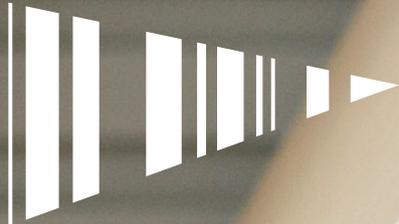


# The new revenue recognition standard - asset management

January 2015



## Overview

Fund managers may need to change their revenue recognition policies and practices as a result of the new revenue standard IFRS 15 *Revenue from Contracts with Customers* jointly issued by the International Accounting Standards Board (the IASB) and the Financial Accounting Standards Board (the FASB) (collectively, the Boards). IFRS 15 will supersede virtually all revenue recognition standards in IFRS and US GAAP, including any industry-specific requirements that fund managers may use today.

IFRS 15 specifies the accounting treatment for all revenue arising from contracts with customers. It affects all entities that enter into contracts to provide goods or services to their customers (unless the contracts are in the scope of other IFRS requirements, such as IAS 17 *Leases* or IAS 39 *Financial Instruments: Recognition and Measurement*). The standard also provides a model for the recognition and measurement of gains and losses on the sale of certain non-financial assets, such as property and equipment and intangible assets.

The new standard affects all fund managers that enter into contracts to provide services to their customers. Among the more significant potential changes are the accounting for performance-based fees, upfront fees and contract costs. IFRS 15 constrains the amount of revenue to be recognised to amounts for which it is highly probable that there will not be a significant reversal in the amount of cumulative revenue recognised and provides factors to consider in making that determination. Therefore, the recognition of performance-based fees will require significant judgement and the new standard may change the pattern of recognition for fund managers.

The new standard also requires the identification of performance obligations and the allocation of revenue to those obligations. Upfront fees earned on the sale of fund interests may or may not be considered distinct from the ongoing management services performed by the fund manager, which may result in a change in the timing of recognition of those fees.

The accounting for certain contract costs may also change for some fund managers. Under the new standard, incremental costs of obtaining a contract and certain direct fulfillment costs will be recognised as assets if the costs are expected to be recovered. Such costs will need to be evaluated for impairment.

Applying the new standard will require a number of judgements and estimates based on the individual facts and circumstances. For example, as described later, identifying the customer is important because that identification may affect when up-front fees are recognised and the accounting for contract costs.

The new standard is not expected to impact investment funds significantly as interest and dividend income and gains and losses on investments are generated by transactions that are outside the scope of IFRS 15.

This publication considers key implications of the new standard for fund managers. It provides an overview of the revenue recognition model in IFRS 15 and highlights key considerations for the fund management industry. This publication supplements our *Applying IFRS, A closer look at the new revenue recognition standard* (June 2014)<sup>1</sup> (general publication) and should be read in conjunction with that publication. IFRS 15 has significant disclosure requirements which are covered in our general publication.

---

<sup>1</sup> Available on [www.ey.com/ifrs](http://www.ey.com/ifrs)

To support stakeholders with the implementation of the new standard, the Boards have established a Joint Transition Resource Group for Revenue Recognition (TRG). The TRG was created to help the Boards determine whether additional interpretation, application guidance or education is needed on implementation issues and other matters submitted by stakeholders. The TRG will not make formal recommendations to the Boards or issue application guidance. Any views produced by the TRG are non-authoritative.

The views we express in this publication are preliminary. We may identify additional issues as we analyse the standard and as entities begin to apply it and our views may evolve during that process.

# Contents

Overview .....	1
1. Summary of the new standard .....	5
2. Effective date and transition .....	5
3. Scope .....	6
4. Identify the contract with the customer .....	7
4.1 Combining contracts .....	7
4.2 Contract modifications .....	8
5. Identify the performance obligations in the contract .....	9
5.1 Other fee arrangements .....	10
5.2 Upfront fees .....	10
5.3 Other services .....	10
6. Determine the transaction price .....	11
6.1 Base management fees.....	11
6.2 Performance-based fees .....	12
7. Allocate the transaction price to the performance obligations....	14
8. Satisfaction of performance obligations .....	15
9. Contract costs .....	16
9.1 Costs to obtain a contract .....	16
9.2 Costs to fulfil a contract.....	16
10. Next steps .....	17

## What you need to know

- ▶ IFRS 15 creates a single source of revenue requirements for all entities in all industries. The new revenue standard is a significant change from current IFRS.
- ▶ The new standard applies to revenue from contracts with customers and replaces all of the revenue standards and interpretations in IFRS, including IAS 11 *Construction Contracts*, IAS 18 *Revenue* and related Interpretations.
- ▶ Under the new standard, performance-based fees will not be recognised until it is highly probable that a significant reversal in the amount of cumulative revenue will not occur.
- ▶ IFRS 15 also specifies the accounting treatment for certain items not typically associated with a revenue standard, such as certain costs associated with obtaining and fulfilling a contract and the sale of certain non-financial assets.
- ▶ IFRS 15 is effective for annual periods beginning on or after 1 January 2017. Early adoption is permitted for IFRS preparers, provided that fact is disclosed.

# 1. Summary of the new standard

IFRS 15 specifies that the requirements an entity must apply to measure and recognise revenue and the related cash flows. The core principle of the standard is that an entity will recognise revenue at an amount that reflects the consideration to which the entity expects to be entitled in exchange for transferring promised goods or services to a customer.

The principle in IFRS 15 is applied using the following five steps:

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

An entity will need to exercise judgement when considering the terms of the contract(s) and all of the facts and circumstances, including implied contract terms. An entity also will have to apply the requirements of IFRS 15 consistently to contracts with similar characteristics and in similar circumstances. On both an interim and annual basis, an entity will generally need to disclose more information than it does under current IFRS. Annual disclosures will include qualitative and quantitative information about the entity's contracts with customers, significant judgements made (and changes in those judgements) and contract cost assets.

# 2. Effective date and transition

IFRS 15 is effective for annual periods beginning on or after 1 January 2017. Early adoption is permitted for IFRS preparers, provided that fact is disclosed, and for first-time adopters of IFRS.

The effective date of the standard for public entities applying US GAAP is for annual periods beginning on or after 15 December 2016, which is essentially the same as for IFRS preparers. However, US public entities will not be permitted to early adopt the standard.<sup>2</sup>

All entities will be required to apply the standard retrospectively, either using a full retrospective or a modified retrospective approach. The Boards have provided certain practical expedients to assist entities in the use of a full retrospective approach.

Under the modified retrospective approach, financial statements will be prepared for the year of adoption using IFRS 15, but prior periods will not be adjusted. Instead, an entity will recognise a cumulative catch-up adjustment to the opening retained earnings (or other appropriate component of equity) at the date of initial application for contracts that still require performance by the entity (i.e., contracts that are not completed). In addition, an entity will disclose all line items in the year of adoption as if they were prepared under current IFRS (i.e., IAS 18, IAS 11 and related Interpretations).

For more information about the effective date and transition options, see our general publication.

---

<sup>2</sup> US non-public entities will be required to apply the new standard to reporting periods beginning after 15 December 2017. Early adoption is permitted, but not prior to reporting periods beginning after 15 December 2016.

### 3. Scope

IFRS 15 applies to all contracts with customers to provide goods or services in the ordinary course of business, except for the following contracts which are specifically excluded from the scope:

- ▶ Lease contracts within the scope of IAS 17
- ▶ Insurance contracts within the scope of IFRS 4 *Insurance Contracts*
- ▶ Financial instruments and other contractual rights or obligations within the scope of IFRS 9 *Financial Instruments* or IAS 39, IFRS 10 *Consolidated Financial Statements*, IFRS 11 *Joint Arrangements*, IAS 27 *Separate Financial Statements* and IAS 28 *Investments in Associates and Joint Ventures*
- ▶ Non-monetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers

Fund managers typically enter into a variety of contracts to provide management and other services to investment vehicles structured as companies, trusts or partnerships (such as hedge funds, private equity funds and open-ended investment companies), which invest in a variety of different products. While the legal forms of the arrangements vary, these vehicles generally provide for investor capital to be pooled and invested to earn a return. Funds typically pay base management fees and performance-based fees to the fund manager (or general partner if the fund is structured as a limited partnership).

Fund managers may receive upfront fees from investors when they subscribe for interests in funds.

In addition, entities within the same group as the fund manager may provide other services, such as shareholder services, transfer agency and safe custody. The principles underlying each of the model's five steps are discussed in the following sections and are illustrated using a hypothetical arrangement between a fund (Fund), general partner (GP) and an investment manager (IM). The following summarises key terms of the hypothetical arrangement.

#### **Illustration 3-1 – Hypothetical scenario assumptions**

A fund manager provides services to a Fund through two wholly owned entities: a GP and an IM to which certain management functions are assigned. The IM earns a management fee that is invoiced and payable quarterly based on 0.5% of the Fund's ending net asset value (NAV) (i.e., a 2% annual fee). The GP is entitled to a performance-based fee on 31 December of 20% of any year-over-year increase in the Fund's NAV.

*In the following illustrations we consider the impact of the new standard on the consolidated figures for the fund manager which would include the GP and IM. We do not focus on the impact of the new standard on the individual company figures for the IM or GP.*

## 4. Identify the contract with the customer

The model in IFRS 15 applies to each contract with a customer. Contracts may be written, verbal or implied by an entity's customary business practices, but must be legally enforceable and meet specified criteria.

For fund managers, their customers may be the funds they manage or the investors in those funds, which may impact when revenue is recognised.

Properly identifying the customer is important because revenue is recognised only when performance obligations in contracts with customers are satisfied. For fund managers, their customers may be the funds they manage or the investors in those funds, which may impact when revenue is recognised.

Consider a fund that is structured as a company. Such a fund typically has a board of directors, but no other employees, and a large number of shareholders (investors). In such circumstances, it is generally the fund that contracts with parties (including the fund manager) to obtain services and the investors are unlikely to be involved in the set up of the fund or be a party to the contracts.

Therefore, the fund (and not the fund's investors) may be viewed as the fund manager's customer. Contracts with such a fund to provide other services like custody and transfer agency may be evaluated similarly.

In contrast, consider a fund established by a GP for one limited partner (LP). In this case, it is likely that the LP will be involved in the set up of the fund and the negotiation of contracts and, therefore, it may be reasonable to conclude that the LP is the customer.

### How we see it

The terms of an arrangement should be evaluated carefully to identify the customer. The proper identification of the customer is important because of the potential for differences in accounting for upfront fees and costs of obtaining a contract, among others.

### 4.1 Combining contracts

The standard requires two or more contracts entered into at or near the same time with the same customer (or related parties of the customer) to be combined and accounted for as a single contract when any of the following criteria are met: (1) the contracts are negotiated as a package with a single commercial objective; (2) the amount of consideration to be paid in one contract depends on the price or performance of the other contract; or (3) the goods or services promised in the contracts (or some goods or services promised in the contracts) are a single performance obligation (as discussed below).

#### Illustration 4-1 – Identify the contract with a customer

Based on the assumptions in Illustration 3-1, the fund manager would combine the contract with the IM (relating to the management fee) and the contract with the GP (for the performance-based fee) for revenue recognition purposes because:

- ▶ The contracts are negotiated together with a single commercial objective.
- ▶ The services promised in the contracts are generally a single performance obligation (i.e., while there are separate contracts entitling the fund manager to different types and amounts of compensation, there is generally one underlying service, which is the management of the Fund's assets).

## How we see it

IFRS 15 requires that contracts with the same customer are combined when one or more of the criteria are met. Accordingly, while service contracts may have economic differences (e.g., the management fee is based upon NAV, whereas the performance fee is only based on increases in NAV), the contracts would be combined if the underlying service is a single performance obligation. Determining whether contracts need to be combined will depend on the facts and circumstances and will require judgement.

Although the requirement to combine contracts is generally consistent with the underlying principles in current IFRS, entities should carefully evaluate whether any of the criteria to combine contracts are met when applying the new standard.

A fund often enters into service contracts for other services, including shareholder services, transfer agency and custody. In many cases, funds enter into these contracts at the same time and the service providers may be controlled by a common parent.

While the specific facts and circumstances need to be evaluated to determine whether the contracts need to be combined, it is likely that the individual, separate contracts would not be combined because:

- There are different commercial objectives for each service contract.
- There is generally no pricing interdependence between the contracts.
- The contracts contain separate performance obligations.

For example, we generally would not expect a management contract and a custody contract with the same fund to be combined even if the custodian is an affiliate of the fund manager. The management contract is primarily to supervise and manage the fund's assets, including handling portfolio transactions, and the custody contract is to provide safe custody of the assets. As such, there are different commercial objectives for each contract, even though the transaction price of both contracts may be based on NAV.

## 4.2 Contract modifications

A contract modification is a change in the scope or price (or both) of a contract. An entity must determine whether the modification creates a new contract or whether it will be accounted for as part of the existing contract. The determination of a new and separate contract is driven by whether the modification results in the addition of distinct goods or services, priced at their stand-alone selling prices (see Section 7).

## 5. Identify the performance obligations in the contract

Once an entity has identified the contract with a customer, it evaluates the contractual terms and its customary business practices to identify all the promised goods or services within the contract and determine which of those promised goods or services (or bundles of promised goods or services) will be treated as separate performance obligations.

Promised goods and services represent separate performance obligations if the goods or services are:

- Distinct (by themselves or as part of a bundle of goods and services)

Or

- Part of a series of distinct goods and services that are substantially the same and have the same pattern of transfer to the customer (see Section 8 below)

A good or service (or bundle of goods and services) is distinct if the customer can benefit from the good or service on its own or together with other readily available resources (i.e., the good or service is capable of being distinct) and the good or service is separately identifiable from other promises in the contract (i.e., the good or service is distinct within the context of the contract).

Management services provided to investment funds are provided continuously over the contract period, so the services in the contract will generally represent a single performance obligation.

Example 25 in IFRS 15 (specifically paragraphs IE129 and IE130) illustrates this concept by describing a five-year investment management contract that entitles the investment manager to both a quarterly management fee and a performance fee that is based on cumulative results over the five-year term of the contract. The example concludes that the management services are a single performance obligation because the entity is providing a series of distinct services that are substantially the same and have the same pattern of transfer.

### Illustration 5-1 – Identify the performance obligations in the contract

Based on the facts in the previous illustrations, there is a single performance obligation that is a series of distinct goods or services (management activities) that are substantially the same and have the same pattern of transfer.

Although there are two separate forms of compensation, there is generally only one service, which is the management of the Fund's assets. A fund manager generally does not offer either base management services or performance-based services separately. As a result, the Fund generally cannot benefit from either the base management service or the performance-based service with another service that is readily available. Therefore, the performance-based service and the base management service would not be considered distinct from each other.

## 5.1 Other fee arrangements

Other fee arrangements between funds and fund managers also will need to be analysed to identify all promised goods or services and to determine what (if any) separate performance obligations exist. Distinct performance obligations cannot be combined unless the separate performance obligations are part of a series of distinct goods or services that are substantially the same and have the same pattern of transfer to the customer. As a result, services that are not substantially the same are not combined, even if they have similar terms and the basis for determining the compensation is the same (e.g., NAV).

## 5.2 Upfront fees

Fund managers may market and sell their products directly to investors or may delegate this function to an entity within the same group as the fund manager or a third party. When the fund manager performs this function itself, it may earn upfront fees payable by the investor.

The recognition of upfront fees depends on whether the sale of fund interests represents a separate performance obligation from the management services.

If the marketing and sales function is assessed as a separate performance obligation, this obligation will be satisfied on the sale of the interest and the upfront fee will be recognised immediately.

Alternatively, if the marketing and sales function is assessed to be a supporting function of the management services, then it will not be a separate performance obligation, but rather an advance payment for management services.

Fund managers will need to consider the specific facts and circumstances of each arrangement, which may be impacted by whether the fund or the investor is the customer.

If the marketing and sales function is performed by an entity within the same group as the fund manager, which also provides other services, then a similar assessment will be required.

## 5.3 Other services

Other services, as detailed in Section 4, are often provided pursuant to separate contracts and the fees are often based on a percentage of NAV. These are unlikely to be considered supporting services to the management services as they are distinct services.

In general, the revenue recognition considerations for each of these services are similar to those outlined previously for management services. That is, an entity may determine that each contract represents a series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer.

The recognition of upfront fees depends on whether the sale of units represents a separate performance obligation from the management services.

## 6. Determine the transaction price

The transaction price is the amount of consideration to which an entity expects to be entitled. It includes an estimate of any variable consideration, the effect of a significant financing component (i.e., the time value of money), the fair value of any non-cash consideration and the effect of any consideration paid or payable to a customer.

IFRS 15 limits the amount of variable consideration an entity can include in the transaction price to the amount for which it is highly probable that a significant revenue reversal will not occur when the uncertainties related to the variability are resolved. That is, the standard requires an entity to apply a constraint on variable consideration.

In making this determination, both the likelihood and the magnitude of a revenue reversal need to be considered. The constraint on variable consideration focuses on reversals that would be significant when compared with the cumulative amount of revenue recognised, not just variable consideration. Therefore, when the consideration includes both a fixed amount and a variable amount, the entity must assess the magnitude of a possible revenue reversal of the variable amount relative to the total consideration (i.e., the variable and fixed consideration).

The standard also provides factors to consider that could increase the likelihood or the magnitude of a revenue reversal. One such factor is when the amount of variable consideration is highly susceptible to factors outside the entity's influence (e.g., volatility in a market). Other factors include when the entity's experience with similar contracts is limited or has little predictive value, the contract has a large number and broad range of possible consideration amounts and the uncertainty is not expected to be resolved for a long period of time.

The presence of these factors does not necessarily mean that variable consideration cannot be included in the transaction price (note the Boards' use of the term 'factors' rather than 'criteria'), but entities will need to carefully evaluate the application of the constraint when these factors exist.

The fund manager must determine the amount of the transaction price at the contract inception and revisit this determination at the end of each subsequent reporting period. The fund manager must also determine the constraint on variable consideration at the end of each reporting period. Part of the variable consideration may be included in the transaction price, even though the total expected amount may not be included due to the constraint (i.e., part of the performance-based fee may be recognised even though the full amount may not be recognised due to the constraint).

### 6.1 Base management fees

Base management fees represent variable consideration which is based on each period's NAV. The transaction price will generally include the amount determined at the end of the period(s). There may be a few exceptions that could complicate recognition when the calculation date is not the same as the reporting date. Estimates of future period management fees would generally not be included in the transaction price because they would be constrained.

The recognition of performance-based fees will require significant judgement and the new standard may change the pattern of recognition for fund managers.

## 6.2 Performance-based fees

Performance fees based on a fund's performance, relative to a benchmark or the realised appreciation of fund's investments, are types of variable consideration. In many cases, these performance fees are highly susceptible to market volatility until they are crystallised or are no longer subject to clawback, which may be after the end of the reporting period. Under a clawback provision, a fund manager may be required to return certain distributions received from the fund if a specific performance threshold is not met. Therefore, even the receipt of cash may not indicate that performance-based fees may be recognised as revenue.

IFRS 15 prohibits the recognition of variable consideration as revenue until it is highly probable that a significant reversal of the cumulative amount of revenue recognised will not occur upon the resolution of the uncertainty.

Example 25 (specifically paragraph IE132) in the standard discusses a performance-based fee that is based on a fund's return over a defined period. It concludes that an estimate of the variable consideration, both at contract inception and at the end of subsequent reporting periods, would be excluded from the transaction price because the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue will not occur. This is because the performance-based fee depends on the market and, therefore, is highly susceptible to factors outside the entity's influence. The example also indicates that, although an entity may have experience with similar contracts, this has little predictive value.

However, the language in the standard (i.e., the use of the term 'factors' rather than 'criteria') leaves open the possibility that fund managers in certain circumstances may be able to recognise revenue (i.e., part of the performance-based fee) before the fee is no longer subject to clawback. The standard does not provide specific application guidance to make that determination. However, some factors a fund manager may wish to consider in determining whether it is highly probable that a significant reversal of the cumulative amount of revenue recognised will not occur include whether:

- ▶ The fund is near final liquidation
- ▶ The fair value of the remaining assets in the fund is significantly in excess of the threshold at which the manager would earn a performance fee
- ▶ The remaining assets in the fund are low risk
- ▶ The fund's remaining investments are under contract for sale with purchase prices that would result in no clawback

A fund manager might consider other factors in its assessment. No single consideration is determinative and it is likely that some combination of the factors above along with others will need to exist in order to conclude that it is highly probable that a significant reversal in the cumulative amount of revenue will not occur. This evaluation will require significant judgement and will need to be made based on the individual facts and circumstances. A fund manager that concludes that it is highly probable that some amount of the performance-based fee will not be reversed will recognise that amount as revenue.

The recognition of performance-based fees will require significant judgement and the new standard may change the pattern of recognition for fund managers. Performance-based fees are unlikely to be recognised in full until they have crystallised or are no longer subject to clawback. However, the fund manager may determine that part of these performance fees can be recognised before this time.

### Illustration 6-1 – Determine the transaction price

The quarterly management fee and the annual performance fee are determined by reference to NAV, therefore, they represent variable consideration. After considering various factors, including that the fees are subject to market volatility and a broad range of outcomes, assume the GP and the IM are unable to conclude, before the NAV is determined at the end of the quarter (for the management fee) and 31 December (for the performance fee), that it is highly probable that a significant revenue reversal will not occur.

As a result, estimated quarterly management and performance fees expected to be earned for the rest of the year will not be included in the transaction price (i.e., they will be constrained). The estimated variable consideration is reassessed at the end of each reporting period. Therefore, the transaction price at the end of each quarter is the amount that is no longer subject to market volatility.

Assume that the Fund's NAV at the beginning of the year is CU100,000. For simplicity, assume the management fee is based on the end-of-quarter NAV, which is presented in the following table. As a reminder, the performance fee is receivable based on the NAV as at 31 December. The transaction price as at the end of each quarter could be estimated, as follows:

Period	NAV CU	Management fee received CU	Estimated transaction price		Total CU
			Management fee CU	Performance fee CU	
Q1	100,000	500	500	–	500
Q2	300,000	1,500	2,000	–	2,000
Q3	50,000	250	2,250	–	2,250
Q4	150,000	750	3,000	10,000	13,000

#### 6.2.1 Other fees

The consideration for other services is likely to be based on a percentage of NAV (e.g., custody, administrative or shareholder services fees) and, therefore, it will also be considered as variable consideration. The variable consideration is included in the transaction price once it is highly probable that it will not be subject to significant reversal and is allocated to the distinct service periods. Revenue is then recognised at the end of each period and, as a result, revenue recognition under IFRS 15 for these services may be generally consistent with current practice.

## 7. Allocate the transaction price to the performance obligations

Once the performance obligations have been identified and the transaction price has been determined, an entity is required to allocate the transaction price to the performance obligations, generally in proportion to their stand-alone selling prices (i.e., on a relative stand-alone selling price basis), with two exceptions. Firstly, the new standard permits an entity to allocate variable consideration to one or more, but not all, performance obligations in some situations (see below). Secondly, IFRS 15 contemplates the allocation of any discount in an arrangement to one or more, but not all, performance obligations, if specific criteria are met. The transaction price is not reallocated to reflect changes in stand-alone selling prices after contract inception.

When determining stand-alone selling prices, an entity is required to use observable information, if available. If stand-alone selling prices are not directly observable, an entity will need to make estimates based on information that is reasonably available. Possible estimation approaches include an adjusted market assessment approach or an expected cost plus a margin approach. An entity is required to apply estimation methods consistently in similar circumstances.

In order to allocate variable consideration to one or more, but not all, performance obligations, both of the following criteria must be met: (1) the terms of the variable payment relate specifically to the entity's efforts to satisfy a specific performance obligation or transfer a distinct good or service (or to a specific outcome from satisfying the performance obligation or transferring the distinct good or service); and (2) allocating the variable consideration entirely to a performance obligation or the distinct good or service depicts the amount of consideration to which the entity expects to be entitled in exchange for transferring the promised good or service.

### Illustration 7-1 – Allocate the transaction price to the performance obligations in the contract

The performance obligation for the fact pattern described in the previous illustrations is a series of distinct goods or services (quarterly services) that form part of a single performance obligation. Therefore, the transaction price which comprises the variable consideration related to the management fee is allocated to each individual quarter because the management fee relates specifically to the entity's efforts to provide management services during the quarter. The performance fees are not included as it is not highly probable that the performance fees will not be subject to significant reversal.

### How we see it

If the criteria described previously are met, variable fees (whether base management fees or performance-based fees) in multi-year contracts will be allocated entirely to distinct service periods that have already occurred (e.g., prior quarters) once they are no longer subject to a significant revenue reversal. Allocating the transaction price to the performance obligations or to the distinct goods or services that form part of a single performance obligation will depend on the individual facts and circumstances.

## 8. Satisfaction of performance obligations

An entity recognises revenue only when it satisfies a performance obligation by transferring control of a promised good or service to the customer. Control may be transferred over time or at a point in time. A performance obligation is satisfied at a point in time, unless it meets one of the following criteria to be satisfied over time:

- ▶ The customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs
- ▶ The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced
- ▶ The entity's performance does not create an asset with an alternative use to the entity and the entity has an enforceable right to payment for performance completed to date

When a performance obligation is satisfied over time, the standard requires an entity to select a single method, either an input method or an output method, to measure progress for each performance obligation that best depicts the pattern of the entity's performance in transferring the good or service. That method must be applied consistently to similar performance obligations and in similar circumstances.

Investment management services are generally satisfied over time because either the customer simultaneously receives and consumes the benefits provided by the fund manager as the fund manager performs the service or the fund manager's performance enhances the assets that the fund controls.

Using an input method, revenue is recognised based on the ratio of efforts already expended relative to the total efforts expected to be expended. Using an output method, revenue is recognised based on direct measurements of the value to the customer of the goods or services transferred to date. These direct measurements include milestones reached, time elapsed and units produced or delivered.

When an entity applies an output method, the standard provides a practical expedient that allows an entity to recognise revenue in the amount to which the entity has a right to invoice if that consideration corresponds directly with the value to the customer of the entity's performance completed to date (e.g., a services contract in which an entity bills a fixed amount for each hour of service provided or each transaction processed).

### Illustration 8-1 – Recognise revenue when the entity satisfies a performance obligation

Based on the estimated transaction prices described previously, management and performance fees will be recognised under the output method, as follows:

Period	NAV CU	Management fee CU	Performance fee CU	Estimated transaction price at the end of the quarter CU	Revenue recognised CU
Q1	100,000	500	-	500	500
Q2	300,000	1,500	-	2,000	1,500
Q3	50,000	250	-	2,250	250
Q4	150,000	750	10,000	13,000	10,750
				<b>Total</b>	<b>CU13,000</b>

The performance fee would not be included in the transaction price in the second quarter because, in the example, the entity was not able to assert that it was highly probable a significant revenue reversal would not occur. This conclusion was discussed previously in Illustration 6-1.

## 9. Contract costs

The standard also provides guidance to account for an entity's costs incurred in: (1) obtaining and (2) fulfilling a contract to provide goods and services to customers.

### 9.1 Costs to obtain a contract

Incremental costs of obtaining a contract (i.e., costs that would not have been incurred if the contract had not been obtained) will be recognised as an asset if the costs are expected to be recovered. Costs can be recovered directly (i.e., through reimbursement under the contract) or indirectly (i.e., through the margin inherent in the contract). As a practical expedient, IFRS 15 permits immediate expense recognition for contract acquisition costs if the amortisation period of the resulting asset would be one year or less.

Incremental costs of obtaining a contract will be recognised as an asset if the costs are expected to be recovered.

Capitalised costs are amortised in a systematic manner consistent with the pattern of transfer of the related goods or services and are subject to an impairment analysis. Fund managers will need to exercise judgement to determine the period over which to amortise these costs.

An impairment loss will be recognised if the carrying amount of any asset exceeds the amount of consideration the entity expects to receive in exchange for providing those goods or services, less the remaining costs that relate directly to providing those goods or services. The Boards diverged on the reversal of impairment losses in subsequent periods. Under US GAAP, the reversal of previous impairment losses is prohibited. In contrast, under IFRS, IAS 36 permits the reversal of some or all of previous impairment losses on assets (other than goodwill) or cash-generating units if the estimates used to determine the assets' recoverable amount have changed.

An entity will estimate the amount it expects to receive based on the principles for determining the transaction price (see above), except that the requirements for constraining estimates of variable consideration are not applied. That is, an entity will use the unconstrained transaction price, which includes estimated variable consideration, for the impairment test. While unconstrained, this amount must be reduced to reflect the customer's credit risk.

### 9.2 Costs to fulfil a contract

Contract fulfillment costs will be recognised as an asset when those costs: (1) directly relate to a contract or to an anticipated contract that the entity can specifically identify; (2) generate or enhance resources of the entity that will be used in satisfying (or in continuing to satisfy) performance obligations in the future; and (3) are expected to be recovered.

Generally, contract fulfillment costs incurred by fund managers (e.g., salaries paid to employees) will not meet the second criterion above because they will not generate or enhance resources of the entity that will be used to satisfy performance obligations in the future. The standard also states that costs that relate to satisfied (or partially satisfied) performance obligations in the contract (i.e., costs that relate to past performance) are expensed as incurred.

## How we see it

The requirements for contract costs under IFRS 15 may change current practice for some entities. A key part of this analysis will be properly identifying the customer. Certain costs may need to be capitalised, amortised and regularly reviewed for impairment. This will require additional record-keeping.

The costs incurred in bringing new investors into existing funds are unlikely to be considered costs to obtain a contract where the fund is viewed as the customer.

We expect that fund managers will generally expense many costs to fulfil a contract as they are incurred. Managers will capitalise these costs only if they expect to recover the costs and the costs generate or enhance resources that will be used in satisfying performance obligations in the future.

## 10. Next steps

We encourage fund managers to gain an understanding of the new standard and evaluate how it will affect their specific revenue recognition policies and practices.

Entities should consider whether they will need to make any changes to their accounting policies, accounting systems or internal control over financial reporting.

Entities may also wish to monitor the discussions of the Boards, TRG and the Asset Management industry task force formed by the American Institute of Certified Public Accountants (AICPA) to discuss the application of the new standard to common transactions.<sup>3</sup>

---

<sup>3</sup> For more information see <http://www.aicpa.org/interestareas/frc/accountingfinancialreporting/revenuerecognition/pages/revenuerecognition.aspx>

#### **About EY**

EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit [ey.com](http://ey.com).

#### **About EY's International Financial Reporting Standards Group**

A global set of accounting standards provides the global economy with one measure to assess and compare the performance of companies. For companies applying or transitioning to International Financial Reporting Standards (IFRS), authoritative and timely guidance is essential as the standards continue to change. The impact stretches beyond accounting and reporting, to key business decisions you make. We have developed extensive global resources – people and knowledge – to support our clients applying IFRS and to help our client teams. Because we understand that you need a tailored service as much as consistent methodologies, we work to give you the benefit of our deep subject matter knowledge, our broad sector experience and the latest insights from our work worldwide.

© 2015 EYGM Limited.  
All Rights Reserved.

EYG No. AU2874  
ED None



In line with EY's commitment to minimize its impact on the environment, this document has been printed on paper with a high recycled content.

This material has been prepared for general informational purposes only and is not intended to be relied upon as accounting, tax, or other professional advice. Please refer to your advisors for specific advice.