AcSec Update, Volume 7, Number 3 June 2003

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

VOL. 7 NO 3 – June 2003

AcSEC UPDATE

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

Technical Experts Sought for AICPA Industry Panels

The AICPA is looking for highly qualified members to serve on Expert Panels that will focus on accounting and audit issues for certain industries. These volunteer panels, consisting of 10 to 14 members, will identify emerging technical issues and work with the appropriate bodies to arrive at solutions benefiting the public interest. Panel members also serve as liaisons to industry associations and regulators and help develop products and services for CPAs working in specific industries. AICPA members may use the Committee Appointment System at http://volunteers.aicpa.org/apply to apply for service on an Expert Panel.

RECENT AcSEC ACTIVITIES

Non-Traditional Long-Duration Insurance Contracts In June 2003, the FASB did not object to the issuance of a final SOP, *Accounting and Reporting by Insurance Enterprises for Certain Non-Traditional Long-Duration Contracts and for Separate Accounts.* AcSEC will issue a final SOP in early July 2003, with the SOP being effective for financial statements for fiscal years beginning after December 15, 2003, with earlier adoption encouraged.

Allowance for Credit Losses On June 19, 2003, AcSEC issued an exposure draft of a proposed SOP, *Allowance for Credit Losses*. The proposed SOP addresses the recognition and measurement by creditors of the allowance for credit losses related to all *loans*, as that term is defined in FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, with certain exceptions, and would apply to all creditors other than state and local governmental entities and federal governmental entities. The comment letter deadline is September 19, 2003.

Separate Account Financial Highlights At its April 2003 meeting, AcSEC voted to approve the proposed SOP, *Financial Highlights of Separate Accounts – An Amendment of the Audit and Accounting Guide Audits of Investment Companies,* for exposure subject to negative clearance. On June 25, 2003, the FASB Board did not object to the exposure of the proposed SOP. AcSEC plans to issue an exposure draft SOP in early July 2003 with a 60 day comment period, and an effective date for fiscal years ending after December 15, 2003.

Reporting Financial Highlights and Schedule of Investments by Nonregistered Investment Partnerships At its April 2003 meeting, AcSEC cleared for exposure, a proposed SOP, *Reporting Financial Highlights and Schedule of Investment by Nonregistered Investment Partnerships* an amendment to the Audit and Accounting Guide, *Audits of Investment Companies, and SOP 95-2*. On June 25, 2003, the FASB Board did not object to the exposure of the proposed SOP. AcSEC expects to issue the exposure draft in July with a 60 comment period, and an effective date for fiscal years ending after December 15, 2003.

Clarification of the Scope of the Investment Companies Guide In December 2002, AcSEC issued an exposure draft of a proposed SOP, *Clarification of the Scope of the Audit and Accounting Guide* Audits of Investment Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. The comment letter deadline was March 31, 2003. AcSEC will discuss a revised draft in July 2003.

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 have been made in conjunction with issuance of the proposed SOP. In February 2003, the FASB decided that AcSEC should continue its deliberations toward issuing a final SOP (subject to FASB clearance) and that the SOP would be limited to certain topics. In April and June 2003, AcSEC discussed task force recommendations on key issues. AcSEC will discuss a revised draft SOP in July 2003.

Real Estate Time-Sharing Transactions In February 2003, AcSEC issued an exposure draft of the proposed SOP, *Accounting for Real Estate Time-Sharing Transactions*. Concurrently, the FASB issued an exposure draft of a proposed Statement of Financial Accounting Standards, *Accounting for Real Estate Time-Sharing Transactions—an amendment of FASB Statements No. 66, 67, and 135*. That proposed Statement includes amendments to certain FASB pronouncements that would be made in conjunction with issuance of the proposed SOP. In June 2003, AcSEC discussed the comment letters received on the proposed SOP and task force recommendations. In view of the FASB/IASB revenue recognition project, the Board discussed on June 18, 2003 whether a final SOP should include (as AcSEC recommended) or exclude revenue-recognition-related guidance. The Board decided that, in view of the current level of uncertainty associated with that project (timing of project, possible scope-out of real estate) that AcSEC is not precluded from proceeding with an SOP that includes revenue recognition guidance. The Board reserved the right, however, to reassess at any SOP clearance meeting the status of the revenue recognition project and possibly have AcSEC remove the revenue recognition guidance from the SOP at that time. AcSEC will discuss a revised draft SOP in July 2003.

DAC on Internal Replacements In March 2003, AcSEC issued an exposure draft of a proposed SOP, *Accounting by Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements Other Than Those Specifically Described in FASB Statement No. 97.* At its June 2003 meeting, AcSEC discussed comments received. AcSEC will discuss task force recommendations at the July 2003 meeting for any revised methodologies or approaches for the SOP.

Other-Than-Temporary Impairment for Not-for-Profit Health Care Entities Technical Practice Aids Issued The AICPA staff, helped by industry experts, released a technical question and answer (Q&As) on other-than-temporary impairment for not-for-profit health care entities.

FASB Statement No. 136 Technical Practice Aids Issued The AICPA staff, helped by industry experts, released a set of technical questions and answers (Q&As) on FASB Statement No. 136, *Transfers of Assets to a Not-for-Profit Organization or Charitable Trust That Raises or Holds Contributions for Others.* The TPAs apply to not-for-profit organizations, including health care organizations. The purpose of the TPAs is to address the net asset classifications reported by a beneficiary pertaining to its interest in the net assets of the recipients.

The Q&As will be housed in the AICPA publication titled *Technical Practice Aids*, copies of which are available through the AICPA order department at (888) 777-7077. In addition, the Q&As are available from the accounting standards part of the AICPA Web site at aicpa.org/members/div/acctstd/general/othitem.htm

EFFECTIVE DATES

SOP 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others,* for financial statements issued for fiscal years beginning after December 15, 2001. Earlier application is encouraged.

SOP 02-2, *Accounting for Derivative Instruments and Hedging Activities by Not-for-Profit Health Care Organizations, and Clarification of the Performance Indicator.* The provisions are effective for fiscal years beginning after June 15, 2003. Earlier application is encouraged but is permitted only as of the beginning of any fiscal quarter that begins after issuance of the SOP. The provisions of the SOP should be applied prospectively.

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/cpa2biz Order Department, NQ, P.O. Box 2209, Jersey City, NJ 07303–2209. Exposure drafts should be obtained through the AICPA web site; see "AcSEC ON AICPA WEB SITE" later in this issue.

To order final pronouncements online, go to the store www.cpa2biz.com/store and choose Accounting and Auditing, then choose Professional Literature; recent pronouncements should be towards the bottom of the page. Or, go to www.cpa2biz.com and enter the 6-digit product number in the search field.

AcSEC MEMBER ACTIVITIES

Speeches by AcSEC Members

Mark Sever - AcSEC Update, Houston CPA Society, 23rd Annual Financial Reporting Symposium, Houston, TX, May 8, 2003

AcSEC Update, Baruch College Second Annual Financial Reporting Conference, New York, NY, May 1, 2003

AcSEC Update, 30th Annual AICPA National Conference on Current SEC Developments, Washington, DC, December 13, 2002

-Sarbanes-Oxley Act of 2002, University of Notre Dame Beta Alpha Psi, Notre Dame, IN, November 13, 2002

-AcSEC Update, AICPA 2002 National Conference on Banks and Savings Institutions, Washington, DC, November 7, 2002

Val Bitton - SEC Update, Real Estate Industry Current Accounting and Reporting Update, Deloitte & Touche, Chicago, IL, December 10, 2002

-AcSEC Update, Current Financial Reporting Issues Conference, Financial Executives International, New York, NY, November 4, 2002

-Coping with Sarbanes-Oxley Act and New Corporate Governance Requirements, Milwaukee Chapter of the American Society of Corporate Secretaries and Bowne, Milwaukee, WI, November 1, 2002

Andrew Mintzer – AcSEC Update, University of Southern California; Leventhal School of Accounting 22nd Annual SEC and Financial Reporting Institute Conference, Pasadena, CA, May 29, 2003

AcSEC Update and Current Developments, University of South Florida Accounting Circle Conference, Tampa, FL, May 22, 2003

AcSEC Update, Thirteenth Annual Conference on Financial Reporting, HAAS School of Business, University of California at Berkeley, San Francisco, CA, November 8, 2002

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AcSEC AGENDA PROJECTS

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As of June 30, 2003

	1Q		2Q		3Q		4Q		1Q
Financing and Lending Activities									
Loans and Certain Debt Securities — SOP					**F**				
Certain Entities that Lend or Finance — Guide					**F**				
Allowance for Credit Losses — SOP			**E**						**F**
Investment Industry									
Scope Clarification, Investment Companies Guide — SOP	**E**								**F**
Reporting Financial Highlights and Schedule of Investments by Nonregistered Investment Partnerships - SOP					**E**		**F**		
Insurance Industry									
Non-Traditional Long-Duration Contracts — SOP					**F**				
DAC on Internal Replacements — SOP	**E**								**F**
Separate Account Financial Highlights — SOP					**E**		**F**		
Real Estate Industry									
Real Estate Time-Sharing Transactions — SOP			**E**				**F**		
Other Projects									
Costs and Activities Related to PP&E — SOP							**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 Loans and Certain Debt Securities Acquired in a Transfer (formerly known as Accounting for Certain Purchased Loans and Debt Securities)

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 *all* acquisitions of loans (both with and without evidence of deterioration of credit quality since origination), including acquisitions of loans in a purchase business combination:

- 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 previously established by the seller. This prohibition applies to all purchases of loans, including those in a purchase business combination.

- New disclosures are required, 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*.

Additionally, for loans acquired with evidence of deterioration in credit quality since origination[1]:

- ♦ 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 yield (referred to as accretable yield). Contractual cash flows in excess of cash flows expected to be collected (referred to as nonaccretable difference) should not be recognized as yield.

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1 This 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*)

- ♦ Probable subsequent decreases in cash flows expected to be collected result in recognition of an impairment rather than being recognized as a prospective yield adjustment over the life of the loan. Probable subsequent increases in cash flows expected to be collected should be recognized prospectively as a yield adjustment.

- ♦ If a new, higher yield on a loan is established (due to a probable increase in cash flows to be collected), that higher yield should be used as the effective interest rate in any later test for impairment.

- ♦ Loans that are refinanced or restructured after acquisition are prohibited 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).

- ♦ Loans may not be aggregated for purposes of determining evidence of credit deterioration since origination; each loan, whether purchased in a pool or individually, must be individually evaluated. Pooling or aggregation of loans meeting the SOP's scope is allowed subsequently for recognition, measurement, and disclosure purposes if certain criteria are met. 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 will not be provided because that guidance does not exist for originated loans. Income recognition is prohibited 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. Since that time, AcSEC representatives and FASB staff have worked together to improve the illustrations in Appendix A. The revised format is intended to be easier to understand and implement. The SOP and the basis for conclusions have not been modified substantially except for a reduction in the disclosures (which includes removal of the 'table' for loans acquired in a business combination). In short, the basic tenets of the SOP were not modified. Based on the length of time that has passed since the AcSEC discussions, AcSEC was asked at the July 2002 meeting if the changes that have been made to the SOP are representative of the model and AcSEC's prior conclusions. This was not an opportunity for AcSEC members to revote on the overall SOP or debate existing conclusions.

AcSEC expects to have a clearance meeting with FASB and issue the SOP in July 2003. The effective date has been modified to loans acquired in fiscal years beginning after December 15, 2004.

Staff: Dan Noll

Accounting by Certain Entities (Including Entities with Trade Receivables) That Lend to or Finance the Activities of Others – Proposed Audit and Accounting Guide

Description and background. SOP 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others*, issued in December 2001, and this Guide (also referred to as the combined Guide) apply 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 Guide will also apply to manufacturers, retailers, wholesalers, and other business enterprises that provide financing for products and services.

All entities (except insurance companies and 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 were subject to the provisions of the AICPA Audit and Accounting Guide *Audits of Finance Companies*.

SOP 01-6 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), portions of which have been superseded by the issuance of that SOP. The 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.

This project consists of two parts. First, SOP 01-6 reconciles the specialized accounting and financial reporting guidance established in the Guides. With limited exceptions, the SOP includes guidance for *all* entities engaged in lending and financing activities (including trade receivables). AcSEC believed that this guidance should stand alone in an SOP. If that guidance had been included only in the combined Guide, AcSEC was concerned that preparers and auditors would have focused on the organizational structure of an entity rather than the activities of the entity. In other words, auditors and preparers could have potentially overlooked guidance contained in an industry-specific Guide. In addition to being issued as a stand-alone SOP, the SOP will be included in the combined Guide.

Second, 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

Current developments and plans. The chapters for the combined Guide were posted to the AICPA web site for comment during the first quarter of 2001. AcSEC expects to issue the final combined Guide during the third quarter of 2003.

Staff: Myrna Parker

Allowance For Credit Losses

Description and background. This project will provide additional guidance, within the framework of existing FASB literature, on periodic credit loss provisions and the related allowance for credit losses. The guidance will apply to all creditors other than state and local governments and entities subject to pronouncements of the Federal Accounting Standards Advisory Board (FASAB).

Tentative conclusions. The proposed SOP addresses the recognition and measurement by creditors of the allowance for credit losses related to all *loans*, as that term is defined in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 114, *Accounting by Creditors for Impairment of a Loan*, with certain exceptions.

The proposed SOP provides that:

- The allowance for credit losses reported on a creditor's balance sheet should consist only of (1) a component for individual loan impairment recognized and measured pursuant to FASB Statement No. 114 and (2) one or more components of collective loan impairment recognized pursuant to FASB Statement No. 5, *Accounting for Contingencies*, and measured in accordance with the guidance in the proposed SOP.
- If a creditor evaluates or grades an individual loan as part of a credit risk evaluation or grading process, that loan has been "identified for evaluation" within the meaning of paragraph 6 of FASB Statement No. 114.
- A creditor should group into pools, based on similar credit risk characteristics**,** loans other than those that were individually determined to be impaired. Those pools should be evaluated for collective loan impairment and include loans that were individually evaluated and determined to not be impaired and loans that were not individually evaluated. Loans that have been individually evaluated and have been determined to be impaired, regardless of whether an impairment allowance has been recorded, should not be included in those pools.
- Creditors should specifically consider relevant observable data in the recognition and measurement of components of collective loan impairment and each component of collective loan impairment should be supported with one or more sets of relevant observable data.
- The measurement of a component of collective loan impairment should be directionally

consistent with changes in the related observable data from period to period, taking into account the interaction of components of collective loan impairment over time.

- Creditors should change the observable data considered only if changes in the environment indicate that other observable data have become more relevant or if new observable data that is more relevant become available.
- Components of the allowance for credit losses recognized pursuant to FASB Statement No. 5, that is, components of collective loan impairment, should be measured based on the present value of expected future cash flows. Each component of collective impairment should be estimated based on relevant observable data relating to existing conditions; creditors should not project changes in the observable data that may occur in the future. The estimate of loss in pools of loans should reflect losses that have already been incurred, even if not yet identifiable, and not losses that might be incurred over the remaining life of the loans, even if predictable based on historical experience.

The provisions of the proposed SOP would be effective for financial statements for fiscal years beginning after December 15, 2003, with earlier application permitted. The effect of initially applying the provisions of the proposed SOP would be reported as a change in accounting estimate. Previously issued financial statements should not be restated.

Current developments and plans. On June 19, 2003, AcSEC issued an exposure draft for public comment. Comments on the exposure draft are due by September 19, 2003.

Staff: Myrna Parker

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:

- The SOP should include an overarching definition of an *investment company* (a separate legal entity), focusing on purpose (investing in multiple substantive investments for current income, capital appreciation, or both rather than for strategic operating purposes and holding itself out as an investment company); independence and autonomy (day-to-day operations of investees are separate from the operations of the entity and the entity does not obtain benefits that are unavailable to unrelated noninvestor entities); and temporary investments (exit strategies)

- The SOP should include indicators to help entities weigh all existing evidence in determining whether the entity meets the overarching definition of an *investment company*. Depending on the facts and circumstances, some indicators may be more significant than others. (The indicators should be derived from the conditions in the ED. AcSEC intends that all of the conditions in the ED would be included either in the indicators or as part of the overarching definition of an *investment company*.)

- The number of categories of investment companies should be reduced to two: regulated investment companies (continue to be within the scope of the Guide) and all other investment companies (to be included or excluded from the scope of the Guide based on the overarching definition and evaluation of indicators). Accordingly, the second and third categories in the ED (nonregulated entities with pooled funds and nonregulated entities without pooled funds) should be combined and pooled funds (to be defined less explicitly than in the ED) would be an indicator but not a requirement.

- The SOP should include illustrations demonstrating the application of the guidance in the SOP to various fact patterns. (Such fact patterns would be used to illustrate how certain indicators may be more or less significant depending on the facts and circumstances.)

- The SOP should not include separate guidance for direct interests in real estate. The SOP should include illustrations of behavior pertaining to investments of direct interests in real estate and application of the guidance in the SOP to those fact patterns. The aim of those illustrations should be to demonstrate that typical activities undertaken by investment companies pertaining to direct interests in real estate would not necessarily disqualify the entity from using investment company accounting. Those illustrations also should provide indications of the type of activities related to real estate operations that would be inconsistent with the activities of an investment company.

- 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. In December 2002, AcSEC issued an exposure draft of a proposed SOP, *Clarification of the Scope of the Audit and Accounting Guide* Audits of

Investment Companies *and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies*. The comment letter deadline was March 31, 2003. At its June 2003 meeting, AcSEC discussed the direction of the project. At its July 2003, meeting, AcSEC will discuss a revised draft of the SOP.

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.

In July 2002, AcSEC issued an exposure draft of a proposed SOP *Accounting and Reporting by Insurance Enterprises for Certain Non-Traditional Long-Duration Contracts and for Separate Accounts*. The comment letter deadline was October 31, 2002.

At the December 2002 meeting, AcSEC discussed comment letters received on the proposed SOP. Twenty comment letters were received.

AcSEC specifically addressed the following issues:

- Interest in Separate Account – AcSEC voted in favor of the proposed short-cut method (under this method, the Company's portion of separate account units would be considered an investment in equity securities - this method views the separate account as if it were a separate legal entity and looks through to the substance of the transaction as if the insurance enterprise owned a portion of the units and the contract holders owned the remainder of units) provided that an insurance company's interest in the separate account does not represent significant influence and to the extent the underlying separate account investments meet the definition of securities under FASB Statement No. 115 or paragraph 46 of FASB Statement No. 60 as amended by Statement 115.

  AcSEC considered whether to modify the proposed short-cut method to include a criterion that debt and equity securities would have to be classified as trading to eliminate some of the differences between the original concept. AcSEC concluded that it should not proscribe trading as the sole classification but also would allow the available for sale classification. However, as part of the clearance process with the FASB, AcSEC agreed to revise the SOP to require trading classification.

- Annuitization Options – AcSEC agreed with the task force proposal, which is to require the accrual of an additional liability for the extra benefit cost arising from annuitization incentives, with appropriate adjustments for expected persistency and utilization. It was also discussed that it was not the task force's intention to change the period of DAC amortization.

- *Accounting for Contracts that Contain Death or Other Insurance Benefit Features* – AcSEC noted that the presumption of significance for contracts offering minimum guaranteed death benefit (MGDB) features should be included as a conclusion, not in the Basis for Conclusions – effectively removing the significance test.

- Sales Inducements – The proposed SOP concluded that sales inducements that meet specific criteria should be deferred and amortized using the same methodology and assumptions used to amortize capitalized acquisition costs. The insurance enterprise should demonstrate that such amounts are (a) incremental to amounts credited on similar contracts without sales inducements and (b) higher than the contract's expected ongoing crediting rates for periods after the inducement, as applicable. Several respondents questioned whether the proposed SOP *required* that a "similar product" without a sales inducement be offered by the insurance enterprise, in order to qualify for deferral.

  AcSEC discussed the merits of requiring similar products for only some of the types of bonuses or not requiring a similar product at all. AcSEC concluded that a similar product should be required, and reached a consensus that a similar product is required for all types of bonuses, with the exception of the Day One bonus.

- Contractually Referenced Pool of Assets – AcSEC agreed with the approach recommended by the task force (not to change the guidance in the proposed SOP), but suggested reviewing SOP 97-1, *Accounting by Participating Mortgage Loan Borrowers,* to see if a similar analogy should be made for recording the change in the liability (instead of EITF 86-28).

- International Contracts – Some respondents commented that insurance products similar to variable annuities that are sold in international markets do not meet the SOP's criteria for separate account presentation. AcSEC agreed (12 to 1) with the task force recommendation not to change the separate account criteria.

At the January 2003 meeting, AcSEC continued discussing comments received on the proposed SOP.

AcSEC specifically addressed the following issues:

- Minimum Guaranteed Death Benefit (MGDB) Liability Calculation – AcSEC discussed two methods for calculating guarantee reserves:
  a) method proposed in the exposure draft (based on assessments), and
  b) method proposed by the American Academy of Actuaries (based on estimated gross profits – "EGPs").

  AcSEC agreed to retain the guidance that had been in the proposed SOP but agreed to include wording in the Basis for Conclusions noting:

  "In situations where expenses are proportionate to assessments, AcSEC understands that the use of EGPs as a basis, instead of assessments, may produce consistent results."

The Task Force will perform additional sensitivity testing between the two methods and will communicate the results to AcSEC.

- Interest in Separate Accounts – AcSEC voted in favor of including the proposed short-cut method in the SOP, without requiring that equity securities be classified as trading. However, to qualify for the short-cut method, certain criteria would need to be met.

  The Task Force also agreed to revise the short-cut method criteria of allowable investments to include cash and cash equivalents. The Task Force also agreed to include an example in the SOP of how to apply the proposed guidance (look-through method).

- Disclosures – AcSEC voted that the Appendix C example disclosures should not include sensitivity analysis.

Current developments and plans. At its March 2003 meeting, AcSEC approved a final SOP subject to negative clearance, and FASB clearance. In June 2003 the FASB did not object to the issuance of the issuance of a final SOP, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*. AcSEC plans to issue a final SOP in early July 2003.

Staff: Kim Kushmerick Hekker

DAC on Internal Replacements

Description and background. 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.

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

- *Internal Replacements.* An internal replacement is defined as a modification in product benefits or features that occurs by amendment or rider to an existing contract or by the exchange of an existing contract for a new contract. In addition, the election of a feature within an existing contract may result in a modification that would require evaluation under the provisions of this SOP. The legal form of an internal replacement should not determine the accounting applicable to the transaction. The same accounting treatment should apply to a given modification however made, whether structured as an amendment or rider to an existing contract or as the issuance of a new contract in replacement of the original contract. Certain specified modifications of an existing contract are not considered internal replacements if they are both contemplated in the original contract and do not change the inherent nature of the original contract.

- *Determining "Not Substantially Different."* An internal replacement transaction results in a contract that is substantially different from the original contract unless the modification is specifically identified in paragraph 9 of this SOP or if all of the following conditions exist:
    a. The modification does not result in a change in the inherent nature of the contract.
    b. An additional deposit, premium or charge relating to the original benefit, in excess of amounts contemplated in the original contract, is not required to effect the transaction.
    c. There is no net decrease in the balance available to the contract holder, when applicable.
    d. The modification does not result in a change to either the amortization method or revenue classification of the contract.
    e. Additional benefits, whether elected as a result of provisions of the original contract or provisions added subsequently, do not become the primary benefits under the contract.

- *Accounting for Internal Replacements that are Substantially Different.* An internal replacement that is deemed to be substantially different from the original contract should be accounted for as an extinguishment of the initial contract and treated as a lapse or surrender. Unamortized deferred acquisition costs, deferred revenue liabilities, and deferred sales inducement assets from the original contract associated with an internal replacement transaction that is substantially different should not be deferred in connection with the replacement contract.

- *Accounting for Internal Replacements that are Not Substantially Different*. An internal replacement that is determined to be not substantially different from the original contract should be accounted for as a continuation of the original contract. Unamortized deferred acquisition costs, deferred revenue liabilities, and deferred sales inducement assets associated with the original contract should continue to be deferred in connection with the replacement contract. Other balances that are determined based on activity over the life of the contract, such as a minimum guaranteed death benefit (MGDB), which under the provisions of proposed SOP, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*, are determined based on estimated gross profits and benefit costs, should consider the entire life of the contract, including activity during the term of the original (replaced) contract.

- *Sales Inducements.* New sales inducements that otherwise meet the criteria in proposed SOP, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts,* offered in conjunction with an internal replacement that is not substantially different from the original contract, should be accounted for as if they were explicitly identified in the original contract at inception.

- *Costs and Charges Related to Internal Replacements.* Acquisition costs incurred in connection with an internal replacement with contracts that are determined to be not substantially different, are considered to be costs associated with renewals. Acquisition costs related to and front-end fees incurred in connection with internal replacement activity should be evaluated for deferral in accordance with the provisions of FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as amended, and other existing accounting literature.

- *Recoverability.* Unamortized deferred acquisition costs and the present value of future profits continue to be subject to loss recognition testing in accordance with the provisions of FASB Statement No. 60.

- *Disclosures.* The notes to the financial statements should clearly describe the accounting policy applied to internal replacements.

Current developments and plans In March 2003 AcSEC issued for comment an exposure draft SOP, *Accounting by Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements Other Than Those Specifically Described in FASB Statement No. 97.* Ten comment letters were received.

At its June 2003 meeting, AcSEC discussed comments received and agreed that the project should continue. AcSEC will discuss task force recommendations for any revised methodologies or approaches for the SOP at the July 2003 AcSEC meeting.

Staff: Kim Kushmerick Hekker

Separate Account Financial Highlights

Description and background AcSEC's Planning Subcommittee added to AcSEC's agenda a project to address the application of certain provisions of AICPA Audit and Accounting Guide, *Audits of Investment Companies* (Guide), specifically reporting financial highlights by separate accounts. The Guide applies to all investment companies, and requires that separate accounts provide relevant financial highlights in their financial statements. Questions have arisen in the application of the Guide with respect to per share and per unit data, and in the computation of per share and per unit data when reporting financial highlights by separate accounts.

Current developments and plans At its April 2003 meeting, AcSEC voted to approve the proposed SOP, *Financial Highlights of Separate Accounts – An Amendment of the Audit and Accounting Guide Audits of Investment Companies,* for exposure subject to negative clearance. On June 25, 2003 the FASB Board did not object to the exposure of the proposed SOP. AcSEC plans to issue an exposure draft SOP in early July 2003 with a 60 day comment period, and an effective date of fiscal years ending after December 15, 2003.

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

- Expense Ratio Disclosure of Ranges – AcSEC agreed that an insurance enterprise is required to disclose financial highlights for its separate accounts, and may elect to present for separate accounts with more than two levels of contract charges or net unit values per subaccount, either:
    a) each contract expense level that results in a distinct net unit value and for which units were issued or outstanding during the reporting period, or
    b) the range of lowest and highest level of expense ratio and total return, and the related unit fair value during the reporting period

- Calculation of Expense Ratio – AcSEC agreed that the expense ratio should consist of annualized contract expenses of the separate account, consisting primarily of mortality and expense charges, for each period indicated. This ratio should include only those expenses that result in a direct reduction to unit values, with additional disclosure that provides the ranges of all charges to the separate account. Charges made directly to the contract owner accounts through the redemption of units and expenses of the underlying fund should be excluded.

- Calculation of Ranges – AcSEC agreed that the lowest to highest ranges for the amounts disclosed in the financial highlights should first be determined for the products having the lowest and highest expense ratio, and that the total return ratio and unit fair value should be presented for those corresponding products.

- Investment Income Ratio – AcSEC concluded that an investment income ratio should be included in the financial highlights and that the calculation should be based on the distribution received from the underlying fund.

- Effective Date & Transition – AcSEC agreed that the SOP would be effective for annual financial statements issued for fiscal years ending after December 15, 2003. It was also agreed that the SOP should be applied prospectively, with restatement allowed but not required.

Additionally, the proposed SOP incorporates and elevates in authority the guidance provided in previously issued Technical Practice Aids (TPAs) No 6910. 11 – 6910.15.

Staff: Kim Kushmerick Hekker

Reporting Financial Highlights and Schedule of Investments by Nonregistered Investment Partnerships

Description and background AcSEC's Planning Subcommittee added to AcSEC's agenda a project to address the application of certain provisions of AICPA Audit and Accounting Guide, Audits of Investment Companies (Guide) to non-registered investment partnerships. The Guide applies to both investment companies registered under the Investment Company Act of 1940 (and similar vehicles) and to non-registered investment partnerships. Because the Guide had principally been directed to registered investment companies, substantial changes were made to the 2001 Guide to clarify the differences in accounting and reporting between registered investment companies and non-registered investment companies. However, despite those changes, questions continue to arise in the application of Guide by non-registered investment partnerships. The differences arise because of the significant dissimilarity between the operating structures of non-registered investment partnerships and registered investment companies.

Current developments and plans AcSEC cleared for exposure, subject to FASB clearance, a draft SOP, *Reporting Financial Highlights and Schedule of Investment by Nonregistered Investment Partnerships* an amendment to the Audit and Accounting Guide, *Audits of Investment Companies, and SOP 95-2*. On June 25, 2003 the FASB Board did not object to the exposure of the proposed SOP. AcSEC expects to issue the exposure draft in July with a 60 day comment period and an effective date of fiscal years ending after December 15, 2003.

Tentative conclusions Tentative conclusions reached by AcSEC:

- Nonregistered investment partnerships, other than those indicated in the next bullet, should calculate and disclose as a financial highlight an annual total rate of return based on a "geometric linking" of performance for each discrete period within a year for which invested capital is constant.

- Nonregistered investment partnerships that meet the criteria by terms of their offering document as indicated in the next sentence should calculate and disclose as a financial highlight an annualized inception-to-date internal rate of return for the current and prior accounting period. The criteria are: (a) have limited lives, (b) do not continuously raise capital, (c) predominant strategy is to return the proceeds from disposition of investments to investors and, (d) do not invest significantly in market-traded securities.

- Nonregistered investment partnerships should calculate expense and net investment income ratios based on average net assets (ANA).

- Nonregistered investment partnerships whose expenses are based on committed capital should provide additional disclosures of the total committed capital of the partnership, the year of formation of the partnership, the year the partnership made its first investment, and the ratio of the total contributed capital to total committed capital.

- Nonregistered investment partnerships should measure and disclose derivative instruments in the condensed schedule of investments based on aggregate fair value or unrealized appreciation (depreciation) by type of derivative (e.g., futures, swaps, options) and underlying (equity index of a particular stock exchange, U. S. Treasury Bond, natural gas), not individual instrument, regardless of counterparty, if fair value exceeds 5 percent of net assets.

- In addition to the name of the investment, "Fund-of-funds" partnerships should provide additional qualitative disclosures for investments in nonregistered investment partnerships that exceed 5 percent of net assets.

- Nonregistered investment partnerships should calculate ANA by using the fund's weighted average net assets (as measured at each accounting period) and any other period in which capital is contributed or withdrawn.

- Fund-of-funds and master-feeder funds should calculate net investment income and expense ratios based on the net investment income and expenses reported in the statement of operations.

Additionally, the proposed SOP incorporates and elevates in authority the guidance provided in previously issued Technical Practice Aids (TPAs) No 6910. 04 – 6910.10.

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 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. Tentative conclusions reached by AcSEC subsequent to the comment period include:

Selling and marketing costs – Selling and marketing costs will be accounted for as proposed in the exposure draft. Direct and incremental costs of tour fulfillment, such as costs of airline tickets to bring customers to a tour location, are to be charged to expense at the time the tour takes place. Costs of tour generation, such as costs of call centers, are to be charged to expense as incurred.

Operations during holding periods – Rental activities during holding periods will be accounted for as incidental operations. The "holding period" begins at the time intervals are held for and are available for sale—for example, when units in domestic locations are legally registered for sale as time-shares. If rental activities occur other than during the holding period, the corresponding units will be depreciated and the activities accounted for as rental operations rather than as incidental operations. A seller is to evaluate each period whether units heretofore considered held for and available for sale should continue to be characterized as such.

Conduit entities – The exposure draft discussed the situation whereby a time-share developer (1) creates a "conduit" entity lacking economic substance and established for the purpose of facilitating sales (for example, for purposes of being able to sell intervals to United States citizens in a country in which citizens of other countries are not allowed to own real estate), (2) transfers real estate to the entity and receives in exchange interests in the entity, and (3) sells interests in the entity to time-share purchasers. Because in substance those interests represent time-sharing intervals, they will be treated as inventory. The task force is in the process of communicating with the FASB staff regarding whether the conduit entity represents a variable interest entity subject to the requirements of FASB Interpretation No. 46, *Consolidation of*

Variable Interest Entities—an Interpretation of ARB No. 51, and, if so, how that would affect the guidance in the proposed SOP.

Owners' associations – Owners' associations (OAs) typically are not-for-profit entities and therefore outside the scope of FASB Interpretation No. 46 (FIN 46). That is, FIN 46 would not apply to a not-for-profit OA unless the OA was set up as a not-for-profit entity expressly for the purpose of circumventing FIN 46. The proposed SOP will not provide guidance as to whether or how a time-share seller should consolidate an OA and will refer the user to the applicable literature on consolidations.

Use of relative sales value method – AcSEC affirmed its conclusion that the relative sales value method is the appropriate approach for recording cost of sales and the related inventory.

Changes in estimate under relative sales value method – Changes in estimate under the relative sales value method will be accounted for prospectively, except for changes relating to percentage of completion, which would be accounted for on a cumulative catch-up (retrospective) basis.

Sales value and sales incentives – Time-share sales value will be reduced by the excess of the fair value of a sales incentive over the amount the time-share purchaser pays for the incentive, and the seller should record the incentive separately. If the seller obtains the incentive through an arm's-length cash transaction with an unrelated third party, ordinarily the developer's cost would be considered the best estimate of fair value. The income statement display of cash and noncash incentives will be the same, which would result in an exception to EITF 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of a Vendor's Products."

Buyer's cumulative payments – The buyer's cumulative payments are to be reduced for sales incentives.

Sales incentives and buyer payments – There will not be a "practicality cut" associated with the method in paragraph 107 of the exposure draft of allocating principal and interest payments, on a buyer's note, that a seller requires before delivering to the purchaser a promised incentive; general considerations of materiality will suffice. If the allocation of payments in the method resulted in a period of negative amortization of the portion of the note related to the time-share interval, the proposed SOP will not impose a limit on the period of negative amortization.

Seller services – If a seller provides program services (such as an exchange, points, or affinity program, or a vacation club) without compensation or at compensation less than market rates, compensation is to be imputed when the sale is recognized and such compensation recognized in income when the seller perform the services. The guidance on valuing the imputed compensation for an internal exchange program will be clarified to state that the fees of independent time-sharing exchange companies are to be considered in determining prevailing market rates, but recognizing that the services of an independent exchange company may be more complex than the services of an internal exchange program. The intent of the guidance with respect to vacation clubs and affinity programs will be clarified as well.

Current developments and plans. In February 2003, AcSEC issued an exposure draft of the proposed SOP, *Accounting for Real Estate Time-Sharing Transactions*. Concurrently, the FASB issued an exposure draft of a proposed Statement of Financial Accounting Standards, *Accounting for Real Estate Time-Sharing Transactions—an amendment of FASB Statements No. 66, 67, and 135*. That proposed Statement includes amendments to certain FASB pronouncements that would be made in conjunction with issuance of the proposed SOP. In June 2003, AcSEC discussed the comment letters received on the proposed SOP and task force recommendations. In view of the FASB/IASB revenue recognition project, the Board discussed on June 18, 2003 whether a final SOP should include (as AcSEC recommended) or exclude revenue-recognition-related guidance. The Board decided that, in view of the current level of uncertainty associated with that project (timing of project, possible scope-out of real estate) that AcSEC is not precluded from proceeding with an SOP that includes revenue recognition guidance. The Board reserved the right, however, to reassess at any SOP clearance meeting the status of the revenue recognition project and possibly have AcSEC remove the revenue recognition guidance from the SOP at that time. AcSEC will discuss a revised draft SOP in July 2003.

Staff: Marc Simon

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

Description and background. 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. Tentative conclusions reached by AcSEC during discussions subsequent to the FASB's February 2003 decision that AcSEC should continue its deliberations toward issuing a final SOP (subject to FASB clearance) include:

Project stage framework – The preacquisition and acquisition-or-construction stages will remain separate and distinct rather than be combined into a single stage. If it becomes no longer probable that specific PP&E will be acquired, the preacquisition stage costs previously capitalized related to the specific PP&E are to be reduced to the lower of cost or fair value less cost to sell.

Property taxes, insurance – In the case of real estate, costs incurred from property taxes and insurance are to be capitalized, for the portion of the property under construction, during the time that activities necessary to get the asset ready for its intended use are in progress. A building or structure held for lease on which construction is substantially complete, except for the construction of leasehold improvements, is considered substantially complete and ready for its intended use.

G&A expenses – General and administrative costs will be charged to expense as incurred. Whether or not classified as "general and administrative costs" by an entity, the following costs are to be charged to expense as incurred: occupancy costs; all costs (including payroll and payroll benefit-related costs) of executive management, corporate accounting, acquisitions, corporate legal, office management and administration, marketing, human resources, and similar functions. With respect to capitalization of payroll and payroll benefit-related costs of employees who devote time to a specific PP&E-related activity, the proposed SOP will neither (1) prescribe a project-time-related threshold (for example, 50% of an employee's time spent on a project) below which an employee's payroll and payroll benefit-related costs would be expensed, nor (2) state that an entity is not required to capitalize payroll and payroll benefit-related costs of an employee who spends a de minimus amount of time on a project.

Removal costs - Removal costs not within the scope of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, will be considered costs associated with the removed asset rather than any replacement asset. Such removal costs are to be expensed, and the proposed SOP will not provide further guidance related to salvage value or the period over which expense should be charged (for example, expensing all removal costs at time of removal versus expensing over the life of the asset through a reduction of the salvage value used in depreciation calculations).

Demolition costs – The proposed SOP's guidance on demolition costs, which represents a limited exception to the guidance on removal costs, will be expanded to cover not only the situation of land and a building thereupon to be demolished but also equipment—for example, a situation in which an entity acquires a factory with equipment to be removed.

Disposals – When an entity disposes of PP&E having a net book value to be removed from the entity's balance sheet upon disposal, the proposed SOP will not provide guidance as to where any income statement effect of the disposal should be recorded (for example, depreciation expense versus gain or loss on disposal).

Component accounting – The proposed SOP will retain the concept of component accounting. The level or degree of componentization would be an accounting policy decision by management.

Disclosures – An entity is to either present in the basic financial statements or disclose in the notes the gross carrying amounts of land and land improvements, buildings and building improvements, machinery and equipment, and construction in progress, as well as total accumulated depreciation for PP&E. Those four categories are to be further subcategorized if costs within a category are significant, either quantitatively or qualitatively, in relation to PP&E as a whole.

Replacement and removal – A "replacement" consists of the removal of a component and the installation of a new component in its place. A replacement is to be interpreted more broadly than a component identical to the one removed—for example, a higher quality component that performs the same function as the component removed. Additionally, "removal" is to be interpreted to mean removal of a component from service and not necessarily an actual physical removal.

Liquidated damages – A purchaser of PP&E is to account for liquidated damages as a reduction of the PP&E cost, with any damages in excess of the total PP&E cost recognized as income.

Transition and component accounting – At transition the component accounting guidance in the proposed SOP will be initially adopted as follows: (a) determine the level of component accounting for all existing PP&E assets; (b) allocate cost and accumulated depreciation to determine net book values of each component as discussed in paragraph 71a of the exposure draft; (c) depreciate the net book value of each component over the remaining expected useful life of that component. For each PP&E asset for which the level of component accounting is unchanged upon adoption from its pre-adoption level, that PP&E asset is considered a single component. Therefore, in future periods, when the entity incurs costs to replace a part or portion of that component, the costs of the replacement are to be charged to expense as incurred. If an entity owns identical PP&E assets, some of which were acquired or constructed prior to adoption and some of which were acquired or constructed after adoption, the election to componentize the post-adoption assets to a more detailed level than the pre-adoption assets will not require that the entity change the level of component accounting for the pre-adoption assets to that of the post-adoption assets.

Change in principle – If an entity, upon replacement of a part or portion of a component, elects to subsequently account for that part or portion as a separate component, this constitutes a change in the level of component accounting and will be accounted for as a change in accounting policy or principle and a cumulative effect adjustment recorded.

Mass-asset accounting – Mass asset accounting (referred to by AcSEC in previous discussions as the group-life method of accounting) is considered an acceptable alternative to component accounting in certain limited circumstances and provided certain criteria are met. The proposed SOP will include those criteria.

Effective date – The effective date of the proposed SOP will be no earlier than for fiscal years beginning after December 15, 2004.

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 have been made in conjunction with issuance of the proposed SOP. In October 2002, the FASB requested that AcSEC not issue a final SOP. At its January 2003 meeting, AcSEC discussed alternatives for the future of the project and decided to recommend to the FASB that AcSEC issue a "carve-out" SOP that would include one or more topics from the original exposure draft SOP. In February 2003, the FASB decided that AcSEC should continue its deliberations toward issuing a final SOP (subject to FASB clearance) and that the SOP would be limited to certain topics. In April and June 2003, AcSEC discussed task force recommendations on key issues. AcSEC will discuss a revised draft SOP in July 2003.

The AICPA staff has discussed with the staff of the IASB with respect to the proposed SOP and the portion of the IASB's "Improvements Project" dealing with IAS 16, *Property, Plant and Equipment*, in order that AcSEC and the IASB can better monitor each other's projects and to promote opportunities for harmonization.

Staff: Marc Simon

OTHER AcSEC ACTIVITIES

AcSEC approved a letter of comment on the International Accounting Standards Board's (IASB) November 7, 2002 exposure draft of the proposed International Financial Reporting Standard, ED 2 *Share-Based Payment.*

AcSEC approved a letter of comment on the IASB's December 5, 2002 exposure drafts of the proposed International Financial Reporting Standards, ED 3 Business Combinations and Proposed Amendments to IAS 36 Impairment of Assets and IAS 38 Intangible Assets.

In January 2003, AcSEC held its annual liaison meeting with members of the AICPA Technical Issues Committee to discuss matters of mutual interest.

In April 2003, AcSEC held its annual liaison meeting with members of the FASB and senior FASB staff to discuss matters of mutual interest.

NEW AND POTENTIAL FUTURE AcSEC PROJECTS

Valuing Privately-Held-Company Equity Securities Issued in Other Than a Business Combination Since October 2001, the Accounting Standards Team has been working with a task force made up of a cross section of experts from industry, public accounting firms, academia, the legal community, 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 final product will be an AICPA Practice Aid addressing valuation and related accounting and disclosure issues. In April 2002, AcSEC's Planning Subcommittee approved a prospectus, subject to FASB clearance, for this project to be an SOP project but in July 2002 the FASB did not clear the prospectus. The Board supports the project but believes that issuance as a Practice Aid is most appropriate. The project's task force posted for comment on the AICPA web site in February 2003 a draft Practice Aid, with a 60-day comment period. The task force has discussed the comments received and plans to discuss a redrafted Practice Aid at the July 2003 AcSEC meeting. A final Practice Aid is expected to be issued later in 2003.

Staff: Marc Simon

Airline Audit and Accounting Guide AcSEC will participate in the AICPA's overhaul of this guide. The financial reporting issues will be captured in a guide project prospectus, subject to AcSEC Planning Subcommitee (PSC) and FASB approval.

Staff: Fred Gill

Casino Audit and Accounting Guide AcSEC will participate in the AICPA's overhaul of this guide. The financial reporting issues will be captured in a guide project prospectus, subject to AcSEC PSC and FASB approval.

Staff: Joel Tanenbaum

UPCOMING AcSEC MEETINGS

AcSEC meetings are open to the public.

July 22-23, 2003	San Francisco, CA
September 9-10, 2003	New York, NY
October 28-29, 2003	New York, NY
December 16-17, 2003	South Beach, FL

AcSEC ON AICPA WEB SITE

Visit the Accounting Standards webpage, located on the AICPA website, at http://www.aicpa.org/members/div/acctstd/index.htm, to view information about AcSEC activities, including AcSEC's meeting agenda and materials, highlights of recent AcSEC meetings, and to obtain a copy of an Exposure Draft.

COMMENTS OR SUGGESTIONS?

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

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

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