PROPOSED FASB STAFF POSITION

No. FAS 144-a

Title: Determination of Cost Basis for Foreclosed Assets under FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings,* and the Measurement of Cumulative Losses Previously Recognized under Paragraph 37 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

Comment Deadline: October 24, 2003

Q—Should a valuation allowance for a loan collateralized by a long-lived asset be carried over as a separate element of the cost basis for purposes of accounting for the long-lived assets under Statement 144 subsequent to foreclosure?

A—No. Upon foreclosure, the lender must measure the long-lived asset received in full satisfaction of a receivable at fair value less cost to sell as prescribed under paragraph 28 of Statement 15. Paragraph 29 of Statement 15 states, "After a troubled debt restructuring, a creditor shall account for assets received in satisfaction of a receivable the same as if the assets had been acquired for cash." Therefore, application of Statement 15 results in the measurement of a new cost basis for the long-lived asset received in full satisfaction of a receivable. That is, the valuation allowance should not be carried over as a separate element of the cost basis for purposes of accounting for the long-lived asset under Statement 144 subsequent to foreclosure.

Paragraph 37 of Statement 144 states that "a loss shall be recognized for any initial or subsequent write-down to fair value less cost to sell. A gain shall be recognized for any subsequent increase in fair value less cost to sell, but not in excess of the cumulative loss previously recognized (for a write-down to fair value less cost to sell)." Accordingly, paragraph 37 limits gain recognition to the extent that cumulative losses have been recognized and measured, while the assets were accounted for as long-lived assets under Statement 144. In other words, Statement 144 does not allow the lender to "look-back" to lending impairments measured and recognized under FASB Statement No. 5, *Accounting for Contingencies*, Statement 15, or FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, for purposes of measuring the cumulative loss previously recognized. The following example illustrates the application of this FSP.

Example

- At December 31, 2002, a lender's net real estate loan receivable was $90,000. The net receivable was comprised of (a) $100,000 principal balance and (b) $10,000 allowance for doubtful accounts due to the deterioration of the borrower's credit worthiness; the allowance was based on the underlying value of the real estate since the loan is collateral dependent.
- Between December 31, 2002 and March 31, 2003, the borrower did not make principal payments. The lender determined that foreclosure was probable on March 31, 2003; the real estate's estimated fair value was $75,000. The estimated costs to sell were $4,000.
- On May 1, 2003, the lender foreclosed on the real estate; the real estate's estimated fair value and costs to sell remained unchanged from March 31, 2003. The real estate was classified as held for sale under Statement 144, subsequent to foreclosure.
- At September 30, 2003, the fair value of the property was $65,000. The estimated costs to sell were $3,000.
- At March 31, 2004, the fair value of the property was $80,000. The estimated costs to sell were $5,000.

Evaluation

Paragraph 8 of Statement 114 states that a loan is impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement. The lender determined that foreclosure is probable at March 31, 2003, and should measure the impairment based on the fair value of the collateral less estimated costs to sell since the selling costs reduce the cash flows available to satisfy the loan as prescribed under paragraph 13 of Statement 114. Accordingly, the lender should recognize a loan loss of $19,000 measured as the difference between the carrying value ($90,000) and the fair value less cost to sell ($71,000). Upon foreclosure on April 1, 2003, the application of Statement 15 results in the measurement of a new cost basis (also $71,000) for long-lived assets received in full satisfaction of a receivable.

The fair value less cost to sell decrease to $62,000 as of September 30, 2003, requires the lender to recognize an impairment of $9,000 ($71,000 − $62,000) under Statement 144. While the long-lived asset's fair value less cost to sell increased $13,000 ($75,000 − $62,000) as of March 31, 2004, the lender's gain recognition is limited to the cumulative losses recognized and measured under Statement 144, or $9,000. The $19,000 of loan impairment losses are excluded from the measurement of cumulative losses under Statement 144.

Transition

The guidance in this FSP is effective immediately upon posting of the final FSP to the FASB website. If applying this FSP results in changes to previously reported information, the cumulative effect of the accounting change shall be reported as of the beginning of the first period ending after the final FSP is posted to the FASB website. The requirements of this FSP may be applied by restating previously issued financial statements for one or more years with a cumulative-effect adjustment as of the beginning of the first year restated.