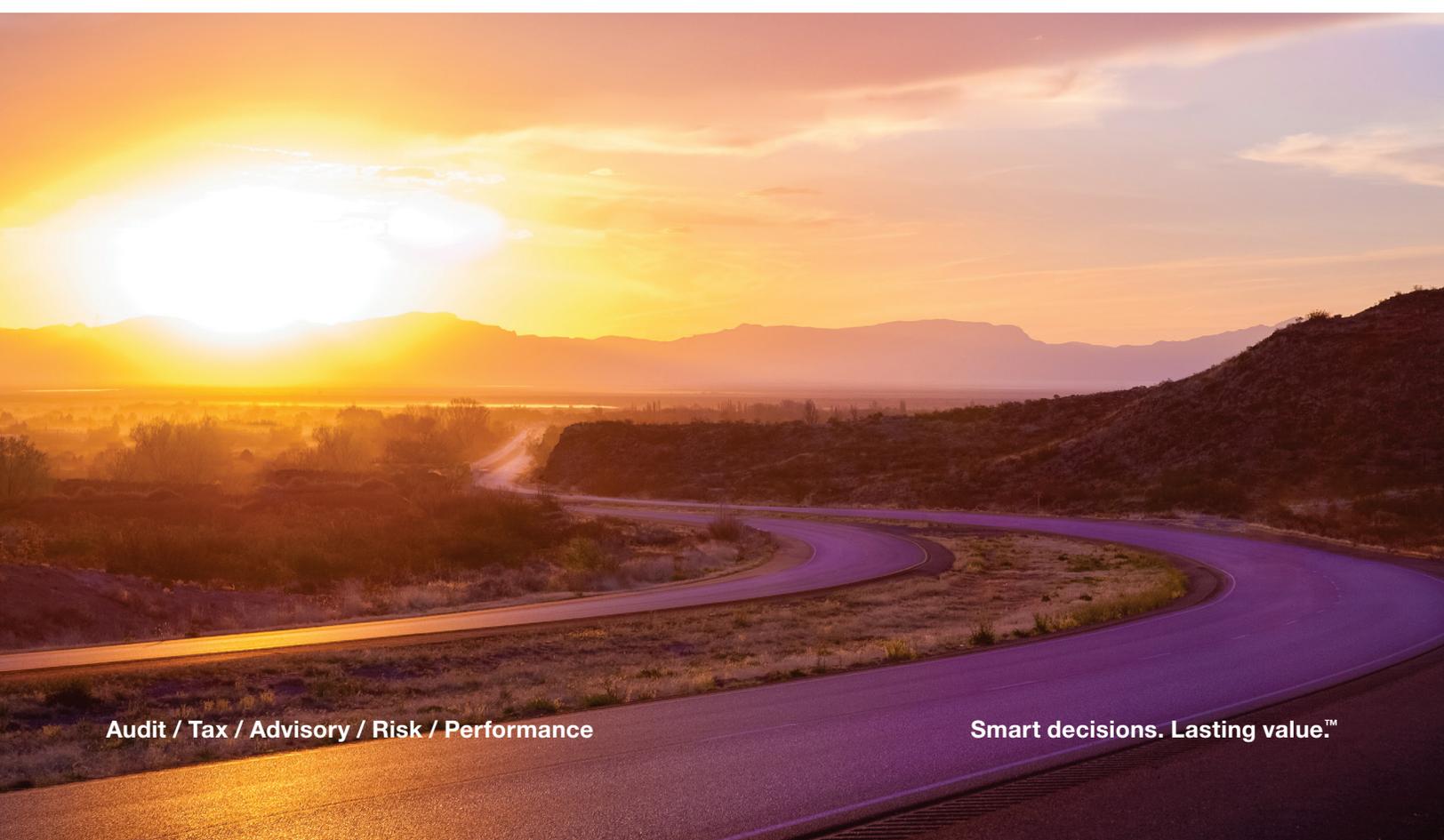


May 2017

# Just Around the Corner

Applying the “New” Revenue Recognition Standard  
to Financial Institutions



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## Executive Summary

It is probably time to cease referring to the Financial Accounting Standards Board's (FASB's) revenue recognition standard, one of FASB's major standards, as "new," given it was issued three years ago in May 2014. FASB purposely provided a lengthy implementation period, but the effective date is just around the corner. For financial institutions that are public business entities (PBEs), the standard becomes effective for annual reporting periods beginning after Dec. 15, 2017 – which means Jan. 1, 2018, for calendar year-ends. Financial institutions that are not PBEs have more time; for them, the standard is effective for annual reporting periods beginning after Dec. 15, 2018.

Wholesale changes are not expected for the financial institution industry, given that most financial instruments (including debt securities, loans, and derivatives) are not in the scope. However, some effort for financial institutions is required. In some cases, how revenue is recognized will change. In other cases, new disclosures will be required. As such, it is important to evaluate all revenue streams, especially noninterest income. It is also important to consider any needed changes to internal controls over financial reporting to evaluate revenue going forward.

## Topic 606: Standardizing Revenue Recognition Practices

Revenue recognition guidance according to current generally accepted accounting principles (GAAP) in the United States was developed on a piecemeal basis with specific guidance applicable to certain industries or transactions. As a result, revenue recognition practices can be different for economically similar transactions. In May 2014, the FASB issued Accounting Standards Update (ASU) 2014-09, “Revenue from Contracts with Customers (Topic 606),” which specifies a standardized approach for revenue recognition across industries and transactions. The FASB subsequently issued additional ASUs to defer the effective date of ASU 2014-09 by one year and to provide additional clarifications.

Though Topic 606 will affect many industries, many transactions common to financial institutions are outside the scope of Topic 606. Some revenue streams for financial institutions, however, are in scope, and each revenue stream will need to be evaluated. Some common transactions, such as service charges on deposit accounts, for example, will likely be within the scope of Topic 606, while transactions such as certain credit card fees are not within the scope of Topic 606. Sales of other real estate owned are within the scope of new Subtopic 610-20. Certain implementation and scope questions (for example, interchange fees) have not yet been formally addressed.

To assist in addressing implementation questions, the FASB created the Revenue Recognition Transition Resource Group (TRG), to solicit, analyze, and discuss stakeholder questions and issues arising from implementation of ASU 2014-09. Since its formation, the TRG has informed the FASB about implementation issues, and this has helped the board determine what, if any, action needed to be taken to address those issues. In addition, the TRG assists stakeholders in learning about the guidance from others involved with implementation. The TRG has addressed certain issues of specific interest to financial institutions, including [Memo Number 52: “Scoping Considerations for Financial Institutions” \(TRG Paper 52\)](#), [Memo Number 55: “April 2016 Meeting – Summary of Issues Discussed and Next Steps” \(TRG Paper 55\)](#), [Memo Number 36: “Credit Cards” \(TRG Paper 36\)](#), and [Memo Number 44: “July 2015 Meeting – Summary of Issues Discussed and Next Steps” \(TRG Paper 44\)](#).

The American Institute of Certified Public Accountants (AICPA) also has 16 industry-specific revenue recognition task forces, one of which is focused on [depository and lending institutions](#). According to the AICPA, the task force is “charged with developing revenue recognition implementation issues that will provide helpful hints and illustrative examples for how to apply the new revenue recognition standard.” Examples of issues addressed by the task force include scoping questions as well as sales of real estate.

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## Evaluating a Financial Institution's Revenue Streams: What Is In and What Is Out?

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

Exhibit 1 depicts common line items in a financial institution's income statement and whether the revenue stream is typically in or out of the scope of Topic 606.

### Exhibit 1: Revenue Streams In and Out of Scope of Topic 606

DESCRIPTION	IN SCOPE	OUT OF SCOPE
<b>Interest income</b>		
Loans		X
Lease financing receivables		X
Securities (including dividend income)		X
<b>Noninterest income</b>		
Service charges on deposit accounts	X	
Trading revenue (e.g., derivatives, cash instruments)		X
Loan servicing fees		X
Gains and losses on sales of other real estate owned (OREO)	X	
<b>Other noninterest income</b>		
Credit card fees		
Balance transfer fees		X
Cash advance and foreign exchange fees		X
Annual fees		X
Interchange fees	See note A	
Financial guarantee fees		X
Asset management fees	X	

Source: Crowe Horwath LLP

Note A: As of the date of writing, no definitive conclusion has been reached on interchange fees. The TRG has not specifically considered the issue, and the AICPA Depository and Lending Institutions Revenue Recognition Task Force has not yet addressed this issue.

Although the information is not included in Exhibit 1, a financial institution might also have an insurance company subsidiary or a broker-dealer subsidiary from which it generates revenue. Insurance contracts issued by an entity in the scope of ASC 944 are specifically out of the scope of Topic 606, though Topic 606 would apply to an insurance contract issued by an entity that is not within the scope of ASC 944.

Many revenue streams of a broker-dealer subsidiary, including trading commissions, investment banking or advisory fees, and underwriting fees, are in the scope of Topic 606. Interested stakeholders can find additional discussion of revenue recognition issues in the broker-dealer industry on the Crowe Horwath LLP [broker-dealer industry](#) web page or on the AICPA [“Brokers and Dealers in Securities Revenue Recognition Task Force”](#) web page.

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While some revenue streams are clear cut as to whether they should be included or excluded from Topic 606, some – like service charges on deposit accounts, loan servicing fees, gains and losses on sales of other real estate owned (OREO), credit card fees, interchange fees, and financial guarantee fees – have required additional discussion to determine their inclusion. Each of these revenue streams, and the considerations related to their inclusion or exclusion from Topic 606, is discussed in detail below. We conclude the section with a brief discussion of asset management fees.

## Service Charges on Deposit Accounts: In Scope

When a customer makes a deposit, the institution records a liability under ASC 405 because the institution has an obligation to deliver cash to its customer on demand. Customers often pay certain fees to the financial institution to access the cash on deposit including certain non-transactional fees such as account maintenance or dormancy fees, and certain transaction-based fees such as ATM, wire transfer, or foreign exchange fees.

The TRG discussed, in TRG Paper 52, three distinct views with respect to whether deposit fees are in the scope of Topic 606. In the first view, deposit fees are linked to an agreement that is accounted for outside the scope of Topic 606 (that is, the contractual obligation from the depository agreement is accounted for under ASC 405), and therefore deposit fees associated with the arrangement would also be outside the scope of Topic 606, notwithstanding ASC 405 does not provide recognition guidance for fees. In addition, this view might have led to a different accounting analysis for fees earned from deposit relationships when compared to fees for noncustomers.

Under the second view, transaction-based deposit fees are within the scope of Topic 606, but nontransaction-based deposit fees are not within the scope of 606 because the fees do not relate to a service provided by the financial institution. Rather, nontransaction-based fees merely encourage customer behavior.

All deposit fees are within the scope of Topic 606 under the third view. The basis for this view is that the FASB indicated in the basis for conclusions in ASU 2014-09 that contractual rights or obligations that fall under other topics, where specific guidance exists in those topics, would not be within the scope of Topic 606; however, there is no other explicit or implicit guidance elsewhere in GAAP that addresses deposit fees.

The TRG concluded that all deposit fees are within the scope of Topic 606, noting that if deposit fees were not within the scope of Topic 606, there would be a void in GAAP with respect to recognition of such fees. The TRG also expressed concerns that preparers would look to other more complex GAAP if deposit fees were not within the scope of Topic 606.

## Loan Servicing Fees: Out of Scope

Topic 606 specifically excludes transactions within the scope of Topic 860 (Transfers and Servicing); however, Topic 860 only provides guidance on whether an intangible servicing asset or liability should be recognized when the compensation for the servicing activities (for example, mortgage servicing) is either above or below the going market rate for those services. Topic 860 does not provide recognition guidance for servicing fees earned, and stakeholders questioned the appropriate recognition model for such compensation.

Some stakeholders believed that Topic 860 provides implicit guidance on the recognition of servicing fees because the subsequent measurement of the intangible servicing asset or liability and the servicing fees cash flows are inextricably linked (that is, the measurement of the servicing asset or liability necessarily takes into consideration the fees earned from servicing).

In contrast, other stakeholders believed that because Topic 860 does not address recognition of servicing fees, Topic 606 would apply by default. The TRG concluded that fees earned from servicing activities are outside the scope of Topic 606 because the TRG found merit in the argument that Topic 860 provides implicit recognition guidance. Finally, TRG Paper 52 notes the FASB staff would not be concerned if an entity “refers to the accounting framework described in Topic 606 to assist with recognition conclusions for servicing income or to provide the disclosures required by Topic 606 to the extent they are applicable and incremental to the disclosure requirements of Topic 860.”

## Gains and Losses on Sales of Other Real Estate Owned (OREO): In Scope

Topic 606 applies to an entity’s contracts with a customer. As defined in the standard, a customer is “a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities in exchange for consideration.” The ordinary activities of a financial institution do not include buying and selling real estate, and the sale of foreclosed real estate by an institution is not within the scope of Topic 606. However, ASU 2014-09 also added new Subtopic 610-20 (as clarified by ASU 2017-05), which addresses the recognition of gains and losses on the transfer of nonfinancial and in-substance nonfinancial assets. Subtopic 610-20 requires an entity to apply certain recognition and measurement aspects of Topic 606 to transfers of nonfinancial and in-substance nonfinancial assets, which collectively include the sale of OREO by a financial institution.

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## Credit Card Fees: Out of Scope, With Possible Exceptions

Financial institutions that issue credit cards typically have multiple fee-based revenue streams that come from cardholders, including interest income, balance transfer fees, late fees, cash advance fees, foreign exchange fees, over-limit fees, or overdraft protection fees. Topic 310 provides explicit guidance on recognition of these types of fees, which means such fees are not within the scope of Topic 606. Stakeholders requested the TRG consider whether or not annual fees are within the scope of Topic 606 because the card issuer might also provide goods or services (for example, concierge service or airport lounge access) in exchange for the annual fee. While Topic 310 refers only to fees, Topic 606 refers to goods or services, and stakeholders thus questioned whether the ancillary services provided to the cardholder should be accounted for under Topic 606.

The TRG observed that both Topic 310 and the basis for conclusions in Statement of Financial Accounting Standards Number 91 (SFAS 91) refer to credit card fees as relating to services provided to cardholders or services provided during the commitment period. The TRG also considered the results of additional outreach that indicated all credit card fees are accounted for under Topic 310 prior to the adoption of ASU 2014-09. Therefore, the TRG concluded that credit card fees are not within the scope of Topic 606 and will continue to be accounted for under Topic 310.

TRG Paper 36 observes that financial institutions should not assume all of their arrangements are outside the scope of Topic 606. For example, an institution might offer asset management services to its credit card clients for a fee. Fees for asset management services would likely be within the scope of Topic 606.

Similarly, an entity might enter into an arrangement in which the entity issues a credit card to a customer along with transferring control of an automobile to a customer for a fee. While such an arrangement might include a component that is a credit card lending arrangement, the overall substance of such an arrangement must be evaluated to determine the appropriate accounting, and it would likely be inappropriate to conclude that the entirety of the arrangement is within the scope of Topic 310.

Stakeholders also asked the TRG to consider whether credit card rewards programs are within the scope of Topic 606. The TRG believes that if fees for a rewards program are in the scope of Topic 310, then the rewards program is not in the scope of Topic 606.

### **Crowe Observation**

An entity with a rewards program will need to consider the appropriate presentation of the costs related to such a program (for example, as contra-revenue or as an expense).

## Interchange Fees: Unclear as to In/Out of Scope

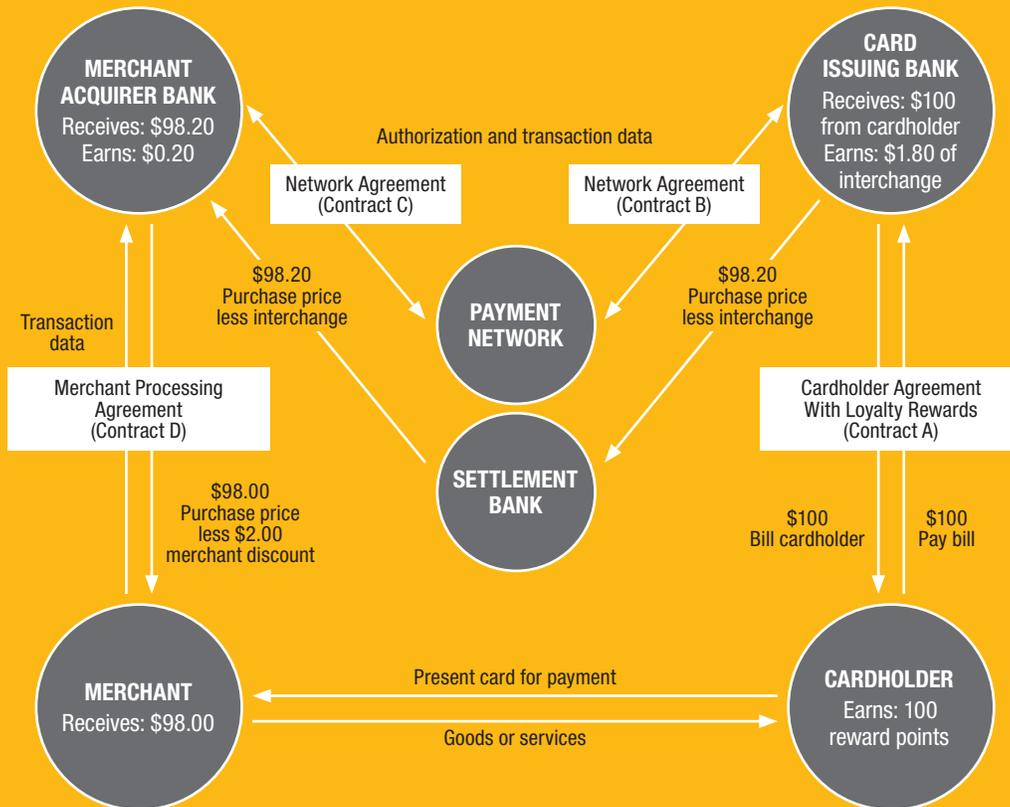
A financial institution that issues credit or debit cards (that is, a card issuer) also must consider whether the interchange fees it earns are within the scope of Topic 606. Interchange represents the portion of the credit or debit card transaction amount that the card issuer retains to compensate it for extending credit and, if applicable, providing rewards. Credit and debit card processing cycles typically include multiple parties including:

- Cardholder – consumer who uses the credit card
- Card issuer – extends credit to the cardholder
- Merchant – sells the good(s) or service(s) purchased by the cardholder
- Merchant acquirer – collects data for the payment network and pays the merchant (or collects refunds from the merchant in the case of cardholder returns)
- Payment network – transmits the authorization from the card issuer and settles the payments between the card issuer and merchant acquirer

A credit or debit card transaction might be processed through an “open loop,” where the payment network is not under common control with the card issuer or the merchant acquirer, or a “closed loop,” where the aforementioned parties are under common control.

Exhibit 2 shows a typical open-loop process for a credit or debit card transaction.

## Exhibit 2: Open-Loop Credit or Debit Card Transaction Process



KEY			
<b>Contract A</b> Cardholder agreement with loyalty rewards between cardholder and card issuer	<b>Contract B</b> Network agreement between card issuer and payment network	<b>Contract C</b> Network agreement between merchant acquirer and payment network	<b>Contract D</b> Merchant processing agreement between merchant and the merchant acquirer

Source: TRG Paper 36

When a financial institution as card issuer considers whether the interchange fees it collects are within the scope of Topic 606, it must analyze whether it has a customer or whether it is the customer from the perspective of the contractual arrangements in Exhibit 2.

As noted earlier, as of the date of writing, neither the TRG nor the AICPA Depository and Lending Institutions Revenue Recognition Task Force has published guidance with respect to Topic 606 scoping considerations for interchange fees.

### **Crowe Observation**

We understand multiple views exist with respect to the identification of the customer for the purposes of interchange fees and whether the fees are within the scope of Topic 606. Potential views include:

The card issuer is the customer of the payment network because the payment network is the entity providing the settlement and other services to the card issuer. Other parties, such as the payment network or merchant, also might be considered customers of the card-issuing bank. This view might result in a conclusion that interchange fees are within the scope of Topic 606.

The card issuer is the customer of the payment network for the reasons noted above, but the card issuer also serves as a vendor of the payment network and the interchange fee is compensation to the card issuer for choosing the payment network to process transactions. Under this view, the interchange fee might be within the scope of paragraph 705-20-25-2 and would therefore be recognized as revenue in the same manner as other sales to customers in accordance with Topic 606.

Additional alternative views are also possible based on the specific facts of an institution’s contracts, including the identification of the customer and the institution’s rights and obligations in the contract. An institution should analyze each of its contracts from which it earns interchange fees to determine whether the fees should be recognized under Topic 606 and whether any related costs should be presented gross or net. Given the diversity of the potential views, institutions should apprise their independent auditors of their conclusions as early in the Topic 606 adoption process as possible.

Because the card issuer, merchant acquirer, and payment network are usually under common control in a “closed loop” process, the card issuer generally has contractually enforceable rights and obligations with the merchant, and the accounting analysis is likely less complex for a “closed loop” process.

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## Financial Guarantee Fees: Out of Scope

A financial institution receives a fee for agreeing to compensate another creditor if a borrower defaults on a loan. The institution is providing a financial guarantee by “lending” its creditworthiness to the borrower. Topic 606 includes an explicit scope exception for guarantees (other than product or service warranties) within the scope of Topic 460 (Guarantees). Certain scope exceptions exist within Topic 460 (for example, certain guarantees accounted for as a credit derivative under Topic 815 or commercial letters of credit, which are akin to a loan commitment); however, financial guarantees generally are within the scope of Topic 460.

Stakeholders raised questions about whether fees paid for a financial guarantee were within the scope of Topic 606 because ASU 2014-09 amended certain paragraphs within GAAP (specifically, paragraphs 310-10-60-4 and 942-825-50-2) to point to Topic 606 for guidance on accounting for arrangements in which an entity lends its creditworthiness to another entity. Additionally, stakeholders observed Topic 460 does not provide comprehensive guidance regarding the circumstances in which each of the subsequent measurement methods described therein would be appropriate.

Other stakeholders observed – and the TRG agreed – that the financial guarantee fee is inextricably linked to the service of providing the financial guarantee, which is specifically excluded from the scope of Topic 606. To resolve the conflict within GAAP, the FASB issued a technical correction in December 2016 in ASU 2016-20 that removed the language pointing to Topic 606 for financial guarantee arrangements.

## Asset Management Fees: In Scope

Financial institutions receive fees for performing asset management services. Such fees might also be referred to as trust fees or investment management fees. A simple example of such an arrangement involves a customer depositing cash, securities, or other assets into an account with the financial institution, and the financial institution directs the investments of those funds. The financial institution typically receives a fee based on the fair market value of the assets it manages, and in some cases a cash incentive fee based on investment results. Such fees typically are within the scope of Topic 606 because the arrangement from which the fees arise is not specifically scoped out of Topic 606 and the fees are earned from a contract with a customer. Other types of incentive fees, including incentive-based capital allocations (for example, carried interests), might require additional scoping analysis.

## For Revenue in Scope: Now What?

The ASU 2014-09 is based on a core principle: “Recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” To achieve this principle, the guidance specifies a five-step process that a company considers in determining when to recognize revenue in its financial statements, as depicted in Exhibit 3.

### Exhibit 3: The Five-Step Revenue Recognition Process in Topic 606



Source: Crowe Horwath LLP based on the five steps in ASU 2014-09 (Topic 606)

A financial institution will apply the five-step revenue recognition process to its revenue streams that are within the scope of Topic 606. Following are detailed examples describing how a financial institution might apply the five-step process to three revenue streams: service charges on deposit accounts, gains and losses on sales of OREO, and asset management fees. Institutions also should consider whether each revenue stream and its related expenses should be presented gross or net in its income statement (that is, as a principal versus an agent), though this topic is outside of the scope of this article.

### Crowe Observation

For its revenue streams that are within the scope of Topic 606, a financial institution will likely spend the majority of its time analyzing Step One (identify the contract with the customer) and Step Two (identify the performance obligation) of the five-step revenue recognition process.

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## Applying the Five-Step Process: Service Charges on Deposit Accounts

### Step One: Identify the Contract

A contract between a financial institution and a deposit account customer is typically documented in writing and is often terminable at will by the customer alone or by both the customer and the institution without penalty. The TRG considered contracts terminable at will by either party without compensation for the termination during its October 2014 meeting and concluded the term of such a contract does not extend beyond the goods and services already transferred. The TRG further considered contracts unilaterally terminable by the customer without penalty in its November 2015 meeting and concluded the views expressed at the October 2014 meeting do not change regardless of whether both parties can terminate or whether only one party can terminate.

The term of a deposit contract between a customer and a depository or lending institution will likely be day-to-day or minute-to-minute, and the termination clause is likely similar to a renewal right where each day or minute represents the renewal of the contract. The day-to-day or minute-to-minute term of the contract affects the analysis of Step Three and Step Five of the revenue recognition process for service charges on deposit accounts.

### Step Two: Identify the Separate Performance Obligation(s) in the Contract

A deposit contract typically obligates a financial institution to serve as a custodian to funds on deposit in exchange for the customer depositing funds. A deposit contract typically also specifies that upon request, a customer can access the funds on deposit (for example, through an ATM withdrawal). A financial institution should consider whether the custodial performance obligation and the performance obligation associated with access to funds are highly interrelated and therefore represent a single performance obligation under Topic 606.

Customers might also be able to request additional services such as paper checks, wire transfers, foreign exchange, or other similar services. Services provided on request likely represent optional purchases under Topic 606.

### Step Three: Determine the Transaction Price

The consideration received at the outset of a deposit contract is the deposit itself, which is outside the scope of Topic 606. The financial institution might charge certain customers for the optional purchases described in the preceding paragraph. An institution might also charge account maintenance or dormancy fees, depending on the terms of the deposit contract. A financial institution should include in the transaction price only those amounts (including variable amounts) to which the institution has rights under the present contract. Until the customer requests a wire transfer or elects to let its account remain dormant, for example, the entity does not have a right to consideration, and a deposit institution should not estimate variable consideration to be received under the contract. However, once a service is requested or a customer’s action allows the account maintenance or dormancy fee be charged to its account, the transaction price includes the variable consideration from the customer request or action.

Some stakeholders questioned whether an institution’s income statement should include revenue and an equal amount of offsetting expense for services provided at no charge. For example, many deposit contracts waive certain fees if the customer maintains a certain minimum deposit or processes a certain number of transactions each period. The FASB staff indicated in TRG Paper 52 that if an institution does not charge any fees to a customer and has no enforceable right to receive any fees, the initial customer deposit, which is outside the scope of Topic 606, is the only consideration received by the institution.

Some stakeholders further questioned whether the customer deposit is akin to providing a loan to the institution that would require an adjustment to the transaction price as a significant financing component under Topic 606; however, the FASB staff indicated in TRG Paper 52 that the day-to-day or minute-to-minute contract term likely renders this question moot. In essence, if a depository or lending institution does not charge a customer a fee for a particular service, it will recognize no revenue and will not adjust interest expense (that is, it would not gross-up its income statement for services provided free of charge).

### Step Four: Allocate the Transaction Price to the Separate Performance Obligations

The consideration for each optional purchase should be allocated to the performance obligation associated with that optional purchase.

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

Revenue for most deposit fees will be recognized as incurred due to the day-to-day or minute-to-minute contractual term; notwithstanding, the institution will need to consider its history of providing refunds when determining the appropriate amount of revenue to recognize.

### **Crowe Observation**

Revenue recognition for a deposit contract with a day-to-day or minute-to-minute term will likely not result in a different pattern of recognition compared to current GAAP, regardless of the number of performance obligations identified.

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## Applying the Five-Step Process: Gains and Losses on Sales of OREO

Financial institutions are not generally in the business of selling foreclosed real estate, and an institution's sale of OREO will not be within the scope of Topic 606. When an institution forecloses on a loan collateralized by real estate, the institution often sells the foreclosed property within a short time frame due to regulatory requirements.

Prior to the adoption of ASU 2014-09, an institution is required to follow the prescriptive guidance of Topic 360 for sales of OREO, which might preclude gain recognition when a seller has continuing involvement with a property. For financial institutions, continuing involvement often takes the form of seller financing. However, upon adoption of ASU 2014-09, an institution will follow Subtopic 610-20 for sales of OREO that are not a business. The central principle of Subtopic 610-20 is that a gain or loss should be recognized upon transfer of control of the asset to the buyer, and Subtopic 610-20 relies on certain recognition and measurement principles in Topic 606 for guidance.

Subtopic 610-20 indicates a seller should derecognize a nonfinancial asset and recognize gain or loss when both a contract exists (Step One of the five-step revenue recognition process) and control of the asset has transferred to the buyer (Step Five) as contemplated in Topic 606 (specifically, ASC 606-10-25-1 through 25-8 and 606-10-25-30, respectively). The gain or loss is calculated as the difference between the institution's carrying value of the nonfinancial asset and the transaction price as determined in accordance with Topic 606 (Step Three).

### Step One: Identify the Contract

Topic 606 lists five criteria that must be met for a contract to exist. It is generally a straightforward analysis to determine if an institution's arrangement for the sale of OREO meets the first four criteria: 1) the parties to the contract have approved the contract; 2) the institution can identify each party's rights and obligations; 3) the institution can identify the payment terms; 4) the contract has commercial substance; and 5) the institution will collect substantially all of the consideration to which it is entitled in exchange for the property, which is transferred to the buyer. It can be a matter of significant judgment to identify whether an arrangement for the sale of OREO meets the fifth criteria, particularly when the institution provides seller financing to the buyer.

Factors an institution should consider in its analysis of collectibility might include:

- Credit rating of the buyer
- The loan-to-value ratio of the seller financing
- Existence of subordination, recourse, repurchase, or other seller support provisions
- Property-specific facts and circumstances (for example, age, location, current cash flow, and whether owner-occupied)
- Noncustomary financing terms (for example, contingent payments, unusual consideration, or payment structures)
- Seller involvement in the property after the sale

Financial institutions might also refer to Chapter 9 (“Credit Losses”) of the AICPA Audit and Accounting Guide, “Depository and Lending Institutions: Banks and Savings Institutions, Credit Unions, Finance Companies, and Mortgage Companies,” for additional discussion of assessing collectibility.

Step Two: Identify the Separate Performance Obligation(s) in the Contract

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

Step Three: Determine the Transaction Price

Determining the transaction price for an arrangement for the sale of OREO without seller financing is generally a straightforward analysis because the transaction price is typically identified in the purchase and sale agreement. However, if an institution provides seller financing, the institution must consider the guidance in Topic 606 regarding a significant financing component to determine the transaction price (see ASC 606-10-32-15 through 20).

The determination of transaction price in an arrangement to sell OREO with seller financing depends on whether the financing uses market terms. If market terms are used, the process of determining transaction price will generally be similar to a transaction without seller financing (that is, the transaction price will be identified in the purchase and sale agreement). However, when seller financing terms are not consistent with market terms, the transaction price will differ from the price stated in the contract. Assuming all other criteria in Subtopic 610-20 are met, an institution must calculate the transaction price to use in the calculation of the gain or loss to be recognized. The institution would generally determine the transaction price by discounting the stated consideration at a market rate of interest. Subtopic 835-30 (Imputation of Interest) provides guidance on how to perform such a calculation.

When determining the transaction price for a sale of OREO, an institution must also consider the credit risk inherent in the arrangement at inception. If the credit risk known at contract inception represents an implied price concession, the price concession would represent variable consideration under Topic 606 and would not be included in the transaction price. Determining whether credit risk at the inception of the contract represents an implied price concession or the risk of an impairment loss is highly judgmental. Paragraph BC194 of ASU 2014-09 indicates an institution should consider all relevant facts and circumstances when analyzing the nature of collectibility issues that were known at the onset of the contract, which would include the factors mentioned above (credit rating, loan-to-value, etc.).

**Crowe Observation**

As noted in BC194, the FASB declined to provide any further guidance on determining whether credit risk known at the inception of the contract represents a collectibility issue or an impairment risk because such an analysis is performed under current revenue recognition guidance (that is, prior to the adoption of ASU 2014-09).

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#### Step Four: Allocate the Transaction Price to the Separate Performance Obligations

The transaction price for a sale of OREO typically is allocated to the single performance obligation identified in Step Two.

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

Subtopic 610-20 indicates a gain or loss on derecognition of a nonfinancial asset occurs when control of the asset has passed to the buyer. Control typically passes as of a point in time for a sale of OREO, and Subtopic 610-20 cross-references to the criteria in Topic 606 discussing satisfaction of a performance obligation at a point in time to assess when control has passed to the buyer. Topic 606 provides the following indicators of when control transfers.

- The seller has a present right to payment for the asset.
- The buyer has legal title of the asset.
- The seller has transferred physical possession of the asset.
- The buyer has the significant risks and rewards of ownership of the asset.
- The buyer has accepted the asset.

#### **Crowe Observation**

The factors above should not be considered all-inclusive, nor should they be considered determinative individually or in specific combinations.

The above criteria will often be satisfied on the closing date of the transaction; however, an institution should consider whether there are specific legal or other restrictions that would preclude the buyer from obtaining control of the property on the closing date. For example, though an institution might obtain legal title to a foreclosed property and transfer the legal title to a buyer through an arrangement for the sale of OREO, certain jurisdictions allow the original creditor to reclaim or redeem the property during a time period after foreclosure specified in the law. In such circumstances, the buyer might not have obtained control of the property because “the customer is limited in its ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset even though the customer may have physical possession of the asset” (ASC 606-10-55-68). If the institution determines control of the property has not transferred to the buyer, the institution would not derecognize the nonfinancial asset and would not recognize a gain or loss until after the redemption period expires and the buyer has obtained control of the property.

## Recognizing Revenue for Interchange Fees

Interchange fees are generally settled on a daily basis. Notwithstanding the conclusion on whether interchange fees are within or outside the scope of Topic 606, the recognition of interchange fees might not differ due to the daily settlement. Institutions should also be aware that interchange revenue likely constitutes variable consideration under Topic 606, and it should consider any constraint on the variable consideration due to returns, refunds, or chargebacks.

## Applying the Five-Step Process: Asset Management Fees

### Step One: Identify the Contract

A contract between a financial institution and an asset management customer is typically documented in writing and is often for a specified term.

### Step Two: Identify the Separate Performance Obligation(s) in the Contract

An asset management contract typically obligates a financial institution to make investment decisions with respect to the funds deposited by its customer. The services provided under such a contract typically would be considered a single performance obligation because it embodies “series of distinct goods or services that are substantially the same and that have the same pattern of transfer to the customer” as described in ASC 606-10-25-14(b). More complex contracts might include additional services, and those additional services would be considered when identifying any additional performance obligations.

### Step Three: Determine the Transaction Price

A typical asset management contract specifies a fee per dollar of assets under management either at a point in time or on average over a specified period (the asset management fee). In some cases, an asset management contract might include an incentive fee based on investment results. Each of these fees represent variable consideration under Topic 606; therefore, an entity must consider whether, at the outset of the arrangement, a significant reversal in the cumulative amount of revenue would occur if the entity included the asset management fee or the incentive fee in the transaction price at contract inception. In light of the susceptibility of the asset management fee and the incentive fee to fluctuations in the value of the assets under management (for example, due to changes in the stock market), it is likely an entity would conclude neither the asset management fee nor the incentive fee should be included in the transaction price at the outset of the arrangement.

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At the end of each reporting period, the entity would reassess its estimate of the transaction price, including both the asset management fee and the incentive fee. If, based on circumstances at the end of the reporting period, the uncertainty with respect to significant reversal of the cumulative amount of revenue is resolved, the entity would include in the transaction price its estimate of the amount of revenue not likely to be reversed in the future.

### **Crowe Observation**

The determination of the transaction price for an incentive fee might be more complex than the analysis for asset management fees due to the specific facts and circumstances of the incentive fee stated in the contract (for example, clawback provisions).

#### Step Four: Allocate the Consideration to the Separate Performance Obligations

The entity allocates the consideration to the distinct services it provided during the reporting period, which as previously discussed is typically a single performance obligation. An entity typically allocates asset management fees to the reporting or measurement period specified in the contract. Incentive fees might require additional analysis based on the specific terms of the contract.

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

Revenue for the typical asset management fee will be recognized at the end of the measurement period specified in the contract (for example, monthly, quarterly, or annually) because the end of the measurement period allows the entity to reliably measure its progress toward completion (that is, the transfer of value to the customer), as contemplated in Topic 606. As noted previously, incentive fees might require additional analysis based on the specific terms of the contract.

## Disclosures

The stated disclosure objective of ASU 2014-09 is for “an entity to disclose sufficient information to enable users of financial statements to understand the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers.” The ASU requires an entity to exercise judgment in disclosing: 1) qualitative and quantitative information about its contracts with customers, 2) the significant judgments, and any changes in the judgments, made in applying the revenue recognition guidance to those contracts, and 3) any assets recognized from the costs to obtain or fulfill a contract with a customer.

Exhibit 4 summarizes the annual disclosure requirements for public business entities (PBEs).

#### Exhibit 4: Disclosure Requirements for Public Business Entities (PBEs)

CATEGORY	INFORMATION REQUIRED
Disaggregation of Revenue	<ul style="list-style-type: none"> <li>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</li> </ul>
Contract Balances	<ul style="list-style-type: none"> <li>Opening and closing balances and revenue recognized during the period</li> <li>Information about significant changes in contract balances</li> </ul>
Performance Obligations	<ul style="list-style-type: none"> <li>Description of when performance obligations are satisfied, significant payment terms, nature of goods or services promised, and obligations for returns, refunds, and warranties</li> <li>Transaction price allocated to remaining performance obligations and when such revenue will be recognized</li> <li>Whether the entity is applying the practical expedient for certain performance obligations</li> </ul>
Significant Judgments	<ul style="list-style-type: none"> <li>The timing of satisfaction of performance obligations and the transaction price and amounts allocated to performance obligations</li> <li>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</li> <li>Judgments made in evaluating when a customer obtains control of promised goods or service for performance obligations satisfied at a point in time</li> <li>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</li> </ul>
Practical Expedients	<ul style="list-style-type: none"> <li>If an entity elects either of the following practical expedients, it should be disclosed: <ul style="list-style-type: none"> <li>Determining the existence of a significant financing component</li> <li>Determining the incremental costs of obtaining a contract</li> </ul> </li> </ul>

Source: Crowe Horwath LLP

Non-PBEs can elect not to provide the above disclosures, but instead must provide certain alternative disclosures related to disaggregation of revenue and contract balances, which are described in paragraphs 606-10-50-7 and 606-10-50-11, respectively. TRG Paper 52 provides an example discussion of developing Topic 606 disclosures for deposit fees.

#### Crowe Observation

Financial institutions will likely spend the most time developing the disaggregated revenue disclosures. Significant judgment is involved in determining the appropriate level of disaggregation and will vary by institution.

## Effective Date and Transition

Exhibit 5 outlines the effective date of ASU 2014-09 and related amendments.

### Exhibit 5: Effective Date of ASU 2014-09

EFFECTIVE DATE FOR PBEs	EFFECTIVE DATE FOR NON-PBEs
<ul style="list-style-type: none"><li>Fiscal years beginning after Dec. 15, 2017, including interims within that fiscal year</li><li>Dec. 31 year-ends – March 31, 2018, interim financial statements</li></ul>	<ul style="list-style-type: none"><li>Fiscal years beginning after Dec. 15, 2018, and interim periods beginning after Dec. 15, 2019</li><li>Dec. 31 year-ends – Dec. 31, 2019, annual financial statements</li></ul>

Source: ASU 2014-09 and Crowe Horwath LLP

ASU 2014-09 allows for one of two transition methods: full retrospective or modified retrospective. The full retrospective approach requires application of the ASU to all prior periods presented; however, the FASB provides preparers with certain practical expedients for the full retrospective approach. The modified retrospective transition method only requires application of the ASU to uncompleted contracts at the date of adoption. Periods prior to the date of adoption are not retrospectively revised, but a cumulative effect of adoption is recognized for the impact of the ASU on uncompleted contracts at the date of adoption. While the FASB intended the modified retrospective transition method to be simpler than the full retrospective method, the modified retrospective method requires certain additional disclosures in the year of adoption (for example, the quantitative impact of adoption on each line item in the financial statements).

### Crowe Observation

We believe many financial institutions will use the modified retrospective transition method. Many institutions expect to have very few uncompleted contracts at the date of adoption because revenue recognition for most contracts that will be in the scope of Topic 606 are as of a point in time under current revenue recognition standards.



## Learn More

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