REVENUE RECOGNITION STANDARD

FINANCIAL INSTITUTIONS

In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2014-09 – Revenue from Contracts with Customers (Topic 606) which attempts to clarify the principles for recognizing revenue. Although the ASU was issued in 2014, the FASB provided a long implementation period. For entities that are not considered public business entities (PBEs), the standard becomes effective for annual reporting periods beginning after December 15, 2018, which means January 1, 2019 for calendar year-ends.

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SO WHAT CHANGED?

The recognition of revenue under current accounting standards requires the consideration of two factors; being realized or realizable and being earned. FASB believes ASU 2014-09 will significantly enhance the comparability of revenue recognition practices while also providing a framework to ensure the guidance remains relevant. Specifically, the core principle of ASU 2014-09 is "that an entity should 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 the core principle, ASU 2014-09 provides a list of steps to be taken.

1. Identify the contract(s) with a customer.
2. Identify the performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the performance obligations in the contract.
5. Recognize revenue when (or as) the entity satisfies a performance obligation.

Each entity will apply this five-step approach to determine when revenue and gains included within the scope of the standard should be recognized.

HOW DOES THIS AFFECT FINANCIAL INSTITUTIONS?

At first glance, the new standard will have minimal effect on financial institutions. The reason is that many financial institution revenue streams are not included within the scope of ASU 2014-09:

- Interest income (loans, lease financing, securities)
- Loan servicing fees
- Credit card fees (such as balance transfer fees, cash advance fees and annual fees)
- Mortgage servicing income
- Loan origination/commitment fees
- Loan late/prepayment fees

WHAT SOURCES OF INCOME ARE AFFECTED BY THE NEW REVENUE STANDARD?

- Services charges on deposit accounts
- Gains/losses on the sale of other real estate owned (OREO)
- Interchange fees
- Insurance premiums related to loans (such as gap insurance)
- Asset management fees
- Safe deposit box fees
- Trust income
- Credit card loyalty program income

Although the new standard may apply to these sources of income, the effect of the new standard may ultimately look the same as current account practices. For example, under current practice, revenue from the sale of an OREO is typically recognized at closing. The accounting will likely not change under the new standard, except for instances in which the sale is a seller financed sale. In those instances, additional consideration will need to be given to whether or not it is probable the financial institution will collect substantially all of the consideration to which it is entitled.

Big picture, financial institutions will need to apply the five-step process to all of their noninterest income to ensure proper revenue recognition under the new standard.

If you have any questions regarding the revenue recognition standard (ASC 606) please contact us.

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