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IFRS industry insights: Banking and securities sector

New Revenue Standard could impact profile of revenue and cost recognition

Headlines

- The **profile of revenue and profit recognition** will change for some entities as the new Standard is more detailed and more prescriptive than the existing guidance and introduces new complexities. In particular, banking and securities companies will need to consider:
  - the impact of new guidance where pricing mechanisms include **variable amounts**;
  - whether particular **costs relating to obtaining a contract** must be capitalised;
  - the extent to which **distinct goods or services** are supplied, which should be accounted for separately;
  - when **upfront fees** should be recognised as revenue; and
  - the appropriate accounting policies for **credit card loyalty schemes.**
- The new Standard requires significantly more **disclosures** relating to revenue and entities will need to ensure that **appropriate processes** are in place to gather the information.

What's happened?

The International Accounting Standards Board (IASB) has published a new Standard, IFRS 15 *Revenue from Contracts with Customers* ('the new Standard'). The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers and supersedes current revenue recognition guidance, which is found currently across several Standards and Interpretations within IFRSs. The core principle is that an entity recognises revenue to reflect the transfer of goods or services, measured as the amount to which the entity expects to be entitled in exchange for those goods or services.

The new Standard is effective for reporting periods beginning on or after 1 January 2017, with earlier application permitted. Entities can choose to apply the Standard retrospectively or use a modified approach in the year of application. It is the result of a convergence project with the US Financial Accounting Standards Board (FASB) that began in 2002. Almost fully converged, the most significant differences between IFRSs and US GAAP relate to interim disclosures and timing of adoption.

Implications for the banking and securities sector

Below, we highlight certain key impacts resulting from the new Standard that will be of particular interest to those in the banking and securities sector and then consider parts of the new Standard that may contribute to those impacts. Of course many more complexities exist and, as described below, Deloitte has produced further guidance which explores these in greater detail.

How might this affect you?

The timing of revenue and profit recognition may be affected by the new Standard

Whereas previously IFRSs allowed significant room for judgement in devising and applying revenue recognition policies and practices, IFRS 15 is more prescriptive in many areas relevant to the banking and securities sector. Applying these new rules may result in changes to the profile of revenue and, in some cases, cost recognition.

This is not merely a financial reporting issue. As well as **preparing the market and educating analysts** on the impact of the new Standard, entities will need to consider wider implications. Amongst others, these might include:

- changes to **key performance indicators** and other **key metrics**;
- changes to the **profile of tax cash payments**;
- availability of **profits for distribution**;
- for **compensation and bonus plans**, impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **regulatory requirements**.

Furthermore, entities in this sector will need to consider how the financial performance of their customers will be impacted as a result of the new Standard as this may impact the loan covenants negotiated with those customers. As noted below, further industry insights are available at www.iasplus.com.

Current accounting processes may require changes to cope with the new Standard

As explained below, IFRS 15 introduces new requirements to move to a more conceptual approach. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in the banking and securities sector may require modifications to existing accounting processes. Entities should ensure they allow sufficient time to develop and implement any required modifications to processes.

What type of revenue is impacted by the new Standard?

IFRS 15 only specifies how to account for revenue which arises as a result of contracts from customers; moreover, certain contracts with customers are scoped out because they are dealt with in other Standards. (Interest income and dividend income, which were within the scope of the previous revenue standard, will now be within the scope of the financial instruments standard, but it is not expected that this will impact the accounting for such income streams.)

What are the most significant changes?

When should variable or uncertain revenues be recognised?

Contracts in the banking and securities sector will often include significant variable elements, such as performance bonuses, penalties or structuring fees. For example, a performance bonus may be payable if and when certain targets are met, or based on net assets under management. There are new specific requirements in respect of variable consideration such that it is only included in the transaction price if it is highly probable that the amount of revenue recognised would not be subject to significant future reversals when the uncertainty is resolved. This approach to variable and contingent consideration is different from that previously reflected in IFRSs and, whilst many entities in the sector will already follow this type of approach, in certain scenarios, a significant degree of judgement will be required to estimate the amount of consideration that should be taken into account. Accordingly, the profile of revenue recognition may change for some entities as a result.

Which costs should be capitalised?

In addition to more prescriptive guidance on revenue recognition, the new Standard introduces specific criteria for determining whether to capitalise certain costs which are not in the scope of other standards, for example the financial instruments standards, distinguishing between those costs associated with obtaining a contract (e.g. sales commissions) and those costs associated with fulfilling a contract. In the banking and securities sector, this becomes an issue because significant costs are incurred that are directly attributable to obtaining contracts with customers, for example through 'success fees' (i.e. commissions that are only payable if a contract is obtained). At present, different entities might treat these costs differently. The new Standard will require entities to capitalise success fees, which will have an impact on operating profits. In addition, the new Standard requires capitalised contract costs to be amortised on a systematic basis that is consistent with the pattern of transfer of the associated services. Entities will need to exercise judgement to determine the appropriate basis and time period for this amortisation.

How should an entity identify and allocate revenue to different goods and services?

Previously, given the lack of specific guidance in IFRSs, there was greater room for judgement when identifying the goods and services within a contract and then allocating the revenue to those goods and services. Entities may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15 and, in particular, the new rules on how revenue is allocated between different items. The new Standard requires the revenue from a contract to be allocated to each distinct good or service provided on a relative standalone selling price basis, though a 'residual' approach is permitted in limited circumstances. The previous revenue standard included detailed guidance for banking entities in respect of how to treat the receipt of various types of fee, and entities will need to consider whether any changes are required to the treatment of such fees in respect of identifying separate goods and services under IFRS 15.

This may result in practical implementation issues in the banking and securities sector where services are often integrated. Customers may be charged for a number of services; for example, investment banks involved in a merger and acquisitions transaction may offer a number of services within the same contract such as identifying a target, performing due diligence, structuring the deal and arranging financing. Where it is concluded that certain elements should be accounted for separately, entities will then typically look to the standalone selling price to apportion the relevant amount of the transaction price to each distinct element in the contract.

When should 'upfront' fees be recognised?

In the banking and securities sector, it is common for entities to receive an initial 'sign-on' fee. New detailed guidance may lead to a change in practice when accounting for such fees. Unless control of distinct services is transferred to the customer at the outset, an upfront fee should be regarded as an advance payment for future services and so should be recognised as revenue when those future services are provided. Often, upfront fees are charged in order to cover initial sign-up costs, but this is not in itself sufficient to justify upfront revenue recognition. The same logic would apply to any additional fees (e.g. fees associated with particular transactions) that may be charged during the term of a contract. It will be necessary to consider whether these relate to distinct services; if they are not separate from the original service provided, they may result in variable consideration relating to the overall banking services.

How should credit card loyalty schemes be recognised?

It is not uncommon for banks to offer loyalty programmes as part of their credit card offerings. For example, the holders of a credit card may receive loyalty points every time they make a purchase. They are then able to use those loyalty points to obtain goods or services, either from the bank or from specified retailers. In such cases, entities will need to evaluate what portion, if any, of their cardholder arrangements that include loyalty programmes are within the scope of the new Standard and, if so, determine the appropriate accounting for such arrangements. They may be required to account for future rewards provided to cardholders under these programmes as separate performance obligations. This would require a portion of the transaction price to be allocated to and recognised as revenue when control of the future benefits under the rewards programme transfers to the cardholder. This requirement may constitute a change from current accounting policies for banking and securities companies.

What else might change?

In addition to the key changes discussed above, the new Standard introduces detailed guidance in many areas regarding the reporting of revenue and entities will need to ensure that they have considered all of these when assessing the extent to which their accounting policy for revenue may need to be amended.

More detailed information on the impact of IFRS 15 can be found in Deloitte's IFRS in Focus publication available from www.iasplus.com. Further industry publications are also available here.

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