

Telecommunications Spotlight

Navigating the New Revenue Standard

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The ASU outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance.

The Bottom Line

- On May 28, 2014, the FASB and IASB issued their final standard on revenue from contracts with customers. The standard, issued as ASU 2014-09¹ by the FASB and as IFRS 15² by the IASB, outlines a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance.
- In applying the ASU's provisions on determining the goods and services in an arrangement that are to be accounted for individually (i.e., as performance obligations), an entity may combine more goods and services for accounting purposes than it did previously. However, arrangements in the telecom industry may contain contract options (e.g., for additional services or renewal) that could give rise to additional performance obligations to which revenue would be attributed.
- The ASU's requirements related to allocating the transaction price may change how telecom entities recognize revenue (e.g., revenue recognition for wireless arrangements may be accelerated because more revenue may be ascribed to the handset); this reallocation of revenue may pose significant implementation challenges for entities in the industry.
- In addition to considering the ASU's potential impact on their accounting policies, entities should begin assessing which transition approach (and adoption date for private companies) is most appropriate for them. When performing this assessment, entities should weigh factors such as resource requirements and the needs of financial statement users.

¹ FASB Accounting Standards Update No. 2014-09, *Revenue From Contracts With Customers*.

² IFRS 15, *Revenue From Contracts With Customers*.

Beyond the Bottom Line

This *Telecommunications Spotlight* discusses the new revenue model and highlights key accounting issues and potential challenges for telecom entities that recognize revenue under U.S. GAAP. For additional information about the new standard, see Deloitte's May 28, 2014, *Heads Up*.

Background

The goals of the ASU are to clarify and converge the revenue recognition principles under U.S. GAAP and IFRSs while (1) streamlining, and removing inconsistencies from, revenue recognition requirements; (2) providing "a more robust framework for addressing revenue issues"; (3) making revenue recognition practices more comparable; and (4) increasing the usefulness of disclosures. The ASU states that the core principle for revenue recognition is that an "entity shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services."

The ASU indicates that an entity should perform the following five steps in recognizing revenue:

- "Identify the contract(s) with a customer" (step 1).
- "Identify the performance obligations in the contract" (step 2).
- "Determine the transaction price" (step 3).
- "Allocate the transaction price to the performance obligations in the contract" (step 4).
- "Recognize revenue when (or as) the entity satisfies a performance obligation" (step 5).

Entities are also required to provide significantly expanded disclosures about revenue recognition, including both quantitative and qualitative information about (1) the amount, timing, and uncertainty of revenue (and related cash flows) from contracts with customers; (2) the judgment, and changes in judgment, used in applying the revenue model; and (3) the assets recognized from costs to obtain or fulfill a contract with a customer.

As a result of the ASU, entities will need to comprehensively reassess their current revenue accounting and determine whether changes are necessary.

Thinking It Through

As a result of the ASU, entities will need to comprehensively reassess their current revenue accounting and determine whether changes are necessary. To monitor the implementation of the new standard, the FASB and IASB have created a joint transition resource group responsible for (1) keeping the boards informed of interpretive issues that arise during implementation of the standard and (2) helping the boards determine actions they may need to take to resolve diversity in practice. In addition, the AICPA has formed 16 industry task forces, including one focusing on telecom entities, to discuss industry-specific issues and help develop a new accounting guide that will provide implementation insights and examples.

Key Accounting Issues

Identifying the Performance Obligations in the Contract (Step 2)

Many arrangements in the telecom industry involve multiple goods or services. For example, a wireless operator typically sells a handset along with a wide range of wireless services or a managed services provider often sells equipment along with implementation, training, or maintenance services. These goods and services may be promised in a single contract or in separate contracts and may be explicitly stated in the contract or implied by a vendor's customary business practices or specific statements.

The ASU's provision that a good or service be "separately identifiable from other promises in the contract" is a new concept under which entities must further evaluate a good or service for separability.

The ASU provides guidance on evaluating the promised "goods or services"³ in a contract to determine each performance obligation (i.e., the unit of account). A performance obligation is each promise to transfer either of the following to a customer:

- "A good or service (or a bundle of goods or services) that is distinct."
- "A series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer."⁴

A promised good or service is distinct (and therefore a performance obligation) if both of the following criteria are met:

- *Capable of being distinct* — "The customer can benefit from the good or service either on its own or together with other resources that are readily available to the customer."
- *Distinct in the context of the contract* — "The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract." The ASU provides the following indicators for evaluating whether a promised good or service is separable from other promises in a contract:
 - "The entity does not provide a significant service of integrating the good or service with other goods or services promised in the contract In other words, the entity is not using the good or service as an input to produce or deliver the combined output specified by the customer."
 - "The good or service does not significantly modify or customize another good or service promised in the contract."
 - "The good or service is not highly dependent on, or highly interrelated with, other goods or services promised in the contract. For example, . . . a customer could decide to not purchase the good or service without significantly affecting the other promised goods or services."

Thinking It Through

The ASU's guidance on determining whether a customer can benefit from a good or service on its own, or with other readily available resources, is generally consistent with the current guidance in ASC 605-25⁵ on determining whether a good or service has stand-alone value. However, the provision that a good or service be "separately identifiable from other promises in the contract" is a new concept under which entities must further evaluate a good or service for separability. As part of this evaluation, telecom entities may need to use significant judgment to determine whether the goods or services in a contract are "highly dependent on, or highly interrelated with" — or whether they "significantly modify or customize" — each other. Under this new requirement, entities that account for goods or services separately under current U.S. GAAP may be required to account for them as a single performance obligation (unit of account) under the ASU.

³ Although the ASU does not define goods or services, it includes several examples, such as goods produced (purchased) for sale (resale), granting a license, and performing contractually agreed-upon tasks.

⁴ A series of distinct goods or services has the same pattern of transfer if both of the following criteria are met: (1) each distinct good or service in the series would meet the criteria for recognition over time and (2) the same measure of progress would be used to depict performance in the contract.

⁵ For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

Telecom entities may need to use significant judgment in evaluating whether options convey a material right to customers.

For wireless operators, the question of whether the sale of a handset along with wireless service results in separate units of account takes on greater significance under the ASU. When currently accounting for transactions under the subsidized handset business model, telecom entities often restrict the amount of revenue recognized in connection with the sale of a handset to the consideration received up front; this restriction is often referred to as the “contingent revenue cap” and results in revenue recognition that is consistent with customer billings. The ASU will not similarly constrain revenue. Therefore, when the sale of equipment and the service represent separate performance obligations, an entity will be required to recognize the portion of the total contract consideration allocated to the equipment when control of the equipment is transferred to the customer. The amount allocated to the equipment may typically be greater than the consideration collected up front from the customer (see [Allocating the Transaction Price \(Step 4\)](#) below). Given the new guidance in the ASU’s Example 50, it is generally expected that the handset and wireless service in typical wireless arrangements will be separate performance obligations; however, telecom entities will need to consider all facts and circumstances in determining whether this is the case. In such circumstances, revenue recognition under the ASU would often be accelerated compared with that under current practice.

Many telecom entities charge customers nonrefundable up-front fees (e.g., activation fees). While entities may perform activities related to these fees (e.g., on-site installation), those activities do not typically constitute separate units of account in current practice and are not likely to result in a separate performance obligation under the ASU. However, the presence of nonrefundable up-front fees may indicate the presence of a “material right” that is to be accounted for separately (see [Nonrefundable Up-Front Fees](#) below). Further, telecom entities will need to consider whether the activities undertaken at the inception of the arrangement result in costs that should be capitalized in accordance with the ASU’s requirements (see [Contract Costs](#) below).

Options

Certain arrangements in the telecom industry, such as wireless contracts, may contain options (e.g., to renew for an additional term or receive additional services). Under the ASU, an option given to a customer to acquire additional goods or services represents a performance obligation if it provides a “material right” to the customer that it otherwise would not have received without entering into the contract (e.g., “a discount that is incremental to the range of discounts typically given for those goods or services to that class of customer in that geographical area or market”). If an option is deemed a performance obligation, an entity must allocate a portion of the transaction price to the option and recognize revenue when control of the goods or services underlying the option is transferred to the customer or when the option expires. Examples 49–52 in the ASU illustrate how this guidance would be applied; note that Example 50 describes a wireless arrangement.

Thinking It Through

Telecom entities may need to use significant judgment in evaluating whether options convey a material right to customers. Arrangements that allow customers to elect to receive additional goods (e.g., additional handsets) or services (e.g., discounted or free minutes in the future) will need to be evaluated to determine whether they give the customer a “material right” that it would not have received without entering into the contract. A portion of the transaction price must be allocated to options that are deemed performance obligations and, as a result, revenue is likely to be deferred in such cases.

Under the ASU, some or all of an estimate of variable consideration is included in the transaction price only to the extent that it is probable that subsequent changes in the estimate would not result in a “significant reversal” of revenue (this concept is commonly referred to as the “constraint”).

Determining the Transaction Price (Step 3)

The ASU requires an entity to determine the transaction price, which is the amount of consideration to which the entity expects to be entitled in exchange for the promised goods or services in the contract. The transaction price can be a fixed amount or can vary because of “discounts, rebates, refunds, credits, price concessions, incentives, performance bonuses, penalties, or other similar items.”

Variable Consideration

Arrangements in the telecom industry may involve variable consideration, including deductions (e.g., allowances and rebates) and contingent payments (e.g., usage-based fees). When the transaction price includes a variable amount, an entity is required to estimate the variable consideration by using either an “expected value” (probability-weighted) approach or a “most likely amount” approach, whichever is more predictive of the amount to which the entity expects to be entitled (subject to the constraint discussed below).

Under the ASU, some or all of an estimate of variable consideration is included in the transaction price (i.e., the amount to be allocated to each unit of account and recognized as revenue) only to the extent that it is probable⁶ that subsequent changes in the estimate would not result in a “significant reversal” of revenue (this concept is commonly referred to as the “constraint”). The ASU requires entities to perform a qualitative assessment that takes into account both the likelihood and magnitude of a potential revenue reversal and provides factors that could indicate that an estimate of variable consideration is subject to significant reversal (e.g., susceptibility to factors outside the entity’s influence, a long period before uncertainty is resolved, limited experience with similar types of contracts, practices of providing concessions, or a broad range of possible consideration amounts). This estimate and the consideration of the constraint would be updated in each reporting period to reflect changes in facts and circumstances.

Thinking It Through

The ASU’s less restrictive guidance on variable consideration will most likely result in earlier recognition of revenue. For example, a telecom entity may have a sufficient basis to include certain usage-based fees in the transaction price before the underlying usage occurs. To comply with the ASU’s requirements for estimating the transaction price and determining what amount, if any, is subject to potential reversal (and should be excluded), management may need to use significant judgment, particularly since the transaction price must be updated in each reporting period.

Significant Financing Component

Adjustments for the time value of money are required if the contract includes a “significant financing component” (as defined by the ASU). No adjustment is necessary if payment is expected to be received within one year of the transfer of the goods or services to the customer. However, when an entity concludes that a significant financing component exists on the basis of the payment terms, the entity should adjust the sales price when recording revenue to present the amount that would have been attained had the buyer paid cash for the goods or services on the date of sale.

⁶ Like the term “probable” related to the collectibility threshold in step 1, “probable” in this context has the same meaning as in ASC 450-20-20: the “future event or events are likely to occur.” In IFRS 15, the IASB uses the term “highly probable,” which has the same meaning as the FASB’s “probable.”

Multiple performance obligations may be common in arrangements in the telecom industry. Under the ASU, when a contract contains more than one performance obligation, an entity would generally allocate the transaction price to each performance obligation on a relative stand-alone selling price basis.

Thinking It Through

For telecom entities, a significant financing component may exist in wireless service arrangements when the timing of revenue recognition differs from the timing of actual cash collections from (billings to) the customer. Such may be the case when a significant portion of the overall consideration is allocated to the handset (and recognized as revenue upon delivery of the handset) but collected over the contract term (as the wireless service is provided). Thus, there may be instances in which an entity may need to use significant judgment in determining when a significant financing component exists in telecom arrangements that extend beyond a year.

Allocating the Transaction Price (Step 4)

Multiple performance obligations may be common in arrangements in the telecom industry. Under the ASU, when a contract contains more than one performance obligation, an entity would generally allocate the transaction price to each performance obligation on a relative stand-alone selling price basis. The ASU states that the “best evidence of a standalone selling price is the observable price of a good or service when the entity sells that good or service separately in similar circumstances and to similar customers.” If the good or service is not sold separately, an entity must estimate the stand-alone selling price by using an approach that maximizes the use of observable inputs. Acceptable estimation methods include, but are not limited to, adjusted market assessment, expected cost plus a margin, and a residual approach (when the price is not directly observable and either highly variable or uncertain). The ASU indicates that if certain conditions are met, there are limited exceptions to this general allocation requirement. When those conditions are met, a discount or variable consideration must be allocated to one or more, but not all, distinct goods or services or performance obligations in a contract.

Changes in the transaction price (e.g., changes in an estimate of variable consideration) after contract inception would be allocated to all performance obligations in the contract on the same basis (unless the terms of the contract meet certain criteria that allow for allocation of a discount or variable consideration to one or more, but not all, performance obligations).

Thinking It Through

As described previously, for wireless operators, the allocation of revenue in arrangements involving the sale of a handset with a wireless service arrangement is likely to change. Specifically, a wireless operator will be required to allocate consideration to the handset on a stand-alone selling price basis regardless of whether the customer is invoiced or pays consideration upon receipt of the handset (that is, the “contingent revenue cap” method will be eliminated).

In addition to the operational challenges of allocating the transaction price for a large volume of contracts, a change in the amounts of revenue allocated between a handset and wireless services may have tax implications. For example, for an arrangement that includes discounted tangible personal property (TPP), the ASU may require entities to change how they allocate revenue between the sale of the TPP and the sale of related services (i.e., they would no longer apply the invoicing and contract treatment). In such cases, part of the amount historically recognized as service revenue over the life of the related service agreement is likely to be allocated to product revenue. This reallocation of revenue could affect the amount of some taxes or fees collected or reported by the vendor.

Other Accounting Issues

Repurchase Rights

Certain arrangements in the telecom industry, particularly in the wireless sector, offer customers trade-in or upgrade rights. Under the ASU, repurchase agreements can represent an entity’s (1) “obligation to repurchase the asset (a forward),” (2) “right to

Telecom entities with contracts subject to modification will need to assess whether changes are “approved” modifications and whether each modification should be accounted for (1) as a separate contract or (2) under the prospective or retrospective method.

repurchase the asset (a call option),” or (3) “obligation to repurchase the asset at the customer’s request (a put option).”

A contract with a forward or call option prevents a customer from having the ability to “direct the use of, and obtain substantially all of the remaining benefits from, the asset” (i.e., control of the asset is not transferred). In such circumstances, the contract would be accounted for as a lease or a financing agreement (depending on how the repurchase price compares with the original selling price). A contract that offers a customer a “significant economic incentive to exercise” a put option (return the good to the entity) would be accounted for as a lease. The ASU also includes detailed implementation guidance on making these determinations.

Thinking It Through

The ASU’s guidance on repurchase rights may apply to more and more arrangements in the telecom industry, since wireless operators increasingly seek to offer customers more flexible terms. Questions have arisen about whether such rights are within the scope of the ASU or whether they should be accounted for as a guarantee under ASC 460. An entity that accounts for such a right under the ASU will have to assess whether a customer has a “significant economic incentive” to exercise the right and, if so, will account for the arrangement as a lease. When a significant economic incentive does not exist, an entity will still need to consider whether it has provided the customer with a “material right,” which would be accounted for as a separate performance obligation.

Contract Modifications

Telecom arrangements may be modified, particularly as customers change, add, or remove specific services. The ASU provides guidance on accounting for “approved” modifications to contracts with customers. A contract modification must be accounted for as a separate contract when (1) it results in a change in contract scope because of additional promised “distinct” goods or services and (2) the additional consideration reflects the entity’s stand-alone selling price for those additional promised goods or services (including any appropriate adjustments to reflect the circumstances of the contract).

If an entity determines that the modification is not a separate contract, the entity would, depending on the specific facts and circumstances of the “modified contract” (as defined in the ASU), apply one of the following methods:

- *The prospective method (i.e., treatment as a new contract)* — If the remaining goods or services are distinct from the goods or services transferred on or before the date of the contract modification, the remaining transaction price and any additional consideration promised as a result of the modification are allocated to the remaining performance obligations in the modified contract.
- *The retrospective method (i.e., a cumulative catch-up adjustment)* — If the remaining goods or services are not distinct and are part of a single performance obligation that is partially satisfied as of the date of the contract modification, the performance obligation’s measure of progress toward completion is updated, which may result in a cumulative catch-up of revenue.
- A combination of these two methods (if the conditions for both are satisfied).

Thinking It Through

Telecom entities with contracts subject to modification will need to assess whether changes are “approved” modifications and whether each modification should be accounted for (1) as a separate contract or (2) under the prospective or retrospective method outlined above. In either case, an entity’s accounting for modifications under the ASU may differ from that under current guidance.

Many telecom entities will find the ASU's requirements challenging to implement — and comply with on an ongoing basis — because of the volume of their customer arrangements and how frequently these arrangements are modified.

Nonrefundable Up-Front Fees

Some arrangements in the telecom industry involve nonrefundable up-front fees. The ASU requires entities to determine whether an up-front fee is related to the transfer of a promised good or service. In addition, the ASU notes that nonrefundable up-front fees are often related to activities an entity must undertake at or around the inception of a contract; however, those activities may not result in the transfer of a good or service to the customer. In such circumstances, the up-front fee may represent an advance payment for future goods or services and would be recognized when those goods or services are transferred to the customer. In some cases, those future goods or services may be provided in periods beyond the initial contract period if the customer has the option of renewing the contract and a “material right” (as discussed above) exists.

Thinking It Through

Nonrefundable up-front fees in the telecom industry may be related to an arrangement's terms and conditions that provide a customer with a material right (i.e., a separate performance obligation), such as options to renew an agreement without paying the fee again. In such cases, the up-front fee would need to be allocated to the performance obligations identified in the contract (including any “material rights”) and would be recognized when those obligations are satisfied. Under current U.S. GAAP, up-front fees are often recognized over the life of the customer. Under the ASU, however, the recognition of some amount of consideration would extend beyond the initial contract period if an option to renew the contract is deemed a material right.

Contract Costs

Many telecom entities may incur contract acquisition costs in connection with long-term contracts, including costs of obtaining a contract (e.g., commissions) and fulfilling a contract (e.g., set-up costs). The ASU contains criteria for determining when to capitalize costs associated with obtaining and fulfilling a contract. Specifically, entities are required to recognize an asset for incremental costs of obtaining a contract (e.g., sales commissions) when those costs are expected to be recovered (as a practical expedient, a recognized asset with an amortization period of less than a year can be expensed as incurred). Costs of fulfilling a contract (that are not within the scope of other standards) would be capitalized only when they (1) are directly related to a contract, (2) generate or enhance resources that will be used to satisfy performance obligations, and (3) are expected to be recovered. The ASU also requires entities to expense certain costs, such as those related to satisfied (or partially satisfied) performance obligations. Capitalized costs would be amortized in a manner consistent with the pattern of transfer of the goods or services to which the asset is related (which may extend beyond the original contract term in certain circumstances).

Thinking It Through

Telecom entities may need to consider the impact of this guidance on their current cost capitalization practices. Many contracts in the industry may not qualify for the practical expedient (i.e., exemption from capitalization) because of their duration, including expected renewals. Therefore, many telecom entities will be required to analyze which costs meet the criteria for capitalization (different considerations exist for acquisition and fulfillment costs). Further, when capitalizing such costs, telecom entities must use judgment in determining (1) the period over which capitalized costs will be amortized (i.e., periods of expected contract renewals would be included) and (2) the approach to monitoring the resulting assets for impairment on an ongoing basis (this may be challenging when there is a large volume of underlying contracts).

Portfolio Accounting

Many telecom entities will find the ASU's requirements challenging to implement — and comply with on an ongoing basis — because of the volume of their customer arrangements and how frequently these arrangements are modified. Although the ASU

should be applied on an individual contract basis, a “portfolio approach” is permitted provided that it is reasonably expected that the impact on the financial statements will not materially differ from the impact when the standard is applied on an individual contract basis.

Thinking It Through

The ASU indicates that the portfolio approach can be applied to a group of contracts (or performance obligations) with “similar characteristics” but provides no further guidance on this matter. Therefore, entities must use significant judgment in determining when portfolio accounting is appropriate and how it is applied. For example, entities would need to carefully define the portfolio parameters to ensure that the portfolio approach is precise enough that revenue recognition under this approach does not materially differ from revenue recognition when the ASU is applied on an individual contract basis. In addition, to implement this new accounting method, entities may need to heavily invest in supporting systems. Because the extent of the resources needed to implement and maintain portfolio accounting is still uncertain, questions remain regarding the efficiency of this approach.

Disclosures

The ASU requires entities to disclose both quantitative and qualitative information that enables “users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.” The ASU’s disclosure requirements are significantly more comprehensive than those in existing revenue standards. For additional information about the new disclosure requirements, see Deloitte’s May 28, 2014, *Heads Up*.

Effective Date and Transition

The ASU is effective for annual reporting periods (including interim reporting periods within those periods) beginning after December 15, 2016, for public entities. Early application is not permitted (however, early adoption is optional for entities reporting under IFRSs). Nonpublic entities can use the same effective date as public entities (regardless of whether interim periods are included) or postpone adoption for one year from the effective date for public entities.

Entities have the option of using either a full retrospective or a modified approach to adopt the guidance in the ASU. Retrospective application would take into account the requirements in ASC 250 (with certain practical expedients). Under the modified approach, an entity recognizes “the cumulative effect of initially applying [the ASU] as an adjustment to the opening balance of retained earnings . . . of the annual reporting period that includes the date of initial application” (revenue in periods presented in the financial statements before that date is reported under guidance in effect before the change). Under the modified approach, the guidance in the ASU is only applied to existing contracts (those for which the entity has remaining performance obligations) as of, and new contracts after, the date of initial application. The ASU is not applied to contracts that were completed before the effective date (i.e., an entity has no remaining performance obligations to fulfill). Entities that elect the modified approach must disclose an explanation of the impact of adopting the ASU, including the financial statement line items and respective amounts directly affected by the standard’s application.

Thinking It Through

The modified transition approach provides entities relief from having to restate and present comparable prior-year financial statement information; however, entities will still need to evaluate existing contracts as of the date of initial adoption under the ASU to determine whether a cumulative adjustment is necessary. Therefore, entities may want to begin considering the typical nature and duration of their contracts to understand the impact of applying the ASU and to determine the transition approach that is practical to apply and most beneficial to financial statement users.

The ASU’s disclosure requirements are significantly more comprehensive than those in existing revenue standards.

Transition Considerations

Increased Use of Judgment

Management will need to exercise significant judgment in applying certain of the ASU's requirements, including those related to the identification of performance obligations and allocation of revenue to each performance obligation. It is important for telecom entities to consider how the standard specifically applies to them so that they can prepare for any changes in revenue recognition patterns.

Retrospective Application

The ASU allows entities to apply the standard retrospectively and use certain optional practical expedients at their discretion. As a result, telecom entities may need to assess contracts that commenced several years before the ASU's effective date. In addition, telecom entities will most likely be required to perform dual tracking of revenue balances during the retrospective period given the potential difficulty of retroactively recalculating revenue balances when the ASU becomes effective.

Systems, Processes, and Controls

To comply with the ASU's new accounting and disclosure requirements, telecom entities will have to gather and track information that they may not have previously monitored. The systems and processes associated with such information may need to be modified to support the capture of additional data elements that may not currently be supported by legacy systems. Further, to ensure the effectiveness of internal controls over financial reporting, management will want to assess whether it should implement additional controls. Telecom entities may also need to begin aggregating essential data from new and existing contracts since many of these contracts will most likely be subject to the ASU.

Note that the above are only a few examples of changes telecom entities may need to make to their systems, processes, and controls; such entities should evaluate all aspects of the ASU's requirements to determine whether any other modifications may be necessary.

Income Taxes

Federal income tax law provides both general and specific rules for recognizing revenue on certain types of transactions (e.g., long-term contracts and arrangements that include advance payments for goods and services). These rules are often similar to the method a taxpayer uses for financial reporting purposes and, if so, the taxpayer employs the revenue recognition method it applies in maintaining its books and records (e.g., cash basis, U.S. GAAP, IFRSs). Although the Internal Revenue Code (IRC) does not require entities to use any particular underlying financial accounting method to determine their taxable income (such as U.S. GAAP), entities must make appropriate adjustments (on Schedule M) to their financial accounting pretax income to determine taxable income under the IRC.

The ASU may change the timing of revenue recognition and, in some cases, the amount of revenue recognized for entities that maintain their books and records under U.S. GAAP or IFRSs. These changes may also affect taxable income. Thus, it will be important for tax professionals to understand the detailed financial reporting implications of the standard so that they can analyze the tax ramifications and facilitate the selection of any alternative tax accounting methods that may be available.

If a change in a tax accounting method is advantageous or expedient (including circumstances in which the book method has historically been used), the taxpayer will most likely be required to obtain approval from the relevant tax authorities to use the new method. Similar requirements may arise in foreign jurisdictions that maintain statutory accounting records under U.S. GAAP or IFRSs. Additional record keeping will also be required when entities are not permitted to use the standard's revenue recognition method for tax purposes.

To comply with the ASU's new accounting and disclosure requirements, telecom entities will have to gather and track information that they may not have previously monitored.

Indirect Taxes

The ASU may significantly affect the indirect taxes of telecom entities. It is important to understand the tax base on which each tax is imposed to determine how each tax will be affected. Given the significant number of taxes imposed in the industry, it may be burdensome to identify the tax base and determine the potential impact. Further, telecom entities may find it challenging to modify tax collection and reporting processes to ensure that taxes are properly collected and remitted. A robust reconciliation process may need to be established to ensure that revenues are not double-reported for regulatory or tax purposes or missed when the retrospective change in accounting is made to book revenue between revenue items that are subject to the respective tax and those that are not.

Thinking Ahead

Although the ASU is not effective until annual reporting periods beginning after December 15, 2016 (with a maximum deferral of one year for nonpublic entities that apply U.S. GAAP), telecom entities should start carefully examining the ASU and assessing the impact it may have on their current accounting policies, procedures, systems, and processes.

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