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AcSEC UPDATE

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

COMMENT LETTER DEADLINE EXTENDED TO NOVEMBER 15 FOR EXPOSURE DRAFT ON PP&E ACCOUNTING

In view of recent world events, the comment letter deadline on the exposure draft of the proposed SOP, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*, has been extended one month to November 15, 2001. See “Recent AcSEC Activities” below.

RECENT AcSEC ACTIVITIES

Accounting by Certain 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's positive clearance was obtained and, in August 2001, the FASB did not object to the issuance of a final SOP, subject to final clearance by the FASB staff. AcSEC expects to issue the SOP during the fourth quarter of 2001.

Changes Related to the National Association of Insurance Commissioners (NAIC) Codification In June 2001, AcSEC approved a final SOP, *Amendments to Specific AICPA Pronouncements for Changes Related to the NAIC Codification*, pending FASB clearance. In July 2001, the FASB did not object to the issuance of a final SOP, subject to final clearance by the FASB staff. AcSEC expects to issue the SOP during the fourth quarter of 2001.

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. At its April 2001 meeting, AcSEC discussed how to address certain issues raised by the FASB at the clearance meeting. In May 2001, AcSEC submitted a letter to the FASB describing AcSEC's intent to change the scope of the proposed SOP. In June 2001, the FASB did not object to the issuance of a final SOP, subject to final clearance by the FASB staff. AcSEC expects to issue the SOP during the fourth quarter of 2001.

Costs and Activities Related to PP&E In July 2001, AcSEC issued an exposure draft of a proposed SOP, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*.

Concurrently, the FASB issued an exposure draft of a proposed Statement of Financial Accounting Standards, *Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant, and Equipment, an amendment of APB Opinions No. 20 and 28 and FASB Statements No. 51 and 67 and a rescission of FASB Statement No. 73*. That proposed Statement includes amendments to certain FASB pronouncements that would be made in conjunction with issuance of the proposed SOP. The comment letter deadline on both the AcSEC and FASB exposure drafts was originally October 15, 2001, but has been extended one month to November 15, 2001.

Nontraditional Long-Duration Insurance Contracts At its September 2001 meeting, AcSEC cleared for exposure, subject to AcSEC's positive clearance and FASB clearance, the draft SOP *Accounting and Reporting by Insurance Enterprises for Certain Non-Traditional Long-Duration Contracts and for Separate Accounts*. AcSEC expects to issue the exposure draft in the first quarter of 2002.

Real Estate Time-Sharing Transactions At its September 2001 meeting, AcSEC cleared for exposure, subject to AcSEC's positive clearance and FASB clearance, the draft SOP *Accounting for Real Estate Time-Sharing Transactions*. AcSEC expects to issue the exposure draft in the first quarter of 2002.

EFFECTIVE DATES

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 SHOWS APPRECIATION

*Thanks to Outgoing AcSEC Members,
Welcome to New AcSEC Members*

AcSEC and the Accounting Standards Team wish to thank the following outgoing members for their dedicated service to the Committee:

Albert G. Adkins — USX Corporation
Cassandra Camp — Carlin, Charron & Rosen LLP
John T. Ciesielski — R.G. Associates
Ray L. Krause — McGladrey & Pullen, LLP

We welcome the following new AcSEC members as of October 1, 2001:

Karin French — Grant Thornton
Robert Laux — Microsoft
Andrew M. Mintzer — Sole practitioner
Ashwinpaul (Tony) Sondhi — A.C. Sondhi & Associates, LLC

AcSEC MEMBER ACTIVITIES

Speeches by AcSEC Members

Mark Sever – FASB/SEC/AcSEC Update, Chicago Bank Controllers Group, Chicago, IL, August 2001

– AcSEC Update, Illinois CPA Society Midwest Financial Reporting Symposium, Chicago, IL, September 2001

Andy Mintzer – Professional Standards Update, California CPA Society, Channels County Chapter, Ventura, CA, September 2001

Rick Moseley – AcSEC Update, NAATS Conference (sponsored by the AICPA), Seattle, WA, July 2001

Mary Stone – “Increasing Accounting Enrollments,” West Alabama Chapter of Management Accountants, Tuscaloosa, AL, September 2001

Article by AcSEC Member

Mary Stone – “How Effective is Joint Public and Private Monitoring? The Case of the AICPA Auditor Change Notification Letter,” *Auditing: A Journal of Practice & Theory*, Volume 20, No. 1, pp. 29-43 (with Michael L. Ettredge and David B. Smith)

AcSEC AGENDA PROJECTS

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

As of September 30, 2001

	3Q		4Q		1Q		2Q		3Q
Financing and Lending Activities									
Purchased Loans and Securities — SOP			F						
Certain Entities that Lend or Finance — SOP			F						
Certain Entities that Lend or Finance — Guide									F
Allowance for Credit Losses — SOP					E				
Investment Industry									
Scope Clarification, Investment Companies Guide — SOP					E				
Blockage Factor — SOP									
Insurance Industry									
Certain Entities that Lend or Finance — SOP			F						
Non-Traditional Long-Duration Contracts — SOP					E				
Changes Related to the NAIC Codification — SOP			F						
Real Estate Industry									
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								
Equity Method Investments (formerly Real Estate Investments)									

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

AcSEC's CURRENT SOP PROJECTS

Accounting for Purchased Loans and Certain 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.
- An investor would be prohibited from carrying over a purchased entity's allowances for loan losses in the accounting for a purchase. That prohibition would apply to all purchases of loans, including those in a purchase business combination.
- 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, *Accounting by Creditors for Impairment of a Loan*, 115, *Accounting for Certain Investments in Debt and Equity Securities*, and 118, *Accounting by Creditors for Impairment of a Loan – Income Recognition and Disclosures*.
- The SOP will be effective for loans acquired in fiscal years beginning after June 15, 2002.
- For loans with evidence of deterioration in credit quality since origination:
 - ◆ Investors should estimate cash flows expected to be collected on the loan at purchase and periodically over the life. Cash flows expected to be collected in excess of the initial investment (purchase price) should be recognized as the yield. Contractual cash flows in excess of cash flows expected to be collected (referred to as nonaccretable difference) should not be recognized as yield.
 - ◆ Probable subsequent decreases in cash flows expected to be collected result in recognition of an impairment (and should not be recognized as an adjustment over the life of the loan). Probable subsequent increases in cash flows expected to be collected should be recognized prospectively.

- ◆ If a new, higher yield on a loan is established (due to a probable increase in future cash flows), that higher yield should be used as the effective interest rate in any later test for impairment.
- ◆ 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
 - receivables from leases
 - loans carried at fair value with changes in fair value included in earnings
 - mortgage loans that are held for sale (which are covered under FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*)
- ◆ 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, and 115).
- ◆ The SOP would allow pooling or aggregation of loans for recognition, measurement, and disclosure purposes provided the individual loans are within the scope of the SOP. Loans may not be aggregated for purposes of scope; each loan, whether purchased in a pool or individually, must be individually evaluated for purposes of determining whether it is within the scope of the SOP. Aggregation is only available 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.
- ◆ With one exception, guidance on recognition of income from loans within the scope will not be provided because that guidance does not exist for originated loans. The SOP will prohibit recognition of income on loans for which an investor expects to substantially improve the collateral for resale or expects to use the collateral in operations.
- ◆ 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.

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. At its April 2001 meeting, AcSEC discussed how to address certain issues raised by the FASB at the clearance meeting. In May 2001, AcSEC submitted a letter to the FASB describing AcSEC's intent to change the scope of the proposed SOP. In June 2001, the FASB did not object to the issuance of a final SOP, subject to final clearance by the FASB staff. AcSEC expects to issue the SOP during the fourth quarter of 2001.

Staff: Sydney Garmon

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

Description and background. This SOP applies to certain 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 also applies 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* (collectively, the Guides). 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.

This project consists of two parts. First, the chapters from the Guides have been combined and redrafted for consistency in a new combined Guide. The Draft Chapters for the Proposed Audit and Accounting Guide, *Certain Financial Institutions and Entities That Lend to or Finance the Activities of Others*, are available online at:

<http://www.aicpa.org/members/div/acctstd/edo/chapters.htm>

Second, the SOP reconciles the specialized accounting and financial reporting guidance established in the Guides. The SOP includes guidance for all entities engaged in lending and financing activities (including trade receivables). AcSEC believes this guidance should stand alone in an SOP. If such guidance were included only in the combined Guide, AcSEC was concerned that preparers and auditors would focus on the organizational structure of an entity rather than the activities of the entity. In other words, auditors and preparers could potentially overlook guidance contained in an industry-specific Guide. Accordingly, the SOP will not only be included in the combined Guide but will provide guidance for *all* entities (including entities with trade receivables) through the issuance of a stand-alone SOP.

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 the 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 intends 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 regulatory agencies, and may not be uniformly applied to the 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 SOP will 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.
- 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 SOP will prescribe 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.

- The SOP should be applied prospectively and will be effective for annual and interim financial statements issued for fiscal years beginning after December 15, 2001.

Current developments and plans. For the SOP: 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's positive clearance was obtained and, in August 2001, the FASB did not object to the issuance of a final SOP, subject to final clearance by the FASB staff. AcSEC expects to issue the SOP during the fourth quarter of 2001.

For the Combined Guide: The chapters were posted to the AICPA web site for comment during the first quarter of 2001. AcSEC expects to issue the Combined Guide during the third quarter of 2002.

Staff: Sydney Garmong

Allowance For Credit 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 credit losses. The task force is expected to develop an SOP that will provide additional guidance on periodic credit loss provisions and the related allowance for credit 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 credit 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 credit losses reported on a creditor's balance sheet should consist only of—
 - a. A component for specifically identified loans that have been evaluated individually for impairment and that are considered to be individually impaired, with impairment measured in accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*.
 - b. 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.
- The allowance for credit losses should be based on observable data, and changes in the allowance should be directionally consistent with changes in the observable data.

- The starting point for estimating collective loan impairment should be historical loss experience.
- Creditors that have no experience or insufficient experience in certain products or markets should use peer group experience to develop collective loan impairment estimates. In order for the peer group experience to be the basis for a reasonable estimate, the specific peer group portfolio must be comparable to the creditor's own portfolio. Once a lender has adequate historical loss experience of its own, it must use that experience.
- The SOP would not prohibit recognition of an amount labeled as "unallocated" or as a "margin for imprecision." However, such a component would need to be supported by relevant observable data. Absent that data, such a provision would not be permitted.
- The SOP should not include different disclosure requirements for reporting entities that are publicly held and those that are not publicly held, nor should it include different disclosure requirements based on the size of the enterprise.

Current developments and plans. In July 2001, AcSEC tentatively agreed that the SOP should—

- Apply to all creditors other than state and local governments and entities subject to pronouncements of the Federal Accounting Standards Advisory Board (FASAB). (Thus, the SOP would apply to entities that are not depository or financial institutions, as well as to depository and financial institutions.)
- Address the allowance for credit losses related to all "loans," as that term is defined in FASB Statement No. 114, except for the following:
 - a. Loans that are measured at fair value or at the lower of cost or fair value
 - b. Leases accounted for in accordance with FASB Statement No. 13, *Accounting for Leases*
 - c. Debt securities, as defined in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*
 - d. Loans, other than credit card receivables, that are—
 - accounts receivable with contractual maturities equal to or less than one year and that arose from the sale by the reporting entity of goods or services, or
 - unconditional promises to give that are assets of not-for-profit organizations and that are due in one year or less
 - e. Amounts intended to provide security for a counterparty to an agreement with the reporting entity (for example, security deposits, retainages on construction contracts)

In September 2001, AcSEC discussed a task force proposal to eliminate from the SOP—

- A statement that a creditor should assess a pool of loans with similar risk characteristics as if the pool were a single asset.
- Guidance stating that FASB Statement No. 114 measurement principles should be applied to the measurement of components of the allowance for credit losses recognized pursuant to FASB Statement No. 5.

AcSEC will discuss a revised draft SOP at its December 2001 meeting and plans to issue an exposure draft (subject to FASB clearance) in the first quarter of 2002.

Staff: Fred Gill

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's positive clearance was obtained, and AcSEC representatives presented an educational session to FASB members in July 2001. Because certain aspects of the SOP address consolidation issues, the FASB has delayed a clearance meeting until the first quarter of 2002 to enable the FASB to have the opportunity to discuss certain issues in the consolidations project.

Staff: Joel Tanenbaum

Non-Traditional 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:

- *Separate Account Presentation* – Separate account assets and liabilities should be reported as summary totals in the statement of financial condition, provided that specified criteria are met. For contracts or elements of contracts meeting the criteria, the assets should be reported as summary totals at fair value with an equivalent summary total for liabilities. Assets or liabilities related to contracts or elements of contracts that do not meet the criteria should be accounted for and reported as general account assets and liabilities.
- *Interest in Separate Accounts* – An insurance enterprise’s proportionate interest in a separate account does not meet the criteria for separate account reporting and valuation. For separate accounts meeting the separate account criteria whereby the contract holder relationship allows for the purchase at fair value of additional units in the separate accounts or where the insurance enterprise is marketing contracts that permit funds to be invested in the separate account, the assets underlying the insurance enterprise’s interest in the separate account should be accounted for in a manner consistent with similar assets held by the general account which the insurance enterprise may be required to sell.
- *Liability Valuation* – The basis for determining the balance that accrues to the contract holder for a long-duration insurance or investment contract that is subject to 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*, is the accreted account balance (FASB Statement No. 97, paragraphs 15 and 17a). The accreted account balance equals:
 - a) deposit(s) net of withdrawals
 - b) plus amounts credited
 - c) less fees and charges assessed
 - d) plus additional interest
 - e) other adjustments (for example, appreciation or depreciation)

For contracts that have features that may result in more than one potential account balance, the accreted account balance should be based on the highest contractually determinable balance that will be available in cash or its equivalent without reduction for future fees and charges expected to be assessed. The accreted account balance should not reflect any surrender adjustments (for example, market value surrender adjustments, surrender charges or credits).

- *Return Based on a Contractually Referenced Pool of Assets or Index* – For a contract that provides a return based on the total return of a contractually referenced pool of assets either

through crediting rates or termination adjustments (or a contractually referenced interest rate index), the accreted account balance should be based on the fair value of the referenced pool of assets (or applicable index value) at the balance sheet date even if the assets are not recognized at fair value.

- *Annuitization Options* – A liability should not be recognized related to the potential effect of annuitization options that represent an elective benefit that is not part of the accumulation phase of a contract.
- *Determining the Significance of Mortality and Morbidity Risk and Classification of Contracts that Contain Death or Other Insurance Benefit Features* – To determine the accounting under FASB Statement No. 97 for a contract that contains death or other insurance benefit features, the insurance enterprise should first determine whether the contract is an investment or universal life-type contract. If the mortality and morbidity risks are other than nominal and the fees assessed or insurance benefits are not fixed and guaranteed, the contract should be classified as a FASB Statement No. 97 universal life-type contract. The determination of significance should be made at contract inception, other than at transition, and should be based on a comparison of the present value of expected excess payments to be made under insurance benefit features to the present value of all amounts assessed against the contract holder (revenues), under reasonably possible outcomes.
- *Accounting for Contracts that Contain Death or Other Insurance Benefit Features* – For contracts classified as insurance contracts having amounts assessed against contract holders each period for the insurance benefit feature that are not proportionate to the insurance coverage provided for the period, a liability should be established in addition to the account balance to recognize the portion of such assessments that compensate the insurance enterprise for benefits to be provided in future periods.
- *Sales Inducements* – Sales inducements provided to the contract holder, whether for an investment or universal life-type contract, should be recognized as part of the liability for policy benefits over the period for which the contract must remain in force for the contract holder to qualify for the inducement or at the crediting date, if earlier, in accordance with the liability valuation guidance of the SOP. No adjustments should be made to reduce the liability related to the sales inducements for anticipated surrender charges, persistency, or early withdrawal contractual features.
- Sales inducements that are recognized as part of the liability under the guidance of the SOP, are explicitly identified in the contract at inception, and meet the following criteria should be deferred and amortized using the same methodology and assumptions used to amortize capitalized acquisition costs. Depending on the nature of the inducement, the insurance enterprise should demonstrate that such amounts are a) incremental to amounts the enterprise credits on similar contracts without sales inducements, and b) higher than the contract's expected ongoing crediting rates for periods after the inducement; that is, the crediting rate excluding the inducement should be consistent with assumptions used in estimated gross profits or margins, contract illustrations, and interest crediting

strategies. The deferred amount should be reported on the balance sheet as an asset and amortization should be reported as a component of benefit expense.

- *Transition* – At the date of initial application of the SOP, an insurance enterprise will have to make various determinations such as: qualification for separate account treatment, FASB Statement No. 115 classification, significance of mortality and morbidity risk, adjustments to contract holder liabilities, and adjustments to estimated gross profits or margins, to determine the cumulative effect of a change in accounting principle from adopting the SOP.

Current developments and plans. At its September 2001 meeting, AcSEC cleared for exposure, subject to AcSEC’s positive clearance and FASB clearance, the draft SOP *Accounting and Reporting by Insurance Enterprises for Certain Non-Traditional Long-Duration Contracts and for Separate Accounts*. AcSEC expects to issue the exposure draft in the first quarter of 2002.

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 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 ending on or after December 15, 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 annual and complete sets of interim financial statements for fiscal years ending on or after December 15, 2001, and audits of those financial statements. If comparative financial statements are presented for prior fiscal years, the disclosure provisions of SOP 94-5 effective prior to the SOP would apply to permitted statutory accounting practices by the domiciliary state insurance department.

Current developments and plans. In June 2001, AcSEC approved a final SOP, *Amendments to Specific AICPA Pronouncements for Changes Related to the NAIC Codification*, pending FASB clearance. On July 18, 2001, the FASB did not object to the issuance of a final SOP, subject to final clearance by the FASB staff. AcSEC expects to issue the SOP during the fourth quarter of 2001.

Staff: Kim Hekker

Equity Method Investments (formerly Interests in Unconsolidated Real Estate Investments)

Description and background. This proposed SOP was intended to 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.

Current development and plans. The exposure draft was issued in November 2000 and the comment deadline was April 15, 2001. At its June 2001 meeting, AcSEC discussed the comment letters and observed that many constituents expressed concern that the project would likely be analogized to for investments in other than real estate and that the exposure draft should be considered for re-exposure under a non-real-estate title.

AcSEC considered several possible courses of action that it could take with respect to the project. AcSEC decided that it should prepare a plan of action, including a new prospectus, for a broader equity method accounting project—that is, one applicable to all unconsolidated investments, rather than only real estate investments. The AcSEC project would use the foundation of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, as a starting point. That is, the equity method of accounting would be considered to be an appropriate and acceptable accounting method for unconsolidated investments. AcSEC would not plan to reconsider whether the equity method of accounting is an acceptable accounting method (versus, for example, fair-value-based methods). The AcSEC project would address the application of the equity method of accounting (including consideration of the hypothetical-liquidation-at-book-value application), as well as which investors should apply the equity method. The plan of action would examine whether amendments to APB Opinion No. 18 may be necessary as part of the AcSEC project, and

whether such amendments would be expected to be limited or extensive in nature. AcSEC also plans to review the original prospectus for this project and assess if the issues in that prospectus are unique to real estate investments or if there are broader practice issues.

AcSEC discussed a proposed plan of action and proposed new prospectus at its September 2001 meeting. AcSEC concluded that a narrow-scope project would be more appropriate than one broader in scope. The current project task force will redraft the proposed plan and prospectus for consideration by AcSEC's Planning Subcommittee in the fourth quarter of 2001. If the Planning Subcommittee approves the prospectus and if the FASB subsequently clears the prospectus, the task force would be expanded to be more representative of the constituents that the new project would affect.

Staff: Fabiola Ferrer

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 revenue recognition methods 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-credit-losses test – The estimability-of-credit-losses 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 credit losses (analogous to the ability to estimate future returns discussed in FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*).

Meaning of "credit losses" – For purposes of estimating credit losses in the collectibility-of-receivables and estimability-of-credit-losses tests, sales cancelled subsequent to being recorded as sales should be considered as credit losses rather than as "sales reversals." A seller should interpret "credit losses" 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 credit losses (for example, collection costs) should not be incorporated into the seller's estimate of credit losses but should instead be charged to selling, general, and administrative expense as incurred.

Accounting for estimated and actual credit losses – For sales (meeting the recognition criteria) that, based on historical and statistical information, are not expected to be collected, 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 selling costs – Selling costs should be accounted for 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 present in its balance sheet the unsold interests in the SPE as time-share 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. At its September 2001 meeting, AcSEC approved for exposure, subject to AcSEC's positive clearance of certain revisions and FASB clearance, the draft SOP *Accounting for Real Estate Time-Sharing Transactions*. AcSEC expects to issue the exposure draft in the first quarter of 2002.

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 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 June 15, 2002, 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. In July 2001, AcSEC issued an exposure draft of a proposed SOP, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*. Concurrently, the FASB issued an exposure draft of a proposed Statement of Financial Accounting Standards, *Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant, and Equipment, an amendment of APB Opinions No. 20 and 28 and FASB Statements No. 51 and 67 and a rescission of FASB Statement No. 73*. That proposed Statement includes amendments to certain FASB pronouncements that would be made in

conjunction with issuance of the proposed SOP. The comment letter deadline on both the AcSEC and FASB exposure drafts was originally October 15, 2001, but has been extended one month to November 15, 2001.

Staff: Marc Simon

Blockage Factor to Value an Unrestricted Investment That Has a Quoted Market Price

Description and background. In August 2001, the FASB approved a prospectus for a project to develop an SOP to address whether it is appropriate to require an entity within the scope of the AICPA Audit and Accounting Guide *Audit of Investment Companies* to use a blockage factor to estimate the fair value of an unrestricted investment that has a quoted market 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.

Current developments and plans. An AcSEC discussion of key issues is planned for the second quarter of 2002.

Staff: Fabiola Ferrer

NEW AND POTENTIAL FUTURE AcSEC PROJECTS

Accounting for Customer Acquisition Costs 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 which circumstances, if any, should an entity 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 AcSEC 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

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.

The task force has met several times and plans to discuss issues with AcSEC during the fourth quarter of 2001.

Staff: Kim Hekker

DAN NOLL TO HEAD AcSEC STAFF

Daniel J. Noll, CPA has been named Director, Accounting Standards at the AICPA. Dan replaces Elizabeth Fender, who is now the Director of Corporate Governance at TIAA-CREF.

Dan will be responsible for directing the activities of the AICPA's Accounting Standards team and for providing technical support to AcSEC and related task forces.

Dan has served the AICPA for six years as a technical manager responsible for developing AcSEC statements of position and other financial reporting guidance. Dan managed, for example, the projects that led to SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*, SOP 98-5, *Reporting on the Costs of Start-Up Activities*, and SOP 00-2, *Accounting by Producers or Distributors of Films*.

UPCOMING AcSEC MEETINGS

AcSEC meetings are open to the public.

December 11-12, 2001	San Antonio, TX
January 29-30, 2002	New York, NY
March 5-6, 2002	New York, NY
April 30-May 1, 2002	New York, NY
June 11-12, 2002	New York, NY
July 25-26, 2002	To be determined

September 18-19, 2002	New York, NY
October 22-23, 2002	New York, NY
December 5-6, 2002	To be determined

The meeting originally scheduled for October 23-24, 2001 was cancelled.

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 has almost completed the initial drafting stage of the project and representatives of AcSEC and the AICPA Auditing Standards Board are prepared to begin their reviews of the draft Guide. Issuance of a final Guide is expected no sooner than the second quarter of 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, valuation, and auditing of acquired in-process research and development (IPR&D). The final product will be an AICPA Practice Aid and is scheduled to be released in the fourth quarter.

Valuing Privately-Held-Company Equity Securities Issued in Other Than a Business Combination

The Accounting Standards Team is working with a cross section of experts from industry, public accounting firms, academia, and valuation firms to identify best practices related to valuation of privately-held-company equity securities that are issued in other than a business combination. The project is in its early stages. The final product is expected to be an AICPA Practice Aid addressing valuation and related accounting/disclosure and auditing issues.

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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The views expressed herein are those of the authors and do not necessarily reflect the views of the American Institute of Certified Public Accountants. Official positions of the AICPA are determined through specific committee procedures, due process, and deliberations.

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