KPMG

Accounting for revenue is changing

What's the impact for investment managers?

October 2016

The new revenue standard[1] – effective from 1 January 2018 – may affect the way you account for revenue. But it is more than just an accounting change.

It could impact:

- bundling or unbundling of performance obligations
- timing of revenue recognition for up-front fees
- deferral and amortisation of costs
- measurement and timing of recognition for variable consideration
- some KPIs or business practices

It's time to engage, particularly as there are also new standards on financial instruments and leases to consider.

If you have:

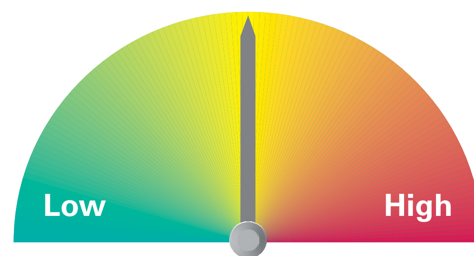
- contracts that include investment management and other services
- non-refundable up-front fees or back-end fees
- performance-based incentive fees
- sub-advisory arrangements
- costs related to obtaining and fulfilling contracts

…it's time to start looking at your contracts and assessing how the new revenue requirements will affect your business.

Engage with your stakeholders to build expectations of how your KPIs or business practices may change.

1. IFRS 15 *Revenue from Contracts with Customers*

Determining the impact



Contracts that include investment management and other services

Potential impact

- Some contracts may integrate different services into a single package – e.g. administrative services, asset management and custody services. IFRS 15 includes new guidance for such arrangements, including:
  - new separation criteria that may affect which services are bundled or unbundled; and
  - new guidance on determining and allocating the transaction price for each performance obligation.
- In some cases, an investment manager may need to apply judgement to determine whether its customer for the services provided is the fund or the underlying investors.

Actions to consider

- Evaluate bundled service contracts against the new separation criteria.
- Consider whether the new revenue standard impacts established business practices – e.g. if any standard contract terms need to be reviewed.
- Develop systems and processes to allocate a contract's transaction price to each performance obligation, generally based on its relative stand-alone selling price.
- Review the terms of contracts to determine whether the funds or the underlying investors are the investment manager's customers under IFRS 15.

Non-refundable up-front fees or back-end fees

Potential impact

- Accounting for non-refundable up-front fees received at or near inception will depend on whether the fee:
  - relates to a specific good or service transferred to the customer; or
  - represents an advance payment for future goods and services in the contract, including future contract periods.
- The timing of the receipt of an up-front fee in comparison to the transfer of the services it relates to may give rise to a significant financing component. In this case, the transaction price may need to be adjusted to reflect the time value of money.
- The treatment of any back-end loaded fees will also need to be considered under the new guidance, impacting the timing of revenue recognition.

Actions to consider

- Assess the impact of the new guidance on the timing of revenue recognition for any non-refundable up-front fees and back-end loaded fees.
- Determine whether the timing of the receipt of a non-refundable up-front fee creates a significant financing component in a contract. If a significant financing component is identified, then design processes to measure the time value of money and ensure that your systems can handle the resulting calculations.

Performance-based incentive fees

Potential impact

- Investment managers often earn performance-based incentive fees for investment management services, which are subject to the variable consideration guidance of the new revenue standard.
- When determining the transaction price, an investment manager estimates the amount of variable consideration using either the 'expected value' or 'most likely amount' method.
- The estimated variable consideration is included in the transaction price to the extent it is highly probable that a significant revenue reversal will not subsequently occur.

Actions to consider

- Consider whether new models or processes are needed to determine the transaction price.
- Evaluate the impact of the new revenue standard on internal management reporting and key performance indicators.

Sub-advisory arrangements

Potential impact

- Investment managers often engage sub-advisors or delegate certain investment management activities related to the service contracts that they enter into. In such cases, the investment manager pays the sub-advisor a fee for these services, often linked to the overall fee earned on the head contract.
- Investment managers will need to consider whether they act as an agent or a principal for such arrangements and therefore whether income should be recognised on a gross or a net basis.

Actions to consider

- Review terms of sub-advisory arrangements to determine if acting as an agent or a principal.

Costs related to obtaining and fulfilling contracts

Potential impact

- Under IFRS 15, certain costs incurred in obtaining and fulfilling a contract are required to be capitalised, if specified criteria are met. This may include capitalisation of commissions or other variable awards payable when an investment contract is obtained. Judgement may be required to determine which costs need to be capitalised.
- Investment managers can elect not to capitalise the costs of obtaining a contract that would be amortised within a year or less.
- Capitalised costs are amortised on a systematic basis consistent with the transfer of the associated goods and services.
- Judgement will be needed to determine the appropriate period and pattern of amortisation – e.g. whether the amortisation period should include anticipated renewals.

Actions to consider

- Assess whether the current capitalisation policy is consistent with the new requirements and whether additional payments may need to be capitalised.
- Make changes to existing systems to capture the costs that will be capitalised and/or to reflect amortisation periods.
- Develop a policy for evaluating capitalised costs for impairment and impairment recoveries.

Transition[1]

Potential impact

- It may be challenging to develop an implementation plan that addresses IFRS 15 as well as the requirements of IFRS 9 *Financial Instruments* and IFRS 16 *Leases*.
- IFRS 15 may be adopted retrospectively, by restating comparatives and adjusting retained earnings at the beginning of the earliest comparative period.
- Alternatively, IFRS 15 may be adopted as of the date of initial application, by adjusting retained earnings at the beginning of the first reporting period and disclosing the effect of adoption on each line of profit or loss for the first period of application.

Actions to consider

- Perform a high-level gap analysis to identify potential drivers of changes in accounting for revenue and certain contracts.
- Develop an overall strategy for transition that incorporates all accounting changes expected in the near future and capitalises on any available synergies.

Disclosures

Potential impact

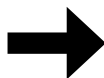
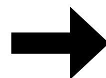
- Extensive new disclosures are required, incorporating both qualitative and quantitative information – e.g. investment managers may need to make more detailed disclosures describing fee structures and explaining why (or why not) amounts have been recognised. There are no exemptions for commercially sensitive information.
- Disclosures will need to include a detailed description of the performance obligations within contracts and the judgements made in determining amounts of variable consideration – i.e. even if performance fees are not recognised, disclosures could be needed to explain the judgements made.
- The level of disaggregation is driven by information about revenue presented for other purposes, including internal reporting and information in annual reports outside the financial statements. Many investment managers have a wide range of fee structures and arrangements with customers. Articulating these in a clear and concise manner may present a challenge.
- In addition, regulators are expecting detailed disclosures in the annual 2016 reports, and interim and annual 2017 reports about the implementation plan and the impact of the new revenue standard, incorporating qualitative and quantitative information.

Actions to consider

- Assess the new disclosure requirements and determine the level of disaggregation required based upon internal reporting and information presented in the annual report.
- Consider the inputs required to meet the disclosure requirements and how this information will be captured, collated and presented.
- Engage with internal stakeholders (legal, marketing and compliance) to consider the impact of disclosing more granular information regarding fee structures.

1. You can find more detailed information about IFRS 15 in our publications *Transition to the new revenue standard* and *Issues In-Depth*.

How KPMG can help

Assess the impacts  Design a tailored approach  Help implement a future state

A robust assessment phase is critical to laying the framework for a successful project, and it is important to start the assessment early to provide flexibility during the implementation phase. An assessment phase typically includes the following activities:

Activities	Actions	Deliverables
Accounting diagnostic	– Identify potential gaps to accounting policy and disclosures by reviewing current accounting policy and sample of contracts – Leverage your existing documents and knowledge	Gap matrix, heat map and contract review summaries
Process and information gap analysis	– Identify new information and process requirements – Trace requirements to existing sources or identify gaps	Business requirements document, process and information gap analysis report
Technology and broader impact evaluation	– Identify potential impact on IT, tax, controls, operations, FP&A, investor relations, etc. – Identify gaps and linkages across the organisation	Final gap matrix and heat map, implementation roadmap
Transition option assessment	– Determine how each option may impact financials and business – Assess readiness to elect the retrospective or cumulative effect option	Transition option assessment report

KPMG's Investment Management practice

KPMG's Investment Management practice is a global network of professionals offering skills, insights and knowledge based on substantial experience. KPMG can identify the issues early and can share leading practices to help avoid the many pitfalls of such projects.

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