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ASC 606 CONSIDERATIONS
for Broker-Dealers

Based on guidance issued by the AICPA, specifically Accounting Standard Update 2013-12, broker-dealers meet the definition of a public business entity and are required to adopt the new standard for periods beginning on or after December 15, 2017 (January 1, 2018 for calendar year entities). Not all of a broker-dealer's activities are within the scope of ASC 606. The following are examples of activities that are not within the scope of ASC 606:

- Realized and unrealized gains and losses relating to proprietary trading and securities lending activities
- Interest and dividend income and expense from financial instruments owned or sold short
- Interest or rebates from securities lending, repurchase and similar activities

STEP ONE: IDENTIFY THE CONTRACT

- ☐ Verbal arrangements can still be considered contracts.
- ☐ Template engagement letters and contracts/agreements with similar characteristics can be evaluated together. Custom arrangements will need to be evaluated on a stand-alone basis.

EXAMPLE: Verbally agreed upon commission arrangements under soft-dollar agreements.

STEP TWO: IDENTIFY THE PERFORMANCE OBLIGATIONS

- ☐ Review existing arrangements and standard engagement letters to determine if there are multiple performance obligations.
- ☐ Retainer Fees and Monthly Work Fees:
  - ○ Consider whether some services provided in the contract may be considered 'distinct' in the context of the contract and thus may be considered separate performance obligations.
  - ○ Give careful consideration to contracts that provide for monthly work fees which reduce the final success fee. These monthly services may not be considered distinct from the ultimate security placement or sale of the business and would constitute one performance obligation.
- ☐ Soft-Dollar Arrangements: Research services provided to a customer are typically separate performance obligations from trade execution services in the same contract.

EXAMPLE: A broker-dealer may enter into a contract to assist in the sale of a business. The contract includes promises to provide due diligence services, a fairness opinion, market analysis reports, etc. A broker-dealer will need to determine if these services constitute ASC 606 distinct performance obligations. This would impact whether or not to allocate a portion of retainer fees to these services and possibly recognize over time or at other milestones not connected to the final sale of the business.

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STEP THREE: DETERMINE THE TRANSACTION PRICE

☐ High quality, probable variable consideration is now considered and included in the transaction price, including success fees.

☐ Determine if the broker-dealer is acting as a principal or agent in a soft-dollar arrangement or when it is part of an underwriting syndicate. If the broker-dealer is acting as a principal, revenue and expenses should be reported at their gross amounts. If the broker-dealer is acting as an agent, revenue should be recorded net of related expenses.

STEP FOUR: ALLOCATE THE TRANSACTION PRICE

☐ Review trade agreements and allocate amounts to execution and research based on relative stand-alone prices

EXAMPLE: A broker-dealer entered into a contract to provide both trade execution and soft dollar services. The total commission earned for trade execution is four cents per share, but one cent per share is earned in conjunction with soft-dollar research services. The broker-dealer should allocate three cents per share to trade execution and one cent per share to soft-dollar commission income.

STEP FIVE: RECOGNIZE REVENUE

☐ Recognition of monthly work fees or retainers in connection with a private placement or M&A transaction may be delayed under the new standard if these services are not deemed to be a separate performance obligation in Step 2.

☐ Revenue earned as a result of a soft-dollar arrangement may be recognized at the time research services are provided if the research services are considered a separate performance obligation.

Example: A customer pays a success fee based on the total consideration received as part of the sale of a portion of their business. The probable fee ultimately achieved should be estimated and included in the total consideration received for the transaction.

OTHER CONSIDERATIONS

Incremental costs of obtaining a contract should be capitalized, if they are expected to be recovered, either directly or as a component of the agreed upon fee for services.

Email us at info@withum.com for a deeper dive into a sample of revenue transactions.

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