Q&A 91—A Guide to Implementation of Statement 91 on Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases: Questions and Answers

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Revised: December 1998; September 2001; October 2002; June 2006
Authored by: Christopher S. Lynch *(1)

Introduction

In December 1986, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases.

The Board cannot anticipate all of the implementation questions that may arise for a particular Statement and provide answers to those questions when the Statement is issued. Accordingly, questions of implementation often are raised with the FASB staff by preparers, auditors, and others. Because of the unusually high number of inquiries received, the FASB staff determined that this Special Report should be issued as an aid in understanding and implementing Statement 91.

The questions and answers in this Special Report are organized by the paragraphs in Statement 91 to which the questions relate. Illustrations are included as necessary to supplement the answers.

Q&A 91 Questions and Answers

Questions on ♦ Paragraph 2 of Statement 91

1. Q—Does FASB Statement No. 91, Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, apply to "lending activities" and loan purchases that do not involve fees?

   A—Yes. The Statement applies to all "lending activities" and purchases of loans and other debt securities whether or not fees are involved. Many types of loans, as well as leases, may not have fees but do have costs associated with the origination of the loan or lease.

2. Q—Does Statement 91 require deferral of direct loan origination costs even though no fees are collected?

   A—Yes. Statement 91 requires that net fees and costs be deferred and subsequently amortized. ♦ Paragraphs 6 and ♦ 35-44 set forth the types of costs that qualify for deferral.

3. Q—Are fees received for providing commercial letters of credit covered by Statement 91?

   A—Yes. Such fees are considered commitment fees, and the accounting is specified in ♦ paragraph 8.
Questions on Paragraph 3 of Statement 91

Paragraph 3 specifies that nonrefundable fees and costs associated with loans carried at market value are excluded from the scope of the Statement.

4. Q—What is meant by the term *carried at market value, if the changes in market value are included in earnings*?[Revised 12/98.]

A—The exclusion provided in paragraph 3 and explained in paragraph 34 refers to a basis of accounting. Thus, the exclusion applies to nonrefundable fees and costs associated with originating loans that are reported at market value and premiums or discounts associated with acquiring loans that are reported at market value. Loans that are reported at cost or the lower of cost or market, loans or debt securities reported at market value with changes in value reported in other comprehensive income (includes financial assets subject to prepayment as defined in paragraph 14 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, a and debt securities classified as available-for-sale under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*), and loans that have a market interest rate, or adjust to a market interest rate, are not considered to be loans carried at market value. In addition, loans designated as a hedged item in a fair value hedge under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, are not outside the scope of Statement 91 (see paragraph 495 of Statement 133). The following table outlines the applicability of Statement 91 to various types of assets: [Revised 12/98; 9/01.]

<table>
<thead>
<tr>
<th>Types of Assets</th>
<th>Basis of Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loans or debt securities held in an investment portfolio</td>
<td>Historical or amortized cost</td>
</tr>
<tr>
<td>Loans held for sale</td>
<td>Lower of cost or market</td>
</tr>
<tr>
<td>Loans or debt securities held in trading accounts by certain financial institutions</td>
<td>Market value, changes in value are included in earnings</td>
</tr>
<tr>
<td>Loans or debt securities, available-for-sale 1(3)</td>
<td>Market value, changes in value reported in other comprehensive income</td>
</tr>
</tbody>
</table>

[Revised 12/98.]

5. Q—In automotive lending, it is common practice for a lending institution to pay a fee to an auto dealer for introducing a customer that requires financing for a completed auto sale. Generally, the lender pays the dealer up front an amount equal to the present value of the interest rate differential between the lender's standard loan rate and the rate charged to the auto dealer's customer with the expectation of recovering this amount from the borrower over time. Because this origination cost is recoverable from the borrower, is it excluded from the scope of Statement 91?

A—No. Statement 91 does not apply to costs that are incurred by a lender in transactions with independent third parties if the lender bills those costs directly to the borrower. In this case, however, the payments to the auto dealer are not billed directly to the borrower. Instead, they are recovered from the borrower through the interest rate charged to the borrower, as are the lender's other costs. (Paragraphs 6 and 39-42 provide guidance for what constitutes incremental direct...
6. **Q**—A lender may receive fees for lending transactions unrelated to the origination of loans. For example, a borrower may pay a fee to the lender for extending the contractual maturity of an existing loan, for converting an adjustable-rate mortgage (ARM) to a fixed-rate loan, or for the assumption of an existing loan by a new borrower. How should a lender account for the fees collected?

**A**—The fees should be recognized over the remaining life of the loan as an adjustment of yield. In each situation, the lender has made some form of concession to the initial or underlying borrower by altering the original terms of the initial underwriting; thus, any fees received should be recognized as an adjustment of yield over the remaining life of the loan.

7. **Q**—Do the provisions of Statement 91 apply to interest and principal-only securities?

**A**—Yes, provided that the interest and principal-only securities are not required to be carried at market value, with changes in value reflected in earnings, under other applicable accounting literature (refer to ♦ paragraph 14 of Statement 140 for additional information). ♦ Interest and principal-only securities represent interests in a loan. ♦ Paragraph 33 of Statement 91 indicates that an enterprise may acquire an investment in a loan or other interest-earning asset by lending or by purchasing. ♦ EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets," provide additional guidance for certain interest-only securities. [Revised 12/98; 9/01; 6/06.]

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**Question on ♦ Paragraph 4 of Statement 91**

8. **Q**—When choosing between accounting for individual loans or aggregating similar loans as provided by paragraph 4, must a lender apply the method chosen to each type of loan?

**A**—No. Paragraph 4 provides that the Statement shall be applied to individual loan contracts unless the provisions of ♦ paragraph 19 are met or if the resulting recognition does not differ materially from the amount that would have been recognized on an individual loan-by-loan basis. Thus, accounting for each loan separately is always appropriate. For loans that do qualify under paragraph 19, a lender may use either method for different loans and select the most appropriate method for a group of loans based on the characteristics of those loans. (For example, homogeneous mortgage loans might be aggregated while construction loans are accounted for separately.) However, once a lender has selected the appropriate method of accounting for a loan or a group of loans, a lender must continue to use the method throughout the life of the loan or group of loans.

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**Questions on ♦ Paragraphs 6 and 7 of Statement 91**

9. **Q**—What are "independent third parties" as contemplated by paragraph 6?

**A**—♦ Paragraph 41 indicates that judgment may be necessary to determine if a third party is independent. However, independent third parties generally possess the following characteristics:

- They are not employees of the lender.
- They are not receiving employee benefits of the lender.
- The party is not under the control of the lender. (♦ Paragraph 24(b) of FASB Statement No. 57, *Related Party Disclosures*, defines control as "the possession, direct or indirect, of the
power to direct or cause the direction of the management and policies of an enterprise through ownership, by contract, or otherwise.”)

- Generally, the party also would provide similar services to other entities unrelated to the lender, and there would not be an agreement between the lender and the party that precludes the party from providing similar services to other entities.

10. Q—Could an entity that provided loan origination-related services on behalf of the lender be considered an independent third party if the lender has an ownership or equity interest in the entity?

A—Such an interest should be evaluated based on the level of ownership and influence that could be imposed. Generally, the existence of an ownership interest indicates a relationship that would not qualify as an independent third party. A nominal passive investment from the standpoint of both the lender and the provider of service probably would not affect the provider’s independence.

11. Q—Assume an enterprise utilizes a third party for loan originations. The third party is not considered an "independent third party" for several reasons but also is not an employee of the enterprise. May the enterprise defer costs associated with specified activities as if the third party were an employee?

A—The enterprise should defer those costs directly related to specified activities that can be determined to meet the criteria of ♦ paragraph 6(b) as long as those costs would not have been incurred but for that loan.

12. Q—What costs could be considered "other costs related to those activities [specified in ♦ paragraph 6] that would not have been incurred but for that loan" and eligible for deferral over the life of the loan?

A—Examples of other direct loan origination costs that may be deferred under paragraph 6 for loans that are granted include:

- Reimbursement of costs for air travel, hotel accommodations, automobile mileage, and similar costs incurred by personnel relating to the specified activities
- Costs of itemized long-distance telephone calls related to loan underwriting
- Reimbursement for mileage and tolls to personnel involved in on-site reviews of collateral before the loan is granted.

13. Q—What is the proper accounting for fees paid to independent third parties for advisory services regarding loan origination activities? What if those same activities are performed internally?

A—Such expenses are not considered to be incurred for the "specified activities" set forth in ♦ paragraph 6 and should be charged to expense as incurred whether paid to independent third parties or performed internally.

14. Q—Does a lender's data processing equipment dedicated to originating loans qualify as "other costs" subject to deferral under ♦ paragraph 6?

A—No. ♦ Paragraph 7 specifies that equipment costs, depreciation, and maintenance must be charged to expense as incurred. Those costs do not meet the criteria for deferral set forth in paragraph 6 as they would have been incurred whether or not a loan was originated.

15. Q—Are costs for software dedicated to loan processing and origination eligible for deferral under ♦ paragraph 6?
A—No. Such costs are not "other costs related to those activities that would not have been incurred but for that loan" as contemplated by paragraph 6.

16. Q—What are examples of payroll-related fringe benefits contemplated by ♦ paragraph 6?

A—Payroll-related fringe benefits include any costs incurred for employees as part of the total compensation and benefits program. Examples of such benefits include:

• Payroll taxes
• Dental and medical insurance
• Group life insurance
• Retirement plans
• 401(k) plans
• Stock compensation plans, such as stock options and stock appreciation rights
• Overtime meal allowances.

17. Q—Are fees paid to a service bureau for loan processing eligible for deferral under ♦ paragraph 6?

A—No. If the services were performed after the loan has already been made, the costs are not origination costs.

18. Q—Are bonuses based on successful production of loans that are paid to employees involved in loan origination activities deferrable under ♦ paragraph 6?

A—Partially. Bonuses are part of an employee's total compensation. The portion of the employee's total compensation that may be deferred is the portion that (a) is directly related to time spent on the activities specified in paragraph 6 and (b) results in the origination of a loan.

19. Q—If compensation for an employee traditionally paid by salary or hourly wage is switched wholly or partially to commissions on successful loan production, would all such costs be deferrable under ♦ paragraph 6?

A—No. As specified in the preceding answer, only the portion of the employee's total compensation directly related to time spent on activities specified in paragraph 6 for completed loans would be deferred. Commission-based compensation arrangements between a lender and its employees may be similar to arrangements a lender may have with independent third parties such as loan brokers. However, when origination activities are performed by the lender's employees, the lender must allocate compensation costs applicable to the activities specified in paragraph 6 based on the portion of time spent by employees. An allocation of the employees' total compensation between origination and other activities is made so that only those costs associated with those lending activities identified in paragraph 6 are deferred for completed loans, even if commissions are 100 percent of such compensation and are based solely on completed loan transactions.

20. Q—What are examples of "specified activities" as contemplated by ♦ paragraph 6?

A—The following are examples of "specified activities":

• Loan counseling, such as discussing alternative borrowing arrangements with borrowers, and negotiating terms
• Application processing
• Appraisal

Superseded by the FASB Accounting Standards Codification on July 1, 2009.
• Initial credit analysis
• Initial credit investigation
• Quality control review performed during the underwriting period
• Direct approval processing
• Loan evaluation and approval committees (all activities involved in origination decisions)
• Loan closing.

21. Q—Does Statement 91 permit an entity to use a standard costing system to determine its direct loan origination costs to be deferred at the time of origination? If so, what methods of costing could be used?

A—Statement 91 does not specify how costs are to be determined but rather what costs must be deferred. In many instances, standard costing may be used to estimate the costs to be deferred in accordance with the provisions of the Statement. For certain loans, the cost of origination may be similar and standard costing may be appropriate for those loans, while other loans may be of such a nature that costs must be identified separately. Lenders may use any one or a combination of methods that will provide adequate information to report financial results in accordance with Statement 91. Development of a standard costing system will require periodic analysis of variances and, if necessary, adjustment of standard costing estimates. Possible standard cost methods that may be used to measure costs applicable to transactions that have occurred include standard costs, actual costs, job process (for example, homogeneous loans), or job order (for example, specific loans).

22. Q—In developing a standard cost system, should a successful-efforts accounting notion be utilized at the functional level or at an enterprise-wide level?

A—The successful-efforts accounting notion utilized at an enterprise-wide level may result in a standard cost system that does not accurately reflect the amount of costs that may be deferred and amortized under the provisions of Statement 91. Successful loan efforts can be determined as a percentage of each function (for example, application, verification, underwriting, appraisal, closing) and may be based on the percentage, adjusted for idle time and time spent on activities for which the related costs cannot be deferred, of successful and unsuccessful efforts determined for each function.

23. Q—Paragraph 7 requires that employees’ compensation and fringe benefits related to idle time be charged to expense as incurred. What is idle time and how can it be measured?

A—Idle time represents the time that a lender's employees are not actively involved in performing origination activities for specific loans. Idle time can be caused by many factors, including lack of work, delays in work flow, and equipment failure. Idle time can be measured through the establishment of standard costs, time studies, ratios of productive and nonproductive time, and other methods.

24. Q—May the portion of executive salaries and benefits of individuals directly related to the origination of loans be considered part of direct loan origination costs?

A—Yes. The portion of total compensation of executive employees that relates directly to the time spent approving successful loans prior to funding may be deferred under ¶ paragraph 6. For example, the amount of compensation allocable to time spent by members of a loan approval committee is a component of direct loan origination costs.

Questions on ¶ Paragraph 8 of Statement 91
25. Q—Is it necessary to distinguish between commitment fees and origination fees for accounting purposes?

A—Yes. Certain commitment fees as prescribed under paragraph 8(a) are amortized on a straight-line basis as service fee income. Origination fees, commitment fees other than those meeting the exceptions in paragraph 8, and other fees are recognized as adjustments of yield and reported as interest income. As a result, it is necessary to distinguish between the types of fees. However, once a loan is made, there is no need to continue that distinction; all fees are deferred and amortized as a yield adjustment.

26. Q—If qualifying costs associated with commitments exceed commitment fees received (or if no fee is charged), may the resulting net cost be deferred?

A—it depends. Statement 91 applies to both nonrefundable fees and costs, and paragraphs 8 and 9 may require that the net of such items be deferred. However, if the likelihood that the commitment will be exercised is remote, any net costs should be charged to expense immediately rather than deferred and amortized on a straight-line basis over the commitment period.

27. Q—The amount of a commitment fee is determined retrospectively as a percentage of the line of credit or commitment available but unused in a previous period. The fee is paid periodically during the life of the facility or commitment, but the costs are incurred when the lender establishes the facility or commitment. How should a lender account for those costs?

A—it depends. Costs that meet the criteria of paragraph 6 should be deferred and amortized based on the terms of the line of credit or commitment facility. If the commitment agreement is a revolving line of credit, the qualifying costs should be recognized in income on a straight-line basis over the period that the revolving line of credit is active. If the loan agreement provides the borrower with the option to convert the revolving line of credit to a term loan, the lender should recognize the costs on a straight-line basis over the combined life of the revolving line of credit and term loan. If the line of credit or commitment facility is not a revolving line of credit, the costs should be deferred and amortized on a straight-line basis over the commitment period unless the likelihood that the commitment will be exercised is remote, in which case any net costs should be charged to expense immediately.

28. Q—A credit facility provides for the extension of multiple, unscheduled drawdowns (or loans) with varying maturities. If the facility does not have the characteristics of a revolving line of credit (for example, repayments of amounts borrowed are not available for reborrowing) and drawdowns are anticipated, how should a commitment fee be recognized?

A—the commitment fee should be deferred until the facility is exercised and a drawdown is made. Given the multiple, unscheduled drawdowns intended under the facility, a pro rata portion of the commitment fee (equal to the percentage of the loan drawn down to the total facility) should be recognized over the life of the applicable drawdown as an adjustment of its yield.

For example, assume that a commitment fee net of deferrable costs of $100,000 is received at the inception of a 2-year facility of $10,000,000 that permits the borrower to make multiple, unscheduled drawdowns of varying maturities during the 2-year commitment period. Assume then that the borrower draws down a $1,000,000 loan due in 3 years in the fourth month of the 2-year commitment period. Assume further that the borrower draws down another $2,000,000 loan due in 5 years in the sixth month of the commitment period. The remainder of the facility expires unused. The commitment fee would be recognized as follows:

• *At inception of the facility:*
Qualifying costs to establish the credit facility would be deferred, and no fee income would be recognized because the entire fee is deferred until a drawdown occurs.

- **Months 1-3:**
  No net fee income would be recognized because no drawdowns have occurred.

- **Month 4:**
  A pro rata portion of the net commitment fee equal to the ratio of the drawdown to the total facility would be recognized over the life of the drawdown as an adjustment of yield.

  In this example:

  \[
  \text{Current drawdown/Total facility x Net commitment fee} = \text{Amount to be recognized over the life of the drawdown as a yield adjustment}
  \]

  For example:

  \[
  \$1,000,000/\$10,000,000 \times \$100,000 = \$10,000
  \]

- **Month 6:**
  Similar to the preceding illustration, a pro rata portion of the deferred net fee equal to the ratio of the current drawdown to the total facility would be recognized over the life of the drawdown as an adjustment of yield.

  In this example:

  \[
  \$2,000,000/\$10,000,000 \times \$100,000 = \$20,000
  \]

- **Months 7-23:**
  No additional net fee income other than amortization of net commitment fees recognized as yield adjustments would be recognized because no further drawdowns have occurred; thus, the remaining $70,000 net commitment fee would continue to be deferred.

- **Month 24:**
  The remaining deferred net commitment fee of $70,000 would be recognized in income upon expiration of the facility because additional drawdowns are not possible.

29. **Q**—Some lenders offer loan commitments known as "multi-option facilities." Those facilities contain several credit structures that borrowers may use in any combination. The lenders may receive a variety of fees in connection with that type of facility. Some fees may be yield related (for example, fees for providing back-up facilities or revolvers), while others may be labeled as compensation for services rendered (for example, management fees or note placement fees). How should those various fees be accounted for under Statement 91? If certain of the fees are to be deferred, over what period should they be amortized?

   **A**—Generally, in accordance with ◆ paragraph 8, all fees must be deferred. For amortization purposes, fees received for a multi-option facility should be allocated to each product in the facility because the amortization of certain fees must be reported as service fee income while the amortization of other fees must be reported as interest income. If a portion of the fee is for a line of credit product, the fee allocated should be recognized in income on a straight-line basis over the period the revolving line of credit is active. If the likelihood that a commitment provided under a multi-option facility will be exercised is remote, paragraph 8(a) requires that the fee be recognized over the commitment period on a straight-line basis as service fee income.

**Question on ◆ Paragraph 9 of Statement 91**
30. **Q**—How should an enterprise account for costs associated with loan originations on loans that have not yet been closed?

**A**—Judgment is required to estimate the number of loans in process that will result in a successful loan origination. Origination costs on a loan in process may be deferred until the loan is either closed or considered an unsuccessful effort. If a loan in process is determined to be unsuccessful after the balance sheet date but before the financial statements are issued, costs that have been deferred through the balance sheet date should be charged to expense in the period ending with the balance sheet date.

**Questions on ♦ Paragraph 10 of Statement 91**

31. **Q**—What period and method should be used to amortize costs associated with credit card originations?

**A**—Only the costs of origination that qualify under ♦ paragraph 6 would be eligible for deferral. All other costs should be charged to expense as incurred. Therefore, costs eligible for deferral would likely exceed fees only when a credit card is first issued.

Credit card origination costs should be netted against the related credit card fee, if any, and the net amount should be amortized on a straight-line basis over the privilege period. In situations where a significant fee is charged, the privilege period is the period that the fee entitles the cardholder to use the credit card. If there is no significant fee, the privilege period should be one year. Significance for this purpose should be evaluated based on the amount of the fee relative to the related costs. Refer to EITF Issues ♦ No. 92-5, "Amortization Period for Net Deferred Credit Card Origination Costs" and ♦ No. 93-1, "Accounting for Individual Credit Card Acquisitions," for additional information. [Revised 12/98.]

32. **Q**—In a typical credit card solicitation effort, an issuer engages an independent third party to solicit and obtain new customers. For a fee, the solicitor prepares and mails the promotional offer to a group of preselected consumers (for example, 1 million consumers). The expected response rate for new cardholders is generally 1 to 2 percent. If only a small percentage of the total solicitation effort is expected to be successful, may the portion of the solicitation performed by an independent third party that is allocable to successful efforts be deferred in accordance with ♦ paragraph 6?

**A**—No. Incremental direct costs to originate a loan are costs that the lender would not have incurred if that lending transaction had not occurred. In this example, the lender would have incurred all of the solicitation costs regardless of the number of credit cards issued. Accordingly, all costs in this example should be charged to expense.

33. **Q**—A financial institution purchases for cash the credit card portfolio of another financial institution at a premium. What period should be used to amortize the premium?

**A**—[Please refer to EITF ♦ Issue No. 88-20, "Difference between Initial Investment and Principal Amount of Loans in a Purchased Credit Card Portfolio," as partially nullified by FASB Statement No. 142, *Goodwill and Other Intangible Assets.*] [Revised 5/03.]

**Questions on ♦ Paragraph 11 of Statement 91**

34. **Q**—In conjunction with management of a syndication and retention of a portion of the syndicated loan, how should the syndicator account for the syndication fee if the yield on the portion of the loan retained by the syndicator is equal to or greater than the average yield to the other syndication
participants?

A—Such fees should be recognized by the syndicator when the syndication is complete under the syndicator's method of accounting for those fees prior to Statement 91.

35. Q—How should net fees and costs associated with a loan participation be accounted for by the originating lender? How should costs associated with purchasing a loan participation be accounted for by a purchaser?

A—For the originator, net fees and costs would become a component of the net loan investment balance to be used in calculating the gain or loss on a subsequent sale as described in ¶ paragraph 16. Costs incurred in connection with acquiring loans or committing to purchase loans, including a participation, should be charged to expense in accordance with ¶ paragraph 15. Refer to EITF ¶ Issue No. 97-3, "Accounting for Fees and Costs Associated with Loan Syndications and Loan Participations after the Issuance of FASB Statement No. 125," for additional information. [Revised 12/98.]

Questions on ¶ Paragraphs 12 - 14 of Statement 91

36. Q—Because of a decline in general interest rates, a lender reduces the interest rate on an existing loan and collects a loan fee. Because the interest rate modification does not require another loan closing, the borrower is not charged many of the standard closing costs. Assuming the transaction is not a troubled debt restructuring, is the arrangement a refinancing or a minor modification for purposes of ¶ paragraphs 12 and 13?

A—The effective yield on the new loan should be compared with the effective yield of comparable loans to the lender's other new customers to determine whether the yield on the new loan is at least as favorable as the effective yield for such loans. If so, the guidance in ¶ EITF Issue No. 01-7, "Creditor's Accounting for a Modification or Exchange of Debt Instruments," should be used to determine whether the modification is considered more than minor under paragraph 13. If not, the unamortized net fees and costs from the original loan and any prepayment penalties should be carried forward as part of the net investment in the new loan. However, if the interest rate modification is provided for in the original loan contract, the change in the interest rate should be accounted for in accordance with ¶ paragraph 18 and not considered a refinancing for purposes of paragraphs 12 and 13. [Revised 10/02.]

37. Q—Assume that a lender modifies the contractual terms of a mortgage loan for a fee. The new terms were not provided for in the original loan agreement. Is this considered a refinancing or a modification under ¶ paragraphs 12-14?

A—The guidance in ¶ Issue 01-7 should be used to determine whether the transaction is a refinancing or a modification under paragraphs 12–14. If the present value of the cash flows under the terms of the new debt instrument is at least 10% different from the present value of the remaining cash flows under the terms of the original agreement, the transaction should be accounted for as an extinguishment of the original agreement. [Revised 10/02.]

38. Q—Blended-rate loans involve lending new funds at market interest rates combined with existing loans at rates currently lower than market rates. (Those funds are not advanced under a line of credit.) The combined loan yields an interest rate between the existing loan rate and the market rate. The resulting loan is subject to the same underwriting standards as all other new loans. Is this arrangement considered a refinancing for purposes of ¶ paragraph 12?

A—It is a refinancing, but it does not meet the yield criteria prescribed in paragraph 12. Thus, the unamortized net fees and costs on the existing loan as well as the net fees and costs relating to the
refinancing should carry over to the new loan because the blended rate is below the market rate of loans with similar collection risks made to the lender's other customers.

**Question on ♦ Paragraph 15 of Statement 91**

39. Q—May fees paid to an independent third party, or incurred internally, for portfolio management or investment consultation be deferred?

   A—No. Such expenses are considered "other costs incurred in connection with acquiring purchased loans or committing to purchase loans" because they constitute investment advisory costs, not loan origination costs. Therefore, such costs should be charged to expense in accordance with ♦ paragraph 15 whether the costs are paid to independent third parties or incurred internally.

**Questions on ♦ Paragraph 18 of Statement 91**

40. Q—♦ Paragraph 18(a) states that "... interest income shall not be recognized to the extent that the net investment in the loan would increase to an amount greater than the amount at which the borrower could settle the obligation." Should a lender consider prepayment penalties on variable rate loans in determining the settlement amount for purposes of recognizing interest income?

   A—Yes, but only if the penalties are effective throughout the loan term. ♦ Footnote 7 to paragraph 18(c) states that the provisions of paragraphs 18(a) and (b) are applicable to variable rate loans whose initial rate differs from the rate its base factor would produce. Thus, it is necessary to consider such prepayment penalties in calculating the settlement amount.

41. Q—For increasing interest rate loans, may the recorded net investment in a loan ever exceed the amount by which the borrower could settle the obligation?

   A—Yes, but only if the excess results from a purchase premium (loans purchased) or loan costs that qualify for deferral in excess of loan fees (loans originated).

42. Q—Loans may be offered for some initial period at an interest rate below the current market rate with the interest rate scheduled to adjust to a market rate after the initial discount period. How should a lender amortize net loan fees and costs on such discount loans?

   A—Amortization of net loan fees and costs is based on the interest method over the life of the loan and limited by the provisions of ♦ paragraphs 18(a) and (c) during the discount period. Thereafter, the provisions of paragraph 18(c) are applicable. ♦ Refer to Tables 5 and 6 of Statement 91 for examples.

43. Q—Which amortization method provided by Statement 91 should be applied to loan fees resulting from negative amortization loans, biweekly mortgages, line of credit loans, overdraft protection loans, home equity loans, and acquisition, development, and construction arrangements accounted for as loans prior to completion of funding for (a) single project and (b) multiple projects with partial drawdowns and payments?

   A—The following amortization methods should be applied to the associated types of loan arrangements:

<table>
<thead>
<tr>
<th>Loan Type</th>
<th>Amortization Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Negative amortization loans</td>
<td>Interest</td>
</tr>
<tr>
<td>Biweekly mortgages</td>
<td>Interest</td>
</tr>
<tr>
<td>Line of credit loans or arrangements with similar characteristics</td>
<td>Straight-line</td>
</tr>
</tbody>
</table>
Overdraft protection loans

Home equity loans

Generally the interest method, but the straight-line method may be used if the arrangement has the characteristics of a revolving line of credit.

Acquisition, development, and construction arrangements accounted for as loans prior to completion of funding

a. Single project
b. Multiple projects with partial drawdowns and payments

Interest *(5)

Generally the interest method, but the straight-line method may be used if the arrangement has the characteristics of a revolving line of credit.

44. Q—How should a lender account for fees and costs on a construction loan (assuming the arrangement does not have the characteristics of a revolving line of credit) when the lender also has made a commitment for the permanent financing that the lender believes has more than a remote probability of being exercised?

A—For loan contracts in which the timing and amount of payments are not specified, estimates must be made by the lender to apply the interest method. The net amount of fees received and costs that meet the criteria specified in ◆ paragraph 6 should be deferred and recognized as an adjustment of yield over the combined life of the construction and permanent loans. If the commitment to provide permanent financing expires unused, any unamortized fees and costs should be recognized as income at that time.

45. Q—◆ Paragraph 18(c) provides that when a loan's stated interest rate varies based on future changes in an independent factor, the lender should calculate a constant effective yield by using the independent factor in effect at the inception of the loan or the factor as it changes over the life of the loan. In applying paragraph 18(c), may the lender change from one alternative to the other during the life of the loan?

A—No. The lender must select one of the two alternatives and apply the method consistently throughout the life of the loan.

46. Q—How is the interest method applied to loans for which interest is collected by the sum-of-the-years digits method?

A—The interest method produces periodic interest income at a constant effective yield on a loan. Thus, in this lending arrangement in which interest collected in earlier periods will be greater than that computed using the interest method, the excess interest collected must be deferred and recognized as interest income in later periods so as to produce a constant yield. Refer to EITF ◆ Topic No. D-10, "Required Use of Interest Method in Recognizing Interest Income," for additional information. [Revised 12/98.]

47. Q—A lender originates a loan with a stated interest rate that is not constant throughout the term of the loan. In accordance with ◆ paragraph 18(c), the constant effective yield necessary to recognize net fees and costs may be based on either an independent factor (for example, an index or rate) that is in effect at the inception of the loan or on the factor as it changes over the life of the loan. Assume a lender elects to calculate a constant effective yield by using the factor as it changes over the loan term. In a period in which the independent factor on a variable rate loan changes, is the
constant effective yield recalculate from the inception of the loan or from the time of the change?

A—The calculation of the constant effective yield is made from the time of the change. Refer to Table 9 of Statement 91 for an example.

Questions on Paragraph 19 of Statement 91

48. Q—If a lender amortizes net fees and costs on a loan-by-loan basis, may the lender estimate prepayments?

A—No. If loan-by-loan accounting is used, net fees and costs should be amortized over the contract life and adjusted based on actual prepayments.

49. Q—If a lender aggregates loans for purposes of estimating prepayments and subsequently sells some of the loans, how are net fees and costs associated with the loans sold included in the gain or loss calculation?

A—Generally, loans that are aggregated have lost their individual distinction; thus, a pro rata calculation of net fees and costs based on the ratio of the outstanding principal balances of the loans sold would be appropriate. If the lender has sufficiently detailed accounting records for the aggregated loans, specific identification may be used in the gain or loss calculation.

50. Q—If an enterprise purchases an individual callable bond at a premium, may the premium be amortized to the earliest call date?

A—No. Under paragraph 19, an enterprise must have a large number of similar loans in order to consider estimates of future principal prepayments when applying the interest method.

51. Q—What characteristics should be considered in determining whether the lender holds a large number of similar loans for purposes of estimating prepayments in accordance with paragraph 19?

A—The objective is to evaluate all characteristics that would affect the ability of the lender to estimate the behavior of a group of loans. The following are examples of some characteristics that should be considered when aggregating loans:

- Loan type
- Loan size
- Nature and location of collateral
- Coupon interest rate
- Maturity
- Period of origination
- Prepayment history of the loans (if seasoned)
- Level of net fees or costs
- Prepayment penalties
- Interest rate type (fixed or variable)
- Expected prepayment performance in varying interest rate scenarios.

52. Q—If a lender meets the requirements of paragraph 19 for considering principal prepayments in calculating constant effective yield, what factors should be considered in estimating those principal prepayments?
A—The lender should consider historical prepayment data in making its estimate of future prepayments. Also, the lender should consider external information, including existing and forecasted interest rates and economic conditions and published mortality and prepayment tables for similar loans. If periodic changes in estimates occur or actual prepayments are different from estimated prepayments, an adjustment will be necessary.

53. Q—An institution originates ARMs that have a below-market interest rate in the first year that subsequently will be adjusted to a market rate in the second year. The ARMs are sold to an independent third party at a discount reflecting the below-market interest rate in year 1. ¶ Paragraph 15 provides that "the initial investment frequently differs from the related loan's principal amount at the date of purchase. This difference shall be recognized as an adjustment of yield over the life of the loan." Over what period should the buyer amortize the discount?

A—The discount should be recognized as an adjustment of yield over the life of the loan in accordance with ¶ paragraphs 18(a) and (c). The purchase discount should be amortized to create a constant effective yield; thus, the majority of the discount would be recognized as interest income in the first year.

54. Q—Case 2 in Appendix B of Statement 91 is an example of a lender using contract life to amortize net deferred fees and costs for a group of loans with a full prepayment in year 3. If the lender receives a partial prepayment in year 3 rather than a full prepayment, how should the lender calculate the adjustment to unamortized net fees as required in ¶ paragraph 19?

A—¶ Paragraph 16 states that a lender using contract life to amortize net fees and costs must adjust the unamortized amount if, and when, loan prepayments occur. Such prepayments should not result in a change in the effective interest rate of the loan. The lender should calculate the adjustment to unamortized net fees under either of the two examples below depending on the terms of the loan contract. In Example No. 1, the lender will determine a new annual payment assuming the borrower will continue to make the payments through the original term of the loan contract. In Example No. 2, the borrower will continue to make the original annual payment, however, over a shorter period than the term specified in the loan contract.

Example No. 1

| Year | Cash (Out) | Stated Interest | Amortization | Interest Income 1 |  |
|------|-----------|-----------------|--------------|-------------------|  |
|      | Inflow    |                 |              | $                  | $ |
|      |           | Stated Interest | Amortization |                   |   |
|      | $ (98,000)|                 |              |                   |   |
| 1    | 16,275    | $10,000         | $ 264        | $10,264           | $ |
| 2    | 16,275    | 9,373           | 262          | 9,635             | $ |
| 3    | 26,275    | 8,682           | 407 (4)      | 9,089             | $ |
| 4    | 14,220 (1)| 6,923           | 216          | 7,139             | $ |
| 5    | 14,220    | 6,193           | 204          | 6,397             | $ |
| 6    | 14,220    | 5,391           | 187          | 5,578             | $ |
| 7    | 14,220    | 4,508           | 165          | 4,673             | $ |
| 8    | 14,200    | 3,537           | 136          | 3,673             | $ |
| 9    | 14,220    | 2,469 a(6)      | 99           | 2,568             | $ |
| 10   | 14,220    | 1,289 b(7)      | 60           | 1,349 a(8)        | $ |

$2,000

Step Calculation
1. Determine new annual payment
   Remaining periods = 7
   Remaining principal = $69,230
   Stated rate = 10%
   Calculated payment = $14,220

2. Determine new carrying amount
   Calculated payment (Step 1) = $
   Remaining periods = 7
   Original effective interest rate =
   Calculated carrying amount = $

3. Determine the remaining balance
   of unamortized net fees
   Remaining principal balance (S
   Less carrying amount (Step 2)

4. Determine the adjustment to
   unamortized net fees
   Prior year balance of unamortized net fees
   Less calculated unamortized net fees
   Adjustment

Example No. 2

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<tr>
<th>Year</th>
<th>Cash(Out)</th>
<th>Stated Interest</th>
<th>Amortization</th>
<th>Interest Income</th>
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<td></td>
<td>Inflow</td>
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<td>$ (98,000)</td>
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<td></td>
<td></td>
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<td></td>
</tr>
<tr>
<td>1</td>
<td>16,275</td>
<td>$10,000</td>
<td>$ 264</td>
<td>$10,264</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>16,275</td>
<td>9,373</td>
<td>262</td>
<td>9,635</td>
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<tr>
<td>3</td>
<td>26,275</td>
<td>8,682</td>
<td>546 (4)</td>
<td>9,228</td>
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<td>16,275 (1)</td>
<td>6,923</td>
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<tr>
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<td>1,214</td>
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<td>--</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>$2,000</td>
<td></td>
</tr>
</tbody>
</table>

**Step**

1. Determine new payment period
   Remaining principal = $69,230
   Stated rate = 10%
   Annual payment = $16,275
   Calculated payment period = 5,81

2. Determine new carrying amount
   Annual payment = $16,275
   Calculated payment period (Step
   Original effective interest rate = 1

Superseded by the FASB Accounting Standards Codification on July 1, 2009.
Questions on ¶ Paragraph 20 of Statement 91

55. **Q**—Statement 91 provides that any net fees and costs on demand loans may be recognized on a straight-line basis over a period consistent with the understanding between the borrower and lender or, if no understanding exists, the lender's estimate of the loan term. Does Statement 91 require an adjustment when a loan remains outstanding beyond the lender's original estimate of the loan term and the net fees and costs have been fully amortized as an adjustment of yield?

**A**—Such estimates should be monitored regularly and revised as appropriate. If, contrary to expectation, a loan remains outstanding beyond the anticipated payment date, no adjustment is required.

56. **Q**—In the case of a revolving line of credit (or similar loan arrangements), Statement 91 provides that any net fees and costs should be amortized on a straight-line basis over the term the revolver is active, assuming that borrowings are outstanding for the maximum term provided in the loan contract. How should such net fees and costs be accounted for if borrowings are repaid and the revolver is unused for a period of time even though the borrower can reborrow under the contract?

**A**—If the borrower continues to have a contractual right to borrow under the revolving line of credit, net fees and costs associated with revolving lines of credit should be amortized over the term of the revolver even if the revolver is unused for a period of time.

57. **Q**—A lender grants a loan that matures in 90 days and collects a nonrefundable fee that approximates market. Any future extension of credit would be evaluated at maturity of the original loan and would include an extension fee at that time. Based on experience, the lender anticipates that the credit will be extended an additional 90 days, however; the lender is not committed to provide an extension. Over what period should the fee collected on the original 90-day loan be amortized?

**A**—The fee, net of qualifying origination costs, should be deferred and amortized over the original 90-day loan contract.

58. **Q**—A lender originates a 10-year loan with a call feature after 3 years. Over what period should any fees collected be amortized?

**A**—The fees should be amortized over the 10-year contract life.

Questions on ¶ Paragraph 21 of Statement 91

59. **Q**—Does a lender report unamortized net fees and costs gross or net in its financial statements?

**A**—Origination and certain commitment fees and costs of completed loans and commitments to lend should be netted and reported along with the related loans. Additional disclosures such as unamortized net fees and costs may be included in the footnotes to the financial statements if the lender believes that such information is useful to the users of financial statements. Commitment fees that meet the criteria of ¶ paragraph 8(a) should be classified as deferred income in the financial statements.

Questions on ¶ Paragraph 27 of Statement 91

60. **Q**—Assume that a lender owns a mortgage banking entity that originates mortgage loans for the lender, who intends to hold the loans to maturity. Both entities issue audited financial statements

Superseded by the FASB Accounting Standards Codification on July 1, 2009.
Paragraph 13 of FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*, requires that mortgage loans originated for an affiliated entity be transferred at the "originator's acquisition cost." Does Statement 91 impact the determination of such acquisition cost?

A—Yes. The "originator's acquisition cost" must conform to the provisions set forth in Statement 91. The "originator's acquisition cost" is equal to the principal amount of the loan adjusted for unamortized net fees and costs and any unearned discounts or premiums.

**Questions on ♦ Paragraph 28 of Statement 91**

61. [Question deleted 12/98 because the effective date of Statement 91 has passed.]

Q—♦ Paragraph 28 states that "this Statement shall be applied prospectively to lending and leasing transactions entered into and commitments granted in fiscal years beginning after December 15, 1987 . . ." What constitutes a "lending transaction entered into"?

A—That phrase refers to lending transactions initiated by a lender rather than those transactions closed by a lender at that date.

62. [Question deleted 12/98 because the effective date of Statement 91 has passed.]

Q—To what extent should the results of past business combinations be restated if Statement 91 is adopted retroactively? Is restatement appropriate only for lending activities after the combination, or would the acquired entity's records be adjusted for the entire restatement period? Would it make a difference if the business combination were accounted for as a purchase or as a pooling of interests?

A—If the business combination was accounted for as a purchase, lending assets acquired would have been adjusted to fair value at the date of acquisition. Because the acquired lender's income prior to the acquisition is not included in the acquiror's preacquisition results, any adjustment prior to the acquisition would be inappropriate. For example, assume an entity was acquired at the beginning of 1984, then restatement of pre-1984 years would be inappropriate. Therefore, retroactive adoption of Statement 91 would require restatement of the acquired entity subsequent to the acquisition date.

In a business combination accounted for as a pooling of interests, however, historical costs of both combining companies are carried forward. Therefore, accounts of the acquired entity would have to be restated for the entire restatement period.

**Other Questions on Statement 91**

63. Q—Given the footnote disclosures presently made by certain lenders (for example, by industry type, by country of origin, by product line), must the unamortized net fees or costs associated with each loan category be reported with that category, or may the total unamortized net fees and costs be reported as a part of the various loan categories presented?

A—If material, the unamortized net fees and costs should be reported as a part of each loan category.

64. [Question deleted 12/98 because the effective date of Statement 91 has passed.]

Q—Must an entity that adopts Statement 91 prospectively during a fiscal year restate its interim financial statements for the effect of applying Statement 91 to transactions consummated prior to
Paragraph 28 of Statement 91 requires adoption as of the beginning of a fiscal year.

65.  [Question deleted 12/98 because it was no longer applicable.]

Q—The December 1973 AICPA Industry Guide, Audits of Finance Companies, permits finance companies to use the rule of 78's in amortizing deferred finance income. Paragraph 19 of Statement 91 requires lenders to use the interest method when amortizing interest instruments. May finance companies continue to use the rule of 78's method of amortization?

A—No. Paragraphs 16 and 17 of APB Opinion No. 12, Omnibus Opinion—1967, paragraph 15 of APB Opinion No. 21, Interest on Receivables and Payables, and paragraph 19 of Statement 91 require that the interest method of amortization be used for all interest instruments. (See Question 46 for more information.) Further, the 1973 Guide is being revised, and the new Guide is expected to be consistent with this response.
1 (Popup - Footnote *)  
Q&A 91 Footnote *—At the date of issuance of this implementation guide, Christopher S. Lynch was a practice fellow at the FASB and the positions and opinions expressed were his. Revisions to this implementation guide have been made by current members of the FASB staff. Official positions of the FASB are determined only after extensive due process and deliberation.

2 (Popup - Footnote a)  
Q&A 91, #4, Footnote a—Statement 140, which superseded FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, carried forward without reconsideration paragraph 14 of Statement 125. [Revised 9/01.]

3 (Popup - Footnote 1)  
Q&A 91 Footnote 1—This includes financial assets subject to prepayment as defined in paragraph 14 of Statement 140 and debt securities classified as available-for-sale under Statement 115. Statement 140, which superseded Statement 125, carried forward without reconsideration paragraph 14 of Statement 125. [Revised 9/01.]

4 (Popup - Footnote 2)  
Q&A 91 Footnote 2—Refer to ♦ footnote 1.

5 (Popup - Footnote *)  
Q&A 91, #43, Footnote *—For loan contracts in which the timing and amount of payments are not specified, estimates must be made to apply the interest method.

6 (Popup - Footnote a)  
Q&A 91, #54, Example No. 1, Footnote a—$1.00 rounding adjustment

7 (Popup - Footnote b)  
Q&A 91, #54, Example No. 1, Footnote b—$4.00 rounding adjustment

8 (Popup - Footnote a)  
Q&A 91, #54, Example No. 1, Footnote a—$1.00 rounding adjustment

9 (Popup - Footnote b)  
Q&A 91, #54, Example No. 2, Footnote b—$4.00 rounding adjustment

10 (Popup - Footnote a)  
Q&A 91, #54, Example No.2, Footnote a—$1.00 rounding adjustment