a month-to-month contract that has only voice and data services. Alternatively, when a contract includes several performance

obligations (for example, a handset and voice and data services), similar types of performance obligations could be grouped into a portfolio.

What does "not differ materially" mean and when should it be assessed?

20. In BC69 and BC287 through BC293 of ASU 2014-09, the Boards acknowledged that an entity would need to apply judgment in selecting the size and composition of the portfolio in such a way that the entity reasonably expects that the application of the revenue recognition model to the portfolio would not differ materially from the application of the model to individual contracts or performance obligations. The Boards indicated that they did not intend for an entity to quantitatively evaluate each outcome and, instead, the entity should be able to take a reasonable approach to determine the portfolios that would be appropriate for its types of contracts.

21. Companies are required to assess whether their financial statements are materially correct with respect to both interim and annual financial statements. That requirement exists regardless of whether the portfolio method is applied. Therefore, FinREC believes that the difference between applying the portfolio method and accounting for individual contracts may have to be evaluated at contract inception and on an ongoing basis. The amount of effort required to make a conclusion on an interim or annual basis will depend on a company's specific facts. For example, simple portfolios may require little effort and evaluation to support the conclusion that the portfolio method does not differ materially from the individual contract approach, whereas more complex portfolios may require a more rigorous evaluation to support a similar conclusion. FASB ASC 606-10-10-4 and BC69 of ASU 2014-09 indicate that a quantitative analysis is not required every period. However, FinREC believes that management must have basis to conclude that the difference between the portfolio method and individual contract method have not materially changed over time.

Implementation issues to consider when applying portfolio accounting

22. While conceptually simple, application of the portfolio approach raises questions that may be challenging for financial statement preparers. In the telecommunications industry, there are a handful of significant implementation questions that arise. The following are a number of items that an entity should consider: 1) determining how to evaluate whether the portfolio approach results in a material difference from the individual contract approach including the determination of materiality itself (as previously discussed in paragraphs 13 through 21); 2) the overall approach to allocating the transaction price to multiple performance obligations including the impact of variable consideration on the transaction price; 3) the approach to applying the contract modification guidance to a portfolio; 4) the application of the portfolio approach to deferred contract costs, including contract asset impairment; and 5) application of the significant financing component guidance.

<u>Using a portfolio approach to allocate the transaction price to multiple performance obligations</u>.

23. This item is important as performance obligations that may otherwise be identical may be allocated varying amounts of the transaction price. An example may be the sale of a wireless handset and a service for which there are two performance obligations. Contract 1, for example, comprises a wireless handset sold at a discounted price of $500 with a standalone sales price of $600 and a 24 month contract with a monthly service fee of $45 (a fee that is the standalone sales price for such a plan). Contract 2, for example, comprises the same type of wireless handset (again, sold at a discounted price of $500 and a standalone sales price of $600) and a 24 month contract with a monthly service fee of $75 (a fee that is the standalone sales price for such a plan). In these examples, the amount allocated to identical wireless handsets varies under a simple application of the relative selling price approach. FinREC believes that while a portfolio approach used in the initial allocation of the transaction price may be one of many ways to apply the practical expedient, the prevalence of modifications in some businesses could make maintaining those portfolios challenging. An example of using a portfolio approach for the initial allocation follows.

24. There are many ways a company may choose to apply the portfolio approach to allocating transaction prices to a portfolio of contracts. However, in all cases, a company must adhere to the principles in FASB ASC 606-10-32-28 through 32-41 and ensure that any approach is carefully evaluated such that a conclusion can be reached that there is no material difference to the individual contract approach.

25. Using a portfolio allocation factor to allocate revenue to the various performance obligations in a bundled arrangement (e.g., wireless contract with subsidized handset) is illustrated in the following example. One practical method would be to determine a single overall portfolio allocation factor, which is applied to the stand-alone selling price (SSP) of each of the performance obligations in the portfolio in order to determine their respective allocated transaction price. This approach simplifies the application of the contract by contract approach in that one overall allocation factor is used for each performance obligation for every contract in the portfolio, as compared to performing separate allocation calculations for every performance obligation in every contract.

A contract's individual allocation factor is the ratio between the transaction price (TP) of the contract and the sum of the SSP of contract elements (this is the relative selling price approach as it would be applied in a contract by contract approach). Assume a contract includes both hardware (HW) and service elements (SVC), the calculation would be:

$$Allocation\ factor = \frac{TP}{SSP_{SVC} + SSP_{HW}}$$

The formula for the overall allocation factor of the entire portfolio (PF), then, is:

$$Allocation\ factor_{PF} = \frac{\sum TP}{\sum SSP_{SVC} + \sum SSP_{HW}}$$

The portfolio allocation factor sums the SSP for the service and hardware elements within the portfolio. The SSP of the service component represents the price for the service without hardware. The SSP of the hardware is the price when individually sold on a stand-alone basis.

In developing an appropriate allocation factor, an entity must consider the similarity in each of the contracts and the overall volume of each of the contracts, as further indicated below. Judgment will be required in determining how often the allocation factor will need to be calculated and applied (for example, where contracts and promotional offers change more rapidly a monthly determination of the allocation factor may be appropriate, whereas if contracts and promotions are not changing then an annual determination may be appropriate—in all cases, judgment is required).

Once the allocation factor is determined, it is then applied to the SSP of each performance obligation in a contract for that given portfolio. Revenue is then recognized in accordance with the attribution requirements of the overall revenue standard.

To illustrate, assume a portfolio is comprised of 300 contracts that split into three contract types, all containing a mobile phone and a service element. These contract types are by definition different but comprise sufficient similarities to be grouped within the same portfolio. Further assume that each type of contract is evenly represented in the portfolio (100 contracts fall in the Contract 1 category, for example).

Contract 1	Transaction price	Stand-alone selling price	Relative stand-alone selling price by means of the allocation factor
Mobile phone	360	500	470
Service	720	648	610
Total	**1,080**	**1,148**	**1,080**

Individual allocation factor (TP of 1,080 / SSP of 1,148):	0.940767

Contract 2	Transaction price	Stand-alone selling price	Relative stand-alone selling price by means of the allocation factor
Mobile phone	300	490	428
Service	600	540	472
Total	**900**	**1,030**	**900**

Individual allocation factor (TP of 900 / SSP of 1,030):	0.873786

Contract 3	Transaction price	Stand-alone selling price	Relative stand-alone selling price by means of the allocation factor
Mobile phone	400	700	592
Service	800	720	608
Total	**1,200**	**1,420**	**1,200**

Individual allocation factor (TP of 1,200 / SSP of 1,420):	0.845070

Portfolio:

Portfolio	Transaction price	Sum of stand-alone selling prices	Relative standalone selling price using an overall portfolio factor	Relative standalone selling price by means of individual contract factors	Spread	Spread %
Mobile phone	1,060	1,690	1,494	1,490	4	0.24%
Service	2,120	1,908	1,686	1,690	-4	-0.21%
Total	**3,180**	**3,598**	**3,180**	**3,180**	**0**	**0.03%**

Portfolio allocation factor (TP of 3,180 / SSP of 3,598):	0.883824

In this case, the overall portfolio allocation factor of 0.883824 is applied, for example, to the sum of the SSPs for the mobile phones ($1,690) to arrive at the stand alone selling price of $1,494. The same result occurs when you determine the percentage of the portfolio's mobile phone SSPs to the total SSPs ($1,690/$3,598 or 46.97%) then apply it to the total transaction price of $3,180 ($3,180 X 46.97% = $1,494).

Note that in the above example, if one contract type is proportionately more representative than the other two contract types in the portfolio (e.g., the Contract 1 category comprises 200 contracts and Contract 2 and 3 categories comprise 50 contracts each), a weighted approach would be appropriate.

In the example above, when the allocation factor is applied on a portfolio basis, minimal differences arise as compared to the contract by contract approach (as demonstrated above in the "spread" column). Accordingly, the requirement that no material differences exist when applying the portfolio method would be met.

The difference (allocation difference) is minimized as the contracts within a portfolio are more homogeneous (meaning, the specific ratios of the relative selling prices to the transaction prices are close). As these differences increase, FinREC recommends that companies use appropriate judgment in defining portfolios to ensure the differences do not become material.

26. A telecommunications company may use an overall portfolio approach to account for more than just the allocation of the transaction price or estimate the impact of variable consideration. However, FinREC recommends that the entity consider all of the implications of applying such an approach including the allocation of the transaction price and related discounts to separate performance obligations and any related effect of contract assets and liabilities that may exist over the term of each contract, significant financing elements, contract modifications, etc. Such an approach may prove challenging, however in evaluating whether that approach materially differs from the individual contract method and raises further questions about its overall acceptability particularly if the underlying billing system cannot be reconciled to the amounts ultimately reported in the financial statements.

Applying the contract modification guidance to a portfolio of contracts.

27. Portfolios of contracts may comprise thousands of contracts that may be modified numerous times prior to their contract expirations.

28. The accounting for contract modifications under the portfolio approach will depend greatly on how a telecommunications company applies the portfolio approach. If the portfolio approach is used solely to allocate the contract's initial transaction price (meaning once the transaction price has been allocated to the contract's performance obligations, other accounting procedures are performed on an individual contract basis), then there would be no impact as each modification would then be accounted for at the individual contract level.

29. If, however, the portfolios are used for the attribution of all performance obligations in the contracts, significant estimates and judgments may be necessary to address the accounting results of numerous contract modifications. Some contract modifications will be accounted for as the addition of a new contract whereas others will be accounted for as the termination of the existing contract with an adjustment to the contract asset or liability through earnings (and in many cases, revenue). The nature and volume of those modifications will have a significant impact on how the portfolios are accounted for and companies will need to ensure the application of any reasonable approach meets the guidance in FASB ASC 606-10-10-4 to conclude the portfolio approach does "not differ materially" from applying the guidance to the individual contracts.

Applying the contract costs guidance to a portfolio of contracts.

30. This item is important as absent a portfolio approach, customer acquisition and fulfillment costs will require specific tracking by customer contract to identify the specific amount of capitalizable costs and the timing of their amortization (for example, through a contract expiration date or an earlier expected cancellation date – churn).

31. FinREC believes that an organization's portfolios of contracts may be defined differently for purposes of recognizing revenue and recognizing deferred costs. Considerations for developing deferred costs portfolios should include assessments of the impact of modifications to any deferred costs and related effects such as impairment. In practice, portfolio composition could vary, depending on the purpose of the portfolio approach, because the key factors to ensure consistency within contracts may vary. For instance, when determining portfolios for the sake of accounting for contract costs, the expected duration of the customer relationship and the customer churn rates would be key factors to consider, although these may be less relevant in the context of creating portfolios for accounting for the revenue side. This is because anticipated contracts (and renewals) should be considered in the amortization period for deferred costs but are ignored for revenue recognition purposes.

32. As described in FASB ASC 340-40-35-1 an asset recognized for deferred contract costs is amortized on a systematic basis that is consistent with the transfer of the goods or services to which the asset relates. On a contract-by-contract basis, if a customer terminates, the remaining asset would be written-off to expense at that time. However, for a portfolio of telecommunication service contracts, FinREC believes that an alternative approach may be to determine the average duration of the expected customer relationship for those that comprise a portfolio and amortize the asset over such period. In deriving the period, an entity would consider churn rates, thereby allowing the entity to set up the amortization of the asset at the outset of the arrangement and amortize it over the estimated customer relationship period. Adjustments would only occur if initial estimates for the pool change over the period.

33. Group methods of depreciation are already being used in practice for the accounting of large numbers of homogeneous tangible assets. FinREC believes that such an approach, by analogy to this practice, may be acceptable in the accounting for portfolios of deferred costs. Under this method, homogeneous tangible assets are aggregated and depreciated by applying a rate to the group based on the average expected useful life of the assets in the group. By analogy to the above practice, FinREC recommends that the entity evaluate several factors to determine whether a portfolio approach is appropriate for the purpose of amortizing contract costs:

    - Dispersion of actual useful lives around the expected life;
    - Statistical data generally should be used to support the parameters of the method, such as expected useful life, actual lives, and dispersion around the expected life;
    - The statistical data generally should be supported by regular, periodic studies;

- Expected useful lives and depreciation calculations should be assessed and adjusted as appropriate periodically;
- Activity within the asset groups should be monitored for any unusual early contract termination or other significant variances from expectations; and
- The method should be applied consistently from period to period.

34. Generally, if contracts are terminated normally (meaning within a reasonable range of the expected useful life) no gain or loss would be recognized under the composite approach because those terminations would be an input factored into the application of the portfolio approach. FinREC believes that an entity with significant, unusual or early contract termination or other situations (such as unexpected uncollectibility), representing significant variations from expectations, should evaluate them and determine whether an impairment loss or write-off is appropriate. Impairment losses and write-offs should be accounted for as a charge to earnings and disclosed appropriately.

<u>Applying the financing component guidance to a portfolio.</u>

35. This item is important because the application of financing components requires consideration of a significant financing at the individual contract level only. If a financing is significant at the contract level it must be separately accounted for. Notwithstanding, as further discussed in paragraph 36, a portfolio of contracts each with insignificant financing elements should not be aggregated together for the purpose of determining whether individually insignificant financing elements could be material when grouped together.

36. BC234 of ASU 2014-09 explains that for many contracts, an entity will not need to adjust the promised amount of customer consideration because the effects of the financing component will not materially change the amount of revenue that should be recognized in relation to a contract with a customer. In other words, for those contracts, the financing component will not be significant. The Boards' have clarified, however, that an entity should only consider the significance of a financing component at a contract level rather than consider whether the financing is material at a portfolio level. The Boards' decided that it would have been unduly burdensome to require an entity to account for a financing component if the effects of the financing component were not material to the individual contract, but the combined effects for a portfolio of similar contracts were material to the entity as a whole.

Presentation and disclosures considerations.

37. FASB ASC 606-10-45-1 requires contract balances to be presented either as a net asset or a net liability. In applying a portfolio approach there is a risk that the net contract asset of one contract is netted with the contract liability of another, which is not permitted under the standard. Accordingly, FinREC recommends that, when analyzing contracts, telecommunications companies consider the balance sheet presentation results of applying the portfolio method to ensure the result is not materially different from applying the guidance to the individual contracts within that portfolio.

38. FASB ASC 606-10-50-1 requires an entity to disclose qualitative and quantitative information to enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. The Boards' did not specifically address how to satisfy the disclosure requirements for those companies that apply portfolio accounting and, so, no specific relief from those disclosures requirements is provided.

Disclosure on the disaggregation of revenue.

39. FASB ASC 606-10-50-5 and 50-6 require disclosure on the disaggregation of revenue and the relationship between disaggregated revenue and revenue information disclosed within segment reporting. FinREC believes that this information may prove more challenging to produce for telecommunications companies that have portfolios across more than one revenue category or sector, for example, if a portfolio of similar contracts across various regions is applied. This results as additional allocation decisions related to revenues, costs and assets may need to be applied to arrive at each separate segment's required reporting.

40. FASB ASC 606-10-50-22 requires disclosures on the practical expedients used by an entity, however it does not specifically require an entity to disclose its use of the portfolio practical expedient. FASB ASC 606-10-50-17, however, requires an entity to disclose its judgments and change to its judgments that affect measurement,

allocation and recognition of revenue. FinREC recommends that telecommunications companies that use the portfolio approach should consider disclosing any significant judgments they have exercised on the portfolios.

Comments should be received by October 1, 2016, and sent by electronic mail to Desiré Carroll at dcarroll@aicpa.org, or you can send them by mail to Desiré Carroll, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.