

**From:** Lisa Sanborn [mailto:Lisa.Sanborn@mossadams.com]  
**Sent:** Thursday, July 30, 2009 1:53 PM  
**To:** Jekel, Linda (DFI)  
**Cc:** Scott Ewing  
**Subject:** RE: Director of Credit Unions requesting comments and guidance on accounting for OREO

Hi Linda,  
Attached are some technical references for today's conference call. We can certainly talk about these specific accounting standards during the call, but I thought it might be handy to have them all in one document for your future reference.

Thanks, and we'll talk to you soon,

-Lisa

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**Attachment:**

Washington Department of Financial Institutions, Division of Credit Unions;  
current rulemaking on "Other Real Estate Owned (OREO)"

Accounting Issues

1. Should the rule provide a general discussion of GAAP related to OREO or should the GAAP discussion be in a guidance document? (Currently, the proposed rule references FAS 15, FAS 144, SPO 92-3, FAS 34, FAS 67, and FAS 66.)
  - I have no preference.
2. Does GAAP have a definition of OREO?
  - In the GAAP practice manual for Audits of Financial Institutions, it discusses the fact that financial institutions often receive assets from borrowers in settlement of loans, either voluntarily or involuntarily. Involuntary settlements are referred to as foreclosures. Voluntary settlements occur when the borrower transfers assets to the institution without foreclosure proceedings. In either case, the assets received are accounted for as foreclosed assets. Other names for

foreclosed assets are “other real estate owned (OREO) or other real estate (ORE).

- The GAAP practice manual for Banking and Thrift Institutions refers to OREO as “foreclosed real estate.”
3. Does GAAP have a definition of “fair value”?
    - The definition of fair value in FAS 157 retains the exchange price notion in earlier definitions of fair value, but FAS 157 “clarifies that the exchange price is the price in an orderly transaction between market participants to sell the asset or transfer the liability in the market in which the reporting entity would transact for the asset or liability, that is, the principal or most advantageous market for the asset or liability. The transaction to sell the asset or transfer the liability is a hypothetical transaction at the measurement date, considered from the perspective of a market participant that holds the asset or owes the liability. Therefore, the definition focuses on the price that would be received to sell the asset or paid to transfer the liability (an exit price), not the price that would be paid to acquire the asset or received to assume the liability (an entry price).”
  4. Does GAAP provide definition of the “recorded amount of loan”, i.e. what is included in recorded amount of loan?
    - SOP 01-6 defines recorded amounts of loans in paragraph 8 as follows: “*Loans and Trade Receivables Not Held For Sale*. Loans and trade receivables that management has the intent and ability to hold for the foreseeable future or until maturity or payoff should be reported in the balance sheet at outstanding principal adjusted for any chargeoffs, the allowance for loan losses (or the allowance for doubtful accounts), any deferred fees or costs on originated loans, and any unamortized premiums or discounts<sup>3</sup> on purchased loans.”
    - APB Opinion No. 21 Appendix A defines the recorded amount of a loan as the “present value of the contractual principal and interest cash flows discounted at the loan's effective interest rate.”
    - FAS 5 defines “all amounts due” as both principal and interest.
    - FAS 114 defines the “recorded investment in the loan” as to include “accrued interest, net deferred loan fees or costs, and unamortized premium or discount.” The term *recorded investment in the loan* is distinguished from net carrying amount of the loan because the latter term is net of a valuation allowance, while the former term is not. The recorded investment in the loan does, however, reflect any direct write-down of the investment.
  5. Are there other definitions in GAAP related to OREO?
    - FSP FAS 144-1, “Determination of Cost Basis for Foreclosed Assets under FAS 115” discusses the measurement of losses taken when an institution receives a long-lived asset in full satisfaction of a loan by foreclosing on the asset.
  6. Does GAAP require an appraisal when OREO acquired? Does GAAP require periodic re-evaluation of value during OREO holding period?

- GAAP does not require an appraisal when OREO is acquired. However, the AICPA audit guide for Audits of Financial Institutions, Section 1002, requires foreclosed assets to be recorded at their fair value less cost to sell at the date of foreclosure or transfer. If a recent appraisal is not available, the auditor must assess the reasonableness of the client's estimate of the property's fair value based on sales of similar properties, past appraisals adjusted for current conditions, or other methods. Therefore, the burden of proof is placed on the institution to support the value of the OREO property and it is generally considered the most appropriate to accomplish this through an independent appraisal.
  - Appendix 8C of the AICPA's Audit Guide for Audits of Financial Institutions specifies that "appraisals over two years old for large real estate loans are often criticized by banking and thrift examiners. In those instances, if the market or project economic conditions have not changed significantly, a letter update appraisal may be acceptable to the examiners." This is consistent with the general attitude of auditors, and to an even greater extent over the most recent 6 to 8 quarters.
7. The regulator wants credit unions to account for OREO under GAAP even if the individual journal transaction would not be "material" under GAAP. From an accounting professional, what are the pros and cons of such a requirement?
- Pros – clarity and consistency in accounting and reporting between institutions.
  - Cons – it will take more time and expertise for credit unions to account for these transactions correctly, but I don't agree that there are system limitations. The loan would remain in the loan subsidiary ledger to retain the detail and history of the borrower and transactions that have occurred. The reclassification of OREO to a separate general ledger account would occur on a monthly basis and would be a reconciling item between the loan subsidiary ledger and the general ledger.