

Statutory Issue Paper No. 80

Debt

STATUS

Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 15

Type of Issue:

Common Area

SUMMARY OF ISSUE

1. Current statutory accounting guidance for debt is provided in the Accounting Practices and Procedures Manuals for Life and Accident and Health (Life/A&H Accounting Practices and Procedures Manual) and for Property and Casualty Insurance Companies (P & C Accounting Practices and Procedures Manual). This guidance provides that debt be reported at the unpaid amount at the balance sheet date. Loans secured by mortgages on company real estate are treated as a reduction from the asset value of such real estate. Additionally, debt obligations of Employee Stock Ownership Plans (“ESOP”) must be recorded as debt obligations of company sponsors, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company stock, contributions from the company or the sale or exchange of the company’s securities. See *Issue Paper No. 41—Surplus Notes* (Issue Paper No. 41) for discussion of surplus notes.

2. GAAP addresses accounting for debt in *Accounting Principles Board Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants* (APB 14), *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables* (APB 21), *Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt* (APB 26), *FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt* (FAS 4), *FASB Statement No. 47, Disclosure of Long Term Obligations* (FAS 47), *FASB Statement No. 76, Extinguishment of Debt* (FAS 76), *FASB Statement No. 84, Induced Conversions of Convertible Debt* (FAS 84) and in *AICPA Statement of Position 93-6, Employers’ Accounting for Employee Stock Ownership Plans* (SOP 93-6).

3. The purpose of this issue paper is to establish statutory accounting principles for debt that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

4. Debt shall be reported as a liability unless it is debt on real estate (i.e., reported as a reduction in the carrying value of real estate) in accordance with *Issue Paper No. 40—Real Estate Investments* (Issue Paper No. 40), or is offset against another asset in accordance with *Issue Paper No. 76—Offsetting and Netting of Assets and Liabilities* (Issue Paper No. 76) or is specified elsewhere within the codification. Instruments that meet the requirements to be recorded as surplus as specified in *Issue Paper No. 41—Notes*, are not considered debt. Interest on debt shall be accrued over the life of the debt and charged to operations, except when capitalized in accordance with *Issue Paper No. 44—Capitalization of Interest* (Issue Paper No. 44). Interest payable shall include interest payable on all debt reported as a liability, approved interest on surplus notes and interest payable on debt reported as a reduction in the carrying value of real estate.

5. Debt discount or premium, if any, shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. Such discount or premium shall be amortized over the life of the note using the interest method.
6. Debt issuance costs (i.e., loan fees, legal fees, etc.) do not meet the definition of an asset as defined in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* (Issue Paper No. 4). Accordingly, such costs shall be charged to operations.
7. Debt obligations of ESOPs shall be reported as borrowed money by company sponsors, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company stock, contributions from the company or the sale or exchange of the company's securities. ESOPs are addressed in *Issue Paper No. 78—Employee Stock Ownership Plans*.
8. Debt which is subject to a troubled debt restructuring shall be accounted for in accordance with *Issue Paper No. 36—Troubled Debt Restructurings* (Issue Paper No. 36).
9. Convertible debt securities that are convertible into common stock of the issuer or an affiliated company at a specified price at the option of the holder and which are sold at a price not significantly in excess of the face amount shall be accounted for solely as debt at the time of issuance. An expense shall be recognized, equal to the fair value of additional securities granted or other consideration issued to induce conversion subsequent to the issuance of convertible debt securities.
10. Proceeds from debt issued with detachable stock purchase warrants shall be allocated based on the relative fair value of the two securities at the time of issuance. The value attributable to the warrants shall be accounted for as paid-in capital.
11. Other types of debt securities shall be accounted for in accordance with the substance of the transaction.
12. Debt shall be considered extinguished if the debtor is relieved of primary liability for the debt by the creditor and it is probable that the debtor will not be required to make future payments as guarantor of the debt. Even if the creditor does not relieve the debtor of its primary obligation, such debt shall be considered extinguished if the debtor irrevocably places cash or other monetary assets (that are essentially risk free as to the amount, timing, and collection of interest and principal) in a trust to be used solely for satisfying scheduled payments of both interest and principal of a specific obligation and the possibility that the debtor will be required to make future payments with respect to that debt is remote. The monetary assets held by the trust shall provide cash flows (from interest and maturity of those assets) that approximately coincide, as to timing and amount, with the scheduled interest and principal payments on the debt that is being extinguished. Gains and losses from extinguishment of debt are capital gains or losses, and shall be charged to operations in accordance with *Issue Paper No. 24—Discontinued Operations and Extraordinary Items* (Issue Paper No. 24).
13. The financial statements or notes thereto shall disclose the following items related to debt:
 - date issued;
 - pertinent information concerning the kind of borrowing (e.g. debentures, commercial paper outstanding, bank loans, lines of credit, etc.);
 - face amount of the debt;
 - carrying value of debt;
 - the rate at which interest accrues;
 - the effective interest rate;
 - the combined aggregate amount of maturities and sinking fund requirements for each of the five years following the latest balance sheet presented;

- collateral requirements;
- a summary of significant debt terms and covenants and any violations;
- interest paid in the current year;
- if debt was considered to be extinguished by in-substance defeasance prior to the effective date of this issue paper and any of the debt remains outstanding, a general description of the transaction and the amount of debt that is considered extinguished at the end of the period; and
- if assets are set aside after the effective date of this issue paper solely for satisfying scheduled payments of a specific obligation, a description of the nature of restrictions placed on those assets

DISCUSSION

14. This issue paper adopts current statutory guidance for debt. It expands on current statutory guidance to address the accounting for debt discount and premium, debt issuance costs, convertible debt securities, debt issued with detachable stock purchase warrants and extinguishment of debt. It also expands current statutory guidance to address disclosure requirements regarding the carrying value of the debt, effective interest rate, combined aggregate amount of maturities and sinking fund requirements for each of the five years following the latest balance sheet presented and interest paid in the current year.

15. This issue paper adopts APB 14 and FAS 84. The requirement in paragraph 13 to disclose the aggregate amount of maturities and sinking fund requirements for each of the next five years is consistent with subparagraph 10b of *FASB Statement No. 47, Disclosure of Long Term Obligations*.

16. This issue paper adopts APB 21 with a modification to require that debt issuance costs be charged to operations. These costs represent deferred charges which are immediately expensed for statutory accounting, whereas GAAP requires that such costs be reported on the balance sheet as deferred charges and be recognized over the period of the borrowing as an adjustment to the effective interest rate. Immediately expensing debt issuance costs is consistent with the Statement of Concepts which states “Accounting treatments which tend to defer expense recognition do not generally represent acceptable SAP treatment”.

17. This issue paper rejects FAS 4 and *FASB Statement No. 64, Extinguishment of Debt Made to Satisfy Sinking Fund Requirements—an Amendment of FASB Statement No. 4*. This issue paper also rejects *FASB Emerging Issues Task Force No. 84-40, Long-Term Debt Repayable by a Capital Stock*.

18. This issue paper adopts APB 26 with modification to require that gains and losses from extinguishment of debt be reported as capital gains or losses, and charged to operations in accordance with Issue Paper No. 24. This issue paper adopts paragraphs 13 and 25 of SOP 93-6 with a modification to exclude debt obligations when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company’s stock, contributions from the company or the sale or exchange of the company’s securities. Such obligations do not meet the definition of liabilities (of the sponsor) as defined in *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets* (Issue Paper No. 5). This issue paper rejects paragraph 37 of SOP 93-6 as it relates to reporting gain and losses on extinguishment of debt. Such gains and losses shall be accounted for consistent with Issue Paper No. 24. SOP 93-6 will be addressed in its entirety in Issue Paper No. 78.

19. This issue paper adopts *FASB Emerging Issues Task Force No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion*, with a modification to reject guidance related to earnings per share and *FASB Technical Bulletin No. 80-1, Early Extinguishment of Debt through Exchange for Common or Preferred Stock*, with a modification to reject guidance related to classification of the loss as an extraordinary item.

20. Additionally, this issue paper adopts the following pronouncements which clarify and/or provide guidance in certain circumstance (such pronouncements are not reproduced herein due to length and limited scope):

Accounting Principles Board Opinion No. 12, paragraphs 16 and 17, Omnibus Opinion – 1967
AICPA Accounting Interpretations of APB 21, Interest on Receivables and Payables
AICPA Accounting Interpretations of APB 26, Early Extinguishment of Debt
FASB Emerging Issues Task Force No. 85-9, Revenue Recognition on Options to Purchase Stock of Another Entity
FASB Emerging Issues Task Force No. 85-17, Accrued Interest upon Conversion of Convertible Debt
FASB Emerging Issues Task Force No. 85-29, Convertible Bonds with a “Premium Put”
FASB Emerging Issues Task Force No. 86-8, Sale of Bad-Debt Recovery Rights
FASB Emerging Issues Task Force No. 86-15, Increasing-Rate Debt
FASB Emerging Issues Task Force No. 86-18, Debtor’s Accounting for a Modification of Debt Terms
FASB Emerging Issues Task Force No. 86-28, Accounting Implications of Indexed Debt Instruments
FASB Emerging Issues Task Force No. 86-36, Invasion of a Defeasance Trust
FASB Emerging Issues Task Force No. 95-15, Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount

21. This issue paper is consistent with the reporting for surplus notes as addressed in Issue Paper No. 41, the reporting of encumbrances on real estate as discussed in Issue Paper No. 40, the offsetting of assets and liabilities as addressed in Issue Paper No. 76 and the reporting of gains and losses on troubled debt restructurings as discussed in Issue Paper No. 36.

22. The conclusions above are consistent with the Statement of Concepts which states:

Objectives of Statutory Financial Reporting

The primary responsibility of each state insurance department is to regulate insurance companies in accordance with state laws with an emphasis on solvency for the protection of policyholders. The ultimate objective of solvency regulation is to ensure that policyholder, contractholder and other legal obligations are met when they come due and that companies maintain capital and surplus at all times and in such forms as required by statute to provide an adequate margin of safety. The cornerstone of solvency measurement is financial reporting. Therefore, the regulator’s ability to effectively determine relative financial condition using financial statements is of paramount importance to the protection of policyholders. An accounting model based on the concepts of conservatism, consistency, and recognition is essential to useful statutory financial reporting.

Drafting Notes/Comments

- Reverse repurchase agreements are addressed in *Issue Paper No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements*.
- Pledged assets are addressed in *Issue Paper No. 77—Disclosure of Accounting Policies, Risks & Uncertainties, and Other Disclosures*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

23. The P & C Accounting Practices and Procedures Manual includes the following guidance in Chapter 13 (only the pertinent excerpts are included below):

Borrowed Money

Borrowed money includes liabilities for loans except those secured by mortgages on company real estate and surplus loans. The amount to be reported is the amount unpaid at the balance sheet date. Resolution authorizing borrowed money are usually shown in the minutes of the board of directors, executive, investment, or finance committees.

Loans secured by mortgages on company real estate are treated as a reduction from the asset value of such real estate rather than as "Borrowed Money." For further discussion, see Chapter 4-Real Estate.

Surplus loans, i.e., subordinated surplus debentures, are covered in Chapter 24-Paid-In or Contributed Surplus.

Interest Payable

Interest payable includes interest on "Borrowed Money" as well as interest on real estate and surplus loans. It also includes interest on funds held as a deposit or security, such as those held by a ceding company against a reinsurer. Further treatment of funds held by a ceding company may be found in Chapter 22-Reinsurance.

The interest on "Borrowed Money" is also shown parenthetically as part of the caption of this liability item in the annual statement.

Debt Obligations of Employee Stock Ownership Plans (ESOP)

Insurance company sponsors of ESOP's must record the debt obligations of such ESOP's on the books of the company in all situations, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company's stock, contributions from the company, or the sale or exchange of the company's securities.

24. The Life/A&H Accounting Practices and Procedures Manual includes the following guidance in Chapter 17 (only the pertinent excerpts are included below):

Borrowed Money

Borrowed money is debt, other than subordinated surplus debentures, contribution notes, or similar indebtedness. The amount to be reported is the amount unpaid at the balance sheet date plus the related accrued interest. See Chapter 27 for a discussion of subordinated surplus debentures, etc.

Debt Obligations of Employee Stock Ownership Plans (ESOP)

Insurance company sponsors of ESOP's must record the debt obligations of such ESOP's on the books of the company in all situations, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company's stock, contributions from the company, or the sale or exchange of the company's securities.

25. The NAIC Annual Statement Instructions (Annual Statement Instructions) for Property and Casualty Insurance Companies provide the following guidance. Substantially similar guidance is provided in the Annual Statement Instructions for Life and Accident and Health Insurance Companies.

7. Borrowed Money

Instruction:

Furnish pertinent information concerning the kind of borrowing (e.g., debentures, commercial paper outstanding, bank loan, lines of credit, etc.). Indicate redemption price, if any, interest

features, collateral requirements, maturity date, etc., for money borrowed by the company. Also include information regarding material loan provisions (i.e., covenants) that must be satisfied or maintained on a continuing basis and indicate if the society is in violation of any such loan provisions. Identify the terms of reverse repurchase agreements whose amounts have been included in the liability for borrowed money.

Generally Accepted Accounting Principles

26. APB 14 provides the following guidance (only the pertinent excerpts are included below):

CONVERTIBLE DEBT

Discussion

3. Convertible debt securities discussed herein are those debt securities which are convertible into common stock of the issuer or an affiliated company at a specified price at the option of the holder and which are sold at a price or have a value at issuance not significantly in excess of the face amount. The terms of such securities generally include (1) an interest rate which is lower than the issuer could establish for nonconvertible debt, (2) an initial conversion price which is greater than the market value of the common stock at time of issuance, and (3) a conversion price which does not decrease except pursuant to antidilution provisions. In most cases such securities also are callable at the option of the issuer and are subordinated to nonconvertible debt.

7. The most important reason given for accounting for convertible debt solely as debt is the inseparability of the debt and the conversion option. A convertible debt security is a complex hybrid instrument bearing an option, the alternative choices of which cannot exist independently of one another. The holder ordinarily does not sell one right and retain the other. Furthermore the two choices are mutually exclusive; they cannot both be consummated. Thus, the security will either be converted into common stock or be redeemed for cash. The holder cannot exercise the option to convert unless he forgoes the right to redemption, and vice versa.

Opinion

12. The Board is of the opinion that no portion of the proceeds from the issuance of the types of convertible debt securities described in paragraph 3 should be accounted for as attributable to the conversion feature. In reaching this conclusion, the Board places greater weight on the inseparability of the debt and the conversion option (as described in paragraph 7) and less weight on practical difficulties.

DEBT WITH STOCK PURCHASE WARRANTS

Opinion

16. The Board is of the opinion that the portion of the proceeds of debt securities issued with detachable stock purchase warrants which is allocable to the warrants should be accounted for as paid-in capital. The allocation should be based on the relative fair values of the two securities at time of issuance.² Any resulting discount or premium on the debt securities should be accounted for as such.³ The same accounting treatment applies to issues of debt securities (issued with detachable warrants) which may be surrendered in settlement of the exercise price of the warrant. However, when stock purchase warrants are not detachable from the debt and the debt security must be surrendered in order to exercise the warrant, the two securities taken together are substantially equivalent to convertible debt and the accounting specified in paragraph 12 should apply.

² The time of issuance generally is the date when agreement as to terms has been reached and announced, even though the agreement is subject to certain further actions, such as directors' or stockholders' approval.
APB 14 Footnote 3

³ See Chapter 15 of ARB No. 43 (as amended by paragraph 19 of APB Opinion No. 6 and paragraph 17 of APB Opinion No. 9) and paragraphs 16 and 17 of APB Opinion No. 12.

17. When detachable warrants are issued in conjunction with debt as consideration in purchase transactions, the amounts attributable to each class of security issued should be determined separately, based on values at the time of issuance.² The debt discount or premium is obtained by comparing the value attributed to the debt securities with the face amount thereof.

OTHER TYPES OF DEBT SECURITIES

Opinion

18. The Board recognizes that it is not practicable in this Opinion to discuss all possible types of debt with conversion features, debt issued with stock purchase warrants, or debt securities with a combination of such features. Securities not explicitly discussed in this Opinion should be dealt with in accordance with the substance of the transaction. For example, when convertible debt is issued at a substantial premium, there is a presumption that such premium represents paid-in capital.

27. APB 21 provides the following guidance (only the pertinent excerpts are included below):

Opinion

15. Amortization of discount and premium. With respect to a note which by the provisions of this Opinion requires the imputation of interest, the difference between the present value and the face amount should be treated as discount or premium⁸ and amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period. This is the “interest” method described in and supported by paragraphs 16 and 17 of *APB Opinion No. 12, Omnibus Opinion--1967*. However, other methods of amortization may be used if the results obtained are not materially different from those which would result from the “interest” method.

⁸ Differences between the recognition for financial accounting purposes and income tax purposes of discount or premium resulting from determination of the present value of a note should be treated as timing differences in accordance with *APB Opinion No. 11, Accounting for Income Taxes*.

16. Statement presentation of discount and premium. The discount or premium resulting from the determination of present value in cash or non-cash transactions is not an asset or liability separable from the note which gives rise to it. Therefore, the discount or premium should be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. It should not be classified as a deferred charge or deferred credit. The description of the note should include the effective interest rate; the face amount should also be disclosed in the financial statements or in the notes to the statements.⁹ Amortization of discount or premium should be reported as interest in the statement of income. Issue costs should be reported in the balance sheet as deferred charges.

⁹ Refer to the Appendix for illustrations of balance sheet presentation.

28. APB 26 provides the following guidance (only the pertinent excerpts are included below):

Opinion

19. Reduction of alternatives. The Board concludes that all extinguishments of debt before scheduled maturities are fundamentally alike. The accounting for such transactions should be the same regardless of the means used to achieve the extinguishment.

20. Disposition of amounts. A difference between the reacquisition price and the net carrying amount of the extinguished debt should be recognized currently in income of the period of extinguishment as losses or gains and identified as a separate item.¹ The criteria in *APB Opinion No. 9* should be used to determine whether the losses or gains are ordinary or extraordinary items. Gains and losses should not be amortized to future periods.

¹ If upon extinguishment of debt, the parties also exchange unstated (or stated) rights or privileges, the portion of the consideration exchanged allocable to such unstated (or stated) rights or privileges should be given appropriate accounting recognition. Moreover, extinguishment transactions between related entities may be in essence capital transactions.

21. Convertible debt. The extinguishment of convertible debt before maturity does not change the character of the security as between debt and equity at that time. Therefore, a difference between the cash acquisition price of the debt and its net carrying amount should be recognized currently in income in the period of extinguishment as losses or gains.
29. FAS 47 provides the following guidance (only the pertinent excerpts are included below):
10. The following information shall be disclosed for each of the five years following the date of the latest balance sheet presented:
- b. The combined aggregate amount of maturities and sinking fund requirements for all long-term borrowings
30. FAS 84 provides the following guidance (only the pertinent excerpts are included below):

APPLICABILITY AND SCOPE

2. This Statement applies to conversions of convertible debt to equity securities pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance (including changes that involve the payment of consideration) for the purpose of inducing conversion. This Statement applies only to conversions² that both (a) occur pursuant to changed conversion privileges that are exercisable only for a limited period of time and (b) include the issuance of all of the equity securities issuable pursuant to conversion privileges included in the terms of the debt at issuance for each debt instrument that is converted. The changed terms may involve reduction of the original conversion price thereby resulting in the issuance of additional shares of stock, issuance of warrants or other securities not provided for in the original conversion terms, or payment of cash or other consideration to those debt holders who convert during the specified time period. This Statement does not apply to conversions pursuant to other changes in conversion privileges or to changes in terms of convertible debt instruments that are different from those described in this paragraph.

² For purposes of this Statement, a conversion includes an exchange of a convertible debt instrument for equity securities or a combination of equity securities and other consideration, whether or not the exchange involves legal exercise of the contractual conversion privileges included in terms of the debt.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Recognition of Expense upon Conversion

3. When convertible debt is converted to equity securities of the debtor pursuant to an inducement offer described in paragraph 2 of this Statement, the debtor enterprise shall recognize an expense equal to the fair value of all securities and other consideration transferred in the transaction in excess of the fair value of securities issuable pursuant to the original conversion terms. The expense shall not be reported as an extraordinary item.
4. The fair value of the securities or other consideration shall be measured as of the date the inducement offer is accepted by the convertible debt holder. Normally this will be the date the debt holder converts the convertible debt into equity securities or enters into a binding agreement to do so.
31. SOP 93-6 provides the following guidance related to debt obligations of ESOPs (only the pertinent excerpts are included below):

Leveraged ESOPs

12. Unlike other kinds of employee benefit plans, an ESOP is permitted by ERISA to borrow from a related party or with the assistance of a related party. A leveraged ESOP borrows money to acquire shares of the employer company. The debt usually is collateralized by the employer's shares. The shares initially held by the ESOP in a suspense account are called *suspense shares*.⁴ The debt is generally repaid by the ESOP from employer contributions and dividends on the employer's stock. As the debt is repaid, suspense shares are released from the suspense account, and the released shares must be allocated to individual accounts as of the end of the ESOP's fiscal year. The money can be borrowed by the ESOP from the sponsor, with or without a related outside loan, or directly from an outside lender. Outside loans to the ESOP are generally guaranteed by the sponsor.

⁴ Terms defined in the glossary are in italicized type the first time they appear in this SOP.

Reporting the Purchase of Shares by ESOPs

13. An employer should report the issuance of shares or the sale of treasury shares to an ESOP when they occur and should report a corresponding charge to unearned ESOP shares, a contra-equity account. That account should be presented as a separate item in the balance sheet. Furthermore, even if a leveraged ESOP buys outstanding shares of employer stock on the market rather than from the employer, the employer should charge unearned ESOP shares and credit either cash or debt, depending on whether the ESOP is internally or externally leveraged (see paragraph 24).

Reporting of Debt and of Interest

24. For purposes of applying this SOP, ESOP debt is characterized as follows:

- *Direct loan* - A loan made by a lender other than the employer to the ESOP. Such loans often include some formal guarantee or commitment by the employer.
- *Indirect loan* - A loan made by the employer to the ESOP, with a related outside loan to the employer.
- *Employer loan* - A loan made by the employer to the ESOP, with no related outside loan.

ESOPs with indirect loans and employer loans are often referred to as internally leveraged.

25. Employers that sponsor an ESOP with a direct loan should report the obligations of the ESOP to the outside lender as liabilities. Furthermore, employers should accrue interest cost on the debt and should report cash payments to the ESOP that are used by the ESOP to service debt, regardless of whether the source of cash is employer contributions or dividends, as reductions of the debt and accrued interest payable when the ESOP makes the payments to the outside lender.

26. Employers that sponsor an ESOP with an indirect loan should report outside loans as liabilities. Employers should not report a loan receivable from the ESOP as an asset and should, therefore, not recognize interest income on such receivable. Employers should accrue interest cost on the outside loan and should report loan payments as reductions of the principal and accrued interest payable. Contributions to the ESOP and the concurrent payments from the ESOP to the employer for debt service would not be recognized in the employer's financial statements.

27. Employers that sponsor an ESOP with an employer loan should not report the ESOP's note payable and the employer's note receivable in the employer's balance sheet. Accordingly, employers should not recognize interest cost or interest income on an employer loan.

Accounting for Terminations

35. Upon termination of a leveraged ESOP, either in whole or in part, all outstanding debt related to the shares being terminated must be repaid or refinanced. An ESOP may repay the debt using an employer contribution to the plan, dividends on ESOP shares, the proceeds from selling suspense shares to the employer or to another party, or some combination of these. The law limits the shares employers may reacquire to the number of shares with a fair value equal to the applicable unpaid debt and requires that the remaining shares, if any, be allocated to participants.

36. If the employer makes a contribution to the ESOP or pays dividends on unallocated shares that are used by the ESOP to repay the debt, the employer should charge the debt and accrued interest payable when the ESOP makes the payment to the outside lender. Similarly, an employer sponsoring a ESOP with an indirect loan should report loan repayments as reductions of the debt and accrued interest payable.

37. If the ESOP sells the suspense shares and used the proceeds to repay the debt, the employer should report the release of the suspense shares as a credit to unearned ESOP shares based on the cost of the shares to the ESOP, charge debt, and accrued interest payable, and recognize the difference in paid-in capital. However, if there is a difference between the amount paid to an outside lender and the net carrying amount of the debt, paragraph 20 of *APB Opinion No. 26, Early Extinguishment of Debt*, as amended by *FASB Statement of Financial Accounting Standards No. 4, Reporting Gains and Losses from Extinguishment of Debt*, requires that difference to be included in the employer's income when the debt is extinguished.

38. If an employer reacquires the suspense shares from the ESOP, the purchase of the shares should be accounted for as a treasury stock transaction. The treasury stock should be reported at the fair value of the shares at the reacquisition date. Unearned ESOP shares should be credited for the cost of the shares, and the difference should be recognized in additional paid-in capital.

39. If the fair value of the suspense shares on the termination date is more than the unpaid debt balance, the release of the remaining suspense shares to participants should be charged to compensation in accordance with paragraphs 14 to 18 of this SOP. That is, compensation cost should equal the fair value of the shares at the date the ESOP debt is extinguished, because that is when the shares are committed to be released.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manuals for Life and Accident and Health Insurance Companies, Chapter 4, Real Estate and Chapter 17, Other Liabilities
- Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies, Chapter 4, Real Estate and Chapter 13, Other Liabilities
- NAIC Annual Statement Instructions for Property and Casualty Insurance Companies
- NAIC Annual Statement Instructions for Life and Accident and Health Insurance Companies
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 5—Definition of Liabilities, Loss Contingencies and Impairments of Assets*
- *Issue Paper No. 23—Property Occupied by the Company*
- *Issue Paper No. 24—Discontinued Operations and Extraordinary Items*
- *Issue Paper No. 36—Troubled Debt Restructurings*
- *Issue Paper No. 40—Real Estate Investments*

- *Issue Paper No. 41—Surplus Notes*
- *Issue Paper No. 44—Capitalization of Interest*
- *Issue Paper No. 45—Repurchase Agreements, Reverse Repurchase Agreements and Dollar Repurchase Agreements*
- *Issue Paper No. 76—Offsetting and Netting of Assets and Liabilities*

Generally Accepted Accounting Principles

- *Accounting Principles Board Opinion No. 12, paragraphs 16 and 17, Omnibus Opinion – 1967*
- *Accounting Principles Board Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*
- *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables*
- *Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt*
- *FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt*
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- *FASB Statement No. 84, Induced Conversions of Convertible Debt*
- *AICPA Statement of Position 93-6, Employers’ Accounting for Employee Stock Ownership Plans*
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- *FASB Emerging Issues Task Force No. 84-40, Long-Term Debt Repayable by a Capital Stock*
- *FASB Emerging Issues Task Force No. 85-9, Revenue Recognition on Options to Purchase Stock of Another Entity*
- *FASB Emerging Issues Task Force No. 85-17, Accrued Interest upon Conversion of Convertible Debt*
- *FASB Emerging Issues Task Force No. 85-29, Convertible Bonds with a “Premium Put”*
- *FASB Emerging Issues Task Force No. 86-8, Sale of Bad-Debt Recovery Rights*
- *FASB Emerging Issues Task Force No. 86-15, Increasing-Rate Debt*
- *FASB Emerging Issues Task Force No. 86-18, Debtor’s Accounting for a Modification of Debt Terms*
- *FASB Emerging Issues Task Force No. 86-28, Accounting Implications of Indexed Debt Instruments*
- *FASB Emerging Issues Task Force No. 86-36, Invasion of a Defeasance Trust*
- *FASB Emerging Issues Task Force No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion*
- *FASB Emerging Issues Task Force No. 95-15, Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount*
- *FASB Technical Bulletin No. 80-1, Early Extinguishment of Debt through Exchange for Common or Preferred Stock*

State Regulations

- No additional guidance obtained from state statutes or regulations.