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**International
Accounting Standards
Board**

This observer note is provided as a convenience to observers at IFRIC meetings, to assist them in following the IFRIC's discussion. Views expressed in this document are identified by the staff as a basis for the discussion at the IFRIC meeting. This document does not represent an official position of the IFRIC. Decisions of the IFRIC are determined only after extensive deliberation and due process. IFRIC positions are set out in Interpretations.

Note: The observer note is based on the staff paper prepared for the IFRIC. Paragraph numbers correspond to paragraph numbers used in the IFRIC paper. However, because the observer note is less detailed, some paragraph numbers are not used.

INFORMATION FOR OBSERVERS

IFRIC meeting: September 2006, London

Project: Revenue recognition in respect of initial fees received by a fund manager (Agenda Paper 6)

INTRODUCTION

1. In its May meeting, the IFRIC agreed to take on a project to consider when revenue should be recognised in respect of initial fees received by a fund manager. These fees are typically received by a fund manager when an investor makes an investment in a fund, and are non-refundable regardless of how long the investor chooses to remain invested.
2. This paper considers how revenue in respect of these arrangements should be recognised.
3. Once the IFRIC has tentatively agreed how revenue should be recognised in respect of this type of arrangement, the staff intends to develop the arguments used to support this treatment into principles which may be applied to other situations.

ARRANGEMENTS CONSIDERED BY THIS PAPER

4. As discussed above, this paper considers only the example of revenue recognition in respect of initial fees received by fund managers. In these situations, a fund manager may receive a fee from an investor at the point at which the investor chooses to invest in a fund. This fee (for example 5% of the initial investment) is non-refundable. Subsequent to the receipt of this fee, the fund manager will receive an ongoing fee from the fund (say 1% of the fund assets per annum) for ongoing fund management.
5. The question considered by this paper is whether the initial fee should be recognised as revenue upfront, or whether it should be spread over the life of the investment.
6. Whilst the paper only considers the above example, to the extent that the conclusions reached may differ depending on the distribution route, it also discusses alternative distribution routes commonly used by fund managers. In particular, the following distribution routes have been identified :
 - The fund manager provides both the distribution and ongoing management charge (ie the fund manager receives the upfront fee of 5% and the ongoing 1% fees).
 - One fund manager (or other distributor) provides the distribution and another the ongoing fund management (ie one fund manager receives the upfront fee of 5%, and another receives the ongoing 1%).
 - A fund manager (or other distributor) provides the upfront distribution but there is no ongoing fund management.
 - One fund manager (or other distributor) receives part of the upfront fee (for example 3%) with the remainder (for example 2%) remaining with the fund manager who will provide the ongoing services.

KEY DECISION POINTS

7. This section identifies the key decisions which need to be made in deciding when revenue from the initial fee should be recognised. Each of these key decision points is discussed in further detail later in this paper.

What is the transaction? (see para 19 – 27 and 73 - 77 below)

8. IAS 18.13 requires that revenue recognition criteria be applied separately to each transaction. It states that in certain circumstances it is necessary to apply the criteria to identifiable components of a single transaction. Conversely, the recognition criteria should be applied to two or more transactions when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole.
9. In the case of fund managers, the initial fee is paid by the investor to the fund manager, whereas the ongoing fee is paid by the fund to the fund manager. The fund management industry therefore considers that there are two separate transactions.
10. **In concluding on how the revenue should be recognised, it will be necessary to consider in which circumstances ongoing fees paying for ongoing services should be considered as separate from initial fees, and in which circumstances they should both be considered as part of one through life transaction.**
11. It should be noted that for simplicity, this paper principally discusses whether the entire initial fee relates to upfront services, or the entire initial fee relates to ongoing services. The IFRIC may conclude that a mixed model exists whereby some of the upfront fee relates to separately identifiable upfront services, some to fund management services which are provided upfront but are not separately identifiable from ongoing fund management services, and some to ongoing fund management services.

What is the service? (para 28 – 72 below)

12. IAS 18 requires that revenue be recognised in line with the rendering of services.
13. The staff considers that, because the investor can cancel the arrangement at any time, receipt of the ongoing fee cannot be considered as probable before it is received or receivable. Since it is received equally over the period that regular ongoing services are provided, it should be recognised as it is received or becomes receivable.

14. In order to decide when the initial fee should be recognised, it is first necessary to consider what service it relates to, and when this service is provided.
15. **The staff considers that identifying the service for which the upfront fee is paying is the critical question which must be addressed in assessing when revenue should be recognised.**

Measurement of revenue (para 81 below)

16. Depending on what services the IFRIC conclude that the initial fee relates to and whether the IFRIC conclude that the initial fee and ongoing fees should be considered as part of one through life transaction, a methodology for the measurement of revenue will be required.
17. If it is concluded that the initial fee all relates to upfront services, or if it is concluded that the initial fee all relates to ongoing through-life services, then this may be relatively straightforward. In other cases, for example if it is decided that the initial fee relates partly to upfront services and partly to ongoing services, then a more complex model for the measurement of revenue may be required.
18. Paragraph 81 sets out the differing revenue recognition models which may result depending on whether the IFRIC concludes that the initial fee relates to an upfront service or ongoing services, and whether the IFRIC concludes that there is a separately identifiable upfront transaction or just one through-life transaction.

WHAT IS THE TRANSACTION?

19. IAS 18.13 states :

“The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the selling price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognised as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.”

20. In the case of a fund manager, the initial fee is paid by the investor to the fund manager at the point at which the investor initially invests in the fund. The ongoing fee is paid on a periodic basis by the fund to the fund manager.
21. Since the initial fee has a different counterparty (the investor) to the ongoing fee (the fund) the staff considers that the two should initially be considered as separate transactions.
22. Differing views exist as to whether these two transactions should be considered together for the purpose of considering the revenue recognition criteria in IAS 18.
23. Supporters of the view that the two transactions should be considered separately note that fund management has a different fact pattern from insurance contracts and health clubs, where the upfront fee and the ongoing fee are both part of the same agreement with the same counter-party. They note that the initial fee relates to upfront services provided at the time that the initial fee is paid. The ongoing fee relates to ongoing management services provided subsequent to the initial investment
24. Others believe that, from a customer perspective, the commercial effect of the initial transaction cannot be understood without reference to the transaction as a whole. Supporters of this view argue that the customer's main point of reference is the total fee over the life of the investment, and as such that the commercial effect of the initial and ongoing fees cannot be understood separately by the customer.
25. The staff considers that, the decision as to whether the two should be considered together or not is, at least in part, influenced by what service the initial fee is paying for. For example, if it is concluded that there is an upfront service in providing investment advice and that is paid for by the initial fee, then it would be more likely that the investor could understand the commercial effect of the initial fee (for investment advice) separate from the ongoing fee (for fund management).
26. Since the question of what the transaction is is so intertwined with the issue of what service the payment is for, the staff considers that this question cannot be resolved without reference to the question of "what is the service?"

27. The staff has therefore deferred concluding on whether the transactions should be considered together or separately until the IFRIC has concluded on what service the initial fee is paying for. This issue is re-considered in paragraphs 73 – 77 of this paper.

WHAT IS THE SERVICE?

28. IAS 18 requires that revenue is recognised in line with the provision of services. In order to recognise revenue upfront in respect of the initial fee received, it is therefore necessary to demonstrate that there is an upfront service provided to the customer by the fund manager.
29. This section considers what services a customer pays for when they pay an initial fee as part of an arrangement with a fund manager. Once the IFRIC has concluded as to which service the upfront fee relates to, the paper re-considers whether the initial fee and ongoing fee should be viewed together for the purposes of recognising revenue or whether they should be considered separately, and the practical implications of that assessment.

Differing views

30. There are at least two differing views as to whether an upfront service exists in the case of fund managers. View 1 suggests that there are upfront services which are provided separately from the ongoing fund management services. View 2 suggests that the upfront activities of the fund manager amount to advertising, selling, regulatory and administrative activities, which are not services performed on behalf of a customer.
31. Supporters of view 1 list a number of services which are provided upfront. Supporters of view 2 believe that the initial fee is an advance payment for ongoing fund management services.
32. In considering what the initial fee relates to, the staff have considered the following potential services :
- i. Services relating to the provision of upfront investment advice.
 - ii. Services relating to the creation of units in the fund and brokerage.
 - iii. Services related to the payment of a sales commission.
 - iv. Services connected to ongoing fund management.

33. Each of these services is considered separately below

Upfront investment advice

34. Supporters of view 1 argue that fund managers offer an advisory service which takes place upfront. This service includes identifying customer needs, identifying the best investment to meet those needs, educating the customer about the investment and its risks, and assisting them in acquiring units in that investment.
35. Supporters of view 1 note that some investors pay investment advisors on a per hour basis rather than as part of a commission. The fact that these investors are willing to pay for this service in return for a reduction in the initial fee suggests that these investors view the investment advice as a service which they are willing to pay for, and that they view the initial fee as relating to that service.
36. They also compare the investment advice to services provided by professional firms under contingent fee arrangements. In this case, a customer may enter into a contract with a professional services firm on the basis that a fee only becomes payable if certain conditions are met (for example if a transaction is secured). The contingent fee is recognised at the point at which the contingent event occurs (ie when the transaction is completed).
37. In the case of an investment advisor, it will be made clear to an investor when they start discussions with the advisor that the fee for the advisor services is payable if a transaction is secured. There is no difference between this situation and that of any other contingent fee arrangement.
38. Supporters of the view that the provision of upfront investment advice is a service also note that the upfront fee is often lowered in situations where less advice is required (for example in the case of tracker funds or where the investment is sold direct through a website.)
39. Supporters of view 2 argue that a potential customer may walk in to an IFA or a fund manager and obtain the same investment advice and, if they do not enter into the fund, will not be required to pay for the advice.
40. They believe that this is a similar example to a potential customer who walks into a computer shop and receives advice about the best computer for them, but does not have to pay until the point at which they acquire a computer.

41. Supporters of this view believe that this kind of advice is a form of advertising.
42. This view is supported by the fact that in some situations, investors will pay an upfront fee without receiving detailed investment advice. For example, an investor buying into a fund advertised in a newspaper will not necessarily receive or require investment advice.

Services relating to the creation of units in the fund and brokerage

43. Supporters of view 1 also point to activities involving the creation of units and brokerage as being services to the customer.
44. Supporters of this view note that, if the customer wished to acquire a well balanced portfolio of investments, they could do this themselves by investigating the market and potential investments, and acquiring shares individually. The fund manager provides a service by compiling a well balanced and regulated investment on behalf of the investor.
45. The initial fee pays for the intellectual capital invested in compiling the portfolio as well as a brokerage fee to enter the fund. The customer benefits from not having to undertake the research or incur the brokerage fees to compile the portfolio themselves.
46. Supporters of this view argue that this service is a service related to the selling of the units, which is separate from the ongoing management of the units.
47. Supporters of this view also note that there is a service element in ensuring that the service is provided to a pre-agreed deadline to ensure that the investor is able to obtain the price quoted for the units at the correct time on the correct date.
48. Opponents of this view believe that the service provided at this point is little more than an administration activity for the fund manager. The associated acts, including creating and registering units, registering the unit holder, complying with regulatory requirements around the selling of units, sending out contracts, sending out information to the unit holders etc, are administrative requirements of the fund and are not services.
49. They argue that a company in which an investor buys shares will undertake many of these acts when a share is issued to an investor, but that these acts will

be viewed as administration costs of the entity rather than being services provided to the investor¹.

A sales commission

50. Some argue that the upfront fee is largely a fee paid to cover the upfront commission of the selling party.
51. [Paragraph omitted from observer note].
52. Supporters of this view argue that the investors are aware that the initial payment is merely paying to cover the costs of selling and acquiring the fund and that it is effectively a re-charge of these costs to them.
53. Opponents of this view believe that a sales commission does not represent a service provided to the customer and therefore is not something that should result in the recognition of revenue.

Services connected to ongoing fund management

54. Supporters of view 2 believe that the initial fee is a payment for the ongoing fund management services. They believe that an investor is only interested in one “through-life” investment management service which commences at the beginning of the investment and exists throughout the investment. Based upon this view, the initial fee should be spread over the life of the investment.
55. Supporters of this view also point to key features documents which do not distinguish between upfront and ongoing fees when presenting examples to demonstrate the effects of the fees on the investment over time.
56. They note that an investor who wishes to invest for 5 years is only concerned with the expected value of their investment after 5 years. The service which they receive and pay for is an investment management service over that 5 year period.
57. Supporters of view 2 also believe that, since there is no clearly identifiable upfront service and it cannot be demonstrated that the initial fee relates to an upfront service provided to the customer, the initial fee should be recognised on a straight line basis over the course of the investment. They point to IAS 18.25

¹ The staff note that the situation in which an entity issues a share in itself to an investor is different to the one where a fund manager assists in issuing a unit in a fund (which is separate from the manager) to an investor.

which states that “when services are performed by an indeterminate number of acts over a specified period of time, revenue is recognised on a straight-line basis”.

58. Opponents of this view believe that investors clearly understand that the initial fee relates to upfront services. They note that if the initial fee did relate to ongoing services, then presumably it would be refundable if those services were not performed.

Staff analysis

59. The staff considers that some of the upfront services identified share many of the features of advertising and administrative activities. In particular, many of the services described as customer advice are similar in nature to those which are used by a sales team for a product. For example, a car salesperson will understand his customer and his customer’s needs, identify the correct vehicle for them, and then explain the features of that vehicle to them.
60. Similarly, many of the items described as brokerage and setup have similar features to administrative activities.
61. On the other hand, the staff notes that investors are willing to pay for these upfront services in other situations (for example, investors do pay for investment advice on an hourly rate, and do pay brokerage and setup fees for other types of investment). The staff also believes that, just because some of the upfront activities are not services to the customer, this does not mean that none of the upfront activities are services to a customer.
62. From a customer perspective, the staff considers that investors are primarily interested in the through life cost of the investment. However, this does not necessarily mean that the service is provided equally over the life of the investment, or that there is no upfront service.
63. The staff believes that there are differing views as to whether the investor believes that they are paying for upfront services or ongoing services, or are simply reimbursing sales commissions which have been incurred in selling the fund.
64. The staff considers that the above demonstrates there are arguments both for and against the existence of an upfront service. The staff also considers that there

are arguments which can be made in support of the view that the initial fee relates to the ongoing service.

65. If the IFRIC can not conclude on what the initial fee relates to, then the staff suggests that the IFRIC may wish to consider the relationship between the delivery of services and the ongoing obligations of the fund manager.
66. The staff notes that the initial fee is payable after the upfront investment advice and brokerage have been completed. As soon as the upfront fee becomes payable, it is not refundable, even if the investor leaves the fund after a very short period of time, or if the fund manager fails to perform satisfactorily (for example if the returns from the fund are not satisfactory).
67. This is in contrast to the ongoing fee which the investor can avoid (by leaving the fund) if the fund manager fails to perform.
68. Under normal circumstances, if an entity (entity A) pays a fee to another entity (entity B) for an ongoing service, then that fee will be refundable (either contractually or in law) if entity B fails to perform the service.
69. The staff considers that the IFRIC may conclude that since the fund manager has no legal or contractual obligation to perform any ongoing service after receipt of the initial fee, and since the fee is non-refundable even if the fund manager fails to perform an ongoing service then, in the absence of evidence to the contrary, this gives an indication that the initial fee does not relate to the ongoing service and instead relates to the initial service.

Conclusions as to what service the initial fee is paying for

70. As discussed above, by considering the activities of the fund manager and the relationship with the investor, arguments can be found both for and against the assertion that the initial fee relates to an upfront service.
71. The staff considers that the question of what service the initial fee relates to is central to concluding how the fee should be accounted for and so that the IFRIC will have to conclude whether the initial fee relates to an upfront or an ongoing service (or a mixture of both).
72. The staff considers that if the IFRIC is unable to conclude based on a consideration of the activities of the fund manager as they relate to the investor, then the IFRIC may wish to consider the relationship between the obligations

and liabilities of the fund manager and the services provided by the fund manager. For example, the IFRIC may wish to consider whether the fact that the initial fee is non-refundable and that there are no future obligations on the fund manager as a result of receiving the fee indicates that the initial fee relates to the upfront services.

The staff asks the IFRIC to consider:

- a) Whether it believes that the initial fee relates to an upfront or an ongoing service?**
- b) If the IFRIC concludes that the upfront fee relates to an upfront service, whether this conclusion is based solely on considering the activities of the fund manager or whether it is based on considering the lack of a present obligation?**

REASSESSMENT OF WHAT IS THE TRANSACTION?

- 73. As discussed in paragraphs 19 – 27 above, the staff considers that the initial and ongoing fees are two separate transactions (since they have different counterparties). To conclude whether they should be considered together for the purposes of applying the revenue recognition criteria in IAS 18, it is necessary to consider whether the commercial effect of the transactions can be understood without reference to each other.
- 74. If the IFRIC concluded under paragraph 72 above that the service provided relates to an ongoing through-life investment management service, then the staff considers that it would be impossible to understand the ongoing service relating to the initial fee separately from the ongoing services relating to the ongoing fee. The commercial effect of the transactions could not therefore be understood in isolation, and the transaction (incorporating the initial payment and the ongoing fee) must be seen as being one through-life fund management transaction.
- 75. If, on the other hand, the IFRIC concluded that the initial fee relates to services provided upfront, then it will be necessary to consider whether there is a separately identifiable transaction upfront.
- 76. The staff notes that :

- the parties to the upfront fee are different from the parties to the ongoing fee arrangement.
- the ongoing fee is for an ongoing management service. To the extent that an upfront service exists, it is not an ongoing management service and so its commercial effect can be understood separately from the ongoing service.

77. The staff therefore concludes that if the IFRIC considers that the initial fee relates to an upfront service, then the provision of and payment for that upfront service should be considered as a separate transaction from the ongoing fee for the ongoing management service.

Do the IFRIC members believe that:

- **the initial fee relates to a separately identifiable upfront service; or**
- **the initial fee and ongoing fees both relate to one ongoing through-life service?**

PRACTICAL CONSIDERATIONS

78. The staff considers that there are a number of practical implications associated with choosing a model for revenue recognition. These practical implications are discussed in detail in Appendix 1 to this paper. The key issues are summarised below :

- Deferring revenue and recognising it over the expected life of the investment may result in the smoothing of income, with credits deferred in the balance sheet when the business is performing strongly, and released when the business is performing poorly.
- If the fee is recognised upfront, then entities operating in an environment without strong competition may be motivated to charge increased upfront fees and reduced ongoing fees to accelerate the recognition of revenue.
- Deferring initial fees reduces visibility of the amount of new business being generated by a fund manager in a period. It also reduces visibility of ongoing fee trends, and may therefore reduce the usefulness of the financial information to preparers.

- If fund managers are able to recognise revenue in respect of upfront activities provided on behalf of other fund managers' funds but not in respect of the same upfront activities provided for their own funds, then they may be incentivised to sell products other than their own to accelerate revenue recognition.

79. IAS 18.35b requires disclosure of the amount of each significant category of revenue recognised during a period. The staff considers that, if initial fees are recognised as revenue as received, then separate disclosure of initial revenue and ongoing revenue would also be required.

80. If initial fees are recognised, and disclosed separately from ongoing fees, this would allow users of accounts to understand a fund's ability to attract new members and to receive ongoing fees from those new members. This would not be possible if the fees were not recognised or disclosed upfront.

MEASUREMENT

81. The staff considers that there are four possible models which could be used for the measurement of revenue depending on what the IFRIC concludes that the initial fee relates to. These models are summarised below.

Scenario	Approach to revenue recognition	Staff comments
1. The initial fee relates to a separately identifiable upfront service.	Revenue is recognised upfront.	
2. The initial fee relates wholly to ongoing fund management services.	Revenue is recognised on a straight line basis over the estimated average investment period.	

3. The initial fee relates to ongoing fund management with some of this service provided upfront (but not as a separate service).	Revenue is recognised using a percentage of completion method based on the costs of services provided to date.	Robust guidance may be required as to which upfront costs may be included in the percentage of completion computation.
4. A separate initial service is identified but only part of the initial fee relates to that initial service.	In this situation, revenue should be recognised upfront to the extent of the fair value of the service provided. Any additional amounts received should be recognised on a straight line basis over the expected average life of the investment.	Guidance may be required as to how the fair value of the revenue should be estimated.

CONCLUSIONS

82. The staff considers that there are plausible arguments supporting both the view that the initial fee relates to upfront services and that it relates to ongoing services.
83. In order to conclude on the recognition of revenue, it is necessary to identify which services the initial fee relates to.
84. One approach to concluding on this issue may be to consider what further obligations the fund manager has in respect of the initial fee after receipt. Specifically, the IFRIC may conclude that since the fund manager has no further obligations to perform a service after receipt, then the initial fee must relate to the upfront services.
85. The staff considers that if the IFRIC concludes that the initial fee relates to upfront services, then it should be regarded as a separate transaction and the

initial fee should be recognised upfront. If it is concluded that the initial fee relates to ongoing services, then it should be regarded as part of one through-life transaction and should be deferred and amortised over the expected life of the investment.

86. Differing models may be required if the IFRIC concludes that part of the initial fee relates to a separate upfront service or that it relates to upfront services, the commercial effect of which cannot be understood without reference to the ongoing fund management service.

APPENDIX 1: Practical implications of differing revenue recognition models for upfront revenue recognition

INTRODUCTION

87. The staff considers that there are a number of practical considerations which should be borne in mind when considering whether to recognise revenue upfront or whether to amortise it over the expected average life of the investment.
88. Whilst this is not an exhaustive list, the staff have considered below what it believes to be the most significant of these issues as they relate to fund managers.
89. In particular, the staff considered :
- a) The smoothing effect of the deferral of revenue;
 - b) Potential manipulation if revenue is recognised upfront;
 - c) Visibility and understandability of financial reporting; and
 - d) Impacts on the business model.
90. A more detailed discussion of each of these issues is set out below.

A) SMOOTHING OF INCOME

91. The deferral of revenue and its recognition over the expected average life of the investment will result in revenue being recognised a number of years after the initial fees have been received by an entity. At its simplest level, this deferral will result in the smoothing of revenue, and may conceal ongoing fluctuations in the fund's performance.
92. Supporters of the upfront recognition of initial fees also point to the following example:
- Suppose fund A has deferred revenue of \$500m on its balance sheet which it is recognising on a straight line basis over the expected average investment period of 10 years.
 - Fund A is therefore recognising \$50m of revenue pa.

- Suppose that the fund manager leaves, and the fund is unable to attract a fund manager of a similar quality. Following this adverse change in the fund manager, the average investment period is assessed to have reduced to 4 years.
 - The fund will now amortise its deferred revenue over a 4 year period and so will recognise \$125m pa.
93. Supporters of the upfront recognition of initial fees consider that in this type of example, adverse developments in the fund, and a deteriorating performance in the fund will lead to an increase in revenue recognised in the short term. This does not reflect the commercial substance of what has happened within the fund.
94. Supporters note that this type of example means that not only will the deferred recognition of revenue result in the smoothing of revenue over a period of time, but it will also result in credits being deferred in the balance sheet when the fund is performing well, and being released to profit when the fund is performing poorly.
95. This deferral and amortisation will be influenced by the fund manager's expectations of customer behaviour, which in turn will be driven by the manager's optimism about the market, the fund performance, customer behaviour, etc. Similar funds may therefore have very different expected lives based upon their level of optimism about future performance.
96. Supporters of the upfront recognition of revenue believe that the deferral of revenue may result in the recognition of revenue in inverse proportion to the performance of the fund, which will result in fund managers publishing results that do not reflect their current performance.
97. For this reason, the staff understands that analysts prefer the upfront recognition of initial fees to the deferred recognition of initial fees.

B) POTENTIAL FOR MANIPULATION

98. In some situations, if entities are able to recognise initial fees as revenue upfront, there may be an incentive to alter the charging structure so that the

initial fee is increased, and the ongoing fee is reduced to accelerate the recognition of revenue.

99. This manipulation of reporting may result in a situation where an entity is forced to continue to obtain new business to bolster reduced margins, and potential losses in their ongoing fees and work.

C) REDUCED VISIBILITY

100. Analysts and users of accounts may argue that in the case of a fund manager, some of the key metrics which may be helpful in assessing fund performance include :
- How well the fund manager attracts new business.
 - How well the fund manager retains and develops existing business.
101. If initial fees are spread forwards, and ongoing fees are recognised as received, this information will not be visible to users of the accounts.
102. For example, if a fund manager which is amortising revenue over 10 years ceases to generate any new business, then revenue from initial fees will fall by 10% pa for 10 years. This trend, whilst negative, may mask the true issue which is that the fund has ceased to generate any new business.
103. If a model is used where initial fees are recognised upfront and are disclosed separately, then analysts and users of accounts will be able to view useful information about trends in new business which is being generated, as well as trends in ongoing income.

D) INCENTIVISATION OF FUND MANAGERS

104. A fund manager (“A”) may sell its own products, as well as products which have ongoing fund management services provided by another fund manager (“B”).
105. If A sells its own products, it will receive a 5% initial fee, followed by a 1% pa management charge. If it sells B’s products, it will only receive the 5% initial fee.

106. If A is required to spread the fees in respect of its own fund forward, but not those in respect of funds sold on behalf of B, then this may result in A being incentivised to sell the product of B to advance its revenue recognition.
107. Not only does this example demonstrate that spreading the fee forward may result in inconsistent treatments, but some fund managers believe that it may also result in a situation where fund managers are incentivised to undertake less than optimal transactions to avoid negative accounting consequences.