FASB Emerging Issues Task Force

Issue No. 13-F

Title: Classification of Certain Government Insured Residential Mortgage Loans upon Foreclosure by a Creditor

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Background

1. Government insured mortgage loans are mortgages that the government agrees to pay the creditor for if the homeowner stops making payments. This insurance provides creditors with protection against losses resulting from homeowners who default on their loans, and takes the place of private mortgage insurance. Loans are extended by approved creditors, and those loans must meet certain requirements established by the program to qualify for insurance. Currently, the most common government loan guarantee programs are those offered by the Federal Housing Administration (FHA) of the U.S. Department of Housing and Urban Development (HUD), which insures mortgages on single family and multifamily homes to low-income and first-time home buyers; the U.S. Department of Veterans Affairs (VA), which insures mortgages on homes purchased by eligible veterans; and the U.S. Department of Agriculture's Rural Housing Service (RHS), which provides loan guarantees to creditors for low and moderate-income families who want to buy a single-family home in rural areas. Each program has its own requirements and the amount guaranteed varies. This Issue only applies to government guarantees that entitle the

* **The alternative views presented in this Issue Summary are for purposes of discussion by the EITF. No individual views are to be presumed to be acceptable or unacceptable applications of Generally Accepted Accounting Principles until the Task Force makes such a determination, exposes it for public comment, and it is ratified by the Board.**

creditor to the full unpaid principal balance of the loan. Based on that criterion, this Issue predominately affects mortgage loans fully guaranteed by the FHA.

2. The general fact pattern and process for reimbursement under the claim related to those residential mortgage loans fully guaranteed by the FHA is as follows:

a. The creditor initiates foreclosure (or obtains and records a deed in lieu of foreclosure) to acquire the property within a specified timeframe from the date of default. If the property is vacant or abandoned, the creditor must initiate foreclosure or obtain a deed in lieu of foreclosure within a specified timeframe from the date of default or the property being discovered as vacant. Foreclosure is initiated upon the first public action required by law, such as filing a complaint or petition, recording a notice of default, or publication of a notice of sale through public record.

b. The creditor is required to exercise reasonable diligence in bringing the foreclosure proceedings to completion and in acquiring title and possession of the property and ensuring that specified timeframes are met. Differences in state procedures and redemption periods will affect the length of time required to complete foreclosure. Completion of foreclosure under FHA claim guidelines is deemed to be the date on which the foreclosure deed is recorded (for example, sheriff's or trustee's deed). The deed is generally executed after the expiration of the redemption period and before eviction of the occupant, if applicable.

c. At foreclosure, the creditor generally takes title to the property and conveys the property to HUD under the FHA guarantee. In some jurisdictions the foreclosure deed may convey title directly to HUD instead of the creditor. Direct conveyances are less common. If not conveyed directly, the property is usually conveyed to HUD shortly after foreclosure or a deed in lieu of foreclosure agreement is completed. Under special circumstances, a creditor may be allowed to make a claim on the guarantee even when a third party purchases and takes title to the property at foreclosure instead of the creditor. That is, the creditor's loan would be satisfied by a combination of the proceeds from the third party at the foreclosure sale, and the proceeds from the HUD guarantee. The staff understands that currently, claims under this special program make up about 5 percent to 10 percent of the total claims.

d. The creditor submits the insurance claim to HUD after the foreclosure process is completed; specifically, the HUD guidelines indicate the claim must be submitted on the date the deed is filed for record or mailed to the recording authority.

e. To be eligible to receive payment of the claim, the creditor is required to follow all inspection and servicing requirements set out by HUD.

f. Upon receipt of an acceptable application, HUD pays the unpaid principal balance plus debenture interest, which is less than the contractual note rate. The debenture interest is the amount of interest earned on the balance from the date of default as defined by the FHA to the date of the initial settlement of the claim. The difference between the note rate and the debenture rate is never recovered by the creditor. The creditor's failure to comply with the HUD requirements might result in a loss of debenture interest.

g. HUD also reimburses creditors of FHA guaranteed loans for certain expenses and allowances (for example, tax and utility liens on the property, reasonable hazard insurance payments, a percentage of foreclosure costs, certain repairs and maintenance expenses), provided all FHA claim requirements have been met on a timely basis.

h. HUD can refuse conveyance of the property if claim requirements are not met. Also, if a creditor conveys a property to HUD that is ineligible for insurance benefits or otherwise fails to comply with the regulations, the creditor must promptly correct the defect or HUD may convey the property back to the creditor.

i. The creditor can elect to sell the property to a third party and thereby never make a claim to HUD under the FHA guarantee; for example, if the fair value of the property increases subsequent to foreclosure such that it is greater than the recorded investment in the loan or if the creditor otherwise determines that making a claim under the guarantee may not be advantageous as compared with holding or selling the property on its own.

Scope

3. This Issue applies to the balance sheet classification of residential mortgage loans issued by banks or other mortgage lenders that have both of following two characteristics:

a. The loan has a government guarantee (that is not separable from the loan) entitling the creditor to the full unpaid principal balance of the loan

b. At the time of foreclosure (as determined by paragraph 310-40-40-6), the creditor has the intent to make a claim on the guarantee and the ability to recover through the guarantee.

Accounting Issue and Alternatives

4. Currently, there is diversity in practice related to creditors' classification and disclosure of foreclosed government insured residential mortgage loans. This Issue is intended to reduce that diversity by addressing the classification of government guaranteed loans directly held by the creditor. This Issue Summary outlines four views of the classification of a fully guaranteed loan after foreclosure:

A. Classify the foreclosed real estate and the guarantee receivable separately, the sum representing the full amount of the guarantee.

B. Classify the foreclosed real estate as real estate at the full amount of the guarantee.

C. Continue to classify as a loan at the full amount of the guarantee.

D. Classify the foreclosed real estate as a receivable (separate from loans) at the full amount of the guarantee.

The staff understands that based on outreach and discussions with regulators of financial institutions, Views B and D are most often applied in practice. The staff understands that Views A and C are rarely, if ever, applied in practice. This Issue does not address the accounting for investments in mortgage-backed securities that may contain FHA-guaranteed mortgage loans.

View A: The creditor should record two units of account: foreclosed real estate and a guarantee receivable.

5. Under this view, upon foreclosure (as determined per paragraph 310-40-40-6), the recorded investment in the loan would be derecognized and two units of account would be recognized by the creditor: foreclosed real estate and a guarantee receivable. Proponents of this view believe that separate recognition of the real estate is required upon foreclosure because the guidance in Subtopic 310-40, Receivables—Troubled Debt Restructurings by Creditors, related to

recognition of assets received in satisfaction of a loan is directly applicable and requires recognition of foreclosed real estate.

6. Subtopic 310-40 provides that when a creditor receives assets from a debtor in satisfaction of a receivable, the creditor should account for *those assets* received at their fair value. Paragraph 310-40-40-2 states:

> A creditor that receives from a debtor in full satisfaction of a receivable either or both of the following shall account for those assets (including an equity interest) at their fair value at the time of the restructuring:
>
> a. Receivables from third parties, real estate, or other assets
> b. Shares of stock or other evidence of an equity interest in the debtor.

7. Paragraph 310-40-40-3 further requires that foreclosed real estate received in satisfaction of a loan shall be initially recognized at the fair value of the property less cost to sell when foreclosure (including in-substance foreclosure) occurs. That paragraph states:

> A creditor that receives long-lived assets that will be sold from a debtor in full satisfaction of a receivable shall account for those assets at their fair value less cost to sell, as that term is used in paragraph 360-10-35-43. The excess of the recorded investment in the receivable satisfied over the fair value of assets received (less cost to sell, if required above) is a loss that shall be recognized. For purposes of this paragraph, losses, to the extent they are not offset against allowances for uncollectible amounts or other valuation accounts, shall be included in measuring net income for the period.

8. Proponents of this view believe that foreclosure of FHA guaranteed loans should not be treated in a different manner from other mortgage loans under the requirements cited in the preceding two paragraphs. That is, a creditor should reclassify all mortgage loans to real estate upon foreclosure at the real estate's fair value less cost to sell. However, a receivable should be recognized in addition to the foreclosed real estate in an amount equal to (a) the amount expected to be recovered through the guarantee (including the principal balance, interest, and eligible expenses), less (b) the carrying amount of the foreclosed real estate. The recognition of this receivable is appropriate because it represents an insurance recovery for a loss that has been incurred (a loan that is in default and reclassified to real estate at its fair value less cost to sell)

and the creditor has the intent and ability to recover the full loan amount under the guarantee. The receivable is also appropriate because it results in measurement that is consistent with how the guarantee would have been considered in the loan impairment determination prior to it being reclassified to foreclosed real estate. Under this view, the creditor would subsequently assess the receivable for collectability and recognize a reserve against it if, for example, the creditor determines during the foreclosure process that it violated the eligibility requirements for the guarantee and it no longer qualifies for debenture interest (see paragraph 2(f)). The creditor would also subsequently adjust the balance of the receivable if the value of the foreclosed real estate changes because the amount to be recovered from the guarantee would correspondingly change.

9. Proponents of this view believe that establishing two units of account for FHA guaranteed loans in the scope of this Issue is the most transparent and appropriate presentation when compared to the other alternatives provided. This view treats and presents all foreclosed real estate similarly, regardless of whether they are government-guaranteed or non-guaranteed loans. Proponents believe that the real estate treatment is appropriate for all foreclosed mortgage loans because the creditor would have equivalent legal title across all such loans. This treatment also appropriately captures the real estate risk held by the creditor in the event that the creditor no longer has the intent and ability to recover through the guarantee.

10. Opponents of this view believe that the recognition of real estate for a foreclosed FHA guaranteed loan is not appropriate because the creditor does not have risks and rewards of real estate ownership provided that the creditor has the intent and ability to recover the full principal balance under the guarantee. When a foreclosure takes place, the creditor files a claim with HUD and recovers the full principal balance. Therefore, opponents of this view do not believe that real estate presentation and accounting is appropriate. Opponents also point out that real estate classification is not appropriate because, although less common, the creditor may not ever take title to the property and yet still make a claim under the guarantee. In those circumstances, either the property is directly conveyed to the FHA or purchased by a third party at foreclosure.

11. Other opponents of this view do not object to the real estate presentation but believe that creating two units of account is not appropriate (see View B). They also note that if the amounts were individually material and separately presented on the balance sheet, the real estate presented could potentially be misleading without providing the additional information to the users about how it interacts with the receivable.

12. Proponents of this view believe that the amount receivable under guarantees related to foreclosed assets along with the carrying value of the associated real estate should be disclosed if the two are grouped in the same financial statement line item. In most cases the carrying value of the real estate and guarantee receivable will not be significant enough to require separate line items on the balance sheet. While the assets should be accounted for as two units of account, the guarantee and the real estate are linked, and, accordingly, disclosing solely the foreclosed real estate in the footnotes would not be reflective of the actual recoverable amount. Therefore, proponents of this view believe that the disclosure of the receivable would be relevant to users of financial statements.

View B: The creditor should reclassify the loan to other real estate owned (OREO) at the amount expected to be recovered through the guarantee.

13. Under this view, the foreclosed loan and the guarantee are considered a single unit of account because they are considered inseparable. Proponents of this view note that the government guarantee does not exist separate from the loan and therefore should not be a separate unit of account. The guarantee was obtained at the time of origination of the loan and is not independent from the contractual relationship between the debtor and creditor because the origination of the loan was dependent on the existence of the guarantee program. Furthermore, the benefits of the guarantee follow the loan in the event the loan is transferred to a third party.

14. In further support of the view that the loan and guarantee are a single unit of account, proponents note that a single unit of account is utilized before foreclosure as evidenced in the estimation of probable incurred losses under the impairment guidance in current U.S. GAAP. Guidance in paragraph 310-10-35-26 states that the estimates of expected future cash flows shall

be the creditor's best estimate based on reasonable and supportable assumptions and projections. Reporting entities applying that guidance consider the guarantee in estimating future cash flows including an assessment of the likelihood that the guarantor will perform on its guarantee. From day one of the loan through foreclosure, the creditor considers both the cash flows of the borrower and creditor when assessing impairment. Proponents of this view therefore believe that because the asset was one unit of account prior to foreclosure and the substance of the arrangement under the loan has not changed, it should not become two units of account upon foreclosure.

15. In supporting the argument that the guarantee is not a separate unit of account, proponents of this view also analogize to the separation criteria in Subtopic 605-25, Revenue—Multiple-Element Arrangements. They point to paragraph 605-25-5(a), which states:

> The delivered item or items have value to the customer on a standalone basis. The item or items have value on a standalone basis if they are sold separately by any vendor or the customer could resell the delivered item(s) on a standalone basis. In the context of a customer's ability to resell the delivered item(s), this criterion does not require the existence of an observable market for the deliverable(s).

Proponents of this view point out that the guarantee does not have value on a standalone basis because government guarantees are not available for purchase without the loan and the borrower cannot resell the guarantee before or after foreclosure.

16. While proponents of View B believe that the loan and the guarantee are not separable, they agree with proponents of View A that the real estate should be recognized upon foreclosure. Because the proponents of this view do not support two units of account, they believe that the asset resulting from foreclosure on a guaranteed loan has characteristics that are more akin to real estate than a receivable since the creditor generally has title to the property upon foreclosure even if that title is held only for a short period of time. They believe that once an FHA guaranteed loan is foreclosed, presentation and accounting as a loan or as a receivable is not

appropriate. Therefore, proponents of this view support reclassifying the loan to foreclosed real estate to reflect the fact that foreclosure has occurred.

17. Proponents of this view believe that because the loan and guarantee are not separable, measurement of the real estate asset should consider the existence of the guarantee. That is, the measurement of the real estate should be based on the amount expected under the guarantee, rather than the fair value of the property less cost to sell, because a creditor who files a claim with HUD expects to recover the guaranteed loan balance, which would be in excess of the fair value of the real estate. Under this view, the amount expected under the guarantee becomes the "cost" basis of the foreclosed real estate to reflect the existence of the guarantee. Proponents also note that it is a practical approach because the Consolidated Report of Condition and Income (the Call Report) currently requires entities to separately show other real estate-owned investments related to foreclosed properties backing FHA loans.

18. Others who take this view support measuring the foreclosed real estate at the guaranteed amount based on the guidance in Subtopic 820-10, Fair Value Measurement—Overall, which provides that fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction in the principal (or most advantageous) market at the measurement date under current market conditions (that is, an exit price). Paragraph 820-10-35-6 notes that if there is a principal market for the asset or liability, the fair value measurement shall represent the price in that market (whether that price is directly observable or estimated using another valuation technique), even if the price in a different market is potentially more advantageous at the measurement date. Proponents of this view believe that the principal market for conveying foreclosed property with an FHA guarantee is through a claim to HUD. They note that most foreclosed properties with an FHA guarantee are conveyed to HUD so it is the market with the greatest volume. Proponents acknowledge that conveying to HUD does not meet the typical characteristics of a market, but they also point out that the property is considered held for sale under Topic 360 and the transfer of the property to HUD is how the entity will ultimately "sell" the property. They believe that paragraph 820-10-35-9A supports that view:

> The reporting entity must have access to the principal (or most advantageous) market at the measurement date. Because different entities (and businesses within those entities) with different activities may have access to different markets, the principal (or most advantageous) market for the same asset or liability might be different for different entities (and businesses within those entities). Therefore, the principal (or most advantageous) market (and thus, market participants) shall be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities.

19. Opponents of this view believe that there is no support in U.S. GAAP for carrying the foreclosed real estate above its fair value less costs to sell. They point out that the actual property is likely to be sold by HUD in the real estate market without the guarantee and therefore do not believe that the guarantee should be included in the value of the real estate. Other opponents do not object to the valuation aspect but believe that classification of a foreclosed loan as real estate is not appropriate when that real estate will be conveyed to the FHA, or in certain circumstances purchased by a third party at foreclosure.

20. Proponents of this view believe that because the asset will be reflected in the statement of financial condition as a single unit of account, the existence of the government guarantee and the portion attributable to the guarantee should be disclosed in the notes to the financial statements for transparency. With such disclosure, proponents of this view believe that View B results in as much transparency as View A because under View A, both units of account would still be classified within Other Assets by most creditors. Therefore, proponents of View B believe that requiring those items to be separated into two units of account under View A does not provide incremental information.

View C: The creditor should continue to classify the asset as a mortgage loan (no reclassification).

21. Consistent with View B, under this view, the foreclosed loan and the guarantee are considered a single unit of account. However, proponents of View C believe that the asset should not be reclassified from loans to foreclosed real estate or to another receivable. They argue that the creditor is not receiving an asset from the borrower in full satisfaction of the receivable. The creditor is merely foreclosing on the asset so it can ultimately collect the

outstanding principal of the loan. Therefore, proponents of View B believe that there is no basis under Subtopic 310-40 to derecognize the loan.

22. Proponents of this view emphasize that the creditor does not intend to sell the real estate to recover on the loan, but instead intends to convey the property to the guarantor. Accordingly, the real estate does not satisfy the receivable. The proponents note that although the creditor receives title to the property, the creditor is effectively acting as an agent for the guarantor. Assuming the creditor has the intent to recover under the guarantee and has met all eligibility requirements to recover under the guarantee program, the creditor never intends to receive a "marketable" title to the property.

23. Proponents of View C believe that title passing to the creditor as an interim step in conveying the property to the guarantor does not itself change the character of the asset to foreclosed real estate. For a loan guaranteed by the FHA, some jurisdictions allow property to be directly conveyed to the FHA, while in other jurisdictions the creditor transfers the property shortly after receiving title (for example, within 30 days). Proponents of this view believe that no distinction should be made when the asset is directly conveyed or conveyed shortly after the creditor receives title because the receipt of title and subsequent conveyance to the guarantor simply facilitates the ultimate settlement of the asset through the guarantee. That is, the title passes through the creditor in some cases but, in substance, proponents believe that this is no different from a direct conveyance. Accordingly, the substance of the arrangement is the same in both cases such that the guarantor, rather than the creditor, bears the risk of loss on the property because the unpaid principal balance of the loan is expected to be collected by the creditor.

24. Furthermore, proponents of this view believe that since the creditor has a contract under which it will receive cash under the terms of the guarantee, the entire amount is best represented as a financial asset and not as real estate. Proponents of this view believe that the asset continues to meet the definition of a loan, as stated in the Master Glossary of the FASB Accounting Standards Codification:

> A contractual right to receive money on demand or on fixed or determinable dates that is recognized as an asset in the creditor's statement of financial position. Examples include but are not limited to accounts receivable (with terms exceeding one year) and notes receivable.

25. For example, for FHA guaranteed loans, claims for insurance benefits on conveyed property are settled in cash. The entire unpaid balance of the loan will be satisfied through a cash payment from either the debtor or the guarantor, rather than through the sale of the property securing the loan. Because the creditor never looks to the value of the real estate for recovery in the event of the debtor’s default, proponents believe that the asset should not change from a financial asset to a nonfinancial asset.

26. Proponents of this view also point to the guidance related to substitution of debtors in Subtopic 310-40 as being applicable in this situation. The guidance in paragraph 310-40-25-2 states the following (in part):

> A troubled debt restructuring may involve substituting debt of another business entity, individual, or government entity for that of the troubled debtor or adding another debtor (for example, as a joint debtor). Government entities include, but are not limited to, states, counties, townships, municipalities, school districts, authorities, and commissions. That kind of restructuring should be accounted for according to its substance. For example, a restructuring in which, after the restructuring, the substitute or additional debtor controls, is controlled by, or is under common control (as defined in paragraph 810-10-15-8) with the original debtor is an example of one that shall be accounted for by the creditor as prescribed in this Topic [under guidance that was formerly in FASB Statement No. 114]. ….In contrast, a restructuring in which the substitute or additional debtor and the original debtor do not have any of the relationships described above after the restructuring shall be accounted for by the creditor according to the provisions of paragraphs 310-40-40-2 through 40-4.

27. The guidance above indicates that the accounting for situations in which there is a substitution of debtors depends upon the substance of the arrangement and whether the receivable is new or a modification of an existing receivable. A difference in accounting exists depending on whether a creditor in a troubled debt restructuring accepts a new receivable from a different debtor to replace an existing receivable from a debtor experiencing financial difficulties or whether the original underlying debtor-creditor relationship, though modified, continues.

Proponents of this view believe that the government guarantor becomes the new debtor in the case of foreclosure. As a result, they believe that the original debtor is replaced by the guarantor, which does not trigger derecognition of the loan.

28. Opponents of this view note that the creditor has to manage the real estate, is likely to incur some non-reimbursable expenses during the foreclosure process, and, in most cases, ultimately will have to take title to the property for a period of time. Accordingly, opponents believe that the guidance in Subtopic 310-40 for recognizing real estate upon satisfaction of the loan is applicable. They also note that the timing of completing the foreclosure process and filing the claim is uncertain, so the receivable no longer meets the definition of a loan because the timing of the cash payment from the guarantor is not "fixed or determinable." They also do not believe that a substitution of debtors has occurred because they note that the impairment analysis for the loan has always relied on the government guarantee, so they do not believe that it is consistent to then argue that a troubled debt restructuring has occurred.

29. Some proponents of this view still prefer to require disclosure of the collateral value of the underlying property less cost to sell. However, other proponents believe that requiring that disclosure is not consistent with the premise that the asset is still a loan.

View D: The creditor should reclassify the loan to a separate receivable.

30. Consistent with Views B and C, under this view, the foreclosed loan and the guarantee are considered a single unit of account because they are considered inseparable. In addition, this view is similar to View C in that proponents believe that the asset continues to be a financial asset. However, proponents of View D believe that the loan should be reclassified to a receivable from the guarantor in the full amount expected to be recovered, for several reasons. They believe that the asset no longer meets the definition of a loan because, unlike contractual principal and interest payments of a residential mortgage loan, the timing of the cash payment from the guarantor is not as technically fixed or determinable as it would be in the case of a loan contract. Also, they note that the amount owed under the guarantee is not the same amount owed under the loan because the amount owed to the creditor also includes reimbursement for certain

expenses and allowances. Additionally, proponents of this view believe that the receivable is no longer a loan because the counterparty to the receivable has changed from the borrower to the guarantor upon foreclosure. They also note that at the point of foreclosure or obtaining a deed in lieu of foreclosure the creditor can no longer look to the borrower to recover on the loan.

31. Proponents of this view agree that upon foreclosure, Subtopic 310-40 is applicable with respect to derecognition of the loan. However, they do not believe that they have "received long lived assets that will be sold from a debtor" because the creditor intends to convey the loan to the FHA. Instead, proponents believe that a receivable from a third party has satisfied the loan from the borrower.

32. Opponents of this view point to various arguments outlined in Views A, B, and C. Those who hold View A or View B will note that the entity has taken title to the property and therefore should recognize real estate. Those who hold View C will highlight that the nature of the receivable has not changed and therefore does not require reclassification out of loans.

33. Proponents of this view believe that consistent with View B, because the asset will be reflected in the statement of financial condition as a single unit of account, the amount receivable under government guarantee and the fair value less cost to sell of the property should be disclosed in the notes to the financial statements.

Recurring Disclosures

34. As outlined in all of the views, some proponents believe that entities should provide disclosures of the full amount expected to be received under the guarantee, and the fair value less cost to sell of the underlying property of the government guaranteed loans. Currently, depository institutions are required to separately show other real estate-owned investments related to foreclosed properties backing government guaranteed loans as part of the Call Report. In a separate Issue (EITF Issue No. 13-E, "Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring"), the Task Force is currently deliberating the timing of reclassifying residential mortgage loans to real estate upon foreclosure and related disclosures.

The proposed disclosures in that Issue would require disclosure of the total amount of foreclosed residential real estate.

Transition

35. Presented below are two transition alternatives for consideration. The staff considered but did not identify any scenario in which the net assets in the current or prior periods would be affected as a result of changing from one classification to another within the four views because total assets would always represent the amount the creditor expects to recover under the guarantee, less any reserves. Therefore, the following two transition alternatives only affect balance sheet classification.

View A: Entities should apply this Issue on a full retrospective basis to all loans within the scope of this Issue.

36. The financial statements for all periods presented would be adjusted upon the date of adoption. Full retrospective transition provides comparability between all periods presented. Opponents note that reliable records necessary for retrospective application may not be available for periods prior to the date of adoption especially if a consensus is reached on View A because the creditor would have to estimate the fair value (and cost to sell) of all foreclosed real estate existing in the prior periods presented. Therefore the use of hindsight may be needed. Proponents argue, however, that fair value of the real estate would have to be determined under any of the four views as long as a disclosure is required for the receivable and the real estate. Early adoption would be permitted.

View B: Follow the same transition approach as decided by the Task Force under Issue 13-E.

37. In Issue 13-E, the Task Force is currently deliberating the timing of reclassifying residential mortgage loans to real estate. The scope of that Issue is a subset of the scope of Issue 13-E. The staff assumes under View B that Issue 13-E is finalized and effective either at the same time or before this Issue would be effective. The Task Force tentatively decided that the proposed amendments of Issue 13-E would be adopted based on a modified retrospective approach with a

cumulative effect adjustment as of the beginning of the period of adoption, if any, booked through beginning retained earnings. Proponents of View B point out that applying this guidance to prior periods in which Issue 13-E is not adopted (because of a modified retrospective or prospective adoption of that Issue) could result in reclassification of foreclosed real estate that should not have been derecognized out of loans in the first place. Therefore, applying the same method of transition would be more understandable and less complex. Early adoption would be permitted.

38. Opponents of View B believe that the consistent and comparable presentation of FHA guaranteed loans that have been foreclosed is preferable to the lack of comparability in the presentation of those loans merely for the sake of achieving consistent transition provisions between the two Issues.

Transition Disclosures

39. The guidance on other presentation matters in Subtopic 250-10, Accounting Changes and Error Corrections—Overall, is applicable for any voluntary change in accounting principle, including a change in the method of applying an accounting principle. The staff recommends that the Task Force require companies to apply the disclosure requirements in Section 250-10-50 for an accounting change required by this Issue. Additionally, the staff recommends that the Task Force not require any additional disclosures other than the requirements in paragraphs 250-10-50-1 through 50-3.