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AcSEC UPDATE

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AICPA

American Institute of Certified Public Accountants

AICPA ESTABLISHES EXPERT PANELS

As part of its effort to revamp the Institute's volunteer structure (see the October 1999 *AcSEC Update*), the AICPA Board of Directors has approved the establishment of Expert Panels that focus on identifying industry-specific business reporting issues with an emphasis on audit and accounting. The AICPA is establishing Panels in areas in which its membership and the public have a high stake and in which the AICPA can add significant value. Initially, the AICPA will establish Panels in the following areas: Biotechnology and Pharmaceuticals, Computer Auditing and Electronic Delivery, and High Technology, which are all new areas of focus, and Employee Benefit Plans, Financial Services, Health Care, and Government/Not-for-Profit, which are continuing areas of focus, with some consolidation. A cross-functional Oversight Group, reporting to the AICPA Board of Directors, is being established to approve, evaluate, and oversee the activities of the Panels.

The Panels enable standards setters, such as AcSEC, the ASB, FASB, and GASB, to continue to leverage the AICPA membership's industry expertise, as well as provide a means for the profession to liaise with outside groups, such as regulators. The Panels will organize and recommend members for liaison task forces, set up by industry area, that will support and advise the Panels. In addition, the Panels are designed to broaden the AICPA's activities beyond those that were traditionally undertaken by committees, in order to help achieve the Vision. The AICPA will begin implementing the new structure in the first quarter of year 2000.

The AICPA will continue to use the task force model identified by the Board in July, with the Panels identifying projects and then handing them off to task forces. The AICPA will leverage off the broad and deep expertise of the membership to undertake the projects, as well as to serve on the Panels. The AICPA will incorporate a state-of-the-art database of member expertise to help facilitate that process. Task Force opportunities will be announced on the AICPA Web site and through other means.

For more information, contact Arleen Thomas, VP Professional Standards and Services (212-596-6115, *athomas@aicpa.org*) or Joel Tanenbaum, Technical Manager, Accounting Standards (212-596-6164, *jtanenbaum@aicpa.org*).

RECENT AcSEC ACTIVITIES

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*. The comment period closed on April 29, 1999. AcSEC plans to continue its discussion of major matters raised in the comment letters at its March 2000 meeting. See page 4 for details on the project.

Motion Pictures. In September 1999, AcSEC approved a final SOP, *Accounting by Producers and Distributors of Films*, subject to FASB clearance. AcSEC expects to meet with the FASB in March 2000 and issue an SOP early in the second quarter of 2000. See page 7 for details on the project.

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*. Those revisions have been made and a discussion with the FASB for purposes of clearance for exposure is expected during the first quarter of 2000. See page 5 for details on the project.

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RECENT AcSEC ACTIVITIES *continued from page 1*

Mutual Company Reorganizations. At its October 1999 meeting, AcSEC voted to expose a proposed SOP and plans to issue an exposure draft in the first quarter of 2000, subject to FASB clearance. See page 6 for details on the project.

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. AcSEC expects to issue the final Guide in the second quarter of 2000.

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 proposed Guide 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.

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EFFECTIVE DATES

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.

SOP 99-2, *Accounting for and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans*, for plan years beginning after December 15, 1998, with earlier application encouraged.

SOP 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters*, for plan years ending after December 15, 1999, with earlier application encouraged in fiscal years for which annual financial statements have not been issued.

Editor: **Marc Simon**

Administrative Editor: **Sharon Macey**

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.

Recent AcSEC Activities *continued from page 2*

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. AcSEC discussed the comment letters received on the exposure draft at its April 1999 meeting. At its September 1999 meeting, AcSEC voted to issue a final Guide to reflect AcSEC's consideration of the comment letters and expects to issue the final Guide in the second quarter of 2000, subject to FASB clearance.

The Guide discusses those aspects of accounting and auditing unique to investment companies and was developed to assist investment companies in preparing financial statements in conformity with GAAP and to assist independent auditors in auditing and reporting on those financial statements. The proposed Guide will provide new guidance on accounting for offering costs, amortization of premium or discount on bonds, liabilities for excess expense plans, reporting complex capital structures, payments by affiliates, and financial statement presentation and disclosures for investment companies and nonpublic investment partnerships. The proposed revised Guide will be effective for fiscal years beginning after December 15, 2000.

AcSEC AGENDA PROJECTS

	2000			
As of December 31, 1999	1Q	2Q	3Q	4Q
Lending Institutions				
Discounts Related to Credit Quality — SOP (page 4)		F		
Banks, Credit Unions, Finance Companies, and Savings Institutions — SOP (page 4)	E			
Allowance for Loan Losses — SOP (page 5)				
Employee Benefit Plans				
Health and Welfare Benefit Plans — SOP (page 5)	E			
Investment Industry				
Investment Companies — Guide (page 3)		F		
Scope Clarification, Investment Companies Guide — SOP (page 5)			E	
Insurance Industry				
Life and Health Insurance Entities — Guide (page 2)		F		
Nontraditional Contracts — SOP (page 6)				E
Mutual Company Reorganizations — SOP (page 6)	E			
Motion Picture Industry				
Motion Pictures — SOP (page 7)		F		
Real Estate Industry				
Real Estate Investments — SOP (page 8)		E		
Real Estate Time-Sharing Transactions — SOP (page 8)			E	
Real Estate Cost Capitalization — SOP (page 9)				

Codes: E – Exposure Draft anticipated issuance date
F – Final Pronouncement anticipated issuance date

AcSEC's CURRENT SOP PROJECTS

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 a loan's life. Practice Bulletin (PB) 6, *Amortization of Discounts on Certain Acquired Loans*, further addresses amortization of discounts on certain acquired loans, which involves intertwining issues of amortization 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.

Tentative conclusions. AcSEC has reached the following tentative conclusions for loans and debt securities purchased at a discount related to credit quality:

- Investors should display purchased loans at the initial investment amount on the balance sheet. Investors should not display discounts on purchased loans in the balance sheet and should not carry over the allowance for loan losses established by the seller.
- Investors should 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) should be recognized as the loan's yield. The excess of contractual cash flows over expected cash flows (referred to as nonaccretable difference) should not be recognized as yield.
- PB 6's treatment of changes in estimates of cash flows after acquisition is preserved. Probable subsequent decreases in expected cash flows result in recognition of an impairment (and not recognized as an adjustment over the life of the loan). Probable subsequent increases in expected cash flows should be recognized prospectively.
- If a new, higher yield on a loan is established (due to a probable increase in expected future cash flows), that higher yield should be used as the effective interest rate in any later test for impairment.
- Loans purchased at a discount related to credit quality should 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 SOP explicitly excludes 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 SOP will not apply to revolving credit accounts where the customer has revolving privileges at the purchase date (but will apply to accounts where the customer has lost revolving privileges).
- Retained interests will be excluded from the scope of the SOP.
- The scope will include loans acquired in purchase business combinations. AcSEC found no reason to exclude such loans while at the same time including individual or "bulk" loan purchases.
- Only those mortgage loans that are held for sale (which are covered under FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*) will be excluded from the scope of the SOP.
- Receivables from leases should be excluded from the scope of the SOP, and the SOP should be clarified as to what constitutes the purchase of a lease.
- The SOP prohibits loans within its scope that are refinanced or restructured after acquisition from being accounted for as new loans, other than through a troubled debt restructuring (such loans are already covered by FASB Statement Nos. 15, 114, and 115).

Current developments and plans. The exposure draft was issued December 30, 1998 and the comment period closed on April 29, 1999. AcSEC discussed major matters raised in the comment letters at its July 1999 and October 1999 meetings, and will continue its discussion at the March 2000 meeting. Certain of the tentative conclusions above have been modified to include changes agreed to by AcSEC in deliberations subsequent to the exposure draft. AcSEC expects to issue a final SOP with the title "Accounting for Certain Purchased Loans" in the second quarter of 2000, subject to FASB clearance.

Staff: Sydney Garmong

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.

Tentative conclusions.

Some of the more important tentative conclusions reached by AcSEC are as follows:

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AcSEC's CURRENT SOP PROJECTS *continued from page 5*

- 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 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 SOP, finance companies will follow trade date accounting.

- FASB Statement Nos. 114, *Accounting by Creditors for Impairment of a Loan*, and 118, *Accounting by Creditors for Impairment of a Loan — Income Recognition and Disclosures*, address loan impairment measurement and disclosure requirements, but they 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 SOP, such guidance for finance companies will be eliminated.

- 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. In July 1999, the FASB did not object to AcSEC issuing the proposed SOP for exposure, subject to certain revisions. AcSEC expects to issue the exposure draft in the first quarter of 2000.

Staff: Sydney Garmong

Allowance For Loan Losses

Description and background. AcSEC has established a task force whose primary objective is to provide additional guidance on the application of GAAP as it relates to the allowance for loan losses. In this context, the task force intends to review existing GAAP with a view toward identifying aspects that may need clarification. The initial expectations are that the task force will develop an SOP that will provide additional guidance on periodic loan loss allowances and the related allowance for loan losses. The project may result in amendment of the AICPA Audit and Accounting Guide *Banks and Savings Institutions*.

Current developments and plans. In September 1999, the FASB did not object to the prospectus for the project, subject to certain revisions. The task force meets monthly and is preparing for discussion of preliminary conclusions with AcSEC in March 2000.

Staff: Sydney Garmong

Accounting and Reporting For Certain Health and Welfare Benefit Plan Transactions

Description and background. This proposed SOP would amend chapter 4 of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*. This project was undertaken because, in recent years, many employers have amended their plans to reduce benefits provided, to introduce cost-sharing arrangements, or both. To the extent that cost sharing has been introduced or increased, the total cost of the benefits has remained essentially the same, while the portion of the total cost paid by the plan sponsor has decreased. Such benefit reductions and cost-sharing arrangements were not prevalent when SOP 92-6 was issued, and thus they were not addressed in SOP 92-6. In addition, since SOP 92-6 was issued, there has been confusion among preparers and auditors in understanding and implementing some of its requirements.

Tentative conclusions.

This proposed SOP:

- Revises the standards for measuring, reporting, and disclosing estimated future postretirement benefit payments that are to be funded partially or entirely by plan participants
- Specifies the presentation requirements for benefit obligation information
- Establishes standards of financial accounting and reporting for certain postemployment benefits provided by health and welfare benefit plans
- Clarifies the measurement date for benefit obligations
- Requires the identification of investments that are 5% of the net assets available for benefits.

Current developments and plans. At its January 1999 meeting, AcSEC cleared the draft SOP for exposure pending certain revisions. Those changes have been made and discussion with the FASB for purposes of clearance for exposure is expected during the first quarter of 2000.

Staff: Wendy Frederick

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

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AcSEC's CURRENT SOP PROJECTS *continued from page 5*

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.

Tentative conclusions: At its December 1999 meeting, AcSEC discussed a draft of a proposed SOP and reached the following conclusions:

The SOP will prescribe a two-tiered approach for deciding which activities or characteristics should result in application of the Guide. The first tier would consider entities registered under either the Investment Company Act of 1940 or the Small Business Investment Company Act of 1958, foreign registered mutual funds, investment partnerships, common (collective) funds, and other investment fund entities (such as venture capital funds and private equity funds). The Guide would apply to those entities if no more than 20% of the entity is owned by related parties and if certain other criteria regarding the purpose of the entity are met.

The second tier would include entities not meeting the first tier requirements, but that invest for appreciation of investments or for current income from individual investees, represent themselves to be an investment company, hold investments in multiple investees, and have an exit strategy for their investments. The Guide would apply to those entities if the investor also does not participate in certain prohibited activities such as participating in the day-to-day management of investees, providing significant administrative or support services to investees, providing financial guarantees or collateral for investees, benefiting directly from the products or processes of investees, or linking investee management compensation to the performance of the investor.

Current developments and plans. AcSEC expects to continue its discussion of the draft of the proposed SOP at its March 2000 meeting.

Staff: Fred Gill

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 former AICPA Insurance Companies Committee identified this project because of the growing trend in insurers offering such contracts.

Tentative conclusions. At its April 1999 meeting, AcSEC tentatively decided the following:

Sales inducements — Sales inducements that are earned by the customer immediately, such as "day-one bonuses," should be expensed immediately. Sales inducements that are earned over a period of time, such as persistency bonuses or enhanced yields, should be expensed over time.

Definition of a separate account — Separate accounts should be recorded in the financial statements of the insurance enterprise that owns them. Separate accounts should be reported as single line items on the respective sides of the balance sheet ("one-line" presentation) if all of the following criteria are met:

- assets reside in a legally recognized separate account;
- the separate account is bankruptcy remote from the insurance enterprise;
- the policyholder directs allocation of investments;
- all investment performance (net of contract fees) is passed through to the policyholder (including contracts with minimum guarantees, but excluding contracts with caps or ceilings).

The guaranteed portion of separate accounts with minimum guarantees should be recorded as a liability in the general account, consistent with the bifurcation approach for embedded derivatives in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. Seed money and other insurance company funds invested in separate accounts should be classified and valued as any other general account asset.

Current developments and plans. AcSEC will continue the discussion at a future meeting.

Staff: Kim Hekker

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 (MIHCs). The former AICPA Insurance Companies Committee identified this project because of the growing trend for mutual insurers to form mutual holding companies or to demutualize.

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AcSEC's CURRENT SOP PROJECTS *continued from page 6*

Tentative conclusions.

Some of the more important tentative conclusions reached by AcSEC are as follows:

Accounting for expenses related to a demutualization and the formation of an MIHC — AcSEC determined that the classification of expenses related to a demutualization and the formation of an MIHC should be considered an other than extraordinary expense.

Presentation of 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 needed to be determined. AcSEC concluded that SOP 95-1 should continue to be applied. However, provisions of paragraph 42 of FASB Statement No. 60 relating to dividends on 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. 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 that will never inure to the shareholders should be set up as a liability. AcSEC decided upon establishment of a dividend liability for excess earnings due to policyholders that cannot inure to shareholders.

Accounting for retained earnings — At the date of formation of an MIHC or demutualization, shares of capital stock will be issued. AcSEC concluded that, for a distribution-form demutualization, an insurance enterprise should reclassify all of its retained earnings as of the date of demutualization to capital stock and additional paid-in capital accounts (the capital accounts). AcSEC concluded that a subscription-form demutualization should not in and of itself result in reclassification of retained earnings. AcSEC concluded that the equity accounts of the MIHC at the date of formation should be determined using the principles for transactions of companies under common control with the amount of retained earnings of the demutualized insurance enterprise, before reclassification to the capital accounts, being reported as retained earnings of the MIHC.

Current developments and plans. At its October 1999 meeting, AcSEC voted to expose a proposed SOP subject to FASB clearance. AcSEC plans to meet with the FASB in February 2000 and, if cleared, issue an exposure draft in the first quarter of 2000.

Staff: Kim Hekker
Consultant: Elaine Lehnert

Motion Pictures

Description and background. This project was undertaken by AcSEC at the request of the FASB, and the resulting SOP will replace FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*.

Tentative conclusions. Major changes to the October 16, 1998 exposure draft SOP include:

Changes to the film required of the producer after delivery — 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 — 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 — All exploitation costs would be accounted for under SOP 93-7, *Reporting on Advertising Costs*.

Impairment assessments — At each balance sheet date, capitalized film costs would be assessed for their net realizable value and written down as necessary.

Statement of cash flows — Cash outflows for film costs, participation costs, exploitation costs, and manufacturing costs would be reported as operating activities in the statement of cash flows.

Revenue recognition — The requirement that licensees transfer substantially all risks and rewards of ownership (capital lease analogy, paragraph 7) in order for film entities to initially recognize revenue would be deleted.

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Fee allocations in multiple film licensing arrangements — Flat fee allocations to individual films would be based on the fair value of the films; AcSEC deleted the "entity-specific" and "product-specific" requirements discussed in the exposure draft.

Minimum guarantees — Nonrefundable minimum guarantees in variable fee arrangements on multiple films would be recognized as revenue similar to how an entity accounts for flat fees on single film arrangements. However, when the films are cross-collateralized, the guarantee fee would be recognized as revenue similar to how an entity accounts for variable fees, with any excess guarantee fee over variable fee being recognized as revenue at the end of the license period.

Net realizable value — NRV assessments would consider estimates of future costs of exploitation.

Transition — The effective date will be extended for one year, making the SOP effective for fiscal years beginning after December 15, 2000.

Current developments and plans. AcSEC approved the final SOP at its September 1999 meeting subject to AcSEC's positive clearance (which has been received) and clearance by the FASB. AcSEC expects to meet with the FASB in March 2000 and issue an SOP early in the second quarter of 2000.

Staff: Dan Noll

Interests in Unconsolidated Real Estate Investments

Description and background. This proposed SOP would supersede 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.

Tentative conclusions. At its December 1999 meeting, AcSEC reached the following conclusions (see the October 1999 *AcSEC Update* for AcSEC's other tentative conclusions):

- The proposed SOP would not attempt to redefine the concept of constructive obligation but would carry forward the relevant wording from SOP 78-9.
- Loans and advances by an investor to an investee would, for purposes of application of the hypothetical liquidation at book value method, be considered subordinate to claims of noninvestor creditors of the investee. This subordination would be applied by priority of legal claim, that is, an investor's (legally) senior claim would be subordinate to noninvestor senior claims but would have priority over junior noninvestor claims.
- The scope of the proposed SOP would reflect that an investor holding an equity investment in an investee would follow equity method accounting for that investee when the investor has significant influence over the investee. For investees that are organized in a "specific ownership account" structure (e.g., general partnerships, limited partnerships, LLCs, LLPs) and over which the investor does not have significant influence, the investor's accounting would depend on whether its ownership interest meets the definition in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, of an equity security having a readily determinable fair value. If the ownership interest meets this definition, the investor would apply Statement 115; if it does not, the investor would apply the equity method.

Current development and plans. AcSEC will discuss a revised draft SOP at its January 2000 meeting for purposes of clearance for exposure. AcSEC plans to issue an exposure draft in the second quarter of 2000, subject to clearance by the FASB.

Staff: Marc Simon

Real Estate Time-Sharing Transactions

Description and background. AcSEC added this project to its agenda at the request of the former AICPA 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 in practice.

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?

Tentative conclusions. At its December 1999 meeting, AcSEC concluded the following:

- In the basic time-sharing accounting model, collectibility of receivables will be demonstrated by either (a) passing a test similar to the "90% test" from the retail land sales (RLS) model of FASB Statement No. 66, *Accounting for Sales of Real Estate*, or (b) collection by the seller of cumulative principal payments of at least 25% of the sales price of the time-share.
- For purposes of estimating the default percentages in the profit recognition tests of the basic time-sharing accounting model, any sales cancelled subsequent to their being recorded as sales would be considered defaults rather than as "sales reversals."
- Provisions for time-sharing defaults would be recorded as in paragraph 70c of the RLS model of Statement 66, which specifies that costs of sales are based on sales net of those sales expected to be cancelled in future periods.
- In the basic time-sharing accounting model, the 10%-of-principal test for buyer's commitment would be passed by receipt by the

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seller of cumulative down payments of at least 10% of the sales price.

- Rentals of unsold time-sharing interests would be considered as holding-period activities and accounted for as incidental operations under FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*.

- Selling and marketing costs would be excluded from the calculations of the percentage-of-completion method as described in Statement 66.

Current developments and plans. AcSEC will continue to discuss key issues at its January 2000 meeting, with the intention to issue an exposure draft (subject to FASB clearance) in the third quarter of 2000.

Staff: Marc Simon

Real Estate Cost Capitalization

Background and description. Diversity in practice concerning the recording of costs for improvements, replacements, betterments, additions (and terms synonymous with these such as redevelopments, refurbishments, renovations, and rehabilitations), and repairs and maintenance is one of the most prevalent problems in the real estate industry at this time. The AcSEC task force is working on an SOP to address accounting and disclosure issues related to determining which costs related to real estate assets should be capitalized as improvements and which should be expensed as repairs and maintenance. The SOP will also address capitalization of indirect and overhead costs and componentization of real estate assets for depreciation purposes.

Current developments and plans. In January 1999, the FASB did not object to AcSEC proceeding with the project. AcSEC formed a task force and an initial discussion of key issues is planned for AcSEC's January 2000 meeting.

Staff: Marc Simon ❖

OTHER ACTIVITIES OF THE ACCOUNTING STANDARDS TEAM OF THE AICPA

GASB's New Financial Reporting Model Affects AICPA Audit and Accounting Guides

On June 30, 1999, the Governmental Accounting Standards Board (GASB) issued GASB Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. This standard greatly changes the financial reporting model that governments have been following. The standard is effective in three phases. Large governments (total annual revenues of $100 million or more) will have to implement the standard for periods beginning after June 15, 2001. Medium-sized governments (total annual revenues of $10 million or more but less than $100 million) have until periods beginning after June 15, 2002 to implement the standard. Smaller governments (total annual revenues of less than $10 million) have until periods beginning after June 15, 2003 to implement the standard.

As a result of these changes, the AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units* (the Guide) will require significant revisions to reflect the new accounting requirements as well as to address a number of related audit issues. An AICPA task force was established in mid-1999 to work on this project. At present the task force does not anticipate a need to develop new accounting requirements as a result of the Guide revision. Instead, the plan is to conform the accounting guidance included in the Guide to reflect Statement No. 34's requirements. The Guide's auditing guidance will also be revised.

The task force is currently developing the necessary revisions to the Guide. Because it is not expected that new accounting requirements will be developed, there is no plan for full AcSEC deliberation and clearance. Instead, several AcSEC representatives will review the changes made to conform the Guide to Statement No. 34. However, that plan could change if the task force determines that there is a need for new accounting requirements as a result of Statement No. 34's revisions to the Guide.

The AICPA Audit and Accounting Guide *Not-For-Profit Organizations*, which was issued in 1996, superseded the three AICPA Audit and Accounting Guides *Audits of Voluntary Health and Welfare Organizations*, *Audits of Colleges and Universities*, and *Audits of Certain Nonprofit Organizations* (Guides). These three Guides were last updated in 1994; however, they continue to be applicable to some governmental entities because current GASB literature references them. When using these last three Guides, consideration should be given as to whether guidance issued subsequent to the last update affects the guidance contained in the Guides. Once Statement No. 34 becomes effective, these three Guides will no longer have any authoritative standing and should no longer be referred to.

Staff: Mary Foelster

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. The IPR&D task force expects to release its findings in several months.

Technical Practice Aids

Staff of the Accounting Standards Team recently released a second set of nonauthoritative questions and answers (Q&As), commonly referred to as Technical Practice Aid (TPAs), pertaining to software revenue recognition.

The Q&As may be viewed on the AICPA web site at *http://www.aicpa.org/members/div/acctstd/general/tpal.htm*. These Q&As will be included in the next update of the AICPA's Technical Practice Aids. AICPA members with questions on these TPAs should call the AICPA's Technical Hotline, which provides nonauthoritative guidance on accounting and attest issues, at (888) 777–7077. ❖

OTHER AcSEC ACTIVITIES

At its October 1999 meeting, AcSEC discussed a comment letter on the IASC's exposure draft of the proposed International Accounting Standard, *Investment Property*. In its comment letter, AcSEC did not support the basic premise of the exposure draft that all investment property should be measured at fair value but believed instead that a historical cost measure was more appropriate.

At its December 1999 meeting, AcSEC discussed and approved a comment letter on the FASB's exposure draft of a proposed Statement of Financial Accounting Standards, *Business Combinations and Intangible Assets*. Despite its preference that the entire issue of new basis accounting be first addressed, AcSEC was supportive of the FASB issuing a final standard on business combinations if certain issues are adequately addressed.

The comment letters will be available on the AICPA web site. ❖

AcSEC ON AICPA WEB SITE

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." ❖

Comments or Suggestions?

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. ❖

Upcoming AcSEC Meetings

AcSEC meetings are open to the public.

January 27–28, 2000	New Orleans, LA
March 7–8, 2000	New York, NY
April 25–26, 2000	New York, NY
June 13–14, 2000	New York, NY
July 25–26, 2000	Seattle, WA
September 12–13, 2000	New York, NY

To Order Copies of AcSEC Pronouncements

Write: AICPA Order Department, NQ, P.O. Box 2209, Jersey City, NJ 07303–2209; **order via fax,** 800–362–5066; or **call** 888–777–7077 (option #1). Ask for Operator NQ. Orders for exposure drafts must be written or faxed. Exposure drafts may also be obtained through the AICPA web site; see "AcSEC ON AICPA WEB SITE" above.

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