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STATEMENT OF POSITION 01-6

AICPA

American Institute of Certified Public Accountants

December 26, 2001

Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others

Issued by the
Accounting Standards Executive Committee

NOTE

Statements of Position on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

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SUMMARY

What This Statement of Position Means for All Entities

This Statement of Position (SOP) applies to any entity that lends to or finances the activities of others. For example, that arrangement may be a secured mortgage loan, an unsecured commercial loan or a financing arrangement that only involves extending credit to trade customers resulting in trade receivables. Those financing activities of all entities are included in the scope of this SOP. Consistent with the approach taken in the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide *Audits of Finance Companies* (FC Guide), such financing activities will remain subject to those provisions, as modified by this SOP, to which they were subject under that Guide. This SOP provides specific guidance for other types of transactions, such as securities purchases, for certain financial institutions listed in the scope paragraphs of the SOP. To the extent an entity is not considered such a financial institution, as described in those paragraphs, the other guidance provided is not applicable. In other words, only the guidance in this SOP related to the financing and lending activities is applicable for entities not considered to be financial institutions.

What This SOP Means for Entities With Trade Receivables

Entities that extend trade credit to customers were included in the scope of the FC Guide and accordingly are also included in the scope of this SOP. The FC Guide covered all financing activities of business enterprises designed to encourage customers to purchase products and services. This included financings of different types and duration, from shorter term trade financings to extended term arrangements both for an entity's own products and services as well as for the products and services sold by unaffiliated

businesses. While the Accounting Standards Executive Committee (AcSEC) does not believe the recognition and measurement provisions within this SOP will result in a change in practice for trade receivables, entities should carefully consider those provisions of this SOP. This SOP provides certain presentation and disclosure changes for entities with trade receivables as part of the objective of requiring consistent accounting and reporting for like transactions. This SOP also provides specific guidance for other types of transactions specific to certain financial institutions. To the extent an entity is not considered such a financial institution, the other guidance provided is not applicable.

What This SOP Means for Corporate Credit Unions and Mortgage Companies

Corporate credit unions and mortgage companies are included in the scope of this SOP. Corporate credit unions were previously explicitly not subject to the provisions of the AICPA Audit and Accounting Guide *Audits of Credit Unions* (CU Guide). Mortgage companies were previously not explicitly subject to the provisions of the AICPA Audit and Accounting Guide *Banks and Savings Institutions* (BSI Guide). Under this SOP, corporate credit unions and mortgage companies are explicitly subject to new accounting and reporting provisions and disclosure requirements, including disclosures about regulatory capital and net worth requirements.

What This SOP Means for Insurance Companies

Insurance companies were explicitly excluded from the scope of the FC Guide. Consistent with the objective of providing consistent guidance, lending and financing activities of insurance companies are included in this SOP. Additional guidance provided for financial entities, such as deposit liability disclosures, are not applicable to insurance companies.

Why Issued

In the past, the AICPA has issued Audit and Accounting Guides providing industry-specific guidance for preparers and auditors of financial statements of banks, savings institutions, credit unions, finance companies, and other entities with financing activities (including trade receivables). Although many of the transactions covered by the Guides were similar, over time the accounting guidance varied. Divergence in accounting practices among certain elements of the financial services industry for similar transactions has resulted in the need for a reconciliation of existing guidance. This SOP reconciles and conforms, as appropriate, the accounting and financial reporting provisions established by the BSI Guide, CU Guide, and FC Guide (the Guides). This SOP also explicitly incorporates mortgage companies, corporate credit unions, and certain activities of insurance companies in its scope. This SOP will be incorporated in a new AICPA Audit and Accounting Guide, which will supersede the existing Guides. The AICPA Industry Audit and Accounting Guides are included in category (b) of generally accepted accounting principles (GAAP) in the hierarchy established by AICPA Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles.

This SOP eliminates differences in accounting established by the Guides where such differences are not warranted. In addition, the SOP carries forward accounting guidance for transactions unique to certain financial entities. Most of the differences between the respective Guides represent presentation or disclosure requirements; for example, one of the more important differences involves disclosure about regulatory capital requirements. The BSI Guide requires such disclosures, but the CU Guide does not. Under the SOP, regulatory capital disclosures are required for credit unions. Many of the other presentation and disclosure differences are similarly reconciled.

FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if at least five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in its review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.

2. The proposal will result in an improvement in practice.

3. The AICPA demonstrates the need for the proposal.

4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, before clearance, the FASB will propose suggestions, many of which are included in the documents.

Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others

Introduction

1. Most lending and deposit-taking transactions are similar and should be accounted for similarly. Prior to this Statement of Position (SOP), certain differences in accounting for similar transactions existed among banks, savings institutions, credit unions, and finance companies (including entities with trade receivables). That banks, savings institutions, credit unions, and finance companies are organized differently is less relevant to the accounting and financial reporting of underlying transactions than that each primarily extends credit or takes deposits (or both).

2. Therefore, this SOP clarifies that accounting and financial reporting practices for lending and financing activities should be the same regardless of the type of entity engaging in those activities. Second, this SOP eliminates potentially confusing distinctions in the former American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guide *Audits of Finance Companies* (FC Guide) between what constituted a "finance company" and "financing activities." Last, this SOP conforms, where appropriate, differences among the accounting and financial reporting provisions previously established by the AICPA Audit and Accounting Guides *Banks and Savings Institutions* (BSI Guide), *Audits of Credit Unions* (CU Guide), and the FC Guide. The SOP provides for the resolution of accounting differences for similar transactions. As a result, it will improve the consistency in accounting and reporting by those entities. This SOP carries forward accounting guidance for

transactions by differently organized entities determined to have unique transactions. The SOP also explicitly incorporates mortgage companies, corporate credit unions, and certain activities of insurance companies in its scope.

Scope

3. This SOP applies to all banks, savings institutions, credit unions, finance companies, and other entities (including entities with trade receivables) subject to the existing AICPA Audit and Accounting Guides: BSI Guide, CU Guide, and FC Guide, respectively. That population includes the following:

    a. Finance companies, including finance company subsidiaries

    b. Entities that do not consider themselves to be finance companies that engage in transactions that involve lending to or financing the activities of others (including trade receivables and independent and captive financing activities of all kinds of entities[1])

    c. Depository institutions insured by the Federal Deposit Insurance Corporation's (FDIC's) Bank Insurance Fund (BIF) or Savings Association Insurance Fund (SAIF), or the National Credit Union Administration's (NCUA's) National Credit Union Share Insurance Fund (NCUSIF)

    d. Bank holding companies

    e. Savings and loan association holding companies

    f. Branches and agencies of foreign banks regulated by U.S. federal banking regulatory agencies

1. The term *enterprises* is used in practice as business enterprises organized for profit. To the extent that a not-for-profit organization, as defined in Appendix D of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 116, *Accounting for Contributions Received and Contributions Made*, conducts activities in the scope of paragraph 3, provisions of this SOP should be applied. The AICPA Industry Audit Guide *Not For Profit Organizations* provides such guidance in Appendix D, paragraph 1.27 as follows: "However, some not-for-profit organizations conduct activities in some of those industries and should apply the guidance concerning recognition and measurement of assets, liabilities, revenues, expenses, gains and losses in those pronouncements to the transactions unique to those industries."

g. State-chartered banks, credit unions, and savings institutions that are not federally insured

h. Foreign financial institutions whose financial statements are purported to be prepared in conformity with accounting principles generally accepted in the United States

4. This SOP also applies to the following:

a. Mortgage companies

b. Entities that do not consider themselves to be mortgage companies that engage in transactions that involve mortgage activities or transactions

5. Corporate credit unions are explicitly included in the scope of this SOP.

6. Financing and lending activities of insurance companies are explicitly included in the scope of this SOP.

7. This SOP does not apply to the following:

a. Investment companies, broker-dealers in securities, employee benefit plans and similar entities that carry loans and trade receivables at fair value with the unrealized gains and losses included in earnings

b. Governmental or federal entities that follow the principles of the Governmental Accounting Standards Board (GASB) or the Federal Accounting Standards Advisory Board (FASAB)

c. Financing and lending transactions that are subject to category (a) of generally accepted accounting principles (GAAP) in the hierarchy established by AICPA Statement on Auditing Standards (SAS) No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles,[2] if the category (a) guidance differs from the guidance in this SOP

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2. For example, Accounting Principles Bulletin (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, provides accounting guidance for stock loans and accordingly, such transactions are not in the scope of this SOP.

Conclusions

Recognition and Measurement for All Entities

8. Entities within the scope of paragraphs 3 to 6 are subject to the following recognition and measurement principles.

    a. *Loans and Trade Receivables Not Held For Sale.* Loans and trade receivables that management has the intent and ability to hold for the foreseeable future or until maturity or payoff should be reported in the balance sheet at outstanding principal adjusted for any chargeoffs, the allowance for loan losses (or the allowance for doubtful accounts), any deferred fees or costs on originated loans, and any unamortized premiums or discounts[3] on purchased loans.[4]

    b. *Nonmortgage Loans Held For Sale.* Nonmortgage loans held for sale should be reported at the lower of cost or fair value.[5]

    c. *Sales of Loans Not Held For Sale.* Once a decision has been made to sell loans not previously classified as held for sale, such loans should be transferred into the held-for-sale classification and carried at the lower of cost or fair value.[6] At the time of the transfer into the held-for-sale classification, any amount by which cost exceeds fair value should be accounted for as a valuation allowance.

    d. *Credit Losses.* Credit losses for loans and trade receivables, which may be for all or part of a particular loan or trade receivable, should be deducted from the

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3. Discounts offered as a result of the pricing of a sale or a product or service may be termed *sales discounts*. This SOP does not address these discounts.
4. The Accounting Standards Executive Committee (AcSEC) expects to issue an SOP, *Accounting for Loans and Certain Debt Securities Acquired in a Transfer*, in the first quarter of 2002. The SOP updates Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*, and is effective for transfers of loans acquired in fiscal years beginning after June 15, 2002.
5. This paragraph applies to nonmortgage loans. Readers should refer to FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, for mortgage loans classified as held for sale.
6. This paragraph applies to both mortgage and nonmortgage loans.

allowance.[7] The related loan or trade receivable balance should be charged off in the period in which the loans or trade receivables are deemed uncollectible. Recoveries of loans and trade receivables previously charged off should be recorded when received.[8]

e. *Credit Losses on Off-Balance-Sheet Instruments.* An accrual for credit loss on a financial instrument with off-balance-sheet risk should be recorded separate from a valuation account related to a recognized financial instrument. Credit losses for off-balance-sheet financial instruments should be deducted from the liability for credit losses in the period in which the liability is settled.[9]

f. *Standby Commitments to Purchase Loans.* Entities sometimes enter into forward standby commitments to purchase loans at a stated price in return for a standby commitment fee. In such an arrangement, settlement of the standby commitment is at the option of the seller of the loans and would result in delivery to the entity only if the contract price equals or exceeds the market price of the underlying loan or security on the settlement date. A standby commitment differs from a mandatory commitment in that the entity assumes all the market risks of ownership but shares in none of the rewards. A standby commitment is, in substance, a written put option that will be exercised only if the value of the loans is less than or equal to the strike price. Many entities use standby commitments to supplement their normal loan origination volume. If the settlement date is

7. AcSEC has a project that is addressing certain issues related to the allowance for credit losses. Readers should be alert to any final pronouncement.

8. AcSEC recognizes that practices differ between entities as some industries typically credit recoveries directly to earnings while financial institutions typically credit the allowance for loan losses for recoveries. AcSEC reevaluated this practice as part of this project. AcSEC decided not to amend this practice because the combination of this practice and the practice of frequently reviewing the adequacy of the allowance for loan losses results in the same credit to earnings in an indirect manner.

9. *Off-balance-sheet financial instruments* refers to off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments with off-balance-sheet credit risk except for instruments within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities.*

within a reasonable period (for example, a normal loan commitment period) and the entity has the intent and ability to accept delivery without selling assets, standby commitments are generally viewed as part of the normal production of loans, and entities record loans purchased under standby commitments at cost on the settlement date, net of the standby commitment fee received, in conformity with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. However, if the settlement date is not within a reasonable period, or the entity does not have the intent and ability to accept delivery without selling assets, the standby commitment generally is accounted for as a written put option. In that case, the option premium received (standby commitment fee) should be recorded as a liability representing the fair value of the standby commitment on the trade date. Thereafter, the liability should be accounted for at the greater of the initial standby commitment fee or the fair value of the written put option. Unrealized gains (that is, recoveries of unrealized losses) or losses should be credited or charged to current operations.[10]

g. *Criteria for Sale of Servicing Rights*. Criteria that should be considered when evaluating whether a transfer of servicing rights qualifies as a sale are the guidance, as applicable, in Emerging Issue Task Force (EITF) Issue No. 95-5 "Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights",[11] and the following:

10. This paragraph applies only to standby commitments to purchase loans. It does not apply to other customary kinds of commitments to purchase loans, nor does it apply to commitments to originate loans. The FASB staff has issued tentative guidance in Statement 133 Implementation Issue No. C13, "When a Loan Commitment Is Included in the Scope of Statement 133," regarding the circumstances in which a loan commitment or other credit arrangement should be accounted for as a derivative under FASB Statement No. 133. Readers should be alert to any final guidance.

11. EITF Issue No. 95-5 provides guidance for determining whether a transfer of servicing rights should be accounted for as a sale.

- Whether the seller has received written approval from the investor if required
- Whether the buyer is a currently approved seller/servicer and is not at risk of losing approved status
- In the event of a sale in which the seller finances a portion of the sales price, whether an adequate nonrefundable down payment has been received (necessary to demonstrate the buyer's commitment to pay the remaining sales price) and whether the note receivable from the buyer provides full recourse to the buyer. Nonrecourse notes or notes with limited recourse (such as to the servicing) do not satisfy this criterion
- Also, temporary servicing performed by the transferor for a short period of time should be compensated in accordance with a subservicing agreement that provides adequate compensation.

h. *Sales of Servicing Rights*. Sales of servicing rights relating to loans previously sold should be recognized in income subject to the considerations above. Sales of servicing rights relating to loans that are retained should also be recognized in income subject to the considerations above and at the date of sale, the carrying amount should be allocated between the servicing rights and loans retained using relative fair values in a manner consistent with paragraph 10(b) of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*.[12]

i. *Federal Home Loan Bank or Federal Reserve Bank Stock*. Federal Home Loan Bank (FHLB) and Federal Reserve Bank (FRB) stock should be classified as a restricted investment security, carried at cost, and

12. FASB Statement No. 140 does not address transfers of servicing rights because they are not financial assets. However, this SOP addresses transactions in which loans are transferred with servicing retained, and governs allocation of basis between loans and servicing rights for those transactions.

evaluated for impairment. Both cash and stock dividends[13] received on FHLB stock are reported as income. The stock dividends are redeemable at par value. FHLB stock is generally viewed as a long-term investment. Accordingly, when evaluating FHLB stock for impairment, its value should be determined based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The determination of whether the decline affects the ultimate recoverability is influenced by criteria such as the following:

- The significance of the decline in net assets of the FHLBs as compared to the capital stock amount for the FHLBs and the length of time this situation has persisted
- Commitments by the FHLBs to make payments required by law or regulation and the level of such payments in relation to the operating performance of the FHLBs
- The impact of legislative and regulatory changes on institutions and, accordingly, on the customer base of the FHLBs
- The liquidity position of the FHLBs

j. *Delinquency Fees*. Delinquency fees should be recognized in income when chargeable, assuming collectibility is reasonably assured.

k. *Prepayment Fees*. Prepayment penalties should not be recognized in income until loans (or trade receivables, if applicable) are prepaid, except that the existence of prepayment penalties may affect the accounting resulting from the application of paragraph 18(a) of FASB Statement No. 91.

l. *Rebates*. Rebates represent refunds of portions of the precomputed finance charges on installment loans (or trade receivables, if applicable) that occur when payments are made ahead of schedule. Rebate calculations generally are governed by state laws and

13. Chapter 7 of Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, provides guidance for stock-splits.

may differ from unamortized finance charges on installment loans or trade receivables because many states require rebate calculations to be based on the Rule of 78s or other methods instead of the interest method. Accrual of interest income on installment loans or trade receivables should not be affected by the possibility that rebates may be calculated on a method different from the interest method, except that the possibility of rebates affects the accounting resulting from the application of paragraph 18(a) of FASB Statement No. 91. Differences between rebate calculations and accrual of interest income merely adjust original estimates of interest income and should be recognized in income when loans or trade receivables are prepaid or renewed.

m. Factoring Arrangements. Transfers of receivables under factoring arrangements meeting the sale criteria of paragraph 9 of FASB Statement No. 140 are accounted for by the factor as purchases of receivables. The acquisition of receivables and accounting for purchase discounts such as factoring commissions should be recognized in accordance with FASB Statement No. 91 or AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*, as applicable.[14] Transfers not meeting the sale criteria in FASB Statement No. 140 are accounted for as secured loans (that is, loans collateralized by customer accounts or receivables). Paragraph 15 of FASB Statement No. 140 provides additional guidance in those situations. Factoring commissions under these arrangements should be recognized over the period of the loan contract in accordance with FASB Statement No. 91. That period begins when the finance company (or an entity with financing activities [including trade receivables]) funds a customer's credit and ends when the customer's account is settled.

14. See footnote 4.

Recognition and Measurement for Financial Institutions[15] and Entities With Financing or Mortgage Activities

9. *Insurance Commissions*. For entities within the scope of paragraphs 3 to 5, income from experience-rated or retrospective commission arrangements should be recognized over the applicable insurance risk period.

Recognition and Measurement for Financial Institutions

10. Entities within the scope of paragraphs 3 (excluding 3b) and 4 (excluding 4b) and 5 are subject to the following recognition and measurement principles.

    a. *Regular-Way Securities*. Regular-way[16] purchases and sales of securities should be recorded on the trade date. Gains and losses from regular-way security sales or disposals should be recognized as of the trade date in the statement of operations for the period in which securities are sold or otherwise disposed of.

    b. *Short Sales of Securities*. The obligations incurred in short sales[17] should be reported as liabilities and adjusted to fair value through the income statement at each reporting date. Such liabilities are generally called "securities sold, not yet purchased." The fair value adjustment should be classified in the income statement with gains and losses on securities. Interest on the short positions should be accrued periodically and reported as interest expense.

    c. *Deposits*. The institution's liability for deposits originates and should be recognized at the time deposits are received rather than when the institution collects the funds. Checks that are deposited by customers

15. For purposes of this SOP, *financial institution* (or *institution*) denotes a bank, credit union, finance company, mortgage company, or savings institution.

16. In Paragraph 275 of FASB Statement No. 133, *regular-way* is defined as follows:

    Regular-way security trades are those that are completed (or settled) within the time period generally established by regulations and conventions in the marketplace or by the exchange on which the transaction is being executed.

17. Paragraph 59(d) of FASB Statement No. 133 discusses short sales.

and that are in the process of collection and are currently not available for withdrawal (deposit float) should be recorded as assets and liabilities. Deposits should not be recorded based solely on collections.

Recognition and Measurement for Credit Unions

11. The following are accounting practices unique to credit unions that were initially established by the CU Guide and are carried forward to this SOP. Credit unions within the scope of paragraph 3c of this SOP and corporate credit unions within the scope of paragraph 5 of this SOP are subject to the following recognition and measurement provisions:

    a. *NCUSIF Deposit*. Amounts deposited with the NCUSIF should be accounted for and reported as assets as long as such amounts are fully refundable. The refundability of NCUSIF deposits should be reviewed for impairment. When the refundability of a deposit is evaluated, the financial condition of both the credit union and of the NCUSIF should be considered. Deposits may be returned to solvent credit unions for a number of reasons, including termination of insurance coverage, conversion to insurance coverage from another source, or transfer of operations of the insurance fund from the NCUA Board. However, insolvent or bankrupt credit unions are not entitled to a return of their deposits. To the extent that NCUSIF deposits are not refundable, they should be charged to expense in the period in which the deposits are made or the assets become impaired.

    b. In years in which the equity of the NCUSIF exceeds "normal operating levels," the NCUA Board is required to make distributions to insured credit unions to reduce the equity of the NCUSIF to normal operating levels. Such distributions may be in the form of a waiver of insurance premiums, premium rebates, or cash payments. Distributions in connection with that reduction in the equity of the NCUSIF should be reported in the income statement in the period in which it is determined that a distribution will be made.

c. The system of savings account insurance established by the recapitalization of the NCUSIF, which provided for reserves of 1 percent of insured deposits, is based on the concept that the required deposits create a fund with an earning potential sufficient to provide for the risk of losses in the credit union system. In years in which the earnings of the fund have been adequate to provide insurance protection and cover all expenses and losses incurred by the fund, the NCUA Board has elected to waive the insurance premiums due from insured credit unions. In those years, it has been industry practice to net imputed earnings on the insurance deposits against imputed premium expense rather than present them as gross amounts on the statement of income. In years in which the insurance premiums are not waived by the NCUA Board, the premiums should be expensed in the period to which they relate. To the extent that the NCUA Board assesses premiums to cover prior operating losses of the insurance fund or to increase the fund balance to "normal operating levels," credit unions should expense those premiums when assessed.

d. *Member Deposits*. Generally accepted accounting principles (GAAP)[18] require that all member deposit accounts of credit unions, including member shares, be reported unequivocally as liabilities in the statement of financial condition.[19] The statement of financial condition either (1) presents deposit accounts as the first item in the liabilities and equity section or (2) includes deposit accounts within a captioned subtotal for total liabilities. An unclassified presentation whereby all liabilities and equity are shown together under one subheading and savings accounts are presented as the last item before retained earnings is not

18. The Credit Union Membership Access Act (CUMAA) (H.R. 1151) was passed into law in August 1998. This legislation requires all federally insured credit unions with assets of $10 million and over to follow generally accepted accounting principles (GAAP).

19. In October 2000, the FASB issued an exposure draft of a proposed Statement, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*, and an exposure draft of a proposed amendment to FASB Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements* entitled *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities*. Readers should be alert to any final pronouncements.

an acceptable presentation. The interest paid or accrued on these accounts, commonly referred to as *dividends*, should be reported as an expense on the statement of income, and the amount of interest payable to members should be included as a liability in the statement of financial condition. This is the same position that the EITF reached in EITF Issue No. 89-3, "Balance Sheet Presentation of Savings Accounts in Financial Statements of Credit Unions."

Recognition and Measurement for Finance Companies and Entities With Financing Activities (Including Entities With Trade Receivables)

12. *Favorable Financing Arrangements.* For entities within the scope of paragraphs 3a and 3b, transactions in which captive finance companies offer favorable financing to increase sales of related companies are not exempted from the scope of Accounting Principles Board (APB) Opinion No. 21, *Interest on Receivables and Payables*, by paragraph 3(d) of that Opinion. APB Opinion 21 provides accounting guidance to use if the face amount of the note does not reasonably represent the present value of the consideration given or received in an exchange.

Presentation and Disclosure for All Entities

13. Entities within the scope of paragraphs 3 to 6 are subject to the following presentation and disclosure principles.

    a. Accounting Policies for Loans and Trade Receivables. The summary of significant accounting policies should include the following:

    (1) The basis for accounting for loans, trade receivables, and lease financings, including those classified as held for sale

    (2) The method used in determining the lower of cost or fair value of nonmortgage loans held for sale (that is, aggregate or individual asset basis)[20]

20. A similar requirement exists for mortgage loans held for sale. See paragraph 29 of FASB Statement No. 65.

(3) The classification and method of accounting for interest-only strips, loans, other receivables, or retained interests in securitizations that can be contractually prepaid or otherwise settled in a way that the holder would not recover substantially all of its recorded investment[21, 22, 23]

(4) The method for recognizing interest income on loan and trade receivables, including a statement about the entity's policy for treatment of related fees and costs, including the method of amortizing net deferred fees or costs.

b. *Accounting Policies for Credit Losses and Doubtful Accounts*. In addition to disclosures required by FASB Statements No. 5, *Accounting for Contingencies* 114, *Accounting by Creditors for Impairment of a Loan*,[24] and 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures*, a description of the accounting policies and methodology the entity used to estimate its allowance for loan losses, allowance for doubtful accounts,[25] and any liability for off-balance-sheet credit losses[26] and related charges for loan, trade receivable or other credit losses should be included in

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21. This disclosure requirement applies to instruments within the scope of paragraph 14 of FASB Statement No. 140. The FASB plans to provide guidance on (*a*) which types of instruments qualify for the exception in paragraph 14 of FASB Statement No. 133 and (*b*) whether beneficial interests in securitized financial assets that are subordinated to other interests meet FASB Statement No. 133's definition of derivative instrument. Statement 133 Implementation Issue No. D1, "Recognition and Measurement of Derivatives: Application of Statement 133 to Beneficial Interests in Securitized Financial Assets" provides interim guidance. Readers should be alert to any final guidance.

22. See footnote 4.

23. Footnote 17 of FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, states that "The *recorded investment in the receivable* is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous write-down of the investment."

24. FASB Statement No. 114 states in paragraph 4, "For purposes of this Statement, a loan is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable."

25. See footnote 7.

26. *Off-balance-sheet credit losses* refers to losses on off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments, except for instruments within the scope of FASB Statement No. 133.

the notes to the financial statements. Such a description should identify the factors that influenced management's judgment (for example, historical losses and existing economic conditions) and may also include discussion of risk elements relevant to particular categories of financial instruments.

c. *Accounting Policies for Nonaccrual and Past Due Loans and Trade Receivables*. The summary of significant accounting policies should include the following:

   (1) The policy for placing loans (and trade receivables if applicable) on nonaccrual status (or discontinuing accrual of interest) and recording payments received on nonaccrual loans (and trade receivables if applicable), and the policy for resuming accrual of interest

   (2) The policy for charging off uncollectible loans and trade receivables

   (3) The policy for determining past due or delinquency status (that is, whether past due status is based on how recently payments have been received or contractual terms)

d. *Sales of Loans and Trade Receivables*. The aggregate amount of gains or losses on sales of loans or trade receivables (including adjustments to record loans held for sale at the lower of cost or fair value) should be presented separately in the financial statements or disclosed in the notes to the financial statements.[27]

e. *Loans or Trade Receivables*. Loans or trade receivables may be presented on the balance sheet as aggregate amounts. However, such receivables held for sale should be a separate balance-sheet category. Major categories of loans or trade receivables should be presented separately either in the balance sheet or in the notes to the financial statements. The allowance for

27. AcSEC acknowledges that many financial institutions currently present such gains or losses separately on the face of the income statement. By requiring financial statement disclosure, AcSEC is not suggesting that this industry practice should be discontinued.

credit losses, the allowance for doubtful accounts, and, as applicable, any unearned income, any unamortized premiums and discounts,[28] and any net unamortized deferred fees and costs, should be disclosed in the financial statements.

f. Foreclosed and Repossessed Assets. Foreclosed and repossessed assets should be classified as a separate balance-sheet amount or included in other assets on the balance sheet with separate disclosures in the notes to the financial statements. Certain returned or repossessed assets, such as inventory, should not be classified separately if the assets subsequently are to be utilized by the entity in operations.

g. Nonaccrual and Past Due Loans and Trade Receivables. The recorded investment[29] in loans (and trade receivables if applicable) on nonaccrual status as of each balance-sheet date should be disclosed in the notes to the financial statements. The recorded investment in loans (and trade receivables if applicable) past due ninety days or more and still accruing should also be disclosed. For trade receivables that do not accrue interest until a specified period has elapsed, nonaccrual status would be the point when accrual is suspended after the receivable becomes past due.

h. Securities on Deposit. Insurance subsidiaries may be required to deposit securities with state regulatory authorities. If so, the carrying amount of securities deposited should be disclosed.

i. Assets Serving as Collateral. The carrying amount of loans, trade receivables, securities and financial instruments that serve as collateral for borrowings, should be disclosed pursuant to paragraphs 18 and 19 of FASB Statement No. 5.

28. See footnote 4.

29. See footnote 23.

Presentation and Disclosure for Financial Institutions

14. Entities within the scope of paragraphs 3 (excluding 3b), 4 (excluding 4b), and 5 are subject to the following presentation and disclosure principles.

    a. *Cash Restrictions*. Restrictions on the use or availability of certain cash balances, such as deposits with an FRB, FHLB, or correspondent financial institutions to meet reserve requirements or deposits under formal compensating balance agreements, should be disclosed in the notes to the financial statements.

    b. *Reciprocal Balances and Related Overdrafts*. A financial institution that accepts deposits may have balances due from the same financial institution from which it has accepted a deposit. Those account balances, also called reciprocal balances, should be offset if they will be offset in the process of collection or payment. Overdrafts of such accounts should be reclassified as liabilities, unless the financial institution has other accounts at the same financial institution against which such overdrafts can be offset.

    c. *Sales of Premises and Equipment*. For premises and equipment, net gains or net losses on dispositions should be included in noninterest income or noninterest expense.

    d. *Securities*. The carrying amount of investment assets that serve as collateral to secure public funds, securities sold under repurchase agreements, and other borrowings, that are not otherwise disclosed under FASB Statement No. 140, should be disclosed in the notes to the financial statements.

    e. *Deposits*. Disclosures about deposit liabilities should include the following:

        (1) The aggregate amount of time deposit accounts (including certificates of deposit) in denominations of $100,000 or more at the balance-sheet date

(2) Securities, mortgage loans, or other financial instruments that serve as collateral for deposits, that are otherwise not disclosed under FASB Statement No. 140

(3) The aggregate amount of any demand deposits that have been reclassified as loan balances, such as overdrafts, at the balance-sheet date

(4) Deposits that are received on terms other than those available in the normal course of business.

f. *Borrowings*. Significant categories of borrowings should be presented as separate line items in the liability section of the balance sheet, or as a single line item with appropriate note disclosure of components. Institutions may, alternatively, present debt based on the debt's priority (that is, senior or subordinated) if they also provide separate disclosure of significant categories of borrowings.

g. *Long-Term Obligations*. Accounting and reporting requirements for long-term obligations are the same for financial institutions as for other entities. If the financial institution has an unclassified balance sheet, there is no need to separate balances into current and long-term portions.[30]

h. *Debt*. For debt, the notes to the financial statements should describe the principal terms of the respective agreements including but not limited to the title or nature of the agreement, or both; the interest rate (and whether it is fixed or floating); the payment terms and maturity date(s); collateral; conversion or redemption features; whether it is senior or subordinated; and restrictive covenants (such as dividend restrictions), if any.

i. *Secured Borrowings*. Transfers of mortgages accounted for under FASB Statement No. 140 as secured borrowings of the issuing institution should be classified as debt on the institution's balance sheet. Such mortgage-backed bonds should be classified

30. FASB Statement No. 47, *Disclosure of Long Term Obligations*, requires disclosure of future payments on long-term borrowings.

separately from advances, other notes payable, and subordinated debt.

j. *Offsetting Amounts in the Balance Sheet for Credit Life and Credit Accident and Health Policies.* Unearned premiums and unpaid claims on certain insurance coverage issued to finance customers by a subsidiary may represent intercompany items because premiums are added to the consumer loan account, which is in turn classified as a receivable until paid, and most or all of the payments on claims are applied to reduce the related finance receivables. Therefore, unearned premiums and unpaid claims on certain credit life and credit accident and health insurance policies issued to finance customers should be deducted from finance receivables in the consolidated balance sheet. Alternatively, the balance sheet may present only the net finance receivables if the notes to the financial statements contain sufficient disclosure of unearned premiums and unpaid claims and the allowance for losses. Unearned premiums and unpaid claims for credit life and accident and health coverage should not be applied in consolidation against related finance receivables for which the related receivables are assets of unrelated entities. In those circumstances, such amounts should be presented as liabilities.

k. *Offsetting Amounts in the Balance Sheets for Property Insurance and Term Life Policies.* In the consolidated financial statements, unpaid claims for property insurance and level term life insurance, however, should not be offset against related finance receivables because finance companies generally do not receive substantially all proceeds of such claims. That prohibition also applies to credit life and accident and health coverage written on policies for which the related receivables are assets of unrelated entities. In those circumstances, such amounts should be presented as liabilities.

l. *Redeemable Preferred Stock Dividends.* For redeemable preferred stock of a subsidiary accounted

for as a liability in a parent's consolidated financial statements, dividends should be included in the determination of income as interest expense. For redeemable preferred stock of a subsidiary accounted for as a minority interest in a subsidiary in a parent's consolidated financial statements, the dividends should be presented as minority interest in income of a subsidiary. For redeemable preferred stock of a parent treated as capital, but displayed in the balance sheet as mezzanine capital, dividends should be included in the statement of changes in shareholders' equity.[31]

m. *Off-Balance-Sheet Credit Risk*. For financial instruments with off-balance-sheet credit risk,[32] except for those instruments within the scope of FASB Statement No. 133, an entity should disclose the following information:

(1) The face or contract amount

(2) The nature and terms, including, at a minimum, a discussion of the:

  (*a*) Credit and market risk of those instruments

  (*b*) Cash requirements of those instruments

  (c) Related accounting policy pursuant to APB Opinion 22, *Disclosure of Accounting Policies*

(3) The entity's policy for requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Examples of activities and financial instruments with off-balance-sheet credit risk include obligations for loans sold with recourse (with or without a floating-interest-rate provision), fixed-rate and variable-rate

31. See footnote 19.

32. *Off-balance-sheet credit risk* refers to credit risk on off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments, except for instruments within the scope of FASB Statement No. 133.

loan commitments, financial guarantees,[33] note issuance facilities at floating rates, and letters of credit.

15. Entities within the scope of paragraphs 3 and 5 of this SOP are subject to the following presentation and disclosure principles.

    a. *Regulatory Capital Disclosures for Branches of Foreign Institutions*. Branches of foreign financial institutions, while they do not have regulatory capital requirements, may be required to maintain capital-equivalent deposits and, depending on facts and circumstances, supervisory-mandated reserves. These requirements carry regulatory uncertainty of a nature similar to that posed by the regulatory capital rules in that failure to meet such mandates can result in supervisory action and ultimately going-concern questions. Accordingly, branches should disclose such requirements. Quantitative disclosure should be made, highlighting mandated deposit or reserve requirements and actual balances in those reserve or deposit accounts at the balance-sheet date(s) reported.

       Further, if an uncertainty exists related to a parent that creates a higher-than-normal risk as to the viability of a branch or subsidiary, then that matter should be adequately disclosed in the notes to the financial statements of the branch or subsidiary. If factors do not exist that indicate a higher than normal amount of risk or uncertainty regarding parent capital and other regulatory matters, then disclosures of capital and supervisory issues of the parent would not be required.

    b. *Regulatory Capital Disclosures for Trust Operations*. If an institution is subject to capital requirements based on trust assets under management, a discussion of the existence of these requirements, ramifications of failure to meet them, and a measurement of the entity's position relative to imposed

33. A guarantor is required to disclose and account for a financial guarantee under EITF Issue 85-20, "Recognition of Fees for Guaranteeing a Loan."

requirements should be disclosed in the notes to the financial statements.

c. *Regulatory Capital Disclosures for Business Combinations*.[34] Following a business combination accounted for as a pooling of interests, the prior-year disclosures should—

(1) Contain quantitative disclosures limited to the combined Tier I, Tier II, and total capital, or net worth, as applicable, and related assets or risk-weighted assets, as applicable, and the ratios derived therefrom

(2) Not compare such ratios to either statutory or regulatory capital adequacy or prompt corrective action minimums, the mandated minimums of either premerged entity, or a composite of the premerged entities' mandated minimums

(3) Include a discussion of whether the entities, precombination, were required to hold capital in excess of statutory regulatory minimums in order to be considered well and/or adequately capitalized, and the reasons for those amended minimums

(4) Include a statement that there was not a determination by regulatory authorities as to the capital adequacy or prompt corrective action category of the combined entity relative to the premerger combined amounts and ratios presented

d. Following a business combination accounted for as a purchase, because prior capital position can be less relevant as a result of capital repatriation to former owners and the effects of purchase accounting adjustments and the push-down of basis, judgment should be used as to relevant disclosures. Minimum disclosures should include the capital position of the

34. In June 2001, the FASB issued FASB Statement No. 141, *Business Combinations*, which supersedes APB Opinion 16, *Business Combinations*. FASB Statement No. 141, which applies to all business combinations except those between not-for-profit enterprises, requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method. The provisions of FASB Statement No. 141 are applicable to business combinations accounted for by the purchase method completed after June 30, 2001.

purchaser at the prior period end and information to highlight comparability issues, such as significant capital requirements imposed or agreed to during the regulatory approval process, and the effects of purchase accounting, if any, on regulatory capital determination.

Presentation and Disclosure for Credit Unions

16. ***Regulatory Capital Disclosures for Credit Unions***. The following are regulatory capital disclosure requirements for credit unions (within the scope of paragraph 3c or 3g of this SOP) and corporate credit unions (within the scope of paragraph 5 of this SOP).

    a. Noncompliance with regulatory capital requirements could materially affect the economic resources of a credit union and claims to those resources. Accordingly, at a minimum, the institution should disclose the following in the notes to the financial statements:[35]

    (1) A description of the regulatory requirements (*a*) for capital adequacy purposes and (*b*) prompt corrective action

    (2) The actual or possible material effects of noncompliance with those requirements

    (3) Whether the institution is in compliance with the regulatory capital requirements, including, as of each balance-sheet date presented, the following with respect to quantitative measures:

    (*a*) Whether the institution meets the definition of a complex credit union as defined by the National Credit Union Administration[36]

35. Disclosures should also be presented for any state-imposed capital requirements that are more stringent than or significantly different from federal requirements.

36. The NCUA Board adopted prompt corrective action rules in response to the CUMAA requirement that the NCUA adopt a system to restore the net worth of inadequately capitalized federally insured credit unions. In conjunction with the adopted Prompt Corrective Action Rule, the NCUA Board also issued a rule, which defines a "complex" credit union and establishes risk-based net worth requirements. Readers should refer to the NCUA Regulations for the risk-based net worth and prompt corrective action requirements.

(*b*) The institution's required and actual capital ratios and required and actual capital amounts

(*c*) Factors that may significantly affect capital adequacy, such as potentially volatile components of capital, qualitative factors, or regulatory mandates

(4) As of each balance-sheet date presented, the prompt corrective action category in which the institution was classified

(5) If, as of the most recent balance-sheet date or issuance of the financial statements, the institution is not in compliance with capital adequacy requirements, the possible material effects of such conditions on amounts and disclosures in the financial statements

(6) Whether subsequent to the balance-sheet date and prior to issuance of the financial statements, management believes any events or changes have occurred to change the institution's prompt corrective action category.

b. Noncompliance with regulatory capital requirements may, when considered with other factors, raise substantial doubt about a credit union's ability to continue as a going concern for a reasonable period of time. Additional information that might be disclosed in situations in which there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time may include the following:

- Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- Possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events and any mitigating factors
- Possible discontinuance of operations

- Management's plans (including any relevant financial information)
- Information about the recoverability or classification of recorded asset amounts or the amounts or classifications of liabilities

Presentation and Disclosure for Mortgage Companies and Activities

17. ***Capital Requirements by Mortgage Companies and Entities With Mortgage Banking Activities.*** The following are capital disclosure requirements for mortgage companies and other activities within the scope of paragraph 4 of this SOP.

    a. Noncompliance with minimum net worth (capital) requirements imposed by secondary market investors or state-imposed regulatory mandates could materially affect the economic resources of a mortgage banking entity and claims to those resources. To the extent an entity is subject to such requirements, the entity should disclose the following in the notes to the financial statements:

    (1) A description of the minimum net worth requirements related to:

    (*a*) secondary market investors and

    (*b*) state-imposed regulatory mandates

    (2) The actual or possible material effects of noncompliance with those requirements

    (3) Whether the entity is in compliance with the regulatory capital requirements, including, as of each balance-sheet date presented, the following with respect to quantitative measures:

    (*a*) The entity's required and actual net worth amounts

    (*b*) Factors that may significantly affect adequacy of net worth such as potentially volatile components of capital, qualitative factors, or regulatory mandates

(4) If, as of the most recent balance-sheet date, the entity is not in compliance with capital adequacy requirements, the possible material effects of such conditions on amounts and disclosures in the notes to the financial statements.

b. Further, noncompliance with minimum net worth requirements may, when considered with other factors, raise substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time. Additional information that might be disclosed in situations where there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time may include the following:

- Pertinent conditions and events giving rise to the assessment of substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time
- Possible effects of such conditions and events
- Management's evaluation of the significance of those conditions and events and any mitigating factors
- Possible discontinuance of operations
- Management's plans (including any relevant financial information)
- Information about the recoverability or classification of recorded asset amounts or the amounts or classifications of liabilities

c. Servicers with net worth requirements from multiple sources should disclose, in the notes to the financial statements, the net worth requirement of the following:

(1) Significant servicing covenants with secondary market investors with commonly defined servicing requirements[37]

37. At the time of issuance of this SOP, common secondary market investors include the U.S. Department of Housing and Urban Development (HUD), Federal National Mortgage Association (FNMA), Government National Mortgage Association (GNMA), and Federal Home Loan Mortgage Corporation (FHLMC).

(2) Any other secondary market investor where violation of the requirement would have a significant adverse effect on the business

(3) The most restrictive third-party agreement if not included above

Impact on Other Literature

18. The provisions of this SOP supersede the relevant accounting and financial reporting provisions of the AICPA Audit and Accounting Guides *Banks and Savings Institutions* (May 2000), *Audits of Credit Unions* (May 2000), and *Audits of Finance Companies* (May 2000).

Effective Date and Transition

19. References in this SOP to other literature do not change the effective date specified in that other literature. Except as described in paragraph 20, changes in accounting and financial reporting required by this SOP should be applied prospectively and shall be effective for annual and interim financial statements issued for fiscal years beginning after December 15, 2001. As described in the following paragraph, the cumulative effect should be determined and reported in conformity with paragraph 20 of APB Opinion 20, *Accounting Changes*. No proforma effects need be disclosed. Earlier application is encouraged.

20. The following paragraphs outline the recognition and measurement transition guidance for each type of entity covered by this SOP.

    a. *Banks and Savings Institutions*. If initial application of paragraph 8h, "Sales of Servicing Rights," or paragraph 9, "Insurance Commissions," results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20.

b. Credit Unions. If initial application of the following paragraphs results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20:

(1) Paragraph 8b, "Nonmortgage Loans Held for Sale"

(2) Paragraph 8f, "Standby Commitments to Purchase Loans"

(3) Paragraph 8h, "Sales of Servicing Rights"

(4) Paragraph 8i, "FHLB and FRB Stock"

(5) Paragraph 9, "Insurance Commissions"

(6) Paragraph 10b, "Short Sales of Securities"

(7) Paragraph 10c, "Deposits"

(8) Paragraph 14l, "Redeemable Preferred Stock Dividends"

c. Finance Companies. If initial application of the following paragraphs results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20:

(1) Paragraph 8a, "Loans and Trade Receivables Not Held for Sale"

(2) Paragraph 8b, "Nonmortgage Loans Held for Sale"

(3) Paragraph 8c, "Sales of Loans Not Held for Sale"

(4) Paragraph 8f, "Standby Commitments to Purchase Loans"

(5) Paragraph 8h, "Sales of Servicing Rights"

(6) Paragraph 8i, "FHLB and FRB Stock"

(7) Paragraph 9, "Insurance Commissions"

(8) Paragraph 10a, "Regular-Way Securities"

(9) Paragraph 10b, "Short Sales of Securities"

(10) Paragraph 10c, "Deposits"

(11) Paragraph 14l, "Redeemable Preferred Stock Dividends"

d. Financing Activities (including Trade Receivables). If initial application of the following paragraphs results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20:

(1) Paragraph 8a, "Loans and Trade Receivables Not Held for Sale"

(2) Paragraph 8b, "Nonmortgage Loans Held for Sale"

(3) Paragraph 8c, "Sales of Loans Not Held for Sale"

(4) Paragraph 8f, "Standby Commitments to Purchase Loans"

(5) Paragraph 8h, "Sales of Servicing Rights"

(6) Paragraph 8i, "FHLB and FRB Stock"

e. Corporate Credit Unions. If initial application of the following paragraphs results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20:

(1) Paragraph 8a, "Loans and Trade Receivables Not Held for Sale"

(2) Paragraph 8b, "Nonmortgage Loans Held for Sale"

(3) Paragraph 8c, "Sales of Loans Not Held for Sale"

(4) Paragraph 8f, "Standby Commitments to Purchase Loans"

(5) Paragraph 8h, "Sales of Servicing Rights"

(6) Paragraph 8i, "FHLB and FRB Stock"

(7) Paragraph 9, "Insurance Commissions"

(8) Paragraph 10a, "Regular-Way Securities"

(9) Paragraph 10b, "Short Sales of Securities"

(10) Paragraph 10c, "Deposits"

(11) Paragraph 11a, "NCUSIF Deposit"

(12) Paragraph 14l, "Redeemable Preferred Stock Dividends"

f. Mortgage Companies. If initial application of the following paragraphs results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20:

(1) Paragraph 8a, "Loans and Trade Receivables Not Held for Sale"

(2) Paragraph 8b, "Nonmortgage Loans Held for Sale"

(3) Paragraph 8c, "Sales of Loans Not Held for Sale"

(4) Paragraph 8f, "Standby Commitments to Purchase Loans"

(5) Paragraph 8h, "Sales of Servicing Rights"

(6) Paragraph 8i, "FHLB and FRB Stock"

(7) Paragraph 9, "Insurance Commissions"

(8) Paragraph 10a, "Regular-Way Securities"

(9) Paragraph 10b, "Short Sales of Securities"

(10) Paragraph 10c, "Deposits"

(11) Paragraph 14l, "Redeemable Preferred Stock Dividends"

g. Mortgage Activities. If initial application of the following paragraphs results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20:

(1) Paragraph 8a, "Loans and Trade Receivables Not Held for Sale"

(2) Paragraph 8b, "Nonmortgage Loans Held for Sale"

(3) Paragraph 8c, "Sales of Loans Not Held for Sale"

(4) Paragraph 8f, "Standby Commitments to Purchase Loans"

(5) Paragraph 8h, "Sales of Servicing Rights"

(6) Paragraph 8i, "FHLB and FRB Stock"

h. *Insurance Companies*. If initial application of the following paragraphs results in changes in accounting, the cumulative effect should be included in income in the year in which this SOP is first applied and reported in conformity with paragraph 20 of APB Opinion 20:

(1) Paragraph 8a, "Loans and Trade Receivables Not Held for Sale"

(2) Paragraph 8b, "Nonmortgage Loans Held for Sale"

(3) Paragraph 8c "Sales of Loans Not Held for Sale"

(4) Paragraph 8f, "Standby Commitments to Purchase Loans"

(5) Paragraph 8h, "Sales of Servicing Rights"

(6) Paragraph 8i "FHLB and FRB Stock"

(7) Paragraph 8j to 8m, "Fees, Rebates, and Factoring Arrangements"

21. For entities following transition paragraphs 20a to 20d, the paragraphs not enumerated are those that such entities should have been following prior to this SOP. Accordingly, an initial application of the paragraphs not included in paragraph 20 should be reported as a correction of an error. In applying these provisions to paragraph 8h, "Sales of Servicing Rights," previously deferred gains on the sale of servicing rights should be recognized at transition. Paragraph 11 and 12 of this SOP represents specialized industry practices and should have already been followed by entities subject to this guidance.

22. In initially applying this SOP for financial statements issued for the fiscal year beginning after December 15, 2001, the disclosures required by paragraphs 13 to 17 of this SOP need not be included in prior fiscal years' financial statements that are presented for comparative purposes. For all subsequent years, the requirements of paragraphs 13d, "Sales of Loans and Trade Receivables," and 14c, "Sales of Premises and Equipment," of this SOP should be included in each year for which an income statement is presented and all other information required to be disclosed should be applied for each year for which a statement of financial

condition is presented. Earlier application of the disclosure provisions of paragraphs 13 to 17 is encouraged.

The provisions of this Statement of Position need not be applied to immaterial items.

APPENDIX A

Background Information and Basis for Conclusions

Background

A.1. In the past, the American Institute of Certified Public Accountants (AICPA) has issued Audit and Accounting Guides that provide industry-specific guidance for preparers and auditors of financial statements of banks, savings institutions, credit unions, finance companies, and entities with financing activities (including trade receivables). Divergence in accounting practices for similar transactions has resulted in the need for a reconciliation of existing guidance.

A.2. At its May 19, 1993 meeting, the Financial Accounting Standards Board (FASB) did not object to a prospectus for an Accounting Standards Executive Committee (AcSEC) project to combine and revise the AICPA Industry Audit and Accounting Guide *Audits of Banks* (Bank Guide) with the AICPA Audit and Accounting Guide *Audits of Savings Institutions* (Savings Institutions Guide).[1] AcSEC initiated the project in response to diversity in practice for similar transactions by entities covered by these guides.

A.3. In preparing the 1993 prospectus, the AICPA Banking and Savings Institutions Committees considered including the AICPA Audit and Accounting Guide *Audits of Credit Unions* (CU Guide) in the project's scope. The Committee did not consider whether to include finance companies in the project's scope.

1. For ease of reference, the proposed AICPA Audit and Accounting Guide is also referred to as *new Guide* or *combined Guide* in this SOP. The existing AICPA Audit and Accounting Guide *Banks and Savings Institutions* is referred to as the *BSI Guide*. The AICPA Audit and Accounting Guide *Audits of Credit Unions*, is referred to as the *CU Guide*. The AICPA Audit and Accounting Guide, *Audits of Finance Companies*, is referred to as the *FC Guide*.

A.4. As explained in the 1993 prospectus, credit unions ultimately were excluded as a result of the following:

a. Issuance in late 1992 of a revised CU Guide

b. Concerns that due process for a combined Guide would delay banking guidance

c. The AICPA Credit Unions Committee's conclusion that a combined Guide was not likely to be as useful to auditors and preparers of credit-union financial statements as the existing stand-alone CU Guide

The prospectus explained that the accounting guidance established in the new Guide would be used to conform the CU Guide for transactions similar among banks, savings institutions, and credit unions.

A.5. At the FASB's May 1993 meeting, the chair of AcSEC agreed, as a condition for clearance, that AcSEC would debate any identified accounting differences between credit unions and banks and savings institutions, and pursue a Statement of Position (SOP) to amend the CU Guide to conform the accounting.

A.6. At its April 22, and June 4, 1996, meetings, AcSEC's Planning Subcommittee (PSC) reconsidered the approach to conforming the accounting for similar transactions and agreed to create a single Guide that also would include finance companies. The PSC concluded that, though certain accounting guidance on unique transactions may be preserved, most lending and deposit-taking transactions are similar and should be accounted for similarly. Further, the PSC believed the issuance of FASB Statement of Financial Accounting Standards No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities* (which was later superseded by FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*), would increase accounting consistency.

A.7. At its December 4, 1996 meeting, the FASB did not object to the AICPA's project to combine the existing AICPA Audit and Accounting Guide *Banks and Savings Institutions*

(BSI Guide), the CU Guide, and the *Audits of Finance Companies* (FC Guide).

Approach and Background on the Combined Guide for Financial Institutions

A.8. As the November 1996 prospectus was being developed, the National Credit Union Administration (NCUA), the Credit Union National Association (CUNA), and various preparers and auditors of credit union financial statements expressed concern to the AICPA and the FASB about including credit unions in a combined Guide. They were concerned primarily that a combined Guide would eliminate needed focus on the uniqueness of the credit union industry and, thus, would be a less effective tool for preparers and auditors because a combined Guide would address certain transactions or issues (for example, taxation) that are not applicable to credit unions.

A.9. AcSEC believes the revised Guide should include credit unions to reconcile accounting principles, end accounting inconsistencies that are not justified, and prevent future anomalies. That credit unions, banks, savings institutions, and finance companies are organized differently is less relevant to the preparation and audit of their financial statements than that each primarily lends or takes deposits (or both). Also, as with the existing stand-alone Guides, preparers and auditors need not read and act on guidance involving transactions in which the entity does not engage.

A.10. Though most lending and deposit-taking activities are the same, some transactions addressed will be irrelevant to one or more entities. For example, credit unions are not subject to income taxes, not every community bank or thrift has or would be permitted to have transactions involving certain trading securities or futures contracts, and finance companies do not take deposits. However, existing Guides have been effective for entities having different levels of assets or complexity. AcSEC believes a single Guide that addresses comprehensively transactions that may be encountered by financial institutions best serves preparers and auditors of financial statements.

A.11. AcSEC does not intend to seek formal comments on the combined Guide. The starting point for the redrafting of the chapters for the combined Guide was the BSI Guide. The BSI Guide had recently been exposed for comment and contained more guidance than the CU Guide or the FC Guide. AcSEC solicited feedback from interested parties during the drafting of the combined Guide chapters.

Approach and Background on the SOP

A.12. AcSEC took the approach of reconciling the differences by including in the exposure draft only the accounting and reporting literature of the respective Guides that did not exist in other authoritative literature.

A.13. AcSEC believed this approach was preferable for several reasons. The SOP includes guidance for all entities engaged in lending and financing activities (including trade receivables). Although this was not an expansion of scope from the existing Guides, AcSEC believed this guidance should stand alone in an SOP. By including such guidance in the combined Guide only, AcSEC was concerned the preparers and auditors would focus on the organizational structure of an entity rather than the activities of the entity. In other words, auditors and preparers might potentially overlook guidance contained in an industry-focused Guide. That such entities are organized differently is less relevant to the accounting and financial reporting of underlying transactions than that each primarily lends or takes deposits (or both) and, accordingly, the guidance is provided based on the activity rather than the entity. Accordingly, this SOP will not only be included in the combined Guide but will provide guidance for all entities (including entities with trade receivables) through the creation of this stand-alone SOP rather than an AICPA Industry Guide. Second, as a condition for clearance of the prospectus, as described in paragraph A5, AcSEC agreed to reconcile and expose for comment the accounting and reporting differences in the SOP.

A.14. AcSEC issued an exposure draft of a proposed SOP, *Accounting by Certain Financial Institutions and Entities That Lend to or Finance the Activities of Others*, on May 30, 2000. The original comment period ended August 31,

2000. Several respondents commented that the scope, particularly relating to the inclusion of insurance companies, was unclear. AcSEC agreed and extended the comment period to October 31, 2000, to solicit additional views. AcSEC received eighteen comment letters in response to the exposure draft.

Scope

A.15. ***Entities With Trade Receivables.*** The scope of the FC Guide included not only finance companies but also those entities that lend to or finance the activities of others. Those financing arrangements include extending credit to trade customers to purchase goods or services resulting in trade receivables. Although AcSEC does not envision that the recognition and measurement provisions within this SOP will result in a change in practice for trade receivables, those provisions should be carefully considered for impact.

A.16. ***Finance Companies.*** In deliberating the scope of the SOP and combined Guide, AcSEC determined that settling on a precise definition of a finance company was difficult. The FC Guide applies to both "independent and captive financing activities of other companies," and AcSEC agreed with this approach. That is, the activities of companies engaged in financing activities are more important for determining the scope of the SOP and combined Guide, rather than the kind of company that the entity purports to be. Accordingly, paragraph 3b of this SOP indicates that the SOP should apply to both "independent and captive financing activities of all kinds of entities."

A.17. ***Entities With Financing Activities***. In preparing this SOP, AcSEC considered the inherent overlaps resulting from reconciling the accounting and disclosure principles in the Guides based on *kinds of activities* instead of the *nature of entities* in an Audit and Accounting Guide that is prepared for specific entities. AcSEC intends that all entities with financing activities follow the accounting and reporting provisions of this SOP for *those activities*. There was no further attempt to distinguish between *lending activities* and *financing activities*, because no practical dis-

tinction could be made for purposes of determining whether provisions of this SOP should apply. However, AcSEC did not intend to expand the applicability of all of the provisions of this SOP to all transactions of an entity that is not considered to be a finance company or mortgage company but engages in such lending or financing activities. Accordingly, AcSEC concluded that an entity that has a portion of its business in lending or financing activities (as defined in paragraphs 3b, 4b, and 6), but does not meet the provisions of paragraphs 3 (other than 3b), 4 (other than 4b) and 5 of this SOP, is not subject to the other provisions of this SOP, such as trade date accounting for regular way securities transactions, solely through application of the SOP. In other words, to the extent an entity is not considered such a financial institution, the other guidance provided is not applicable. For certain of these areas, other accounting literature may provide guidance.

A.18. ***Insurance Companies***. All entities that lend to or finance the activities of others, not just finance companies, have been subject to the provisions of the existing FC Guide. However, the scope of the FC Guide explicitly excluded insurance companies. AcSEC considered the scope exception and agreed this SOP should apply to all similar transactions and found no conceptual reason to exclude financing and lending transactions of insurance companies. Based on the objective of consistent guidance for similar transactions, this SOP includes the financing and lending activities of insurance companies.

A.19. ***Corporate Credit Unions***. Corporate credit unions were previously excluded from the scope of the CU Guide. In its project to reconcile the accounting and reporting for entities under the BSI Guide, CU Guide, and FC Guide, AcSEC reconsidered the exclusion of corporate credit unions from the SOP and combined Guide. AcSEC decided to include corporate credit unions in the scope because the nature of the activities and financial statements of corporate credit unions are essentially the same as other financial institutions covered by this SOP. Therefore, inclusion would meet the objective of reconciling and having in one place accounting guidance for financial entities whose primary activities are lending money or taking deposits, or both.

A.20. ***Mortgage Companies***. Mortgage companies were not explicitly noted in the scope of the previous BSI Guide or CU Guide. However, in practice, many mortgage companies followed the provisions of these Guides. Given that the combined Guide covers the primary activities of mortgage companies, AcSEC concluded that these companies should be explicitly included in the scope of the SOP and combined Guide.

A.21. ***Higher Level Guidance***. Financing and lending transactions subject to category (a) of generally accepted accounting principles (GAAP) in the hierarchy established by AICPA Statement on Auditing Standards (SAS) No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, are not in the scope of this SOP. For example, Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*, provides accounting guidance for stock loans and, accordingly, the accounting for stock loans is not in the scope of this SOP.

A.22. Those entities, such as investment companies, broker-dealers, and employee benefit plans, that carry loans and trade receivables at fair value, with unrealized gains and losses included in earnings, are excluded from this SOP.

Recognition and Measurement

A.23. The BSI Guide was generally the most comprehensive of the three Guides in addressing activities and related accounting and disclosure requirements that affect many types of financial institutions. In many cases, recognition and measurement guidance established by the BSI Guide was not addressed in the CU Guide and the FC Guide. Transactions encountered by banks and savings institutions may not be applicable or relevant to credit unions or finance companies. In other more limited situations, principles in the FC Guide were not addressed in the recognition and measurement guidance in the BSI or CU Guides. Again, such guidance may not be applicable or relevant to the other entities.

A.24. Regardless of the relative applicability of individual elements of guidance, AcSEC believes it was appropriate to carry forward such guidance from the BSI Guide and the FC Guide, so that the combined Guide would continue to be comprehensive and address transactions that may be encountered by each kind of entity. The accounting and reporting provisions in the BSI Guide and the FC Guide were generally carried forward to this SOP without significant modification. Guidance in the following paragraphs of this SOP generally represents application or formalization of existing recognition and measurement provisions. AcSEC believes these provisions are straightforward and do not require further elaboration.

a. Paragraph 8a, "Loans and Trade Receivables Not Held For Sale"

b. Paragraph 8b, "Nonmortgage Loans Held For Sale"

c. Paragraph 8c, "Sales of Loans Not Held For Sale"

d. Paragraph 8g, "Criteria for Sales of Servicing Rights"

e. Paragraph 8i, "FHLB and FRB Stock"

f. Paragraphs 8j-8l, "Fees and Rebates"

g. Paragraph 10b, "Short Sales of Securities"

h. Paragraph 10c, "Deposits"

i. Paragraph 11d, "Member Deposits"

Recognition and Measurement for All Entities

A.25. ***Entities With Trade Receivables.*** Entities with trade receivables should follow the recognition and measurement guidance in paragraph 8 of this SOP to the extent the guidance is applicable. AcSEC does not envision the application of this guidance will result in a change in practice for such entities.

A.26. ***Credit Losses.*** Paragraph 8d of this SOP states that recoveries of receivables previously charged off should be recorded when received. Most financial institutions recognize such recoveries as an addition to the allowance for loan losses. Others generally recognize such recoveries as a

direct credit to earnings. AcSEC reevaluated these practices as part of this project. AcSEC decided not to prescribe or proscribe a particular practice because the practice of frequently reviewing the adequacy of the allowance results in the same credit to earnings either directly or indirectly.

A.27. ***Credit Losses on Off-Balance-Sheet Instruments***. The guidance in the BSI Guide provided that credit losses for off-balance-sheet financial instruments should be deducted from the liability for credit losses in the period in which the liability is settled[2] and that an accrual for credit loss on a financial instrument with off-balance-sheet risk should be recorded separate from a valuation account (allowance for loan losses or doubtful accounts) related to a recognized financial instrument was based on guidance in paragraph 92 of FASB Statement No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*. Because FASB Statement No. 105 was superseded by FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and the guidance in paragraph 92 of FASB Statement No. 105 was not included in FASB Statement No. 133, AcSEC included the language in the former paragraph 92 of FASB Statement No. 105 in paragraph 8e of this SOP to clarify its requirements.

A.28. ***Standby Commitments to Purchase Loans***. The BSI Guide addressed accounting for forward standby commitments to purchase loans. Essentially, this guidance requires such commitments to be accounted for either as a commitment fee in accordance with paragraph 8 of FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, or at the higher of fair value or historical proceeds depending on whether settlement date is within a reasonable period and certain other factors. AcSEC considered whether the BSI Guide should be modified by

2. *Off-balance-sheet financial instruments* refers to off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments with off-balance-sheet credit risk except for instruments within the scope of FASB Statement No. 133.

requiring standby commitments to purchase loans to be accounted for at fair value in all cases. However, no practical distinction could be made between forward standby commitments to purchase receivables and other commitments to purchase or originate receivables. Accordingly, AcSEC decided to retain the existing guidance of the BSI Guide and carry it forward in paragraph 8f of this SOP.

A.29. ***Sales of Servicing Rights***. Paragraph 8.20 of the BSI Guide stated that: "Sales of servicing rights relating to loans that are retained should not be recognized in income at the time of sale. The proceeds from such sales should be accounted for in a manner similar to loan discounts and amortized using the interest method as an adjustment to the yield of the related loans." FASB Statement No. 140 governs transfers of loans and other financial assets but does not address transfers of servicing rights because servicing rights are not considered financial assets. Under FASB Statement No. 140, when loans are sold with servicing retained, the previous carrying amount (or basis) is allocated to separate components—that is, loans (without servicing) and servicing rights—based on their relative fair values at date of sale. AcSEC concluded that paragraph 8.20 of the BSI Guide should be revised to follow a "basis allocation" approach similar to FASB Statement No. 140, once it has been determined that a transfer of servicing rights qualifies as a sale and, accordingly, included this guidance in paragraph 8h of this SOP. This conclusion does not affect FASB Emerging Issues Task Force (EITF) Issue No. 95-5, "Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights," and other related guidance that addresses whether a transfer of servicing rights should be accounted for as a sale.

A.30. ***Factoring Arrangements***. Paragraph 2.24 of the FC Guide has been modified in paragraph 8m of this SOP to clarify that FASB Statement No. 91 may apply to the accounting for factoring commissions. Paragraph 2.24 addresses accounting for factoring commissions but does not distinguish between accounting for commissions when receivables are purchased versus when receivables are financed. AcSEC concluded that the accounting for factoring

commissions would depend on whether the receivables were purchased or financed, and that the sales criteria in paragraph 9 of FASB Statement No. 140 should be used to make that distinction. When receivables are purchased by a finance company (factor), factoring commissions are in substance "interest adjustments," and are addressed by FASB Statement No. 91 or AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*.[3] When receivables are financed by a finance company (factor), factoring commissions should be recognized in accordance with FASB Statement No. 91.

Recognition and Measurement for Financial Institutions and Financing Activities

A.31. ***Insurance Commissions***. Insurance companies are not subject to paragraph 9 of the SOP. Paragraph 9 provides guidance for income from experience-rated or retrospective commission arrangements. Insurance companies have guidance providing recognition and measurement guidance including FASB Statements No. 60, *Accounting and Reporting by Insurance Enterprises*; No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*; and No. 120, *Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts*; and SOP 95-1, *Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises*.

Recognition and Measurement for Financial Institutions

A.32. ***Regular-Way Securities***. Paragraph 170 of FASB Statement No. 140 does not explicitly address when to recognize (or derecognize) contracts to purchase or sell securities in (or from) the balance sheet. FASB Statement No. 140 does

3. AcSEC expects to issue an SOP, *Accounting for Loans and Certain Debt Securities Acquired in a Transfer*, in the first quarter of 2002. The SOP updates Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*, and is effective for transfers of loans acquired in fiscal years beginning after June 15, 2002.

not modify other GAAP, including AICPA Audit and Accounting Industry Guides for certain industries that require accounting at the trade date for certain contracts to purchase or sell securities. Guidance to that effect existed for banks, savings institutions, and credit unions in the respective Guides for those industries. The FC Guide did not explicitly address this issue. In keeping with the objective of this project to reconcile the accounting practices among similar financial institutions, AcSEC concluded that accounting for regular-way securities transactions at trade date should be required for finance companies.

Recognition and Measurement for Credit Unions

A.33. ***National Credit Union Share Insurance Fund Deposit.*** AcSEC concluded that it was appropriate to carry forward specific industry guidance for credit unions related to the National Credit Union Share Insurance Fund (NCUSIF) deposit. The credit union share insurance fund has unique legal and operating aspects that make it different than the deposit insurance fund for banks and savings institutions. Most importantly, credit unions are entitled to a refund of their deposit in the share insurance fund, subject to certain limitations. Unique characteristics of the fund are discussed further below.

A.34. A federally insured credit union is required to maintain on deposit with the NCUSIF an amount equal to one percent of its total insured shares. The amount on deposit is adjusted periodically for changes in the amount of a credit union's insured shares. For example, if the insured shares decline, a pro rata portion of the amount on deposit with the NCUSIF is refunded to the credit union. This deposit would be refunded to a credit union if its insurance is terminated, it converts to insurance coverage from another source, or the operations of the fund are transferred from the NCUA Board.

A.35. The NCUA aims to keep the Fund's reserve ratio at or near 1.3 percent of insured deposits. The Fund's reserves consist of the 1 percent required deposit plus any additional amounts accumulated through interest earnings and insurance premiums. The reserves are invested in Treasury

securities, and interest on those securities accrues to the Fund. In addition, the NCUA has discretion to impose an annual premium of 1/12 of 1 percent of insured deposits. If the Fund's reserve ratio exceeds 1.3 percent, the NCUA must pay the excess as a dividend on the credit unions' one percent deposit. To cover losses and operating expenses, the Fund first uses reserves in excess of the one percent deposit. However, if the Fund's reserve ratio ever falls below one percent, credit unions would be required to restore the deposit to one percent by January 1 of the following year.

A.36. The accounting for payments to the NCUSIF differs from the accounting for premiums paid to the Federal Deposit Insurance Corporation (FDIC) insurance fund. FDIC insured banks and thrifts expense their deposit insurance fund premiums when paid as these premiums are nonrefundable.

Recognition and Measurement for Finance Companies and Activities

A.37. ***Favorable Financing Arrangements.*** Paragraph 2.14 of the FC Guide stated that: "Captive finance companies that offer favorable financing to increase sales of related companies may present particular problems. APB Opinion 21, *Interest on Receivables and Payables*, provides accounting guidance to use if the face amount of a note does not reasonably represent the present value given or received in an exchange." That paragraph was modified by the FC Guide to clarify the application of APB Opinion 21 to captive finance companies. AcSEC believes that paragraph 3(d) of APB Opinion 21 was not intended to exempt "captive finance companies" from the Opinion's scope and accordingly included this interpretation in paragraph 12 of this SOP. Favorable financing offered by captive finance companies to increase sales of products of affiliated companies does not constitute customary cash lending activities or demand and savings deposit activities of a financial institution.

Guidance Eliminated for Finance Companies

A.38. ***Advances and Overadvances to Factoring Clients.*** Paragraphs 2.26 and 2.27 of the FC Guide described an accounting approach whereby finance companies buy loans but do not pay the full purchase price in cash to the seller. AcSEC concluded that such industry-specific guidance should not be carried forward to this SOP without substantial justification, and none was evident in this case. Further, AcSEC believes that the accounting for purchases of receivables and related advances and overadvances in factoring arrangements are sufficiently addressed in paragraph 8m of this SOP.

A.39. ***Income Recognition on Impaired Loans for Finance Companies.*** Paragraphs 2.15 to 2.17 of the FC Guide provided specific guidance on the recognition of interest income on impaired loans. The BSI and the CU Guides did not address this issue. In 1994, FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, was amended by FASB Statement No. 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures*, to delete guidance on income recognition. The Board concluded that those provisions (paragraph 17 to 19 of FASB Statement No. 114) were secondary in importance to provisions that address the measurement of loan impairment. In the earlier project to revise and combine the then-separate Bank Guide and Savings Institutions Guide, industry-specific guidance related to interest income recognition on impaired loans was not carried forward to the BSI Guide. At the time, AcSEC decided that specifying or illustrating certain income recognition methods could imply that one or more methods are preferable to others. AcSEC also recognized that FASB's financial instruments project would likely consider related issues, including present value-based measurements and income recognition. For purposes of this SOP, AcSEC concluded that industry-specific guidance should not be carried forward to this SOP for the same reasons. Because this SOP eliminates existing guidance on income recognition for impaired loans for finance companies, a finance company that makes a change in accounting with respect to income recognition for impaired loans must justify why the change is preferable in accordance with the requirements of APB Opinion 20, *Accounting Changes*.

Presentation and Disclosure

A.40. Disclosure and presentation principles established by the BSI Guide are also carried forward to this SOP, when not addressed in the CU Guide or the FC Guide, or when addressed in a very similar or identical fashion. However, due to differing levels of emphasis in the respective Guides for similar transactions and activities, underlying differences in the nature of the entities themselves, and perhaps for other reasons, disclosure and presentation principles were not always addressed similarly in the respective Guides. AcSEC evaluated those situations on a case-by-case basis, and decided the most appropriate guidance to carry forward to this SOP. In some cases, those evaluations resulted in the application of disclosures required for one or more kinds of entities to one or more other kinds. In some cases, the evaluations resulted in the elimination of disclosure requirements previously required for credit unions in lieu of applying them to banks, savings institutions, and finance companies. In one case, the evaluation resulted in a new disclosure for all entities.

A.41. Guidance in the following paragraphs of this SOP generally represent application or formalization of existing presentation and disclosure provisions. AcSEC believes these provisions are straightforward and do not require further elaboration.

a. Paragraph 13a (Items (1), (2), and (4)), "Accounting Policies for Loans and Trade Receivables"

b. Paragraph13b, "Accounting Policies for Credit Losses and Doubtful Accounts"

c. Paragraph 13c, "Accounting Policies for Nonaccrual and Past Due Loans and Trade Receivables"

d. Paragraph 13d, "Sales of Loans and Trade Receivables"

e. Paragraph 13e, "Loans or Trade Receivables"

f. Paragraph 13h, "Securities on Deposit"

g. Paragraph 13i, "Assets Serving as Collateral"

h. Paragraph 14a, "Cash Restrictions"

i. Paragraph 14c, "Sales of Premises and Equipment"

j. Paragraph 14d, "Securities"

k. Paragraph 14e (Items (2), (3), and (4)), "Deposits"

l. Paragraph 14f, "Borrowings"

m. Paragraph 14g, "Long-Term Obligations"

n. Paragraph 14h, "Debt"

o. Paragraph 14i, "Secured Borrowings"

p. Paragraph 14l, "Redeemable Preferred Stock Dividends"

Presentation and Disclosure for All Entities

A.42. ***Entities With Trade Receivables.*** Entities with trade receivables should follow the presentation and disclosure guidance in paragraph 13 to the extent the guidance is applicable. AcSEC does not envision the application of this guidance will result in a change in practice for such entities.

A.43. ***Accounting Policies for Loans and Trade Receivables.*** Paragraph 13a, item (3) of this SOP requires disclosure of classification and method of accounting for interest-only strips, loans, other receivables, or retained interests in securitizations that can be contractually prepaid or otherwise settled in a way that the holder would not recover all of its recorded investment pursuant to paragraph 14 of FASB Statement No. 140. Paragraph 6.74 of the BSI Guide prescribed accounting policy disclosure requirements for loans. However, this paragraph does not address accounting policy disclosure for instruments accounted for under paragraph 14 of FASB Statement No. 140. Further, no such disclosures are required by FASB Statements No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, or No. 140, or otherwise. Instruments within the scope of paragraph 14 of FASB Statement No. 140 may be classified as available-for-sale or trading, and further balance-sheet presentation may differ among various entities. Accordingly, AcSEC concluded that the disclosure of the

classification and method of accounting for instruments accounted for under paragraph 14 of FASB Statement No. 140 would be informative for financial statement users.

A.44. ***Foreclosed and Repossessed Assets***. Paragraph 13f of this SOP requires foreclosed and repossessed assets to be classified as a separate balance-sheet amount or included in other assets with separate disclosures in the notes to the financial statements. Certain returned or repossessed assets, such as inventory, should not be classified separately if the assets were sold by the entity to a third party and subsequently are to be resold by the entity to another third party.

A.45. ***Nonaccrual Loans and Trade Receivables***. FASB Statement No. 118 requires entities to disclose the amount of loans[4] defined as "impaired" under paragraph 8 of FASB Statement No. 114. Further, FASB Statement No. 114 does not apply to "large groups of smaller-balance homogeneous loans that are collectively evaluated for impairment, which may include credit card, residential mortgage, and consumer installment loans." Significant portions of the portfolios of credit unions, finance companies, and entities with financing activities (including trade receivables) consist of smaller-balance homogeneous loans. Accordingly, credit unions and finance companies often disclosed insignificant amounts, or sometimes no amounts, of impaired loans in their financial statements. Credit unions, finance companies, and entities with financing activities continued to be required by their respective Guides to disclose the amount of nonaccrual loans and trade receivables, even after the effective date of FASB Statement No. 118. In keeping with the objective of this project to reconcile the accounting and disclosure practices among similar entities with similar transactions, AcSEC concluded that such guidance should be carried forward to paragraph 13g of this SOP and applied to banks and savings institutions as well.

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4. FASB Statement No. 118 amended FASB Statement No. 114. FASB Statement No. 114 states in paragraph 4, "For purposes of this Statement, a loan is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position."

A.46. ***Past Due Loans and Trade Receivables.*** Paragraph 13g of this SOP requires disclosure of loans and trade receivables past due ninety days or more and still accruing interest and the accounting policy for determining past due status. Some entities do not automatically place loans on nonaccrual once they become ninety days past due. Accordingly, AcSEC concluded that disclosure of both nonaccrual and past due ninety days or more and still accruing loans and trade receivables would provide more complete information about loan portfolio credit quality. Further, given this new requirement to disclose loans past due ninety days or more, AcSEC believed that it would be important for financial statement users to understand how past due status is determined by the entity.

Presentation and Disclosure for Financial Institutions

A.47. ***Reciprocal Balances and Related Overdrafts.*** The BSI Guide provided the following guidance: "Overdrafts of correspondents or other demand deposit accounts that represent borrowings rather than outstanding drafts should be reclassified as liabilities, unless the depositors have other accounts at the same depository institution for which there is the right of setoff. Balances due to and due from a single depository institution, also called reciprocal balances, should also be offset if right of setoff exists. FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, defines right of setoff and specifies conditions that must be met to have that right." The exposure draft of this SOP did not address whether the guidance in the BSI Guide for offsetting reciprocal balances and correspondent overdrafts should be applied to all financial institutions. AcSEC reasoned that, because FASB Interpretation No. 39 provided a scope exception for specified accounting that existed in AICPA Industry Audit Guides, discussion in this SOP was unnecessary. FASB Statement No. 135, *Rescission of FASB Statement No. 75 and Technical Corrections*, amended the Interpretation as follows: "In paragraph 7, *Industry Audit Guide, Audits of Banks* is replaced by *Audit and Accounting Guide, Banks and Savings Institutions*." Therefore, AcSEC reasoned that FASB Interpretation No.

39's scope would exclude any reciprocal balances and correspondent overdrafts of financial institutions. However, as one respondent suggested, because the reference in that Interpretation was only to the BSI Guide and because that guidance was absent in the CU Guide and FC Guide, the guidance should be included in this SOP. Additionally, corporate credit unions and mortgage companies, which were not included in an AICPA guide, are now included in this SOP. Accordingly, AcSEC decided to clarify the appropriateness of applying this guidance to all financial institutions that have reciprocal balances. AcSEC understands that the offsetting of reciprocal balances and correspondent overdrafts is current practice for financial institutions and, in keeping with the objective of consistent application of guidance regardless of entity type, agreed to apply that guidance to all financial institutions with such balances. In considering this issue, AcSEC revisited the original guidance in the Bank Guide and found that language preferable to the BSI Guide language. Accordingly, AcSEC revised the criteria in paragraph 14b to reflect current industry practice. AcSEC intends this guidance to be applied only to financial institutions and applying it in other situations may not be appropriate.

A.48. ***Deposits***. Disclosures about deposit liabilities should include the aggregate amount of time deposit accounts (including certificates of deposit) in denominations of $100,000 or more at the balance-sheet date. This established practice is meaningful to readers as this amount gives an indication of potential liquidity concerns. The denomination of $100,000 represents a common threshold within FDIC insurance limits. Generally, deposits in excess of the insurance limits are considered to have a higher risk of withdrawal. AcSEC concluded that this information is meaningful to financial statement users and included this disclosure in paragraph 14e.

A.49. ***Offsetting Amounts in the Balance Sheet***. FASB Interpretation No. 39 does not preclude the special balance-sheet offsetting established by paragraphs 14j and 14k of this SOP. Paragraph 7 of the Interpretation does not modify the accounting treatment for particular circumstances prescribed by AICPA SOPs.

A.50. ***Off-Balance-Sheet Credit Risk***. Paragraph 6.78 of the BSI Guide addressed disclosure requirements of financial instruments with off-balance-sheet risk, specifically referring to FASB Statements No. 105 and 119, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*. Paragraphs 17 and 18 of FASB Statement No. 105, as amended by FASB Statement No. 119, required disclosure of the extent, nature, terms, and credit risk of financial instruments with off-balance-sheet credit risk. FASB Statements No. 105 and 119 were superseded by FASB Statement No. 133. Certain financial instruments with off-balance-sheet credit risk are not derivative instruments as defined in FASB Statement No. 133, and thus are not subject to its disclosure requirements. Examples of these instruments, commonly used by lending institutions, include off-balance-sheet loan commitments, financial guarantees, and letters of credit. AcSEC concluded that because disclosures about such off-balance-sheet instruments existed in the BSI Guide before FASB Statement No. 105, the disclosure requirements for such off-balance-sheet financial instruments, as previously addressed in FASB Statement No. 105, should still be applied to entities within the scope of this SOP and included the guidance in paragraph 14m.

A.51. ***Regulatory Capital Disclosures for Branches of Foreign Institutions***. As discussed in the preface to the BSI Guide, the Guide applied to the preparation and audits of financial statements of entities regulated by the federal banking regulatory agencies, including branches and agencies of foreign banks. The existing disclosure requirements related to capital adequacy and prompt corrective action in the BSI Guide did not apply to branches of foreign banking organizations because such branches do not have capital. Foreign branches, while they do not have capital requirements, are required to maintain capital-equivalent deposits and, depending on facts and circumstances, supervisory-mandated reserves. These requirements carry regulatory uncertainty of a nature similar to that posed by the regulatory capital rules in that failure to meet such mandates can result in supervisory action and, ultimately, going-concern questions. Accordingly, AcSEC believes that those foreign bank branches should disclose such requirements and the degree of compliance therewith.

A.52. ***Regulatory Capital Disclosures for Trust Operations.*** Trust banks are required by certain federal regulators to hold capital as a percentage of discretionary and nondiscretionary assets under management. The percentages vary for each category. The percentages are not standardized as with other capital requirements and are communicated on an entity-by-entity basis in the application to obtain a trust charter or by other supervisory processes. Depending on the type of charter, these entities may be subject to risk-based standards as well. Because these are not published requirements, these guidelines are applied on a discretionary basis by the agencies and may not be uniformly applied to all entities. Because failure to meet capital requirements can have an adverse effect on the financial condition and results of operations of an entity, AcSEC concluded that, in cases in which these requirements are applied, a discussion of the existence of these requirements, ramifications of failure to meet them, and a measurement of the entity's position relative to imposed requirements should be disclosed.

A.53. ***Regulatory Capital Disclosures for Business Combinations.***[5] The BSI Guide required that comparative disclosures be presented relating to regulatory capital compliance. In applying this requirement to entities that have completed a business combination, AcSEC recognized that special requirements were necessary. First, because the post-transaction capital of two entities combined through a purchase differs from that of the same two entities had the transaction been accounted for as a pooling, different approaches to comparative capital disclosures must be taken for pooling of interests and purchase business combinations. Second, the determination of regulatory capital position involves not only purely quantitative elements but also potentially highly subjective qualitative factors, such as relative operation risks, risks associated

5. In June 2001, the FASB issued FASB Statement No. 141, *Business Combinations*, which supersedes APB Opinion 16, *Business Combinations*. FASB Statement No. 141, which applies to all business combinations except those between not-for-profit enterprises, requires that all business combinations initiated after June 30, 2001 be accounted for using the purchase method. The provisions of FASB Statement No. 141 are applicable to business combinations accounted for by the purchase method completed after June 30, 2001.

with nontraditional activities, and other factors, which may in turn be mitigated by the relative sophistication of management and systems. Finally, AcSEC believes it would not be representationally faithful to simply compare the combined capital and risk-weighted assets of the pre-merged entities, even in a pooling, to statutory capital adequacy and prompt corrective action minimums or to actual or composite adjusted minimums of the premerged entities. Such an approach might overlook mitigating factors that may have been enhanced or risks that may have been magnified and assessed differently in a combined entity rather than in separate entities and inappropriately suggest that the regulators may have reviewed and accepted such combined levels as adequate when they actually had never made such an evaluation. Accordingly, for these reasons, and those related to purchase business combinations described in paragraph 15c of this SOP, AcSEC believes that the required disclosures are the best means to achieve the objective of comparative presentations.

Presentation and Disclosure for Credit Unions

A.54. ***Regulatory Capital Disclosures for Credit Unions***. The BSI Guide required that banks and savings institutions disclose in notes to their financial statements certain matters about the institution's capital adequacy relative to regulatory minimum capital standards and prompt corrective action requirements. The rationale for such disclosure requirements was that failure to comply with regulatory capital requirements could have a material adverse effect on the financial position and results of operations of affected institutions. The CU Guide did not contain such requirements. AcSEC believes that a credit union's relative compliance with minimum net worth and capital and prompt corrective action requirements is equally important to readers of credit union financial statements and thus similar disclosures by credit unions to those currently in place for banks and savings institutions should be required.

Presentation and Disclosure for Mortgage Activities

A.55. ***Capital Disclosures by Mortgage Companies and Entities With Mortgage Banking Activities.*** Failure to comply with minimum net worth (capital) requirements imposed by secondary market investors and regulators could have a material adverse effect on the financial position and results of operations of affected entities. In developing this SOP, AcSEC considered making these disclosures conditional, that is, not requiring them only when the risk of noncompliance is remote. However, AcSEC concluded that the compliance of a mortgage company or an entity with mortgage banking activities with minimum net worth requirements should be disclosed similar to the required disclosures for banks, savings institutions, and credit unions.

A.56. AcSEC was concerned with the volume of disclosures in instances in which an entity has multiple servicing arrangements with different investors. AcSEC decided to limit this requirement to the disclosures required by the most significant investor arrangement.

Guidance Eliminated for Credit Unions

A.57. Regarding the disclosures eliminated for credit unions as contained in the paragraph B.8. of Appendix B, "Amended Paragraphs of AICPA Industry Guides to Show Changes Made by This Statement," of this SOP, AcSEC believed that these disclosures were redundant and should be eliminated in the interest of disclosure effectiveness.

Effective Date and Transition

A.58. ***Recognition and Measurement.*** This SOP represents unique transition challenges. Certain recognition and measurement principles will be applied to certain entities for the first time. Some provisions may not require a change in accounting method for certain entities, particularly if no guidance existed on the subject for their industry, as the guidance in this SOP may have already been applied by analogy. AcSEC recognized that the application of the provisions in paragraphs 8, (except for paragraph 8h, "Sales of

Servicing Rights"); 9, "Insurance Commissions;" and 10 result in a change in accounting method for entities not previously subject to this guidance.

A.59. ***Financing Activities and Trade Receivables***. All entities, regardless of whether they were within the FC Guide, should have followed the FC Guide guidance if they engaged in kinds of transactions covered by paragraph 3b. The paragraphs not enumerated in the transition paragraphs in paragraphs 20c and 20d are those that all entities with financing activities (including trade receivables) should have been following prior to this SOP. Accordingly, an initial application of the paragraphs not included in paragraphs 20c and 20d should be reported as a correction of an error. In applying these provisions to paragraph 8h, "Sales of Servicing Rights," previously deferred gains on the sale of servicing rights should be recognized at transition. Paragraph 12 of this SOP represents specialized industry practices and should have already been followed by entities subject to this guidance.

A.60. ***Banks and Savings Institutions***. The paragraphs not enumerated in the transition paragraphs in paragraph 20a are those that such entities should have been following prior to this SOP. Accordingly, an initial application of the paragraphs not included in paragraph 20a should be reported as a correction of an error. In applying these provisions to paragraph 8h, "Sales of Servicing Rights," previously deferred gains on the sale of servicing rights should be recognized at transition.

A.61. ***Credit Unions***. The paragraphs not enumerated in the transition paragraphs in paragraph 20b are those that such entities should have been following prior to this SOP. Accordingly, an initial application of the paragraphs not included in paragraph 20b should be reported as a correction of an error. In applying these provisions to paragraph 8h, "Sales of Servicing Rights," previously deferred gains on the sale of servicing rights should be recognized at transition. Paragraph 11 of this SOP represents specialized industry practices and should have already been followed by entities subject to this guidance.

A.62. ***Presentation and Disclosure***. AcSEC concluded that, in the initial year of applying the provisions of this SOP, all new disclosures should be required only as of the most recent balance-sheet date. Disclosures of prior year information would be encouraged but not required. However, obtaining many of the prior year disclosures may be difficult for many entities, and the benefits of doing so may likely not justify the costs. AcSEC concluded that, after transition, comparative information should be provided.

APPENDIX B

Amended Paragraphs of AICPA Industry Guides to Show Changes Made by This Statement of Position

B.1. This Statement of Position (SOP) reconciles and conforms, as appropriate, the accounting and financial reporting provisions established by the American Institute of Certified Public Accountants (AICPA) Audit and Accounting Guides *Banks and Savings Institutions* (BSI Guide), *Audits of Credit Unions* (CU Guide), and *Audits of Finance Companies* (FC Guide). For those entities subject to one of the previously issued AICPA Guides listed above, the Accounting Standards Executive Committee (AcSEC) included, by industry guide, the marked paragraphs to show the changes that were carried forward to this SOP as well as guidance eliminated. The paragraphs refer to the Guides in existence (with conforming changes as of May 1, 2000) at the date of issuance of this SOP.

Recognition and Measurement

Guidance from the BSI Guide

B.2. Recognition and measurement principles established by and carried forward from the BSI Guide to this SOP follow. Conforming changes are specifically noted by bold italicized or strike-through text. Reference to specific paragraphs within the respective Guides is noted parenthetically.

a. ***Regular-Way***[1] ~~P~~***p***urchases and sales of securities ***should be*** ~~are~~ recorded ~~in the balance sheet~~ on the

1. In Paragraph 275 of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, *regular-way* is defined as follows:

   Regular-way security trades are those that are completed (or settled) within the time period generally established by regulations and conventions in the marketplace or by the exchange on which the transaction is being executed.

trade date. Gains and losses from ***regular-way*** security sales or disposals should be recognized as of the trade date in the statement of operations for the period in which securities are sold or otherwise disposed of. (BSI Guide, paragraph 5.92; CU Guide, paragraph 4.21)

b. The obligations incurred in short sales[2] should be reported as liabilities and adjusted to fair value through the income statement at each reporting date. Such liabilities are generally called "securities sold, not yet purchased." ***The fair value adjustment should be classified in the income statement with gains and losses on securities***. Interest on the short positions should be accrued periodically and reported as interest expense. (BSI Guide, paragraph 5.93)

c. ~~Therefore,~~ Federal Home Loan Bank (FHLB) ~~or~~ ***and*** Federal Reserve Bank (FRB) stock ***should be*** ~~is more properly~~ classified as a restricted investment security, carried at cost, and evaluated for impairment. (BSI Guide, paragraph 5.97) Both cash and stock dividends[3] ~~are~~ received on FHLB stock ~~and~~ are reported as income. The stock dividends are redeemable at par value. (BSI Guide, paragraph 5.99) ~~In evaluating the effects of legislation on the FHLBs, the independent accountant may that at least a temporary decline in value could have occurred if such legislation requires an FHLB to make payments to the Resolution Funding Corporation (REFCORP) or other entities in addition to the required payments to the Financing Corporation (FICO) and if these payments cause the FHLB's total equity to fall below its aggregate capital stock amount~~. FHLB stock is generally viewed as a long-term investment. Accordingly, ***when evaluating FHLB stock for impairment,*** its value should be determined based on the ultimate recoverability of the par value rather than by recognizing temporary declines in value. The determina-

2. Paragraph 59(d) of FASB Statement No. 133 addresses short sales.
3. Chapter 7 of Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, provides guidance for stock-splits.

tion of whether the decline ~~is other than temporary in nature~~ ***affects the ultimate recoverability*** is influenced by criteria such as ***the following***:

- The significance of the decline in net assets of the FHLBs as compared to the capital stock amount for the FHLBs and the length of time this situation has persisted
- Commitments by the FHLBs to make ~~future~~ payments ~~to REFCORP and other entities~~ ***required by law or regulation*** and the level of such payments in relation to the operating performance of the FHLBs
- The impact of legislative and regulatory changes on ~~the savings~~ institutions ~~industry~~ and, accordingly, on the customer base of the FHLBs
- The liquidity position of the FHLBs (BSI Guide, paragraph 5.100)

d. Loans ***and trade receivables*** that management has the intent and ability to hold for the foreseeable future or until maturity or payoff should be reported in the balance sheet at outstanding principal adjusted for any chargeoffs, the allowance for loan losses ***(or the allowance for doubtful accounts)***, any deferred fees or costs on originated loans, and any unamortized premiums or discounts[4] on purchased loans.[5] (BSI Guide, paragraph 6.48; CU Guide, paragraph 5.16)

e. ~~Other~~ ***Nonmortgage*** loans held for sale should be reported at the lower of cost or ~~market~~ ***fair*** value.[6] (BSI Guide, paragraph 6.49)

f. ~~Banks and savings institutions~~ ***Entities*** sometimes enter into forward standby commitments to pur-

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4. Discounts offered as a result of the pricing of a sale or a product or service may be termed *sales discounts*. This SOP does not address these discounts.

5. AcSEC expects to issue an SOP, *Accounting for Loans and Certain Debt Securities Acquired in a Transfer*, in the first quarter of 2002. The SOP updates Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*, and is effective for transfers of loans acquired in fiscal years beginning after June 15, 2002.

6. This paragraph applies to nonmortgage loans. Readers should refer to FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, for mortgage loans classified as held for sale.

chase loans at a stated price in return for a standby commitment fee. In such an arrangement, settlement of the standby commitment is ***at*** the option of the seller ***of the loans*** and ***would*** result~~s~~ in delivery ***to the entity*** only if the contract price ***equals or*** exceeds the market price of the underlying loan or security on the settlement date. A standby commitment differs from a mandatory commitment in that the ~~institution~~ ***entity*** assumes all the market risks of ownership but shares in none of the rewards. A standby commitment is, in substance, a ***written*** put option ***that will be exercised only if the value of the loans is less than or equal to the strike price***. Many ~~institutions~~ ***entities*** use standby commitments to supplement their normal loan origination volume. If the settlement date is within a reasonable period (for example, a normal loan commitment period) and the ~~institution~~ ***entity*** has the intent~~ion~~ and ability to accept delivery without selling assets, standby commitments are generally viewed as part of the normal production of loans, and ~~institutions~~ ***entities*** record loans purchased under standby commitments at cost on the settlement date ~~and amortize~~, ***net of*** the standby commitment fee ***received*** ~~over the estimated life of the loans~~, in conformity with Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standard No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. However, if the settlement date is not within a reasonable period, or the ~~institution~~ ***entity*** does not have the intent~~ion~~ and ability to accept delivery without selling assets, the standby commitment generally is accounted for as a written put option. In that case, the option premium received (standby commitment fee) should be recorded as a liability representing the ***fair value*** ~~unrealized loss~~ of the standby commitment on the trade date. Thereafter, the liability should be accounted for at the greater of the ***initial standby commitment*** fee or ***the fair value of the written put option*** ~~unrealized loss~~. Unrealized gains (that is, recoveries of unrealized

losses) or losses should be credited or charged to current operations.[7] (BSI Guide, paragraph 6.72)

g. ~~Actual~~ ***C***~~c~~redit losses for loans ***and trade receivables,*** which may be for all or part of a particular loan ***or trade receivable***, should be deducted from the allowance.[8] ~~and t~~***T***he related loan ***or trade receivable*** balance should be charged off in the period in which ~~they~~ ***the loans or trade receivables*** are deemed uncollectible. Recoveries of loans ***and trade receivables*** previously charged off should be ~~added to the allowance~~ ***recorded*** when received.[9] (BSI Guide, paragraph 7.30; CU Guide, paragraph 6.15; FC Guide, paragraph 2.42)

h. ***An accrual for credit loss on a financial instrument with off-balance-sheet risk should be recorded separate from a valuation account related to a recognized financial instrument.*** ~~Actual~~ ***C***~~c~~redit losses for off-balance-sheet financial instruments should be deducted from the liability for credit losses in the period in which ~~they are deemed uncollectible~~ ***the liability is settled***.[10] (BSI Guide, paragraph 7.30; FC Guide, paragraph 2.42)

i. Once a decision has been made to sell loans ***not previously classified as held for sale***, ~~they~~ ***such loans*** should be ***transferred into the held-for-sale***

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7. This paragraph applies only to standby commitments to purchase loans. It does not apply to other customary kinds of commitments to purchase loans, nor does it apply to commitments to originate loans. The FASB staff has issued tentative guidance in Statement 133 Implementation Issue No. C13, "When a Loan Commitment Is Included in the Scope of Statement 133," regarding the circumstances in which a loan commitment or other credit arrangement should be accounted for as a derivative under FASB Statement No. 133. Readers should be alert to any final guidance.

8. AcSEC has a project that is addressing certain issues related to the allowance for credit losses. Readers should be alert to any final pronouncement.

9. AcSEC recognizes that practices differ between entities as some industries typically credit recoveries directly to earnings while financial institutions typically credit the allowance for loan losses for recoveries. AcSEC reevaluated this practice as part of this project. AcSEC decided not to amend this practice because the combination of this practice and the practice of frequently reviewing the adequacy of the allowance for loan losses results in the same credit to earnings in an indirect manner.

10. *Off-balance-sheet financial instruments* refers to off-balance-sheet loan commitments, standby letters of credits, financial guarantees, and other similar instruments with off-balance-sheet credit risk except for those instruments within the scope of FASB Statement No. 133.

classification and carried at the lower of cost or ~~market~~ ***fair*** value.[11] ***At the time of the transfer into the held-for-sale classification, any amount by which cost exceeds fair value should be accounted for as a valuation allowance.*** (BSI Guide, paragraph 8.14; CU Guide, paragraph 7.10)

j. Criteria that should be considered when evaluating whether a ***transfer*** ~~sale~~ of ~~mortgage~~ servicing rights ~~has occurred~~ ***qualifies as a sale*** ~~should include~~ ***are the guidance, as applicable, in Emerging Issue Task Force (EITF) Issue No. 95-5 "Determination of What Risks and Rewards, If Any, Can Be Retained and Whether Any Unresolved Contingencies May Exist in a Sale of Mortgage Loan Servicing Rights",***[12] ***and the following:***

- Whether the seller has received written approval from the investor if required
- Whether the buyer is a currently approved seller/servicer and is not at risk of losing approved status
- In the event of a sale in which the seller finances a portion of the sales price, whether an adequate nonrefundable down payment has been received (necessary to demonstrate the buyer's commitment to pay the remaining sales price) and whether the note receivable from the buyer provides full recourse to the buyer. Nonrecourse notes or notes with limited recourse (such as to the servicing) do not satisfy this criterion (BSI Guide, paragraph 8.24; CU Guide, paragraph 7.18)
- Also, temporary servicing performed by the transferor for a short period of time should be compensated in accordance with a subservicing agreement that provides ***adequate compensation*** ~~a normal subservicing fee~~ (BSI Guide, paragraph 8.25)

11. This paragraph applies to both mortgage and nonmortgage loans.
12. EITF Issue No. 95-5 provides guidance for determining whether a transfer of servicing rights should be accounted for as a sale.

k. Sales of servicing rights relating to loans previously sold ***should*** ~~may~~ be recognized in income subject to the considerations ~~discussed below~~ ***above***. Sales of servicing rights relating to loans that are retained ~~should not be recognized in income at the time of sale~~ ***should also be recognized in income subject to the considerations above and at the date of sale, the carrying amount should be allocated between the servicing rights and loans retained using relative fair values in a manner consistent with paragraph 10(b) of FASB Statement No. 140,*** **Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.**[13] ~~The proceeds from such sales should be accounted for in a manner similar to loan discounts and amortized using the interest method as an adjustment to the yield of the related loans~~. (BSI Guide, paragraph 8.20; CU Guide, paragraph 7.13)

l. The institution's liability for deposits originates and should be recognized at the time deposits are received rather than when the institution collects the funds. (BSI Guide, paragraph 11.30) Checks that are deposited by customers and that are in the process of collection and are currently not available for withdrawal (deposit float) should be recorded as assets and liabilities. Deposits should not be recorded based solely on collections. (BSI Guide, paragraph 11.31)

Guidance from the CU or FC Guide

B.3. Following are accounting practices unique to credit unions or finance companies that were initially established by the CU Guide or the FC Guide, and are carried forward, with conforming changes, to this SOP.

a. Amounts deposited with the NCUSIF should be accounted for and reported as assets as long as such

13. FASB Statement No. 140 does not address transfers of servicing rights because they are not financial assets. However, this SOP addresses transactions in which loans are transferred with servicing retained, and governs allocation of basis between loans and servicing rights for those transactions.

amounts are fully refundable. The refundability of NCUSIF deposits should be ~~evaluated periodically~~ ***reviewed for impairment***. When the refundability of a deposit is evaluated, the financial condition of both the credit union and of the NCUSIF should be considered. Deposits may be returned to solvent credit unions for a number of reasons, including termination of insurance coverage, conversion to insurance coverage from another source, or transfer of operations of the insurance fund from the NCUA Board. ***However, i***~~I~~nsolvent or bankrupt credit unions are not entitled to a return of their deposits. To the extent that NCUSIF deposits are not refundable, they should be charged to expense in the period in which the deposits are made or the assets become impaired. (CU Guide, paragraph 10.20)

In years in which the equity of the NCUSIF exceeds “normal operating levels,” the NCUA Board is required to make distributions to insured credit unions to reduce the equity ***of the NCUSIF*** to normal operating levels. Such distributions may be in the form of a waiver of insurance premiums, premium rebates, or cash payments. ~~Payments received~~ ***Distributions*** in connection with that reduction in the equity of the NCUSIF should be reported ~~as current period~~ ***in the*** income ***statement*** in the period in which it is determined that a distribution will be made. (CU Guide, paragraph 10.21)

The system of savings account insurance established by the recapitalization of the NCUSIF, which provided for reserves of 1 percent of insured deposits, is based on the concept that the required deposits create a fund with an earning potential sufficient to provide for the risk of losses in the credit union system. In years in which the earnings of the fund have been adequate to provide insurance protection and cover all expenses and losses incurred by the fund, the NCUA Board has elected to waive the insurance premiums due from insured credit unions. In those years, it has been industry practice to net imputed earnings on the insurance deposits against imputed

premium expense rather than present them as gross amounts on the statement of income. In years in which the insurance premiums are not waived by the NCUA Board, the premiums should be expensed in the period to which they relate. To the extent that the NCUA Board assesses premiums to cover prior operating losses of the insurance fund or to increase the fund balance to "normal operating levels," credit unions should expense those premiums when assessed. (CU Guide, paragraph 10.22)

b. Generally accepted accounting principles (GAAP)[14] require that all member deposit accounts of credit unions, including member shares, be reported ***unequivocally*** as liabilities in the statement of financial condition.[15] ~~It must be unequivocal on the face of the statement of financial condition that deposit accounts are a liability.~~ The statement of financial condition ~~must~~ either ~~(a)~~ *(1)* presents deposit accounts as the first item in the liabilities and equity section or ~~(b)~~ *(2)* includes deposit accounts within a captioned subtotal for total liabilities. An unclassified presentation whereby all liabilities and equity are shown together under one subheading and savings accounts are presented as the last item before retained earnings is not an acceptable presentation. The interest paid or accrued on these accounts, commonly referred to as *dividends*, should be reported as an expense on the statement of income, and the amount of interest payable to members should be included as a liability in the statement of financial condition. This is the same position that the ~~FASB's Emerging Issues Task Force (~~EITF~~) took~~ ***reached*** in EITF Issue No. 89-3, "Balance Sheet Presentation of

14. The Credit Union Membership Access Act (CUMAA) (H.R. 1151) was passed into law in August 1998. This legislation requires all federally insured credit unions with assets of $10 million and over to follow generally accepted accounting principles (GAAP).

15. In October 2000, the FASB issued an exposure draft of a proposed Statement, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*, and an exposure draft of a proposed amendment to FASB Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements*, entitled *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities*. Readers should be alert to any final pronouncements.

Savings Accounts in Financial Statements of Credit Unions." (CU Guide, paragraph 8.05)

c. ***Transactions in which*** **c**~~C~~aptive finance companies ~~that~~ offer favorable financing to increase sales of related companies ~~may present particular problems~~ ***are not exempted from the scope of Accounting Principles Board (APB) Opinion No. 21,*** **Interest on Receivables and Payables,** ***by paragraph 3(d) of that Opinion.*** APB Opinion 21 provides accounting guidance to use if the face amount of the note does not reasonably represent the present value of the consideration given or received in an exchange. (FC Guide, paragraph 2.14)

Guidance from the FC Guide

B.4. Following are recognition and measurement principles initially established by the FC Guide, and carried forward, with conforming changes, to this SOP:

a. Delinquency fees ~~conceptually~~ should be recognized in income when chargeable, assuming collectibility is reasonably assured. ~~In practice, delinquency fees generally are recognized in income when collected, because that approach simplifies efforts to account for such relatively minor receipts.~~ (FC Guide, paragraph 2.21)

b. Prepayment penalties should not be recognized in income until loans ***(or trade receivables, if applicable)*** are prepaid***, except that the existence of prepayment penalties may affect the accounting resulting from the application of paragraph 18(a) of FASB Statement No. 91***. (FC Guide, paragraph 2.22)

c. Rebates ***represent refunds*** ~~are cancellations~~ of portions of the precomputed finance charges on ***installment*** ~~discount~~ loans ***(or trade receivables, if applicable)*** that occur when ~~loan~~ payments are made ahead of schedule. Rebate calculations generally are governed by state laws and may differ from unamortized finance charges on ***installment*** ~~discount~~ loans ***or trade receivables*** because many

states require rebate calculations to be based on the Rule of 78s or other methods instead of the interest method. Accrual of interest income on ***installment*** ~~discount~~ loans ***or trade receivables*** should not be affected by the possibility that rebates may be calculated on a method different from the interest method***, except that the possibility of rebates affects the accounting resulting from the application of paragraph 18(a) of FASB Statement No. 91***. Differences between rebate calculations and accrual of interest income merely adjust original estimates of interest income and should be recognized in income when loans ***or trade receivables*** are prepaid or renewed. (FC Guide, paragraph 2.23)

d. ~~Finance companies should recognize factoring commissions over the periods in which services are rendered. Those periods begin when finance companies approve customers' credit and end when the customers' accounts are settled. In practice, finance companies generally recognize factoring commissions are bought, not over the longer period of providing services, because the differences between the effects of such allocations and the effects of immediate recognition generally would be immaterial. If the differences between the effects of such allocations and the effects of immediate recognition are material, recognized over the longer period of providing services.~~ ***Transfers of receivables under factoring arrangements meeting the sale criteria of paragraph 9 of FASB Statement No. 140 are accounted for by the factor as purchases of receivables. The acquisition of receivables and accounting for purchase discounts such as factoring commissions should be recognized in accordance with FASB Statement No. 91 or AICPA Practice Bulletin No. 6,*** Amortization of Discounts on Certain Acquired Loans, ***as applicable.***[16] ***Transfers not meeting the sale criteria in FASB Statement No. 140 are accounted for as secured loans (that is, loans collateralized by customer***

16. See footnote 5 of Appendix B.

accounts or receivables). Paragraph 15 of FASB Statement No. 140 provides additional guidance in those situations. Factoring commissions under these arrangements should be recognized over the period of the loan contract in accordance with FASB Statement No. 91. That period begins when the finance company (or an entity with financing activities (including trade receivables)) funds a customer's credit and ends when the customer's account is settled. (FC Guide, paragraph 2.25)

e. Income from experience-rated or retrospective commission arrangements should be ~~accrued~~ ***recognized*** over the applicable insurance risk period. (FC Guide, paragraph 5.22)

Presentation and Disclosure

Guidance from the BSI Guide

B.5. Presentation and disclosure principles established by and carried forward from the BSI Guide to the combined Guide follow. Conforming changes are specifically noted by bold italicized or strike-through text. Certain of these disclosure principles were also established separately for credit unions or finance companies or both. Reference to specific paragraphs within the respective Guides is noted parenthetically.

a. Restrictions on the use or availability of certain cash balances, such as deposits with a F~~ederal~~ R~~eserve~~ B~~ank~~, ~~or~~ FHLB, ***or correspondent financial institutions*** to meet reserve requirements or deposits under formal compensating balance agreements, should be disclosed in the ***notes to the*** financial statements. (BSI Guide, paragraph, 4.06; and the CU Guide, paragraph 3.06)

b. ***A financial institution that accepts deposits may have balances due from the same financial institution from which it has accepted a deposit***. ~~Balances due to and due from a single depository institution~~ ***Those account balances***, also called reciprocal balances, should ~~also~~

be offset if ***they will be offset in the process of collection or payment*** ~~right of setoff exists~~. Overdrafts ***of such accounts*** ~~of correspondents or other demand deposit accounts that represent borrowings rather than outstanding drafts~~ should be reclassified as liabilities, unless the ~~depositors have~~ ***financial institution has*** other accounts at the same ~~depository~~ ***financial institution against which overdrafts can be offset***. ~~institution for which there is the right of setoff.~~ (BSI Guide, paragraph 4.07)

c. ~~Management's disclosure in t~~***T***he summary of significant accounting policies should include ***the following***:

(1) The basis for accounting for loans, ***trade receivables*** and lease financings, ~~both held in a portfolio and~~ ***including those classified as*** held for sale

(2) The method ~~for~~ ***used in*** determining the ~~carrying amounts~~ ***lower of cost or fair value*** of ***nonmortgage*** loans held for sale ***(that is, aggregate or individual asset basis)***[17]

(3) ***The classification and method of accounting for interest-only strips, loans, other receivables, or retained interests in securitizations that can be contractually prepaid or otherwise settled in a way that the holder would not recover substantially all of its recorded investment***[18, 19, 20]

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17. A similar requirement exists for mortgage loans held for sale. See paragraph 29 of FASB Statement No. 65.

18. This disclosure requirement applies to instruments within the scope of paragraph 14 of FASB Statement No. 140. The FASB plans to provide guidance on (*a*) which types of instruments qualify for the exception in paragraph 14 of FASB Statement No. 133 and (*b*) whether beneficial interests in securitized financial assets that are subordinated to other interests meet FASB Statement No. 133's definition of derivative instrument. Statement 133 Implementation Issue No. D1, "Recognition and Measurement of Derivatives: Application of Statement 133 to Beneficial Interests in Securitized Financial Assets" provides interim guidance. Readers should be alert to any final guidance.

19. See footnote 5 of Appendix B.

20. Footnote 17 of FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*, states that "The *recorded investment in the receivable* is the face amount increased or decreased by applicable accrued interest and unamortized premium, discount, finance charges, or acquisition costs and may also reflect a previous write-down of the investment."

(4) The method for recognizing interest income on loans ***and trade receivables***, including a statement about the ~~institution's~~ ***entity's*** policy for treatment of ~~loan~~ ***related*** fees and costs, including the method of amortizing net deferred fees or costs. (BSI Guide, paragraph 6.74; CU Guide, paragraph 5.48)

d. The carrying amount of investment assets ~~pledged~~ ***that serve as collateral*** to secure public funds, securities sold under repurchase agreements, and ~~for~~ other borrowings, ***that are not otherwise disclosed under FASB Statement No. 140,*** should also be disclosed in the notes to the financial statements. (BSI Guide, paragraph 5.105; CU Guide, paragraph 4.34)

e. Loans ***or trade receivables*** ~~are typically~~ ***may be*** presented on the balance sheet as ~~an~~ aggregate amount**s**. However, ~~loans~~ ***such receivables*** held for sale should be a separate balance-sheet category. Major categories of loans ***or trade receivables*** should be presented separately either in the balance sheet or in the notes to the financial statements. The allowance for credit losses, ***the allowance for doubtful accounts and, as applicable, any*** unearned income, ***any*** unamortized premiums and discounts,[21] and ***any*** net unamortized deferred fees and costs, should be disclosed in the financial statements. ~~Also, the undisbursed portion of loans receivable (loans in process) should be disclosed~~. (BSI Guide, paragraphs 6.75 and 8.30; CU Guide, paragraphs 5.38–.39, 6.19, and 7.22; FC Guide, paragraph 2.44)

f. The carrying amount of loans, ***trade receivables, securities and financial instruments that serve*** ~~pledged~~ as collateral for borrowings should be disclosed ***pursuant to paragraphs 18 and 19 of FASB Statement No. 5,*** **Accounting for Contingencies**. (BSI Guide, paragraph 6.76; CU Guide, paragraph 5.43)

21. See footnote 5 of Appendix B.

g. ***For financial instruments with off-balance-sheet credit risk,***[22] ***except for those instruments within the scope of FASB Statement No. 133,*** **Accounting for Derivative Instruments and Hedging Activities,** ***an entity should disclose the following information:***

(1) ***The face or contract amount***

(2) ***The nature and terms, including, at a minimum, a discussion of the:***

  (a) ***Credit and market risk of those instruments***

  (b) ***Cash requirements of those instruments***

  (c) ***Related accounting policy pursuant to APB Opinion No. 22,*** **Disclosure of Accounting Policies**

(3) ***The entity's policy for requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments***

~~FASB Statement No. 105, *Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk*, as amended by FASB Statement No. 119, requires disclosure of (*a*) the extent, nature, and terms of financial instruments with off-balance-sheet risk (paragraph 17); (*b*) credit risk of financial instruments with off-balance-sheet credit risk (paragraph 18); and (*c*) concentrations of credit risk of all financial instruments (paragraph 20). The disclosure requirements set forth in paragraph 17 of FASB Statement No. 105 similarly are required for financial instruments without off-balance-sheet risk by paragraph 8 of FASB Statement No. 119.~~ Examples of ***activities and*** financial instruments with off-balance-sheet ***credit*** risk include ***obligations for***

22. *Off-balance-sheet credit risk* refers to credit risk on off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments, except those instruments within the scope of FASB Statement No. 133.

loans sold with recourse (with or without a floating-interest-rate provision), fixed-rate and variable-rate loan commitments, financial guarantees,[23] note issuance facilities at floating rates, and letters of credit. (BSI Guide, paragraph 6.78)

h. In addition to disclosures required by FASB Statements No~~s~~. 5; 114, *Accounting by Creditors for Impairment of a Loan*;[24] and 118, *Accounting by Creditors for Impairment of a Loan—Income Recognition and Disclosures*, a description of the accounting policies and methodology the ~~institution~~ ***entity*** used to estimate its allowance ***for loan losses, allowance for doubtful accounts,***[25] and ***any*** liability ***for off-balance-sheet credit losses***[26] and related ~~provisions~~ ***charges*** for loan***, trade receivable*** or other credit losses should be included in the notes to the financial statements. Such a description should identify the factors that influenced management's judgment (for example, historical losses and existing economic conditions) and may also include discussion of risk elements relevant to particular categories of financial instruments. (BSI Guide, paragraph 7.33; CU Guide, paragraph 5.48; FC Guide, paragraph 2.43)

i. The ***aggregate*** amount of ~~aggregate~~ gains or losses on sales of loans ***or trade receivables*** (including adjustments to record loans held for sale at the lower of cost or ~~market~~ ***fair*** value) should be presented separately ~~on the face of the income~~ ***in the financial*** statements ***or disclosed in the notes to the financial***

23. A guarantor is required to disclose and account for a financial guarantee under EITF Issue 85-20, "Recognition of Fees for Guaranteeing a Loan."

24. FASB Statement No. 114 states in paragraph 4 "For purposes of this Statement, a loan is a contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable."

25. See footnote 8 of Appendix B.

26. *Off-balance-sheet credit losses* refers to losses on off-balance-sheet loan commitments, standby letters of credit, financial guarantees, and other similar instruments, except for instruments within the scope of FASB Statement No. 133.

statements.[27] (BSI Guide, paragraph 8.30; CU Guide, paragraph 7.22)

j. Foreclosed ***and repossessed*** assets ***should*** be classified as a separate balance-sheet amount or included in other assets on the balance sheet with separate disclosures in the notes to the financial statements. ***Certain returned or repossessed assets, such as inventory, should not be classified separately if the assets subsequently are to be utilized by the entity in operations.*** (BSI Guide, paragraph 9.11; CU Guide, paragraph 10.16; FC Guide, paragraph 2.33)

k. ***For premises and equipment,*** ~~N~~***n***et gains or net losses on dispositions should be ~~reflected~~ ***included*** in noninterest income or noninterest expense. (BSI Guide, paragraph 10.11)

l. Disclosures about deposit ***liabilities*** should include the following:

(1) The aggregate amount of time deposit accounts (including certificates of deposit) ~~exceeding~~ ***in denominations of*** $100,000 ***or more*** at the balance-sheet date (BSI Guide, paragraph 11.32a; CU Guide, paragraph 8.04)

(2) Securities, mortgage loans, or other financial instruments ~~pledged~~ ***that serve*** as collateral for deposits, ***that are otherwise not disclosed under FASB Statement No. 140*** (BSI Guide, paragraph 11.32c; CU Guide, paragraph 8.04)

(3) The aggregate amount of any demand deposits that have been reclassified as loan balances, ***such as overdrafts,*** at the balance-sheet date (BSI Guide, paragraph 11.32d; CU Guide, paragraph 8.04)

(4) Deposits that are received on terms other than those available in the normal course of business. (BSI Guide, paragraph 11.32f)

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27. AcSEC acknowledges that many financial institutions currently present such gains or losses separately on the face of the income statement. By requiring financial statement disclosure, AcSEC is not suggesting that this industry practice should be discontinued.

m. Significant categories of borrowings should be presented as separate line items in the liability section of the balance sheet, ***or as a single line item with appropriate note disclosure of components. Institutions may, alternatively, present debt based on the debt's priority (that is, senior or subordinated) if they also provide separate disclosure of significant categories of borrowings***. (BSI Guide, paragraph 13.27; CU Guide, paragraph 9.09; FC Guide, paragraphs 3.24–.25)

n. ***For debt, t***~~T~~he notes to the financial statements should describe the principal terms of the respective agreements including~~,~~ but not limited to~~,~~ the title or nature of the agreement, or both; the interest rate (and whether it is fixed or float~~s~~***ing***); the payment terms and maturity date(s); collateral; conversion or redemption features; whether it is senior or subordinated; and restrictive covenants (such as dividend restrictions), if any. (BSI Guide, paragraph 13.27; CU Guide, paragraph 9.09)

o. Accounting ***and reporting requirements*** for long-term obligations ~~is~~ ***are*** the same for ***financial*** ~~banks and savings~~ institutions as for other ***entities*** ~~enterprises~~. ***If the*** ~~However, because~~ financial institution has an unclassified balance sheet, there is no need to separate balances into current and long-term portions.[28] (BSI Guide, paragraph 13.28; FC Guide, paragraph 3.25)

p. For redeemable preferred stock of a subsidiary accounted for as ~~liabilities~~ ***a liability in a parent's consolidated financial statements***, dividends should be included in the determination of income ***as interest expense***. ***For redeemable preferred stock of a subsidiary accounted for as a minority interest in a subsidiary in a parent's consolidated financial statements, the dividends should be presented as***

28. FASB Statement No. 47, *Disclosure of Long-Term Obligations*, requires disclosure of future payments on long-term borrowings.

minority interest in income of a subsidiary. For redeemable preferred stock ***of a parent*** treated as capital, but displayed in the balance sheet as mezzanine capital, dividends should be included in the statement of changes in shareholders' equity.[29] (BSI Guide, paragraph 13.28)

q. ***Transfers of mortgages accounted for under FASB Statement No. 140 as secured borrowings*** ~~Mortgage backed bonds are debt obligations~~ of the issuing institution and should be classified as debt on the institution's balance sheet. ~~They~~ ***Such mortgage-backed bonds*** should be classified separately from advances, other notes payable, and subordinated debt. (BSI Guide, paragraph 13.30)

Guidance from the FC and CU Guide

B.6. The following are presentation and disclosure principles initially established by the CU Guide and the FC Guide or both, and carried forward, with conforming changes, to the combined Guide and applicable to all entities within its scope.

a. ~~Management's disclosure in t~~***The*** summary of significant accounting policies should include the following:

(1) ~~The method for recognizing interest income on loans, including the policy for discontinuing accrual of interest on nonperforming loans.~~ ***The policy for placing loans (and trade receivables if applicable) on nonaccrual status (or discontinuing accrual of interest) and recording payments received on nonaccrual loans (and trade receivables if applicable), and the policy for resuming accrual of interest*** (CU Guide, paragraph 5.48; FC Guide, paragraph 2.47)

(2) The policy for charging off uncollectible loans ***and trade receivables*** (FC Guide, paragraph 2.47)

29. See footnote 15 of Appendix B.

(3) ***The policy for determining past due or delinquency status (that is, whether past due status is based on how recently payments have been received or contractual terms).***

b. The ~~amount~~ ***recorded investment***[30] ~~of~~ ***in*** loans ***(and trade receivables if applicable)*** on ~~a~~ nonaccrual ~~basis~~ ***status as of each balance-sheet date*** should be disclosed ***in the notes to the financial statements. The recorded investment in loans (and trade receivables if applicable) past due ninety days or more and still accruing should also be disclosed. For trade receivables that do not accrue interest until a specified period has elapsed, nonaccrual status would be the point when accrual is suspended after the receivable becomes past due.*** (CU Guide, paragraph 5.39; FC Guide, paragraph 2.44)

c. Insurance subsidiaries ***may be*** ~~are~~ required to deposit ~~some~~ securities~~, usually not a significant amount,~~ with state regulatory authorities. ~~However, if significant,~~ ***If so***, the ***carrying*** amount ***of securities*** deposited should be disclosed. (FC Guide, paragraph 5.19)

d. Unearned premiums and unpaid claims on certain insurance ~~policies~~ ***coverage*** issued to finance customers by a subsidiary may represent intercompany items because premiums are added to the consumer loan account, which is in turn classified as a receivable until paid, and most or all of the payments on claims are applied to reduce the related finance receivables. Therefore, unearned premiums and unpaid claims on certain credit life and credit accident and health insurance policies issued to finance customers should be deducted from finance receivables in the consolidated balance sheet.~~ That will cause the receivables to be stated at net realizable value.~~ Alternatively, the balance sheet may present only the net finance receivables if the notes to the financial statements contain sufficient disclosure of

30. See footnote 20 of Appendix B.

unearned premiums and unpaid claims and the allowance for losses. ***Unearned premiums and unpaid claims for credit life and accident and health coverage should not be applied in consolidation against related finance receivables for which the related receivables are assets of unrelated entities. In those circumstances, such amounts should be presented as liabilities.*** (FC Guide, paragraph 5.26)

e. ***In the consolidated financial statements, u***~~U~~npaid claims for property insurance and ~~a portion of~~ level term life insurance, however, ***should*** ~~generally may~~ not be ***offset*** ~~applied in consolidation~~ against related finance receivables because finance companies generally do not receive substantially all proceeds of such claims. That prohibition also applies to credit life and accident and health coverage written on policies for which the related receivables are assets of unrelated ~~enterprises~~ ***entities***. In those circumstances, such amounts should be presented as liabilities. (FC Guide, paragraph 5.27)

Guidance Eliminated from the BSI Guide

B.7. The requirements from the May 1, 2000 BSI Guide eliminated for banks and savings institutions are as follows:

- Specific guidance about balance-sheet presentation of cash and cash equivalents, interest-bearing deposits with other institutions, and federal funds purchased and repurchase agreements. (BSI Guide, paragraphs 4.06 and 12.31.)
- Disclosure of long-term debt for regulatory capital purposes. (BSI Guide, paragraph 13.32)

Guidance Eliminated from the CU Guide

B.8. The requirements from the May 1, 2000, CU Guide eliminated for credit unions are as follows:

- Disclosure of significant factors affecting the carrying amount of mortgage-related derivative securities, such as prepayments and interest rates, and separate

disclosure of carrying amount and fair value of mortgage-related derivative securities (CU Guide, paragraph 4.44.)

- Disclosure of additional information about repurchase and reverse repurchase agreements, apart from disclosures already required by FASB Statements No. 107, *Disclosures About Fair Value of Financial Instruments*; and No. 140, such as a description of securities underlying the agreements, cost of the agreements and accrued interest, market value of securities underlying the agreements, and so forth (CU Guide, paragraphs 4.47 and 9.14.)
- Disclosure of additional information about servicing activities, apart from disclosures required by FASB Statement No. 140, such as the amount of the credit union's servicing portfolio, a roll-forward of deferred loan sale premium or discount activity, the nature and extent of any recourse provisions, and the nature and extent of off-balance-sheet escrow accounts (CU Guide, paragraph 7.22.)
- Disclosure of additional information about credit union deposits, including major kinds of interest-bearing and non-interest-bearing deposits by interest rate ranges, weighted average interest rates paid on deposits and related balances by kind of deposit at year end, and dividend (interest) expense by kind of account (CU Guide, paragraph 8.04.)

Guidance Eliminated from the FC Guide

B.9. The requirements from the May 1, 2000, FC Guide eliminated for finance companies are as follows:

- Specific guidance for suspending income recognition on nonperforming loans to be consistent with other Guides (FC Guide, paragraphs 2.15 to 2.17.)
- Specific guidance on accounting for repossessed assets to be consistent with the other Guides (FC Guide, paragraphs 2.33 to 2.35.)

- Specific guidance on disclosure of other income (FC Guide, paragraph 2.47.)
- Income statement classification guidance of interest on overnight investments (FC Guide 3.23)
- Specific guidance on accounting for premium revenue recognition for different kinds of policies to be consistent with the other Guides (FC Guide, paragraph 5.15.)

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