

Financial Reporting Center – Revenue Recognition

Working Draft: Depository Revenue Recognition Implementation Issue



Issue #5-4: Sale of Non-Operating Assets (Other Real Estate Owned)

Expected Overall Level of Impact to Industry Accounting:
Moderate for entities engaging in seller-financed sales of Other Real Estate Owned

Wording to be Included in the Revenue Recognition Guide:

Scope – Collectability

1. Banks selling nonfinancial assets repossessed upon a loan default and not considered a business will likely apply the guidance in FASB ASC 610-20, which is applicable to sales of nonfinancial assets to parties that are not customers. FASB ASC 606-10-20 defines “customer” as “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.” A bank’s “ordinary activities” include investing in financial assets and does not typically include investing in nonfinancial assets. FinREC believes that while a seller-financed sale of real estate that is not considered a business would involve a product (i.e., a loan) that is part of a bank’s ordinary activities, the other good that is being obtained by the buyer (i.e., the property) is generally not an output of a bank’s ordinary activities and is therefore in the scope of FASB ASC 610-20. This paper does not contemplate the accounting for the sale of a business by a bank.
2. Under FASB ASC 610-20-40-1(a), an entity shall apply the provisions of ASC 606-10-25-1 through 25-8 to determine whether a contract exists. FASB ASC 606-10-25-1 lists the criteria that need to be met for a contract to exist:
 - a. The parties to the contract have approved the contract (in writing, orally, or in accordance with other customary business practices) and are committed to perform their respective obligations.
 - b. The entity can identify each party’s rights regarding the goods or services to be transferred.
 - c. The entity can identify the payment terms for the goods or services to be transferred.
 - d. The contract has commercial substance (that is, the risk, timing, or amount of the entity’s future cash flows is expected to change as a result of the contract).

- e. It is probable that the entity will collect substantially all of the consideration to which it will be entitled in exchange for the goods or services that will be transferred to the customer (see FASB ASC 606-10-55-3A through 55-3C). In evaluating whether collectability of an amount of consideration is probable, an entity shall consider only the customer's ability and intention to pay that amount of consideration when it 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 (see FASB ASC 606-10-32-7).
3. All five criteria in FASB ASC 606-10-25-1 need to be met for a contract to exist. When banks sell real estate, criteria (b) through (d) are typically met and evidenced through a written agreement between the parties, but criterion (a) and (e) may require further analysis. Specifically the initial and continuing investment made by the buyer in a seller-financed sale of foreclosed assets should be considered in determining whether it is probable that an entity will collect substantially all of the consideration to which it will be entitled and whether the parties are committed to perform under the contract.
4. The seller should consider all facts and circumstances of the transaction to determine whether the buyer is committed to purchase the property. One indicator of a buyer's commitment may be the loan-to-value ratio of the buyer's financing. A significantly high loan-to-value ratio may indicate the buyer is not committed to purchase the property. Another indicator a seller may assess is whether the property will be used as the buyer's primary residence or as an income property. Determination of a buyer's commitment is a matter of judgment and a seller should evaluate all facts and circumstances of the arrangement.
5. The estimated transaction price may be less than the contract price because, for example, an entity anticipates offering a price concession. It is important to note that the collectability assessment to determine whether a contract exists relates to the amount of consideration to which an entity expects to be entitled in exchange for the goods or services that will be transferred to the customer (which is expected to be the transaction price), not the stated contract price as explained in FASB ASC 606-10-55-3A through 55-3C. Therefore, before determining if a contract with a customer exists, an entity will first need to estimate the transaction price so the appropriate values can be assessed for collectability. Generally, FinREC believes a bank that sells real estate and finances a portion of such sale at a market rate will not expect to offer the counterparty a price concession. However, if at contract inception, an entity expects to receive an amount less than the stated contract price, judgment should be applied to determine if the transaction price is less than the stated contract price because it includes a price concession. If a price concession exists, the transaction price would be the stated contract price adjusted for any adjustments as required by FASB ASC 606-10-32-3, including the price concession and any constraints on variable consideration in accordance with FASB ASC 606-10-32-11 through 32-13.
6. If an entity determines that it is not probable that it will collect substantially all of the estimated transaction price from the customer (note that the estimated transaction price may be lower than the stated contract price), it cannot conclude that the contract criterion in FASB ASC 606-10-25-1(e) has been met. Entities may consider the example within FASB ASC 606-10-55-95 on assessing collectability in a sale of real estate when evaluating whether it is probable an entity will collect substantially all of the consideration to which it expects to be entitled. 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 further discussion of management's process for assessing collectability and estimating losses.
7. FASB ASC 606-10-25-5 states that after the criteria for a contract are determined to be met, "an entity shall not reassess those criteria unless there is an indication of a significant change in facts and circumstances...for the remaining goods or services that will be transferred to a customer." Consequently, banks are not required to reassess these criteria after control of the property has been transferred to the customer.
8. As discussed in FASB ASC 606-10-25-6, if it is not probable that the entity will collect the consideration it expects to be entitled or does not meet the other criteria for being considered a contract, the entity should continue to assess the agreement to determine whether the criteria are subsequently met. The agreement would not be considered a contract accounted for under FASB ASC 610-20 until all criteria under ASC 606-10-25-1 are met.

9. FASB ASC 606-10-25-7 states that “when a contract with a customer does not meet the criteria in ASC 606-10-25-1 and an entity receives consideration from the customer, the entity shall recognize the consideration received as revenue only when one or more of the following events have occurred:
 - a. The entity has no remaining obligations to transfer goods or services to the customer, and all, or substantially all, of the consideration promised by the customer has been received by the entity and is nonrefundable.
 - b. The contract has been terminated, and the consideration received from the customer is nonrefundable.
 - c. The entity has transferred control of the goods or services to which the consideration that has been received relates, the entity has stopped transferring goods or services to the customer (if applicable) and has no obligation under the contract to transfer additional goods or services, and the consideration received from the customer is nonrefundable.”
10. FASB ASC 606-10-25-8 states that “the entity shall recognize the consideration received from a customer as a liability until one of the events in ASC 606-10-25-7 occurs or until the criteria in ASC 606-10-25-1 are subsequently met.”

Determining the Amount of Consideration (Transaction Price)

11. FASB ASC 610-20-32-1 refers to select paragraphs in ASC 606 for measuring the consideration to be included in the calculation of the gain or loss recognized upon derecognition of a nonfinancial asset. Specifically, an entity should look to the guidance on determining the transaction price in FASB ASC 606-10-32-2 through 32-27 as well as ASC 606-10-32-42 through 32-45 on accounting for changes in the transaction price.
12. FASB ASC 606-10-32-15 through 20 discusses how to take into account the existence of a significant financing component in the contract. Generally, the transaction price in a bank’s sale of real estate will be the amount in purchase/sale agreement (i.e., the contract price). This includes seller-financed sales of real estate when the financing is at market. However, in seller-financed sales of real estate where the financing terms are not consistent with market, the entity must then determine the transaction price by discounting the amount of promised consideration using a discount rate that would be reflected in a separate transaction between the entity and its customer at contract inception. (see FASB ASC 835-30 Imputation of Interest).
13. Further, when determining the transaction price, an entity is required to determine whether credit risks that were known at contract inception represent implied price concessions (i.e., a form of variable consideration). If they do, such amounts should not be included in the estimated transaction price.
14. However, when an entity believes it is probable that it will collect substantially all but not the full amount of consideration, it may be difficult to determine whether the entity has implicitly offered a price concession or whether the entity has chosen to accept the risk of default by the customer of the contractually agreed-upon consideration. FASB ASC 606 does not include detailed guidance for distinguishing between price concessions and the risk of impairment losses embedded in an at market loan. Therefore, as noted in BC 194 of FASB ASU 2014-09, entities should consider all relevant facts and circumstances when analyzing the nature of collectability issues that were known at the onset of the contract (see further discussion on the collectability contract criterion discussed above).

Satisfaction of Performance Obligations – Transfer of Control at a Point in Time

15. Sales of nonfinancial assets (e.g., real estate) would be recognized when control of the asset transfers to the buyer. Under FASB ASC 610-20-40-1, an entity selling a nonfinancial asset would apply the guidance in ASC 606-10-25-30 on determining when an entity satisfies a performance obligation at a point in time by transferring control of the asset.
16. FASB ASC 606-10-25-30 provides the following indicators to consider when determining whether control of a promised asset has been transferred:
 - a. The entity has a present right to payment for the asset.
 - b. The customer has legal title to the asset.
 - c. The entity has transferred physical possession of the asset.

- d. The customer has the significant risks and rewards of ownership of the asset.
 - e. The customer has accepted the asset.
17. If an entity concludes that control of the asset has not transferred, a sale has not occurred and the asset is not derecognized. The indicators in FASB ASC 606-10-25-30 are not meant to be a checklist, all-inclusive or necessarily determinative individually or in combination with one another.
18. FinREC believes that for banks' sales of real estate, criteria (a), (b), (c) and (e) of FASB ASC 606-10-25-30 are typically met on the sale date. The purchase/sale agreement documents the bank's present right to payment for the property and transfers the legal title to the buyer. The buyer typically indicates that it has obtained physical possession of and accepted the property by either occupying the property directly (owner-occupied properties) or leasing out the property to tenants (income properties).
19. For criteria (c) and (d) of FASB ASC 606-10-25-30, banks are reminded to consider the guidance in FASB ASC 606-10-55-68 which states "If an entity has an obligation or a right to repurchase the asset (a forward or a call option), a customer does not obtain control of the asset 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." Banks may consider the guidance in FASB ASU 2014-04, Receivable – Troubled Debt Restructurings by Creditors (Subtopic 310-40): Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans Upon Foreclosure. FASB ASU 2014-04 acknowledges that "A creditor may obtain legal title to the residential real estate property even if the borrower has redemption rights that provide the borrower with a legal right for a period of time after a foreclosure to reclaim the real estate property by paying certain amounts specified by law." Consequently, if such reclaim rights exists, a bank may be precluded from recognizing revenue on the seller financed sale of foreclosed real estate until the reclaim period expires. Specific facts and circumstances, including applicable laws and regulations, should be considered in evaluating whether physical possession has been transferred.
20. Banks may have to perform further analysis on criterion (d) of FASB ASC 606-10-25-30 in certain cases to determine whether the significant risks and rewards of ownership of the property have transferred to the buyer. However, FinREC believes that banks' sales of real estate typically do not have the common characteristics that would result in the banks retaining the significant risks and rewards of ownership of the property.

Comments should be received by January 2, 2017, and sent by electronic mail to Salome Tinker at sjtinker@aicpa.org, or you can send them by mail to Salome Tinker, Accounting Standards, AICPA, 1455 Pennsylvania Ave., NW Washington, DC 20004-1081