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ASC 606 CONSIDERATIONS

for Investment Managers

STEP ONE: IDENTIFY THE CONTRACT

- ☐ Carried interest arrangements entered into as part of a Limited Partnership Agreement are generally within the scope of ASC 606 and constitute a contract.

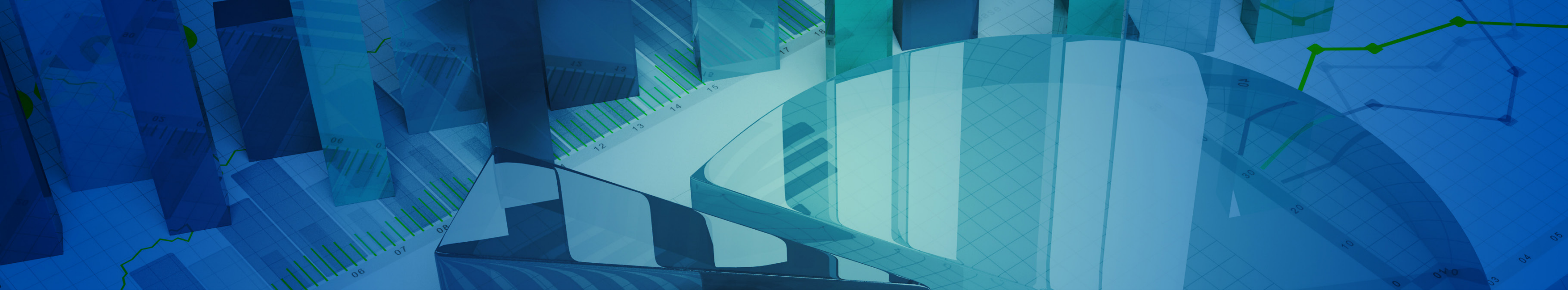
STEP TWO: IDENTIFY THE PERFORMANCE OBLIGATIONS

- ☐ Services provided as part of an investment management agreement such as recordkeeping, administration, fund accounting and custody are considered one performance obligation as part of the investment manager's obligation to manage the daily operations of the fund.

EXAMPLE: An investment manager enters into an agreement with a fund through which they are entitled to a quarterly asset management fee and an annual fee based on performance of the fund. Both fees are paid to the investment manager as consideration for managing the fund and its assets and may be considered one performance obligation.

STEP THREE: DETERMINE THE TRANSACTION PRICE

- ☐ High quality, probable variable consideration is now considered and included in the transaction price.
- ☐ Both management fees and performance fees are considered variable consideration which is constrained, since they are typically tied to the Net Asset Value of the fund. Because of the constraint tied to variable consideration and the high probability of significant revenue reversal, these fees would not be recorded at contract inception.
- ☐ The amount of variable consideration recorded should be limited to the amount for which a significant revenue reversal will not occur when the uncertainties around the variability are resolved. Factors to consider when estimating variable consideration include:
  - The remaining life of the managed fund
  - Dependence on factors outside the control of the investment manager
  - Existence of clawback provisions
  - The extent to which current realized and unrealized gains exceed contractual hurdle rates



- ☐ Evaluate whether variable consideration is still constrained, at a minimum, at each reporting period and record only when there no longer exists a probability of significant revenue reversal (i.e. when the fund liquidates, fee is crystallized, etc).

EXAMPLE: An investment manager contracts with a fund to provide investment management services and receives carried interest based on performance of the fund. At the end of year 1 of the fund, its investments appreciated to $3M from $2M. The fund has a 10 year limited life and is 30% invested. There is no current exit plan for existing investments. Based on these factors, it is not reasonable that a significant revenue reversal would not occur and, therefore, the investment manager should not record any variable income as it relates to carried interest. The investment manager records a management fee for the fourth quarter of $15,000 (AUM of $3,000,000 at year end x .005 (quarterly fee).

STEP FOUR: ALLOCATE THE TOTAL TRANSACTION PRICE TO ALL THE PERFORMANCE OBLIGATIONS

- ☐ Review Limited Partnership and Investment Management Agreements for specified amounts allocated to management fees and performance fees.
- ☐ The standard provides an exception that allows variable consideration to be allocated to one or more distinct goods or services that form part of a single performance obligation if certain criteria are met. Many asset management performance obligations likely will qualify for this exception because the variable consideration relates to the investment manager's efforts to provide investment management services for a certain period within a contract that are distinct from the services provided in other periods.

EXAMPLE: In the example above, the entity receives a 2 percent management fee based on assets under management at the end of each quarter. The investment manager also receives carried interest as 20 percent of fund returns over a certain benchmark. The investment manager allocates the fee based on the specific amounts outlined in the agreement.

STEP FIVE: RECOGNIZE REVENUE AS THE CUSTOMER ACHIEVES CONTROL OF THE SERVICES

- ☐ The factor which constrains management fees, primarily the NAV of the fund, is typically resolved at the end of each period during which the fee is calculated (i.e. quarter, month, etc.), resulting in management fees being recognized in revenue at the time NAV is finalized.

Mark J. Deters, CPA, MS, Partner
Revenue Recognition Accounting
T (973) 867-7489
mdeters@withum.com

Tom Angell, CPA, Partner
Financial Services
T (212) 751-9100
tangell@withum.com