Key highlights of IFRS 15 and IFRS 9 for the asset management sector
Malta Asset Management Forum 2018
27 November 2018
IFRS 15
A high level overview
IFRS 15 – A high level overview

Effective date

The new revenue recognition standard is effective from 1 January 2018.

Scope

IFRS 15 Revenue from Contracts with Customers ("IFRS 15") prescribes the accounting requirements for all contracts to provide goods or services to customers, unless the contract falls within the scope of another IFRS.

Core principle

IFRS 15 provides five steps that entities need to follow in accounting for revenue transactions.
IFRS 15 – A high level overview

**Step 1: Identify the contract**

A legally enforceable contract (including oral or implied) must meet ALL of the following requirements:

- Contracts are approved and the parties are committed to perform
- Each party’s rights can be identified
- Payment terms can be identified
- Commercial substance
- It is probable that the entity will collect the consideration to which it will be entitled

A contract is outside the scope if:

- The contract is wholly unperformed
- Each party can unilaterally terminate the contract without compensation
Step 2: Identify performance obligations

The Standard defines a performance obligation ("PO") as a promise to transfer to the customer a good or service (or a bundle of goods or services) that is **distinct**.

### Identify all (explicit or implicit) promised goods and services in the contract

Are promised goods and services distinct from other goods and services in the contract?

- **a)** Capable of being distinct
  - Can the customer benefit from the good or service on its own or together with other readily available resources?  
  - **YES** Represents a performance obligation
  - **NO** Combine 2 or more promised goods or services and re-evaluate

- **b)** Distinct in context of contract
  - Is the good or service separately identifiable from other promises in the contract?  
  - **YES**
  - **NO** Look out for: Upfront fees, Stand ready obligations and discounted goods/services

Multiple performance obligations may exist

Different performance obligations may have a different impact on revenue recognition

Key highlights of IFRS 15 and IFRS 9

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**Step 3: Determine transaction price**

Transaction price is the amount to which an entity is expected to be entitled in exchange for transferring promised goods or services to a customer, excluding the amount collected on behalf of third parties.
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Step 3: Determine transaction price - Variable consideration

1. **Variable consideration** includes all consideration that is subject to uncertainty for reasons other than collectability.

2. When accounting for variable consideration:
   - Estimate using the “expected value” (probability weighted) or “most likely amount” method, subject to the following “constraint”.
   - Include some or all of the amount of variable consideration in the transaction price to the extent that it is highly probable that a subsequent change in the estimate would not result in a significant revenue reversal.

*Exception: Sales or usage-based royalties*

Need to assess the **likelihood** and **magnitude** of a significant revenue reversal. Consider the following factors:

- Consideration is highly susceptible to factors outside entity’s influence
- Uncertainty related to amount of consideration is not expected to be resolved for a long time
- Entity’s experience with the type of contract is limited or experience has limited predictive value
- Entity typically offers a broad range of price concessions or changing payment terms and conditions
- The contract has a large number and a broad range of possible consideration amounts

Significant revenue reversal

YES
IFRS 15 – A high level overview

Step 4: Allocate transaction price to separate performance obligations

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 the relative standalone selling prices.

Ideally, the standalone selling price should be:

• an observable price;
• a price at which an entity sells similar goods or services;
• a price charged in similar circumstances and to similar customers.

What if a standalone selling price is NOT directly observable?

Must estimate!

Market prices adjusted for entity costs and margins

OR

Forecasted costs adjusted for appropriate margin

OR

Residual method

Maximise use of observable inputs as far as possible

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Step 5: Recognise revenue when entity satisfies a performance obligation

An entity recognises revenue when or as the entity satisfies a performance obligation by transferring a promised good or service to a customer. An asset is transferred when or as the customer obtains control of that asset.

Concept of control within IFRS 15

- Ability to direct the use of the asset;
- Ability to prevent other entities from controlling the asset;
- Ability to obtain substantially all of the remaining benefits from the asset.

Is control transferred...

Over time
- Customer receives and consumes the benefit as the entity performs

OR

Performance creates or enhances a customer controlled asset

At a point in time
- Asset with an no alternative use and the entity has an enforceable right to payment for performance completed to date
IFRS 15 – A high level overview

Contract costs

**Costs to obtain a contract**

- Capitalise costs of obtaining a contract **if they are incremental** and expected to be recovered (e.g., sales commissions), unless the expected amortisation period (noted below) is one year or less (i.e., practical expedient can be applied and cost is expensed).

**Costs to fulfill a contract**

- Recognise assets in accordance with other standards (i.e., IAS 2, IAS 16, IAS 38, etc.), otherwise capitalise costs that meet all of the following:
  - Relate directly to the contract (or specific anticipated contract)
  - Generate/enhance a resource that will be used to satisfy obligations in the future, and
  - Are expected to be recovered.

**Amortise**

Amortise assets recognised in respect of costs of obtaining or fulfilling a contract on a systematic basis consistent with the transfer of the related goods or services to which it relates

**Impair**

Recognise immediately if costs deemed not recoverable, and reverse if facts and circumstances change
IFRS 15 – A high level overview

Disclosures

Enable users of financial statements to understand the nature, amount, timing and uncertainty of revenue and cash flows.

Disclosures about contracts with customers

- Disaggregation of revenue *
- Information about contract balances
- Remaining performance obligations
- Information about performance obligations

Disclosures about significant judgments and estimates

- Timing of satisfaction of performance obligations
- Transaction price, allocation methods and assumptions
- Policy decisions – Time value of money and costs to obtain a contract

Other required disclosures

- Contract costs
IFRS 15
Affect on the asset management sector
## Affect on the asset management sector

### Which are the key issue areas identified as particularly challenging to the asset management sector?

<table>
<thead>
<tr>
<th>Identifying who is the customer in the contract</th>
<th>Unbundling multiple service obligations within a single contract</th>
<th>Treatment of upfront fees</th>
<th>Variable consideration: the recognition of Management fees and Performance fees</th>
<th>Contract costs</th>
</tr>
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<tbody>
<tr>
<td>Who are the customers? The funds or the investors in those funds? This may effect the timing of revenue recognition.</td>
<td>Area in which management may have to exercise a significant level of judgement.</td>
<td>Upfront fees may include fees received for sale of fund interests and initial sign up fees. Recognition depends on whether a PO separate from the PO relative to the provision of management services has been identified.</td>
<td>IFRS 15 requires an entity to apply a constraint on variable consideration. The magnitude and likelihood of a revenue reversal need to be considered. Requires the exercise of judgement and may change pattern of revenue recognition for fund managers.</td>
<td>Certain costs may need to be capitalised, amortised and regularly checked for impairment. IFRS 15 requirements for contract costs may change current practice for some asset managers. Proper customer identification is a key part to this analysis.</td>
</tr>
</tbody>
</table>
Affect on the asset management sector

It makes sense to assess the impact of IFRS 15 because...

Under IFRS 15, the original intent of contracts may not be conveyed

IFRS 15 may potentially impact the timing of revenue and profit recognition and hence your KPIs

Current accounting processes may require significant changes as a result of the new detailed disclosures under IFRS 15
IFRS 9
A high level overview
IFRS 9 – a high level overview

- IFRS 9 replaces IAS 39 in its entirety and is effective from 1 January 2018;
- Applies to ALL entities and to all types of financial instruments with a number of specific exclusions. IFRS 9 therefore applies to asset managers as well as to investment funds.
IFRS 9 – a high level overview

Classification and measurement

On initial recognition financial instruments are measured at fair value, including transaction costs in the case of financial instruments not measured at fair value through profit or loss. Subsequently, financial instruments are measured at amortised cost, FVTPL or FVTOCI.

Under IAS 39, different classifications required different measurements. Under the new accounting standard, classification and measurement are one and the same thing.
IFRS 9 – a high level overview

Criteria for classifying and measuring financial assets

An entity classifies financial assets as subsequently measured at amortised cost, FVOCI or FVTPL on the basis of the SPPI test and business model test:

- **Yes**: Are the cash flows considered to be solely principal and interest ("SPPI")?
  - Hold to collect contractual cash flows
  - Hold to collect contractual cash flows AND to sell
  - All other strategies
  - New in the final version of IFRS 9

- **No**: Certain modifications of the relationship between principal and interest are permissible
  - Amortized Cost
  - FVTPL
  - FVOCI option for equity investments (dividends in P&L)

- What is the business model?
  - New

- What is the measurement category?
  - New

- Are alternative options available?
  - FVTPL option (in case of acc. mismatch)
  - FVTPL Option (in case of acc. mismatch)

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IFRS 9 – a high level overview

Impairment model – IAS 39 vs IFRS 9

**IAS 39**
- At initial recognition...
- Significant increase in credit risk ...
- Credit-impaired ...

**IFRS 9**
- 12-month expected credit loss (Stage 1)
- Lifetime expected credit loss (Stage 2)
- Lifetime expected credit loss (Stage 3)
IFRS 9 – a high level overview

Expected Credit Loss Model under IFRS 9

Change of credit risk since initial recognition

Initial recognition

Loss allowance

Apply effective interest rate to...

12-month expected credit loss
Gross carrying amount

Significant increase in credit risk?

Credit impaired?

Lifetime expected credit losses
Gross carrying amount

Lifetime expected credit losses
Net carrying amount (Amortised cost)

Simplifications and exceptions:
- Low credit risk model
- Purchased or originated credit-impaired financial assets
- Trade receivables and contract assets, lease receivables
IFRS 9
Affect on the asset management sector and investment funds
Affect on the asset management sector and investment funds

The impact of IFRS 9 on asset management companies is expected to be limited to the application of the expected credit loss model to simple financial instruments such as cash, intercompany receivables and other receivable balances BUT the impact is expected to be significant for investment funds with portfolio of assets made up of investments other than those classified as FVTPL.

What are the challenges?

- Applying the SPPI test for investments not classified at FVTPL may prove to be difficult;
- Determining the business model for portfolios is not always straightforward;
- Determining the number of portfolios to be considered for classification purposes is a matter requiring judgement;
- Application of the Expected Credit Loss model for financial assets and investments classified and measured on a basis other than FVTPL;
- Accounting policies to be updated in line with the accounting requirements emanating from IFRS 9; and
- Increased IFRS 7 credit risk disclosures in an entity’s financial statements when Expected Credit Loss model is applied.
Why Deloitte? Our Insights

As the leading global consultancy and audit firm, Deloitte has extensive experience in IFRS Accounting, including IFRS 15, IFRS 9 and IFRS 16.

We have dedicated IFRS working groups that help our clients stay on top of the new challenges by issuing relevant publications and arranging informative client sessions.
Deloitte Complex Accounting Assurance Services

IFRS workshops – private sessions, experience knowledge share

IFRS 15, IFRS 9 and IFRS 16 impact assessments

Implementation of new IFRSs

IFRS technical consultations

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Meet the Deloitte speaker

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Senior Manager

Antoine’s main area of focus is Assurance related projects including IFRS training to middle and senior management, impact assessments and implementation projects across all industries in relation to IFRS 15, IFRS 9 and IFRS 16. Some of the large projects were performed within the Financial Services, Construction, Retail and Distribution and Aviation sectors.

Antoine is also responsible for Statutory Audits mainly within the Financial Services Industry, with a diverse portfolio including equity listed entities in Malta, insurance entities, investment management companies, pension schemes and pension administrators.

In September 2015 Antoine started a 24 month secondment with Deloitte London providing audit and advisory services to a client base of multi-national, FTSE and national insurance and insurance related services entities.

Antoine was also part of the insurance technical team within the London office providing a range of services to advisory clients including detailed impact and readiness assessments on IFRS 15 and IFRS 16. He acted as a technical accountant for one of the UK’s largest insurance intermediaries.

Antoine has a Bachelor of Accountancy (Hons.) from the University of Malta. He is a Certified Public Accountant and Auditor (CPAA) and a Member of the Malta Institute of Accountants (MIA).