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American Institute of Certified Public Accountants. Accounting Standards Executive Committee

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AcSEC UPDATE

A publication of the Accounting Standards Executive Committee and the Accounting Standards Team of the AICPA

AcSEC ISSUES NEW SOP ON SOP 95-2 AMENDMENT

AcSEC issued SOP 01-1, *Amendment to Scope of Statement of Position 95-2,* Financial Reporting by Nonpublic Investment Partnerships*, to Include Commodity Pools* (product no. 014927), on March 27, 2001. The SOP amends SOP 95-2 to include within the scope of SOP 95-2 investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974. SOP 01-1 is effective for financial statements issued for periods ending after December 15, 2001. Earlier application is encouraged.

RECENT AcSEC ACTIVITIES

Accounting by Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities of Others At its February 2001 meeting, AcSEC approved a final SOP, *Accounting by Certain Entities (Including Entities with Trade Receivables) that Lend to or Finance the Activities of Others*, pending AcSEC's positive clearance of certain revisions and FASB clearance. AcSEC expects to issue the SOP during the third quarter of 2001.

Interests in Unconsolidated Real Estate Investments On November 21, 2000, AcSEC issued an exposure draft of the proposed SOP, *Accounting for Investors' Interests in Unconsolidated Real Estate Investments*. Comments are due by April 15, 2001. Because the proposed SOP will replace SOP 78-9, *Accounting for Investments in Real Estate Ventures*, and SOP 78-9 has been applied to other industries besides real estate, AcSEC encourages non-real estate investors interested in accounting for unconsolidated interests to comment on the proposed SOP.

Changes Related to the National Association of Insurance Commissioners (NAIC) Codification On March 21, 2001, the FASB did not object to the issuance of an exposure draft of the proposed SOP, *Amendments to Specific AICPA Pronouncements for Changes Related to the NAIC Codification*. The exposure draft is available on the AICPA website and has a 45-day comment period ending May 18, 2001.

Certain Purchased Loans and Securities (formerly known as Discounts Related to Credit Quality) In March 2000, AcSEC approved a final SOP, *Accounting for Certain Purchased Loans and Debt Securities*, pending AcSEC's positive clearance of certain revisions and FASB clearance. AcSEC's positive clearance was obtained and the proposed SOP was discussed at a meeting with the FASB in January 2001. The FASB objected to the SOP, citing a conflict with FASB Statement No. 5, *Accounting for Contingencies*. The FASB recommended that a criterion for a loss event be added to require deterioration in credit quality from origination to purchase. AcSEC is evaluating alternatives for proceeding with the project.

Health & Welfare Benefit Plans On March 21, 2001, the FASB did not object to issuance of a final SOP, *Accounting and Reporting of Certain Health and Welfare Benefit Plan Transactions*. AcSEC expects to issue the SOP (SOP 01-2) in April 2001.

Costs and Activities Related to PP&E At its September 2000 meeting, AcSEC cleared for exposure, pending AcSEC's positive clearance of certain revisions and FASB clearance, the draft SOP *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*. AcSEC's positive clearance was obtained and on April 11, 2001, the FASB did not object to issuance of the proposed SOP provided certain clarifications are made and a lease-related issue is resolved. AcSEC will discuss those clarifications and that issue at its April 2001 meeting. AcSEC plans to issue an exposure draft in the second quarter of 2001.

EFFECTIVE DATES

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. Earlier application is encouraged in fiscal years for which annual financial statements have not been issued.

SOP 00-2, *Accounting by Producers or Distributors of Films*, for fiscal years beginning after December 15, 2000. Earlier application is encouraged.

SOP 00-3, *Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts*; entities must apply the SOP to financial statements no later than the end of the fiscal year that begins after December 15, 2000. Earlier adoption is encouraged.

SOP 01-1, *Amendment to Scope of Statement of Position 95-2,* Financial Reporting by Nonpublic Investment Partnerships*, to Include Commodity Pools*, for financial statements issued for periods ending after December 15, 2001. Earlier application is encouraged.

SOP 01-2, *Accounting and Reporting by Health and Welfare Benefit Plans*, effective for financial statements for plan years beginning after December 15, 2000. Earlier application is encouraged. Financial statements presented for prior plan years are required to be restated to comply with the provisions of this SOP.

Audit and Accounting Guide, *Audits of Investment Companies*, for annual financial statements issued for fiscal years beginning after December 15, 2000, and for interim financial statements issued after initial application. Earlier application is permitted.

To Order Copies of AcSEC Pronouncements

Call 888-777-7077 (option #1), ask for operator NQ; **order via fax,** 800-362-5066; or **write** AICPA Order Department, NQ, P.O. Box 2209, Jersey City, NJ 07303–2209. 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" later in this issue.

To order final pronouncements through the AICPA web site, www.aicpa.org, go to the area on the web site containing information pertaining to AcSEC activities, 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." Next click on "Technical Documents," and "Documents Available from AICPA Order Dept." Order the documents you need by clicking on the product numbers on the left.

AcSEC MEMBER ACTIVITIES

Mary Stone Reappointed to AcSEC; Mary Barth Appointed to New IASB

Mary Stone, of the University of Alabama and current president of the American Accounting Association (AAA), has been reappointed to AcSEC effective March 2001. Mary had to leave AcSEC after only one year of service (1998-1999) because of her election as AAA president.

Mary Barth's last AcSEC meeting was the February 2001 meeting due to Mary's appointment as a part-time member of the new International Accounting Standards Board (IASB). We would like to thank Mary for her significant contributions to AcSEC and the AICPA.

Speeches and Panel/Roundtable Participation by AcSEC Members

Val Bitton – "Financial Statement Implications of Tax Free Acquisitions," Mid-America Tax Conference – 2000, St. Louis, MO, November 2000

"Current Accounting Issues," Trueblood Seminar for professors (sponsored by the American Accounting Association and Deloitte & Touche), Scottsdale, AZ, March 2001

Mark Sever – "AcSEC and the Standard Setting Process," Beta Alpha Psi—University of Georgia, Athens, GA, October 2000

"AcSEC Update," 25^{th} Annual AICPA National Conference on Banks and Savings Institutions, Washington, D.C., November 2000

"AcSEC Update," University of California-Berkeley, Eleventh Annual Conference on Financial Reporting, Santa Clara, CA, November 2000

"AcSEC Update," Financial Executives International 19^{th} Current Financial Reporting Issues Conference, New York, NY, November 2000

“AcSEC Update,” University of Notre Dame Accounting Association, Chicago, IL, November 2000

“AcSEC Update,” 28th Annual National Conference on Current SEC Developments, Washington, DC, December 2000

Panelist, FASB/American Accounting Association Conference, Norwalk, CT, December 2000

Participant, FASB Roundtable on Exposure Draft on Statement 121 Amendment, Norwalk, CT, January 2001

Article by AcSEC Member

Mary Stone – "Charting a Course to the Future," *Financial Executive Online Edition*, March/April 2001.

AcSEC AGENDA PROJECTS

-----------------2001-----------------   -2002-

As of March 31, 2001

	1Q		2Q		3Q		4Q		1Q
Financing and Lending Activities									
Certain Purchased Loans and Securities — SOP									
Certain Entities that Lend or Finance — SOP					F				
Allowance for Loan Losses — SOP					E				
Employee Benefit Plans									
Health and Welfare Benefit Plans — SOP			F						
Investment Industry									
Scope Clarification, Investment Companies Guide — SOP					E				
SOP 95-2 Amendment — SOP	F								
Insurance Industry									
Certain Entities that Lend or Finance — SOP					F				
Nontraditional Contracts — SOP					E				
Changes Related to the NAIC Codification — SOP			E						
Real Estate Industry									
Real Estate Investments — SOP							F		
Real Estate Time-Sharing Transactions — SOP					E				
Other Projects									
Certain Entities that Lend or Finance — SOP					F				
Costs and Activities Related to PP&E — SOP			E				F		

Codes: **E - Exposure Draft anticipated or actual issuance date**
F - Final Pronouncement anticipated or actual issuance date

AcSEC's CURRENT SOP PROJECTS

Accounting for Certain Purchased Loans and Debt Securities (formerly known as 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 reached the following conclusions for loans and debt securities purchased with credit quality concerns:

- 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. Expected cash flows in excess of the initial investment (purchase price) should be recognized as the yield. Contractual cash flows in excess of 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 retained. Probable subsequent decreases in expected cash flows result in recognition of an impairment (and should not be 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.

- The SOP explicitly excludes originated loans from its scope. FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities, a replacement of FASB Statement No. 125*, provides criteria for distinguishing between purchased and originated loans.

- The SOP does not apply to revolving credit accounts where the customer has revolving privileges at the purchase date (but does apply to accounts where the customer has lost revolving privileges).

- Retained interests are excluded from the scope of the SOP.

- The scope includes loans acquired in purchase business combinations. AcSEC found no reason to exclude those 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*) are excluded from the scope of the SOP.

- Receivables from leases are excluded from the scope of the SOP.

- 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 Statements No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings,* 114, *Accounting by Creditors for Impairment of a Loan*, and 115, *Accounting for Certain Investments in Debt and Equity Securities*).

- The scope also includes aggregations of loans purchased from multiple or single sellers. Such aggregation is available to loans purchased individually or in pools. Aggregation is only available, however, to smaller-balance homogeneous loans. To be aggregated, loans must have a common credit risk (such as past due status or credit score) and have a common predominant risk characteristic (such as type of loan or date of origination). Aggregation is limited to loans purchased in the same fiscal quarter.

- Guidance on recognition of income from loans within the scope will not be provided because that guidance does not exist for originated loans.

- Variable loans with index rate decreases, contractual cash flow decreases, and expected cash flow decreases should be evaluated based on the change in expected cash flows attributable to the decrease in index rates. Those changes should be recognized prospectively rather than as an impairment. The investor must determine the decrease in expected cash flows due to index rate decreases and evaluate those changes against the loan's contractual payments receivable, which must be calculated based on the index rate as it changes over the life of the loan.

- The SOP requires new disclosures for purchased loans within its scope, in addition to those already required by other accounting literature, including FASB Statements No. 5, *Accounting for Contingencies*, 114, 115, and 118, *Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures*. The following disclosures apply whether or not the loans are considered impaired:

    - Beginning and ending carrying amount

    - A reconciliation of the beginning and ending accretable yield balances, including additions, reclassifications, deletions, accretion, and sales

    - Beginning and ending nonaccretable difference balances

    - For loans other than debt securities, loss accruals recorded and reversed.

- The SOP will be effective for loans acquired in fiscal years beginning after June 15, 2001.

Current developments and plans. At its March 2000 meeting, AcSEC approved issuance of a final SOP subject to AcSEC's positive clearance of certain revisions and FASB clearance. AcSEC's positive clearance was obtained and the proposed SOP was discussed at a meeting with the FASB in January 2001. The FASB objected to the SOP, citing a conflict with FASB Statement No. 5. The FASB recommended that a criterion for a loss event be added to require deterioration in credit quality from origination to purchase. AcSEC is evaluating alternatives for proceeding with the project.

Staff: Sydney Garmong

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

Description and background. This proposed SOP would apply to entities that lend to or finance the activities of others. In addition to banks, savings institutions, credit unions, finance companies, corporate credit unions, and mortgage companies, the SOP would also apply to manufacturers, retailers, wholesalers, and other business enterprises that provide financing for products and services.

All entities (except those such as investment companies, broker-dealers, and employee benefit plans, that carry loans receivable at fair value and include gains and losses in earnings) that lend to or finance the activities of others are subject to the provisions of *Audits of Finance Companies*. Although the scope of that Guide explicitly excluded insurance companies, this SOP is intended to include the financing activities of insurance companies.

This SOP also reconciles 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, applicable to all entities that lend to or finance the activities of others. 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. It is not intended to create new accounting guidance.

Tentative conclusions. AcSEC has reached the following conclusions:

- Financing activities, including trade receivables, will continue to be included in the scope of the SOP. This includes manufacturers, retailers, wholesalers, and other business enterprises that provide financing for products and services. AcSEC considered removing trade receivables with terms of less than one year from the scope but decided to retain the scope of the Guide for finance companies, which included all trade receivables. AcSEC asked the task force to change the title of the SOP to reference the inclusion of trade receivables, include a section in the summary to describe the applicability to trade receivables, include the term (where appropriate) *trade receivables* within the SOP, and include a section on trade receivables in the Basis for Conclusions.

- Corporate credit unions and mortgage companies are explicitly included in the scope of the SOP.

- The Guide for finance companies does not explicitly address the recording of regular-way transactions. 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.

- FASB Statements No. 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, that guidance for finance companies will be eliminated.

- 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, *Disclosure about Derivative Financial Instruments and Fair Value of Financial Instruments*, 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, *Accounting for Derivative Instruments and Hedging Activities*. 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 those instruments, commonly used by lending institutions, include off-balance-sheet loan commitments, financial guarantees, and letters of credit. AcSEC concluded that the disclosure requirements for off-balance-sheet financial instruments, previously addressed in FASB Statement No. 105, should still be applied to entities within the scope of this SOP.

- Failure to comply with minimum net worth (capital) requirements imposed by secondary market investors could have a material adverse effect on the reporting entity. AcSEC concluded that a mortgage company's compliance with minimum net worth requirements should be disclosed, similar to the capital disclosures for other entities covered by the SOP. AcSEC was concerned with the volume of disclosures if an entity has multiple servicing arrangements with different investors. AcSEC decided to limit the disclosure requirement to only the most significant investor arrangements.

- AcSEC discussed the application to overdrafts of correspondents and reciprocal balances and the application of unpaid premiums or claims against receivables. The proposed presentation differs from FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*, in that there is only a requirement of a right of offset; the Interpretation requires more than the existence of a right of offset. The Interpretation provides a narrow exception for entities within the scope of an AICPA Guide for this industry practice. As part of the reconciliation process, AcSEC agreed that the proposed provision should be extended to other depository entities within the scope of the SOP. AcSEC intended for the exception to be extended only to other depository institutions. AcSEC believed that applying the provision to other situations for which the exception was not intended is inappropriate.

- The existing disclosure requirements for banks and savings institutions do not apply to branches of foreign banking organizations because those branches do not have capital. However, branches are subject to requirements to maintain certain levels of capital-equivalent deposits and may be required to maintain other specified reserves. AcSEC concluded that because failure to comply with those requirements can have an adverse effect on the entity, disclosures about the balance requirements and a branch's compliance should be required.

- Capital requirements for trust operations are not published, vary between the regulatory agencies, and may not be uniformly applied to all trust operations of all institutions. AcSEC agreed that, to the extent that an institution has been advised of an expectation that certain trust-related capital levels be maintained, the entity's compliance with those regulatory expectations should be disclosed.

- The proposed SOP does not require comparison of the combined capital and risk-weighted assets of pre-merged entities, even in a business combination accounted for as a pooling, with statutory capital adequacy and prompt corrective action minimums or with actual or composite adjusted minimums of the pre-merged entities. AcSEC did not object to the required disclosures of the proposed SOP.

- Banks and savings institutions are required to disclose in their notes certain matters about their capital adequacy relative to regulatory minimum capital standards and prompt corrective action requirements. Failure to comply with regulatory capital requirements could have a material adverse effect on the entity. AcSEC agreed that a credit union's compliance with minimum net worth and capital and prompt corrective action requirements is equally important to readers of credit union financial statements. Therefore, AcSEC agreed to require credit unions to disclose similar information as that currently in place for banks and savings institutions.

- The proposed SOP prescribes transition guidance for recognition and measurement provisions applied to an entity for the first time. For entities not previously subjected to those provisions, initial application may result in a change in accounting and, if so, that change would be reported as a cumulative effect of accounting change in conformity with Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*. The transition guidance also allows for certain disclosure transition alternatives.

Current developments and plans. At its February 2001 meeting, AcSEC approved a final SOP, *Accounting by Certain Entities (Including Entities with Trade Receivables) that Lend to or Finance the Activities of Others*, pending AcSEC's positive clearance and FASB clearance. AcSEC expects to issue a final SOP in the third quarter of 2001.

Staff: Sydney Garmong

Allowance For Loan Losses

Description and background. AcSEC 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. The task force is expected to develop an SOP that will provide additional guidance on periodic loan loss provisions and the related allowance for loan losses. The project may result in amendment of certain AICPA Audit and Accounting Guides, such as *Banks and Savings Institutions*.

Tentative conclusions. Some of the tentative conclusions reached by AcSEC are as follows:

Allowances for loan losses should be established only if available information about past and current events indicates that it is probable that an asset has been impaired or that a loss has been incurred as of the balance sheet date.

- The allowance for loan losses reported on a creditor's balance sheet should consist only of —
    - a component for specifically identified loans that have been evaluated individually for impairment, considered to be individually impaired, with impairment measured in accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, and
    - one or more components for impairment of pools of loans determined in accordance with FASB Statement No. 5, *Accounting for Contingencies*.
- A creditor should not assume that there always would be a single, distinct event that can be identified as the cause of an impairment. Instead, there may be a series of events that have occurred resulting in the impairment of an individual loan or a pool of loans.

Current developments and plans. In July 2000, AcSEC discussed a draft SOP that reflected a task force proposal to base recognition of credit losses on all loans other than smaller-balance loans that are evaluated collectively for impairment on a change in the loans' credit risk grades. Under that proposal, recognition of losses on smaller balance, homogeneous loans would be based on past-due status. In December 2000, AcSEC discussed a task force proposal to dismiss the loss recognition "triggers" discussed at the July 2000 meeting and to instead require that loss recognition for pools of loans be based on loss attributes that reflect the conditions in paragraph 8 of FASB Statement No. 5, *Accounting for Contingencies*, and that are supported by observable data that are relevant to and directly representative of the specific loss attributes.

In March 2001, AcSEC discussed a draft exposure draft SOP that had as its fundamental concepts that the allowance should be based on observable data and that changes in the allowance should be directionally consistent with changes in the observable data. The draft also proposed new disclosures concerning the allowance. Those disclosures included—

- The creditor's accounting recognition and measurement principles and policies for each significant component of the allowance.
- The creditor's methodology for determining the amount of each component of the allowance related to pools of loans.
- The amount of each significant component of the allowance by loan type as of each balance sheet date in sufficient detail to allow users to understand the component distinctions.
- If the creditor has components of the allowance related to pools of loans that are based on a credit evaluation process, narrative information describing that process.
- Whether accrued interest is presented in the outstanding loan balances of the loan portfolio or is presented separately in the balance sheet.

Although AcSEC did not reach any conclusions as to specific proposed requirements, AcSEC agreed that the task force is moving in the right direction. AcSEC will discuss a revised draft SOP at its June 2001 meeting with the objective of approving an exposure draft for public comment.

Staff: Fred Gill

Accounting and Reporting of Certain Health and Welfare Benefit Plan Transactions

Description and background. The 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*. The project was undertaken because, since SOP 92-6 was issued in August 1992, there has been diversity in practice in implementing a number of its requirements, including the measurement date for benefit obligations and the disclosure of certain investment information. In addition, preparers and others have questioned the restrictive nature of some of the presentation requirements of SOP 92-6 and the adequacy of certain disclosure requirements. For example, many employers have amended their plans to add or increase participant contributions, creating the need for more relevant information about how a plan's costs are shared.

Also, in November 1992, FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*, was issued, establishing standards of financial accounting and reporting by employers for certain postemployment benefits provided to former or inactive employees after employment but before retirement. Benefits provided may include salary continuation, supplemental unemployment benefits, severance, disability-related job training and counseling, and continuation of health-care and life insurance. SOP 92-6 contains only limited accounting and reporting guidance related to postemployment benefits provided by health and welfare benefit plans (principally only accumulated eligibility credits). Therefore, this SOP adopts certain measurement concepts of FASB Statement No. 112, which applies to employer accounting. Terminology used in discussing postemployment benefits in this SOP is intended to follow that in FASB Statement No. 112.

Conclusions. The SOP —

1. Specifies the presentation requirements for benefit obligation information.
2. Requires disclosure of information about retirees' relative share of the plan's estimated cost of providing postretirement benefits.
3. Clarifies the measurement date for benefit obligations.
4. Establishes standards of financial accounting and reporting for certain postemployment benefits provided by health and welfare benefit plans.
5. Requires disclosure of the discount rate used for measuring the plan's obligation for postemployment benefits.
6. Requires the identification of investments that are 5 percent of the net assets available for benefits.

Current developments and plans. At its March 21, 2001 meeting, the FASB did not object to issuance of a final SOP. AcSEC expects to issue the final SOP (SOP 01-2) in April 2001.

Staff: Wendy Frederick

Clarification of the Scope of the Investment Companies Guide

Description and background. In February 1999, the FASB cleared a prospectus for a project to develop an SOP to address the scope of the AICPA Audit and Accounting Guide *Audits of Investment Companies*. At that meeting, the FASB expressed concern that the scope of the then proposed Guide may be unclear. (The scope provisions of the Guide, which was issued in November 2000, are unchanged from the previous Guide.) 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 Guide apply to investees of the entity or to subsidiaries that are controlled by the entity.

Tentative conclusions. Some of the tentative conclusions reached by AcSEC are as follows:

- For purposes of the separate financial statements of an entity, the Guide would be applicable to entities that are regulated as investment companies and other entities whose primary business activity involves investing for current income, capital appreciation, or both. The SOP would include conditions that should be evaluated to determine whether the entity's primary business activity is investment activity, including whether investees function as separate autonomous businesses. Entities that meet the investment company conditions would be required to apply the provisions of the Guide in presenting their financial statements. Entities that do not meet those conditions would be prohibited from applying the provisions of the Guide.

- The SOP would also include conditions that must be evaluated to determine whether the specialized industry accounting principles of the Guide applied by a subsidiary or equity method investee should be retained in the financial statements of the parent company or an investor that applies the equity method of accounting to its investments in the entity. Those conditions are intended to evaluate relationships between the parent company or equity method investor and investees that may indicate that investees are not separate autonomous businesses from the parent company or equity method investor. If those conditions are not met, the specialized industry accounting principles of the Guide would not be retained in the financial statements of the parent company or equity method investor and the financial information of the investment company would be adjusted to reflect the accounting principles that would apply to the entity assuming it did not qualify as an investment company within the scope of the Guide.

Current developments and plans. At its October 2000 meeting, AcSEC approved a proposed SOP for exposure, subject to AcSEC's positive clearance and FASB clearance. AcSEC expects to release the exposure draft in the third quarter of 2001.

Staff: Joel Tanenbaum

Nontraditional Long-Duration Contracts

Description and background. This project will address the classification and valuation of liabilities as well as disclosures for nontraditional annuity and life insurance contracts issued by insurance enterprises.

Tentative conclusions. Some of the tentative conclusions reached by AcSEC are as follows:

Definition of a separate account – Separate accounts should be recorded in the financial statements of the insurance enterprise that owns them. Separate account assets and liabilities 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.

Multiple benefit features – AcSEC also is discussing the accounting for products with multiple benefit features, such as variable annuities with minimum guaranteed death benefits (MGDB) features. Decisions to date include —

- For purposes of contract classification, it is necessary to determine if the mortality risk associated with the MGDB feature is "significant." If insignificant or remote, the contract should be classified as an investment contract. If significant, the contract should be classified as an insurance contract.

- The significance of the death benefit should be measured based on a comparison of the present value of expected payments to be made under the MGDB provision (death benefit amounts in excess of the account value) with the present value of all amounts assessed against the policyholder (revenues). Insurers should consider a range of reasonably possible scenarios rather than simply a best estimate using one set of assumptions.

- The direct writer of a variable annuity contract with an MGDB feature should view this as a single contract, accounted for under existing guidance in FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments*, with an additional liability established for the MGDB feature (applying the provisions of paragraph 17(b) regarding unearned revenue to the MGDB element of the contract). Paragraph 17(d) should also be applied with respect to premium deficiency. If the contract is classified as an investment contract, no additional liability is needed for the MGDB feature. If the contract is classified as an insurance contract, an MGDB liability should be recorded in addition to the account value.

- If the contract transfers significant reinsurance risk to the reinsurer, the reinsurer of the MGDB feature of that contract would account for the reinsurance contract by recording an additional MGDB liability. In other words, the treatment is the same as for a direct writer.

Current developments and plans. At its March 2001 meeting, AcSEC continued its discussion of potential liability valuation models. The task force reported that after further exploring annuitization benefits as requested by AcSEC, it recommended the accretion model with no recognition of annuitization options during the accumulation phase. The accretion model accretes to the account balance that would be available in cash or cash equivalents at the earlier of the reset date or contractual maturity. AcSEC tentatively voted in support of the accretion model.

AcSEC tentatively voted to use a modified effective yield model (rather than a liability/expense approach) for sales inducements. That model recognizes debt discount over the expected life of the contract through amortization of a deferred charge based on estimated gross profits.

AcSEC will discuss a draft SOP at its June 2001 meeting. AcSEC plans to issue an exposure draft in the third quarter of 2001.

Staff: Kim Hekker

Changes Related to the NAIC Codification

Description and background. AcSEC formed a task force to review the necessary changes to SOPs related to the completion of the National Association of Insurance Commissioners (NAIC) Codification of statutory accounting practices for certain insurance enterprises. This resulted in a new proposed SOP that combines amendment to accounting SOP 94-5, *Disclosures of Certain Matters in the Financial Statements of Insurance Enterprises,* and auditing guidance that has also been updated as a result of the completion of the NAIC Codification.

The amendments to SOP 94-5 included in the proposed SOP would require insurance enterprises to disclose, at the date of each balance sheet presented, beginning with financial statements for fiscal years beginning on or after January 1, 2001**,** a description of the prescribed or permitted statutory accounting practice and the related monetary effect on statutory surplus of using an accounting practice that differs from either state-prescribed statutory accounting practices or NAIC statutory accounting practices. Retroactive application is not permitted.

Those disclosures should be made if (*a*) state-prescribed statutory accounting practices differ from NAIC statutory accounting practices or (*b*) permitted state statutory accounting practices differ from either state prescribed statutory accounting practices or NAIC statutory accounting practices, and the use of prescribed or permitted statutory accounting practices (individually or in the aggregate) results in reported statutory surplus or risk-based capital that is materially different from the statutory surplus or risk-based capital that would have been reported had NAIC statutory accounting practices been followed.

The proposed SOP also includes the following auditing guidance that has been updated as a result of the completion of the NAIC Codification: AICPA SOP 95-5, *Auditor's Reporting on Statutory Financial Statements of Insurance Enterprises,* and SOP 94-1, *Inquiries of State Insurance Regulators*; and AICPA Auditing Interpretation No. 12, "Evaluation of the Appropriateness of Informative Disclosures in Insurance Enterprises' Financial Statements Prepared on a Statutory Basis," of Statement on Auditing Standards (SAS) 62, *Special Reports* (AICPA, *Professional Standards,* vol. 1, AU sec. 9623.60–.77). The included auditing guidance has been approved by the Auditing Standards Board.

The proposed SOP would be effective for financial statements and audits of financial statements for fiscal years beginning on or after January 1, 2001. If comparative financial statements are presented for fiscal years beginning before January 1, 2001, the disclosure provisions of SOP 94-5 effective prior to this SOP would apply to permitted statutory accounting practices by the domiciliary state insurance department.

Current developments and plans. On March 21, 2001, the FASB did not object to the issuance of an exposure draft of the proposed SOP, *Amendments to Specific AICPA Pronouncements for Changes Related to the NAIC Codification*. The exposure draft is available on the AICPA website and has a 45-day comment period ending May 18, 2001.

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

- With certain exceptions, an investor holding an equity investment in an investee would follow the equity method of accounting for that investee when the investor has the ability to exercise significant influence over the investee. For investees such as general partnerships, limited partnerships, limited liability companies (LLCs), and limited liability partnerships (LLPs) that are organized in a "specific ownership account"-like structure and over which the investor does not have the ability to exercise significant influence, the investor's accounting depends 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 that definition, the investor would apply FASB Statement No. 115; if it does not, the investor would apply the equity method.

- The hypothetical liquidation at book value method (HLBV) would be followed in applying the equity method. HLBV is a balance sheet-oriented approach to equity method accounting. Under HLBV, an investor determines its share of the earnings or losses of an investee by determining the difference between its "claim on the investee's book value" at the end and beginning of the period. That claim is calculated as the amount that the investor would receive (or be obligated to pay) if the investee were to liquidate all of its assets at recorded amounts determined in accordance with GAAP and distribute the resulting cash to creditors and investors in accordance with their respective priorities.

- HLBV takes into account all forms of financial interest that an investor has with respect to an investee, including common stock, preferred stock, general or limited partnership interests, debt securities, loans, advances, notes receivable, and other obligations.

- In applying HLBV, an investor would report a negative investment only to the extent it has guaranteed obligations of the investee, is otherwise committed to provide further financial support for the investee, or if the imminent return to profitable operations by the investee appears to be assured. If the amount an investor would receive or pay upon the hypothetical liquidation of an investee at book value depends on the ability of another investor to fund its negative investment, the investor's claim on the book value of the investee would include only those amounts that it is probable the other investor would fund.

- An investor has a "basis difference" if there is a difference between the amount of its investment in an investee and its claim on the book value of the investee. Generally, a basis difference would be attributed to assets or liabilities of the investee and accounted for as if the investee were a consolidated subsidiary.

Current development and plans. The exposure draft was issued on November 21, 2000 with comments due by April 15, 2001. A copy of the exposure draft can be obtained at www.aicpa.org/members/div/acctstd/edo/index.htm.

Staff: Marc Simon

Real Estate Time-Sharing Transactions

Description and background. AcSEC added this project to its agenda because of diversity in practice caused by a lack of guidance specific to real estate time-sharing transactions.

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

Basic accounting model – The underlying structural basis for the time-sharing accounting model is the retail land sales model (RLS) of FASB Statement No. 66, *Accounting for Sale of Real Estate*, with inclusion of certain of the fundamental principles of the other-than-retail-land-sales model (OTRLS) of that Statement.

Basic accounting model - Buyer's commitment test – The accounting model's test for buyer's commitment is a 10%-of-principal test, similar to that of RLS, which would be met by receipt by the seller of cumulative down payments of at least 10% of the sales price.

Basic accounting model - Collectibility-of-receivables test – Collectibility is demonstrated by either meeting a test based on collection of 85% of prior similar projects' receivables dollars or by the seller's collection of cumulative principal payments of at least 25% of the sales price.

Basic accounting model - Estimability-of-defaults test – The estimability-of-defaults test is a non-bright-line test, subject to certain criteria, whereby a time-sharing entity would have to have sufficient collection experience to demonstrate that it can reliably estimate defaults (analogous to the ability to estimate future returns discussed in FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*).

Meaning of "defaults" – For purposes of estimating default percentages in the collectibility-of-receivables and estimability-of-defaults tests, sales cancelled subsequent to being recorded as sales should be considered as defaults rather than as "sales reversals." A seller should interpret "defaults" broadly to include all situations in which, due to credit concerns, less than 100% of a receivable is collected from a buyer. Costs related to defaults (for example, collection costs) should not be incorporated into the seller's estimate of defaults but should instead be charged to selling, general, and administrative expense as incurred.

Accounting for estimated and actual defaults – For sales (meeting the recognition criteria) that are not expected to be collected, based on historical and statistical information, revenue should be reduced rather than bad debt expense charged.

Accounting for cost of sales and inventory – The relative sales value method should be used to allocate inventory cost and determine cost of sales when inventory relief is recorded as part of a sale.

Passage-of-title requirement – Passage of non-reversionary title is a criterion for treating a time-sharing transaction as a sale rather than a lease.

Rentals of unsold interests – Rentals are considered to be holding-period activities and accounted for as "incidental operations." Incidental operations would be defined as in FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, except that the SOP's definition would not require that the purposes of those operations is to reduce the cost of developing the property for its intended use. Time-sharing interests should be accounted for as inventory rather than fixed assets, and should therefore not be depreciated during times of rental.

Expensing versus deferral of costs – Costs should be handled using the "directly associated" approach of paragraph 18 of FASB Statement No. 67, modified to include some restrictions similar to those in FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*.

Special purpose entities (SPEs) – The issue involves SPE structures in which a seller transfers deeded title to a trust or third party (the SPE) in exchange for stock or other interests in the SPE, which the seller then sells to the time-share buyers. Sales should be recorded only upon the sale of the stock or interests to the time-share buyer, not upon transfer of title to the SPE. Generally, an SPE should be viewed as a non-substantive entity established to facilitate sales, and the seller should show in its balance sheet the interests in the SPE as "timeshare inventory" rather than apply consolidation or some other accounting method to the seller's interests in the SPE as the seller's ownership percentage in the SPE decreases during the sell-out of a project.

Amendments to Level A GAAP – When the final SOP is issued, the FASB would remove from FASB Statement No. 66 the guidance related to time-sharing; that Statement would direct the reader to the SOP for guidance. The FASB would also modify FASB Statement No. 67 to exclude time-sharing transactions from the section in the Statement entitled "Costs Incurred to Sell Real Estate Projects" in view of the SOP's prescribed "incremental" accounting for time-sharing selling costs.

Current developments and plans. AcSEC will continue its discussion of a draft SOP at its April and June 2001 meetings and plans to issue an exposure draft (subject to FASB clearance) in the third quarter of 2001.

Staff: Marc Simon

Certain Costs and Activities Related to Property, Plant, and Equipment

Background and description. Diversity in practice concerning the recording of costs for improvements, replacements, betterments, additions (and terms synonymous with those such as redevelopments, refurbishments, renovations, and rehabilitations), and repairs and maintenance is currently one of the most prevalent problems in the real estate industry. In March 2000, AcSEC expanded the scope of the project beyond real estate to address the accounting for property, plant, and equipment (PP&E) and the accounting for overhaul costs. The FASB approved a revised prospectus for the project. The project addresses accounting and disclosure issues related to determining which costs related to PP&E assets should be capitalized as improvements and which should be charged to expense as repairs and maintenance. The SOP will also address capitalization of indirect and overhead costs and component accounting for PP&E assets.

Tentative conclusions. Some of the significant conclusions reached by AcSEC are as follows:

- The SOP would use a "project stage" framework whereby guidance would be provided in terms of each of the various stages of a PP&E project. The stages would include *preliminary* (occurring prior to acquisition of specific PP&E being probable), *preacquisition* (occurring subsequent to acquisition of specific PP&E being probable but prior to acquisition or construction), *acquisition-or-construction*, and *in-service* (beginning at the time acquisition or construction of PP&E is substantially complete and the PP&E is ready for its intended use).

- Except for the costs of options, preliminary stage costs would be charged to expense as incurred.

- Costs related to PP&E incurred during the acquisition-or-construction stage would be capitalized if the costs are directly identifiable with the specific PP&E. Directly identifiable costs include only:
  - Incremental direct costs of acquiring, constructing, or installing the PP&E incurred in transactions with independent third parties for the specific PP&E.
  - Certain costs directly related to specified activities performed by the entity for the acquisition, construction, or installation of the specific PP&E.

  General and administrative costs and overhead costs would be charged to expense as incurred. Similar conclusions would apply to capitalizability of costs related to PP&E incurred during the preacquisition stage.

- Costs related to PP&E that are incurred during the in-service stage, including costs of normal, recurring, or periodic repairs and maintenance activities, would be charged to expense as incurred unless the costs are incurred for (1) the acquisition of additional PP&E or components of PP&E or (2) the replacement of existing PP&E or components of PP&E. Removal costs would be charged to expense as incurred.

- The costs of planned major maintenance activities are not a separate PP&E asset or component. Those costs would be capitalized to the extent they are capitalizable under the in-service stage guidance of the SOP and represent additions or replacements, and would otherwise be charged to expense as incurred.

- A component is a tangible part or portion of PP&E that (1) can be separately identified as an asset and depreciated over its own expected useful life and (2) is expected to provide economic benefit for more than one year. If a component has an expected useful life that differs from the expected useful life of the PP&E asset to which it relates, the cost would be accounted for separately and depreciated or amortized over its expected useful life.

- If an entity replaces a part or portion of a PP&E asset that has not been previously accounted for as a separate component, and the replacement meets the definition of a component, the entity would capitalize the replacement, account for it as a separate component going forward, estimate the net book value of the replaced item, and charge the net book value of the replaced item to expense in the period of replacement.

- The SOP would be effective for financial statements for fiscal years beginning after December 15, 2001, with earlier application encouraged. For PP&E owned or leased by an entity prior to the adoption date, the component accounting guidance in the SOP would be applied using one of the following two alternatives: (a) apply component accounting for all PP&E assets retroactively, to the extent practicable, on the adoption date, and for those assets for which component accounting is not used retroactively, alternative (b) would be applied, or (b) do not apply component accounting retroactively, and in future periods when an entity incurs capitalizable costs for PP&E that replace PP&E for which component accounting has not been used, the entity would estimate the remaining net book value of the asset replaced and charge that amount to expense. Entities that previously accounted for planned major maintenance activities under methods other than the one prescribed in the SOP would record a cumulative effect adjustment as of the date of adoption. All other costs that were charged to expense prior to adoption that would be capitalized after adoption, or vice versa, would not be reclassified accordingly.

Current developments and plans. At its September 2000 meeting, AcSEC approved for exposure, subject to AcSEC's positive clearance of certain revisions and FASB clearance, the draft SOP *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*. AcSEC's positive clearance was obtained and on April 11, 2001, the FASB did not object to issuance of the proposed SOP provided certain clarifications are made and a lease-related issue is resolved. AcSEC will discuss those clarifications and that issue at its April 2001 meeting. AcSEC plans to issue an exposure draft in the second quarter of 2001.

Staff: Marc Simon

OTHER AcSEC ACTIVITIES

On February 2, 2001, AcSEC met with the AICPA Private Companies Practice Section Technical Issues Committee to discuss matters of mutual interest.

Also in February, AcSEC's Planning Subcommittee approved a comment letter on the FASAB's exposure draft *Elimination of Disclosures Related to Tax Revenue Transactions By the Internal Revenue Service, Customs, and Others*.

In March, AcSEC approved comment letters for the following FASB exposure drafts:

- *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*
- *Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities*
- *Business Combinations and Intangible Assets—Accounting for Goodwill*

In March, AcSEC's Planning Subcommittee approved a comment letter on the GASB's exposure draft *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus* and a comment letter on the FASAB's *Preliminary Views on Eliminating the Category "Required Supplementary Stewardship Information"*.

NEW AND POTENTIAL FUTURE AcSEC PROJECTS

Accounting for Customer Acquisition Costs SOP AcSEC's Planning Subcommittee added to AcSEC's agenda a project to provide guidance on accounting for customer acquisition costs. The issue to be addressed is under what circumstances, if any, an entity should defer and amortize customer acquisition costs. Currently there is diversity in practice across industries. The project would not address areas that are specifically covered by higher level GAAP, including FASB Statements No. 60, *Accounting and Reporting by Insurance Enterprises*, and 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. Other AcSEC standards that include guidance for customer acquisition costs may be amended. In March 2001, the FASB considered a prospectus for the project and expressed concerns about whether AcSEC should undertake the project. Alternatives explored by the FASB included the FASB undertaking the project, with the AICPA perhaps developing initial background information that might assist the Board in its project, if any. The Board asked AcSEC to revise the prospectus to clarify the scope of the project, define the potential asset, and indicate the anticipated direction of the project. The FASB will reconsider the prospectus after those revisions are made.

Staff: Joel Tanenbaum

Blockage Factor AcSEC's Planning Subcommittee added to AcSEC's agenda a project to address whether an entity within the scope of the AICPA Audit and Accounting Guide *Audit of Investment Companies* should use a blockage factor to estimate the fair value of an unrestricted investment that has a quoted marked price in an active market. Currently some entities use a blockage factor to determine fair value. The Guide provides that if an entity's accounting policy, in investment company financial statements issued for fiscal years ending on or before May 31, 2000, was to apply a blockage factor in estimating the fair value of certain unrestricted investments that have a quoted market price in an active market, that entity may continue to apply that policy, with disclosure, to those and similar investments. Otherwise, an entity may not elect to adopt such a policy pending completion of the AcSEC project on this matter or the FASB's project on measuring financial instruments at fair value. A task force has been formed to draft a prospectus seeking FASB clearance to undertake the project.

Staff: Fabiola Ferrer

DAC on Internal Replacements In July 2000, AcSEC's Planning Subcommittee approved a prospectus for an SOP project to provide authoritative guidance on accounting by life insurance enterprises for deferred acquisition costs (DAC) on internal replacements other than those covered by FASB Statement No. 97, *Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments.* The FASB cleared the prospectus in November 2000.

In June 1999, a Staff Discussion Paper was issued on the topic. The intent of the paper was to determine if diversity exists with regard to accounting by life insurance enterprises for internal replacements other than those covered by FASB Statement No. 97 and, if so, whether accounting guidance should be provided. Eleven comment letters were received, with the majority saying that guidance is needed. The task force will review the comment letters and draft materials for a future AcSEC meeting.

Staff: Kim Hekker

UPCOMING AcSEC MEETINGS

AcSEC meetings are open to the public.

April 24-25, 2001	Norwalk, CT
June 19-20, 2001	New York, NY
July 26-27, 2001	Chicago, IL
September 11-12, 2001	New York, NY
October 23-24, 2001	New York, NY

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."

OTHER ACTIVITIES OF THE ACCOUNTING STANDARDS TEAM OF THE AICPA (NON-AcSEC ACTIVITIES)

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*. The standard significantly 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-size 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 Statement No. 34, the AICPA Audit and Accounting Guide *Audits of State and Local Governmental Units* 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 the 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 Statement No. 34's requirements. The Guide's auditing guidance will also be revised.

Because it is not expected that new accounting requirements will be developed, there is no plan for full AcSEC deliberation and exposure. Instead, 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 the revisions to the Guide.

The task force is currently developing the necessary revisions to the Guide and is nearing completion of the initial drafting stage of the project. However, several significant audit-related issues remain that the task force is working to resolve. As a result, the issuance of a final Guide is expected no sooner than early 2002.

Staff: Mary Foelster

Acquired In-Process Research and Development

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 in-process research and development (IPR&D). The final product will be an AICPA Practice Aid.

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.

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AcSEC thanks departing AICPA staff member Elizabeth Fender for over three years of valuable work as director of the AICPA's Accounting Standards Team. During Liz's tenure, AcSEC has issued revised Audit and Accounting Guides on life and health insurance entities and investment companies, as well as SOPs on accounting for mutual company insurance reorganizations, motion pictures, 401(h) features of defined benefit plans, defined contribution plan investments, certain insurance and reinsurance contracts, software revenue recognition, start-up costs, internal-use software costs, and insurance-related assessments. We wish Liz well in her new endeavors.

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.

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