

## Financial Reporting Center – Revenue Recognition

# Working Draft: Broker-Dealer Revenue Recognition Implementation Issue



### Issue #3-1A: Commission Income – Trade Date vs. Settlement Date

**Expected Overall Level of Impact to Industry Accounting:**  
Minimal

### Wording to be Included in the Revenue Recognition Guide:

*Recognition on Trade date*

1. Acting as an agent, a broker-dealer may buy and sell securities on behalf of its customers. In return for its selling and administrative services, the broker-dealer charges a commission each time a customer enters into a buy or sell transaction. On the trade date, the broker-dealer fills the trade order by finding and contracting with a counterparty and confirms the trade with the customer. On the settlement date, the cash and security from the respective counterparties are transferred to the respective accounts.
2. The trade execution performance obligation is satisfied at a point in time, as discussed in paper 3-1. A broker-dealer should determine the point in time at which it transfers control of the trade execution performance obligation to the customer. Determining when control has transferred depends on how the trade execution performance obligation is defined. FinREC believes that a broker-dealer is performing the service of providing the customer with the ability to acquire or dispose of rights to obtain the economic benefits of a financial instrument (for example, stock, bonds, options). If the customer or the other counterparty does not remit payment/financial instrument on the scheduled settlement date, the broker-dealer remedies the failure to perform by either party, so the customer still benefits from the rights to the financial instrument as of the trade date. Fails occur in a very small percentage of trades, are generally easily and rapidly cleared, and the settlement process is well established and does not require significant effort.
3. FASB ASC 606-10-25-25 defines control of an asset as the ability to direct the use of, and obtain substantially all of the remaining benefits from, the asset. Transfer of control of the trade execution performance obligation should be viewed as occurring on the trade date because that is when the underlying financial instrument (for a purchase) or purchaser (for a sale) is identified and the pricing is agreed upon (i.e., the broker-dealer has identified the counterparty and enters into the contract on behalf of the customer).

4. On the trade date, the customer has obtained control of the service in that it can direct the use of, and obtain substantially all of the remaining benefits from the asset that comes from the trade execution performance obligation. For example, in a security purchase transaction, the customer receives the benefits from changes in value of the underlying security on the trade date. In addition, the customer may direct the further sale of a purchased security to a third-party on the trade date. In a security sales transaction, a customer may not direct the use of the sale proceeds to purchase another security until the settlement date when the cash is deposited into their account. However, the customer is no longer subject to the risk of changes in value of the sold security on the trade date and thus has no rights to the underlying security or related risks and rewards once sold on the trade date.
5. Furthermore, FASB ASC 940-20-25-2, as amended, states that substantially all the efforts in generating the commissions have been completed on the trade date for purposes of evaluating the expenses that should be accrued.
6. FASB ASC 606-10-25-30 also lists indicators of the transfer of control. A broker-dealer may evaluate these indicators as follows:
  - a. The entity has a present right to payment for the asset (i.e., for the service) – The broker-dealer has a present right to payment for the trade execution performance obligation on the trade date. However, if the trade ultimately never settles (which only occurs in extremely rare cases), the broker-dealer may refund the trade commission and/or compensate the customer for any changes in value of the security or asset that the broker-dealer was unable to obtain.
  - b. The customer has legal title to the service – Not an applicable indicator when evaluating the transfer of a service.
  - c. The entity has transferred physical possession of the service – Not an applicable indicator when evaluating the transfer of a service.
  - d. The customer assumes the significant risks and rewards of ownership of the service – The risks and rewards of ownership (i.e., benefits) of the trade execution performance obligation are transferred on the trade date because the rights to the underlying security provided by the service are received on the trade date. For example, the customer is entitled to any dividend or interest payments if the record date of the payment is on or after the trade date. The customer also receives the benefits from changes in value of the underlying security on the trade date and may direct the further sale of the security to a third-party on the trade date. In a security sales transaction, a customer may not use the sale proceeds to purchase another security until the settlement date when the cash is deposited into their account. However, the customer is no longer subject to the risk of changes in value of the sold security on the trade date and has no rights to the underlying security once sold on the trade date. If a trade fails, the broker-dealer compensates the customer for any change in value from the trade date to the actual settlement date, so fails do not affect the customer's risks and rewards of ownership of the service.
  - e. The customer has accepted the service – Often, there is no explicit customer acceptance clause to be evaluated in a brokerage contract (i.e., there is no explicit requirement for the customer to accept the transfer of ownership). However, any customer acceptance clause in a contract likely would be objective and would not affect the entity's determination of when the customer has obtained control of the service, as described in FASB ASC 606-10-55-86.
7. As described above, a broker-dealer may expect to remedy the failure to perform by either party if the customer or the other counterparty does not remit payment/financial instrument on the scheduled settlement date. FinREC believes this remedy may be similar to a warranty (i.e., a warranty of its agency service), which is specifically addressed in paragraphs 30–35 of FASB ASC 606-10-55. The standard states that some warranties may provide a customer with assurance that the related product will function as the parties intended because it complies with agreed-upon specifications, which is consistent with the remedy a broker-dealer provides. These types of warranties are not accounted for as separate performance obligations. Thus, FinREC believes the broker-dealer may need to recognize a liability / expense for any obligations to remedy failures to perform.

8. For those instances described above in which the trade is expected to ultimately never settle, the consideration would be variable consideration and the broker-dealer would estimate the amount of consideration that will be refunded and include that portion in the estimate of the transaction price (i.e., record that portion as a reduction of revenue instead of as an accrual of costs). The estimated variable consideration in the contract will only include the consideration for the performance obligations in the contract (i.e., no consideration should be included for optional purchases as discussed in paper 3-1) less the amount expected to be refunded based on the broker-dealer's historical data of trades that never settle. That is, when determining the estimate of variable consideration, the broker-dealer will not include an estimate of the number of trades expected to be executed.
9. Based on the analysis above, FinREC believes control of the trade execution performance obligation transfers on the trade date. The portion of the transaction price allocated to the trade execution performance obligation should be recognized as revenue on that date.

Comments should be received by January 2, 2017, and sent by electronic mail to Irina Portnoy at [iportnoy@aicpa.org](mailto:iportnoy@aicpa.org), or you can send them by mail to Irina Portnoy, Accounting Standards, AICPA, 1211 Avenue of the Americas, NY 10036.