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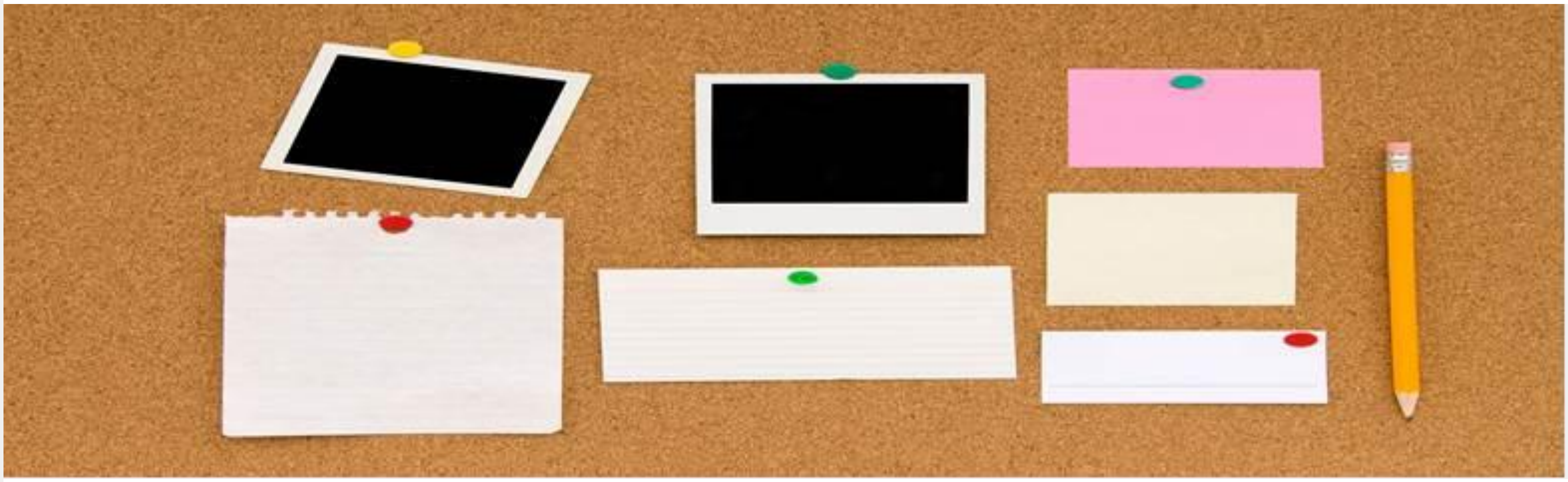

Accounting & Auditing News

IFRS 15 — *Revenue from Contracts with Customers*: Part 3C – Impact on Banking and Securities Sector

When should variable or uncertain revenues be recognized?

Background

Contracts in the banking and securities sector will often include significant variable elements, such as performance bonuses, penalties or restructuring fees. For example, a performance bonus may be payable if and when targets are met, or based on net assets under management. In this regard, IFRS 15 requires that variable consideration will only be included in the transaction price if it is highly probable that the amount of revenue recognized would not be subject to significant future reversals when the uncertainty is resolved.

Effect

Significant degree of judgment will be required to estimate the amount of consideration that should be taken into account. Accordingly, the profile of revenue recognition may be change for some entities as a result.

Which cost should be capitalized?

Background

IFRS 15 introduces specific criteria for determining whether to capitalize certain cost which are not the scope of other standards (for example, the financial instruments standards), distinguishing those costs associated with obtaining a contract (e.g. sales commissions) and those costs associated with fulfilling a contract. In baking 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).

Effect

At present, different entities might treat this costs differently. IFRS 15 will require entities to capitalized success fees, which will have an impact on operating profits. In addition, the new standard requires capitalized contract costs to be amortized on a systematic basis that is consistent with the pattern of transfer of the goods or services. Entities will need to exercise judgment to determine the appropriate basis and time period for this amortization.

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

Background

Previously, given the lack of specific guidance in IFRSs, there was greater room for judgment when identifying the goods and services within a contract and then allocating the revenue to those goods and services identified. Entities may have to amend their current accounting policies as a result of the more detailed guidance in IFRS 15. 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. In addition, the previous revenue standard included detailed guidance for banking entities with 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.

Effect

This may result in practical and implementation issues in the banking and securities sector where services are often integrated. Customers may be charged for a number of service 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 pf the transaction price to each distinct elements in the contract.

When should upfront fees be recognized?

Background

In the banking and securities sector, it is common for entities to receive an initial ‘sign on fee’. This ‘sign on fee’ is normally charged to cover initial sign-up costs. New detailed guidance may lead to a change in practice when accounting for such fees.

Effect

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 recognized as revenue when those future services are provided. The reason that upfront fees are charged to cover initial sign-up costs would not justify its direct recognition. The same logic would apply to any additional fees that may be charged during the term of the contract. It will be necessary to consider whether this 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 scheme be recognized?

Background

It is common for banks to offer loyalty programmes as part of their credit card offerings. For example, the holders of the credit card may receive loyalty points every time they make a purchase. They are able to use those loyalty points to obtain goods or services, either from the bank or from specified retailers.

Effect

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 a separate performance obligations. This would require a portion of the transaction price to be allocated to and recognized 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.

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