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Banks

IFRS 15 could affect 25% of operating income

11 December 2017

Kim Heng
Partner
KPMG Australia

It's time to look beyond IFRS 9

Banks, and other financial institutions, have understandably been focused on IFRS 9 over the past few years – but the time has come to devote more resource to the new revenue recognition rules.

IFRS 15 is complex – involving many judgements and estimates – so you'll need to invest the time to get it right. And that means resources, too.

With 25% or more of your operating income likely to fall within the scope of a complex new standard that's attracting regulatory attention, you're going to need new systems and processes!

A quarter of revenues or more

Commissions, interchange fees, account and service fees – they all fall under the standard. For an investment bank or fund manager where significant revenues are derived from service fees, this could amount to much more than 25% of total operating income.

With a new standard applying to a quarter of your business, you're likely to need to make changes to your IT systems, processes and internal controls, which will take time. Time that is fast running out.

Unbundling IFRS 15 revenues

Getting your head around all the different types of revenue streams and fees charged is one of the more time-consuming tasks – especially for banks with multiple divisions and locations.

These revenue streams then need to be unbundled from related arrangements, which can be complex. For example, how systematically do you currently assess to what extent deposit and treasury services should be split from the related deposit, or loan syndication fees be split from any loans issued as part of the syndication?

IFRS 9 applies to the financial instrument element, but you have to establish what needs to be accounted for under IFRS 15.

Unbundling again

Once you've decided which revenues fall under IFRS 15, there are yet more difficult decisions to make. The IFRS 15 revenues need to be unbundled further, because the timing of when revenue is recognised may be different according to the separate performance obligations identified.

For example, if a contract includes services related to a specified transaction and an ongoing administration or advisory service, deciding that the initial service and ongoing service are separate performance obligations may mean that more revenue is recognised upfront.

Or conversely, deciding that non-refundable upfront fees relate to an administrative task rather than a separate performance obligation (and should therefore not be unbundled from other IFRS 15 fees) could mean more revenue is deferred.

Credit card programmes

One area I've spent a lot of time talking to clients about is their credit card programmes with loyalty points, where there is currently some diversity in accounting practice. Some banks already defer a portion of their fees for the points; others treat the costs of operating these programmes as a marketing expense.

Under IFRS 15, you'll need to decide whether a loyalty programme gives rise to a material right. If it does, a portion of the fees is deferred and recognised when the rights are exercised. Depending on whether the bank regards itself as a principal or agent in the provision of the rights, the deferred revenue could be recognised either gross or net.

Variable fees

Banks enter into many types of arrangement that include variable fees, such as payments contingent on a transaction occurring or an IPO.

The expected fees will need to be estimated using one of the two methods provided by the standard – the 'expected value' or 'most likely amount' approach.

Where there are limited possible outcomes, such as with an IPO, the most likely amount approach will probably be the most appropriate. Where there are a large number of possible outcomes, such as in managing an investment fund and receiving fees dependent on the performance of it, the expected value method is more likely to be used.

Whatever the basis of your estimate, a variable fee can only be recognised once you've performed – and only if it's highly probable that you won't have to back out a significant amount later. IFRS 15 frowns on revenue reversals!

Allocate resource today

There may also be other areas of implementation complexities for your bank – assessing the timing of revenue recognition and the accounting for contract acquisition costs.

The revenue recognition standard deserves and requires serious attention. Time is ticking, so if you haven't done so already, I recommend that you get to grips with it now.

About the author

Kim provides technical accounting advice to financial institutions and corporates in Australia and globally on the application of IFRS 15.