2.3.2 First application of IFRS 15 “Revenue from contracts with customers”

The Group applies IFRS 15 with effect from January 1, 2018. It elected for retrospective application, restating published figures for the 2016 and 2017 comparative periods.

The Group adopted the following authorized practical expedients on initial application:

- for all reporting periods presented before the date of initial application, the Group did not disclose the amount of the transaction price allocated to the remaining performance obligations nor explained when it expects to recognize that amount as revenue;
- the Group did not restate contracts that began and ended before January 1, 2016 (first comparative reporting period).

Application of IFRS 15 to ongoing contracts as of January 1, 2016 resulted in an increase in consolidated reserves of 815 million euros, as of January 1, 2016, of which 674 million euros attributable to owners of the parent company and 141 million euros attributable to non-controlling interests, in return mainly for the recognition of:

- contract assets net of performance obligations liabilities for 1,003 million euros;
- assets related to deferred acquisition costs for 294 million euros;
- deferred taxes for a net impact of (339) million euros.

The recognition of these assets net of liabilities led the Group to reassess the net carrying value of the Cash Generating Units (CGUs) and the results of the impairment tests as of January 1, 2016 and to reflect a goodwill impairment charge of (139) million euros in certain operating segments, in exchange for consolidated reserves.

IFRS 15 introduces a revenue recognition approach focused on:

- the identification of contracts, customers and contract amendments;
- the identification of distinct performance obligations (promises made by the supplier), their reference price (individual selling price) and the transfer to the customer of control of performance obligations continuously or at a point in time;
- the determination of the transaction price (consideration promised by the customer), its fixed and variable components (and related recognition restrictions) and its allocation to the performance obligations.

The main impacts of the new methodology introduced by IFRS 15 compared with the accounting policies previously applied are as follows:

- for bundled service and equipment offerings, prior to adoption of IFRS 15, revenue recognized on the sale of mobile phones was restricted to a contractual amount not dependent on the supply of future services, which was generally the amount received from the customer for the sale of the mobile phone. This amount corresponded conventionally to the amount paid at the time of delivery, or for installments, to discounted amounts payable over 12 or 24 months. Under IFRS 15, the transaction price is allocated between the mobile phone and the service based on individual selling prices and recognized in revenue at the moment of the transfer of control of the equipment or service to the customer. This change primarily impacts bundled offerings comprising the sale of a mobile phone at a reduced price combined with a fixed-term service contract. Accordingly, for this type of offering, the effects on the Group’s accounts are as follows:
  - the overall revenue from the contract does not change, but the pace of recognition and the split between the sold mobile phone and the service are modified (additional equipment revenue at the beginning of the contract, in return for a reduction in revenue of services of the same amount afterwards),
  - accelerated recognition of revenue, at the time of the sale of the equipment is reflected in the consolidated statement of financial position by the presentation of a contract asset which is transformed into a receivable as the provision of communication services progresses;

  IFRS 15 therefore increases the sensitivity of total revenue to equipment sales and to the effect of seasonality of these sales between quarters. Depending on the position in each market, the impact of IFRS 15 on period-on-period total revenue trends will differ from that previously presented under IAS 18, according to whether discounts on equipment levels are increasing or decreasing. In recent years, the markets in which we operate have, excluding exceptions, recorded a decrease in discounted equipment offerings. Compared with IAS 18, the implementation of IFRS 15 also requires new judgements and assumptions, notably regarding the enforceable contract term and the expected total transaction price and the reference price of the transaction components;
- IFRS 15 changed the indicators used to determine whether an entity acts as a principal or an agent in a transaction. This did not, however modify our previous judgements, particularly as regards agreements with our distributors for the supply of mobile phones, under which Orange primarily acts as a principal in the sale of mobile phones to the end-customer. The revenue recognized by Orange on the sale of a mobile phone combined with a fixed-term contract is therefore identical irrespective of the distribution channel;
- IFRS 15 also introduces criteria for identifying a financial component in a commercial transaction that must be recognized separately, unless it has a negligible effect in each contract or concerns a contract of less than one year. A financial component is likely to be identified in offerings combining the supply of a mobile phone and a fixed-term services contract (except payments by installments models which, by nature, meet the definition of a financial receivable). On markets where these offerings exist, the low level of interest rates has not led to the recognition of a separate financial component. This assessment could however change if, for example, contractual terms or interest rates were to increase;
- for our services requiring non-standard equipment (and Internet offerings including the provision of a Livebox®), IFRS 15 has not changed our historical analysis that this equipment is a component of the network controlled by Orange and is not therefore a distinct performance obligation;
- for our straight-forward service offerings for Mass market or Enterprise market, no changes in revenue recognition were identified as a result of application of IFRS 15. Contract assets are not therefore recognized in addition to trade receivables recognized under IAS 18 and IAS 11, or contract liabilities other than deferred income recognized under IAS 18 and IAS 11;
- integration and information technology services proposed to Enterprise market often involve complex contracts which require the exercise of greater judgement and modified estimates under IFRS 15, compared with IAS 18 and IAS 11. This is notably the case for the identification of distinct performance obligations or not (platform build and run phases) and the measurement of contract factors impacting several accounting periods (notably fixed and variable transaction price components), as well as contract amendments. The application of IFRS 15 did not, however, lead to significant changes in revenue recognition;

- wholesale activities (operator customers) also involve complex contracts requiring a similar exercise of judgement and estimates under IFRS 15 as for the above Enterprise market activities. These activities also require the exercise of specific judgement when classifying a transaction as a non-monetary exchange between entities in the same line of business to facilitate sales to customers or potential customers; these transactions are excluded from IFRS 15's revenue recognition scope. Overall, the application of IFRS 15 has not led to significant changes in revenue recognition, with the exception of a network sharing agreement in Spain. In the public initiative network sector, IFRIC 12 application "Service concession arrangements" remains effective and revenue is recognized in accordance with the terms of IFRS 15;
- in a substantial change from IAS 18, IFRS 15 requires the capitalization of certain costs of obtaining a contract and their release to profit or loss on a time-apportioned basis over the expected duration of the contractual relationship. However, due to the Group's strategy in recent years of focusing on direct distribution and the development of Internet sales, sales commissions qualifying for deferral under IFRS 15 are generally decreasing. This new principle requires assumptions to be made regarding the expected duration of contractual relationships. Finally, new costs of fulfilling a contract that must be deferred under IFRS 15 were not identified.

→ Effects on the consolidated financial statements

- Effects on the consolidated income statement:

(in millions of euros, except for per share data)	December 31, 2017			December 31, 2016		
	Historical data	IFRS 15 application effect	Restated data from IFRS 15	Historical data	IFRS 15 application effect	Restated data from IFRS 15
Revenue	**41,096**	**(237)**	**40,859**	**40,918**	**(210)**	**40,708**
Increase / decrease linked to the timing difference of the services revenue recognition [(1)]	-	*(1,071)*	-	-	*(1,180)*	-
Increase / decrease linked to the timing difference of the equipment sales revenue recognition [(2)]	-	*958*	-	-	*1,080*	-
Other [(3)]	-	*(124)*	-	-	*(110)*	-
External purchases	(18,475)	94	(18,381)	(18,281)	95	(18,186)
Increase / decrease linked to the capitalization ot the costs of obtaining a contract [(4)]	-	*(28)*	-	-	*(17)*	-
Other impacts [(3)]	-	*122*	-	-	*112*	-
Other operating income and expense	(17,704)	4	(17,700)	(18,560)	(45)	(18,605)
Operating income	**4,917**	**(139)**	**4,778**	**4,077**	**(160)**	**3,917**
Finance costs, net	(1,715)	-	(1,715)	(2,097)	-	(2,097)
Income tax [(5)]	(1,088)	36	(1,052)	(970)	19	(951)
Consolidated net income of continuing operations	**2,114**	**(103)**	**2,011**	**1,010**	**(141)**	**869**
Consolidated net income of discontinued operations	**29**	**-**	**29**	**2,253**	**-**	**2,253**
Consolidated net income	**2,143**	**(103)**	**2,040**	**3,263**	**(141)**	**3,122**
Net income attributable to owners of the parent company	1,906	(63)	1,843	2,935	(122)	2,813
Non-controlling interests	237	(40)	197	328	(19)	309
Earnings per share (in euros) attributable to parent company						
Net income of continuing operations						
basic	0.61	(0.03)	0.58	0.15	(0.05)	0.10
diluted	0.61	(0.03)	0.58	0.15	(0.05)	0.10
Net income of discontinued operations						
basic	0.01	-	0.01	0.85	-	0.85
diluted	0.01	-	0.01	0.85	-	0.85
Net income						
basic	0.62	(0.03)	0.59	1.00	(0.05)	0.95
diluted	0.62	(0.03)	0.59	1.00	(0.05)	0.95

(1) For contracts combining a discounted sale of equipment and telecommunication services, revenue allocated to telecommunication services is lower due to the new revenue allocation method under IFRS 15 (i.e. allocation of revenue to all performance obligations in proportion to individual selling prices). The Group therefore recognized an adjustment to reflect this new revenue allocation.
(2) For the same offerings and again due to the change in the revenue allocation method, equipment revenue is higher to reflect the value of the asset that the customers receive at the beginning of the contract.
(3) Mainly concerns the effects associated to a RAN sharing contract in Spain.
(4) the Group pays sales commission and agent costs to distributors as part of obtaining firm contracts with customers. Previously booked in expenses when incurred, these costs are now capitalized and amortized over the contract term.
(5) Effect on deferred tax recognition of the IFRS 15 impacts presented above and the adjustment of the recoverable amount of deferred tax assets.

– Effects on the consolidated statement of financial position:

(in millions of euros)	December 31, 2015 historical data	IFRS 15 appli-cation effect	January 1, 2016 restated data from IFRS 15	December 31, 2016 historical data	IFRS 15 appli-cation effect	January 1, 2017 restated data from IFRS 15	December 31, 2017 historical data	IFRS 15 appli-cation effect	January 1, 2018 restated data from IFRS 15
Assets									
Goodwill [(1)]	27,071	(139)	26,932	27,156	(177)	26,979	27,095	(184)	26,911
Deferred tax assets	2,430	(293)	2,137	2,116	(269)	1,847	1,825	(239)	1,586
Total non-current assets	**71,330**	**(432)**	**70,898**	**74,819**	**(446)**	**74,373**	**74,035**	**(423)**	**73,612**
Other customer contract assets	-	1,442	1,442	-	1,335	1,335	-	1,204	1,204
Customer contract assets [(2)]	-	*1,027*	*1,027*	-	*916*	*916*	-	*815*	*815*
Costs of obtaining a contract [(3)]	-	*294*	*294*	-	*273*	*273*	-	*250*	*250*
Costs to fulfill a contract [(4)]	-	*121*	*121*	-	*146*	*146*	-	*139*	*139*
Other current assets	983	-	983	1,073	-	1,073	1,101	(7)	1,094
Prepaid expenses [(4)]	495	(122)	373	540	(146)	394	594	(139)	455
Total current assets	**14,312**	**1,320**	**15,632**	**19,849**	**1,189**	**21,038**	**20,679**	**1,058**	**21,737**
Assets held for sale	**5,788**	**-**	**5,788**	**-**	**-**	**-**	**-**	**-**	**-**
Total assets	**91,430**	**888**	**92,318**	**94,668**	**743**	**95,411**	**94,714**	**635**	**95,349**
Equity and liabilities									
Total equity	**33,267**	**815**	**34,082**	**33,174**	**671**	**33,845**	**32,942**	**570**	**33,512**
Deferred tax liabilities	879	45	924	658	48	706	611	44	655
Total non-current liabilities	**36,537**	**45**	**36,582**	**35,590**	**48**	**35,638**	**32,736**	**44**	**32,780**
Trade payables	6,227	4	6,231	6,211	3	6,214	6,522	5	6,527
Customer contract liabilities [(5)]	-	2,121	2,121	-	2,071	2,071	-	2,021	2,021
Deferred income [(5)]	2,136	(2,097)	39	2,134	(2,050)	84	2,081	(2,005)	76
Total current liabilities	**21,626**	**28**	**21,654**	**25,904**	**24**	**25,928**	**29,036**	**21**	**29,057**
Total equity and liabilities	**91,430**	**888**	**92,318**	**94,668**	**743**	**95,411**	**94,714**	**635**	**95,349**

(1) The new standard generates a change in the composition of the net carrying amount of tested assets of cash generating units. The net carrying amount of tested assets now includes the contract assets. This change led to the recognition of impairment losses on goodwill in Poland of (139) million euros as of January 1, 2016 and in Romania of (55) million euros in 2016.

(2) The accelerated recognition of revenue resulting from the new revenue allocation method is reflected in the balance sheet by a contract asset recognized on signature of the contract for an amount corresponding in part to the discount granted to the customer on the equipment. This contract asset decreases over the enforceable period of the contract, to the extent the discount granted on the equipment is recovered each month through invoicing of the service contract. An impairment reflects the risk of non-recovery of the contract asset and depending on the geographical area, instances of fraud or churn where termination costs are not billed. To assess this risk, the countries determine a contract asset impairment rate according to the nature of the event and the relevant customer segment, using a historical statistical approach.

(3) The Group pays sales commission and agent costs to distributors as part of obtaining firm contracts with customers. Previously booked in expenses when incurred, these costs are now capitalized and amortized over the contract term.

(4) Prior to application of IFRS 15, costs of fulfilling a contract were recognized in prepaid expenses. They are now included in other assets related to contracts with customers.

(5) As for prepaid expenses, deferred income relating to customer contracts was reclassified to liabilities related to contracts with customers. Residual deferred income are out of IFRS 15 scope.

3

- Effects on the consolidated statement of cash flows:

(in millions of euros)	December 31, 2017			December 31, 2016		
	Historical data	IFRS 15 application effect	Restated data from IFRS 15	Historical data	IFRS 15 application effect	Restated data from IFRS 15
Consolidated net income	2,143	(103)	2,040	3,263	(141)	3,122
Non-monetary items and reclassified items for presentation						
Impairment of goodwill	(20)	-	(20)	772	42	814
Change in provisions	(73)	(7)	(80)	(159)	(2)	(161)
Income tax	1,088	(36)	1,052	970	(19)	951
Changes in working capital						
Increase (decrease) in trade payables	409	3	412	85	(1)	84
Changes in other customer contract assets and liabilities	-	112	112	-	66	66
Changes in other assets and liabilities	132	31	163	(762)	55	(707)
Net cash provided by operating activities (a)	10,174	-	10,174	8,750	-	8,750
Net cash used in investing activities (b)	(7,941)	-	(7,941)	(4,879)	-	(4,879)
Net cash used in financing activities (c)	(2,738)	-	(2,738)	(1,883)	-	(1,883)
Net change in cash and cash equivalents (a) + (b) + (c)	**(505)**	**-**	**(505)**	**1,988**	**-**	**1,988**

The information required as at December 31, 2018 on the net assets and liabilities from customer contracts are presented in Note 4.4.

2.4 Main standards and interpretations compulsory after December 31, 2018 with no early application elected by the Group

2.4.1 IFRIC 23 “Uncertain fiscal positions”

The IFRIC 23 “Uncertain fiscal positions” text, the application of which is compulsory after December 31, 2018, will not have a significant effect on the consolidated annual financial statements of the Orange group.

2.4.2 IFRS 16 “Leases”

IFRS 16 implementation has been subject to a dedicated project within the Group. After having finalized the analysis and concluded on the scope of application (still subject to new interpretations), the Group started, in 2018, the implementation and deployment of the tools dedicated to lease accounting. As at December 31, 2018, the Group is finalizing the inventory of contracts, the tools deployment and the data collection in order to be able to present, as of 2019, financial statements in compliance with IFRS 16.

In order to define the scope of application of this new standard, the Group has analyzed all of its leases (under IAS 17) and service contracts in order to determine whether these contracts contain a lease component. The Group defines a contract as a lease if it conveys to the lessee the right to control the use of an identified asset.

After this analysis phase the Group defined four main categories of leases contracts:

- real estate: point of sales, offices buildings, technical buildings;
- mobile network: lands, certain contracts with TowerCos;
- fixed network: access to the local loop, colocation in technical building, certain dark fiber contracts;
- general expenses: vehicles, technical cars, datacenter.

From January 1, 2019 onward, the Group (as lessee) will record all of its leases contracts using a unique model in which an asset will be recognized on the balance sheet for the right of use of the assets leased against a liability for the corresponding lease obligations.

The accounting measurement of these items on the balance sheet depend on the following:

- the assessment of the term to be retained for each contract. This duration corresponds to the non-cancelable lease term, plus the time periods in any extension option the lessee can be reasonably certain to exercise and any option to cancel which the lessee is certain will not be exercised. The definition of this contract term must also take into account laws and practices in each jurisdiction or sector of activity regarding the duration of a firm commitment granted by lessors;
- the combination of the fixed and variable components of contractual payments;
- the determination of the incremental borrowing rate if the contract’s implicit rate cannot easily be established.

The Group has also chosen to use the two exemptions proposed by the standard on leases contracts:

- contracts with a duration of less than 12 months;
- contracts for which the the underlying asset new value is around 5,000 euros.