AASB 15
Revenue from contracts with customers
Your facilitators for today are....

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Agenda

- Introduction
- The 5 step model with practical examples
- Other contract considerations with practical examples
- Implementation considerations
Introduction
Financial services entities covered...

- Asset management
- Banks
- Insurance companies
- Brokers / Agents
Where are we at?

Applicable years beginning on or after 1 Jan 2018

<table>
<thead>
<tr>
<th>Comparative period*</th>
<th>First year</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Jan 2017</td>
<td>31 Dec 2017</td>
</tr>
<tr>
<td>1 April 2017</td>
<td>31 Dec 2018</td>
</tr>
<tr>
<td>1 July 2017</td>
<td>31 March 2018</td>
</tr>
<tr>
<td>1 Oct 2017</td>
<td>30 June 2018</td>
</tr>
<tr>
<td></td>
<td>30 Sept 2018</td>
</tr>
<tr>
<td></td>
<td>31 Dec 2018</td>
</tr>
<tr>
<td></td>
<td>31 March 2019</td>
</tr>
<tr>
<td></td>
<td>30 June 2019</td>
</tr>
<tr>
<td></td>
<td>30 Sept 2019</td>
</tr>
</tbody>
</table>

* If a retrospective transition method applied

Disclosures around standards issued but not yet effective
What does AASB 15 require?

**Core principle**
Recognise revenue to depict transfer of promised goods or services to customers in amount that reflects consideration to which entity expects to be entitled in exchange for those goods or service.

1. Identify the contract(s) with a customer
2. Identify the performance obligations in the contract
3. Determine the transaction price
4. Allocate the transaction price to performance obligations in the contract
5. Recognise revenue when (or as) the entity satisfies a performance obligation
Scope of the standard

All contracts with customers to deliver goods or services as part of the entity’s ordinary business excluding those within the scope of other standards.

Out of scope:

Any contracts in the scope of:

- Financial Instruments (AASB 9)
- Leases (AASB 16)
- Insurance contracts (AASB 4)

Non-monetary exchanges between entities in the same line of business to facilitate sales.
Revenue types

Out of scope include:

- Interest earned on loans and investments
- Dividend and distribution income
- Servicing of financial instruments
- Gains and losses on sale of financial instruments
- Insurance premiums

In scope include:

- Wealth and investment management services
- Underwriting fees
- Service fees
- Loyalty and reward programmes
- Interchange fees
- Other …
Contracts partially in scope

Contract partially in scope of other accounting guidance?

Yes

That standard have separation and/or initial measurement guidance that applies?

No

Apply guidance in new standard to separate and/or initially measure the contract based on relative stand-alone selling prices

Yes

Apply that guidance to separate and/or initially measure the contract

Exclude amount initially measured under that guidance from transaction price

No

Apply new standard to contract (or part of contract in its scope)
Example 1: Contracts partially in scope

• Bank A enters into a contract with Customer C where it received a cash deposit of $100,000 and agrees to provide administration services for free.

• Administration services are typically provided at a yearly rate of $250, determined based on cost plus a profit margin.

Q: How does A determine how much of contract is accounted for under AASB 15?
Example 1 solution: Contracts partially in scope

Cash deposit in scope of AASB 9
Administration services in scope of AASB 15

Yes

AASB 9 has initial measurement
guidance that is applied to cash
deposit

No

Residual amount of $0 for
administration services in scope
of AASB 15

Yes

Cash deposit valued at
$100,000

No

N/A

Exclude $100,000
Example 2: Contracts partially in scope

• Fund ABC leases an office block to Company B for one year.

• Contract requires maintenance services to be provided by ABC.

• Annual payments are $2,000.

• Similar maintenance service are offered separately by third parties for $440 a year.

• Market rental rate for a similar office block without maintenance services is $1,760.

Q: How does ABC determine how much of contract is accounted for under AASB 15?
Example 2 solution: Contracts partially in scope

- **Lease in scope of AASB 16**
- **Maintenance in scope of AASB 15**

- **AASB 16 has measurement guidance that refers back to AASB 15 allocating transaction price**
  - Yes
  - No

- **Residual amount of $400* for maintenance in scope of AASB 15**
  - Yes
  - No

- **Allocate based on relative standalone selling price***
  - N/A
  - Exclude $1,600*

* See next slide for relative stand alone selling prices allocation
Example 2 solution: Contracts partially in scope (contd)

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>Stand-alone price</th>
<th>Selling price ratio</th>
<th>Price allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lease</td>
<td>$1,760</td>
<td>80%</td>
<td>$1,600 ($2,000 X 80%)</td>
</tr>
<tr>
<td>Maintenance services</td>
<td>$  440</td>
<td>20%</td>
<td>$  400 ($2,000 X 20%)</td>
</tr>
<tr>
<td></td>
<td><strong>$2,200</strong></td>
<td></td>
<td><strong>$2,000</strong></td>
</tr>
</tbody>
</table>
The 5 step model with practical examples
Step 1: Identifying the contracts with customers

A contract exists if...

... it has commercial substance.

... collection of consideration is considered probable.

... rights to products or services and payment terms can be identified.

... it is approved and the parties are committed to their obligations.
Who is the customer?

From perspective of responsible entity

- Management fee to Responsible Entity
- Investment decisions to Fund
- Customer to Responsible Entity

- Management fee to Fund
- Investment return to Investors
- Customer to Fund and Investors

Why do we care?

- Identifying performance obligations
- Assess timing of revenue recognition
- Capitalising contract costs
## Who is the customer: what to consider

<table>
<thead>
<tr>
<th>Factor</th>
<th>Indicators <strong>fund</strong> is customer</th>
<th>Indicators <strong>investor</strong> is customer</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of investors</td>
<td>Large number of investors (e.g. fund established in order to pool investor capital)</td>
<td>Few investors (e.g. fund established by a general partner for one limited partner)</td>
</tr>
<tr>
<td>Activities of fund, investor involvement</td>
<td>Investors are not involved in set-up of fund or setting fund’s investment strategy Fund contracts with parties to obtain additional services (e.g. fund accounting)</td>
<td>Investor is involved in set-up of fund Investor can influence investment strategy decisions Investor is a party to fund’s contracts and is involved in related negotiations</td>
</tr>
<tr>
<td>Fund operation</td>
<td>Third party distributor holds shares, manages subscription and redemption process</td>
<td>Fund interacts directly with investor and asset manager</td>
</tr>
</tbody>
</table>
Combining contracts

Contracts may be combined and accounted for as a single contract.

Contracts are combined if entered into at or near the same time with the same customer and one or more of following criteria are met.

- Negotiated as package with a single commercial objective.
- Consideration in one contract depends on the other contract.
- Products and services are a single performance obligation.
What is the length of contracted term?

A contract only exists in the period it is enforceable

- Can customer leave at any time?
- Are there significant termination penalties?

Contract term can impact:
- Performance obligations identified
- Determination of transaction price
- Period over which upfront fees/ revenue can be recognised
- Period over which fulfilment costs can be amortised
Example 3: What is the term of the following contracts?

<table>
<thead>
<tr>
<th>#</th>
<th>Description</th>
<th>Term</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>5 year initial term with customer option to extend for 2 years at a renegotiated rate</td>
<td>5 years</td>
</tr>
<tr>
<td>2</td>
<td>5 year initial term with customer option to extend for 2 years at a discounted rate</td>
<td>5 years*</td>
</tr>
<tr>
<td>3</td>
<td>7 year term but customer can terminate after 5 years by paying substantial penalty</td>
<td>7 years</td>
</tr>
<tr>
<td>4</td>
<td>7 year term but customer can terminate at any point for no cost</td>
<td>0 years</td>
</tr>
</tbody>
</table>

* Consider if material right exists
Step 2: Identify performance obligations

A promise to transfer to the customer a **distinct** good or service

**Capable of being distinct**
Can the customer benefit from promise on its own or together with other resources that are readily available?

**Distinct within the context of the contract**
Is it separately identifiable from other promises in the contract?
Distinct within the context of the contract

1. Are we providing a significant service of integration?
2. Are we customising or modifying the goods significantly?
3. Is the good or service highly dependent on or highly interrelated with other goods or services in the contract?

If the answer is yes to any of these questions, not separately identifiable
Example 4: Credit card arrangements

• Bank A issues a credit card to Customer C (cardholder), which includes a customer loyalty programme that provides C with airline miles.

• A enters into agreement with airline to provide airline miles to C.

• A receives an interchange fee (2% of purchase price) from merchants for transferring funds when C makes a purchase.

• Under loyalty programme, for every $1 cardholders spend on goods, they are rewarded with 1 airline mile.

• Airline charges A $0.007 for every airline mile rewarded to cardholder.
Example 4: Credit card arrangements

Bank (Card Issuer)

$980 (Purchase price less interchange $20)

Merchant

Present card

Purchase goods $1,000

Cardholder

Earns 1,000 airline miles

Pay bill $1,000

Cardholder receives airline miles

$7 Reward cost

Airline
Example 4 solution: Credit card arrangements

- Lending / credit
- Interchange
- Airline miles

Watch this space!
Performance obligations and upfront fees

Does fee relate to specific goods or services transferred to customers?

Yes
- Account for as promised good or services
  - Recognise allocated consideration as revenue on transfer of promised good or services

No
- Account for as advanced payment for future goods or services
  - Recognise as revenue when future goods or services are provided, which may include future contract periods
Example 5: Upfront fees

Q: Should F consider initial set up of investors as a separate performance obligation?

Upfront fee is marketed as covering costs of initially setting Investor up on register and inputting them into relevant computer systems.

Investor

$5,000 initial investment

$5,000 initial investment

$4,950 investment ($5k less 1% upfront fee)

495 units

Fund Manager F

Fund ABC

$4,950 investment ($5k less 1% upfront fee)
Example 5 solution: Upfront fees

Does upfront fee relate to transfer of a promised good or service to customers?

Consider all relevant facts and circumstances:

a) Has a good or service been transferred to customer; and

b) Is customer able to realise benefit from the good or service received.

Account for as advanced payment for future goods or services.
Step 3: Determine the transaction price

- Variable consideration
- Non-cash consideration
- Significant financing component
- Consideration payable to customer

Transaction price
Variable consideration

Variable consideration can be:

- Discounts
- Credits
- Incentives
- Performance bonuses
- Many more...

Variable consideration is estimated using most appropriate method of either:

- **Expected Value**
  (Sum of probability-weighted amounts in a range of possible outcomes)

- **Most Likely Amount**
  (Single most likely outcome, when the transaction amount has a limited number of possible outcomes)

Capped at an amount for which it is ‘highly probable’ that a significant reversal will not occur.
Example 6: Performance fees - estimating variable consideration

- Fund Manager A is entitled to a performance-based fee payable on 30 June 2018 of 5% of a five-year average net asset value (NAV), if NAV increases each year by 15% over a 5-year period.

- First 3 years, A met performance targets.

- NAV at 30 June 2016 was $21m (year 3).

Q: Would A include performance fee in transaction price?
### Example 6 solution: Estimating variable consideration - constraint considerations

<table>
<thead>
<tr>
<th>Factor</th>
<th>Considerations</th>
</tr>
</thead>
<tbody>
<tr>
<td>Final liquidation of fund</td>
<td>Is fund nearing final liquidation?</td>
</tr>
<tr>
<td>Fair value of remaining assets in fund</td>
<td>Is fair value significantly in excess of threshold at which manager would earn a performance fee?</td>
</tr>
<tr>
<td></td>
<td>Could fund sustain total losses on remaining assets and still achieve performance fee?</td>
</tr>
<tr>
<td>Asset risk profile</td>
<td>Are all of remaining asset in fund low risk?</td>
</tr>
<tr>
<td>Contracted sales</td>
<td>Are remaining assets under contract for sale for agreed purchase prices?</td>
</tr>
<tr>
<td>Termination clauses</td>
<td>Ability to terminate contract?</td>
</tr>
<tr>
<td>Completion of performance period</td>
<td>Completion of performance period shortly after reporting date?</td>
</tr>
</tbody>
</table>

At 30 June 2016, performance fee received is likely to be NIL
Example 7: Trail commissions

• Insurance Broker B sells an insurance policy to Policyholder P for Insurance Company I.

• B receives an initial commission of $100 for selling policy and will receive a trail commission of $50 each time P renews their annual policy.

• B does not have any ongoing obligation to provide additional services to P or I in relation to this insurance policy, after initial sale of policy.

• Based on history of similar contracts and customers, B expects following:
  – 50% probability P will renew for 1 year
  – 30% probability P will renew for 3 years
  – 20% probability P will renew for 5 years

Q: What is B’s accounting for trail commission?
Example 7 solution: Trail commissions

<table>
<thead>
<tr>
<th>Commission</th>
<th>Transaction Price</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial</td>
<td>$100</td>
</tr>
<tr>
<td>Trail – 5 years</td>
<td>$82.5 (50% X $50 X 1) + (30% X $50 X 3) + (20% X $50 X 5)</td>
</tr>
<tr>
<td></td>
<td>$182.5</td>
</tr>
</tbody>
</table>

Consider constraining revenue
Step 4: Allocating consideration to performance obligations

Allocate based on relative stand-alone selling prices

- Determine stand-alone selling prices
  - Observable price
  - Fair value measurement
  - Estimate price
    - Adjusted market assessment approach
    - Expected cost plus a margin approach
    - Residual approach only if selling price is highly variable or uncertain
Example 8: Allocating transaction price

Bank A

- Following on from Example 4.
- Bank A receives a $20 interchange fee.

Q: How is transaction price allocated to performance obligations?
### Example 8 solution: Allocating transaction price

<table>
<thead>
<tr>
<th>Performance obligation</th>
<th>Stand-alone price</th>
<th>Selling price ratio</th>
<th>Price allocation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interchange service</td>
<td>$20</td>
<td>62.5%</td>
<td>$12.50 ($20 \times 62.5%)</td>
</tr>
<tr>
<td>Airline miles</td>
<td>$12 (a)</td>
<td>37.5%</td>
<td>$ 7.50 ($20 \times 37.5%)</td>
</tr>
<tr>
<td></td>
<td>$32</td>
<td></td>
<td>$20</td>
</tr>
</tbody>
</table>

(a) Estimates based on cost of points, reasonable margin and breakage

Consider need to include annual credit card fee
Step 5: Recognising revenue over-time

A performance obligation is satisfied over-time if:

1. Customer simultaneously receives and consumes the benefits as the entity performs.

2. The customer controls the asset as the entity creates or enhances it.

3. The entity’s performance does not create an asset for which the entity has an alternate use and there is a right to payment for performance to date.

OR

Routine or recurring services, e.g. maintenance services

OR

Asset built on customer’s site, e.g. power plant on customer’s land

OR

Asset built to order
Recognising revenue at a point-in-time

Indicators that control has passed include a customer having:

- A present obligation to pay
- Physical possession
- Legal title
- Risks and rewards of ownership
- Accepted the asset
### Example 9: Recognising revenue: over-time or point-in-time?

<table>
<thead>
<tr>
<th>Service</th>
<th>Over-time</th>
<th>Point-in-time</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investment management / performance fee</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Roadside assistance fee</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Broker fee</td>
<td>X</td>
<td>X</td>
</tr>
<tr>
<td>Fee for servicing a loan</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Credit card interchange fee</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Customer loyalty points</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>IPO Success fee</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Credit card annual fee</td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

Q: Is revenue recognised over-time or at a point-in-time for these services?
Other contract considerations with practical examples
 Principal vs agent

Control over specified goods or services in advance of transferring them to customer

A principal

Indicators that entity is a principal

Inventory risk

Discretion to establish prices for specified goods or services

Primary responsibility to provide specified goods or services

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Document Classification: KPMG Public
Example 10: Principal vs agent

- A Responsible Entity (RE) for a registered Fund arranges for other entities to provide services to Fund, such as investment management and custody services.
- RE arranges payments to service providers.
- RE receives a fee of 10% of net asset value of Fund for its services, including those relating to management and custody services.
- Customer of RE is Fund.
- Corporations Act indicates following in regards to a RE:
  - Required to take responsibility for operating its Funds
  - Has power to appoint an agent; however, it remains legally liable for behaviour of agent
Example 10 solution: Principal vs agent

Indicators to consider

**Discretion to set prices**
Negotiates investment fees, custodian fees and fees with the fund

**Primary responsibility for delivery of service**
Under Corporations Act, RE cannot absolve itself of its responsibility and liability by outsourcing to an agent

**Inventory risk**
None

**Control of services**
RE is able to control investment management services through its ability to remove and/or direct decisions of Investment Manager and Custodian

Principal:
Present gross revenue and costs

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Pre-contract costs

Would costs be incurred regardless of whether contract is obtained?

No

Are incremental costs expected to be recovered?

No

Capitalise costs

Yes

Yes

Expenses costs as they are incurred

Do costs fall in scope of other guidance?

OR

Do they meet criteria to be capitalised as fulfillment costs?

(1) Relate to existing contract or specific anticipated contract; and

(2) Will generate or enhance resources of entity that will be used to satisfy POs in future; and

(3) Costs are expected to be recovered

No

No

As a practical expedient, capitalisation of contract acquisition costs not required if amortisation period would be one year or less.
Example 11: Contract costs

- Fund Manager M incurs following costs when bringing new investors into Fund XYZ.
  - Advertising costs
  - Commission paid to broker
  - Cost of developing a product disclosure statement

Q: Which pre-contract costs can be capitalised?
### Example 11 solution: Contract costs

<table>
<thead>
<tr>
<th></th>
<th>Customer Fund</th>
<th>Customer Investor</th>
</tr>
</thead>
<tbody>
<tr>
<td>Advertising costs</td>
<td>✗</td>
<td>✗</td>
</tr>
<tr>
<td>Commission paid to broker</td>
<td>✗</td>
<td>✓</td>
</tr>
<tr>
<td>Product Disclosure Statement</td>
<td>✗</td>
<td>✗</td>
</tr>
</tbody>
</table>
Implementation considerations
Broader impacts

Financial and operational system changes
- Existing systems may not capture required data
- Inventory of incremental information
- Processes re-designed
- Update systems vs new systems
- Dual systems for certain transition options
- Processing changes to contracts

Governance and change
- Impact on internal resources
- Revenue change management team
- Change to contract practices
- Training (accounting, sales, etc)
- Multi-national locations
- Effect on management compensation metrics
- Impact on forecasting and budgeting processes

Internal control assessment
- Effect on internal control environment
- New controls vs modify existing controls
- Identify new risk points
- Management review controls
- IT controls
- Process level controls

Communication with stakeholders
- Key to successful implementation
- Identify relevant stakeholders
- Messaging
- Timing of communication
- Comparability of data communicated
- Expected impact of change

Revenue Recognition
Implementation requires time ....

- **2016**
  - Contract analysis
  - Analysis of processes/IT
  - Business model
  - Accounting and Reporting
  - Systems and processes
  - People and change
  - Business
  - Analysis

- **2017**
  - Accounting guidelines
  - Solution development
  - Training concept
  - Sales concepts
  - Design

- **2018**
  - Preparation of the transition
  - Roll-out of new solutions
  - Performance of trainings
  - Stakeholder and capital markets communication
  - Implementation
  - Stabilisation
Assessing the impact to your organisation is a critical first step.
The following activities may help position you to plan an effective implementation:

1. Establish project team and governance
2. Determine impacts to your accounting policies and disclosures
3. Identify new information requirements
4. Identify system and process gaps
5. Consider impact to internal controls
6. Involve tax resources
Next steps

7. Identify other parties that need to be involved
8. Develop initial thoughts regarding transition approach
9. Build a project plan
10. Determine the resource needs
11. Communicate with stakeholders and those charged with governance
12. Involve your external auditor throughout the process
What questions do you have?
KPMG resources available

Implementation considerations for revenue standard - AASB 15

17 September 2015

Are you across the latest updates regarding the new revenue recognition standard AASB 15? We provide a refresher on the core concepts of the new revenue recognition model of AASB 15 Revenue from Contracts with Customers. We outline some of the key implementation challenges identified in the 18 months since the revenue standard was issued.

Highlights
- Webinar outline
- Revenue recognition standard AASB 15 – implementation considerations
- Revenue recognition standard AASB 15 webinar, September 2015
Thank you

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