

In depth

A look at current financial reporting issues

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Revenue from contracts with customers *The standard is final – A look at the issues arising from the new revenue model*

Banking industry

At a glance

On 28 May 2014, the IASB and FASB issued their long-awaited converged standard on revenue recognition. Although the standard was a converged standard when it was first issued, the FASB and IASB have made slightly different amendments, so the application of the guidance could differ under US GAAP and IFRS. Almost all entities will be affected to some extent by the significant increase in required disclosures. However, the changes extend beyond disclosures, and the effect on entities will vary depending on industry and current accounting practices.

PwC global guide to accounting for revenue from contracts with customers provides detailed guidance on applying the new revenue standard. This publication explains certain issues specific to entities in the banking industry as they transition to the new standard. This publication only addresses the potential issues arising from the new standard for entities that report under IFRS. Differences in IFRS and US GAAP, together with differences in the scope of other relevant guidance in the US, mean that different accounting outcomes are possible.

Background

Overview

The impact of IFRS 15 will vary depending on a bank's existing accounting policies and the nature and mix of its products. Areas most affected could include, but are not limited to, credit cards and loyalty schemes, commissions, advisory contracts and bundled products. There might not be significant changes in how some banks account for revenue, but all banks will need to review their contracts to ascertain how the new standard applies to their particular circumstances. Banks should also consider how they will comply with the new disclosures required by IFRS 15.

Scope

IFRS 15 explicitly excludes from its scope transactions governed by IFRS 9. However, not all of a bank's transactions are accounted for under IFRS 9; so, when assessing the impact of IFRS 15, banks must determine which revenue streams are within its scope.

Banks will need to continue to assess which fees earned are an integral component of the effective interest rate ('EIR') of financial assets and liabilities measured at amortised cost. Those that are an integral component of the EIR calculation will be within the scope of IFRS 9, and therefore outside the scope of IFRS 15. We note that the guidance around determining what is included in the EIR has not changed under IFRS 9.

Banks often enter into contracts that cover a number of different services. Such contracts might contain components within, and components outside, the scope of IFRS 15. IFRS 15 looks first to guidance included in other standards on how to separate and measure one or more parts of a contract. Therefore, a bank only applies the guidance in IFRS 15 where it has contracts that are all or partly outside the scope of IFRS 9.

The table below, split by product, shows common revenue streams earned by banks and whether or not these are likely to be within the scope of IFRS 15. The table is not an exhaustive list of revenue streams that banks can earn, and it is intended to be used as a guide only. Conclusions might differ depending on the specific contracts that a bank has with its customers.

Product/service	Fee/compensation received	Generally in scope of:	
		IFRS 15	IFRS 9
Credit cards	Interchange fees	✓	
	Annual fees ^(a)	✓	
	Interest		✓
	Loyalty schemes	✓	
	Balance transfer fees		✓
Broking fees	Trade execution	✓	
Commission	Insurance commission ^(b)	✓	
Credit facilities	Interest		✓
	Origination fees		✓
	Commitment fees ^(c)		✓
	Early redemption fees		✓
Savings and current accounts	Interest		✓
	Account and transaction fees	✓	
Investment banking	Underwriting fees	✓	
	Advisory fees	✓	
	Syndication fees ^(d)		✓
Private banking	Management fees	✓	
	Performance fees	✓	
	Administration fees	✓	
	Trade execution fees	✓	

Notes:

- Annual fees will typically be fully within the scope of IFRS 15. However, in some instances, where another product (such as an insurance policy) is provided by the bank in connection with the credit card arrangement, a portion of the fee might have to be allocated to this.
- The analysis in this publication considers the scenario where the bank is an agent of the insurer.
- Commitment fees are within the scope of IFRS 15 where it is unlikely that a specific lending arrangement will be entered into and the loan commitment is not measured at FVPL. [IFRS 9 para B5.4.3(b)].
- Loan syndication fees received by a bank that arranges a loan and retains no part of the loan package for itself (or retains a part at the same EIR for comparable risk as other participants) are within the scope of IFRS 15. [IFRS 9 para B5.4.3(c)].

The five-step approach

The standard contains principles that an entity will apply to determine the amount and timing of revenue. The underlying principle is for an entity to recognise revenue as it transfers goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. Entities will apply a five-step approach:

Step 1: Identify the contract(s) with the customer.

Step 2: Identify the separate performance obligations in the contract.

Step 3: Determine the transaction price.

Step 4: Allocate the transaction price to separate performance obligations.

Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

There could be challenges in each of the steps above, depending on the nature of the contract under analysis. The [PwC global guide to accounting for revenue from contracts with customers](#) provides detailed guidance with respect to applying each of these steps.

Areas of focus

The purpose of this publication is to highlight the areas of potentially greater complexity for banking entities when they are implementing the new revenue standard. As a result, some steps are not discussed in detail.

1. Loyalty arrangements and credit cards

Credit card arrangements are complex and involve multiple parties, typically the card-issuing bank, the merchant acquirer, the payment network, the merchant and the cardholder. There are various forms of credit card arrangement, and the parties commonly enter into different agreements with each other, each of them being components of, and necessary to the overall execution of, credit card transactions.

Greater complexity	Five-step approach
✓	Step 1: Identify the contract(s) with the customer.
✓	Step 2: Identify the separate performance obligations in the contract.
	Step 3: Determine the transaction price.
✓	Step 4: Allocate the transaction price to separate performance obligations.
	Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

The analysis below sets out the key factors to consider in the steps highlighted in the table above.

Step 1: Identify the contract(s) with the customer

Who is (are) the customer(s)?

The new standard requires an entity to identify the contract with the customer. As part of this step, an entity must determine which party is its customer. A customer is defined 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'. This is an area of judgement that has ramifications throughout the revenue model, and it might significantly affect how the new standard is applied in this area.

A contract is defined in IFRS 15 as an agreement between two or more parties that creates enforceable rights and obligations. This contract can be written, oral or implied by an entity's customary business practices. A written contract that creates enforceable rights and obligations will exist between the bank and the cardholder under which the bank will provide services, sometimes in exchange for annual and other fees. It might be more difficult to ascertain whether a contract that creates enforceable rights and obligations exists between the bank and other parties to the arrangement, such as the merchant, and what services are delivered, and to which party, in exchange for interchange fees.

Management will need to apply judgement to determine which party is, or which parties are, the bank's customer(s) based on their specific facts and circumstances.

Identifying the customers is particularly relevant where the arrangement involves loyalty plans for which the bank is a principal (see 'Principal versus Agent' below). Where a bank concludes that the cardholder is the only customer, it has to consider whether the interchange fee is received for services delivered to the cardholder. This might result in some of the revenue from interchange fees being allocated to the obligation to satisfy the loyalty points and deferred until those points are redeemed.

Step 2: Identify the separate performance obligations in the contract

What are the different performance obligations that exist in the contract(s) with the customer(s)?

For each of its identified customers, the bank will need to assess the specific terms of each of its contracts to identify all of its performance obligations, because these will drive when and how revenue is recognised.

The new standard requires an entity to assess the services promised in a contract with a customer, and to identify as performance obligations those services that are distinct. A service is distinct if:

- a) The customer can benefit from the service either on its own or together with other resources that are readily available to the customer; and
- b) The entity's promise to transfer the good or service to the customer is separately identifiable from other promises in the contract.

Paragraph 29 of IFRS 15 provides additional factors to consider when assessing (b) above.

If a service is not distinct, the entity must combine the services until such a point that a bundle of services is viewed as distinct. In some cases, this will result in all services being combined into a single performance obligation.

The customer's perspective should be considered when assessing whether a promise gives rise to a performance obligation. Therefore, conclusions regarding which party is the customer (see step 1 above) are likely to impact this determination.

The following are some of the services that might exist in a contract with a cardholder:

- Issuance of loyalty points (which are options to acquire goods/services for free or at a discount in the future), usually based on the monetary volume of card transactions;
- Payment processing service;
- Insurance (for example, home insurance) where the bank is not the insurer; for situations where the bank writes the insurance, the accounting is outside the scope of IFRS 15 and the contract is accounted for in accordance with IFRS 4;
- Ancillary services (for example, access to lounge areas in airports);
- Fraud protection; and
- Processing of certain transactions, such as purchases in a foreign currency and cash withdrawals.

Banks might offer more than one credit card product to customers (for example, a basic and a premium product). It is likely that the performance obligations identified will differ depending on the nature of the product, which might affect the pattern and timing of revenue.

Step 4: Allocate the transaction price to separate performance obligations

How should fees received be allocated to each of the performance obligations?

The transaction price is allocated to each performance obligation based on the relative stand-alone selling prices of the goods or services being provided to the customer.

The bank will usually have a published price list that provides evidence of the relative stand-alone selling prices for some of the goods or services being provided to the customer. Banks might have to estimate the stand-alone selling price of some other goods or services.

The allocation of the transaction price to each of the separate performance obligations will not necessarily be required where there is more than one performance obligation but the performance obligations are all satisfied at the same time or evenly over the period.

Other areas to consider:

a) Is the bank the principal or agent in the loyalty arrangements?

Another important consideration is determining whether the bank is the principal or agent in relation to loyalty arrangements. The guidance on assessing whether an entity is principal or agent has changed under IFRS 15, and so entities will need to reassess whether they are principal or agent under the new standard.

An entity is the principal in an arrangement if it obtains control of the goods or services of another party in advance of transferring control of those goods or services to a customer. The entity is an agent if its performance obligation is to arrange for another party to provide the goods or services. An entity will need to evaluate if and when it obtains control. If an entity obtains legal title of a product only momentarily before the title is transferred to the customer, this does not necessarily indicate that the entity is acting as the principal in the arrangement. Where another party is involved in providing goods or services to a customer, an entity that is a principal obtains control of any one of the following:

- A good or another asset from the other party that it then transfers to the customer;
- A right to a service to be performed by the other party, which gives the entity the ability to direct that party to provide the service to the customer on the entity's behalf; or
- A good or service from the other party that it then combines with other goods or services in providing the specified good or service to the customer.

Assessing these indicators for loyalty arrangements is complex and will depend on a number of factors. The bank will typically be principal where it redeems the points itself and controls the related goods or services before they are delivered to the customer. More judgement is typically required where the points are redeemed by a third party, and the bank should consider whether it controls the goods or services before they are transferred to the customer.

If the determination of whether the company controls the specified good or service (that is, whether it is a principal) is unclear, the company should evaluate the following indicators:

- Primary responsibility for fulfilling the promise;
- Inventory risk; and
- Discretion in establishing price.

Whether a bank is principal or agent will determine whether the bank recognises revenue for the amounts collected from cardholders, or whether it recognises revenue only for its commission for arranging transactions on behalf of other suppliers. It will also affect the timing of revenue recognition in some cases.

Where the bank is acting as an agent, it will have to remit some of the fees that it collects (if any) to a third party (the principal for the obligation to provide goods/services to the cardholder, or the award plan operator). The transaction price is only the commission retained by the bank (in other words, revenue is recognised net of the amounts paid to the principal). If the bank is agent and its only obligation is in respect of issuing the points, revenue will be recognised once the points have been issued.

Where the bank is the principal, it will recognise as revenue the gross amount paid and allocated to the performance obligation. It will also recognise an expense for the direct costs of satisfying the performance obligation. Where the bank is the principal, the revenue allocated to the performance obligation to redeem the loyalty points is deferred until the points are redeemed.

b) What is the impact on revenue of cash rewards offered by a bank to a credit card customer?

Under IFRS 15, the bank accounts for consideration payable to a customer (such as a cashback award) as a reduction of the transaction price, and therefore of revenue, unless the payment to the customer is in exchange for a distinct good or service that the customer transfers to the bank.

Consideration payable to a customer includes cash amounts (including credit or other items, such as a coupon or voucher) that can be applied against amounts owed to the bank and that the bank pays, or expects to pay, to the customer.

c) *How should a bank account for the loan commitment included in credit card contracts?*

The promise to provide financing to the cardholder is a loan commitment. Banks should assess, based on their specific facts and circumstances, whether part of the fees received under the arrangement should be considered as a commitment fee received by the bank to originate a loan. We expect that this will not generally be the case. However, where it is, and if it is probable that the bank will enter into a specific lending arrangement, the fee would be within the scope of IFRS 9 (that is, the fee would be an integral part of the EIR of the loan).

2. Insurance commission

Insurance commissions are commissions received by banks for introducing new clients to third party insurers, where the bank does not underwrite the insurance policy itself. These commissions are usually paid periodically (for example, monthly) to banks based on the volume of new policies (and/or renewal of existing policies) originating from clients introduced by the bank.

IFRS 15 requires an entity to recognise revenue as goods and services are transferred to the customer, using the amount that it expects to be entitled to in exchange for the goods and services. The new guidance could lead to revenue being recognised earlier, where the bank is entitled to renewal commissions and there are no further implied or contractual services to be performed in the renewal periods.

Greater complexity	Five-step approach
	Step 1: Identify the contract(s) with the customer.
✓	Step 2: Identify the separate performance obligations in the contract.
✓	Step 3: Determine the transaction price.
	Step 4: Allocate the transaction price to separate performance obligations.
	Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

See below the key considerations for the steps highlighted in the table.

Step 2: Identify the separate performance obligations in the contract

What are the performance obligations in the contract with the insurer?

Depending on the contract, in addition to introducing new clients to the insurer (that is, placement of the insurance policy), the bank might perform additional activities, such as managing and processing claims, promoting marketing campaigns, and negotiating future renewals with the policyholder.

Where the bank performs other distinct services in addition to the original placement, a portion of revenue, if material, would be recognised as those services are performed. Banks will need to ensure that they have a full understanding of the nature of each of the performance obligations, so that they can assess when they are satisfied and when the revenue should be recognised.

Step 3: Determine the transaction price

How should renewal fees be accounted for?

The transaction price might include an element of consideration that is variable or contingent on the outcome of future events, such as policy cancellations, lapses or renewals, volume of business or claims experience. This is known as ‘variable consideration’.

The recognition of variable consideration is estimated and included in the transaction price based on the most likely amount or expected value, depending on which method provides the best prediction. As noted above, variable consideration is also subject to a constraint, and it is included in the transaction price only when it is highly probable that the resolution of the uncertainty will not result in a significant reversal of revenue.

Management will need to determine if there is a portion of the variable consideration (that is, some minimum amount) that it is highly probable will not result in a significant cumulative revenue reversal. If so, that portion of variable consideration will need to be included in the transaction price, even if the variable amount is not included in its entirety.

For further detailed guidance on the challenges of applying the new revenue standard to this area, please refer to our ‘[Insurance intermediaries industry supplement](#)’ (at page 4).

3. Bundled products

Banks frequently ‘package’ banking products, as well as other benefits, into a single contract with their customers. One example is the provision of current account services to customers. Current account contracts usually allow customers to access a variety of services, which include processing of wire transfers, use of ATMs for cash withdrawals, the issue of debit cards, and provision of account statements; sometimes, they might also include access to car, home, travel or mobile phone insurance and other benefits. The terms and services provided by the banks vary widely in practice. A common scenario is a current account contract, where fees are charged on a monthly basis and give the customer access to banking services and additional benefits.

Greater complexity	Five-step approach
	Step 1: Identify the contract(s) with the customer.
✓	Step 2: Identify the separate performance obligations in the contract.
	Step 3: Determine the transaction price.
✓	Step 4: Allocate the transaction price to separate performance obligations.
	Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

See below the key considerations for the steps highlighted in the table.

Steps 2 and 4: Identify the separate performance obligations in the contract, and allocate the transaction price to separate performance obligations

Identifying performance obligations in bundled banking products

IFRS 15 requires the identification of performance obligations, and so banks will need to assess whether contracts that include a bundle of products give rise to distinct services that create separate performance obligations.

An example would be a bank that offers its customers a premium type of bank account for which a monthly fee is charged and that includes the right to consult with the bank’s investment advisors, as many times as requested by the customer, on a range of investment products in the market. Here, the provision of investment advice, as and when required by the customer, is a distinct promise in the bundled product offered by the bank. That is because the customer can enjoy the service on its own; and the promise is separately identifiable, since the investment advice is not highly dependent on, or interrelated to, other promises in the contract. Further guidance on how to determine if a performance obligation is distinct is included in step 2 under ‘Loyalty arrangements and credit cards’.

In this case, at least a portion of the fee charged by the bank relates to the performance obligation of providing investment advice to the customer. However, even though the contract might include different performance obligations, they are likely to be satisfied within the same reporting period. In such cases, the allocation of the transaction price to each of the separate performance obligations will not be necessary for accounting purposes, because all performance obligations are satisfied at the same time or evenly over the period.

This example is only provided to illustrate some of the relevant considerations when assessing bundled products. These products vary widely in practice, and so banks should prepare their assessments based on the specific facts and circumstances.

4. Advisory contracts

Advisory contracts with customers are common in investment banking. These contracts are not standardised, and so a detailed analysis is required on a contract-by-contract basis. These contracts might be complex, with different promises made to the customer, and they often include variable consideration. For example, investment banks advising customers on mergers and acquisitions (M&A) transactions, or supporting customers in an initial public offering of securities, might include contingent fees that are only payable on meeting agreed milestones.

Greater complexity	Five-step approach
	Step 1: Identify the contract(s) with the customer.
✓	Step 2: Identify the separate performance obligations in the contract.
✓	Step 3: Determine the transaction price.
	Step 4: Allocate the transaction price to separate performance obligations.
✓	Step 5: Recognise revenue when (or as) each performance obligation is satisfied.

See below the key considerations for the steps highlighted in the table.

Step 2: Identify the separate performance obligations in the contract

What are the performance obligations in the contract?

Advisory contracts are bespoke in nature, and so banks will need to carefully assess the specific promises made to customers in order to understand the nature of the performance obligations in each contract and when they will be satisfied. Further guidance on how to determine if a performance obligation is distinct is included in step 2 under 'Loyalty arrangements and credit cards'.

Step 3: Determine the transaction price

How are success fees accounted for?

It is common for advisory contracts to include success fee clauses, where the fee is only payable on the successful execution of a specific milestone (such as the acquisition of a target company or the completion of a successful IPO). Where the related performance obligations are satisfied over time (see guidance on step 5 below), judgement is required to determine at which point success fees are highly probable of not being subject to significant reversal and therefore included in the transaction price. Further guidance on variable consideration is included in step 3 under 'Insurance commission'. Banks will often only meet the criteria to include such variable consideration where the events are no longer contingent.

Step 5: Recognise revenue when (or as) each performance obligation is satisfied

Is revenue from advisory contracts recognised on a 'point in time' or an 'over time' basis?

An entity will recognise revenue when (or as) a good or service is transferred to the customer and the customer obtains control of that good or service. For each identified performance obligation, an entity should determine at contract inception whether it satisfies the performance obligation over time or at a point in time.

An entity will recognise revenue over time if any of the following criteria are met:

- The customer concurrently receives and consumes the benefits provided by the entity's performance as the entity performs its obligation.
- The entity's performance creates or enhances a customer-controlled asset.
- The entity's performance does not create an asset with an alternative use, and the entity has a right to payment for performance completed to date.

An entity will recognise revenue at a point in time (that is, when control transfers) for performance obligations that do not meet the criteria for recognition of revenue over time.

Banks will have to assess whether the nature of the service provided is such that the customer only benefits on completion or whether it benefits as the services are provided. For example, on M&A deals, the bank will need to assess whether the customer benefits from advice provided by the bank as it is provided, or there is no benefit for the customer unless the deal is completed. This will drive whether the performance obligations identified in the contract are satisfied over time or at a point in time.

5. Management and performance fees

In private banking businesses, banks are usually entitled to management and performance fees as consideration for wealth management services provided to their customers. For further consideration and guidance on applying IFRS 15 to those types of fees, please refer to our '[Asset management industry supplement](#)'.

6. Recognition of contract costs

An important change as a result of IFRS 15 is the additional guidance on accounting for contract costs. There is currently diversity in practice under the existing standards. For banks, the accounting for such costs will have to be reassessed on transition to IFRS 15.

The guidance on accounting for contract costs is applicable for costs arising for all revenue streams within the scope of IFRS 15, and it might change the accounting, especially for contracts where services are provided over longer periods.

See below for some of the key considerations.

Key considerations on implementation	Key considerations on implementation
<p>Incremental costs</p> <p>An entity should recognise an asset for the incremental costs to obtain a contract if management expects to recover those costs. Incremental costs of obtaining a contract are costs that the entity would not have incurred if the contract had not been obtained (for example, sales commissions). Costs that the entity would have incurred if the contract had not been obtained (such as facilities costs and sales force salaries) are not capitalised. An entity can elect to expense the cost of obtaining a contract if the amortisation period would be one year or less.</p>	<p>Banks might agree to make upfront payments for obtaining customer contracts (for example, commissions paid to agents in obtaining these contracts). Such costs might well have been expensed in the past, in view of the lack of specific guidance, and they should be recognised as assets, if the criteria are met, and the practical expedient does not apply.</p>
<p>Costs to fulfil a contract</p> <p>An entity will recognise an asset for costs to fulfil a contract if those costs:</p> <ul style="list-style-type: none">• Relate directly to a contract or anticipated contract that the entity can specifically identify;• Generate or enhance the entity's resources that will be used to satisfy future performance obligations; and• Are expected to be recovered.	<p>The new guidance on costs to fulfil a contract might be of particular relevance to advisory contracts (as discussed above), since these contracts are usually performed over longer periods. As with incremental costs of obtaining a contract, banks will need to assess whether their current accounting policy is in compliance with the new requirements, and they will need to capitalise costs that meet the criteria in IFRS 15.</p>
<p>Amortisation of recognised assets</p> <p>An asset recognised for the costs to obtain or fulfil a contract will be amortised on a systematic basis as the goods or services to which the assets relate are transferred to the customer. The asset will also be assessed for impairment each reporting period.</p>	

Other considerations

Disclosures

IFRS 15 includes extensive disclosure requirements intended to enable financial statement users to understand the amount, timing and judgements related to revenue recognition, and corresponding cash flows arising from contracts with customers. These requirements are more detailed than currently required under IAS 18. Some of the more significant disclosure requirements include qualitative and quantitative information about:

- Contracts with customers;
- Reconciliation of contract balances;
- The significant judgements, and changes in judgements, made in applying the guidance to those contracts; and
- Assets recognised from the costs to obtain or fulfil contracts with customers.

IFRS 15 also requires an entity to disclose the amount of its remaining performance obligations and the expected timing of the satisfaction of those performance obligations for contracts with durations of greater than one year, and both quantitative and qualitative explanations of when amounts will be recognised as revenue.

The new disclosure requirements might require banks to collect additional information, even if the impact of IFRS 15 on revenue recognition is not significant.

Transition

Entities can apply the revenue standard retrospectively to each prior reporting period presented (the ‘full retrospective method’), or retrospectively with the cumulative effect of initially applying the standard recognised at the start of the year of initial application, but without restating comparative periods (the ‘modified retrospective method’). Additional disclosures are required when the modified retrospective method is applied.

Whichever method is selected, it is important to note that an entity should recognise the cumulative effect of initially applying the revenue standard as an adjustment to retained earnings at the date of initial application. Therefore, for fees where IFRS 15 changes the revenue recognition profile, the impact on the income statement will relate only to the revenue earned in the period presented (that is, the cumulative impact in prior periods will already have been recognised in retained earnings and will never be shown in the income statement).

Questions?

PwC clients who have questions about this *In depth* should contact their engagement partner.

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