Section 6995

Credit Unions

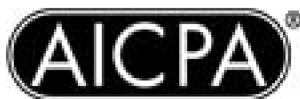
.01 Financial Reporting Issues Related to Actions Taken by the National Credit Union Administration on January 28, 2009 in Connection with the Corporate Credit Union System and the National Credit Union Share Insurance Fund

Inquiry—On January 28, 2009, the National Credit Union Administration (NCUA) announced certain actions it was taking to stabilize the corporate credit union system. The NCUA indicated that the expense of the actions would be passed on proportionately to all federally-insured credit unions through the partial (currently estimated by NCUA to be 51 percent) write-off of such credit unions' existing deposits with the National Credit Union Share Insurance Fund (NCUSIF), as well as the assessment of an insurance premium sufficient to return the NCUSIF's equity to insured shares ratio to 1.30 percent.

Federally insured credit unions (including corporate credit unions) are required to maintain a refundable deposit with the NCUSIF in an amount equal to one percent of the credit union's total insured shares. The amount on deposit in the insurance fund is periodically adjusted for changes in the balance of a credit union's insured shares. In addition, a credit union is required to pay an additional annual insurance premium equal to one-twelfth of one percent of its insured shares.

Credit unions also have their own financial system, the Corporate Credit Union Network, consisting of the U.S. Central Federal Credit Union (USC) and its member corporate credit unions. These state or regional corporate credit unions make available a wide range of investments and correspondent financial services for credit unions, and the USC serves as a financial intermediary for corporate credit unions. The USC and many of the corporate credit unions made investments in asset-backed securities that became impaired during 2008.

In a letter to federally-insured credit unions (NCUA Letter No. 09-CU-02) issued on January 28, 2009, the NCUA stated that the corporate credit union system is now facing unprecedented strains on its liquidity and capital due to credit market disruptions and the current economic climate, and that given the importance of the USC as a liquidity and payment systems provider to both corporate credit unions and, by extension, natural person credit unions, NCUA is taking decisive action to stabilize the USC's financial position and provide stability for the liquidity needs of the corporate system. In the letter,



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the NCUA announced two significant actions it was taking to address the current status of the corporate credit union system, as follows:

- The NCUA is injecting $1 billion in cash from the NCUSIF into the USC in the form of capital. The NCUA has stated that while a capital infusion has cost implications for all credit unions, it is a lower cost alternative than liquidation and sale of the distressed securities held by the USC in today's market. The staff notes that in the *unaudited* January 2009 financial statements of the NCUSIF, this investment in the USC was immediately written off.
- The NCUA is offering a voluntary temporary NCUSIF guarantee of member shares in corporate credit unions through December 31, 2010. The guarantee will cover all shares, but does not include paid-in capital and membership capital accounts. The NCUA believes the guarantee helps provide stability to meet the liquidity needs of the corporate system, which will allow for the orderly pay down of stressed securities and, in turn, reduces the overall resolution cost. The NCUA's initial estimate of the liability attributable to this guarantee is $3.7 billion, based on current corporate credit union balance sheets (that is, the holdings of impaired asset-backed securities) and the modeling of various market scenarios. The NCUA has indicated that this estimate could change significantly depending on a host of factors including, but not limited to, credit loss estimates.

In consideration of AU section 560, *Subsequent Events* (AICPA, *Professional Standards*, vol. 1), do the actions of the NCUA constitute a type 1 or type 2 subsequent event with regard to the valuation of a federally-insured credit union's NCUSIF deposit at December 31, 2008? Secondly, when and how should the obligation for the insurance premium be recognized for financial reporting purposes?

Reply—

Issue 1: NCUSIF Deposit. The AICPA staff believes that there is diversity in opinion on this issue and based on the facts known at the time this question and answer was issued, the staff does not express a preference for either of the views discussed in the following paragraphs.

Existing authoritative guidance for the accounting for the NCUSIF deposit is in paragraph 11 of Statement of Position (SOP) 01-6, *Accounting by Certain Entities (Including Entities With Trade Receivables) That Lend to or Finance the Activities of Others* (ACC sec. 10,850 par. .11), as follows:

> *a. NCUSIF Deposit.* Amounts deposited with the NCUSIF should be accounted for and reported as assets as long as such amounts are fully refundable. The refundability of NCUSIF deposits should be reviewed for impairment. When the

refundability of a deposit is evaluated, the financial condition of both the credit union and of the NCUSIF should be considered. Deposits may be returned to solvent credit unions for a number of reasons, including termination of insurance coverage, conversion to insurance coverage from another source, or transfer of operations of the insurance fund from the NCUA Board. However, insolvent or bankrupt credit unions are not entitled to a return of their deposits. To the extent that NCUSIF deposits are not refundable, they should be charged to expense in the period in which the deposits are made or the assets become impaired.

- Alternative A—Type 1 Subsequent Event

  AU section 560 states that a type 1 subsequent event is an event that provides additional evidence with respect to conditions that existed at the date of the balance sheet and affects the estimates inherent in the process of preparing financial statements. It further states, "All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence." AU section 560 also states that subsequent events affecting the realization of assets, such as receivables and inventories or the settlement of estimated liabilities, ordinarily will require adjustment of the financial statements because such events typically represent the culmination of conditions that existed over a relatively long period of time.

  Proponents of type 1 subsequent event accounting maintain that the actions taken by the NCUA on January 28, 2009 constitute additional evidence regarding strained liquidity and capital deterioration conditions that existed at December 31, 2008, and that the NCUA announcement on January 28, 2009 of the partial write-off of the NCUSIF deposit is a confirmation of those conditions at December 31, 2008.

  Proponents of this view also believe that Emerging Issues Task Force (EITF) Issue No. 87-22, "Prepayments to the Secondary Reserve of the FSLIC," addresses a situation that may be considered relevant. Similar to the NCUSIF, the Federal Savings and Loan Insurance Corporation (FSLIC) required insured institutions to make annual prepayments of their regular future insurance premiums. In May 1987, the Federal Home Loan Bank Board eliminated the secondary reserve of the FSLIC as of December 31, 1986. The Task Force reached a consensus that the impairment of the secondary reserve of the FSLIC was a type 1 subsequent event.

- Alternative B: Type 2 Subsequent Event

  AU section 560 states that a type 2 subsequent event consists of those events that provide evidence with respect to conditions that did not exist at the date of the

balance sheet being reported on, but arose subsequent to that date. These events should not result in adjustment of the financial statements.

Proponents of type 2 subsequent event accounting refer to the NCUA's disclosures that it had no obligation to undertake the actions approved on January 28, 2009, and that the NCUSIF deposits were refundable under the circumstances noted in SOP 01-6 until January 28, 2009. As such, proponents of this view believe that the NCUSIF deposits did not become impaired until January 28, 2009.

Proponents of this view also believe that EITF Topic No. D-47, *Accounting for the Refund of Bank Insurance Fund and Savings Association Insurance Fund Premiums*, in which the Financial Accounting Standards Board (FASB) staff expressed their belief that insured institutions should not accrue a liability for a potential special assessment of deposit insurance premium until the period in which any proposed legislation is enacted, can be used by analogy to support their view regarding the NCUSIF deposit.

Issue 2: Premium Assessment.

- View A—Record in 2009. Proponents of this view support recognition of the obligation to pay the insurance premium when assessed, at January 28, 2009, and refer to SOP 01-6, which states that to the extent that the NCUA Board assesses premiums to cover prior operating losses of the insurance fund or to increase the fund balance to "normal operating levels," credit unions should expense those premiums when assessed.

  Further reference is made to the aforementioned EITF Topic No. D-47, in which the FASB staff expressed their belief that insured institutions should not accrue a liability for a potential special assessment of deposit insurance premium until the period in which any proposed legislation is enacted.

- View B—Record in 2008. If NCUSIF deposit impairment is recognized in 2008, proponents of view B believe that both the NCUSIF deposit impairment and the additional premium assessment relate to the same event and conditions that caused the deposit impairment that existed at December 31, 2008, and that both should be recorded as of December 31, 2008.

Section 6995

Credit Unions

.02 Evaluation of Capital Investments in Corporate Credit Unions for Other-Than-Temporary Impairment

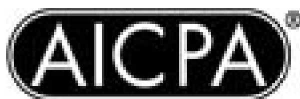
Inquiry—In a letter to its shareholders on February 2, 2009, the U.S. Central Federal Credit Union (USC) explained its financial position to other corporate credit unions that have direct capital investments in the USC in the form of membership capital shares (MCS) and paid-in capital (PIC). The letter also explained that on December 31, 2008, $450 million of members' MCS were converted to a new form of capital, paid-in capital II (PIC II). On January 28, 2009, the USC announced that it would record other-than-temporary impairment (OTTI) charges of approximately $1.2 billion for 2008 in relation to its portfolio of asset-backed securities as a result of severe deterioration in economic and market data during the fourth quarter of 2008, and that this charge resulted in an accumulated deficit (negative retained earnings) for the USC of approximately $493 million. The staff notes that audited financial statements of the USC as of and for the year ended December 31, 2008 were not available at the time of issuance of this question and answer. On January 28, 2009, the National Credit Union Administration (NCUA) announced that it was injecting $1.0 billion from the National Credit Union Share Insurance Fund (NCUSIF) in the form of new PIC to the USC, which is senior to all other forms of USC capital. The staff notes that in the *unaudited* January 2009 financial statements of the NCUSIF, this investment in the USC was immediately written off.

According to the NCUA Rules and Regulations, *membership capital* means funds contributed by members that are

- adjustable balance with a minimum withdrawal notice of 3 years or are term certificates with a minimum term of 3 years
- available to cover losses that exceed retained earnings and PIC
- not insured by the NCUSIF or other share or deposit insurers
- cannot be pledged against borrowings

Paid-in capital means accounts or other interests of a corporate credit union that are

- perpetual, noncumulative dividend accounts
- available to cover losses that exceed retained earnings
- not insured by the NCUSIF or other share or deposit insurers
- cannot be pledged against borrowings



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How should a corporate credit union evaluate its MCS and PIC in the USC for OTTI at December 31, 2008? Similarly, how should a natural person credit union evaluate its MCS and PIC investments in other corporate credit unions for OTTI at December 31, 2008?

Reply—The staff believes the following authoritative literature is helpful in making that evaluation.

Financial Accounting Standards Board (FASB) Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, addresses equity securities that have readily determinable fair values. As there is no active market for MCS or PIC investments, FASB Statement No. 115 would not apply. Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, generally requires that investments in common stock that result in the investor having the ability to exert significant influence over the issuer be accounted for using the equity method. Otherwise, the cost method would apply. APB Opinion No. 18 also indicates that a series of operating losses of an investee or other factors may indicate that a decrease in value of the investment has occurred, which is other than temporary and should accordingly be recognized, and reference is then made to FASB Staff Position (FSP) FAS 115-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*. MCS and PIC do not represent common stock investments; however, the concepts of APB Opinion No. 18 can be considered. According to the aforementioned USC letter to corporate credit unions, the ownership of MCS or PIC, or both, by any particular corporate credit union would not provide it the opportunity to exert significant influence over the USC, particularly given "one member, one vote." As such, it appears appropriate to consider investments in MCS and PIC cost method equity investments and that evaluation for impairment by corporate credit unions is required.

Although FASB Statement No. 115 does not specifically apply to MCS and PIC, FSP FAS 115-1 addresses issues of impairment not covered in FASB Statement No. 115 and includes within its scope cost method equity investments. Paragraph 4c of FSP FAS 115-1 states that the guidance in this FSP is applicable for investments in equity securities that are not subject to the scope of FASB Statement No. 115 and not accounted for under the equity method pursuant to APB Opinion No. 18 and related interpretations (cost-method investments). Paragraph 10 of FSP FAS 115-1 provides guidance on how to determine impairment on such cost-basis investments without readily determinable fair values.

Step 1 of the impairment framework detailed in FSP FAS 115-1 requires an investor to determine whether or not the fair value of the investment is less than its cost basis. Paragraph 10 of FSP FAS 115-1 regarding cost-method investments (that have no readily determinable fair value) includes the following:

> Because the fair value of cost-method investments is not readily determinable, the evaluation of whether an investment is impaired shall be determined as follows:

a. If an investor has estimated the fair value of a cost-method investment (for example, for disclosure under FASB Statement No. 107, Disclosures about Fair Value of Financial Instruments), that estimate shall be used to determine if the investment is impaired for the reporting periods in which the investor estimates fair value. If the fair value of the investment is less than its cost, proceed to Step 2.

b. For reporting periods in which an investor has not estimated the fair value of a cost-method investment, the investor shall evaluate whether an event or change in circumstances has occurred in that period that may have a significant adverse effect on the fair value of the investment (an "impairment indicator"). Impairment indicators include, but are not limited to:
   1. A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
   2. A significant adverse change in the regulatory, economic, or technological environment of the investee
   3. A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
   4. A bona fide offer to purchase (whether solicited or unsolicited), an offer by the investee to sell, or a completed auction process for the same or similar security for an amount less than the cost of the investment
   5. Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

FASB Statement No. 157, *Fair Value Measurements,* defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The staff understands that, in practice, fair value disclosures under FASB Statement No. 107 for MCS and PIC have generally reflected redemption values (at par), and have recognized that such investments were interest-earning at assumed market rates of interest. This is similar to historical fair value disclosures for investments in Federal Home Loan Bank stock.

Paragraph 13 of FSP FAS 115-1 states the following:

> When the fair value of an investment is less than its cost at the balance sheet date of the reporting period for which impairment is assessed, the impairment is either temporary or other than temporary. An investor shall apply other guidance that is pertinent to the determination of whether an impairment is other than temporary, such as paragraph 16 of Statement 115 (which references SEC Staff Accounting Bulletin Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*), paragraph 6 of Opinion 18, and EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased and Retained

> Beneficial Interests and Beneficial Interests in Securitized Financial Assets [*sic*]."[1]

The staff notes that entities holding MSC or PIC should first determine whether fair values are believed to be less than the cost bases of the respective holdings at the balance sheet date. If so, such impairment is assessed as either temporary or other than temporary. In this regard, SEC Staff Accounting Bulletin Topic 5M indicates the following:

> The value of investments in marketable securities classified as either available-for-sale or held-to-maturity may decline for various reasons. The market price may be affected by general market conditions which reflect prospects for the economy as a whole or by specific information pertaining to an industry or an individual company. Such declines require further investigation by management. Acting upon the premise that a write-down may be required, management should consider all available evidence to evaluate the realizable value of its investment.
>
> There are numerous factors to be considered in such an evaluation and their relative significance will vary from case to case. The staff believes that the following are only a few examples of the factors which, individually or in combination, indicate that a decline is other than temporary and that a write-down of the carrying value is required:
>
> a. The length of the time and the extent to which the market value has been less than cost;
> b. The financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer such as changes in technology that may impair the earnings potential of the investment or the discontinuance of a segment of the business that may affect the future earnings potential; or
> c. The intent and ability of the holder to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in market value.
>
> Unless evidence exists to support a realizable value equal to or greater than the carrying value of the investment, a write-down to fair value accounted for as a realized loss should be recorded. In accordance with the guidance of paragraph 16 of Statement 115, such loss should be recognized in the determination of net income of the period in which it occurs and the written down value of the investment in the company becomes the new cost basis of the investment.

Accordingly, investors should consider an evaluation of the financial position of the USC and its ability to redeem the MSC or PIC within anticipated time frames. The staff believes the audited financial statements of the USC as of and for the year ended December 31, 2008 would be useful evidence to appropriately evaluate MSC or PIC for

[1] Emerging Issues Task Force Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets."

other-than-temporary impairment. The evaluation for impairment should consider the specific facts and circumstances, including consideration of the regulatory capital requirements of the USC. However, the staff does not believe that regulatory capital requirements should be the primary consideration for assessing whether impairment is other than temporary. As noted earlier in this question and answer, the NCUSIF has immediately written off the investment in the USC. The staff believes this action by the NCUSIF should be considered in the assessment of whether impairment is deemed to be other than temporary.

The staff also notes that a natural person credit union that invests in a corporate credit union whose direct investment may be impaired, should evaluate that investment for other-than-temporary impairment using the same guidance noted earlier. The staff notes that the evaluation for impairment in any of these cases should be determined in view of the specific facts and circumstances.