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AcSEC Update, the newsletter of the AICPA Accounting Standards Executive Committee and the AICPA Accounting Standards Team, is published three to four times a year.

Editor: Marc Simon

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Recent AcSEC Activities

previous next

Life and Health Insurance Entities. On September 4, 1998, the AICPA released for public comment a proposed Audit and Accounting Guide Life and Health Insurance Entities. The proposed Guide would supersede the AICPA Industry Audit Guide Audits of Stock Life Insurance Companies, which was issued in 1972 and updated only for conforming changes. AcSEC discussed the comment letters received on the exposure draft at its March 1999 meeting. AcSEC voted to issue a final Guide to reflect AcSEC's consideration of the comment letters, subject to clearance by the chair of AcSEC, a subcommittee of AcSEC, and the FASB. The final Guide is expected to be issued in the fourth quarter of 1999.

The proposed Guide discusses those aspects of accounting and auditing unique to life and health insurance entities and was developed to assist life and health insurance entities in preparing financial statements in conformity with GAAP and to assist independent auditors in auditing and reporting on those financial statements. In addition, the proposed Guide contains significant discussions of statutory accounting practices (SAP), which comprise laws, regulations, and administrative rulings adopted by various states that govern the operations and reporting requirements of life insurance entities. The proposed Guide does not reflect SAP under the National Association of Insurance Commissioners codification project. The relevant SAP section in the proposed Guide is currently being updated to reflect those standards.

The proposed Guide also incorporates accounting and financial reporting requirements issued by the FASB and AcSEC since the issuance of the AICPA Industry Audit Guide Audits of Stock Life Insurance Companies. Also incorporated in this proposed Guide are new auditing standards issued by the AICPA Auditing Standards Board since the issuance of the pronouncements that the proposed Guide would supersede.

The proposed Guide is not intended to establish any new accounting standards or interpret any existing accounting standards, except for the inclusion of an SEC staff announcement regarding the effects of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities, made at the July 12, 1994 EITF meeting, on certain assets and liabilities.

Investment Companies. On September 22, 1998, AcSEC issued an exposure draft of a completely revised Audit and Accounting Guide Audits of Investment Companies. This proposed Guide will replace the AICPA Audit and Accounting Guide Audits of Investment Companies which was issued in 1987 and updated only for conforming changes. The proposed Guide will provide new guidance on accounting for offering costs, amortization of premium or discount on bonds, liabilities for excess expense plans, and on reporting complex capital structures. The comment deadline was December 22, 1998. AcSEC discussed the comment letters at its April 1999 meeting, and is scheduled to discuss a revised audit guide at its September 1999 meeting. A final Guide is expected to be issued in the first quarter of 2000.

Discounts Related to Credit Quality. On December 30, 1998, AcSEC issued an exposure draft of a proposed SOP Accounting for Discounts Related to Credit Quality. Comments were due by April 29, 1999. AcSEC plans to discuss major matters raised in the comment letters at its July 1999 meeting.

Motion Pictures. In March and April 1999, AcSEC discussed the major matters raised in the comment letters received on the October 16, 1998 exposure draft SOP. AcSEC plans to review a draft of a final SOP at its July 1999 meeting.

Employee Benefit Plans. At its January 1999 meeting, AcSEC cleared for exposure, pending certain revisions, the draft SOP Accounting and Reporting of Certain Health and Welfare Benefit Plan Transactions. The revised draft is expected to be sent to FASB during the third quarter of 1999. At this same meeting AcSEC cleared for final issuance, after certain revisions, the SOP Accounting and Reporting of 401(h) Features of Defined Benefit Pension Plans.

Pending clearance by FASB, the final SOP is expected to be issued during the third quarter of 1999. In February 1999, FASB cleared for exposure, after certain revisions, the draft SOP Accounting and Reporting for Certain Employee Benefit Plan Investments and Other Disclosure Matters. An exposure draft was issued on May 17, 1999.

AcSEC on AICPA Web Site

previous next

Look for information about AcSEC activities on the AICPA web site, "AICPA Online." The AICPA web site address is: http://www.aicpa.org, and the area containing information pertaining to AcSEC activities is entitled "Accounting Standards Team." This area can be accessed by clicking in the "choose a topic" section underneath "Information Solutions," selecting "Accounting/Financial Reporting," and clicking on "Go." To view minutes of recent AcSEC meetings, click next on "Technical Status Updates" and then "Highlights of Recent AcSEC Meetings." Or, to obtain a copy of an exposure draft, after clicking on "Go" click on "Technical Documents."

Effective Dates

previous next

SOP 97-3, Accounting by Insurance and Other Enterprises for Insurance-Related Assessments, for fiscal years beginning after December 15, 1998, with earlier adoption encouraged.

SOP 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use, for years beginning after December 15, 1998, with earlier application encouraged in fiscal years for which annual financial statements have not been issued.

SOP 98-2, Accounting for Costs of Activities of Not-for-Profit Organizations and State and Local Governmental Entities That Include Fund Raising, for years beginning on or after December 15, 1998, with earlier application encouraged in fiscal years for which financial statements have not been issued.

SOP 98-5, Reporting on the Costs of Start-Up Activities, for years beginning after December 15, 1998, with earlier application encouraged in fiscal years for which annual financial statements have not been issued.

SOP 98-7, Deposit Accounting: Accounting for Insurance and Reinsurance Contracts That Do Not Transfer Insurance Risk, for fiscal years beginning after June 15, 1999, with earlier adoption encouraged.

SOP 98-9, Modification of SOP 97-2, "Software Revenue Recognition," With Respect to Certain Transactions, extends the deferral of the application of certain passages of SOP 97-2 provided by SOP 98-4, , Deferral of the Effective Date of a Provision of SOP 97-2, "Software Revenue Recognition," effective December 15, 1998 to March 15, 1999; all other provisions are effective for transactions entered into in fiscal years beginning after March 15, 1999. Earlier adoption is permitted as of the beginning of fiscal years or interim periods for which financial statements or information have not been issued.

AcSEC Agenda Projects

previous next

	1999			2000	
As of June 30, 1999	2Q	3Q	4Q	1Q	2Q
General Applicability					
Managed Care - SOP					
Lending Institutions					
Discounts Related to Credit Quality - SOP				F	
Banks, Credit Unions, Finance Companies, and Savings Institutions - SOP		E			
Employee Benefit Plans					
Cost Sharing and Benefit Reduction Arrangements - SOP		E			
401(h) Features - SOP		F			
Investments and Other Disclosure Matters - SOP	E	F			
Investment Industry					
Investment Companies - Guide				F	
Scope Clarification, Investment Companies Guide - SOP					
Insurance Industry					
Life and Health Insurance Entities - Guide			F		
Mass Tort Exposures - SOP					
Nontraditional Contracts - SOP				E	
Mutual Company Reorganizations - SOP			E		
Motion Picture Industry					
Motion Pictures - SOP			F		
Real Estate Industry					
Real Estate Investments - SOP				E	
Real Estate Time-Sharing Transactions - SOP				E	
Real Estate Cost Capitalization - SOP					

Codes:

- E - Exposure Draft Issued
- F - Final Pronouncement Issued

AcSEC's Current SOP Projects

previous next

Accounting for Discounts Related to Credit Quality

Description and background. FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, requires that discounts be recognized as an adjustment of yield over an instrument's life. Practice Bulletin (PB) 6, Amortization of Discounts on Certain Acquired Loans, further addresses accretion of discounts on certain acquired loans, which involves intertwining issues of accretion of discount, measurement of credit losses, and recognition of interest income. This project considers whether PB 6's objectives and guidance continue to be relevant given a number of FASB pronouncements issued subsequent to PB 6 to address various related issues.

The project proposes the following conclusions for loans and debt securities purchased at a discount related to credit quality:

- Investors would display purchased loans at the initial investment amount on the balance sheet. Investors would not display discounts on purchased loans in the balance sheet and would not carry over the allowance for loan losses established by the seller.
- The investor would estimate expected cash flows on the loan at inception and periodically over the life of the loan. The excess of expected cash flows over the initial investment (purchase price) would be recognized as the loan's yield. The excess of contractual cash flows over expected cash flows would not be recognized as yield. Subsequent decreases in expected cash flows would result in recognition of an impairment. Subsequent increases in expected cash flows would be recognized prospectively.
- Loans purchased at a discount related to credit quality would not be considered impaired at acquisition for either measurement or disclosure purposes. However, the proposed SOP requires new disclosures for purchased loans within its scope, in addition to those already required by other accounting literature, including FASB Statement No. 114, Accounting

by Creditors for Impairment of a Loan, and FASB Statement No. 118, Accounting by Creditors for Impairment of a Loan — Income Recognition and Disclosures. Such disclosures apply whether or not loans are considered impaired.
- The proposed SOP would explicitly exclude originated loans from its scope. FASB Statement No. 125, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, provides criteria for distinguishing between purchased and originated loans. The proposed SOP also excludes transactions in which the investor acquires loans from the transferor through an agency relationship, for example, when the transferor bears no risk of loss in making and selling the loans.

Current developments and plans. In October 1998, FASB did not object to AcSEC issuing the proposed SOP for exposure. The exposure draft was issued December 30, 1998 and comments were due by April 29, 1999. AcSEC will discuss major matters raised in the comment letters at its July 1999 meeting.

Staff: Brad Davidson

Managed Care Arrangements

Description and background. This project was undertaken in response to recent structural and operational changes occurring throughout the health care and insurance industries. The proposed SOP would address whether substantive differences in accounting for similar transactions entered into by health care organizations and insurance organizations should continue. The proposed SOP would amend the audit and accounting guide Health Care Organizations and SOP 89-5, Financial Accounting and Reporting of Prepaid Healthcare Services, and it could amend Audits of Stock Life Insurance Companies. The SOP would apply to all nongovernmental entities and potentially to certain governmental entities.

The project addresses the following issues:

- Bifurcation. Should revenues be bifurcated between premiums and administrative fees?
- Reinsurance. Should reinsurance transactions be presented gross or net in the income statement?
- Accounting for loss contracts. For purposes of determining whether a premium deficiency exists: How should contracts be grouped? How should costs that do not vary with a contract or group of contracts be treated? Should anticipated investment income be considered?
- Incurred-but-not-reported (IBNR) claims. Which costs should be accrued as incurred-but-not-reported (IBNR) claims?
- Deferred acquisition costs. Should acquisition costs be capitalized? If so, which costs should be eligible for capitalization?

Current developments and plans. At its March 1999 meeting, AcSEC discussed key issues in the proposed SOP and agreed that it should continue to pursue a revenue and expense model that is most useful to users of the financial statements, given a liability recognition model for all costs that are both probable (through the contract period) and reasonably estimable based on known events. AcSEC asked the task force to explore a model that reports revenues and expenses consistent with current practice (revenue is reported ratably over the contract period, and expenses are reported as services are rendered and as the entity is otherwise obligated under the terms of the contract), and that reports liabilities for all costs that are both probable and reasonably estimable through the contract period based on known events.

In addition, AcSEC asked the task force to explore other issues, such as (a) the operationality of identifying and measuring costs that are both probable (through the contract period) and reasonably estimable based on known events and (b) whether the balance sheet debit that results under that model meets the definition of an asset.

Staff: Joel Tanenbaum

Employee Benefit Plans

There are three proposed SOPs that would amend the Audit and Accounting Guide Audits of Employee Benefit Plans, SOP 92-6, Accounting and Reporting by Health and Welfare Benefit Plans, and SOP 94-4, Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined Contribution Plans, and would supersede PB 12, Reporting Separate Investment Fund Option Information of Defined-Contribution Pension Plans.

Description and background. The first SOP, Accounting and Reporting of Certain Health and Welfare Benefit Plan Transactions, would address issues related to employee health and welfare benefit plans that were not prevalent when SOP 92-6 was issued, including cost-sharing arrangements and amendments of plans to reduce benefits.

Current development and plans. At its January 1999 meeting, AcSEC cleared the draft SOP for exposure pending certain revisions. The revised draft is expected to be sent to FASB for clearance to expose during the third quarter of 1999.

Description and background. The second SOP, Accounting and Reporting of 401(h) Features of Defined Benefit Pension Plans, would address the accounting for and disclosure of features of defined benefit pension plans that are permitted under section 401(h) of the Internal Revenue Code. That Code section allows sponsors of defined benefit pension plans to fund a portion of their postretirement medical obligations related to their health and welfare benefit plans through their defined benefit pension plans. The project would provide guidance for reporting by both defined benefit pension plans and health and welfare benefit plans.

Current developments and plans. At its January 1999 meeting, AcSEC cleared the SOP for final issuance after certain revisions. Pending clearance by FASB, the final SOP is expected to be issued during the third quarter of 1999.

Description and background. The third SOP, Accounting and Reporting for Certain Employee Benefit Plan Investments and Other Disclosure Matters, would eliminate the requirement for defined contribution pension plans to report separate investment fund option information as required by PB 12.

Current developments and plans. FASB cleared the draft SOP for exposure in February 1999. An exposure draft was issued on May 17, 1999. Comments are due by July 17, 1999.

Staff: Wendy Frederick

Financial Institutions: Banks, Credit Unions, Finance Companies, and Savings Institutions

Description and background. This SOP project is to reconcile the specialized accounting and financial reporting guidance established in the existing Guides Banks and Savings Institutions, Audits of Credit Unions, and Audits of Finance Companies. The final provisions would be incorporated in a final combined Guide, Financial Institutions: Banks, Credit Unions, Finance Companies, and Savings Institutions.

The proposed SOP eliminates differences in accounting and disclosure established by the respective Guides, and carries forward accounting guidance for transactions determined to be unique to certain financial institutions. Some of the more important tentative conclusions reached by AcSEC are as follows:

Mortgage companies and corporate credit unions will be explicitly included in the scope of the combined Guide.

Regulatory capital disclosures will be required for mortgage companies, credit unions, banks, and thrifts.

Credit unions report amounts placed in their deposit insurance fund as an asset if such amounts are fully refundable, due to unique legal and operational aspects of the credit union share insurance fund. Banks and thrifts expense payments to their deposit insurance fund as incurred. Under the proposed SOP, both practices are expected to be preserved because of differences in how the funds operate.

Finance companies record purchases and sales of securities on the settlement date, whereas banks, thrifts, and credit unions follow trade date accounting. Under the proposed SOP, finance companies will follow trade date accounting.

FASB Statement Nos. 114 and 118 address loan impairment measurement and disclosure requirements, but do not specify how to recognize income on impaired loans. The Guide for finance companies gives specific guidance on the recognition of interest income on impaired loans. Under the proposed SOP, such guidance for finance companies will be eliminated.

Under the proposed SOP, certain disclosures for credit unions will be eliminated. These disclosures include, for example, additional information about repurchase agreements, servicing assets, and deposit liabilities.

Current developments and plans. AcSEC cleared the exposure draft of the proposed SOP at its December 1998 meeting. Discussion with the FASB for purposes of clearance for exposure will occur in July 1999.

Staff: Brad Davidson

Mass Tort Exposures of Insurance Enterprises

Description and background. AcSEC added this project to its agenda in 1996 in response to a request from the Insurance Companies Committee for a project to address diversity in practice in the recognition and measurement of liabilities for mass tort exposures of insurance enterprises.

This proposed SOP would —

- Include guidance on specific accounting issues that are present in the recognition of the various components of liabilities for mass tort exposures, including environmental and asbestos claims, in the financial statements.
- Address how the various components of mass tort exposure liabilities are measured.
- Include an educational discussion of the various methodologies and assumptions that are used to estimate mass tort exposure liabilities.
- Specify the disclosures to be provided in the notes to the financial statements for insurance enterprises.

Current developments and plans. AcSEC discussed a draft SOP at its December 1998 meeting. AcSEC members questioned the extent of improvement in practice that would result from the draft SOP. Some suggested that a Practice Bulletin (PB) or other publication may be more appropriate. A redrafted document will be reviewed at a future AcSEC meeting to determine whether such guidance is needed and, if so, what form is appropriate.

Staff: Fred Gill

Motion Pictures

Description and background. This project was undertaken by AcSEC at the request of the FASB.

Since the issuance in 1981 of FASB Statement No. 53, Financial Reporting by Distributors and Producers of Motion Picture Films, the industry has undergone substantial changes. For instance, new forms of distribution such as videocassettes, cable television, and pay-per-view television have been introduced or have increased markedly in significance. Additionally, foreign markets have increased in significance.

Current developments and plans. In March and April 1999, AcSEC had its first discussions of the major points raised in the comment letters received on the October 16, 1998 exposure draft SOP. AcSEC plans to review a draft of a final SOP at its July 1999 meeting.

In the March and April 1999 meetings, AcSEC indicated its preliminary positions on the following matters raised by those commenting on the exposure draft:

Abandoned properties — AcSEC continues to support the proposed accounting.

Episodic television losses — AcSEC continues to support the proposed accounting, including the limitation on secondary market revenues.

Changes to the film required of the producer after delivery — AcSEC supports a change to the exposure draft whereby significant changes to a film would be defined as those changes that are additive, which involves creation by entities of new or additional content after delivery. Changes such as dubbing and adding subtitles would therefore not be considered significant changes that preclude revenue recognition.

Participations and residuals — AcSEC supports a change to the exposure draft whereby participations and residuals would be accounted for under current practice, that is, costs should be accrued as revenue is earned, similar to accounting for royalties.

Exploitation costs — AcSEC supports a change to the exposure draft whereby all exploitation costs would be accounted for under SOP 93-7, Reporting on Advertising Costs.

Asset classification — AcSEC supports a change to the exposure draft whereby films are viewed as being similar to inventory rather than long-lived assets. This would cause changes in the cash flow and balance sheet presentations and in the accounting for impairments.

Financial statements — AcSEC supports the final SOP stating that (1) classified and nonclassified balance sheets should present and disclose, respectively, the current and noncurrent portions of film assets, and (2) film entities should be allowed to decide their operating cycles and should disclose the cycle length.

Revenue recognition — AcSEC supports a change to the exposure draft (paragraph 7) whereby the requirement that licensees transfer substantially all risks and rewards of ownership (capital lease analogy) in order for film entities to initially recognize revenue would be deleted.

Minimum guarantees — AcSEC believes that film entities should not recognize minimum guarantees on variable fees as revenue up front; minimum guarantees should be deferred and amortized over the term of the licensing arrangement.

Transition — AcSEC supports extending the effective date one year, making the SOP effective for fiscal years beginning after December 15, 2000.

Staff: Dan Noll

Nontraditional Long-Duration Contracts

Description and background. In February 1998, the FASB cleared a prospectus for the development of an SOP on accounting by insurance companies for certain nontraditional long-duration contracts and for separate accounts. The SOP will address the classification and valuation of liabilities as well as disclosures for nontraditional annuity and life insurance contracts issued by insurance enterprises. The AICPA Insurance Companies Committee identified this project because of the growing trend in insurers offering such contracts.

Current developments and plans. At its April 1999 meeting, AcSEC expressed the following views:

Sales inducements — AcSEC discussed whether sales inducements should be expensed as incurred or whether they should be accrued over the contract period. AcSEC concluded that there may be some basis for capitalizing and amortizing certain sales inducements if additional interest is paid up front to entice the buyer into a contract. Other "bonus" inducements paid at the end of contracts should be accrued during the contract period. The task force will consider developing criteria for determining if certain sales inducements should be capitalized and amortized, and for what period, because of the variation in how sales inducements including bonus interest provisions are offered.

Definition of a separate account — AcSEC discussed whether a separate account is similar to a mutual fund or a bank trust account and therefore should not be presented in the financial statements of the insurance enterprise. Three differences between separate accounts and mutual funds or trust accounts were identified:

- Separate account assets are legally owned by the insurance enterprise, whereas a bank does not own trust assets.
- Contracts offered through separate accounts have insurance features.
- State statutes provide that, during bankruptcy or liquidation, the liabilities of a separate account will be satisfied by the separate account assets first-general account policyholders do not have a right to the separate account assets (referred to as the "bankruptcy remote feature"). However, any excess

of separate account assets over separate account liabilities reverts to the insurance enterprise.

AcSEC concluded that separate accounts should be included in the financial statements of the insurance enterprise.

Presentation of separate account assets and liabilities — AcSEC discussed three models for display of separate accounts in the financial statements of insurance enterprises.

- Allow separate accounts that meet certain criteria to be presented as a single line item on the balance sheet. A single-line presentation on the respective sides of the balance sheet would be for pure pass-through separate accounts, and an additional single-line presentation on the respective sides of the balance sheet would be for certain separate accounts with some investment guarantee. (Option 1)
- Allow only separate accounts without any kind of guarantee to be presented as a single line item on the balance sheet of an insurance enterprise. Additionally, separate accounts with any form of investment guarantee would be consolidated. (Option 2)
- Amend paragraphs 53 and 54 of FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, to eliminate the single presentation for all assets and liabilities related to contracts offered through separate accounts. (Option 3)

AcSEC concluded that Option 3 should be eliminated. AcSEC discussed the criteria proposed by the task force for determining whether the assets and liabilities of separate accounts should be reported as a single line item under Option 1. AcSEC favored Option 2 unless the criteria in Option 1 can be made more operational.

AcSEC will continue the discussion at its October 1999 meeting.

Staff: Elaine Lehnert

Real Estate Time-Sharing Transactions

Description and background. AcSEC added this project to its agenda at the request of the Real Estate Committee because of diversity in practice caused by a lack of guidance specific to real estate time-sharing transactions. The SOP would attempt to reduce the diversity.

Issues to be addressed in this proposed SOP include:

- Which profit recognition method should be used?
- How should allowances for uncollectible receivables be determined?
- What kinds of selling costs may be deferred?

Current developments and plans. At its April 1999 meeting, AcSEC confirmed the following tentative conclusions:

- The SOP will provide accounting guidance only for sellers of time-sharing arrangements.
- The underlying structural basis for the time-sharing accounting model would be the retail land sales (RLS) model of FASB Statement No. 66, Accounting for Sales of Real Estate, with inclusion of certain of the fundamental principles of the other-than-retail-land-sales (OTRLS) model of Statement 66.
- A cumulative 10% down payment (on principal) test to conclude the buyer is committed, similar to that in the RLS model, would need to be passed in order for a time-share seller to be able to record a sale under an accounting method other than the deposit method.
- A receivable collectibility test such as the "90% / 20%" test in the RLS model (paragraph 45c of Statement 66) would need to be passed in order for a seller to be able to record a sale under an accounting method other than the installment method.
- A test of the seller's ability to estimate future defaults would also have to be passed in order for a seller to be able to record a sale under an accounting method other than the installment method. This test is analogous to the ability to estimate future returns discussed in FASB Statement No. 48, Revenue Recognition When Right of Return Exists.

AcSEC will continue to discuss key issues at its September 1999 meeting.

Staff: Marc Simon

Interests in Unconsolidated Real Estate Investments

Description and background. This proposed SOP would supersede portions of SOP 78-9, Accounting for Investments in Real Estate Ventures. AcSEC added this project to its agenda in 1991 in response to inconsistent practice, especially in the area of loss recognition, and a lack of guidance on reporting on unincorporated entities.

Current development and plans. In December 1998, AcSEC decided that the SOP would benefit from a "fresh-start" rewrite to make it more concise and clearer to financial statement preparers. AcSEC determined that the key conclusions of the most recent draft of the SOP would be retained, among which are the requirement that all unconsolidated real estate partnership investments follow equity method accounting, the use of the hypothetical-liquidation-at-book-value method, and inclusion of investments in real estate corporations and corporate joint ventures in the scope of the SOP provided an investor has the ability to significantly influence the investee's operating or financial decisions.

A working group has been formed and has prepared a rewritten draft SOP which will be discussed at the July 1999 AcSEC meeting.

Staff: Marc Simon

Real Estate Cost Capitalization

Description and background. An SOP titled Capitalization of Costs in Real Estate Assets Not Within the Scope of FASB Statement No. 67 will be developed by a task force of AcSEC to address accounting and disclosure issues related to the determination of which costs related to real estate assets should be capitalized as improvements or expensed as repairs and maintenance.

Diversity in practice regarding the capitalization of costs for improvements, replacements, betterments, additions (and terms synonymous to these such as redevelopments, refurbishments, renovations, and rehabilitations), and repairs and maintenance is one of the most prevalent accounting problems in the real estate industry at this time.

Current development and plans. In January 1999, the FASB did not object to AcSEC proceeding with the project. A task force has been established, and an initial discussion of key issues is planned for the October 1999 meeting.

Staff: Marc Simon

Mutual Company Reorganizations

Description and background. In February 1999, the FASB cleared a prospectus for the development of an SOP on accounting by insurance enterprises for demutualizations and formations of mutual insurance holding companies. The AICPA Insurance Companies Committee identified this project because of the growing trend for mutual insurers to form mutual holding companies or to demutualize.

Current development and plans. At its April 1999 meeting, AcSEC had an educational session and began discussing issues related to the proposed SOP. The discussion included the accounting for a "closed block," which relates to segregated assets and insurance liabilities for certain identified participating life insurance policies. The establishment of a closed block is generally the result of an agreement between the insurance regulators and the mutual insurance company and is done to protect the expected dividends for participating policyholders after the demutualization. AcSEC acknowledged that there are differences between a separate account and a closed block. AcSEC further acknowledged that the conclusions reached on the presentation of separate accounts for the long-duration contracts project should not impact the conclusions reached on the financial statement presentation of the closed block for this project.

At its June 1999 meeting, AcSEC expressed the following views:

Accounting for expenses related to a demutualization and the formation of an MIHC — AcSEC discussed whether the classification of expenses related to a demutualization and the formation of an MIHC should be considered a normal expense, an extraordinary expense, or as part of the reorganization (reduction of retained earnings). AcSEC was split on this conclusion, with a plurality in favor of treating demutualization and MIHC formation expenses as extraordinary and a minority of the members in favor of treating the expenses as ordinary.

Presentation of the closed block — AcSEC discussed whether the presentation of closed block assets, liabilities, revenue, and expenses should continue to be presented as single line items on the financial statements of the insurance enterprise or should be included with the corresponding financial statement items of the insurance enterprise, with appropriate disclosures relating to the closed block. AcSEC concluded that closed block assets and liabilities from the closed block should be included with the corresponding financial statement items of the insurance enterprise.

Accounting for pre-demutualization participating contracts after the demutualization date or formation of an MIHC — SOP 95-1, Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises, established accounting principles to be applied by a mutual life insurance company to certain participating policies. FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises, provides only limited guidance on the accounting to be applied to stock life insurance company participating policies. Accounting guidance on whether a mutual life insurance company that converts to a stock company should continue to apply the provisions of SOP 95-1 or could apply the provisions of FASB Statement No. 60 to its participating policies would need to be determined. AcSEC discussed what accounting literature should be applied to demutualized insurance enterprise (or MIHC) participating contracts that were issued before the date of demutualization or date of formation of the MIHC that meet the conditions of SOP 95-1. AcSEC decided to continue to apply SOP 95-1. However, provisions of paragraph 42 of FASB Statement No. 60 relating to dividends to participating contracts should apply to such contracts sold before the date of demutualization or date of formation of the MIHC.

Deferral of excess earnings — AcSEC discussed that the maximum future contribution of the closed block to the earnings of the company is typically the excess of the GAAP liabilities over the GAAP assets at the date of demutualization. FASB Statement No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts, and SOP 95-1, paragraphs 14 and 42, indicate that a deferred dividend liability (DDL) should not be established based upon the concepts under which the principles for accounting for mutual life insurance company participating policies were developed. Under FASB Statement No. 60, paragraph 42, a dividend liability should be established for current earnings that will be paid to policyholders through future benefits. From a shareholder perspective, excess earnings of the closed block which will never inure to the shareholders should be set up as a liability. AcSEC decided upon establishment of an additional dividend liability for excess earnings due to policyholders which cannot inure to shareholders.

Accounting for participating policies sold outside the closed block after the date of demutualization or formation of the MIHC — AcSEC discussed how participating policies sold outside the closed block after the date of demutualization or formation of the MIHC should be accounted for. AcSEC decided to apply SOP 95-1. However, provisions of paragraph 42 of FASB Statement No. 60 relating to dividends to participating contracts should apply to such contracts sold after the date of demutualization or date of formation of the MIHC.

AcSEC will continue its discussion of this project at its September 1999 meeting.

Clarification of the Scope of the Investment Companies Guide

Description and background. In February 1999, the FASB approved a prospectus for a project to develop an SOP to address the scope of the AICPA Audit and Accounting Guide Audits of Investment Companies, which was issued in 1987 and updated only for conforming changes, and the 1998 exposure draft revising that Guide. The scope provisions of the exposure draft are unchanged from the current Guide, and FASB at its July 1998 meeting expressed concern that the scope of the proposed Guide may be unclear. This project will address whether more specific attributes of an investment company can be identified to determine if an entity is within the scope of the Guide. Until this project is finalized, an entity should consistently follow its current accounting policies for determining whether the provisions of the current Guide apply to investees of the entity or to subsidiaries that are controlled by the entity.

Current development and plans. At its April 1999 meeting, AcSEC discussed key issues and did not object to the general approach of the project. AcSEC is scheduled to discuss a draft of the proposed SOP at its July 1999 meeting.

Other AcSEC Activities

previous next

At its April 1999 meeting, AcSEC discussed a draft comment letter on the FASB's exposure draft (ED) of a proposed Statement Consolidated Financial Statements: Purpose and Policy. The comment letter, which did not support the ED as drafted, was subsequently approved by mail ballot.

At its June 1999 meeting, AcSEC discussed comment letters on three FASB EDs:

- A proposed Concepts Statement, Using Cash Flow Information and Present Value in Accounting Measurements (final issuance is subject to the positive approval of AcSEC)
- A proposed Statement, Accounting for Derivative Instruments and Hedging Activities (approved and issued)

- A proposed Interpretation, Accounting for Certain Transactions Involving Stock Compensation: an interpretation of APB Opinion 25 (approved and issued)

The letters supported issuance of final pronouncements. However, AcSEC had substantive recommendations for the FASB's final Statements on present value and stock compensation.

On June 16, 1999, the Chair of AcSEC's Task Force on Accounting for Loan Losses testified before U. S. House of Representatives' Subcommittee on Financial Institutions and Consumer Credit with respect to establishing clearer guidance for financial institutions' allowances for loan losses under GAAP.

The comment letters and testimony are available on the AICPA web site.

Potential Future AcSEC Project

previous next

Allowance for Loan Losses SOP. Allowance for Loan Losses SOP. In June 1999, AcSEC's Planning Subcommittee approved a prospectus (subject to certain revisions) for a project to provide guidance related to identifying the appropriate point for loan loss accruals. The focus of the project will be on financial institutions, the lending process, and identifying the situation at a reporting date that gives rise to a recognizable loss. The project is expected to expand upon relevant guidance in the AICPA Audit and Accounting Guide Banks and Savings Institutions and FASB Statements No. 5 and 114, Accounting for Contingencies and Accounting by Creditors for Impairment of a Loan, respectively. After some revisions to the prospectus, a meeting to clear the prospectus with the FASB will be set for sometime in the third quarter of 1999.

Upcoming AcSEC Meetings

previous next

AcSEC meetings are open to the public.

July 27-28, 1999	Colorado Springs, CO
September 14-15, 1999	New York
October 19-20, 1999	New York
December 14-15, 1999	New York Area

Other Activities of the Accounting Standards Team of The AICPA

previous next

Acquired In-Process Research and Development (IPR&D;)

The Accounting Standards Team is working with a cross section of experts from industry, public accounting firms, the financial analyst community, and appraisal firms to identify best practices related to definitions, accounting, disclosures, valuation, and auditing of acquired IPR&D.; An IPR&D; task force has formed working groups for this purpose and expects to release its findings in 1999.

Comments or Suggestions?

previous next

We welcome any comments or suggestions you may have concerning this publication. Please send to msimon@aicpa.org, fax to 212-596-6064, or write to Marc Simon at AICPA, 1211 Avenue of the Americas, New York, NY 10036-8775.

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