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American Institute of Accountants. Bureau of Information

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ACCOUNTING QUESTIONS

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APPORTIONING INCOME ON F.H.A. LOANS

Question

We would appreciate receiving from you, if possible, information concerning the proper procedure, for accounting purposes, of recording the interest income differential on F.H.A. loans to corporations engaged in the mortgage loan business. The following procedure has been presented to us and we desire to know if you consider such method good accounting procedure.

Assume an F.H.A. loan of \$4,400, five per cent interest, principal and interest payable monthly over a period of $19\frac{1}{2}$ years. Interest differential to mortgage firm three fourths of one per cent. The total interest for $19\frac{1}{2}$ years shown by F.H.A. form 2037 is \$2,495.42. If we divide that total interest, \$2,495.42, by 234, the number of monthly payments in a $19\frac{1}{2}$ year loan, we obtain an average monthly payment of \$10.66.

Assuming that we receive an interest differential of three fourths of one per cent, our average monthly interest differential is \$1.60. The first interest differential which we receive is \$2.75. However, we take only the average, i.e., \$1.60, and the difference between the average and the amount received in the first month, i.e., \$1.15, is credited to a reserve called "Reserve for future servicing expense." When the monthly interest differential which we receive eventually becomes less than the average of \$1.60, we draw on the reserve to make up the average. Assuming that there are no prepayments on the loan during its life, the reserve would be completely used up when the last monthly collection is made.

If the foregoing is a satisfactory method for accounting purposes, could you suggest any simpler method of apportioning the income?

Answer No. 1

In the case in question the procedure suggested by the correspondent seems to me to be perfectly proper if the company receiving the interest differential has a continuing service to render. If, however, all of its service has been rendered at the time of making the loan, then I believe it is unnecessary to average the amount taken into income. It would be simpler and just as correct to take in the actual amounts received from year to year.

Answer No. 2

It is apparent from your inquiry that the "interest differential" is treated by the mortgage firm as a servicing fee, which in effect it is, since that organization has no personal responsibility for the account but merely acts as collecting agent for the Federal Housing Authority. However, even though the income received is in the nature of a servicing fee, we do not believe that there is sufficient justification for deferring the income by the means outlined in your letter. The "interest differential" is the measure of the fee and bears a direct relation to the amount of the loan.

It is, therefore, our opinion that the "interest differential" should be reported as income at the time of accrual or upon receipt by the mortgage firm depending upon the method of accounting employed.