Crowe Horwath.

Smart decisions. Lasting value.™

Revenue Recognition: Financial Institutions

January 24, 2018

Leslie Yates

Housekeeping

- All phones will be automatically muted upon entering the meeting. Please also place your phone on mute if that feature is available to you.
- WebEx technical support can be reached at 800.508.8758, or you can press *0 to speak with an operator.
- Please submit questions through the Q&A function on your screen. Questions will be addressed at the end of the presentation.
- To download a copy of the presentation, click File > Save As > Document, and select PDF as the file type.

CPE Details

- **CPE Credit**
  - Login individually to the WebEx session
  - Successfully complete 3 of the 4 polling questions
- **NO CPE Credit**
  - Fail to successfully complete 3 of the 4 polling questions
  - Viewing a recording of this session (CPE is only awarded for live sessions)
- **Upon completion of this program you will receive:**
  - Evaluations
  - Sent within 48 hours
- **Your feedback is important**
  - CPE certificate of completion
  - E-mailed within two weeks of upon successfully passing this program

Today's Speaker

Leslie Yates
Senior Manager
Financial Services Audit Practice
Crowe Horwath LLP

Agenda

- Effective Dates and Scoping of Revenue
- Steps To Implement The Standard
- Evaluate the Required Disclosures
- Evaluate the 5 Steps of Revenue Recognition Through Industry Examples
- Transition Methods
- Control Environment and Other Considerations

Learning Objectives

As a result of participating in this session, you should be able to:

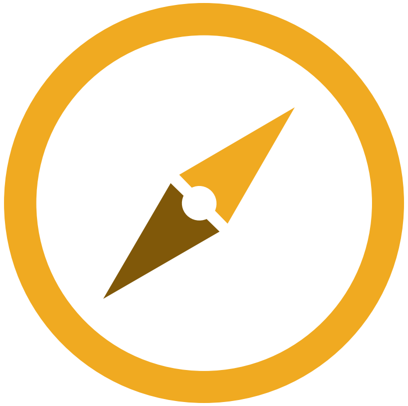
Identify what is in and what is out of the standard as it relates to financial institutions

Distinguish between areas of judgment and related issues

Recite what you need to do to gather data and the steps that you need to take to implement the standard

List relevant industry examples will talk through the intricacies of the standard which you will be able to apply as you go through your documentation process

Discuss the necessary control environment and other matters such as practical expedients that will assist you through the process



Effective Dates

Standard	Effective Dates for PBEs	Effective Dates for non-PBEs
Revenue Recognition ASU No. 2014-09 (May 2014)	Fiscal years beg. after Dec. 15, 2017, including interims within	Fiscal years beg. after Dec. 15, 2018, and interim periods beg. after Dec. 15, 2019
	Dec. 31 year-ends – March 31, 2018 interim F/S	Dec. 31 year-ends – Dec. 31, 2019 annual F/S
		Early adoption is permitted, in line with PBE date

Revenue Recognition: Scoping for Financial Institutions

In Scope

- Service Charges on Deposit Accounts
- Gains/Losses on Other Real Estate Owned
- Asset Management Fees
- Interchange Fees

Out of Scope

- Interest Income
- Trading Revenue
- Loan Servicing Fees
- Credit Card Fees
- Guarantee Fees

Note

Broker-dealer subsidiaries and insurance related operations are not contemplated in this documentation

Revenue Recognition: Scoping for Financial Institutions

For financial institutions, many revenue streams are outside the scope, and in general, revenue streams that are covered by other topics are excluded from consideration under Topic 606. Topic 606 specifically does not apply to revenue related to:

- **Financial instruments and other contractual rights or obligations within the scope of topics:**

310 (Receivables)	470 (Debt)
320 (Investments – Debt and Equity Securities)	815 (Derivatives and Hedging)
323 (Investments – Equity Method and Joint Ventures)	825 (Financial Instruments)
325 (Investments – Other)	860 (Transfers and Servicing)
405 (Liabilities)	

- **Guarantees within the scope of Topic 460 (Guarantees)**
- **Insurance contracts within the scope of Topic 944 (Financial Services – Insurance)**
- **Leases within the scope of Topic 840 (Leases)**
- **Nonmonetary exchanges between entities in the same line of business to facilitate sales to customers or potential customers, which are often within the scope of Topic 845**

What Do You Need To Do To Implement This Standard?

1. Map out your income statement to determine your key revenue streams

Revenue item	Revenue	% of Revenue	In-Scope	Out-of-Scope
Interest Income	$100,000,000	74.3%		x
Service charges of deposits	$ 15,000,000	11.2%	X	
Interchange Income	$ 6,000,000	4.5%	X	
Mortgage Banking	$ 3,000,000	2.2%		X
Trust and investment product fees	$ 5,000,000	3.7%	X	
Gain/Loss on Sale of OREO	$ 500,000	0.4%	X	
Gain/Loss on Sales of securities	$ 1,000,000	0.7%		X
BOLI income	$ 1,000,000	0.7%		X
Credit Card Fees	$ 1,000,000	0.7%		X
Other	$ 2,000,000	1.6%	See comment	See comment
Total Revenue	$134,500,000	100%		

Evaluate what is included in “Other Income” to determine if there are any additional revenue streams not previously considered.

Polling Question #1

Which revenue stream is included under Topic 606?

A. Guarantees

B. Credit Card Fees

C. Asset Management Fees

D. Interest Income on Securities

What Do You Need To Do To Implement This Standard?

2. Gather contracts for the revenue streams that are deemed in- scope and material to your financial statements.

Obtain a sample of contracts and determine if the contracts are similar or if they need to be evaluated separately

Designate a point person to perform the contract reviews, who can review Topic 606 and apply the standard

What Do You Need To Do To Implement This Standard?

3. Begin evaluating the 5 step framework for all material in- scope revenue streams

Documentation should include:

How revenue was being booked pre-Topic 606 and how revenue will be recognized under Topic 606

Conclusions for each of the 5 steps of the Revenue Recognition framework

Entities should document whether 100% of their revenue streams are in scope or out of scope and then consider whether each revenue stream is material

What Do You Need To Do To Implement This Standard?

4. Evaluate the disclosure requirements under ASC 606-10-50:

CATEGORY	INFORMATION REQUIRED
Disaggregation of Revenue	• Quantitative disclosure of revenue disaggregated into categories that show how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors
Contract Balances	• Opening and closing balances and revenue recognized during the period • Information about significant changes in contract balances
Performance Obligations	• Description of when performance obligations are satisfied, significant payment terms, nature of goods or services promised, and obligations for returns, refunds, and warranties • Transaction price allocated to remaining performance obligations and when such revenue will be recognized • Whether the entity is applying the practical expedient for certain performance obligations

What Do You Need To Do To Implement This Standard?

4. Evaluate the disclosure requirements under ASC 606-10-50:

CATEGORY	INFORMATION REQUIRED
Significant Judgments	• The timing of satisfaction of performance obligations and the transaction price and amounts allocated to performance obligations • The method used to recognize revenue for performance obligations satisfied over time and why that method is representative of the transfer of good or services • Judgments made in evaluating when a customer obtains control of promised goods or service for performance obligations satisfied at a point in time • Methods, inputs, and assumptions used for determining the transaction price, assessing constraints on variable consideration, allocating transaction price, and measuring obligations for returns, refunds, and similar obligations

Practical Expedients	• If an entity elects either of the following practical expedients, it should be disclosed:
	  ◦ Determining the existence of a significant financing component
	  ◦ Determining the incremental costs of obtaining a contract

Disclosure Requirements

Disclosure: Disaggregated Revenue

606-10-50-5

An entity to disaggregate revenue from contracts with customers into categories that depict how the nature, amount, timing, and uncertainty of revenue and cash flows are affected by economic factors.

Types of Information to Consider:

- Disclosures presented outside of the financial statements (earnings releases, investor presentations, etc.)
- Information regularly reviewed by decision makers
- Other information that is similar to information above that is used by the entity or users of the financial statements to evaluate financial performance or resource allocation decisions

(Refer to 606-10-55-90)

Disclosure: Disaggregated Revenue

Types of Categories to Consider:

- Major product lines
- Geographical regions
- Type of customer
- Duration of contract
- Point in time vs Transferred over time
- Type of contract
- Sales channels

(Refer to 606-10-55-91)

606-10-50-2

An entity shall consider the level of detail necessary to satisfy the disclosure objective and how much emphasis to place on each of the various requirements. An entity shall aggregate or disaggregate disclosures so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have substantially different characteristics

Disclosure: Disaggregated Revenue

If segment reporting applies

An entity shall disclose sufficient information for users to understand the relationship between disaggregated revenue and revenue information that is disclosed for each reportable segment

Other Considerations:

The extent of disaggregation depends on facts and circumstances, some companies may have several categories. Other company's may meet the objective by using only one type of category to disaggregate revenue

Disclosures only need to be provided once. If disclosure is made elsewhere or pursuant to another standard and meets the objective, no need to repeat

Disclosure: Disaggregated Revenue

Non-PBE Disclosure Accommodation

For financial institutions not deemed to be a PBE, an election may be made to exclude quantitative disaggregated revenue discussed on the previous slide

What is required if a non-PBE chooses the Disclosure Accommodation:

At a minimum, non-PBEs are required to disclose disaggregated revenue according to goods and services transferred to customers over time vs goods and services transferred at a point in time

Also, must disclose qualitative information about how economic factors affect the nature, amount, timing and uncertainty of revenue and cash flows

Disclosure: Contract Balances

606-10-50-8

An entity to disclose opening and closing balances of receivables, contract assets, and contract liabilities from contracts with customers

Contract Asset

An entity's right to consideration in exchange for goods or services that the entity has transferred to a customer when that right is conditioned on something other than the passage of time (for example, the entity's future performance)

606-10-45-3

If an entity performs by transferring goods or services to a customer before the customer pays consideration or before payment is due, the entity shall present the contract as a **contract asset**, excluding any amounts presented as a receivable. A contract asset is an entity's right to consideration in exchange for goods or services that the entity has transferred to a customer. An entity shall assess a contract asset for impairment in accordance with Topic 310 on receivables. An impairment of a contract asset shall be measured, presented, and disclosed in accordance with Topic 310 (see also paragraph 606-10-50- 4(b)).

Disclosure: Contract Balances

Contract Liability

An entity's obligation to transfer goods or services to a **customer** for which the entity has received consideration (or the amount is due) from the customer

606-10-45-2

If a **customer** pays consideration, or an entity has a right to an amount of consideration that is unconditional (that is, a receivable), before the entity transfers a good or service to the customer, the entity shall present the contract as a contract liability when the payment is made or the payment is due (whichever is earlier). A contract liability is an entity's obligation to transfer goods or services to a customer for which the entity has received consideration (or an amount of consideration is due) from the customer.

Receivable

606-10-45-4

A receivable is an entity's right to consideration that is unconditional. A right to consideration is unconditional if only the passage of time is required before payment of that consideration is due. For example, an entity would recognize a receivable if it has a present right to payment even though that amount may be subject to refund in the future.

Disclosure: Contract Balances

Additional disclosures include:

Revenue recognized in the reporting period that was included in the contract liability balance at the beginning of the period

(Refer to 606-10-50-8a)

Explain how the timing of satisfaction of an entity's performance obligations relates to typical timing of payments and its impact to contract assets and liabilities.

(Refer to 606-10-50-9)

Revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price)

(Refer to 606-10-50-8c)

Revenue recognized in the reporting period from performance obligations satisfied (or partially satisfied) in previous periods (for example, changes in transaction price)

For example, impairment of contract asset, changes in time frame for a performance obligation to be satisfied, changes related to business combinations, etc.)

(Refer to 606-10-50-8a)

Disclosure: Contract Balances

Non-PBE Disclosure Accommodation

For financial institutions not deemed to be a PBE, an election may be made to exclude contract balance disclosures discussed above and on the previous slide.

(Refer to 606-10-50-11)

What is required if you choose the non-PBE Disclosure Accommodation:

At a minimum, you are required to disclose the opening and closing balances of receivables, contract assets and contract liabilities from contracts with customers.

(Refer to 606-10-50-11)

Disclosure: Contract Balances

Where might contract assets and contract liabilities come into play for financial institutions?

Disclosure: Performance Obligations

606-10-50-12 | An entity shall disclose information about its performance obligations in contracts with customers

When entity's typically satisfy its performance obligations (e.g., as services are rendered, upon completion of service, upon delivery, etc.)

Significant payment terms (e.g., variable consideration, financing components, etc.)

Nature of goods and services and corresponding performance obligations

Obligations for returns, refunds and other

Types of warranties and related obligations

606-10-50-13 | An entity shall disclose the following information about its remaining performance obligations

Aggregate amount of transaction price allocated to the performance obligations that are unsatisfied as of the end of the reporting period.

Explanation of when the entity expects to recognize the revenue in the previous step quantitatively by time bands or by using qualitative information.

Disclosure: Performance Obligations

Practical Expedient

606-10-50-14

An entity need not disclose information in **606-10-50-13** in the previous slide regarding performance obligations if either of the following conditions are met:

The performance obligation is part of a contract that has an original expected duration of one year or less.

The entity recognizes revenue from the satisfaction of the performance obligation in accordance with paragraph **606-10-55-18**.

606-10-55-18 states that for performances performed over time an entity shall disclose the methods used to recognize revenue (input or output methods and how they are applied and explanation of why the methods used provide a faithful depiction of the transfer of goods or services.

Then qualitatively disclose if you are utilizing the practical expedient and whether any consideration from contracts with customers is not included in the transaction price **(606-10-50-15)**

Non-PBE Disclosure Accommodation

606-10-50-16

For financial institutions not deemed to be a PBE, an election may be made to exclude disclosures in paragraphs **606-10-50-13** through **50-15**)

Disclosure: Significant Judgments

606-10-50-17	Disclose significant judgments and changes in those judgements that are used in determining the timing of satisfaction of performance obligations and significant changes to the transaction price and amounts allocated to performance obligations

Timing of Satisfaction of Performance Obligations

606-10-50-18	For performance obligations satisfied over time, disclose methods used to recognize revenue (input vs output methods) and an explanation of why the method used provides a faithful depiction of the transfer of goods or services
606-10-50-19	For performance obligations satisfied at a point in time, disclose significant judgments made in evaluating when a customer obtains control of promised goods or services

Non-PBEs may elect to not disclose the text in red.

Disclosure: Significant Judgments

Transaction Price

606-10-50-14 An entity shall disclose information about the methods, inputs, and assumptions used for all of the following:

Determining the transaction price (for example, estimating variable consideration, adjusting for the time value of money, measuring noncash consideration)	Assessing whether an estimate of variable consideration is constrained	Allocating transaction price to standalone selling prices and allocating discounts and variable consideration	Measuring obligations for returns, refunds, and other

Non-PBEs may elect to not disclose the text in red.

Disclosure: Practical Expedients

More Practical Expedients

606-10-32-18

As a practical expedient, an entity need not adjust the promised amount of consideration for the effects of a significant financing component if the entity expects, at contract inception, that the period between when the entity transfers a promised good or service to a customer and when the customer pays for that good or service will be one year or less.

340-40-25-4

As a practical expedient, an entity may recognize the incremental costs of obtaining a contract as an expense when incurred if the amortization period of the asset that the entity otherwise would have recognized is one year or less.

If these practical expedients are utilized, this must be disclosed

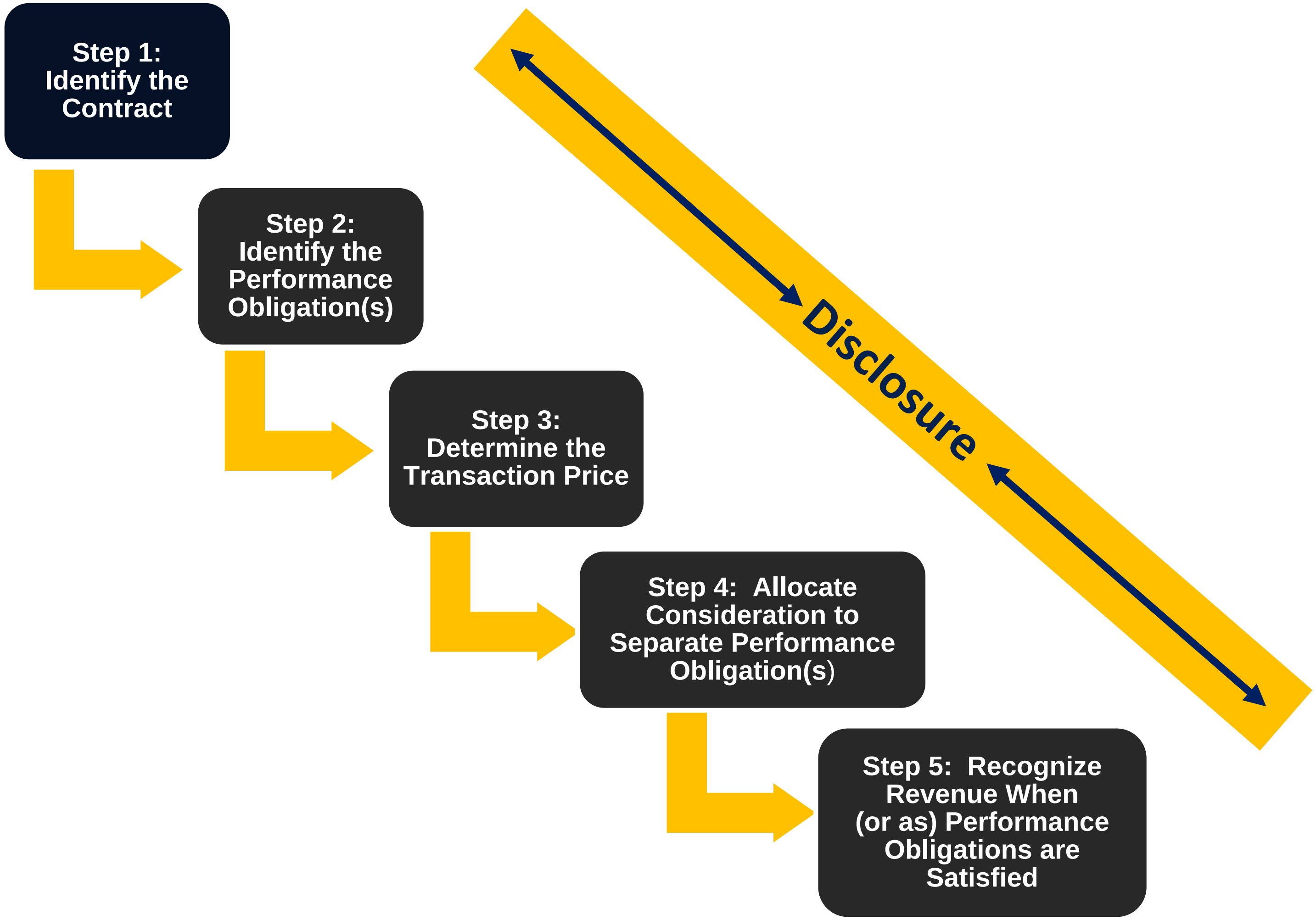
Non-PBE Disclosure Accommodation

606-10-50-23

For financial institutions not deemed to be a PBE, an election may be made to exclude disclosures mentioned above

Five Steps of Revenue Recognition

Revenue Recognition: Five Steps



Polling Question #2

Which is not one of the Five Steps of Revenue Recognition?

A. Disaggregate the Revenue Streams

B. Determine the Transaction Price

C. Identify the Performance Obligation

D. Identify the Contract

Deposit Service Fees and Charges

Deposit Service Fees and Charges:
Step 1: Identify the Contract

A contract exists if all of the following criteria is met:

Parties have approved the contract and are committed to perform their obligations

Each party’s rights can be identified

Payment terms can be identified for the goods and services to be transferred

Contract has commercial substance

It is probable that the entity will collect the consideration to which it is entitled, considering only the customer’s ability and intention to pay when the consideration is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession

Entities should consider whether an arrangement with a customer includes enforceable rights and obligations. An entity should then apply the guidance to the contractual period over which the parties have present enforceable rights and obligations.

Deposit Service Fees and Charges:
Step 1: Identify the Contract

Deposit service fees and charges could include items such as ATM fees, dormant fees, stop payment fees, wire transfer fees, etc.

Deposit contracts are in writing and have enforceable right by law.

Analysis:

a) The Bank has a written contract with all of their depository customers.

b) Rights are defined in the contract

c) Payment terms are generally set globally for the various products that the Financial Institution offers

d) Contract has commercial substance

e) It is probable that payment will be collected as most of these fees are collected at the time of service

The **TRG** considered contracts that are terminable at will by either party without compensation for the termination and determined that the contract does not extend past the goods and services already transferred. Therefore, the term of the depository contract is likely day to day or minute to minute. The termination clause is similar to a renewal right where each day or minute represents the renewal of the contract. The renewal is treated like a new contract for purposes of applying the 5 steps in the standard.

Deposit Service Fees and Charges:
Step 2: Identify the Performance Obligations

Guidance

Identify goods and services that are distinct or a series of distinct goods or services that are substantially the same and have the same pattern of transfer.

If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

Contracts are generally explicit about the goods or services transferred, however you should also consider other promises that are implied or are customary business practices.

Deposit Service Fees and Charges:
Step 2: Identify the Performance Obligations

Analysis

A deposit contract typically obligates a financial institution to serve as custodian to funds on deposit in exchange for the customer depositing the funds. It is customary practice that a customer can access its funds in various manners such as through ATMs withdrawals.

Customers might also have the option to add additional services, which is usually an indication that the additional performance obligation is distinct. Also, these add on products/services generally have distinct fees.

Deposit Service Fees and Charges:
Step 3: Determine the Transaction Price

Guidance

The transaction price is the amount of consideration to which an entity expects to be entitled in exchange for transferring promised goods or services to a customer, excluding amounts collected on behalf of third parties (for example, some sales taxes).

The consideration promised in a contract with a customer may include fixed amounts, variable amounts, or both.

Evaluate the following:

Variable consideration

Constraining estimates of variable consideration

The existence of significant financing components

Noncash consideration

Consideration payable to a customer

Deposit Service Fees and Charges:
Step 3: Determine the Transaction Price

Analysis

The transaction price is set globally by the financial institution for each individual service.

No significant financing component

No noncash consideration

No consideration payable to a customer

Variable consideration

Need to consider refunds. For example, waived dormant account fees

Other Considerations:

If deposit products have annual fees and have bundled services, it may be necessary to allocate the transaction price to identified performance obligations based on guidance in Step 4

Deposit Service Fees and Charges:
Step 3: Determine the Transaction Price

Variable Consideration

If you allow refunds, reversals, price concessions, etc., variable consideration exists

606-10-32-8

An entity shall estimate an amount of variable consideration by using either of the following methods, depending on which method the entity expects to better predict the amount of consideration to which it will be entitled:

a) **The expected value –** The expected value is the sum of probability-weighted amounts in a range of possible consideration amounts. An expected value may be an appropriate estimate of the amount of variable consideration if an entity has a large number of contracts with similar characteristics.

b) **The most likely amount –** The most likely amount is the single most likely amount in a range of possible consideration amounts (that is, the single most likely outcome of the contract). The most likely amount may be an appropriate estimate of the amount of variable consideration if the contract has only two possible outcomes (for example, an entity either achieves a performance bonus or does not).

Deposit Service Fees and Charges:
Step 3: Determine the Transaction Price

Variable Consideration

If you allow refunds, reversals, price concessions, etc. variable consideration exists.

For example:

Dormant account fees: Consider current practice of refunding/reversing dormant account fees. Assume dormant account fees are $15 per occurrence and using the expected value method, you determine that 13% of dormant account fees are normally refunded. **Equates to a transaction price of $13 ($15-$2)**

Next you need to consider any constraining estimates of the variable consideration determined and if it is probable that there will be a significant reversal of the above transaction price. Including: Consideration is susceptible to factors outside the entity's influence, uncertainty is not expected to be resolved for a long time, experience with similar contracts is limited, entity has a practice of offering broad range of concessions, or large number of possible outcomes). **Assume none.**

Entry

Cash $15
Revenue $13
Refund Liability $2

**Re-evaluate the liability at the end of each period.

Practical matter: Could determine refunds are not material to the financial statements and that most are resolved in a timely fashion, therefore impact to any period is insignificant.

Deposit Service Fees and Charges:

Step 4: Allocating the Transaction Price to the Performance Obligations

Guidance

Allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis.

Analysis

In the case of most charges on deposit products, the fees are set and charged based on each distinct performance obligation.

Deposit Service Fees and Charges:
Step 5: Recognize Revenue When (or as) Performance Obligations Are Satisfied

Guidance

Allocate the transaction price to each performance obligation identified in the contract on a relative stand-alone selling price basis.

Control is either transferred over time or at a point in time

To determine the point in time when control transfers consider the following:
have present right to payment, customer has legal title to the asset, physical transfer of the asset has occurred, customer has significant rewards and ownership of the asset.

Analysis

In the case of most charges on deposit products, the fees are set and charged based on each distinct performance obligation.

Deposit Service Fees and Charges:

Takeaways

Not much has changed as it relates to the timing of revenue recognition on deposit service fees and charges unless you believe that there are constraints on variable consideration that could materially impact the transaction price.

If any of your products have upfront fees these would be recorded as a contract liability until the performance obligation was complete. **This is likely similar to current day accounting.**

Deposit Service Fees and Charges:

Disclosures

Since a depository arrangement is likely a day to day contract with ongoing renewal options, the duration of the contract does not extend beyond the service performed, therefore, the following would not apply:

- Disclosure of contract balances
- Disclosure of remaining performance obligations
- No significant judgments about amount or timing of deposit fee revenue

Should consider whether disaggregation of revenue applies and what is significant to your organization. Ways to disaggregate revenue on deposit service fees and charges might be based on the following:

- Type of service charge
- Types of deposit products
- Geography of the customers

Gain/Loss on Sale of Other Real Estate Owned

Gain/Loss on Other Real Estate Owned

Step 1: Identify the Contract

A contract exists if all of the following criteria

Parties have approved the contract and are committed to perform their obligations

Each party's rights can be identified

Payment terms can be identified for the goods and services to be performed

Contract has commercial substance

It is probable that the entity will collect the consideration to which it is entitled, considering only the customer's ability and intention to pay when the consideration is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession

Entities should consider whether an arrangement with a customer includes enforceable rights and obligations. An entity should then apply the guidance to the contractual period over which the parties have present enforceable rights and obligations.

Gain/Loss on Other Real Estate Owned

Step 1: Identify the Contract

This example relates to sales of OREO in which the financial institution is financing the sale. In instances where the sale is financed elsewhere, gain or loss might be recognized immediately.

Analysis:

Generally criteria 2-4 will all be satisfied by the contract.

Next, the entity needs to determine whether the parties are committed to perform their obligations and if so, whether it is probable that they will collect substantially all of the consideration to which they are entitled.

The Company should evaluate based on the transaction price which may include price concessions.

Gain/Loss on Other Real Estate Owned

Step 1: Identify the Contract

Collectability

When assessing collectability these factors could include but are not limited to:

- Amount of cash paid as a down payment
- Existence of recourse provisions
- Financing terms
- Credit rating of the buyer
- Loan to Value (LTV) ratio of the seller financing
- Property specific facts and circumstances (age, location, current cash flow and whether the property is owner-occupied)
- Non-customary financing terms
- Seller involvement in the property after the sale
- Cash flow from the property

Analysis

If all of the criteria are met on the previous slide and the contract creates enforceable rights then a contract exists between the entity and the buyer.

Or

If the entity concludes that the buyer is not committed to perform their obligations and/or collectability is not probable then a contract does not exist and the OREO asset may not be derecognized. Therefore, no revenue may be recognized.

Gain/Loss on Other Real Estate Owned

Step 2: Identify the Performance Obligations

Guidance

Identify goods and services that are distinct or a series of distinct goods or services that are substantially the same and have the same pattern of transfer.

If a promised good or service is not distinct, an entity shall combine that good or service with other promised goods or services until it identifies a bundle of goods or services that is distinct. In some cases, that would result in the entity accounting for all the goods or services promised in a contract as a single performance obligation.

Analysis:

The performance obligation in a sale of OREO typically will be the transfer of the property to the buyer.

Gain/Loss on Other Real Estate Owned

Step 3: Determine the Transaction Price

While the transaction price is explicitly stated in the contract between the financial institution and the buyer of the OREO property, the seller must consider guidance in 606-10-32-15 through 20 regarding a significant financing component.

If the financing arrangement uses market terms, then the transaction price will generally be the price stated in the contract.

If the financing arrangement is not at market terms then the transaction price may differ. The transaction price would be determined by discounting the stated consideration at a market rate of interest

Price concessions expected are determined to be variable consideration and should be evaluated when determining the transaction price.

This transaction price will be used to calculate the gain or loss on sale.

Objective: Recognize revenue at an amount that reflects the price that would have been paid if the customer paid cash.

Gain/Loss on Other Real Estate Owned

Step 3: Determine the Transaction Price

There are 3 scenarios for which a significant financing component would not apply:

The customer paid for the goods or services in advance, and the timing of the transfer of those goods or services is at the discretion of the customer.

A substantial amount of the consideration promised by the customer is variable, and the amount or timing of that consideration varies on the basis of the occurrence or nonoccurrence of a future event that is not substantially within the control of the customer or the entity (for example, if the consideration is a sales-based royalty).

The difference between the promised consideration and the cash selling price of the good or service (as described in paragraph 606-10-32-16) arises for reasons other than the provision of finance to either the customer or the entity, and the difference between those amounts is proportional to the reason for the difference. For example, the payment terms might provide the entity or the customer with protection from the other party failing to adequately complete some or all of its obligations under the contract

Gain/Loss on Other Real Estate Owned

Step 3: Determine the Transaction Price

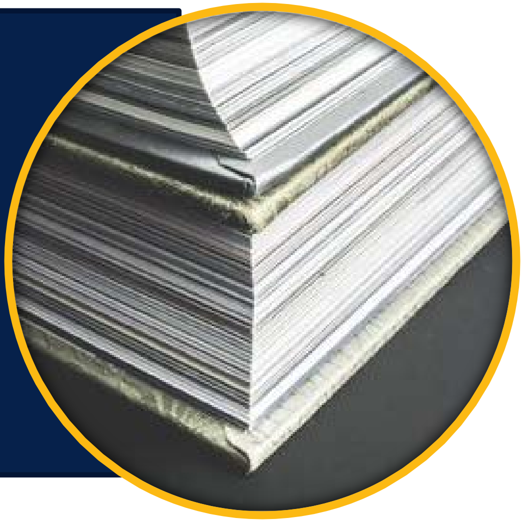
Practical Expedient

If the period of payment is expected to be one year or less, an entity is not required to adjust for the effects of a significant financing component.

Gain/Loss on Other Real Estate Owned

Step 4: Allocating the Transaction Price to the Performance Obligations

The transaction price for the sale of OREO is allocated to the single performance obligation which is the transfer of the property to the buyer.



Gain/Loss on Other Real Estate Owned

Step 5: Recognize Revenue When (or as) Performance Obligations Are Satisfied

Gain/Loss on Sale of OREO will be recognized at a point in time.

To determine the point in time when control transfers consider the following: have present right to payment, customer has legal title to the asset, physical transfer of the asset has occurred, customer has significant rewards and ownership of the asset.

The OREO asset will be derecognized when control of the asset passes to the buyer. This is generally at closing, however consider legal or other restrictions that would preclude the buyer from obtaining control of the property at the closing date. For example, if there are redemption rights that allow the original debtor to reclaim the property, the OREO asset would not be derecognized until the redemption period expires.

Gain/Loss on Other Real Estate Owned

Takeaways

- Under Topic 606, revenue might be recognized sooner than under the previous method.
- Under the previous methods, the gain on sale of OREO in a seller financed transaction required a minimum down payment of 5-25% for full profit recognition, otherwise the installment method, cost-recovery method, reduced profit method or deposit methods were used to record revenue which deferred recognition of the gain on sale.
- If an asset cannot be derecognized under Topic 606, the payments received from the borrower are recorded as a contract liability.
- Don’t forget to assess significant financing components or price concessions in determining the transaction price.

Gain/Loss on Other Real Estate Owned

Disclosures

Most entities are seeing declining OREO balances, therefore gain/loss on sale of OREO for financed transactions may not be material.

Discuss any significant payment terms such as significant financing components

If a contract liability exists, as discussed in the previous slide the following disclosures are required:

- Opening and closing balance of contract liability
- Revenue recognized in the reporting period for the current reporting period as well as revenue that recognized in the reporting period for performance obligations satisfied in previous periods
- Explain how the timing of the satisfaction of the performance obligation relates to typical timing of payment and how those impact the contract liability.
- Discuss any significant changes in the contract liability during the reporting period.

Consider if further disaggregation is necessary in order to depict how the nature, amount, timing and uncertainty of revenue and cash flows are affected by economic factors.

Polling Question #3

What would not be a good way to disaggregate revenue?

A. Geography

B. Duration of the contract

C. Alphabetical order

D. Type of customer

Asset Management Fees

Asset Management Fees

Step 1: Identify the Contract

A contract exists if all of the following criteria is met:

Parties have approved the contract and are committed to perform their obligations

Each party’s rights can be identified

Payment terms can be identified for the goods and services to be performed

Contract has commercial substance

It is probable that the entity will collect the consideration to which it is entitled, considering only the customer’s ability and intention to pay when the consideration is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession

Entities should consider whether an arrangement with a customer includes enforceable rights and obligations. An entity should then apply the guidance to the contractual period over which the parties have present enforceable rights and obligations.

Asset Management Fees

Step 1: Identify the Contract

Contracts between a financial institution and an asset management customer are generally documented in writing which identifies all of the terms of the contract.

It is probable that the fees will be collectible as funds being managed are accessible by the asset manager.

In addition, asset management contracts typically have enforceable rights and generally have a stated duration, which informs an entity as to the period over which rights and obligations exist.

Asset Management Fees

Step 2: Identify the Performance Obligations

The performance obligation of the asset manager is generally to make investment decisions on the funds deposited by the customer.

According to 606-10-25-14(b), this would qualify as a series of distinct goods or services that are substantially the same pattern of transfer to the customer

AND

According to 606-10-25-27, the customer simultaneously receives and consumes the benefits provided by the entity's performance as the entity performs.

Asset Management Fees

Step 3: Determine the Transaction Price

Guidance

Generally, an asset management contract specifies the transaction price as a fee per dollar of assets under management either using a point in time or average over a period. These contracts can also include incentive fees that are based on a % of investment returns.

Each fee above represents variable consideration.

When evaluating variable consideration, you are required to consider constraining estimates and determine whether it is probable that a significant reversal would not occur.

One of the items to consider is:
Susceptibility to factors outside the entity's influence, such as market volatility

Asset Management Fees

Step 3: Determine the Transaction Price

Analysis

The amount of transaction price is typically subject to certain contingencies outside of the control of the asset manager, such as market volatility, and may have a broad range of possible consideration amounts. Therefore it might be reasonable that neither of these fees should be included in the transaction price at the beginning of the period.

Fees can be assessed monthly/quarterly/annually, therefore at the end of the period, the entity should reassess whether the constraining factors have been resolved and can at that time include both the asset management fee as well as the incentive fee into the transaction price.

Note

The incentive fee may cover different periods of time or may contain clawback features that are required to be considered.

Asset Management Fees

Step 4: Allocating the Transaction Price to the Performance Obligations

The transaction price for the asset management fees is allocated to the single performance obligation which was determined to be the asset management services that are performed in the service period (i.e., month/quarter/year).

The incentive fees would be similarly tied to the single performance obligation of managing the fund over the period in which the incentive based on.

Asset Management Fees

Step 5: Recognize Revenue When (or as) Performance Obligations Are Satisfied

Asset management fees will generally be recognized at the end of the period (month/ quarter/year as designated in the contract) because this is the point in time that the uncertainty with respect to the constraint on the estimate of management fees is resolved.

Incentives are generally tied to fund performance, the constraint on the incentive fees might be resolved at the end of the incentive period (month/quarter/year) depending on how the incentive is structured and when the uncertainty is resolved

Asset Management Fees

Takeaways

Revenue is generally deferred to the end of the period (month/quarter/year as designated in the contract) due to the uncertainty of factors that are outside of the entity's influence and have a broad range of possibilities and are therefore not predictive

Incentive fees may contain claw-back provisions that prevent the entity from recording revenue even if payment has already been made. In this instance a contract liability would be recorded until uncertainty related to the claw-back provisions were removed.

Asset Management Fees

Disclosures

Disaggregated Revenue	Determine if further disaggregation is necessary in order to depict how the nature, timing, and uncertainty of revenue and cash flows are affected by economic factors
Contract Balance:	Generally contract assets or liabilities would not exist as the revenue would be recorded at the end of the month/quarter and funds would be remitted simultaneously out of the customer's account.

In the situation of incentive fees, the entity may need to show contract liability if cash has been received but claw-back features are in place

If a contract asset, contract liability or receivable exists, opening and closing balances shall be disclosed as well as the revenue recognized in the reporting period and revenue recognized in the period from performance obligations satisfied in previous periods

Disclosure of the timing of the satisfaction of the performance obligations should also be disclosed and timing of typical payments and the effect on contract asset and contract liability balances.

Asset Management Fees

Performance Obligations

Need to disclose information about the performance obligation and payment terms. Can elect the Practical Expedient to exclude remaining term of performance obligation if term is less than one year.

Significant Judgments

As it relates to incentive fees and claw-back features, disclosure of judgments and changes in judgments should be made as it relates to timing of satisfaction of performance obligations and the transaction price and amounts allocated to the performance obligations.

Would also disclose that based on variable constraint due to market conditions, all revenue is recognized at the end of the month/quarter.

Interchange Fees

Interchange Income

What is going on with interchange?

Is it out?

Is it in?

Interchange Fees

Step 1: Identify the Contract

A contract exists if all of the following criteria is met:

Parties have approved the contract and are committed to perform their obligations

Each party's rights can be identified

Payment terms can be identified for the goods and services to be performed

Contract has commercial substance

It is probable that the entity will collect the consideration to which it is entitled, considering only the customer's ability and intention to pay when the consideration is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession

Entities should consider whether an arrangement with a customer includes enforceable rights and obligations. An entity should then apply the guidance to the contractual period over which the parties have present enforceable rights and obligations.

Interchange Fees
Step 1: Identify the Contract

Let's assume we are referring to debit card interchange

Who is the customer?

Is it the Merchant who sells the goods and sets the price of the goods?

Is it the cardholder with whom you have a formal written contract and who has funds on deposit at your institution?

Or are you the customer of the payment network?

Let's discuss…

Interchange Fees
Step 1: Identify the Contract

A contract exists if all of the following criteria is met:

Parties have approved the contract and are committed to perform their obligations

Each parties rights can be identified

Payment terms can be identified for the goods and services to be performed

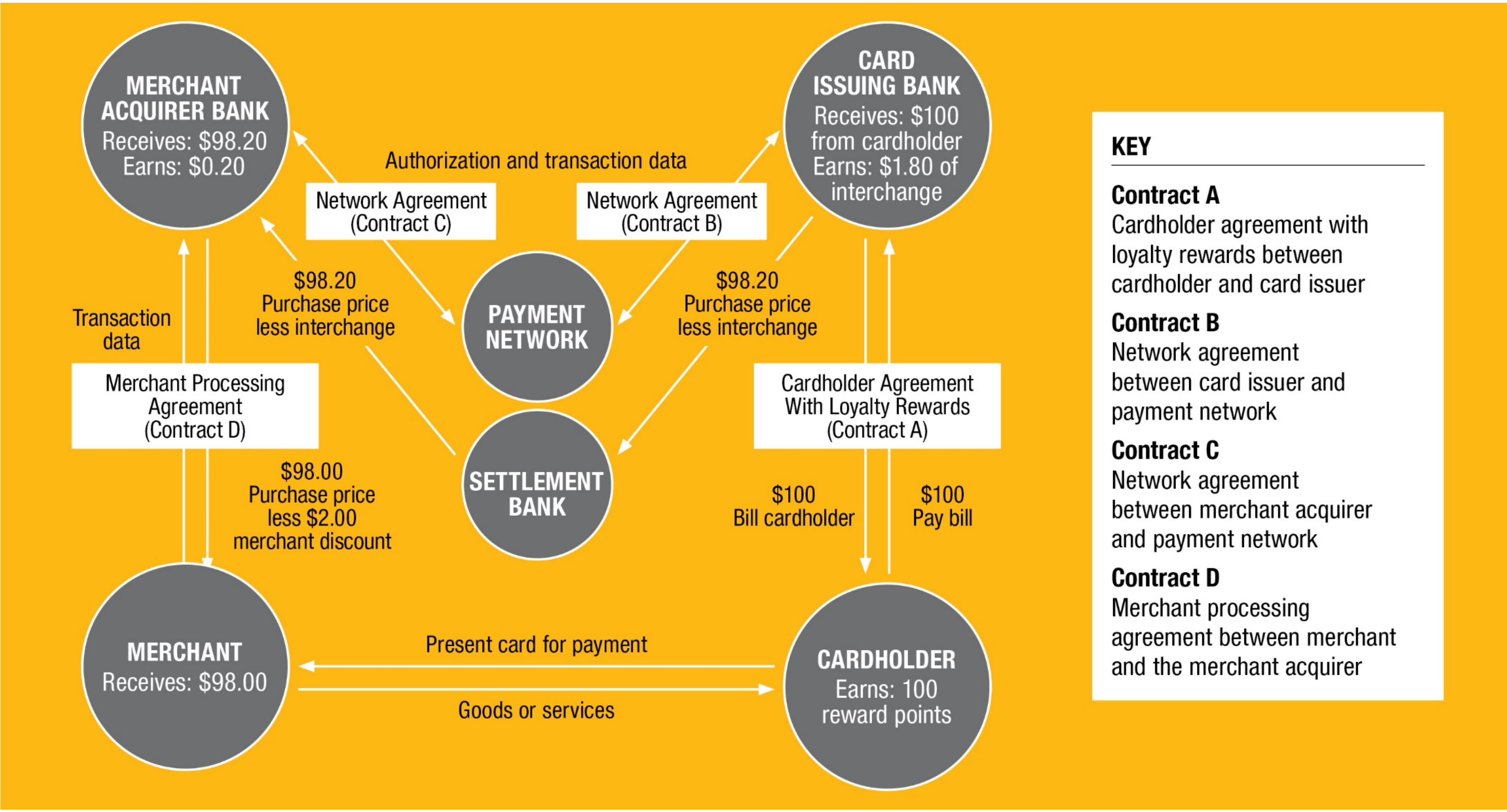
Contract has commercial substance

It is probable that the entity will collect the consideration to which it is entitled, considering only the customer's ability and intention to pay when the consideration is due. The amount of consideration to which the entity will be entitled may be less than the price stated in the contract if the consideration is variable because the entity may offer the customer a price concession

Entities should consider whether an arrangement with a customer includes enforceable rights and obligations. An entity should then apply the guidance to the contractual period over which the parties have present enforceable rights and obligations.

One might determine that in all of the previous scenarios, that a contract exists.

Interchange Flowchart



Source: TRG Paper 36

Interchange Fees

Step 2: Identify the Performance Obligations

The Card Issuer performs a bundle of services that together are distinct at the time of the swipe (e.g. giving the cardholder access to their funds, performing fraud monitoring on the transaction, etc.) which result in one performance obligation: approving the transaction which results in interchange fees.

The Card Issuer either gave the customer access to funds through the use of the card on an as needed basis or gave the Merchant access to a broader customer base than it may not have had otherwise.

Interchange Fees

Step 3: Determine the Transaction Price

The transaction price is the interchange fee, which is derived based on a complex set of calculations and can change based on various fact patterns. This fee is calculated, collected and remitted by the individual payment networks.

Interchange fees likely represents variable consideration and the entity should determine if any refunds, chargebacks or other reversals should be considered in determining the transaction price. In the rest of the example, we will assume no significant activity that would cause reversals.

Visa USA Consumer Check Card Exempt and Regulated Interchange Reimbursement Fees
Visa USA Interchange Reimbursement Fees

A Visa USA Consumer Check Card Exempt and Regulated Interchange Reimbursement Fees

Rates Effective October 14, 2017

Fee Program	Exempt Visa Check Card	Regulated Visa Check Card
Card Present Transactions		
CPS/Supermarket, Debit	$0.30	0.05% + $0.21*
CPS/Retail, Debit	0.80% + $0.15	0.05% + $0.21*
CPS/Automated Fuel Dispenser (AFD), Debit	0.80% + $0.15 ($0.95 Cap)	0.05% + $0.21*
CPS/Service Station, Debit	0.80% + $0.15 ($0.95 Cap)	0.05% + $0.21*
CPS/Small Ticket, Debit	1.55% + $0.04[1]	0.05% + $0.21*
CPS/Restaurant, Debit	1.19% + $0.10	0.05% + $0.21*
CPS/Hotel and Car Rental Card Present, Debit	1.19% + $0.10	0.05% + $0.21*
CPS/Passenger Transport Card Present, Debit	1.19% + $0.10	0.05% + $0.21*
Travel Service, Debit	1.19% + $0.10	0.05% + $0.21*
CPS/Retail Key Entry, Debit[2]	1.65% + $0.15	0.05% + $0.21*
Card Not Present Transactions		
CPS/Retail 2 – Card Not Present, Debit	0.65% + $0.15 ($2.00 Cap)	0.05% + $0.21*
CPS/Debt Repayment	0.65% + $0.15 ($2.00 Cap)	0.05% + $0.21*
CPS/Utility, Debit	$0.65	0.05% + $0.21*
CPS/Government	0.65% + $0.15 ($2.00 Cap)	0.05% + $0.21*
CPS/Card Not Present, Debit	1.65% + $0.15	0.05% + $0.21*
CPS/e-Commerce Basic, Debit	1.65% + $0.15	0.05% + $0.21*

14 October 2017 Visa Public 3

Interchange Fees

Step 3: Determine the Transaction Price

Principal vs Agent

606-10-55-36	When another party is involved in providing goods or services to a customer, the entity should determine whether the nature of its promise is a performance obligation to provide the specified goods or services itself (that is, the entity is a principal) or to arrange for those goods or services to be provided by the other party (that is, the entity is an agent).

Principal

606-10-55-37

An entity is a principal if it controls the specified good or service before that good or service is transferred to a customer. ….. 606-10-55-37B When (or as) an entity that is a principal satisfies a performance obligation, the entity recognizes revenue in the gross amount of consideration to which it expects to be entitled in exchange for the specified good or transferred.

Agent

606-10-55-38

An entity is an agent if the entity's performance obligation is to arrange for the provision of the specified good or service by another party. An entity that is an agent does not control the specified good or service provided by another party before that good or service is transferred to the customer. When (or as) an entity that is an agent satisfies a performance obligation, the entity recognizes revenue in the amount of any fee or commission to which it expects to be entitled in exchange for arranging for the specified goods or services to be provided by the other party. An entity's fee or commission might be the net amount of consideration that the entity retains after paying the other party the consideration received in exchange for the goods or services to be provided by that party.

Interchange Fees

Step 3: Determine the Transaction Price

The financial institution never receives the gross amount of the interchange deducted from the transaction amount paid to the merchant because of the various pieces that are deducted at various points in the interchange process.

ASU 2016-08, BC37-BC38- Book the amount you are due when you do not know the overall transaction price.

Based on various discussions with financial institutions, interchange is currently recorded net in the settlement process.

Gross vs. Net

Interchange Fees

Step 4: Allocating the Transaction Price to the Performance Obligations

The transaction price determined in the previous step is allocated to the single performance obligation identified in Step 2 which is each debit card transaction. Debit card transactions take many forms such a swipe which uses PIN or signature, online purchases, ACH purchases, etc. Each type has a separate interchange fee.

Interchange Fees

Step 5: Recognize Revenue When (or as) Performance Obligations Are Satisfied

ASC 606 requires an entity to recognize revenue when or as the entity satisfies its performance obligation.

Therefore once the Cardholder has purchased the goods or services with the “swipe” of their debit card, the Merchant is then entitled to receive their payment for the goods, net of the interchange fees to be remitted to the payment network and Card Issuer. At this point, both the Merchant and the Cardholder have received benefits from the transaction.

Interchange fees are generally settled with their payment network on a daily basis. If interchange is not settled daily, then a contract asset should be recorded to account for the services performed that have not yet been paid.

Interchange Fees

Takeaways

- Interchange is complex due to the assumptions that the financial institution needs to make in their analysis.
- It is expected that the industry will continue to record interchange in the same manner, which is to book the amount due when you receive the settlement from the payment network.
- If your debit/credit cards have a rewards program, common current practice is to net rewards costs with interchange. This practice is expected to continue under the new standard.
- **Key takeaway:** Given the variation of approaches in this area such as who is the customer, are rewards involved, etc. it is important to disclose how you are accounting for each of the pieces of interchange.

Interchange Fees

Disclosures:

Disaggregated Revenue: Determine if further disaggregation is necessary in order to depict how the nature, timing, and uncertainty of revenue and cash flows are affected by economic factors.

Contract Balance: Contract balances are likely immaterial unless a large upfront payment from the payment network was made that could be refunded.

If a contract asset, contract liability or receivable exists, opening and closing balances shall be disclosed as well as the revenue recognized in the reporting period and revenue recognized in the period from performance obligations satisfied in previous periods.

Disclosure of the timing of the satisfaction of the performance obligations should also be disclosed and timing of typical payments and the effect on contract asset and contract liability balances.

Performance Obligations: Need to disclose information about the performance obligation, payment terms. Can elect the Practical Expedient to exclude the remaining term of performance obligation if term is less than one year.

Significant Judgments: None identified in scenario but could be unique to the entity.

Polling Question #4

Who are the various parties in a transaction that results in interchange fees?

A. Merchant

B. Cardholder

C. Payment Network

D. All of the above

Transition Methods

Full Retrospective Method – requires application to all prior periods presented

Modified Retrospective Method – allows the option to account for either all contracts or just open contracts on the transition date.

A cumulative adjustment is made to opening retained earnings

Prior periods are not restated

We expect most financial institutions to adopt using the modified retrospective method.

Control Environment and Other

Audit Committee (or equivalent) responsibility

- Understand the new standard
- Evaluate the Company's impact and what will change
- Evaluate the implementation plan
- Understand transition method and disclosures

Ensure internal controls are both designed and put into operation in regards to:

- Ensuring that all new contracts flow through the appropriate channels for review
- Determining in-scope revenue streams and application its of Topic 606.
- This review should be documented.

All departments should be trained and educated of the standard, so that contracts can be appropriately considered.

Consider if your current IT systems have the capability to generate data needed for the new required disclosures.

Control Environment and Other

Additional Considerations

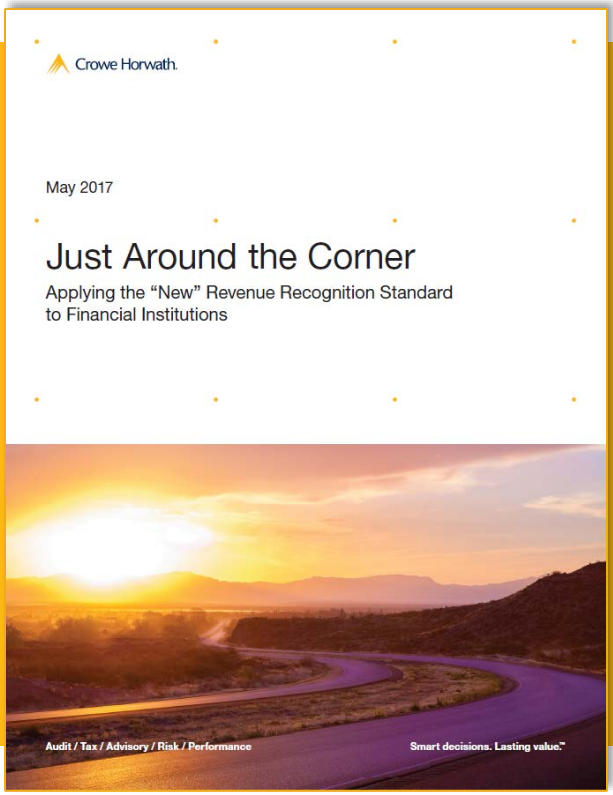
Sale with right of return	Warranties	Principal versus agent considerations
Customer options for additional goods or services	Customers’ unexercised rights	Nonrefundable upfront fees
Licensing	Sales-based or usage-based royalties	Repurchase agreements
Consignment arrangements	Bill-and-hold arrangements	Customer acceptance

If any of these additional consideration items come into play, refer to the standard in order to evaluate the impact that it may have on revenue recognition. Controls should be designed and operating to identify these types of issues.

Resources

“Just Around the Corner: Applying the ‘New’ Revenue Recognition Standard to Financial Institutions”

- Issued May 25, 2017 (24 pages)
- Contents
  - Standardizing Revenue Recognition Practices
  - Evaluating a Financial Institution’s Revenue Streams: What Is In and What Is Out?
  - For Revenue in Scope: Now What?
  - Disclosures
  - Effective Date and Transition



Crowe Horwath.

Thank you

Leslie Yates

Senior Manager

Financial Services Audit Practice

Crowe Horwath LLP

Office 574.236.2423

leslie.yates@crowehorwath.com