Credit Card Scope Clarified for Revenue Recognition

Financial institutions face unique challenges in applying Accounting Standards Update (ASU) 2014-09, *Revenue from Contracts with Customers (Topic 606)*, due to the variety of revenue streams common in the industry. The Financial Accounting Standards Board (FASB) recently addressed one issue, but many others remain.

Scope

Credit Card Fees

The new guidance applies to all contracts with customers and contains several scope exceptions that primarily apply to items covered in other standards. A card-issuing bank can have various income streams from a cardholder. Revenue related to interest income and fees for balance transfers, delinquency, returned checks, cash advances and overdraft protection are within the scope of Topic 310, *Receivables*, and not included in the scope of the new revenue standard. Some card issuers have questioned whether other credit cards fees such as periodic or annual fees are in the scope of Topic 310 or Topic 606. These fees frequently cover additional services provided with the lending arrangement, such as concierge services or airport lounge access.

This topic was discussed at the July 2015 Transition Resource Group (TRG) meeting. FASB members and the TRG agreed that the standard is clear: Credit card fees are not within the scope of Topic 606 and no modifications are needed, based on the following:

- All credit card fees are currently accounted for under Topic 310 rather than the current revenue guidance in Topic 605. The new revenue standard did not make any modifications to Topic 310 changing scope, so the conclusions under existing and new revenue recognition guidance should be the same.
- Language in the basis for conclusion of Statement No. 91, *Accounting for Nonrefundable Fees and Cost Associated with Originating or Acquiring Loans and Initial Direct Cost of Leases*, although nonauthoritative, provides context that credit card fees cover many services to cardholders. While Topic 310 refers to a "fee" and Topic 606 relates to "goods and services," TRG members concluded the services being performed in exchange for that fee also would be in the scope of Topic 310.

TRG members reiterated that entities should not default to the guidance in ASC 310 for all credit card arrangements. Instead, if the transaction includes goods or services (or both) that are "clearly unrelated" to the credit card arrangement, entities would need to perform additional analysis.

Reward Programs

TRG members also agreed that if an entity concludes a credit card arrangement is within the scope of ASC 310, the associated rewards program also would be within the scope of ASC 310. A scope conclusion is a judgment issue that should be based on specific facts and circumstances. If an entity concludes a reward program fell into scope of Topic 606, the entity should consider the following items when determining the appropriate accounting:

- The entity would need to determine who its customers are in the arrangement, *e.g.*, the entity's customer may be the merchant paying interchange fees, the cardholder or both.
- If the contracts are not with the same customer, *e.g.*, where there is a contract with the cardholder and a separate contract with the merchant and the two are not related parties, the entity would not need to combine the contracts.

- If an entity concluded a contract is in the scope of Topic 606 and the cardholder is a customer, the entity would assess whether goods and services provided under the rewards program are distinct goods or services. It is important to note that even though a cardholder is determined to be a customer, it may or may not be the card issuer's only customer, *i.e.*, the card issuer may conclude its customers are the cardholders and the merchants.

Additional Outstanding Issues

While the credit card scope question has been resolved, many concerns remain for financial institutions in adopting the new revenue standard. To address these concerns, the American Institute of CPAs (AICPA) plans to develop a single revenue recognition guide to help entities implement the new standard; the guide is scheduled for release in mid-2016. AICPA has organized 16 industry-specific task forces, including one for depository and lending institutions; the members include preparers, auditors and industry professionals. Each task force has generated a list of implementation issues and will develop recommendations to be reviewed by AICPA's Financial Reporting Executive Committee (FinRec) before being referred to the TRG. Below are the implementation issues identified by the task force.

Depository and Lending Institutions Revenue Recognition Task Force – Issues List		
Issue #	Description of Implementation Issue	Status
1	**Revenues scoped out of ASC 606:** ▪ Lending-related fees • Interest income on receivables • Rebates of accrued interest income • Prepayment charges • Delinquency charges (late fees) • Loan commitment fees • Loan origination fees and costs, premiums, discounts ▪ Mortgage servicing rights	
2	**Revenues to be evaluated for applicability of ASC 606:** ▪ Other bank service charges, including online, monthly fees, NSF, etc. ▪ Bundled arrangements that include a service-based fee arrangement and an out-of-scope financial instrument ▪ Standby loan guarantee fees	
3	**Applicability of ASC 606 to card arrangements for card-issuing banks and merchant-acquiring banks:** ▪ Evaluation of interchange and merchant revenue ▪ Evaluation of rewards programs and other services—specifically whether they are considered a performance obligation and, if so, when the obligation is satisfied ▪ Evaluation of cardholder fee revenue—determining the applicability of ASC 310 versus 606	
4	**Sale of nonoperating assets (other real estate owned)** – This implementation issue provides considerations for depository institutions in applying the guidance in ASC 606 to sales of other real estate owned	**Submitted to FinRec**
5	**Fees associated with other real estate owned** – The underlying principles of ASC 360-20 provide that full profit on a real estate sale could be recognized if the profit was determinable and the earnings process was virtually complete (under RRWG review)	

Additional Resources

BKD has prepared several papers on the new revenue recognition standard and will continue to monitor updates. These resources are collected in the Hot Topics section of **bkd.com**. For more information, contact your BKD advisor.

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