



# IFRS 15 for investment management companies

Are you good to go?



Application guidance



May 2018

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# Purpose of this document

## What is *Good to go*?

IFRS 15 *Revenue from Contracts with Customers*, which became effective on 1 January 2018, may change the way investment management companies account for their services.

In the past, when major IFRS change has led to large-scale implementation projects, management at companies – usually group financial controllers – have asked us ‘How will I know when we’re done?’

To help to answer that question, we’ve created this guide to highlight the key considerations that all investment management companies need to focus on to get to the finish line. This guide will help investment management companies to understand how to apply IFRS 15’s five-step model, providing examples that illustrate how to apply the standard to common fact patterns.

Each section within this guide deals with a different issue and considers the new requirements and how they differ from previous requirements.

## More information

Please refer to the back of this publication for further resources to help you apply the new standard’s requirements.

## 1

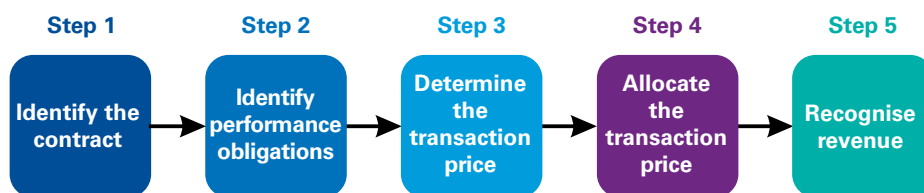
# Overview

The new standard provides a framework that replaces previous revenue guidance in IFRS.

New qualitative and quantitative disclosure requirements aim to enable financial statement users to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

Entities apply a five-step model to determine when to recognise revenue, and at what amount. The model specifies that revenue is recognised when or as an entity transfers control of goods or services to a customer at the amount to which the entity expects to be entitled. Depending on whether certain criteria are met, revenue is recognised:

- over time, in a manner that best reflects the entity's performance; or
- at a point in time, when control of the goods or services is transferred to the customer.



The new standard provides application guidance on numerous related topics, including revenue recognition for non-refundable up-front fees. It also provides guidance on when to capitalise the costs of obtaining a contract and some costs of fulfilling a contract (specifically those that are not addressed in other relevant authoritative guidance – e.g. for intangible assets).



## Application of the new requirements

For some investment management companies, the new standard may change the timing and amount of revenue recognised for some contracts as well as capitalisation of certain costs, while for other companies there will be little impact. Potential impacts include, but are not limited to, the following.

- Up-front fees may be recognised as revenue over a shorter or longer period compared with previous requirements.
- Variable consideration may be recognised as revenue at a different point in time.
- The transaction price may be allocated differently to the services offered to the customer in a contract or a combination of contracts.
- The principal vs agent analysis of services involving third parties may be different.
- Some costs to obtain a contract that were capitalised under previous requirements may be expensed as incurred under the new standard, and vice versa.

- Capitalised contract costs may be tested for impairment differently under the new standard.

Arriving at a conclusion requires an understanding of the new model and an analysis of its application to particular transactions.

In addition, investment management companies are subject to extensive new disclosure requirements.

This publication outlines the relevant considerations for each of the steps in the five-step model.

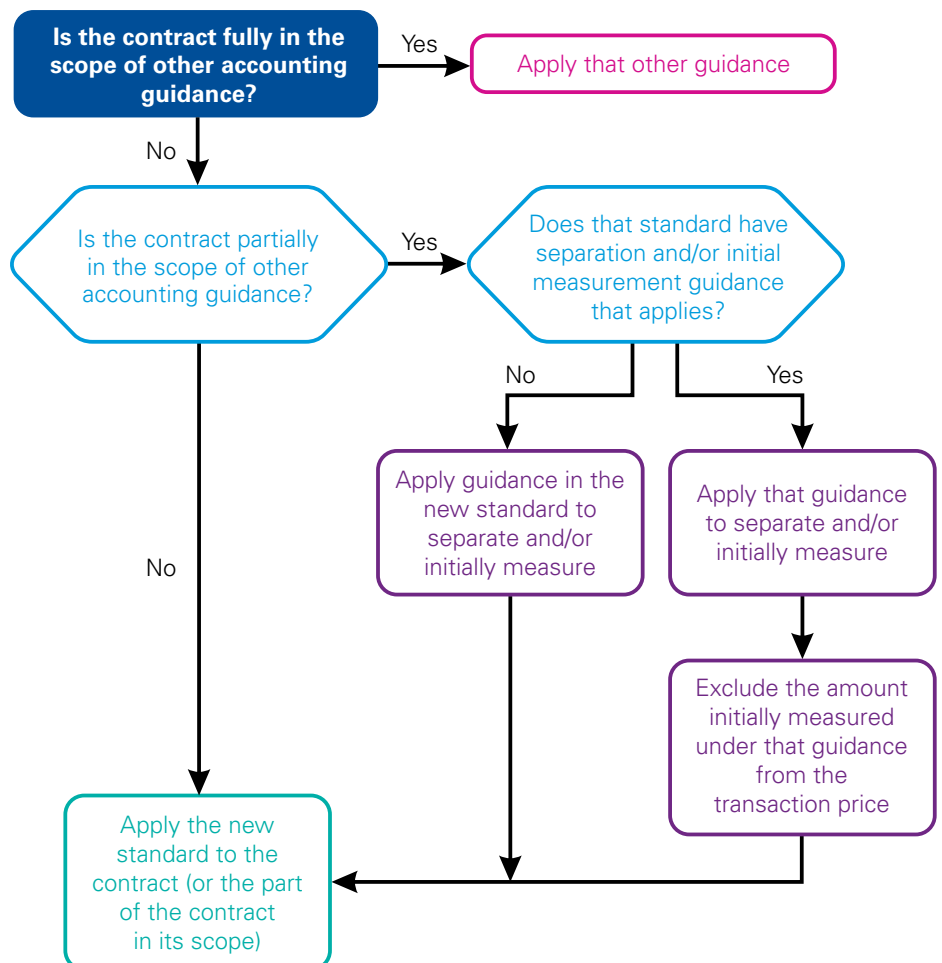
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Key consideration	Section
<b>Step 5 – Recognise revenue</b>	
Determine whether revenue should be recognised over time or at a point in time.	
Step 5 is not discussed in detail in this publication. Revenue for investment management services is generally recognised over time, like most services revenue. This is because the customer generally receives and consumes the benefits from investment management services simultaneously as the company performs them. In practice, issues such as identifying performance obligations (Step 2), and constraining and allocating variable consideration (Steps 3 and 4), are likely to have a greater impact on the revenue profile of an investment manager.	
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# 2 Contracts partially in the scope of IFRS 15

## Requirements of the new standard

IFRS 15 does not apply to contracts with customers that are wholly in the scope of other standards – e.g. insurance contracts and financial instruments. A contract with a customer may be partially in the scope of the new standard and partially in the scope of other accounting guidance. If the other accounting guidance specifies how to separate and/or initially measure one or more parts of a contract, then an entity first applies the requirements in that other guidance. Otherwise, the entity applies the new standard to separate and/or initially measure the separately identified parts of the contract. The following flowchart highlights the key considerations when determining the accounting for a contract that is partially in the scope of the new standard.



These requirements are discussed further in Chapter 4.3 of our [Revenue Issues In-Depth](#) publication.



### How does this approach differ from previous requirements?

Previous revenue guidance did not include similar comprehensive guidance on accounting for contracts partially in the scope of another standard.

IAS 18 *Revenue* included illustrative guidance that addressed whether a variety of financial services fees were accounted for as part of the financial instrument or as a revenue transaction. This guidance has been transferred to IFRS 9 *Financial Instruments* as part of the new standard's consequential amendments. Therefore, it will still be used when determining the financial services fees that are included in the measurement of the financial instrument and those fees that are accounted for under the new standard.



### Application of the new requirements

For investment management companies, the most likely scenario is that a contract may also be in the scope of the financial instruments guidance. In these cases, a company first applies the financial instruments guidance, because it includes specific initial measurement guidance, and then applies the new standard to any residual amount.

For some arrangements, as illustrated below, after applying the financial instruments guidance there may be little or no amount left to allocate to components of the contract that are in the scope of the new standard. As shown in the example, it is possible that the residual amount to be accounted for under the new standard is zero.



### Example – Zero residual amount after applying other accounting requirements

Fund D enters into a contract with a customer. Under the contract, D receives cash in return for issuing a redeemable unit and provides investment management services relating to the amounts received for no additional charge. The redeemable unit is a liability in the scope of the financial instruments guidance. D first applies the initial recognition and measurement requirements in the financial instruments guidance to measure the liability. The residual amount is then allocated to the associated investment management services and accounted for under the new standard. Because the amounts received for the redeemable unit are recognised as a liability, there are no remaining amounts to allocate to the investment management services.

If the arrangement included a monthly service fee on day one, then a similar conclusion might be reached. However, depending on the facts and circumstances, all or part of an ongoing management fee that is charged on a monthly or annual basis is likely to be in the scope of the new standard.



# 3 Identifying the contract

## 3.1 Identifying the customer

### Requirements of the new standard

The new standard applies only to contracts with customers. Contracts with parties other than customers are accounted for under other requirements. A 'contract' is an agreement between two or more parties that creates enforceable rights and obligations. A 'customer' is a party that has contracted with an entity to obtain goods or services, which are an output of the entity's ordinary activities, in exchange for consideration.



#### How does this approach differ from previous requirements?

Previous revenue guidance focused on the goods and services that an entity delivers as part of its ordinary activities. It did not use the concept of identifying a contract with a customer.

The definition of a contract in the new standard focuses on legal enforceability. Although the term 'contract' is also defined in IAS 32 *Financial Instruments: Presentation*, the IAS 32 definition is different and stops short of requiring the contract to be legally enforceable.

The IASB did not amend the definition of a contract in IAS 32 on the grounds that this could have unintended consequences on the accounting for financial instruments. As a result, there are two definitions of a contract in IFRS – one in IFRS 15 and another in IAS 32.



#### Application of the new requirements

The new standard does not provide specific guidance on how to identify a customer. Investment management companies apply judgement about the specific facts and circumstances of each arrangement and adopt a consistent approach in their evaluation. However, it is important to note that a contract with a customer only exists when the company has enforceable rights and obligations with the customer.

Determining which party is the customer is an important consideration for investment management companies. An investment manager generally enters into contracts with a fund to provide services, but the funds are vehicles that enable investors to pool their money to benefit from an investment manager's services. This situation raises the question of whether the investment manager's customer is the fund or each individual investor in the fund. Subtle differences in the structure of the arrangements may lead to different conclusions on whether a fund, or an investor in the fund, is the customer in a contract. This conclusion could affect the following.

- *Timing of revenue recognition*: For example, when an investment manager has multiple contracts or multiple promises in a contract that would be accounted for either separately or as a single performance obligation depending on who the customer is for each individual contract or promise – see [Section 5](#).
- *Accounting for certain costs*: For example, costs associated with launching a new fund or obtaining new investors could be either expensed as incurred or capitalised depending on whether they are associated with obtaining customers or fulfilling performance obligations – see [Section 9](#).

Investment management companies need to consider the specific facts and circumstances of each arrangement when identifying the customer. However, the key when identifying the customer is to identify which party the company has enforceable rights and obligations with. For large retail funds, the fund is often the customer of the fund manager. However, for smaller, boutique funds, the individual investor could be identified as the customer because, in these cases, it is more likely that enforceable rights and obligations will exist directly between the investor and the fund manager – e.g. a limited liability partnership set up by a fund manager that has a small number of investors, each of whom are limited partners.

The following characteristics may be helpful when determining whether a fund (rather than its investors) is the customer.

Characteristic	Description
<b>Visibility of the ultimate investor</b>	<ul style="list-style-type: none"> <li>– The fund has a large number of investors with a high turnover in the investor base.</li> <li>– The investors have subscribed through a third party – e.g. through a broker or a dealer – such that they are not visible to the investment manager.</li> </ul>
<b>Fee arrangements</b>	<ul style="list-style-type: none"> <li>– The fund's management fees are negotiated by the fund and are predetermined for each class of investor.</li> <li>– The investor has little or no ability to negotiate the management fees.</li> </ul>
<b>Fund governance</b>	<ul style="list-style-type: none"> <li>– Governance of the fund is independent of its management.</li> <li>– The investors' representation in the governing body is limited.</li> </ul>
<b>Legal structure</b>	<ul style="list-style-type: none"> <li>– The fund is a separate legal entity – e.g. a partnership or a corporation.</li> </ul>
<b>Termination clause</b>	<ul style="list-style-type: none"> <li>– The investors' ability to remove the investment manager is limited.</li> </ul>
<b>Service providers</b>	<ul style="list-style-type: none"> <li>– The fund has multiple contractual arrangements with the investment manager and other service providers to provide different services.</li> </ul>
<b>Regulation</b>	<ul style="list-style-type: none"> <li>– The fund is highly regulated.</li> </ul>

This list is not exhaustive and none of the characteristics on its own is determinative. Investment managers should assess the characteristics and the arrangement's structure as a whole when identifying the customer.



#### Example – Identifying the fund as the customer

Investment Management Company P establishes a closed-end fund (a fund with a fixed number of shares in issue) that issued its units through the local stock exchange. The number of participation units issued to the public is large and investor turnover is high. The fund's terms, as determined by local regulation, are as follows.

- The fund is a separate company that holds the managed assets.
- The fund's investment policy and management fees are predetermined and disclosed to investors in the prospectus.
- A contract exists between the fund and P as fund manager, which sets out the investment policy and the fees that P will receive.
- P cannot be replaced as the fund manager.
- P appoints a trustee to monitor its implementation of the investment policy and compliance with regulatory requirements.

P considers whether the fund or the investors in the fund is the customer in the arrangement.

P notes that it has no direct contact with the investors. Instead, a trustee is appointed to represent the investors' interests. P also identifies that a contract between it and the fund exists, which creates enforceable rights and obligations for the investment management services that it provides and the consideration that it receives for providing those services. Therefore, P concludes that the fund is its customer. This is supported by the following characteristics of the fund.

- The ultimate investors are not visible to P because the units are traded in large volumes and with a high turnover.
- The fund's management fees are identical for all investors and are non-negotiable.
- The managed assets are held by a separate legal entity.
- P cannot be removed from its position as the fund manager.
- P provides all of the services necessary for the fund's operation.
- The fund is highly regulated.



#### Example – Identifying the investors as the customer – Institutional clients

Investment Management Company X establishes a single closed-end fund that serves multiple institutional clients – e.g. insurance companies. X negotiates a bespoke management agreement with each client separately. X's fund issues a special institutional share class for each client in accordance with its management agreement.

X evaluates the arrangement to identify the customer.

X determines that each institutional client is a customer, in a separate contract (see [Section 3.2](#)). This is because X has a separate contract with each institutional client that sets out its enforceable rights and obligations. In addition, X can identify each institutional client, because it has negotiated a bespoke management agreement with each one of them.



**Example – Identifying the investors as the customer – Pension fund**

Pension Fund Manager F manages a pension fund. The fund’s investment policy is set and controlled by F. To invest in the fund, an investor enters into a contract with F that sets out the investment amount, the terms of redemption and the fee payable to F for its investment management services. Each investor can negotiate the management fee that it will pay to F as part of the contract. F keeps a record of all of the investors in the fund and their share of the fund’s assets. The management fees payable to F under the investors’ contracts are paid by the fund directly.

F evaluates the arrangement to identify the customer.

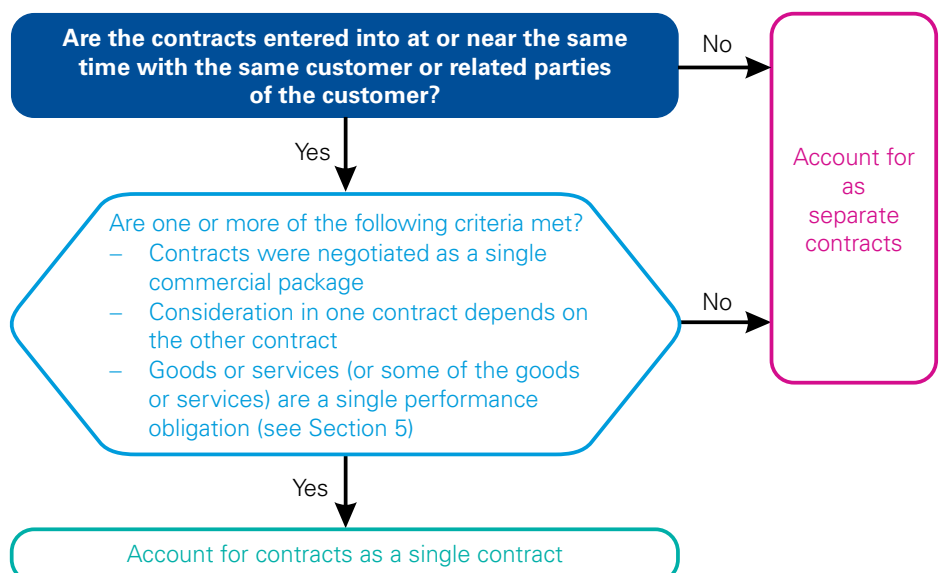
F determines that the individual investors are its customers. This is because it has separate contracts with each investor that set out its enforceable rights and obligations. Further, F can identify each individual investor in the fund and negotiates with them individually to agree the fee for its investment management services.

**3.2**

**Combining contracts**

**Requirements of the new standard**

The following flowchart outlines the criteria in the new standard for determining when an entity combines two or more contracts and accounts for them as a single contract.



These requirements are discussed further in Chapter 5.1.4 of our [Revenue Issues In-Depth](#) publication.



### How does this approach differ from previous requirements?

#### Combining contracts

The new standard is broadly similar to the previous requirements of IAS 11 *Construction Contracts* and IAS 18. However, IAS 11 required an entity to consider combining a group of contracts as a single contract when the contracts were performed concurrently or in a continuous sequence. In contrast, the new standard states that contracts are combined when the goods or services promised in the contracts are a single performance obligation. In addition, it provides more specific guidance than IAS 18 on when to combine contracts and requires contracts to be combined when those conditions are met.

Under previous IFRS, contracts with different customers could be combined in certain circumstances. In contrast, the new standard permits combining of contracts only when the contracts are with the same customer or a related party of the customer.



### Application of the new requirements

#### Combining of contracts depends on the customer's identity

For two or more contracts to be combined, the new standard requires that they need to be with the same customer (or a related party of the customer). Therefore, if the investors in a fund are identified as the customer by a fund manager (see [Section 3.1](#)), then the individual contracts with investors cannot be combined under the new standard.

However, the investment management company may be able to account for the contracts with individual investors together as a portfolio, using the portfolio practical expedient, if:

- those contracts have similar characteristics; and
- the company reasonably expects the outcome from applying the new standard to a portfolio of contracts, or to contracts individually, not to be materially different.

Conversely, if the fund is identified as the customer, then an investment management contract is accounted for as a single unit of account.

### Separate agreements for different services may be combined

Some of the services provided by an investment manager may be included in separate contracts from the main investment management services agreement. For example, investment managers may sign separate contracts with a fund for administrative and distribution services. In addition, investment managers may enter into side letter agreements to modify the contracts with their customers. If the contracts were signed at or near the same time, then they may be combined, depending on the investment manager's specific facts and circumstances.



#### Example – Combining contracts

Fund Manager M enters into a contract to provide investment management services to Fund F. Three days later, in a separate contract, M enters into a contract to prepare F's financial statements and other regulatory reports. During the negotiations, M agrees to provide investment management services at a discount if it also provides administrative services to F.

M concludes that the two contracts should be combined because they were entered into with the same customer at nearly the same time and they were negotiated as a single commercial package.

## 3.3

### Contract term

#### Requirements of the new standard

The new standard applies for the duration of the contract – i.e. the contractual period for which the parties to the contract have presently enforceable rights and obligations.

A contract does not exist if each party to the contract has the unilateral, enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties).

If an entity enters into a contract with a customer that can be renewed or cancelled by either party at discrete points in time without significant penalty, then it accounts for its rights and obligations in the period during which the contract cannot be cancelled by either party. When only the customer has the right to terminate the contract without penalty, the cancellable period is analysed as a customer's option to extend the contract.

These requirements are discussed further in Chapter 5.1 of our [Revenue Issues In-Depth](#) publication.



### How does this approach differ from previous requirements?

#### Contract term affects many parts of the new standard

Previous IFRS requirements did not explicitly address the contract term. Under the new standard, determining the contract term is important because it may affect the measurement and allocation of the transaction price, timing of revenue recognition for non-refundable up-front fees (see [Section 4](#)), accounting for contract modifications, capitalisation of costs to obtain a contract (see [Section 9](#)) and identification of material rights to extend the contract.



### Application of the new requirements

Some investment management contracts are cancellable by either party each period (e.g. on a month-to-month basis) without penalty. These contracts are no different from contracts that require the parties to actively elect to renew the contract each period. In these situations, the contract term does not extend beyond the current period – e.g. the current month.

Further, if the contract is cancellable only at the discretion of the customer without substantive penalty, then the contract period does not extend beyond the period for which the customer has the ability to cancel the contract without substantive penalty.



### Example – Contract term

Investment Management Company R manages a closed-end fund. The fund is approaching the end of its life and its units may be redeemed by their holders at the end of each month. In addition, R is entitled to force redemption of the units at the same date.

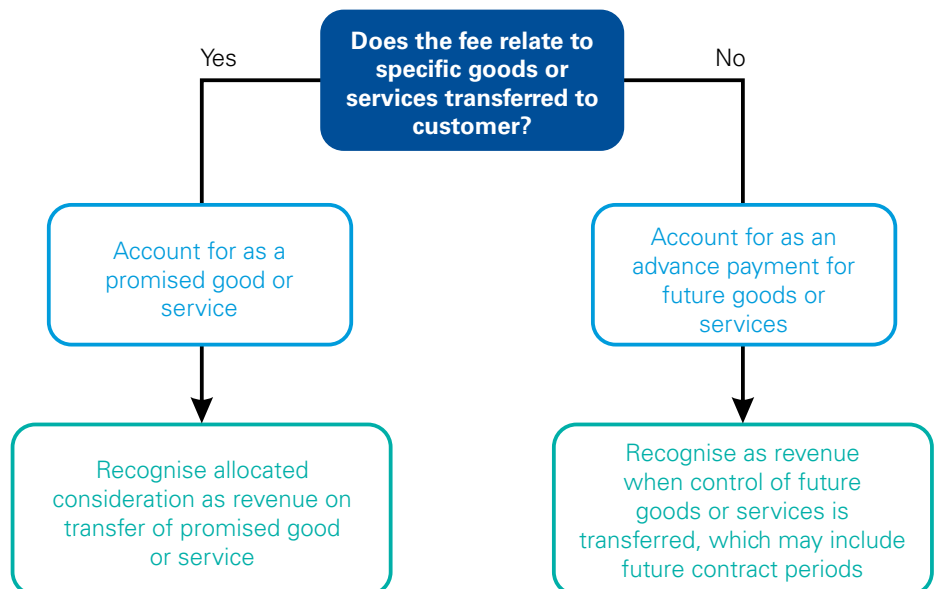
R identifies the unit holders as the customers in this contract. It concludes that the (remaining) term of the investment management contracts with the unit holders is one month because beyond that point, the contract can effectively be terminated by either party without (substantive) penalty.

# 4 Non-refundable up-front fees

## Requirements of the new standard

An entity assesses whether a non-refundable up-front fee relates to the transfer of a promised good or service to the customer. In many cases, even though a non-refundable up-front fee relates to an activity that the entity is required to undertake to fulfil the contract, that activity does not result in the transfer of a promised good or service to the customer. Instead, it is an administrative task. If the activity does not result in the transfer of a promised good or service to the customer, then the non-refundable up-front fee is an advance payment for performance obligations to be satisfied in the future and is recognised as revenue when those future goods or services are provided.

If the non-refundable up-front fee gives rise to a material right for future goods or services, then an entity attributes all of it to the goods and services to be transferred, including the material right associated with the up-front payment.







### How does this approach differ from previous requirements?

Under previous IFRS, any initial or entrance fee was recognised as revenue when there was no significant uncertainty over its collection and the entity had no further obligation to perform any continuing services. It was recognised on a basis that reflected the timing, nature and value of the benefits provided. These fees might be recognised in total, partially up-front or over the contractual or customer relationship period, depending on the facts and circumstances.

Under the new standard, to determine the timing of revenue recognition an entity assesses whether a non-refundable up-front fee relates to a specific good or service transferred to the customer and, if not, whether it gives rise to a material right.



### Application of the new requirements

#### Determining whether a non-refundable up-front fee relates to the transfer of a promised service

In many cases, even though a non-refundable up-front fee relates to an activity that an investment management company is required to undertake at or near contract inception to fulfil the contract, that activity does not result in the transfer of a promised service to the customer. The new standard specifically notes that administrative set-up activities do not represent a service that is transferred to a customer and, therefore, revenue cannot be recognised when these activities are undertaken.

When assessing whether the non-refundable up-front fee relates to the transfer of a promised service, an investment management company considers all relevant facts and circumstances, including:

- whether a service is transferred to the customer in exchange for the non-refundable up-front fee and the customer is able to realise a benefit from the service received. If no service is received by the customer or if it is of little or no value to the customer without obtaining other services from the company, then the non-refundable up-front fee is likely to represent an advance payment for future services; and
- if the company does not separately price and sell the activities covered by the non-refundable up-front fee, then it may not relate to the transfer of a promised service.

#### Non-refundable up-front fee may give rise to a material right

Investment management companies may grant their customers a contractual option to extend their investment management contracts. Alternatively, a customer may have the right to terminate a contract without a penalty (see [Section 3.3](#)). Combined with a non-refundable up-front fee, these clauses may give rise to material rights to extend a contract, which are accounted for as a separate performance obligation (see [Section 5](#)).

A non-refundable up-front fee may provide the customer with a material right if it is of such significance that it is likely to impact the customer's decision on whether to extend the service or not exercise a termination clause.

An investment management company considers both quantitative and qualitative factors when assessing whether a non-refundable up-front fee provides the customer with a material right, because it would probably impact the customer's decision on whether to exercise the option to continue receiving the company's services. These could be, for example, the customer's ability to obtain similar investment management services from other companies without having to pay a non-refundable up-front fee, or regulatory or administrative restrictions that make it inconvenient for the customer to change investment manager.

### Considering whether a non-refundable up-front fee gives rise to a significant financing component

An investment management company may also need to consider whether the receipt of a non-refundable up-front payment gives rise to a significant financing component within the contract. This is because significant financing components arise when there is a timing difference between a company providing the service to the customer and receiving the consideration for that service. When determining if the contract includes a significant financing component, all relevant facts and circumstances need to be evaluated.



#### Example – Non-refundable up-front fees

Investment Management Company U enters into a one-year contract to provide investment management services to an investor.

In addition to a monthly fee of 1% of the managed assets, U charges a one-time subscription fee of 50. U determines that this is a set-up activity that does not transfer a service to the investor, but instead is an administrative task. U expects to earn a monthly fee of 10 from the contract.

At the end of the year, the investor can renew the contract on a month-to-month basis, at a similar monthly rate. The investor will not be charged another fee on renewal.

U considers both quantitative and qualitative factors when determining whether the up-front fee provides an incentive for the investor to renew the contract beyond the stated contract term.

- U compares the up-front fee of 50 with the total transaction price of 170 – i.e. the variable fee of 120 plus the up-front fee of 50. It concludes that the non-refundable up-front fee is quantitatively material.
- U considers the qualitative reasons why the investor might renew the contract. It notes that competitors charge similar management fees and subscription fees to investors for similar contracts. In addition, it notes that changing an investment manager is a long process that may be considered inconvenient to the investor.

These factors are also reflected in a strong history of renewals and an average customer life that is longer than one year.

U concludes that the up-front fee results in a contract that includes a customer option that is a material right. Therefore, it allocates the up-front fee between the one-year investment management services and the material right to renew the contract. The consideration allocated to the material right will be recognised as revenue when that right is exercised or expires.

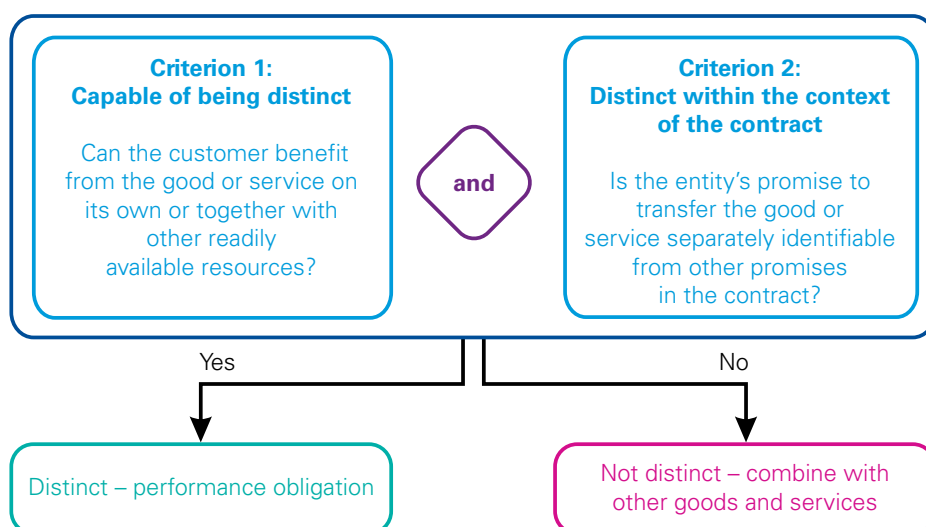
# 5 Performance obligations

## Requirements of the new standard

A performance obligation is the unit of account for revenue recognition. An entity assesses the goods or services promised in a contract with a customer and identifies as a performance obligation either:

- a good or service (or a bundle of goods or services) that is distinct; or
- a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer – i.e. each distinct good or service in the series is satisfied over time and the same method is used to measure progress.

At contract inception, an entity evaluates the promised goods or services to determine which goods or services (or bundle of goods or services) are distinct and, therefore, constitute a performance obligation.



Promises to transfer a good or a service can be stated explicitly in a contract or implicitly, based on established business practices that create a valid expectation that the entity will transfer the good or service. Conversely, tasks that do not transfer a good or service to the customer are not separate performance obligations and are not included in the analysis – e.g. administrative set-up tasks (see [Section 4](#)).

These requirements are discussed further in Chapter 5.2 of our [Revenue Issues In-Depth](#) publication.



### How does this approach differ from previous requirements?

#### More guidance on separating goods and services in the contract

Previous IFRS included limited guidance on identifying whether a transaction contained separately identifiable components. However, our view was that, based on analogy to the test in IFRIC 18 *Transfers of Assets from Customers*, an entity considered whether a component had a stand-alone value to the customer and whether that fair value could be measured reliably.

The new standard introduces comprehensive guidance on identifying separate components, which applies to all revenue-generating transactions. This could result in services being unbundled or bundled more frequently than under previous practice.



### Application of the new requirements

Some contracts offered by investment management companies may integrate different services into a single package – e.g. administrative services, investment management services and custody services. When all of the identified services are performed concurrently for the same period, the impact of separating performance obligations may be limited to disclosure only. In other cases, the identification of performance obligations may impact the timing or amount of revenue recognised for a period, as illustrated below.

An investment management company's conclusion on whether its customer for each service provided is the fund or its underlying investors (see [Section 3.1](#)) may influence the outcome of a company's assessment of the number of performance obligations in a contract. This is because contracts with different, unrelated customers cannot be combined (see [Section 3.2](#)) and, therefore, services granted to different customers cannot be considered as a single performance obligation.

Investment management services contracts are generally considered to meet the series guidance requirements. This is because they represent the delivery of a continuous service to the customer over the contract period with each time increment of service provided – e.g. each hour or each day – being distinct from the next. Each time increment also meets the over-time criteria because the customer consumes the benefits of the service as the investment manager provides it and the measure of progress is the same – i.e. time-elapsing. Because the criteria to apply the series guidance are met, the company accounts for all of the services that make up the series as a single performance obligation.

**Example – Up-front fees for distribution services**

Parent Company G consolidates Investment Management Company F and Broker B, which distributes F's products. B charges investors up-front fees on subscription to F's funds.

Judgement is required to determine whether:

- both services are provided to the same party – i.e. the fund or its investors;
- B's distribution services contract and F's investment management contract should be combined into a single contract;
- distribution is a task that transfers a service to the investor or the fund; and
- distribution services are a separate performance obligation, or a supporting activity of the overall investment management services offered by G.

If the distribution services are a separate performance obligation satisfied at a point in time, then revenue is recognised up-front, even if G did not charge a fee for this service separately. If the distribution and investment management services are a single performance obligation, then any up-front fee is recognised over time (see [Section 4](#)).

A similar analysis would be required if F provided both the distribution service and the investment management services to the customers.

**Example – Series of distinct services**

Investment Management Company S enters into a five-year contract with a customer to provide investment management services. S receives a 2% quarterly management fee based on the assets under management at the end of each quarter.

S concludes that the individual time increments of service within the five-year contract are distinct from each other. Criterion 1 is met because the customer can benefit from each time increment of service provided independently of the other. Criterion 2 is met because each time increment does not significantly modify or customise the other and S is not providing a service of combining the time increments together to create a single combined output for the customer.

However, S concludes that all of the time increments during the five-year contract represent a series of distinct services. Therefore, the contract is treated as a single performance obligation.

The distinct time increments meet the series criteria because:

- the services provided in each time increment are substantially the same;
- the services meet the over-time criteria, because the customer consumes the benefits of the services as they are provided; and
- the same method to measure progress would apply to each time increment of service – i.e. a time-based measure of progress.

Even though the series guidance applies and the entire contract is treated as a single performance obligation, S concludes that it can allocate the quarterly management fee to each quarter using the allocation guidance in the new standard, which allows an entity to allocate variable consideration to one or more distinct goods or services within the contract – see [Section 8](#).

## 6

# Principal vs agent

## Requirements of the new standard

When other parties are involved in providing goods or services to an entity's customer, the entity determines whether the nature of its promise is a performance obligation to provide the specified goods or services itself, or to arrange for them to be provided by another party – i.e. whether it is a principal or an agent. This determination is made by identifying each specified good or service promised to the customer in the contract and evaluating whether the entity obtains control of the specified good or service before it is transferred to the customer.

When another party is involved, an entity that is a principal obtains control of any one of the following:

- a good from another party that it then transfers to the customer;
- a right to a service that will be performed by another party, which gives the entity the ability to direct that party to provide the service on the entity's behalf; or
- a good or a service from another party that it combines with other goods or services to produce the specified good or service promised to the customer.

The new standard includes indicators to help an entity evaluate whether it controls a specified good or service before it is transferred to the customer – i.e. inventory risk, discretion to establish prices for specified goods or services and primary responsibility to provide specified goods or services.

These requirements are discussed further in Chapter 10.3 of our [Revenue Issues In-Depth](#) publication.



### How does this approach differ from previous requirements?

#### From risk and reward to transfer of control

There was a similar principle in previous IFRS that amounts collected on behalf of a third party were not accounted for as revenue. However, determining whether the entity is acting as an agent or a principal under the new standard differs from previous IFRS, as a result of the shift from the risk-and-reward approach to the transfer-of-control approach. Under previous IFRS, the entity was a principal in the transaction when it had exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. The IASB noted that the indicators serve a different purpose from those in previous IFRS, reflecting the overall change in approach.



## Application of the new requirements

### Sub-advisers may be principals or subcontractors in the transaction

Investment management companies often engage sub-advisers or delegate certain investment management activities related to the service contract that they enter into. Judgement is required to determine whether the company directs the advisers to provide investment management services on its behalf instead of hiring its own employees – i.e. they are used as subcontractors.

### Further analysis is required in stand-alone financial statements

Some investment management companies provide their customer with services through subsidiaries – e.g. distribution services by a broker or a distribution subsidiary. Although from a consolidated perspective, the group is usually considered as a principal in the transaction with the customer, further analysis is required in the stand-alone financial statements of the broker or distribution subsidiary.



### Example – Company is acting as a principal

Investment Management Company P engages Advisory Company S to provide it with consulting services in implementing the investment management policy of its customer, Fund F.

P notes that:

- it has entered into a contract with F before engaging with S;
- it is the counterparty to the consulting services contract, rather than F; and
- it has a contractual right to direct how S provides the services and also to suspend S's services.

P concludes that these factors indicate that it is using S as a subcontractor and that it is a principal directing S to provide services on its behalf. In reaching this decision, P also considered the indicators of control provided by the new standard.

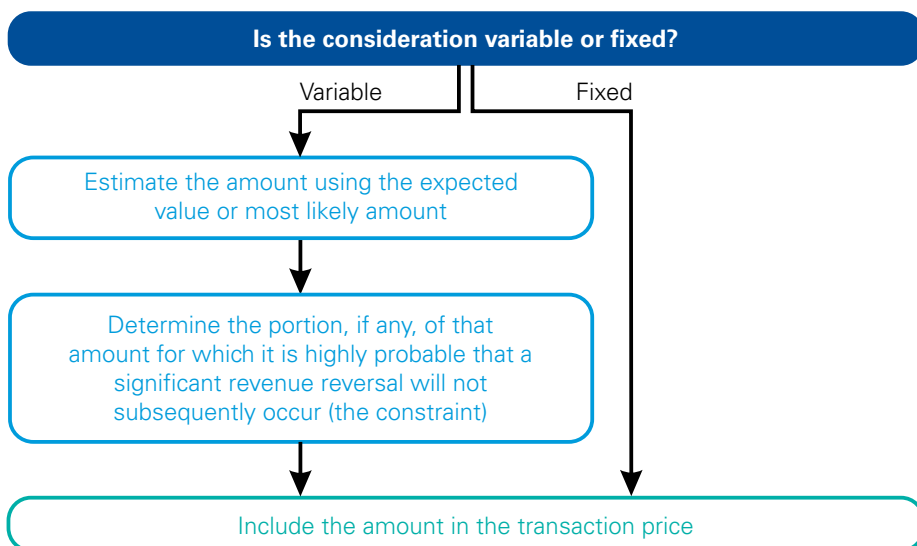
- P is considered by F as the company with the primary responsibility for the fulfilment of the investment management services contract and for the acceptability of those services by F.
- P has determined the price of the investment management services before it has signed a contract with S.

# 7 Variable consideration

## Requirements of the new standard

Items such as price concessions, incentives, performance bonuses, completion bonuses, price adjustment clauses, penalties, discounts, refunds, rights of return, credits or similar items may result in variable consideration.

The following flowchart sets out how an entity accounts for variable consideration.



The method used by an entity to estimate variable consideration is not an accounting policy choice. The entity selects the method that best predicts the amount of consideration it expects to receive.

<b>Expected value</b>	The entity considers the sum of probability-weighted amounts for a range of possible consideration amounts. This may be an appropriate estimate of the amount of variable consideration if the entity has a large number of contracts with similar characteristics.
<b>Most likely amount</b>	The entity considers the single most likely amount from a range of possible consideration amounts. This may be an appropriate estimate of the amount of variable consideration if the contract has only two (or perhaps a few) possible outcomes.

After estimating the variable consideration, an entity may include some or all of it in the transaction price – but only to the extent that it is highly probable that a significant reversal in the amount of cumulative revenue will not occur when the uncertainty associated with the variable consideration is subsequently resolved.



To assess whether – and to what extent – it should apply this ‘constraint’, an entity considers both:

- the likelihood of a revenue reversal arising from an uncertain future event; and
- the potential magnitude of the revenue reversal when the uncertainty related to the variable consideration has been resolved.

When making this assessment, an entity uses judgement, giving consideration to all facts and circumstances – including the following factors, which could increase the likelihood or magnitude of a revenue reversal.

- The amount of consideration is highly susceptible to factors outside the entity’s influence – e.g. volatility in a market.
- The uncertainty about the amount of consideration is not expected to be resolved for a long period of time.
- The entity’s experience with (or other evidence from) similar types of contracts is limited, or has limited predictive value.
- The contract has a large number and a broad range of possible consideration amounts.

This assessment needs to be updated at each reporting date.

These requirements are discussed further in Chapter 5.3 of our [Revenue Issues In-Depth](#) publication.



#### How does this approach differ from previous requirements?

##### **New approach for calculating amounts of consideration that are variable**

Under the new standard, the approach to accounting for variable consideration is significantly different from the approach followed under previous requirements.

Under previous IFRS, both fixed and variable components of revenue were measured at fair value and an entity recognised revenue only if it could estimate the amount reliably – i.e. uncertainty over the outcome could have precluded recognition of the full variable amount.

The new standard specifies two approaches for estimating variable consideration – neither of which is a fair value approach – and limits the amount of cumulative revenue that can be recorded to the amount that will not be subject to significant revenue reversal (the ‘constraint’), rather than precluding recognition. The new standard also uses the term ‘highly probable’ in its requirements, which is a higher hurdle than ‘probable’. This may result in later recognition of variable amounts.

##### **New prescriptive guidance on allocating discounts and variable consideration**

There was no specific guidance on allocating a discount in previous IFRS. If an entity allocates consideration according to the relative fair value of components, then it effectively allocates a discount to all components in the arrangement. If an entity uses the residual method to allocate consideration, then it effectively allocates the discount to the delivered component. The new standard introduces specific guidance on allocating discounts.

There was also no specific guidance in previous IFRS on allocating variable consideration. Arguably, the general requirement in previous IFRS to measure revenue at the fair value of the consideration received or receivable means that this guidance is less relevant under the new standard.

However, the new standard's guidance on variable consideration and the constraint could produce counter-intuitive results if variable consideration were always allocated to all performance obligations in a contract. The new standard therefore requires alternative approaches in specific circumstances.



### Application of the new requirements

#### Constraining variable consideration depends on the nature of the fee

For investment management contracts, the majority of the consideration in the contract will generally be variable consideration. Variable consideration may take many forms. A management fee based on net asset value (NAV) at the end of each quarter and performance fees payable when a specified return level is achieved are both examples of variable consideration. In addition, fees that vary depending on whether a fund under- or over-performs compared with a benchmark (often referred to as 'fulcrum fees') are also a form of variable consideration.

The most appropriate approach for estimating these types of variable consideration is the expected value method because there are a large number of possible outcomes. However, if the variable consideration is a one-off bonus payment when a specified level of returns is achieved, then the most likely amount approach may be appropriate.

Variable consideration in investment management contracts may be constrained to zero until the uncertainty is resolved. This is because the magnitude of the variability is generally significant. In addition, market volatility is outside the control of the company and previous contracts may have a limited predictive value regarding the outcome of the current contract. For example, if the contract includes a performance fee that is paid based on performance over the entire contract period, then the company may not be able to recognise revenue for this element of the transaction price until the end of the contract period. This may be the case for 'carried interest' arrangements, where the fund manager is compensated only after the fund returns all of its investors' capital contributions and an agreed-on rate of return. Similarly, if a fee is subject to claw-back, then the company may not be able to recognise revenue for the fee that is subject to the claw-back until the claw-back period has expired.

However, a company may be able to recognise revenue for management fees that are based on NAV at specified dates during the contract period, and not subject to subsequent claw-back, because the variability for these fees is generally resolved at the specified date. For a discussion of the allocation of variable fees to distinct time increments within a performance obligation, see [Section 8](#).

### Fee waivers and fee caps may be either variable consideration or a contract modification

Accounting for fee waivers and fee caps depends on the specific facts and circumstances of the investment management contract in which they are included. These clauses may be:

- *variable consideration*: if they are part of the original terms of the investment management agreement (or a contract that is combined with the original investment management agreement (see [Section 3.2](#))). This evaluation includes an assessment of the investment management company's past practice and other activities that could give rise to an expectation at contract inception that the transaction price includes a variable component; or
- *a contract modification*: if a customer and an investment management company agree to amend the consideration in an existing investment management contract (or enter into a new contract that amends the consideration in an existing investment management contract). Contract modifications are discussed further in Chapter 7 of our [Revenue Issues In-Depth](#) publication.



### Example – Applying the constraint and allocating variable consideration

Investment Manager M enters into a two-year contract to provide investment management services to its customer, Fund N. N's investment objective is to invest in equity instruments issued by large listed companies. M receives the following fees in cash for providing the investment management services.

<b>Quarterly management fee</b>	2% per quarter, calculated on the basis of the fair value of the net assets at the end of the most recent quarter
<b>Performance-based incentive fee</b>	20% of the fund's return in excess of an observable market index over the contract period

M determines that the contract includes a single performance obligation (series of distinct services) that is satisfied over time and identifies that both the management fee and the performance fee are variable consideration. Before including the estimates of consideration in the transaction price, M considers whether the constraint should be applied to either the management fee or the performance fee.

At contract inception, M determines that the cumulative amount of consideration is constrained because the promised consideration for both the management fee and the performance fee is highly susceptible to factors outside its own influence. In addition, M observes that its experience with similar contracts has little predictive value in determining the future performance of this fund. At each subsequent reporting date, M makes the following assessment of whether any portion of the consideration continues to be constrained.

<p><b>Quarterly management fee</b></p>	<p>M determines that the cumulative amount of consideration from the management fee to which it is entitled is not constrained, because it is calculated based on NAV at the end of each quarter. Therefore, the consideration for the quarter is known after the end of each quarter. M determines that it can allocate the entire amount of the fee to the completed quarters, because the fee relates specifically to the service provided for those quarters (see <a href="#">Section 8</a>).</p>
<p><b>Performance-based incentive fee</b></p>	<p>M determines that the full amount of the performance fee is constrained and therefore excluded from the transaction price. This is because:</p> <ul style="list-style-type: none"> <li>– the performance fee has many possible consideration amounts and the magnitude of any downward adjustment could be significant;</li> <li>– although M has experience with similar contracts, this experience is not predictive of the outcome of the current contract because the amount of consideration is highly susceptible to volatility in the market based on the nature of the assets under management; and</li> <li>– there are a large number of possible outcomes.</li> </ul>

As a result, M determines that the revenue recognised during the reporting period is limited to the quarterly management fees for completed quarters. This is determined at each reporting date and could change towards the end of the contract period.



#### Example – Applying the constraint

Investment Manager M enters into a three-year contract to provide investment management services to Fund L. L is nearing its final liquidation and M is asked to execute the investment policy during the run-off period. M will be entitled to a significant bonus at the end of the contract if the proceeds from the liquidation of L's assets exceed 2,000,000. M notes that:

- L's NAV at the end of the second year of the contract was 5,000,000 – i.e. the fair value of the remaining assets in the fund is significantly in excess of 2,000,000;
- L's remaining assets have low risk; and
- market volatility and macro-economic variables affecting L's asset value indicate that a significant decrease is very unlikely to occur.

Therefore, during the third year, M may be able to conclude that it is sufficiently likely that:

- the proceeds from L's liquidation will exceed the required threshold; and
- it is highly probable that a significant reversal in the amount of cumulative revenue recognised will not occur at the end of the contract.

If this is the case, then M may include the expected bonus in the transaction price during the third year of the contract, before the final resolution of the uncertainty.

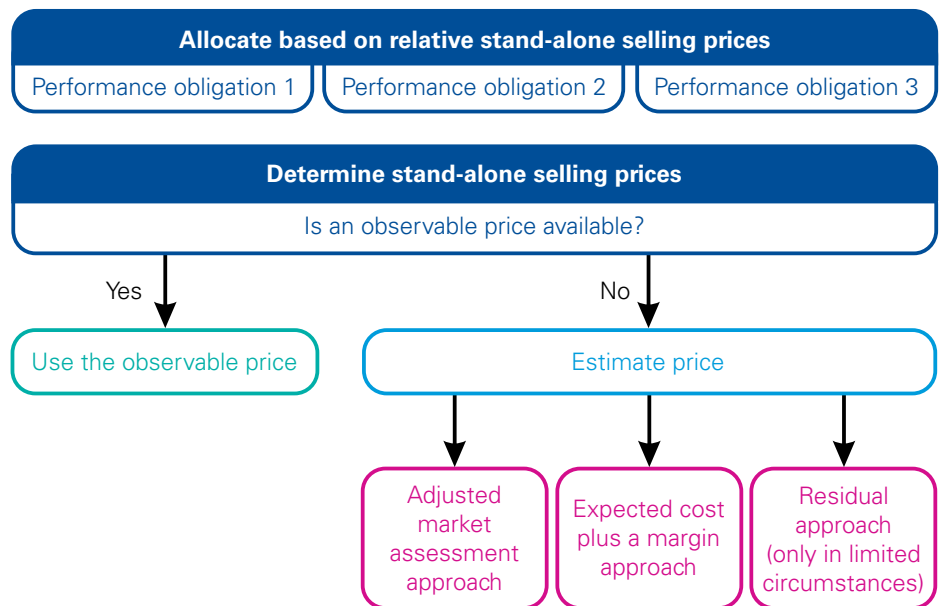
# 8 Allocation of transaction price

The transaction price is allocated to each performance obligation – generally each distinct good or service – to depict the amount of consideration to which an entity expects to be entitled in exchange for transferring the promised goods or services to the customer.

The ‘stand-alone selling price’ is the price at which an entity would sell a promised good or service separately to a customer. The best evidence of this is an observable price from stand-alone sales of the good or service to similarly situated customers.

A contractually stated price or list price may be the stand-alone selling price of that good or service, but this is not presumed to be the case.

If the stand-alone selling price is not directly observable, then the entity estimates the amount under a suitable method as illustrated below. In limited circumstances, an entity may estimate the amount under the residual approach.



At contract inception, the transaction price is generally allocated to each performance obligation on the basis of relative stand-alone selling prices.

However, variable consideration may be attributable to:

- all of the performance obligations in a contract;
- one or more, but not all, of the performance obligations in a contract; or
- one or more, but not all, of the distinct goods or services promised in a series of distinct goods or services that form part of a single performance obligation.

An entity allocates a variable amount – and subsequent changes to that amount – entirely to a performance obligation, or to a distinct good or service that forms part of a single performance obligation, only if both of the following criteria are met:

- the variable payment terms relate specifically to the entity's efforts to satisfy the performance obligation or transfer the distinct good or service (or to a specific outcome of satisfying the performance obligation or transferring the distinct good or service); and
- allocating the variable amount of consideration entirely to the performance obligation or distinct good or service is consistent with the new standard's overall allocation principle when considering all of the performance obligations and payment terms in the contract.

These requirements are discussed further in Chapter 5.4 of our [Revenue Issues In-Depth](#) publication.



#### How does this approach differ from previous requirements?

There was no specific guidance in previous IFRS on allocating variable consideration. Arguably, the general requirement in previous IFRS to measure revenue at the fair value of the consideration received or receivable means that such guidance is less relevant than it is under the new standard.

However, the new standard's guidance on variable consideration and the constraint could produce counter-intuitive results if variable consideration were always allocated to all performance obligations in a contract. The new standard therefore requires alternative approaches in specific circumstances.



#### Application of the new requirements

##### Periodic fees may be allocated to distinct time increments of a service

Investment management services are often accounted for as a single performance obligation, based on the series guidance in the new standard (see [Section 5](#)). However, an investment management company may be able to allocate periodic variable fees to distinct time increments within a performance obligation. For example, if fees are calculated based on the NAV of the managed assets at the end of each quarter, then this allocation will typically lead to recognising the fees as revenue in full at the end of each quarter. This is because the variable consideration is allocated to the distinct time increments of service up to the measurement date at the end of the quarter, and all of the variability associated with those time increments is resolved.

## 9

# Contract costs

## Requirements of the new standard

Sales commissions and other contract costs may be capitalised if they are incremental costs (i.e. costs to obtain, extend or modify a contract) meet the definition of costs to fulfil a contract or are in the scope of another standard (e.g. intangible assets).

However, as a practical expedient that applies only to costs to obtain a contract, an entity is not required to capitalise the incremental costs of obtaining a contract if the amortisation period of the contract cost asset is one year or less.

An entity amortises the asset recognised for the costs to obtain and/or fulfil a contract on a systematic basis, consistent with the pattern of transfer of the good or service to which the asset relates. This can include the goods or services in an existing contract, as well as those to be transferred under a specific, anticipated contract – e.g. goods or services to be provided following the renewal of an existing contract.

An entity recognises an impairment loss in relation to capitalised contract costs to the extent that the carrying amount of the asset exceeds the recoverable amount. The 'recoverable amount' is the:

- remaining amount of consideration expected to be received in exchange for the goods or services to which the asset relates. This amount is determined using the same principles for determining the transaction price. However, any variable consideration is not constrained and the amount is adjusted to reflect the customer's credit risk; *less*
- costs that relate directly to providing those goods or services and that have not been recognised as expenses.

These requirements are discussed further in Chapter 6 of our [Revenue Issues In-Depth](#) publication.



### How does this approach differ from previous requirements?

#### Fewer costs may be capitalised

IAS 18's illustrative examples noted that incremental costs that are directly attributable to securing an investment management contract were recognised as an asset, if it was probable that they were recoverable.

The new standard has more detailed guidance in this area and may lead to an entity capitalising fewer or more costs than it did previously under IAS 18.

#### Impairment test may be done on an undiscounted basis

IAS 18 provided no specific guidance on testing for the recoverability of capitalised incremental costs that are directly attributable to securing an investment management contract. The new standard introduces a new impairment model that applies to costs to obtain and/or to fulfil a contract. This model is based on a contract's transaction price, which may not be discounted – e.g. if a significant financing component does not exist. This may be a change in practice compared with previous requirements for some entities.





## Application of the new requirements

### Capitalisation of costs to obtain a contract may depend on the identity of the customer

Some fund managers pay commissions to distributors – e.g. banks or brokers – when a new investor is introduced to a fund. Fund managers need to evaluate whether these costs are incremental costs of obtaining the contract. This may not always be the case, especially when the fund, rather than the investors in the fund, is identified as the customer. For example, if a fund manager identifies the fund as its customer in an arrangement, then commissions paid to brokers when an investor purchases shares in the fund may not be considered as incremental costs of obtaining the contract. This is because the contract with the customer (the fund) already exists and, in this case, the costs would not qualify to be capitalised as the costs of obtaining a contract.

### Application of the practical expedient

Under the new standard, investment management companies can choose to expense the costs of obtaining a contract as incurred when the amortisation period for the asset created is one year or less. When determining the amortisation period, a company considers the period over which the good or services to which the costs relate will be provided under existing and anticipated future contracts. That is, when making this assessment a company takes into account expected renewals.

For example, if an investment manager incurs incremental costs to obtain contracts with customers that have an initial term of one year, but a significant proportion of these customers renew their contracts at the end of the initial term, then it cannot assume that it is eligible for the practical expedient. Instead, it determines the amortisation period, which is longer than one year.

### Renewal commissions may affect capitalisation

Investment management companies frequently pay commissions to distributors for both initial and renewal contracts. Sometimes the commissions paid for the initial contract are substantially greater than those paid for a renewal contract.

If the renewal commission is considered 'commensurate' with the initial commission, then the commission relates to services over a period up to the payment of the renewal commission. For example, if a renewal commission is payable annually and the subsequent commissions are considered commensurate with the initial commission, then the amortisation period for the initial commission is one year.

When making the 'commensurate' evaluation, a company considers whether the economic benefits that it expects to obtain from the commission – i.e. the margin that it expects to earn from providing the service – is commensurate with the commission paid. Therefore, when a company's expected economic benefits from providing services during a renewal period are commensurate with those from providing the same services during the initial period, the renewal and initial commissions that will be paid will be roughly equal if they are considered 'commensurate' with each other.

### Specific anticipated contracts are considered in the impairment test

The new standard specifies that an asset relating to contract costs is impaired if its carrying amount exceeds the remaining amount of consideration that an investment management company expects to receive, less the costs that relate directly to providing those goods or services and that have not been recognised as expenses.

Under the new standard, an investment management company considers specific, anticipated contracts when capitalising contract costs. Consequently, it includes cash flows from both existing contracts and specific, anticipated contracts when determining the consideration expected to be received when performing the impairment analysis. However, the investment management company excludes from the amount of consideration the portion that it does not expect to collect, based on an assessment of the customer's credit risk.



#### Example – Costs incurred to obtain a contract

Investment Management Company T provides management services to private customers. Following a competitive tender process, T wins a contract to provide services to a new customer. T incurred the following costs to obtain the contract.

External legal fees for due diligence	15
Travel costs to deliver proposal	25
Success fees to sales employees	10
<b>Total costs incurred</b>	<b>50</b>

The success fees payable to sales employees are incremental costs to obtain the contract, because they are payable only on successfully obtaining the contract. Therefore, T recognises an asset of 10, subject to recoverability.

Conversely, the legal fees and travel costs are incurred regardless of whether the contract is obtained. Therefore, T expenses these costs as they are incurred.



#### Example – Costs of bringing new investors to an existing fund

Investment Management Company P establishes a closed-end fund that issues its units in the local stock exchange. P has identified the fund, and not the investor, as the customer in its investment management contract.

P paid Underwriter U a 1,000 success fee for the initial distribution of the fund's units. It has also entered into an agreement to pay Broker B a fee of 0.1 for every unit of the fund that is subsequently marketed to a new investor.

P concludes that:

- the fee of 1,000 paid to U is eligible for capitalisation, because it is incremental to obtaining the contract with the fund and its recovery is expected; and
- the subsequent payments of 0.1 to B are not incremental to obtaining a contract, because the contract between P and the customer (the fund) already exists. Therefore, these payments are costs that are expensed as incurred.

The costs capitalised under the new standard are subject to its amortisation and impairment requirements.



### Example – Renewal commissions

Pension Fund Manager M provides investment management services to employees for a variable annual fee of 1% of the managed assets' value. Employees have the option to move their savings freely between pension funds every year. M concludes that:

- the employees, and not the fund, are identified as the customer when applying the new standard; and
- the term of the contract with the employees is one year only, with no material rights to extend it. This is because the contract is effectively cancellable after one year and no incremental discount is offered on management fees during the extension period.

M pays an insurance agency 500 for securing the initial contract with each employee and will pay 100 to the insurance agency for each renewal – i.e. extending the contract for an additional year. M determines that the payments to the insurance agency represent incremental costs of obtaining contracts.

Securing an initial contract generally requires a significant amount of effort from the insurance agency. Less effort is generally required to secure the renewal, which may only involve making a few phone calls or sending an email to confirm that the employee wants to keep their savings in the fund.

M concludes that the renewal commission is not commensurate with the initial commission. This is because the commission paid initially is five times greater than the renewal commission, but the economic benefits – i.e. the margin – that M expects to obtain from the renewal are roughly the same as those that it expects to obtain from the initial contract.

Therefore, the initial commission is a partial prepayment for the economic benefits that M expects to receive from subsequent renewal periods. This cost is not subject to the practical expedient and is capitalised as an incremental cost of obtaining the contract.

	Initial contract	Expected renewal 1	Expected renewal 2
Expected revenue	10,000	10,400	10,800
Costs of service	(3,000)	(3,000)	(3,000)
<b>Gross margin (exclusive of commission costs)</b>	<b>7,000</b>	<b>7,400</b>	<b>7,800</b>
<b>Commission paid</b>	<b>(500)</b>	<b>(100)</b>	<b>(100)</b>



### Example – Costs of obtaining a contract with a fund and a fund's investors

Investment Management Company L was appointed as the investment manager of two funds:

- *Collective Investment Management Scheme (CIS) C*: the appointment is governed by an investment management agreement negotiated between L and the directors of C. C has a large number of investors who are not involved in its day-to-day administration; and
- *Pension Fund P*: L negotiated bespoke terms and fee arrangements with an institutional client. Due to the size and scale of the capital that the institutional client seeks to invest, L agrees to lower fee rates for this customer compared with those agreed with C.

L manages a single pool of assets within a single legal entity, which it does not consolidate, for the two contracts. The legal entity issues a separate 'institutional share class' to facilitate the investment management contract with P.

#### Step 1 of the model – Identity of the customer (see Section 3.1)

L identifies two contracts with two different customers.

- *Contract with C*: L concludes that the fund, rather than its investors, is the customer. This is because there is a large number of ultimate investors within the fund that are not visible to L. These investors have not negotiated (nor have the power to negotiate) the terms of the investment management service directly with L. This is further supported by the fact that C is a separate legal structure that has a separate governing body, where the investors' representation is limited.
- *Contract with P*: Similarly, L concludes that P, rather than its investors, is the customer. This is because L has negotiated a bespoke investment management service with the institutional client and not its investors.

L notes that the contracts cannot be combined, because C and P are not related parties.

#### Step 3 of the model – Determine the transaction price

Even though L is expected to receive a single stream of fees from managing a pool of assets within a single legal entity, these cash flows represent the transaction price of the contracts with both C and P. Therefore, L allocates the fees between the two contracts when applying the new standard.

#### Contract costs

L employs distribution staff who are paid, in addition to fixed employee benefits, a percentage of the new funds added to the managed assets. L pays its employees:

- fixed employee benefits of 1,000;
- a bonus of 100 for obtaining the contract with P; and
- a bonus of 50 for obtaining new ultimate investors for C.

L concludes that:

- the employee benefits of 1,000 are not eligible for capitalisation, because they are incurred regardless of whether any contract with a customer is obtained;
- the bonus of 100 should be capitalised, because it is incremental to obtaining a contract with P; and
- the bonus of 50 is not incremental to obtaining a contract with a customer, because the contracts between L and C already exist. C's ultimate investors are not considered L's customers. Therefore, this bonus is expensed as incurred.

The costs capitalised under the new standard are subject to its amortisation and impairment requirements.

## 10

# Transition adjustments

## Requirements of the new standard

The new standard offers the following transition options.

<p><b>Retrospective method (with optional practical expedients)</b></p>	<p>Entities recognise the cumulative effect of applying the new standard at the start of the earliest comparative period presented.</p> <p>They can also elect to use any or all of four practical expedients. Two of these provide relief from applying the new standard to certain types of contracts that are completed under previous GAAP. One provides relief with respect to contract modifications and another provides exemption from disclosing the amount of the transaction price allocated to the remaining performance obligations for the comparative periods presented.</p>
<p><b>Cumulative effect method</b></p>	<p>Entities recognise the cumulative effect of applying the new standard at the date of initial application, with no restatement of the comparative periods presented – i.e. the comparative periods are presented in accordance with previous GAAP.</p> <p>An entity may choose to apply the new standard to all its contracts or only to those contracts that are open under previous GAAP at the date of initial application.</p> <p>Entities may also elect to use the practical expedient available with respect to contract modifications.</p> <p>For the current period, entities are required to disclose the quantitative effect and an explanation of the significant changes between the reported results under the new standard and those that would have been reported under previous GAAP.</p>

For detailed discussion on the transition requirements, see our publication [Revenue Transition Options](#).



## Application of the new requirements

### Retrospective or cumulative effect approach

An investment management company can choose to apply the new standard from either the start of the earliest comparative period presented (retrospective approach) or the start of the current period (cumulative effect approach).

If a company applies the new standard from 1 January 2018 and presents one year of comparative information, then under the retrospective approach it would present revenue for both 2017 and 2018 in accordance with the new standard and adjust retained earnings at 1 January 2017. Under the cumulative effect approach, the company would present only the current year, 2018, in accordance with the new standard and adjust retained earnings at 1 January 2018.

The transition approach and practical expedients are applied at the company level – i.e. they cannot be used on a contract-by-contract basis.

### Transition disclosures

An investment management company is required to provide specific disclosures about its transition to the new standard.

Under the retrospective approach, an investment management company needs to provide the disclosures required for a change in accounting policy, including the amount of the adjustment to the financial statement line items and earnings per share amounts affected. However, the impact of the change in accounting policy on the financial statement line items and earnings per share is not required for the year of initial application.

Under the cumulative effect approach, an investment management company is required to disclose:

- the amount by which each financial statement line item is affected in the current period as a result of applying the new standard; and
- an explanation of the significant changes.

When providing disclosures in the condensed interim financial statements about the nature and effect of changes in accounting policies as a result of adopting the new revenue standard, an investment management company that applies the new standard using the cumulative effect approach considers whether the impact disclosures above are necessary to meet the objectives of IAS 34 *Interim Financial Reporting* and the expectations of regulators.

### Completed contracts practical expedient

Under either approach, an investment management company can choose to apply the standard only to those contracts that are not complete at the date of transition. The new standard defines a completed contract as a contract for which the company has transferred to the customer all of the goods or services identified under IAS 11, IAS 18 and related interpretations. Unlike IFRS 15, the previous requirements do not contain specific guidance on determining the term of a contract (see [Section 3.3](#)). Therefore, judgement is needed to determine whether an investment management services contract is completed when it contains termination clauses. For example, a two-year investment management services contract that is cancellable by the customer at any time for no penalty may be considered complete at the date of transition, subject to an evaluation of the company's existing accounting policy for the contract.

An example of a contract that would not meet the definition of a completed contract is a two-year non-cancellable investment management contract that is only partly complete at the date of initial application. This is because, at the date of initial application, the company has not yet delivered all of the services to the customer identified in the contract.

### Contract modification practical expedient

Under the contract modification practical expedient, an investment management company need not evaluate the effects of contract modifications separately before the beginning of the earliest reporting period presented.

Instead, a company may reflect the aggregate effect of all of the modifications that occur before the beginning of the earliest period presented when:

- identifying the satisfied and unsatisfied performance obligations;
- determining the transaction price; and
- allocating the transaction price to the satisfied and unsatisfied performance obligations.

If a company follows the cumulative effect approach, then it can choose to apply this practical expedient to modifications that occur up to the start of the current period.

This practical expedient essentially allows a company to use hindsight when assessing the effect of a modification on a contract. However, it does not exempt a company from applying other aspects of the requirements to a contract – e.g. identifying the performance obligations in the contract and measuring the progress towards complete satisfaction of those performance obligations.

This expedient would provide relief to companies with long-term investment management contracts that have been revised numerous times during the contract period, because it allows them to avoid identifying and assessing the impact of each modification separately.



### Variable consideration practical expedient

When applying the retrospective method, an investment management company may choose to use the transaction price at the date on which the contract was completed, rather than estimating the variable consideration amounts.

The main advantage in applying this practical expedient is that, for completed contracts, a company need not apply the variable consideration guidance to variable amounts in the transaction price. This may result in revenue being recognised earlier than it would have been if a fully retrospective approach had been followed. For example, if a contract included a cumulative performance-based incentive fee, then the company could use the known outcome for that fee when calculating the transaction price, rather than estimating the amount using the variable consideration guidance.

### Disclosure practical expedient

Under this practical expedient, for reporting periods presented before the date of initial application an investment management company need not disclose:

- the amount of the transaction price allocated to the remaining performance obligations; or
- an explanation of when the company expects to recognise that amount as revenue.



### Example – Variable consideration practical expedient

Investment Management Company T entered into a 12-month contract to manage Fund F's assets on 1 July 2016. At the end of the contract, T was entitled to a performance-based incentive fee of 20% of the fund's cumulative return in excess of an observable market index. When the contract was completed on 30 June 2017, T received an incentive fee of 100,000.

Under the new standard, T concludes that it cannot include these types of incentives in the transaction price before the contract is completed, because they are highly susceptible to volatility in the market and, therefore, are subject to the variable consideration constraint.

The contract was completed before the date of initial application of 1 January 2018. T elects to apply the new standard retrospectively. T also chooses to apply the variable consideration practical expedient and includes the incentive fee of 100,000 in the transaction price, recognising it as revenue over the contract period.

Without the application of this practical expedient, T would recognise the entire fee on completion of the contract – i.e. in 2017.

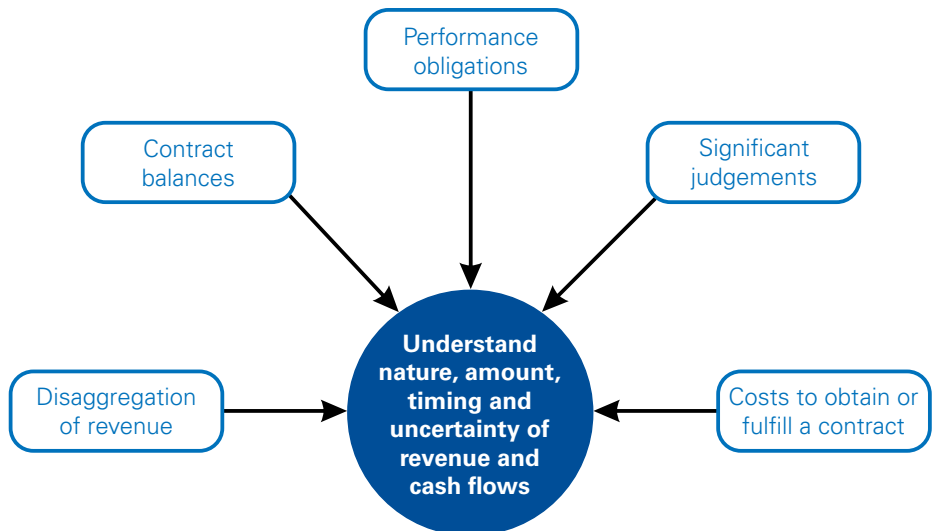
# 11 Disclosure requirements

## Requirements of the new standard

The objective of the disclosure requirements is for an entity to disclose sufficient 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.

Entities disclose, separately from other sources of revenue, revenue recognised from contracts with customers and any impairment losses recognised on receivables or contract assets arising from contracts with customers. If an entity elects either the practical expedient not to adjust the transaction price for a significant financing component, or the practical expedient not to capitalise costs incurred to obtain a contract, then it discloses this fact.

To meet the disclosure objective, the new standard has specific disclosure requirements in the following areas.



For further information on the disclosure requirements, see our [Guide to annual financial statements – IFRS 15 supplement](#). For further guidance on the disclosures for investment management companies, see our [Illustrative disclosures for insurers](#).



### How does this approach differ from previous requirements?

#### Disclosures are significantly expanded under the new standard

Previous IFRSs included minimal specific disclosure requirements for revenue. In comparison, the new standard has extensive disclosure requirements that are intended to help users better understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The new standard introduces disclosures that require information not previously needed for financial reporting. The disclosures may require information that is incremental to the data and information needed for recording revenue in the financial statements.

**Disclosures for remaining performance obligations are different from IAS 11 disclosure requirements**

Under IAS 11, some entities previously provided disclosures on unbilled accounts receivable or deferred revenue, which may limit the amount of new information that those entities have to gather to comply with the new disclosure requirements for contract balances. However, some changes to an entity's disclosures are required.



**Application of the new requirements**

All entities are affected by the new disclosure requirements to some extent. However, the additional information needed will vary depending on the relevance of the different requirements to the entity. It is important to assess the additional disclosure requirements fully.

Investment management companies should assess whether their current systems and processes are capable of capturing, tracking, aggregating and reporting information to meet the new disclosure requirements. For many companies, this may require significant changes to existing data-gathering processes, IT systems and internal controls.

A table of the new disclosures is included in our [Guide to annual financial statements – IFRS 15 supplement](#).

# Further resources

High-level briefing	
IFRS Podcast   <a href="#">IFRS 15 Revenue – Embedding and explaining the changes</a>	Briefing   <a href="#">Accounting for revenue is changing</a>
IFRS Blog   <a href="#">IFRS 15 Revenue – The reality may surprise you</a>	First Impressions   <a href="#">IFRS 15 Revenue</a>
Web article   <a href="#">New revenue standard – Introducing the new IFRS 15</a>	
In-depth analysis	
Issues In-Depth   <a href="#">Revenue Issues In-Depth: IFRS &amp; US GAAP</a>	Guide to annual financial statements   <a href="#">IFRS 15 supplement</a>
Transition Options   <a href="#">Revenue</a>	Guide to annual financial statements   <a href="#">Illustrative disclosures for insurers</a>

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