Deloitte.

Implementing IFRS 15
Revenue from Contracts with Customers

A practical guide to implementation issues
for the asset management sector

Contents

About this guide

A new revenue recognition accounting standard, IFRS 15 *Revenue from Contracts with Customers* ('the Standard'), is effective for periods beginning on or after 1 January 2018 (early adoption is permitted).

As the effective date gets close, entities need to ensure that they have considered the impact of the new Standard. In some cases, the Standard will require significant system changes or will significantly affect other aspects of operations (e.g. internal controls and processes, KPIs, compensation and bonus plans, bank covenants, tax etc.), and, therefore, it is imperative that entities identify any such impacts as soon as possible.

This guide is intended to provide an overview of applying IFRS 15 within the asset management sector. The guidance provided here is not intended to be exhaustive, but aims to highlight some of the potential issues to consider and to indicate how those issues might be approached.

We hope you will find this implementation guide helpful and encourage you to reach out to one of our professionals identified in this guide for additional support as needed.

Overview

The new Standard on accounting for revenue recognition, IFRS 15 *Revenue from Contracts with Customers* ('the Standard') issued by the International Accounting Standards Board ('IASB'), is applicable for entities reporting in accordance with International Financial Reporting Standards ('IFRSs') for periods beginning on or after 1 January 2018 with early application permitted. The new Standard is the result of a joint project by the IASB and the Financial Accounting Standards Board ('FASB') (collectively the 'Boards') to develop a converged set of accounting principles to be applied under both IFRSs and US generally accepted accounting principles ('US GAAP'). The guidance is relevant across all industries and for most types of revenue transaction.

As a result of the issuance of IFRS 15, the following existing requirements in IFRSs have been superseded:

- IAS 11 *Construction Contracts;*
- IAS 18 *Revenue;*
- IFRIC 13 *Customer Loyalty Programmes;*
- IFRIC 15 *Agreements for the Construction of Real Estate;*
- IFRIC 18 *Transfers of Assets from Customers; and*
- SIC-31 *Revenue – Barter Transactions Involving Advertising Services.*

At a glance

Current requirements	
Revenue recognition	
IAS 11 IAS 18 IAS 18 IFRIC 15	Construction contracts Sales of goods Sales of services Real estate sales
IAS 18	Royalties
IFRIC 13	Customer loyalty programmes
IFRIC 18 SIC 31	Transfers of assets from customers Advertising barter transactions
	Previously little guidance on costs of obtaining and fulfilling a contract
Other revenue	
IAS 18 IAS 18	Interest Dividends

New requirements	
Revenue from contracts with customers	
IFRS 15	Point in time or over time
	New guidance on royalty revenue
	New guidance on options for additional goods and services and breakage
	Guidance on non-cash consideration
	New guidance on costs of obtaining and fulfilling a contract
Other revenue	
IAS 39 or IFRS 9	Interest Dividends

The new Standard outlines a single comprehensive model of accounting for revenue arising from contracts with customers. Based around a five-step model, it is more detailed and prescriptive than the existing guidance. There are two significant impacts that entities will need to consider when implementing the new Standard.

The timing of revenue and profit recognition

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 asset management sector. Applying these new rules may result in significant 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**, the impact on the timing of targets being achieved and the likelihood of targets being met; and
- potential non-compliance with **loan covenants**.

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

As explained throughout this document, IFRS 15 introduces new requirements to move to a more prescriptive approach based around a five-step model. The complexity of applying this approach and of producing the detailed disclosures required by the new Standard in the asset management sector may require modifications to existing accounting processes.

In determining the extent to which modifications will be required, entities may wish to consider the need for sufficient flexibility to cope with future changes in the pricing and variety of product offerings made to customers. The 1 January 2018 effective date may set a challenging timeframe for developing new systems.

Issues of particular relevance to the asset management sector

This publication includes guidance on all of the five steps required by the new revenue recognition model under IFRS 15. Throughout the publication we have highlighted those steps which we anticipate being a greater challenge for entities in the asset management industry, including the following five issues:

- identifying who is the customer in the contract;
- unbundling multiple service obligations within a single contract;
- the treatment of upfront fees;
- the impact of variable consideration; and
- capitalisation of costs of obtaining a contract.

The first two issues identified relate to specific stages of the five-step model that may present challenges when assessed in the context of asset management arrangements. The conclusions reached on these issues will have an impact on further stages of the revenue recognition process.

The remaining three issues relate to the treatment of particular accounting situations common to asset management entities that are likely to require significant judgement and present particular challenges.

Scope and core principle

Scope

IFRS 15 applies to all contracts with customers, except for those that are within the scope of other IFRSs. Examples of contracts that are outside the scope of IFRS 15 include, but are not limited to, leases (IFRS 16 Leases or, for entities that have not yet adoption IFRS 16, IAS 17 *Leases*), insurance contracts (IFRS 17, Insurance Contracts, or for entities that have not yet adopted IFRS 17, IFRS 4 *Insurance Contracts*) and financial instruments (IFRS 9 *Financial Instruments* or, for entities that have not yet adopted IFRS 9, IAS 39 *Financial Instruments: Recognition and Measurement*). It is possible that a contract with a customer may be partially within the scope of IFRS 15 and partially within the scope of another standard.

The recognition of interest and dividend income is not within the scope of IFRS 15. However, certain elements of the new model will be applied to transfers of assets that are not an output of an entity's ordinary activities (such as the sale of property, plant and equipment, real estate or intangible assets).

Core principle

The core principle underlying the new model is that an entity should recognise revenue in a manner that depicts the pattern of transfer of goods and services to customers. The amount recognised should reflect the amount to which the entity expects to be entitled in exchange for those goods and services. IFRS 15 provides five steps that companies will need to follow in accounting for revenue transactions.

Scope, core principle and key terms

Step 1. Identify the contract with a customer

Summary of the requirements	
What qualifies as a contract?	For many entities, Step 1 will be relatively straightforward. The key points are to determine when a contract comes into existence. A contract can be written, verbal, or implied. The following criteria are all required in order to qualify as a contract with a customer: • The contract has been approved by the parties; • The entity can identify each party's rights regarding the goods or services to be delivered; • The entity can identify the payment terms for the goods or services to be delivered; • The contract has commercial substance; and • It is probable that the entity will collect the consideration to which it is entitled in exchange for the delivery of the goods or services. Contracts should generally be accounted for separately. However, for accounting purposes, contracts should be combined with other contracts if: • they are negotiated as a package with a single commercial objective, • the amount of consideration to be paid in one contract depends on the goods or services to be delivered in another contract, or • the goods or services promised in the contracts are considered to be a single performance obligation. Entities will additionally need to consider how to account for any subsequent modifications that arise.

Identifying the customer – the fund or the investor(s)?
IFRS 15 defines a customer as "[a] party that has contracted with an entity to obtain goods or services that are an output of the entity's ordinary activities in exchange for consideration". An asset manager will need to consider whether the ultimate customer is the **fund** that is being managed or the **underlying investor(s)** in the fund. As will be discussed later in this guide, identification of who is the customer may affect, for example, the timing of revenue recognition or the accounting for certain costs.

IFRS 15 remains a standard focused on contractual arrangements, and this will need to be the first point of any analysis. However, when considering the ultimate customer, it is important to consider the agent versus principal guidance, i.e. which counterparty has the substantive relationship within the contractual arrangement? Depending on the facts and circumstances, the answer on a case-by-case basis may not be black and white, and judgement will be required.

Certain indicators may point towards a conclusion that the **fund** is the customer. For example, a fund that is being managed might be considered the customer of the asset manager in a situation where it has a number of investors, none of whom exercise significant influence over the fund individually, and where the fund can act with autonomy from investors in regards to operational matters. A specific example of such a situation might be a retail fund with a diffuse range of investors where no one individual or group is deemed to have influence over the contracts between the funds and their service providers.

Other criteria that may be important when assessing whether the fund is the customer include: the fund being a separate legal entity or having a governance structure independent of the manager; fee arrangements being set by the fund and applied consistently across different investors; the fund being highly regulated; or a position where the asset manager and other service providers may have multiple different contractual arrangements with the fund to provide different services.

Alternatively, if a fund vehicle has been specifically designed around the needs of one, or a small number, of investors(s), it may be that the **underlying investor** is the customer, for example, where the investor has been heavily involved in establishment of the fund structure and has interacted directly with the asset manager to determine the fund strategy or investment decisions.

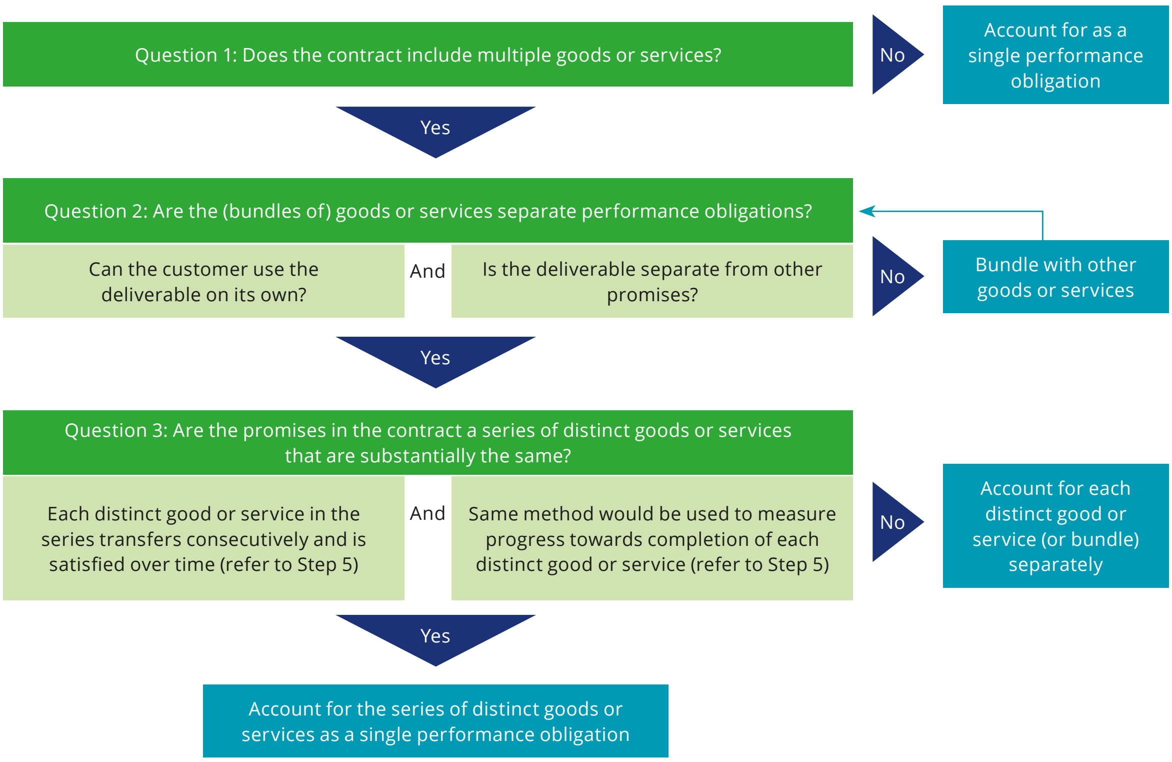
Other criteria that may be important when assessing whether the investor is the customer may include: where there is active negotiation of fees or interaction between the asset manager and individual investors; a lack of governance around the fund that is independent of the fund manager; or where a small group of investors control the fund's activity directly or indirectly.

Step 2. Identify the performance obligations in the contract

Summary of the requirements	
What is 'unbundling'?	Step 2 is concerned with how to identify those deliverables that are accounted for separately ('performance obligations'). This process is sometimes called 'unbundling'. For many entities, this will be a key judgement in recognising revenue. Previously, apart from the guidance in IAS 11 on segmentation of construction contracts, IFRSs contained little guidance on this topic; therefore the requirements of IFRS 15 may lead to a significant change in practice for some entities.
When should 'unbundling' happen?	The performance obligations need to be determined at contract inception, by identifying the 'distinct' goods or services in the contract. If distinct goods or services cannot be identified, entities should combine goods or services until they identify a bundle of goods or services that is distinct.
How are separate performance obligations identified?	In order to do this, an entity will typically first identify all the goods or services, or contract deliverables, which have been promised. These may be implicitly or explicitly promised in a contract. For example, a contract with a customer may also include promises that are implied by an entity's customary business practices or published policies. This requirement highlights the need to analyse the commercial objective of the contract in order to identify all the deliverables. An entity will then determine which of its promised goods or services should be accounted for as performance obligations, by determining which promised goods or services are distinct. For a good or service to be 'distinct', it must satisfy both of the following conditions: • the customer can benefit from the good or service either on its own or in combination with other resources available to the customer; and • the entity's promise to transfer the good or service to the customer is separable from other promises in the contract, as discussed further below. Customers are able to benefit from a good or service if that good or service can be used, consumed, sold for an amount other than scrap value, or otherwise held in a way that generates economic benefits.
What else needs to be considered?	Whether an entity's promise to transfer a good or service is separable from other promises in the contract is a matter that requires judgement and will depend on the facts and circumstances specific to each scenario. Factors that indicate a promised good or service is separable from other promises include, but are not limited to, the following: • the entity does not use the good or service as an input to produce the combined output specified by the contract; • the good or service does not significantly modify or customise another good or service promised in the contract; and • the good or service is not highly dependent on, or highly interrelated with, other promised goods or services. In certain circumstances, the provision of a series of distinct goods or services that are substantially the same and have the same pattern of transfer is to be treated as one performance obligation.
Why does it matter?	The identification of distinct performance obligations will have consequences in Steps 4 and 5 of the Standard's revenue model. These are discussed in further detail below.

All entities will need to consider this requirement carefully to determine whether their current approach will continue to be appropriate under IFRS 15. By applying the following process to contracts, entities should be able to identify whether there are distinct performance obligations.

Step 2. Identifying separate performance obligations



Unbundling multiple performance obligations

Entities in the asset management sector may provide multiple services within a single contract. For example, fee arrangements may cover management, distribution and custodian services. Under the new Standard, an entity will be required to assess whether the deliverables it has promised to the customer are distinct performance obligations. The same assessment will need to be performed if a fee states that it includes multiple services for that fee (e.g. management, administration, distribution and/or set-up). This could potentially become much move common should regulators begin to require “all-in” fees.

Determining what constitutes a distinct performance obligation is an area in which management may have to exercise a greater level of judgement, considering the guidance included in IFRS 15 as noted in the box above.

When the entity has identified its distinct performance obligations, it will have to follow the guidance in Step 4 to determine how to allocate the transaction price to the various performance obligations.

Upfront fees
Asset management agreements may include an upfront fee payable by the customer, often to cover a prepayment of distribution costs or initial sign-up or administrative costs. IFRS 15 includes specific guidance on the treatment of such fees for revenue recognition purposes. In particular, unless distinct goods or services are provided to the customer at the outset, an upfront fee should be recognised as revenue when future goods or services are provided. The fact that an upfront fee may be charged to cover initial sign-up or administrative costs is not sufficient to justify the recognition of revenue at that point. This guidance should be applied even when the upfront fee is non-refundable.

When it is concluded that the upfront fee should not be recognised immediately, an asset manager will need to use judgement to determine over what period the upfront fee should be recognised. This may be the period of investment in the fund when a specific investor has been identified as the customer. Or it may be the lifetime of the fund where the fund has been identified as the customer. The individual facts and circumstances will need to be considered carefully to determine when the upfront fees should be recognised.

Where revenue is recognised more than 12 months after the upfront fee is received, IFRS 15 requires the entity to consider whether the amount recognised should be adjusted to reflect the time value of money (i.e. the effects of a 'significant financing component') as noted in Step 3 below.

Step 3. Determine the transaction price

Summary of the requirements	
What impacts the amount of revenue recognised?	Step 3 is concerned with how to measure the total revenue arising under a contract. IFRS 15 typically bases revenue on the amount to which an entity expects to be entitled rather than the amounts that it expects ultimately to collect. In other words, revenue is adjusted for discounts, rebates, credits, price concessions, incentives, performance bonuses, penalties and similar items, but it is not reduced for expectations of bad debts. There is, however, an exception for transactions that include a significant financing component. For these transactions, revenue is recognised based on the fair value of the amount receivable, which will reflect the customer's credit risk as it is incorporated into the discount rate applied. An entity will need to determine the amount of consideration to which it expects to be entitled in exchange for the promised goods or services (including both fixed and variable consideration). When determining the amount to which the entity expects to be entitled, consideration should be given to past business practices, published policies or specific statements that create a valid expectation in the customer that the entity will only enforce payment of a portion of the stated contract price. For example, if past business practices with a particular customer demonstrate that the entity typically only requires payment of ninety per cent of the stated contract price (i.e. it forgives the balance), for a new contract with the same customer, the transaction price may be determined to be ninety per cent of the stated contract price. The key considerations in determining the transaction price are the effects of any variable consideration, the time value of money (if there is evidence that a significant financing component exists), non-cash consideration and any consideration payable to the customer.
Variable consideration	Variable consideration is any amount that is variable under the contract. Variable consideration will only be included in the transaction price when an entity expects it to be 'highly probable' that the resolution of the associated uncertainty would not result in a significant revenue reversal. This assessment takes into account both the probability of a change in estimate and the magnitude of any revenue reversal that would result. If an entity is unable to include its full estimate of variable consideration, because that could give rise to a significant revenue reversal, it should limit the amount of variable consideration to the amount that would be highly probable of not resulting in a significant revenue reversal. If an entity determines that the contract provides the customer or the entity with a significant benefit of financing the transfer of goods or services to the customer, then the consideration should be adjusted for the time value of money. This may lead to interest expense being recognised if the customer pays for goods or services in advance of the transfer of control or interest income when the goods or services are paid for in arrears.

Summary of the requirements

Time value of money	**Practical expedient** For contracts in which the period between the performance of the obligations and the associated payment is less than a year, the entity can choose not to account for the time value of money. If the period between the performance of the obligations and the associated payment is more than a year, an entity will always need to consider if there is a significant financing component. When determining whether a contract contains a significant financing component, an entity should consider, among other factors: • the difference between the promised amount of consideration and the cash selling price of the promised goods or services; and • the combined effect of the period between an entity fulfilling its performance obligations and customer payment, and the prevailing interest rate in the relevant market. The discount rate used should be a rate that would be reflected in a separate financing transaction between the entity and its customer at contract inception, taking into account credit characteristics. The significant financing component arising on a contract will be accounted for in accordance with IFRS 9 *Financial Instruments* (or, if IFRS 9 has not yet been adopted, IAS 39 *Financial Instruments: Recognition and Measurement*).
Why does it matter?	Management's estimate of consideration will have consequences when applying Steps 4 and 5 of the revenue model. These are discussed in further detail below.

Step 3 requires careful consideration of multiple factors when determining the transaction price. The key considerations relevant to asset management entities have been summarised below.

Step 3. Transaction price

VARIABLE CONSIDERATION
Examples
- Performance bonuses/penalties
- Incentives
- Rights of return
- Discounts
- Clawbacks

NON-CASH CONSIDERATION
Examples
- Share consideration

TRANSACTION PRICE
Amount to which an entity is expected to be entitled for transferring goods or services

TIME VALUE OF MONEY
Factors to consider
- Difference between consideration promised and cash selling price
- Expected length of time between transfer of deliverable and payment (< 1 year – practical expedient)
- Prevailing market interest rates

CONSIDERATION PAYABLE TO CUSTOMER
Examples
- Rebates

Variable consideration

Revenue arrangements in the asset management sector are often variable as the management fees and performance fees earned by the asset manager are normally based on the valuation of underlying investments. Such variable consideration should only be included in the transaction price to the extent that it is **highly probable that its inclusion will not result in a significant future revenue reversal.** In assessing whether it is highly probable that a significant future revenue reversal will not occur an entity will need to consider both the likelihood and magnitude of a revenue reversal. Factors to consider include:

- whether the amount of consideration is highly susceptible to factors outside the entity's influence (e.g. market volatility impacting the fund performance which in turn impacts performance fees);
- whether the uncertainty about the amount of consideration is not expected to be resolved for a long period of time;
- whether the entity's experience (or other evidence) with similar types of contracts is limited, or that experience (or other evidence) has limited predictive value;
- whether the entity has a practice of offering a broad range of price concessions or changing the payment terms and conditions of similar contracts in similar circumstances; and
- whether the contract has a large number and broad range of possible consideration amounts.

This is illustrated by the following example which accompanies the Standard.

Example 1 – Management fees subject to the constraint

[IFRS 15 Illustrative Example 25]

On 1 January 20X8, an entity enters into a contract with a client to provide asset management services for five years. The entity receives a two per cent quarterly management fee based on the client's assets under management at the end of each quarter. In addition, the entity receives a performance-based incentive fee of 20 per cent of the fund's return in excess of the return of an observable market index over the five-year period. Consequently, both the management fee and the performance fee in the contract are variable consideration.

The entity accounts for the services as a single performance obligation in accordance with paragraph 22(b) of IFRS 15, because it is providing a series of distinct services that are substantially the same and have the same pattern of transfer (the services transfer to the customer over time and use the same method to measure progress – that is, a time-based measure of progress).

At contract inception, the entity considers the requirements in paragraphs 50-54 of IFRS 15 on estimating variable consideration and the requirements in paragraphs 56-58 of IFRS 15 on constraining estimates of variable consideration, including the factors in paragraph 57 of IFRS 15. The entity observes that the promised consideration is dependent on the market and thus is highly susceptible to factors outside the entity's influence. In addition, the incentive fee has a large number and a broad range of possible consideration amounts. The entity also observes that although it has experience with similar contracts, that experience is of little predictive value in determining the future performance of the market. Therefore, at contract inception, the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the management fee or the incentive fee in the transaction price.

At each reporting date, the entity updates its estimate of the transaction price. Consequently, at the end of each quarter, the entity concludes that it can include in the transaction price the actual amount of the quarterly management fee because the uncertainty is resolved. However, the entity concludes that it cannot include its estimate of the incentive fee in the transaction price at those dates. This is because there has not been a change in its assessment from contract inception – the variability of the fee based on the market index indicates that the entity cannot conclude that it is highly probable that a significant reversal in the cumulative amount of revenue recognised would not occur if the entity included its estimate of the incentive fee in the transaction price. At 31 March 20X8, the client's assets under management are CU100 million. Therefore, the resulting quarterly management fee and the transaction price is CU2 million.

At the end of each quarter, the entity allocates the quarterly management fee to the distinct services provided during the quarter in accordance with paragraph 84(b) and 85 of IFRS 15. This is because the fee relates specifically to the entity's efforts to transfer the services for that quarter, which are distinct from the services provided in other quarters, and the resulting allocation will be consistent with the allocation objective in paragraph 73 of IFRS 15. Consequently, the entity recognises CU2 million as revenue for the quarter ended 31 March 20X8.

This example demonstrates the scenario where an asset manager is not able to recognise the incentive fee as it is unable to conclude that it is highly probable that a significant reversal in the cumulative amount of revenue will not occur. Alternatively, there may be scenarios under IFRS 15 where an entity concludes that there is a portion of revenue for which it is highly unlikely that a significant revenue reversal will occur and therefore revenue can be recognised. For example, a fund with a long term performance objective may, towards the end of its life, have sold a sufficient number of investments to know that a certain proportion of the performance fee will eventually be payable, even if that amount has not yet crystallised or become due.

A further example is when market analysis is performed and demonstrates that a certain proportion of investment gains made to date are unlikely to be reversed except under very exceptional market conditions. In both of these examples, an entity will need to determine whether there is a minimum amount of revenue that needs to be recognised in respect of the contract. This may mean a change in revenue recognition for entities that historically, under IAS 18, have maintained a policy of booking performance fees only when they crystallise.

The impact of the variable consideration constraint is likely to be most pronounced in the context of funds with multi-year performance fees (e.g. carried interest payments for private equity funds). Another issue that will impact the extent to which revenue is subject to future reversal is the presence of clawback terms where the fund manager may be subject to the possibility of needing to repay variable consideration at a future point in time.

When a contract includes annual performance fees, the variable consideration constraint may still be applicable if the financial reporting period-end does not correspond to the date on which the management or performance fees are crystallised.

The new requirements in IFRS 15 in respect of variable consideration as noted above will need to be carefully considered in such scenarios that entities may encounter. This is particularly important when assessing the probability of a significant amount of revenue being reversed in the future which in turn determines how much consideration is included in the transaction price which ultimately determines the amount of revenue that can be recognised (see Step 5 below).

Step 4. Allocate the transaction price to separate performance obligations

Summary of the requirements	
Allocating the transaction price	After determining the transaction price at Step 3, Step 4 specifies how that transaction price is allocated between the different performance obligations identified in Step 2. Previously, IFRSs included very little in the way of requirements on this topic, whereas IFRS 15 is reasonably prescriptive. Accordingly, this could be an area of significant change for some entities, and entities will need to consider whether their existing systems are capable of allocating the transaction price in accordance with the Standard's requirements.
What method should be used to allocate the transaction price?	If there are multiple performance obligations identified in a single contract, the transaction price should be allocated to each separate performance obligation on the basis of relative standalone selling prices. The standalone selling price should be determined at contract inception and represents the price at which an entity would sell a promised good or service separately to a customer. Ideally, this will be an observable price at which an entity sells similar goods or services under similar circumstances and to similar customers.
Are any other methods available?	If the standalone selling price is not directly observable, the entity should estimate it. Estimation methods that may be used include an adjusted market assessment approach, an expected cost plus margin approach or a residual approach, but the last may only be used if certain conditions are met.
How should any discounts be allocated?	If the standalone selling prices are greater than the promised consideration in a contract with a customer, the customer is deemed to have received a discount. Unless the discount meets the criteria set out in the Standard to be allocated to only some of the performance obligations, the discount should be allocated proportionately to all the performance obligations in the contract. Variable consideration should also be allocated proportionately to all the performance obligations identified unless certain criteria are met.

Step 4. Inputs to allocate transaction price

How to determine the stand-alone selling price?
Best evidence: observable price of a good or service when sold on a stand-alone basis

Not directly observable? → Must estimate!

Market

- Evaluate the market in which goods or services are sold. Estimate the price that customers in that market would be willing to pay.
- Refer to prices from competitors for similar goods or services adjusted for entity-specific costs and margins.

Expected costs

- Forecast expected costs of satisfying a performance obligation adjusted for an appropriate margin.

Residual

- Total transaction price less the sum of the observable stand-alone selling prices.
- This method may only be used when:
  - selling price is highly variable; or
  - selling price is uncertain (a price has not yet been established or good or service has not been previously sold).

Maximise the use of observable inputs
An entity may find that there are practical difficulties regarding systems capabilities of tracking price information in light of the prior prevalent use of the Residual Method and the application of the contingent cap.

Step 5. Recognise revenue as the entity satisfies a performance obligation

Summary of the requirements	
When should revenue be recognised?	The final step is to determine, for each performance obligation, when revenue should be recognised. This may be over time or at a point in time. Previously, IAS 18 required revenue for services to be recognised over time and revenue for goods to be recognised at a point in time, but it did not include guidance on how to determine whether a particular item supplied under a contract should be regarded as a good or a service for these purposes. IFRS 15 does not distinguish between goods and services but instead includes specific and detailed guidance on when to recognise revenue over time and when to recognise revenue at a point in time. Some entities may find that items for which they previously recognised revenue at a point in time now have revenue recognised over time, or vice versa.
What is control and how is it assessed?	An entity should recognise revenue as the performance obligations are satisfied. A performance obligation is satisfied when control of the underlying goods or services for that particular performance obligation is transferred to the customer. 'Control' is defined as 'the ability to direct the use of and obtain substantially all of the remaining benefits from the asset' underlying the good or service. Control can transfer, and hence revenue be recognised, over time or at a point in time.

Summary of the requirements	
When is revenue recognised over time?	Control is deemed to have transferred over time if any one of the following is met: • The customer simultaneously receives and consumes all of the benefits provided by the entity's performance as the entity performs. This means that if another entity were to take over providing the remaining performance obligation to a customer, it would not have to substantially reperform the work already completed by the initial provider. This criterion applies to service contracts where the customer consumes the benefits of the services as they are provided (for example, a service-type warranty); • The entity's performance creates or enhances an asset that the customer controls as the asset is created or enhanced. Control refers to the ability to direct the use of and obtain substantially all of the remaining benefits from the asset. Therefore this criterion is satisfied if the terms of the contract transfer control of the asset to the customer as the asset is being built (i.e. control of work in progress). This asset may be tangible or intangible; or • 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, including a reasonable profit margin. This criterion may apply in situations where the indicators of control are not immediately apparent. Entities will need to assess whether an asset has an alternative use at contract inception. An asset with no alternative use to an entity is one where the entity is unable to readily direct the use of the asset, which may be partially or wholly completed, for another use. This limitation may be imposed contractually or practically. A contractual restriction is one where the terms of the contract would allow the customer to enforce its rights to the promised asset if the entity attempted to direct the asset for another use, whereas a practical restriction is one where the entity would incur significant economic losses to redirect the use of the asset, such as significant costs of rework or significant loss on sale of the asset.
When is revenue recognised at a point in time?	If a performance obligation does not meet the criteria to be satisfied over time, entities should consider the following indicators in evaluating the point in time at which control of the asset has been transferred to a customer: • The entity has transferred title to the asset. • The entity has transferred physical possession of the asset. • The entity has a present right to payment for the asset. • The customer has accepted the asset. • The customer has the significant risks and rewards of ownership of the asset.

One of the key changes in IFRS 15 is the basis for the recognition of revenue. For goods, IAS 18 utilised the concept of the transfer of risks and rewards, whereas IFRS 15 utilises the concept of the transfer of control in all cases. Although applying the two different concepts will often not alter the timing of revenue recognition, it is nevertheless possible in some circumstances for entities to have a different pattern of revenue recognition based on a transfer of control as opposed to a transfer of risks and rewards, and this should be taken into careful consideration. It is possible that as a result of IFRS 15, revenue which was previously recognised over time will now be recognised at a point in time, and vice versa.

Step 5. Recognising revenue over time

Is performance satisfied over time? If YES, recognise revenue over time.
This will depend on facts and circumstances.

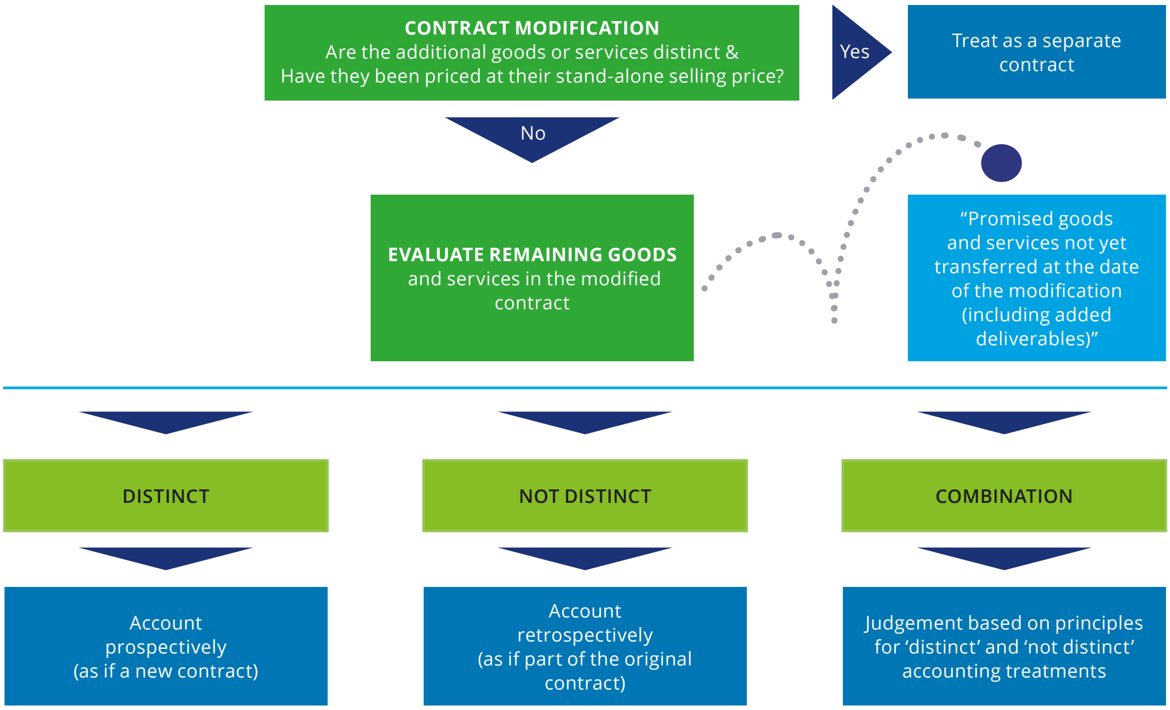
Seller's performance creates or enhances an asset controlled by customer	Seller's performance does not create an asset or any asset created is simultaneously consumed by customer	Seller creates an asset that does **not have alternative use to seller** and the seller has right to be paid for performance to date and expects to fulfill contract as promised
Indicators/Examples • Customer controls WIP • Asset constructed on customer land	Indicators/Examples • Another supplier would not need to reperform • Transportation services • Transaction processing services	Indicators/Examples • Original equipment manufacturers • Consulting report

IF NO, recognise revenue at a point in time

Contract modifications

Summary of the requirements	
Should revenue be adjusted when a contract is modified?	Contract modifications (also sometimes referred to as a change order, variation or amendment) of price, scope or both will have accounting consequences when they are 'approved' such that they create enforceable rights and obligations. Modifications should be treated as an adjustment to the original contract unless they merely add a further performance obligation that is both 'distinct' (as defined by the Standard – see Step 2 above) and priced based on an appropriately adjusted standalone selling price. If both these conditions are met, the modification is treated as a new, separate contract. If the modification is treated as an adjustment to the original contract, the appropriate accounting depends on the remaining goods or services to be delivered under the contract. • If the remaining goods or services are distinct, the modification is accounted for prospectively by allocating the remaining transaction price to the remaining performance obligations in the contract. • If the remaining goods or services are not distinct, the modification is accounted for retrospectively, by updating both the transaction price and the measure of progress for the part-complete performance obligation.

Contract modification



Costs of obtaining a contract
Providers of asset management services may incur costs that are directly attributable to obtaining contracts with customers, for example placement fees or sales commissions.

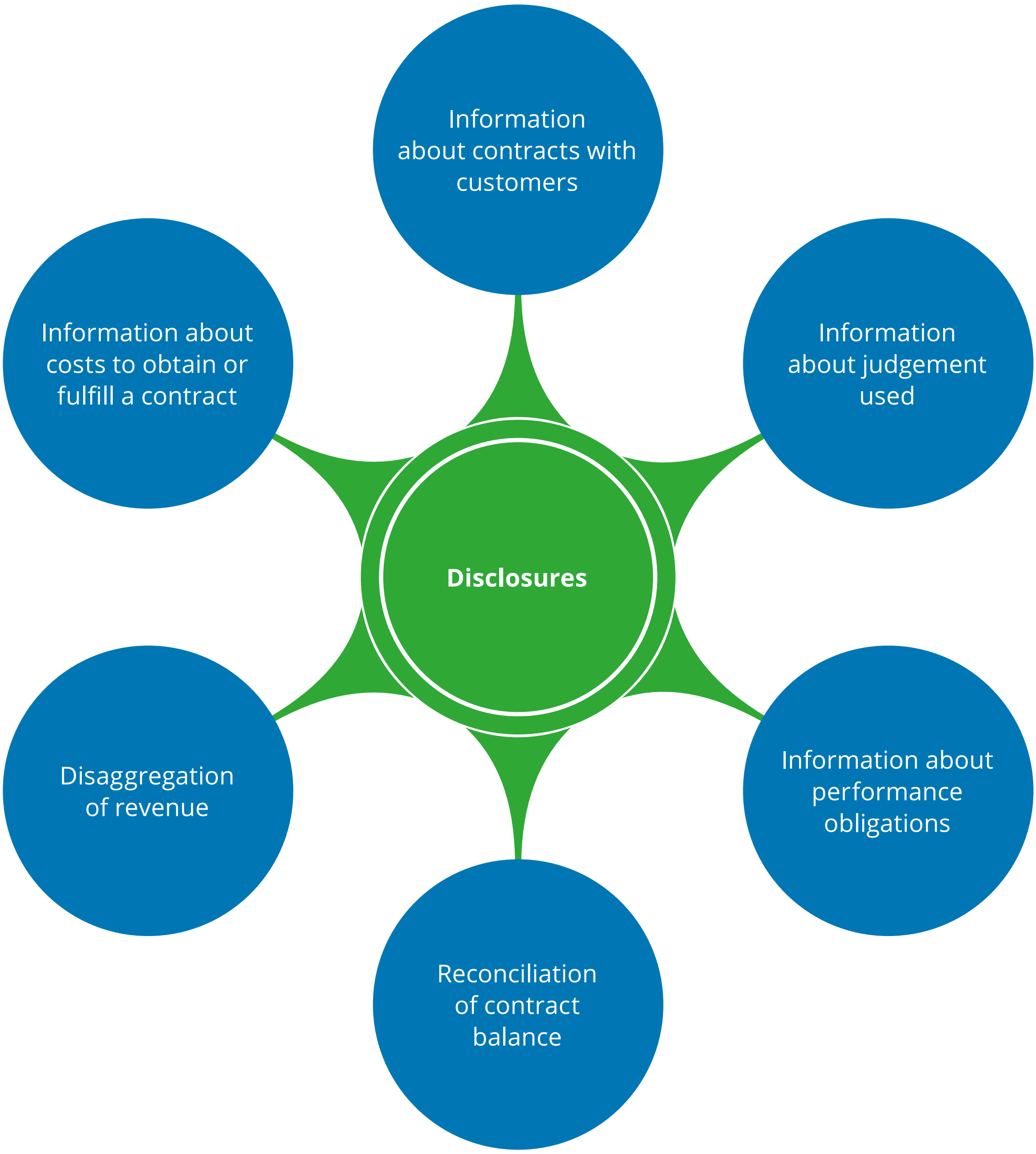
Treatment of these costs is currently varied, with some entities choosing to expense the costs and others choosing to capitalise the costs. When an entity incurs incremental costs that arise directly as a result of successfully obtaining a contract and certain criteria are met, IFRS 15 requires that these shall be recognised as an asset on the balance sheet. Costs that would have been incurred regardless of whether the contract was obtained need to be recognised as an expense, unless these costs are explicitly re-chargeable to the customer. Determining whether the fund or the underlying investor is the customer, as discussed above in step 1, will be important when considering whether certain costs should be capitalised as costs of obtaining a contract. For example, if it is determined that the fund is the customer of the asset manager, then costs of attracting underlying investors to the fund would not qualify as incremental costs of obtaining a contract, because no new contract with a customer would be obtained. Instead, such costs would need to be considered in respect of the guidance for costs of fulfilling a contract.

Practical expedient
This treatment is not mandatory for contracts where the period of amortisation of the asset would have been one year or less.

If an entity recognises an asset as a result of obtaining a contract, the entity will be required to determine the appropriate pattern of amortisation and assess for impairment. A change in treatment of these costs may result in a change in the profile of profit recognition.

Disclosure

IFRS 15 requires an increased level of disclosures about revenue recognition in comparison to previous Standards, which have been criticised for lacking adequate disclosure requirements. Under IFRS 15, the disclosure requirements are driven by the objective of providing users of the financial statements with information that will help them to understand the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers. As such, entities should not approach the disclosure requirements on a 'checklist' basis but should consider how to provide qualitative and quantitative disclosures around their contracts with customers, making clear any significant judgements made in applying IFRS 15 to contracts, and any assets recognised in relation to the cost of obtaining or fulfilling a contract. Updates or changes to the systems and processes of entities may be required to ensure that they are able to comply with the disclosure requirements.



The key disclosures required include:

- Contracts with customers
  - A disaggregation of revenue for the period into categories that depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors. Information must also be provided to demonstrate the relationship between the disaggregated revenue information and any segment revenue disclosures.
  - Information about the entity's contract assets and contract liabilities. This includes opening and closing balances of balance sheet items relating to contracts with customers. Entities will also be required to disclose the amount of revenue recognised in the current year that relates to the satisfaction of performance obligations in previous reporting periods. In relation to remaining performance obligations, entities will need to explain how the future pattern of satisfaction of these will impact on the contract asset and contract liability balance.
  - Information about the entity's remaining performance obligations. Entities will be required to disclose the total transaction price allocated to the remaining performance obligations at the end of each reporting period (unless the remaining performance obligation will be satisfied in less than a year). Other disclosures required include information about when the entity typically satisfies its performance obligations, the significant payment terms, the nature of the goods or services that the entity has promised to transfer and information about obligations relating to warranties, refunds and returns.
- Significant judgements
  - Information about entities' judgements, and any changes in judgements, in relation to the timing of, and the transaction price allocated to, the satisfaction of performance obligations. Entities will be required to disclose how they have made these judgements and why these are a faithful depiction of the transfer of goods or services.
- Assets recognised in relation to the cost of obtaining or fulfilling a contract
  - The closing balance of any assets recognised in relation to costs incurred to obtain or fulfil a contract, in addition to any judgements exercised in determining the amount to be capitalised.
  - Amortisation information for the amount recognised in profit or loss in the current period and the method of amortisation.

There are no disclosure exemptions for commercially sensitive information.

IFRS 15 also amends IAS 34 *Interim Financial Reporting* to require disaggregated revenue information to be disclosed in interim financial statements.

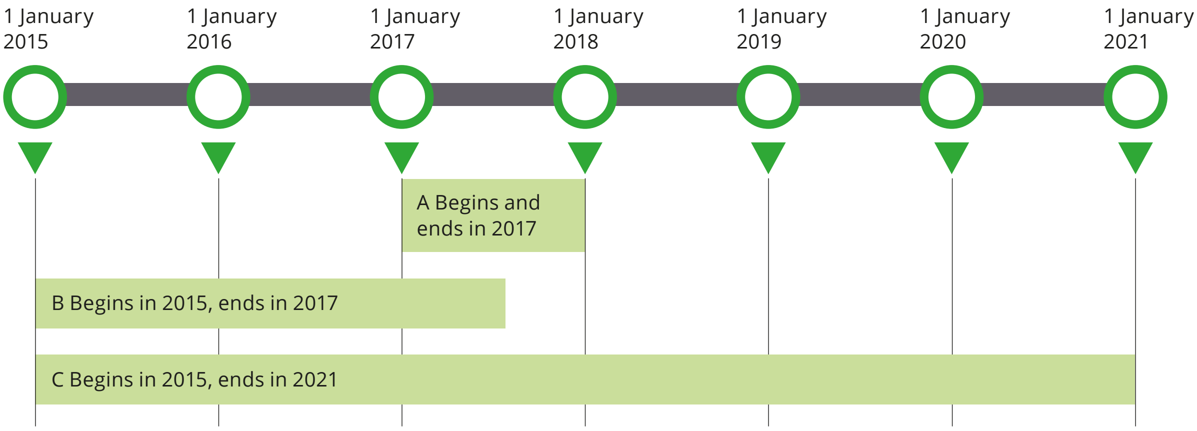
Transition

Entities have two options for transitioning to IFRS 15. Both options are fairly detailed but helpful in providing some relief on initial application of IFRS 15. Both of these options make reference to the date of initial application – which is the start of the reporting period in which an entity first applies the Standard. For example, entities applying the Standard for the first time in financial statements for the year ending 31 December 2018 will have a date of initial application of 1 January 2018.

Transition timeline

Example
Assume December 31 Y/E
Assume 1 year of comparatives only

Date of initial application



Method 1	**Full retrospective approach**
Contract A	Begins and ends in same annual reporting period and completed before the date of initial application – Practical expedient available
Contract B	Adjust opening balance of each affected component of equity for the earliest prior period presented (1 January 2017)
Contract C	Adjust opening balance of each affected component of equity for the earliest prior period presented (1 January 2017)

Method 2	**Simplified transitional approach**
Contract A	Contract completed before the date of initial application – Do not apply IFRS 15
Contract B	Contract completed before the date of initial application – Do not apply IFRS 15
Contract C	Adjust opening balance of each affected component of equity at date of initial application. Disclose information per paragraph 134.2

Option 1

Full retrospective approach

Entities can apply the Standard retrospectively to all comparative periods presented. Under this option, prior year comparatives are restated, with a resulting adjustment to the opening balance of equity in the earliest comparative period. Where this option is chosen, the Standard provides a number of optional practical expedients.
These include:

- For completed contracts, entities are not required to restate contracts that begin and end within the same annual reporting period. For example, for an entity first applying the Standard for a 31 December 2018 year end, contracts entered into and completed in 2017 will not need to be restated (that is, the interim periods in 2017 are not required to be restated).

- For completed contracts, entities are not required to restate any contract that was completed at the beginning of the earliest period presented. For example, for an entity first applying the Standard for a 31 December 2018 year end and presenting comparative information for the year ended 31 December 2017 only, contracts completed before 31 December 2016 do not need to be evaluated.

- For completed contracts that have variable consideration, an entity may use the transaction price at the date the contract was completed rather than estimating variable consideration amounts in the comparative reporting periods. For example, for contracts completed prior to 31 December 2017, an entity first applying the Standard for a 31 December 2018 year end may base earlier revenue figures on the consideration (including any variable consideration) that was ultimately payable rather than estimate variable consideration at earlier dates.

- For all periods presented before the date of initial application, an entity need not disclose the amount of the transaction price allocated to remaining performance obligations and an explanation of when the entity expects to recognise that amount as revenue. For example, for an entity first applying the Standard for a 31 December 2018 year end, no disclosures will be required about remaining performance obligations as at 31 December 2017 with respect to contracts incomplete on that date.

- For contracts that were modified before the beginning of the earliest period presented, an entity is not required to apply the requirements for contract modifications. Instead, an entity can choose to reflect the aggregate effect of those modifications when: (i) identifying the satisfied and unsatisfied performance obligations; (ii) determining the transaction price; and (iii) allocating the transaction price to the satisfied and unsatisfied performance obligations. For example, for an entity first applying the Standard for a 31 December 2018 year end and presenting comparative information for the year ended 31 December 2017 only, a contract which was modified once or more than once before 1 January 2017 will, for each of the requirements listed above, only need to be assessed for the aggregate effect of those modifications instead of each modification being accounted for individually. Note that any modifications after 1 January 2017 would need to be accounted for on an individual basis.

The practical expedients used should be used consistently for all prior periods presented and disclosure should be given with regards to which expedients have been used. To the extent possible, a qualitative assessment of the estimated effect of applying each of those expedients should be provided.

Option 2

Modified approach

Under the modified approach, entities can apply the Standard only from the date of initial application. If they choose this option, they will need to adjust the opening balance of equity at the date of initial application (i.e. 1 January 2018) but they are not required to adjust prior year comparatives. This means that they do not need to consider contracts that have completed prior to the date of initial application. Broadly, the figures reported from the date of initial application will be the same as if the Standard had always been applied, but figures for comparative periods will remain on the previous basis.

Additionally, entities applying the modified approach may also use the practical expedient available for entities applying the full retrospective approach in respect of contract modifications, either for:

- all contract modifications that occur before the beginning of the earliest period presented; or
- all contract modifications that occur before the date of initial application.

If the modified approach is used, disclosure is required of 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 between the reported results under IFRS 15 and the previous revenue guidance followed.

Final thoughts and broader issues

The transition to IFRS 15 will affect all businesses, to varying degrees and with the effective transition date of periods starting on 1 January 2018 fast approaching, businesses need to consider carefully the new requirements and resolve any potential accounting issues in advance. In addition to those potential accounting issues, IFRS 15 will have a wider effect on the business. The following list highlights aspects of the business that may be affected by the transition to IFRS 15, although it is not intended to be exhaustive.

- Systems and processes – as noted previously, in order to gather the information required for reporting under IFRS 15, an entity may require re-designs or modifications to its IT systems and to its processes (e.g. internal controls) more generally.

- Training for employees – entities should provide training to those employees affected by the changes. This will include accountants, internal auditors and those responsible for drawing up customer contracts.

- Bank covenants – changes in the revenue recognition accounting methods may change the amount, timing and presentation of revenue, with a consequent impact on profits and net assets. This may affect the financial results used in the calculation of an entity's bank covenants. As such, entities should seek early discussions with lenders, to establish whether renegotiation of covenants will be necessary.

- KPIs – where they are based on a reported revenue or profit figure, they may be impacted by the changes. As such, an entity may want to begin evaluating the effect of the Standard on key financial ratios and performance indicators that may be significantly impacted by the changes with a view to determining whether its KPI targets should be adjusted. Where there are changes, an entity will also need to consider how to explain these to investors.

- Compensation and bonus plans – bonuses paid to employees are sometimes dependent on revenue or profit figures achieved. Changes in the recognition of revenue as a result of IFRS 15 may have an impact on the ability of employees to achieve these targets, or on the timing of achievement of these targets.

- Ability to pay dividends – in certain jurisdictions, the ability to pay dividends to shareholders is impacted by recognised profits, which in turn are affected by the timing of revenue recognition. Where this is the case, entities will need to determine whether the changes will significantly affect the timing of revenue and profit recognition and, where appropriate, communicate this to stakeholders and update business plans.

- Tax – the profile of tax cash payments, and the recognition of deferred tax, could be impacted due to differences in the timing of recognition of revenue under IFRS 15.

- Stakeholders – users of the financial statements such as the Board of Directors, audit committee, analysts, investors, creditors and shareholders will require an explanation of the changes in IFRS 15 in order to understand how the financial statements have been impacted.

Key Contacts

Global IFRS Leader
Veronica Poole
ifrsglobalofficeuk@deloitte.co.uk

IFRS centres of excellence

Americas		
Canada	Karen Higgins	ifrs@deloitte.ca
Mexico	Miguel Millan	mx-ifrs-coe@deloittemx.com
United States	Robert Uhl	iasplus-us@deloitte.com
Asia-Pacific		
Australia	Anna Crawford	ifrs@deloitte.com.au
China	Stephen Taylor	ifrs@deloitte.com.cn
Japan	Shinya Iwasaki	ifrs@tohmatsu.co.jp
Singapore	James Xu	ifrs-sg@deloitte.com
Europe-Africa		
Belgium	Thomas Carlier	ifrs-belgium@deloitte.com
Denmark	Jan Peter Larsen	ifrs@deloitte.dk
France	Laurence Rivat	ifrs@deloitte.fr
Germany	Jens Berger	ifrs@deloitte.de
Italy	Massimiliano Semprini	ifrs-it@deloitte.it
Luxembourg	Eddy Termaten	ifrs@deloitte.lu
Netherlands	Ralph Ter Hoeven	ifrs@deloitte.nl
Russia	Maria Proshina	ifrs@deloitte.ru
South Africa	Nita Ranchod	ifrs@deloitte.co.za
Spain	Cleber Custodio	ifrs@deloitte.es
United Kingdom	Elizabeth Chrispin	deloitteifrs@deloitte.co.uk

Designed and produced by The Creative Studio at Deloitte, London. J13405