Section 10,910

Statement of Position 04-2
Accounting for Real Estate Time-Sharing Transactions

December 9, 2004

NOTE

Statements of Position on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles, as amended, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by Rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

Summary

This Statement of Position (SOP) provides guidance on a seller's accounting for real estate time-sharing transactions.

- A time-share seller should recognize profit on time-sharing transactions as specified under the profit recognition guidance in the sections in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*, that specify the accounting for other than retail land sales. For purposes of recognizing profit, nonreversionary title should be transferred. If title transfer is reversionary, the seller should account for the transaction as if it were an operating lease.
- Certain sales incentives provided by a seller to a buyer to consummate a transaction should be recorded separately by reducing the stated sales price of the time-share by the excess of the fair value of the incentive over the amount the buyer pays. For purposes of testing for buyer's commitment under FASB Statement No. 66, the seller should reduce its measurement of the buyer's initial and continuing investments by the excess of the fair value of the incentive over the stated amount the buyer pays, except in certain situations in which, to receive the incentive, the buyer is required to make specific payments on its note.
- A reload transaction is considered to be a separate sale of a second interval, and the second interval is accounted for in accordance with the profit recognition guidance of FASB Statement No. 66. For an

upgrade transaction, that guidance is applied to the sales value of the new (upgrade) interval, and the buyer's initial and continuing investments from the original interval are included in the profit recognition tests related to the new interval.

- As used in this SOP, the term *uncollectibles* should be interpreted broadly to include all situations in which, as a result of credit issues, a time-share seller collects less than 100 percent of the contractual cash payments of a note receivable, except for certain transfers of receivables to independent third parties by the seller. An estimate of uncollectibility that, from a historical and statistical perspective, is expected to occur should be recorded as a reduction of revenue at the time that profit is recognized on a time-sharing sale recorded under the full accrual or percentage-of-completion method. Subsequent changes in estimated uncollectibles should be recorded as an adjustment to estimated uncollectibles and thereby as an adjustment to revenue. Under the relative sales value method, the seller effectively does not record revenue, cost of sales, or inventory relief for amounts not expected to be collected. There generally is no accounting effect on inventory when, as expected, a time-share is repossessed or otherwise reacquired.
- The seller should account for cost of sales and time-sharing inventory in accordance with the relative sales value method.
- All costs incurred to sell time-shares should be charged to expense as incurred except for certain costs that are:
  - — Incurred for tangible assets used directly in selling the time-shares.
  - — Incurred for services performed to obtain regulatory approval of sales.
  - — Direct and incremental costs of successful sales efforts under the percentage-of-completion, installment, reduced profit, or deposit methods of accounting.
- Rental and other operations during holding periods, including sampler programs and mini-vacations, should be accounted for as incidental operations, which requires that any excess of revenue over costs be recorded as a reduction of inventory costs.
- The accounting treatment for more complex time-sharing structures such as time-sharing special-purpose entities (SPEs), points systems, and vacation clubs should be determined using the same profit recognition guidance as for simpler structures, provided that the time-sharing interest has been sold to the end user. For balance-sheet presentation purposes, an SPE should be viewed as an entity lacking economic substance and established for the purpose of facilitating sales if the SPE structure is legally required for purposes of selling intervals to a class of nonresident customers, and the SPE has no assets other than the time-sharing intervals and has no debt. In those circumstances, the seller should present on its balance sheet as time-sharing inventory the interests in the SPE not yet sold to end users.
- If the seller, seller's affiliate, or related party operates an exchange, points, affinity, or similar program, the program's operations constitute continuing involvement by the seller, and the seller should determine its accounting based on an evaluation of whether it will

receive compensation at prevailing market rates for its program services.

- This SOP is effective for financial statements for fiscal years beginning after June 15, 2005, with earlier application encouraged. Initial application should be reported as a cumulative effect of a change in accounting principle.

Foreword

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least 10 of AcSEC's 15 members, and (3) a final document that has been approved by at least 10 of AcSEC's 15 members. The document is cleared if at least four of the seven FASB members do not object to AcSEC undertaking the project,[*] issuing the proposed exposure draft, or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in its review of proposed projects and proposed documents include the following:

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, prior to clearance, the FASB will propose suggestions, many of which are included in the documents.

Background

.01 The **real estate time-sharing**[1] industry has experienced significant growth since its inception, both in terms of sales volumes and in the variety of **time-sharing** structures used by sellers.[2] The accounting for real estate time-sharing transactions (also referred to in this Statement of Position [SOP] as *time-sharing transactions*) is based principally on Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*. Time-sharing transactions are characterized by the following:

a. Volume-based, homogeneous sales

b. Seller financing

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[*] At the time the Accounting Standards Executive Committee (AcSEC) undertook this project, at least five of the seven Financial Accounting Standards Board members were required to not object to AcSEC undertaking this project.

[1] Terms defined in the Glossary are set in boldface type the first time they appear in this Statement of Position (SOP).

[2] The term *developer* is used interchangeably and synonymously with *seller* in this SOP.

c. Relatively high selling and marketing costs

d. Upon default, recovery of the time-sharing **interval** by the seller and some forfeiture of principal by the buyer

.02 The FASB issued FASB Statement No. 66 in 1982. The FASB concluded at that time that time-sharing transactions should be accounted for in accordance with the provisions of that Statement. However, the FASB noted that sales of **time-sharing interests** were not addressed in the specialized AICPA Industry Accounting Guides and SOPs whose principles were extracted in that Statement and decided not to provide specific additional guidance on time-sharing transactions as part of the extraction project leading to the issuance of that Statement.

.03 The time-sharing industry has certain characteristics that affect the evaluation of financial performance. Most sales of time-sharing intervals are to retail consumers, who often choose to use seller-provided financing. Although certain financial institutions will participate in the securitization or hypothecation of portfolios of time-sharing receivables, financial institutions typically will not finance the purchase of individual time-sharing intervals. Therefore, a majority of the sales price is often financed by the **time-share** seller through a promissory note (generally, with a term of five to ten years) signed by the buyer. The promissory note is typically a **recourse** note secured by the time-sharing interval. Delinquency and default rates on promissory notes vary widely among individual time-sharing companies and tend to fluctuate in line with the general state of the economy. Selling and marketing costs are significant in relation to sales revenue, and sales **incentives** and **inducements** are common.

.04 The time-sharing industry has introduced a variety of transaction structures to differentiate its products and enhance sales volumes. For example, buyers often have the right to **exchange** periodic use of their time-sharing intervals for use of other time-sharing intervals or for various consumer products, frequently through a third-party exchange company. Time-sharing transactions include the sale of **fixed time** and **floating time**, **points** (which may be redeemed so that a buyer may occupy a specific property), **vacation clubs**, and **fractional interests**; the use of **time-sharing special-purpose entities (SPEs)** to hold title to real estate; and providing the right to use real estate for a specified period.

.05 In an effort to manage cash flows, many time-share sellers will sell, hypothecate, securitize, or otherwise monetize their receivables through another party. In general, those transactions are completed with some recourse to the time-share seller (that is, if receivables are uncollectible, the seller is liable for the bad debts up to stated limits).

.06 All of the above factors illustrate the complexity of the time-sharing industry and the need for accounting guidance. Limited specific guidance on accounting for time-sharing transactions, combined with the varied and numerous structures that time-sharing arrangements have assumed, have resulted in diversity in practice. Areas of diversity addressed in this SOP include accounting for **uncollectibility**, recovery or repossession of time-sharing intervals, selling and marketing costs, operations during **holding periods**, developer subsidies to interval **owners associations**, and **upgrade** and **reload** transactions.

.07 AcSEC understands that the FASB will amend FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, to accommodate this SOP's requirements. The FASB will indicate, in the sections entitled "Incidental Operations" and "Costs Incurred to Sell Real Estate Projects" of FASB Statement No. 67, that paragraphs 10 and 17 through 19 of that Statement do not apply to time-sharing transactions.

Scope

.08 This SOP provides guidance on the accounting by a seller for all real estate time-sharing transactions.[3] Those include:

a. Fee simple transactions in which nonreversionary title and ownership of the real estate pass to the buyer or an SPE

b. Transactions in which title and ownership of all or a portion of the real estate remain with the seller

c. Transactions in which title and ownership of all or a portion of the real estate pass to the buyer and subsequently revert to the seller or transfer to a third party

d. Transactions by a time-share reseller

.09 Paragraphs 3 through 43, 53 through 69, 77 through 90, and portions of Appendixes E and F of FASB Statement No. 66 provide guidance for recognition of profit on **other than retail land sales (OTRLS)** of real estate, including real estate time-sharing transactions. This SOP provides guidance to illustrate the application of the provisions of FASB Statement No. 66 to the specific terms typically encountered in time-sharing transactions. This SOP also establishes standards for accounting issues not addressed in FASB Statement No. 66.

.10 This SOP applies to both annual and interim reporting periods.

Conclusions

Profit Recognition Under FASB Statement No. 66

.11 As noted in paragraph .09 of this SOP, a time-share seller should recognize profit on time-sharing transactions as specified under the profit recognition guidance in the OTRLS sections of FASB Statement No. 66. Paragraphs 25 through 43 of that Statement provide guidance for scenarios under which a seller retains **continuing involvement** with real estate that has been transferred to a purchaser. Appendix C [paragraph .69] of this SOP lists those scenarios and provides comments as to whether they typically do or do not apply to time-sharing transactions.

.12 Paragraph 37 of FASB Statement No. 66 prescribes the **percentage-of-completion** method of profit recognition for time-sharing transactions provided that certain criteria are met. Costs to sell time-sharing intervals (also referred to as *sales and marketing costs*) should be excluded from the calculations of costs under that method.

.13 Paragraphs 22(c) and 22(g) of FASB Statement No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases*, require that title must be transferred in order to recognize

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[3] Financial Accounting Standards Board (FASB) Interpretation No. 43, *Real Estate Sales (an interpretation of FASB Statement No. 66)*, provides guidance that is useful in determining what constitutes real estate for purposes of this SOP.

a sale of real estate. For purposes of recognizing profit on time-sharing transactions under FASB Statement No. 66, such transfer should be nonreversionary. A **contract-for-deed** arrangement meets this criterion. If the title transfer is reversionary, the seller should account for the transaction as if it were an operating lease.

Seller Identification of Projects and Phases

.14 Throughout this SOP, reference is made to a **project** or to a **phase** of a project. A project may consist of a single phase. A time-share seller should establish and delineate a project and its phases at the outset of the project. Each phase should be accounted for separately.

.15 A change in the delineation of a project or its phases that results from a significant change in facts and circumstances related to the project's development—for example, significant revisions in sales prices or discount programs, construction contract price or inflation changes, temporary construction delays, design changes, or a decision by the seller to increase significantly the proportion of luxury versus standard **units** in a project—should be accounted for as a change in accounting estimate on a retrospective basis using a current-period adjustment as discussed in paragraph .41 of this SOP. A change in the delineation of a project or its phases without a significant change in facts and circumstances related to the project's development should be accounted for as a change in the method of applying an accounting principle under Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*, that is, by a cumulative effect of a change in accounting principle. An example of this latter change would be a decision to divide the same development of a project into more or fewer phases, which would be a change only in how the project is accounted for rather than a change in the nature (that is, the facts and circumstances) of the project itself.

Determination of Sales Value

.16 The stated sales price in a time-sharing transaction should be adjusted to determine the **sales value** of the time-sharing interval. This section discusses some of the adjustments that are common in time-sharing sale transactions. This section is not intended to be all-inclusive, and other adjustments to the stated sales price may be necessary to reflect the sales value of a time-sharing interval. See Appendix E, "Illustration of Determination of Sales Value of Time-Share Interval" [paragraph .71], for illustrations of the determination of sales value.

.17 The stated sales price should be reduced by the excess of the fair value of products or services that the seller, as part of consummating the sale, has provided or is legally or otherwise committed to provide the buyer over the stated compensation for those products or services. This deemed compensation to the seller for those products and services, plus the stated compensation, if any, should be accounted for as a reduction in the stated sales price of the time-sharing interval. Often those products or services represent sales incentives provided by the seller to the buyer in order to consummate a time-sharing transaction.[4] The seller should follow the guidance in Emerging Issues Task Force (EITF) Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)," and therefore the accounting for the amount by which the stated sales price was reduced for

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[4] The reduction in sales value for the fair value of an incentive to be delivered at a later date should reflect the effects of the timing of the delivery. See Example 1 in Appendix E [paragraph .71] for an illustration.

an incentive depends on whether the incentive is noncash or cash. For noncash incentives that amount should be accounted for as a separate deliverable with an associated cost of sales, whereas for cash incentives that amount should be accounted for as a discount to the stated sales price.

.18 For purposes of this SOP, a cash incentive is either cash or an incentive provided to a buyer that the buyer would otherwise be required to pay, such as required first-year maintenance fees to an owners association or required closing costs on a time-sharing interval. A noncash incentive is an incentive provided to a buyer that the buyer could elect to purchase, such as a first-year membership in an optional exchange program, amusement park tickets, or a voucher that can be used to obtain airline tickets from an airline at no charge. If a seller provides, at no charge, a noncash incentive, such as an airline voucher, to a buyer in order to consummate a time-sharing transaction, the seller should reduce the stated sales price of the time-sharing interval by the fair value of the voucher and record the fair value of the voucher as a separate revenue item. Alternatively, if a seller sells a time-sharing interval together with a membership in an exchange program and provides the first-year membership at no charge to the buyer, the fair value of the exchange program fees should be treated as a cash incentive because those fees would be required to be paid. Therefore, the stated sales price of the time-sharing interval should be reduced by the fair value of the fees and that fair value should be treated as a reduction in the seller's cost of the fees (rather than as a separate revenue item).

.19 If a seller obtains an incentive through an arm's-length, cash-denominated transaction with an **independent third party** at or near the time that the incentive is delivered to the buyer, that cash-denominated transaction would generally be considered the best estimate of fair value.[5] The determination of incentives excludes any products or services that a buyer pays for, at market rates, through future maintenance charges or other separate fees.

.20 If the seller provides an inducement, which is provided regardless of whether a sale is consummated (for example, providing amusement park tickets to a potential buyer as an inducement to attend a time-sharing sales presentation), the seller should record the cost of the inducement as a selling cost in accordance with paragraphs .44 through .48 of this SOP.

.21 If the seller charges a buyer a fee that is unrelated to financing, such as a sales document preparation fee, the fee should be added to the stated sales price in determining sales value. An exception occurs if the seller charges a buyer a "pass-through" fee that the seller collects to pay to a third party, such as a municipality or taxing authority; the fee should not be added to the sales value or included in the buyer's initial and **continuing investments** (see the next section of this SOP). If the seller charges a buyer a fee that is related to financing the time-share purchase, such as a loan origination fee, the fee should be recorded in accordance with FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, as an adjustment to the stated interest rate on the financing.

.22 Sellers may have programs to accelerate collections of receivables or contract provisions that encourage prepayment, with a reduction of payments

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[5] The FASB has issued an exposure draft of a proposed Statement of Financial Accounting Standards, *Fair Value Measurements*. Readers should be alert to any final pronouncement.

as the major inducement for prepayment. If a seller offers such programs to buyers at the time of sale or has a consistent past practice of offering such programs during the term of the buyers' notes, the seller should incorporate estimated reductions of payments into the determination of sales value.

.23 If a time-sharing transaction is partially or fully financed by the seller and the stated interest rate is less than the prevailing market rate for a purchaser of similar credit quality in a similar transaction, the sales value and recorded amount of the note receivable should be reduced in accordance with APB Opinion No. 21, *Interest on Receivables and Payables*.

Application of Test of Buyer's Commitment

.24 In applying the tests for adequacy of buyer's commitment in paragraph 5(b) of FASB Statement No. 66, the seller should reduce its measurement of the buyer's initial and continuing investments by the excess described in paragraph .17 of this SOP, unless the incentive is conditioned on sufficient future performance (in the form of the buyer meeting his or her contractual obligations associated with the purchase of the time-sharing interval) by the buyer. One example is the seller offering to pay the buyer's second year of maintenance fees if the buyer remains current on his or her contractual obligations for one year. Another example is the seller offering the buyer an airline voucher if the buyer makes the first six monthly payments in a timely manner. If the incentive is conditioned on future performance by the buyer, the seller should determine whether the future performance is sufficient to meet the initial and continuing investments criterion for the buyer's commitment.

.25 In order for future performance by the buyer to be sufficient, the contractual payments (principal and interest) required from the buyer in order to receive the incentive should be at least equal to the fair value of the incentive. For example, upon the sale of a $10,000 time-sharing interval, the seller receives a $1,000 down payment and will provide the buyer with a $500 incentive, conditioned on future performance of the buyer. The buyer's contractual monthly note payment is $175. If the buyer is directly or indirectly required to make at least three monthly payments (totaling $525) before becoming entitled to the incentive, the buyer's initial and continuing investments under paragraph 5(b) of FASB Statement No. 66 would not be reduced for the incentive. The buyer's required contractual payments should cover both the value of the incentive and interest on the unpaid portion of the incentive (that interest was ignored in this example for simplicity).

.26 If future performance is not sufficient, the seller should reduce the measurement of the buyer's commitment by the excess of the fair value of the incentive over the amount the buyer paid for the incentive, in applying the criterion in paragraph 5(b) of FASB Statement No. 66. In the example in the preceding paragraph, assume instead that the buyer was required to make only one monthly payment of $175 prior to receiving the incentive (the $175 is the first payment on the loan, not an incremental payment for the incentive). For purposes of applying the buyer's initial and continuing investments criterion, the initial down payment of $1,000 would be reduced by the $325 excess ($500 incentive less $175 required future performance) to $675. The seller would therefore be considered to have received a $675 initial payment, and the sales value of the time-sharing interval would be $9,500. If, for example, the required level of commitment is 10 percent, to satisfy the initial and continuing investments criterion, the seller would have to receive an additional $275 in cash from the buyer ($675 plus $275 is $950, which is 10 percent of $9,500).

.27 Any portion of the buyer's down payment that is considered to apply toward payment of an incentive—for example, the $325 in the illustration in paragraph .26—rather than toward payment on a time-sharing interval should not be included in determining the buyer's initial or continuing investments.

Upgrade and Reload Transactions

.28 The profit recognition guidance in FASB Statement No. 66 should be applied to determine the appropriate accounting for a reload interval or an upgrade interval. A reload transaction is a sale of a new interval that should be treated as a separate transaction for accounting purposes. Therefore, additional cash or other qualifying consideration is necessary to meet the buyer's commitment criterion in paragraph 5(b) of FASB Statement No. 66. Because a reload is considered a second, separate transaction, the seller should not include the buyer's initial and continuing investments from the original time-sharing interval toward the measurement of the buyer's commitment for the second interval.

.29 An upgrade transaction is a modification and continuation of the original transaction. For an upgrade transaction, the seller should include the buyer's initial and continuing investments from the original (ceded) interval toward meeting the buyer's commitment criterion. The profit recognition guidance in FASB Statement No. 66, including the test for buyer's commitment, is applied to the sales value of the new (upgrade) interval.

Accounting for Uncollectibility

.30 The collection of notes receivable is an important function for sellers of time-sharing intervals. Time-share sellers experience some level of uncollectibility in a notes receivable portfolio in the ordinary course of business. To maximize collections, sellers use several kinds of collection programs, including **modifications**, **deferments**, **assumptions**, and **downgrades**. Sellers incur various costs in using those collection programs. This section provides guidance on accounting for various forms of uncollectibility and the associated costs.

.31 Uncollectibility incorporates losses of both principal and interest. Accrued interest income receivable that is determined to be uncollectible should be charged against interest income at the time the receivable is determined to be uncollectible.

.32 Uncollectibility occurs whenever a receivable either becomes wholly uncollectible or is modified in some manner that results in less than 100-percent collection of the original note. The measurement of uncollectibility should be based on actual receivables collection experience (and other considerations)—whether the seller or a third party is the servicer of the receivables—rather than the amounts a seller receives as proceeds for receivables sales, securitizations, or hypothecations.

.33 An estimate of uncollectibility that, from a historical and statistical perspective, is expected to occur should be recorded as a reduction of sales revenue at the time that profit is recognized on a time-sharing sale recorded under the **full accrual** or percentage-of-completion method. That estimate should incorporate all forms of uncollectibility (for example, note cancellations and collection programs). See Appendix D [paragraph .70] for an illustration of the determination of the reduction of revenue for estimated uncollectibles. Under the **relative sales value method** (see paragraph .41), a corresponding adjustment is made to cost of sales and inventory, through the application of the cost-of-sales percentage, to reflect the reduction of revenue for estimated uncollectibles. See Appendix B [paragraph .68] for illustrations of the relative sales value method.

.34 A note receivable modification, deferment, or downgrade represents a troubled debt restructuring involving only the modification of the terms of a note receivable. Therefore, the creditor (time-share seller) should account for those transactions in accordance with FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*. Any reductions in the recorded investment in a note receivable resulting from the application of FASB Statement No. 114 should be charged against the allowance for uncollectibles, because the estimated losses were recorded against revenue at the time the time-share sale was recognized or were recorded subsequently against revenue as a change in estimate. Incremental, direct costs associated with uncollectibility, such as costs of collection programs, should be charged to expense as incurred.

.35 A note receivable assumption should be accounted for as two separate activities with two different parties. The first—the termination of the arrangement with the original buyer—results in an amount uncollectible to the seller equal to the remaining investment in the original note receivable. That amount should be charged to the allowance for uncollectible receivables. The second activity—a time-sharing transaction with a new buyer—should be accounted for in accordance with the profit recognition criteria in FASB Statement No. 66.

.36 Once an initial time-sharing sale transaction has been recorded (which includes a reduction of recognized revenue for estimated uncollectibles), accounting for the allowance for uncollectibles follows similar valuation principles as any receivable, except that there is no "bad debt expense." Each reporting period and at least quarterly a seller evaluates its receivables, estimates the amount it expects to ultimately collect, and evaluates the adequacy of its allowance pursuant to FASB Statement No. 5, *Accounting for Contingencies*.[6] The allowance is then adjusted, with a corresponding adjustment to current-period revenue through the estimated uncollectibles account, which is a contra-revenue account. A corresponding adjustment is also made to cost of sales and inventory.

.37 The allowance for uncollectibles should be determined based on consideration of uncollectibles by year of sale, as well as the aging of notes receivable and factors such as the location of the time-sharing units, contract terms, collection experience, economic conditions, and other qualitative factors as appropriate in the circumstances. See Appendix D [paragraph .70] for an illustration of the determination of the allowance for uncollectibles.

.38 If a time-share seller sells a portfolio of receivables without recourse, any gain or loss should be recorded as an adjustment of interest income if it is attributable to a change in market interest rates between the date the receivables are generated and the date they are sold, and as an adjustment of revenue otherwise (for example, if the gain or loss is related to a difference in perceived credit quality of the portfolio between the date the receivables are generated and the date they are sold).

Accounting for Cost of Sales and Inventory

.39 This section applies to all time-sharing sale transactions accounted for under the full accrual, percentage-of-completion, installment, cost recovery,

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[6] In June 2003, AcSEC issued an exposure draft of a proposed SOP, *Accounting for Credit Losses*. Readers should be alert to any final pronouncement.

or reduced profit methods of revenue recognition as discussed in paragraphs 3 through 43, 53 through 64, 68, and 69 of FASB Statement No. 66. If a time-sharing transaction is accounted for under the **deposit method**, as discussed in paragraphs 65 through 67 of FASB Statement No. 66, this section does not apply.

.40 Sellers of time-sharing intervals should account for cost of sales and time-sharing inventory using the relative sales value method, which is illustrated in Appendix B [paragraph .68] of this SOP. The relative sales value method should be applied to each phase separately. **Common costs**, including **amenities**, should be allocated to inventory among the phases that those costs will benefit.

.41 The relative sales value method is similar to a "gross profit" method and is used to allocate inventory cost and determine cost of sales in conjunction with a sale. Under the relative sales value method, cost of sales is calculated as a percentage of net sales using a *cost-of-sales percentage*—the ratio of total estimated cost (including costs to complete, if any) to total estimated time-sharing revenue. At least quarterly, both estimates should be recalculated.[7] The estimate of total revenue (actual to-date plus expected future revenue) should incorporate factors such as incurred or estimated uncollectibles, changes in sales prices or sales mix, repossession of intervals that the seller may or may not be able to resell, effects of upgrade programs, and past or expected sales incentives to sell slow-moving inventory units. The cost-of-sales percentage should be similarly recalculated each time estimated revenue or cost is adjusted, using the new estimate of total revenue and total cost (including costs to complete, if any). The effects of changes in estimate should be accounted for in each period on a retrospective basis using a current-period adjustment, that is, the time-share seller should account for a change in estimate in the period of change so that the balance sheet at the end of the period of change and the accounting in subsequent periods are as they would have been if the revised estimates had been the original estimates. The effects of changes in estimate should be disclosed in accordance with paragraph 33 of APB Opinion No. 20. See Appendix B [paragraph .68] for illustrations of the relative sales value method; Examples 2 and 4 of that appendix illustrate changes in estimate. The inventory balance reported in the balance sheet, plus estimated costs to complete that inventory, if any, represents a pool of costs that will be charged against future revenue.

.42 As discussed in paragraph .33 of this SOP, the recording of a sales revenue adjustment for expected uncollectibles is accompanied by a corresponding adjustment to cost of sales and inventory that is effected through the application of the cost-of-sales percentage. However, under the relative sales value method, there is no accounting effect on inventory if a time-sharing interval is repossessed or otherwise reacquired unless the repossession causes a change in expected uncollectibles (and, thereby, estimated revenue) as discussed in the preceding paragraph. The seller should, however, perform impairment testing on its inventory in accordance with paragraphs 34 through 37 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

.43 Costs incurred by a seller that are related to financing, such as loan origination costs, should be accounted for in accordance with FASB Statement No. 91.

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[7] A time-sharing entity should adjust at least quarterly even if it does not issue quarterly financial reports under Securities and Exchange Commission (SEC) reporting requirements.

Costs to Sell Time-Sharing Intervals

.44 All costs incurred to sell time-sharing intervals should be charged to expense as incurred unless they specifically qualify for capitalization under paragraphs .45 through .48 of this SOP.

.45 Costs incurred to sell time-sharing intervals should be deferred until a sale transaction occurs if the costs are:

a. Reasonably expected to be recovered from the sale of the time-sharing intervals or from **incidental operations**; and

b. Incurred for either of the following:

(1) Tangible assets[8] that are used directly throughout the selling period to aid in the sales of the time-sharing intervals

(2) Services that have been performed to obtain regulatory approval of sales

Examples of costs incurred to sell time-sharing intervals that meet the condition of item *b*(1) include the costs of model units and their furnishings, sales property and equipment, and semipermanent signs. An example of costs that meet condition *b*(2) is the costs of preparation and filing of prospectuses, including printing and legal fees. If a transaction occurs, the costs should be allocated proportionately to that transaction based on the relative fair value of the intervals available for sale in the project or phase to which the selling costs are applicable.

.46 Other costs incurred to sell time-sharing intervals should be deferred until a sale transaction occurs if the costs are (*a*) reasonably expected to be recovered from the sale of the time-sharing units, (*b*) directly associated with sales transactions that are being accounted for under the percentage-of-completion, installment, reduced profit, or deposit method of accounting, and (*c*) incremental, that is, the costs would not have been incurred by the seller had a particular sale transaction not occurred. Under the deposit method of accounting, deferred selling costs should be limited to the nonrefundable portion of the deposits received by the seller. Examples of directly associated, incremental costs include commissions, and payroll and payroll benefit-related costs of sales personnel for time spent directly on successful sales efforts.

.47 Deferred selling costs should be charged to expense in the period in which the related profit is recognized. If a sales contract is canceled (with or without refund) prior to profit recognition, the related unrecoverable deferred selling costs should be charged to expense in the period of cancellation.

.48 Examples of costs that do not meet any of the criteria in paragraph .45 or .46 for deferral, and that should therefore be charged to expense as incurred, include all costs incurred to induce potential buyers to take sales tours (for example, the costs of telemarketing call centers); all costs incurred for unsuccessful sales transactions; and all sales overhead such as on-site and off-site sales office rent, utilities, maintenance, and telephone expenses. Advertising costs should be accounted for in accordance with SOP 93-7, *Reporting on Advertising Costs* [section 10,590]. Direct incremental costs of tour fulfillment, such as costs of airline tickets to bring customers to a tour location, should be charged to expense at the time the tour takes place.

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[8] This guidance on "tangible" assets is not intended to prohibit capitalization specifically addressed in other literature, such as internal use software under SOP 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use* [section 10,720].

Operations During Holding Periods

.49 For time-sharing operations, the holding period (as that term is used in the definition of incidental operations in FASB Statement No. 67) begins at the time that intervals are held for and are available for sale—for example, when units in domestic locations are legally registered for sale as time-shares. If rental activities occur other than during the holding period, the corresponding units should be depreciated and those activities should be accounted for as rental operations in accordance with FASB Statement No. 13, *Accounting for Leases*, and related authoritative literature. A seller should evaluate each period as to whether units previously considered held for and available for sale should continue to be characterized as such.

.50 Revenue from and costs of rental and other operations during holding periods should be accounted for as incidental operations. Incremental revenue from incidental operations in excess of incremental costs from incidental operations should be accounted for as a reduction of inventory costs—that is, the pool of inventory costs under the relative sales value method as described in paragraph .41 of this SOP. Estimates of future amounts of such excess should not be factored into the calculations of the relative sales value method. Incremental costs in excess of incremental revenue should be charged to expense as incurred.

.51 Holding period operations include **sampler programs** and **mini-vacations** (see paragraph .53). During holding periods, time-sharing intervals should be accounted for as inventory and should not be depreciated. Costs of operations during holding periods include (*a*) **seller subsidies** and (*b*) maintenance and related costs on time-sharing intervals held for sale.

.52 Costs incurred to rent units during holding periods should be deferred if they are (*a*) directly associated with, and their recovery is reasonably expected from, transactions involving the rental of units during holding periods and (*b*) incremental, that is, the costs would not have been incurred by the seller had a particular holding period rental transaction not occurred. An example of a directly associated, incremental cost is a commission. Deferred costs to rent time-sharing units during holding periods should be charged to expense, or netted in the reduction of inventory costs (as described in paragraph .50), in the period in which the rental takes place.

Sampler Programs and Mini-Vacations

.53 If a buyer pays for a sampler program or mini-vacation but buys a unit without using the entire sampler program or mini-vacation, and the seller applies the unused payment to the sales price, the payment should be treated as part of the buyer's initial and continuing investments for purposes of determining the buyer's commitment (see paragraph .24 of this SOP). Conversely, an amount the seller receives for a sampler program or mini-vacation that a prospective buyer fully uses should not, upon subsequent sale of an interval to the prospective buyer, be included in the buyer's initial and continuing investments, even if the legal documents state or suggest that the payment for the sampler program or mini-vacation is applied to the sales price.

.54 See paragraphs .49 through .52 of this SOP for the accounting for amounts received for sampler programs and mini-vacations.

Special-Purpose Entities, Points Systems, Vacation Clubs, and Similar Structures

.55 The accounting treatment for time-sharing structures such as SPEs, points systems, vacation clubs, and variations and hybrids of those structures should be determined using the profit recognition guidance in the OTRLS sections of FASB Statement No. 66. In applying that guidance, the transactions should be evaluated from the time-sharing seller's perspective rather than from the buyer's perspective, that is, it is necessary to evaluate transactions based primarily on what the seller has transferred and secondarily on what the buyer has received. There should be assessments of whether the seller has transferred nonreversionary title to a time-sharing interval (see paragraph .13 of this SOP), whether the seller has continuing involvement with the buyer, and other matters with respect to meeting the other profit recognition criteria of FASB Statement No. 66. The seller should recognize profit in the same manner and use the same profit recognition guidance as for simple-structure transactions (such as fixed time) provided that the time-sharing interval has been sold to the end user. If the seller has transferred title (for example, to an SPE) but no ultimate buyer has consummated a transaction for the time-sharing interval, no profit should be recognized.

.56 For balance-sheet presentation purposes, an SPE should be viewed as an entity lacking economic substance and established solely for the purpose of facilitating sales if (*a*) the SPE structure is legally required by the applicable jurisdiction(s) to sell time-sharing intervals to the nonresident customers that the developer-seller wishes to sell to (for example, for purposes of being able to sell intervals to United States citizens in a country in which citizens of other countries are not allowed to own real estate) and (*b*) the SPE has no assets, other than the time-sharing intervals, and the SPE has no debt. In those circumstances, the seller should show on its balance sheet as time-sharing inventory the interests in the SPE not yet sold to end users. If an SPE does not meet the conditions in both items *a* and *b* above, the accounting and presentation should be consistent with investments in other SPE structures (for example, the consolidation of controlled SPEs and SPEs in which no other entity has adequate capital at risk).[9]

.57 If the seller, an affiliate of the seller, or other related party operates a points program, vacation club, exchange program, **affinity program**, or similar program, the operation of the program constitutes continuing involvement by the seller.[10] The seller should evaluate whether it receives compensation at prevailing market rates for that service. If the seller provides the service without compensation or at compensation less than prevailing market rates for the service required or on terms not usual for the service to be rendered, compensation should be imputed when the sale is recorded (by reducing the sales value of the interval) and profit should be appropriately recorded under the guidance on continuing involvement in FASB Statement No. 66 (see paragraph 31 of that Statement; also see Appendix C [paragraph .59] of this SOP).

Owners Associations[11]

.58 Time-share projects typically incur significant operating costs, such as costs of property taxes, repairs and maintenance, and reservation systems.

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[9] FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities*, provides guidance on whether special-purpose entities (SPEs) that represent variable interest entities should be consolidated.

[10] The terms *affiliate* and *related party* have the same meaning here as in FASB Statement No. 57, *Related Party Disclosures*.

[11] The AICPA Audit and Accounting Guide *Common Interest Realty Associations* provides additional information on owners associations and similar entities.

Time-share owners are responsible for paying for the costs of owning their intervals. Because there are many time-share owners for a given project, a centralized mechanism generally is used to collect each owner's share of those costs of ownership and to pay for operating costs. A time-share seller typically forms an owners association (OA) to manage the day-to-day operations of a project. Time-share owners pay assessments to the OA. The activities of an OA are governed by its bylaws and by a board of directors. Typically, an OA will hire a manager to handle the day-to-day operations. Often, an affiliate of the original time-share seller is hired by an OA to manage a project. Because the time-share seller owns a majority of units at the beginning of the sellout of a project, it typically will appoint members of the OA's board of directors.

.59 During early stages of project sellout, there are typically not enough dues-paying time-sharing interval owners to support the financial obligations of the OA. Often a time-share seller, for a limited period of time, subsidizes the operations of the OA rather than paying the dues or maintenance fees on the time-sharing intervals that it owns (that is, the unsold intervals in the project). Subsequent to that period, the time-share seller pays dues or maintenance fees on the time-sharing intervals that it owns. Payments by the seller of dues or maintenance fees, except when accounted for as incidental operations during holding periods under paragraphs .49 through .52 of this SOP, should be charged to expense as incurred. Payments by the seller of additional amounts to subsidize losses should be charged to expense as incurred. If a seller is contractually entitled to recover from the OA all or a portion of its subsidy, the seller should record a receivable only if recovery is probable and measurable with reasonable reliability.

.60 A time-share seller hired as the manager of an OA typically is entitled by agreement to a management fee. The seller should recognize that fee as revenue only if it is earned and it is realized or realizable. If a seller is currently subsidizing operations of an OA, to the extent the seller receives a management fee on intervals it owns, the seller should offset the management fee revenue and related subsidy expense.

.61 The guidance in the preceding paragraph applies if the time-share seller does not consolidate the OA. This SOP does not provide guidance as to when (or how) a time-share seller should consolidate an OA. Accounting Research Bulletin (ARB) No. 51, *Consolidated Financial Statements*, as amended by FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*, and FASB Statement No. 144; FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities*; and related EITF Issues provide the relevant guidance. AcSEC notes that FASB Statement No. 144 amended ARB No. 51 to remove the prior exception allowing for the nonconsolidation of an entity when control is likely to be temporary.

Statement of Cash Flows

.62 Changes in time-sharing notes receivable, including sales of the notes, should be reported in the statement of cash flows as cash flows from operating activities.

Presentation and Disclosures

.63 A time-share seller's balance sheet should include gross notes receivable from time-sharing sales, a deduction from notes receivable for the allowance for uncollectibles (see paragraphs .36 and .37 of this SOP), and a deduction from notes receivable for any profit deferred under FASB Statement No. 66.

.64 As noted in paragraph .41 of this SOP, the effects of changes in estimate in the relative sales value method should be disclosed in accordance with paragraph 33 of APB Opinion No. 20. In addition to the information otherwise required by generally accepted accounting principles (GAAP), the financial statements of entities with time-sharing transactions should disclose the following:

a. Maturities of notes receivable for each of the five years following the date of the financial statements and in the aggregate for all years thereafter. The total of the notes receivable balances displayed with the various maturity dates should be reconciled to the balance-sheet amount of notes receivable.

b. The weighted average and range of stated interest rates of notes receivable.

c. The estimated cost to complete improvements and **promised amenities**.

d. The activity in the allowance for uncollectibles, including the balance in the allowance at the beginning and end of each period, additions associated with current-period sales, direct writeoffs charged against the allowance, and changes in estimate associated with prior-period sales. If the developer sells receivables with recourse, the seller should provide the same disclosure of activity on receivables sold.

e. The seller's policies with respect to meeting the criteria for buyer's commitment and collectibility of sales prices in paragraphs 5(b) and 37(d), respectively, of FASB Statement No. 66.

Effective Date and Transition

.65 This SOP should be applied to financial statements for fiscal years beginning after June 15, 2005. Earlier application is encouraged as of the beginning of fiscal years for which financial statements or information have not been issued.

.66 Initial application of this SOP should be reported as a cumulative effect of a change in accounting principle, as described in APB Opinion No. 20. When adopting this SOP, an entity is not required to report the pro forma effects of retroactive application. An entity is required to disclose the effect of adopting this SOP on income before extraordinary items and on net income (and on the related per share amounts) of the period of the change. An entity should not restate previously issued financial statements.

The provisions of this Statement need not be applied to immaterial items.

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Appendix A

Basis for Conclusions

Scope

A-1. The scope of this Statement of Position (SOP) is restricted to time-sharing transactions in real estate and excludes time-sharing transactions in other long-lived assets such as cruise ships, corporate jets, and other kinds of transportation equipment. The Accounting Standards Executive Committee (AcSEC) concluded, accordingly, that the specialized real estate guidance for time-sharing transactions in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*, should be one of the principal foundations for the conclusions in this SOP. Consequently, analogies of the guidance in this SOP to non-real estate transactions may not be appropriate.

A-2. AcSEC concluded that the SOP should apply to time-share resellers as well as time-share developers because many of the same issues apply to both.

Profit Recognition Under FASB Statement No. 66

A-3. The exposure draft of this SOP incorporated a revenue recognition model for time-sharing transactions that was largely based on the fundamental principles of the retail land sales model of FASB Statement No. 66. At its initial meeting to clear a final SOP, the FASB determined that AcSEC should not include a fundamental change in revenue recognition guidance in the SOP. The Board considered a number of factors in arriving at its conclusion, including (*a*) the Board's comprehensive revenue recognition project and the potential for requiring preparers to change their revenue recognition practices twice in a short time frame, (*b*) the "rules based" nature of the proposed revenue recognition requirements, and (*c*) changes in revenue recognition practices that had occurred since AcSEC originally added the project to its agenda. Accordingly, this SOP does not modify the requirement of FASB Statement No. 66 to account for time-sharing transactions under the other-than-retail-land-sales (OTRLS) model of that Statement. Rather, this SOP provides limited guidance relating to revenue recognition by illustrating the application of the revenue recognition provisions of the OTRLS model to the specific terms typically encountered in time-sharing transactions.

A-4. Paragraph 37 of FASB Statement No. 66 prescribes the application of the percentage-of-completion method to time-sharing transactions provided certain criteria are met. FASB Statement No. 66 provides specific guidance on applying the percentage-of-completion method to retail land sales but does not provide similar guidance for OTRLS. AcSEC believes that the guidance appropriate for time-sharing transactions (see paragraphs B-3 through B-6 in Appendix B [paragraph .68] of this SOP) consists of elements of both that guidance in FASB Statement No. 66 and the percentage-of-completion method guidance in SOP 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts* [section 10,330], which applies to "contracts in the construction industry, such as those of general building, earth moving, dredging, demolition, design-build contractors, and specialty contractors (for example, mechanical, electrical or paving)." Because AcSEC does not believe that selling and marketing costs constitute "contract costs" or that the selling and marketing effort constitutes "contract performance," as those terms are used in paragraphs 4 and 22, respectively, of SOP 81-1 [section 10,330.04 and .22], AcSEC concluded that selling and marketing costs should not be included in the percentage-of-completion calculations for time-sharing transactions. AcSEC believes that a time-share developer should recognize profit under the percentage-of-completion method only for costs incurred that benefit the customer by bringing the time-share unit closer to completion and a certificate of occupancy.

A-5. Some respondents to the exposure draft disagreed with the prescribed use of the percentage-of-completion method in the situation in which a developer sells time-sharing intervals prior to the completion of related amenities of a phase that is fully constructed (see footnote 2 to paragraph B-3 in Appendix B [paragraph .68] of this SOP). Those respondents commented that substantial risks and rewards of ownership transfer to the purchaser even if amenities are not complete and, therefore, the full accrual method should be permitted. AcSEC believes, however, that until the applicable amenities are completed, a seller has not fulfilled all of its contractual obligations to the buyer and should therefore delay recognition of a portion of profit until such obligation is fulfilled.

A-6. AcSEC concluded in paragraph .13 of this SOP that transfer of title should be nonreversionary in order to satisfy the requirement under FASB Statement No. 98, *Accounting for Leases: Sale-Leaseback Transactions Involving Real Estate, Sales-Type Leases of Real Estate, Definition of the Lease Term, and Initial Direct Costs of Direct Financing Leases*, that title be transferred in order to recognize a sale of real estate. Paragraph 22(c) of FASB Statement No. 98 indicates that a lease involving real estate must meet the criterion in paragraph 7(a) of FASB Statement No. 13, *Accounting for Leases*, for the lessor to classify the lease as a sales-type lease. Under that criterion, ownership must be transferred by the end of the lease term. AcSEC believes that only a nonreversionary transfer of title satisfies that criterion.

Determination of Sales Value

A-7. AcSEC's conclusion in paragraph .17 of this SOP that the seller's transfer of a time-sharing interval and other products and services (including incentives) that may be "bundled" with the time-sharing interval should be recorded as separate transactions was based on paragraphs 7(b) and 31 (applied, by analogy, to products as well as services) of FASB Statement No. 66. Paragraph 7(b) of that Statement requires that net present value be used as the measure of the other products and services but does not specify what discount rate to use. AcSEC believes, however, that for the typical other products and services associated with time-sharing transactions, fair value represents the intended objective of net present value and may be more readily determinable than the appropriate discount rate. Fair value is also consistent with more recent accounting standards. Accordingly, AcSEC prescribed fair value rather than net present value.

A-8. Some respondents commented that all incentives represent and therefore should be accounted for as selling and marketing expenses, similar to commissions and other direct selling costs, with any stated fees (for example, a nominal [below fair value] fee that a time-share purchaser pays for an airline voucher used as an incentive) being a reduction of those expenses. Those respondents suggested that the sales value of the interval not be adjusted for incentives. AcSEC considered the comment but did not believe an accounting treatment other than that prescribed in paragraphs 7(b) and 31 (applied, by analogy, to products as well as services) of FASB Statement No. 66 could be justified.

A-9. AcSEC's conclusion in paragraphs .17 and .18 of this SOP about the seller's income statement classification of cash and noncash incentives to buyers was based on Emerging Issues Task Force (EITF) Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)," and FASB Statement No. 66. A cash incentive represents a discount or reduction of the selling price of the time-sharing interval under (paragraphs 9 and 17 of) EITF Issue No. 01-9, that is, with no recording of expense for the cash consideration paid. AcSEC believes that a noncash incentive represents a separate deliverable that should be recorded consistent with paragraph 10 of EITF Issue No. 01-9 and paragraphs 7(b) and 31 (applied, by analogy, to products as well as services) of FASB Statement No. 66, that is, as a separate revenue item (with an associated cost of sales). EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," addresses "the accounting, by a vendor, for contractual arrangements in which multiple revenue-generating activities will be performed by the vendor." However, paragraph 4 of that Issue states that the Issue does not apply to a specific situation if higher-level authoritative literature, such as FASB Statement No. 66, provides guidance for that situation.

A-10. AcSEC concluded in paragraph .18 of this SOP that a cash incentive is either cash or an incentive provided to a buyer that the buyer would otherwise be required to pay. AcSEC believes that the seller's providing that incentive to the buyer is equivalent to the seller reimbursing the buyer for the cash the buyer would otherwise have had to pay in any case, which is equivalent to a cash discount from the stated sales price. Similarly, AcSEC's conclusion that a noncash incentive is an incentive a buyer could elect to purchase was based on AcSEC's belief that in this case the seller is not reimbursing the buyer for cash that the buyer would otherwise have had to pay.

A-11. As an illustration of the recording of incentives, assume the seller gives the buyer of a $20,000 interval a voucher with a fair value of $250 that can be used to obtain airline tickets at no charge. The voucher would be considered a noncash incentive. The seller would report revenue from the sale of the interval of $19,750, revenue from the sale of the voucher of $250, and cost of sales for the voucher of $250. If, instead, the seller pays the buyer's first year's worth of required owners association maintenance fees having a fair value of $250, the payment would be considered a cash incentive. The seller would report revenue from the sale of the interval of $19,750 and no revenue or cost for the fees.

A-12. AcSEC observed that time-share sellers frequently offer a variety of incentives, including both payment of assessments/ fees and amusement park or airline tickets, at one time to the same group of customers. The particular incentive given to a particular customer is based on which one the seller believes will induce the customer to close a sale. AcSEC believes that the time-sharing industry is different in this respect from the transactions that the EITF considered. AcSEC believes that the EITF contemplated transactions in which the seller provided one type of incentive to a class of customers. In the time-share industry, the seller is essentially indifferent between offering a voucher for airline tickets with a fair value of $250 or offering to pay $250 of maintenance fees. AcSEC struggled with the fact that under the EITF consensus, a time-share seller could report different revenue based on which of two incentives it provided to buyers, even though the choice between incentives is so flexible and discretionary. Nonetheless, although it might be more understandable to report the same revenue and cost of sales regardless of the form of the incentive given to buyers, AcSEC concluded that the benefit of consistency with the EITF consensus outweighed creating an exception to the consensus for a single type of transaction (time-sharing).

Application of Test of Buyer's Commitment

A-13. Under paragraph 5(b) of FASB Statement No. 66, profit recognition is affected by the buyer's initial and continuing investments. Given AcSEC's conclusions about how to compute sales value (see paragraphs .16 through .23 of this SOP), it became necessary to provide guidance on how the seller should allocate cash received from the buyer between the interval and the incentives or other "bundled" products or services. AcSEC initially concluded that the fair value of other products or services should be subtracted from the buyer's initial and continuing investments, based on the belief that, as a general rule, any cash received by the seller should be applied first towards the sale of the other products or services and second towards the sale of the time-sharing interval. However, if the buyer is directly or indirectly required to make payments on the note to receive the other products or services, AcSEC concluded that it was too harsh to subtract the full fair value from the initial and continuing investments. AcSEC also considered an alternative, favored by some respondents, of allocating all cash received from the buyer pro rata between the interval and the other products or services based on relative fair values. AcSEC rejected that alternative, because it implied that the seller extended the same credit terms to the interval and the other products or services. AcSEC thought it was unlikely that a seller would allow a buyer to pay for incentives, such as airline tickets, amusement park tickets, or maintenance fees, over the typical five- to ten-year term of time-share notes. In the end, AcSEC endorsed a compromise approach that AcSEC believes is a reasonable way to allocate the cash received. Under that compromise approach, any note payments that the buyer is directly or indirectly required to make to receive the other products or services should be subtracted from the fair value of those other products and services, and only the excess (if any) of that fair value over those payments should be subtracted from the buyer's initial and continuing investments for the interval. AcSEC believes that approach is consistent with practice under FASB Statement No. 66—in particular, with regard to how sellers account for their provision of management services at less than prevailing market rates.

A-14. AcSEC believes it is reasonable to apply all buyer payments—including both principal and interest—before seller delivery of the other products or services, and that those payments should cover both the value of the other products or services and interest on the unpaid portion. For accounting purposes, the seller allocates cash received as if there were two separate notes (with the same interest rate)—one for the purchase of the interval (with a term equal to the term of the note the buyer signs) and one for the other products or services (with a term ending on the date the buyer can use them). AcSEC believes that this approach represents a systematic and rational allocation of the cash received between the interval and other products or services. AcSEC observes that under this approach, the hypothetical note for the purchase of the interval may have a period of negative amortization, because the cash receipts allocated to that note might be less than the accrued interest. AcSEC concluded that it was not necessary to reduce the buyer's initial or continuing investments for that negative amortization, because the buyer's continuing performance on the legal note provides sufficient assurance of the buyer's commitment to fulfill its obligations and because that legal note has no negative amortization. Further, AcSEC believes that products or services integral to the time-sharing interval (for example, seller payment of buyer maintenance or exchange fees) reinforce the buyer's commitment to fulfill his or her obligations.

A-15. AcSEC considered providing guidance on distinguishing de minimis promotional items, the costs of which should be considered selling and marketing costs, from incentives. AcSEC elected not to provide such guidance because AcSEC believes that time-share sellers will be able to adequately distinguish between "thank you" gifts, which are inexpensive items such as champagne, flowers, candy, or photographs given to buyers at closing, that would not reasonably be expected to influence the customer's decision, and incentives, which are given only to interval purchasers and might reasonably be expected to influence a customer to close a transaction that day. AcSEC noted that the tests of initial and continuing investment under FASB Statement No. 66 are intended to be stringent, however, and the decision not to provide guidance on distinguishing thank-you gifts from incentives was not intended to provide a means of avoiding the requirements of those tests by allowing the classification of the costs of incentives as selling and marketing costs. Accordingly, AcSEC believes sellers should not exclude de minimis incentives from the calculations of the initial and continuing investment tests.

Upgrade and Reload Transactions

A-16. AcSEC's determination that a reload transaction requires an additional cash payment in order to satisfy the initial and continuing investment tests was based on EITF Issue No. 88-12, "Transfer of Ownership Interest as Part of Down Payment under FASB Statement No. 66." The consensus reached in that Issue was that "purchased property or other assets pledged as security for a note should not be included as part of the buyer's initial investment." AcSEC considered a reload to be the purchase of a second interval unrelated to the equity accumulated in the first interval.

A-17. In contrast, AcSEC believes an upgrade is, in substance, an exchange transaction in which the ultimate interval sold by the developer is the new (upgrade) interval. Because an upgrade transaction can be viewed as the developer buying back the original time-share buyer's equity in the original interval for cash and the buyer then applying that cash towards the purchase of the upgrade interval, AcSEC believes it is appropriate to include the equity in the original interval (measured as the buyer's initial and continuing investments on the ceded interval and excluding changes in market value of the interval) towards the tests of initial and continuing investments on the upgrade interval.

A-18. Under the exposure draft, the sales value in an upgrade transaction was the difference between the sales value of the upgrade interval and the sales value of the original interval at the date of the original sale. The initial and continuing investment tests were to be applied to that incremental sales value. AcSEC had looked to paragraph 9 of FASB Statement No. 66 to conclude that a buyer's equity in its original interval could not be applied toward the initial or continuing investment tests for the upgrade interval.

A-19. Many respondents to the exposure draft commented that both reloads and upgrades should be considered together with the original sale for purposes of applying the initial and continuing investment tests. Comments included the following:

a. Reload transactions are typically undertaken by "mature" timeshare owners who have made cumulative payments on their existing obligations that typically total 25 to 35 percent of the combined purchase prices of the original and reload intervals. In many cases, the purchase obligations are consolidated into a single monthly payment, often involving a single note. Thus, a reload is viewed by both seller and buyer as merely an expansion of the original obligation, with cash paid on the original interval crediting toward the remaining combined obligation on the two intervals.

b. The intent of the initial and continuing investment tests is to demonstrate the buyer has made cash payments that provide a reasonable likelihood of the seller collecting the receivable. Because reload transactions generally are entered into only with customers current on their existing obligation, the resulting note on the second interval is of high quality.

c. EITF Issue No. 88-12 addresses requirements related to an initial down payment, whereas FASB Statement No. 66 and the SOP exposure draft incorporate both initial and continuing investment requirements rather than a down payment requirement. Because the intent of the initial and continuing investment tests is to ensure a reasonable likelihood of collectibility, the test as applied to reloads and upgrades should take into account the buyer's performance and initial and continuing investments with respect to the original interval.

A-20. AcSEC considered the comments and, although EITF Issue No. 88-12 could be interpreted as not being relevant to a test of initial or continuing investment, AcSEC believes that the objective of paragraphs 9 and 10 of FASB Statement No. 66 is that payments on real estate transactions for distinct and separate parcels of real estate should be treated separately for purposes of sale or revenue recognition, even if the two transactions are combined into a single note receivable or are cross-collateralized. Therefore, AcSEC concluded it should not modify its original accounting for reload transactions from that in the exposure draft of this SOP. However, in reconsidering upgrade transactions and observing that the original interval is ceded or, in essence, traded in in such transactions, AcSEC concluded that an upgrade transaction is a modification of the original purchase rather than a purchase of an additional distinct and separate interval, and that it is reasonable to consider the initial and continuing investments on an initial purchase as part of the initial and continuing investments on a modification of that purchase.

Accounting for Uncollectibility

A-21. AcSEC considered the following three alternatives for the classification and display of uncollectibles:

a. Adjust revenue and cost of sales (the approach in this SOP).

b. Record bad debt expense.

c. Adjust revenue and cost of sales for the initial estimates of uncollectibles and record bad debt expense for subsequent increases in estimated uncollectibles.

A-22. The first alternative AcSEC considered was to adjust revenue and cost of sales. AcSEC selected that alternative for this SOP primarily for the following reasons:

a. Some AcSEC members view time-share uncollectibles as having some elements of a right of return as discussed in FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*, because, typically, it is not cost-effective for a time-share seller to pursue buyers for collection after a certain point. Once a time-share seller forecloses on a time-share interval, the seller typically stops pursuing the buyer for collection of the unpaid note, even if the note balance exceeds the fair value less costs to sell of the interval to the seller. Another similarity with a right of return is that a repossessed interval is essentially "good as new" and can be resold at substantially the same price as an interval that never was sold. In contrast to the uncollectible that results from a trade receivable, the sold item (that is, the time-sharing interval) is repossessed in the time-sharing arrangement. As a result, the foreclosure is akin to a sales return that reduces revenue.

b. Time-sharing transactions are characterized by a number of attributes that distinguish them from typical OTRLS transactions. Primary among these attributes are high volume and seller financing. Other distinguishing attributes include relatively low down-payment requirements and marketing and selling efforts with a high cost relative to the price of time-sharing intervals. Paragraph 1 of FASB Statement No. 66 states, "The Statement distinguishes between retail land sales and other sales of real estate because differences in terms of sales and selling procedures lead to different profit recognition criteria and methods." Under the description of retail land sales in paragraph 100 of FASB Statement No. 66, and in view of similarities between their sales and selling procedures, retail land sales and time-sharing transactions share many more of the same attributes than do retail land sales and typical OTRLS transactions. Paragraph 70 of FASB Statement No. 66 provides the following guidance for retail land sales: "Cost of sales...are based on sales net of those sales expected to be canceled in future periods." Although FASB Statement No. 66 provides no comparable guidance for cost of sales in OTRLS transactions, AcSEC believes that the retail land sales concept of not recording transactions expected to be canceled in future periods is also appropriate for time-share transactions.

c. If uncollectibles are recorded as bad debt expense, the seller records revenue (and cost of sales) for more than 100 percent of the intervals constructed, because foreclosed intervals are resold. In fact, the worse the collection experience, the more intervals that are repossessed are resold, leading to higher reported revenue (and cost of sales). AcSEC believes that approach overstates revenue.

d. The time-share industry has, in practice, recorded repossessed intervals at their original cost rather than at fair value on the date of foreclosure. However, FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings* (as amended by paragraph C24 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*), states that foreclosed assets should be recorded at fair value less cost to sell. AcSEC concluded that if foreclosed intervals were recorded at fair value less cost to sell, there would be significant issues over the proper approach to measuring fair value less cost to sell. Some argue for an approach that would essentially eliminate allowances for uncollectibles for many developers that have the selling and marketing infrastructure to sell repossessed intervals at a price close to the original sales price. Others would reject that approach because it fails to reflect an allocated cost of maintaining that infrastructure. Some would make the measurement equal to the net proceeds that an existing time-share owner would receive if the time-share were sold on the secondary market. Some would measure fair value based on reproduction cost. Finally, some would apply the definition of market in paragraph 8 ("Statement 6") of Chapter 4 of Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins*, which states that for purposes of pricing inventory, market is replacement cost, subject to a floor and a ceiling:[1]

> As used in the phrase *lower of cost or market* [footnote omitted], the term *market* means current replacement cost (by purchase or by reproduction, as the case may be) except that:
>
> (1) Market should not exceed the net realizable value (i.e., estimated selling price in the ordinary course of business less reasonably predictable costs of completion and disposal); and
>
> (2) Market should not be less than net realizable value reduced by an allowance for an approximately normal profit margin.

AcSEC chose not to debate those approaches. AcSEC's preferred solution (the alternative presented in item *a* in paragraph A-21 of this SOP), through the application of the relative sales value method, does not require an assessment of fair value.

A-23. AcSEC recognizes that its preferred solution has some disadvantages:

a. It differs from general practice in other industries (other than the retail land sales industry).

b. It includes in inventory the cost of some intervals for which legal title has passed from seller to buyer.

c. It creates an issue of how to address changes in estimates of revenue and cost of sales.

On balance, however, AcSEC believes that the method chosen for this SOP is the best of the alternatives.

A-24. The second alternative AcSEC considered was to record uncollectibles as bad debt expense, measured as the excess of the expected uncollectible receivables over the historical inventory cost of the intervals expected to be repossessed. The advantages of that alternative are the following:

a. This approach would be similar to existing practice in the time-share industry.

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[1] The Financial Accounting Standards Board (FASB) has issued an exposure draft of a proposed Statement of Financial Accounting Standards, *Fair Value Measurements*. Under paragraph C18 of that exposure draft, the Board "clarified that in ARB 43, Chapter 4 the 'market value' measurement resulting from the application of the lower of cost or market measurement required for inventories is not fair value. It places upper and lower limits on the measurement that may not result in a fair value measurement." Readers should be alert to any final pronouncement.

b. This approach would clearly display on the face of the income statement two important metrics for time-share developers—namely, sale transactions closed in the current reporting period and the charge for credit losses net of inventory recoveries. Under AcSEC's approach, those amounts are not required to be displayed in the income statement.

c. Gross profit percentages calculated under this approach may be easier to interpret than under AcSEC's approach.

The disadvantages of the bad debt expense alternative generally are discussed in paragraph A-22 as advantages of AcSEC's approach. Many respondents to the exposure draft expressed a preference for the bad debt expense alternative, largely for the reasons noted in items *a* and *b* of paragraph A-23. Respondents commented also that AcSEC's approach compromises the seller's ability to separately measure the performance of its selling and financing processes because the approach distorts the measurement of both the efficiency of the selling and marketing efforts to produce sales revenue and the performance of the seller's portfolio of notes receivable.

A-25. Finally, AcSEC considered a hybrid approach under which estimated uncollectibles for a short time after a sale (six to twelve months) would be classified as reductions of revenue, but increases in estimated uncollectibles after that time would be classified as bad debt expense. The idea was that uncollectibility that occurs within a short time following the sale transaction is more akin to a return, as if the buyer had a change of heart, whereas uncollectibility after the buyer has built some equity in the property is more akin to "credit losses" in other industries. AcSEC believes strongly, however, that all uncollectibles should be classified in the same line in the income statement. In addition, AcSEC members were concerned that if there were a bright line, sellers could time their changes in estimate and their foreclosure strategies to achieve the classification that they desired. As a result, AcSEC did not pursue this approach.

A-26. AcSEC concluded in paragraphs .30 through .32 of this SOP that the term *uncollectibles* should be interpreted broadly. AcSEC based its conclusion upon certain guidance in FASB Statements No. 15 and No. 114, *Accounting by Creditors for Impairment of a Loan*. Although paragraph 6 of FASB Statement No. 114 states that the Statement does not apply to "large groups of smaller balance homogenous loans that are collectively evaluated for impairment"—characteristics of time-sharing receivables—paragraph 9 of that Statement states that a creditor shall apply the provisions of FASB Statement No. 114 to such smaller balance homogeneous loans if they are restructured.

A-27. A debt restructuring is "troubled" in accordance with paragraph 2 of FASB Statement No. 15 "if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider." A loan is impaired under paragraph 8 of FASB Statement No. 114 when "it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement." AcSEC believes that many situations in which time-share buyers fail to make their original contractual payments fall within the scope of those Statements and that, therefore, any losses that occur as a result of applying those Statements constitute, under this SOP, uncollectibility. Those situations include but are not limited to assumptions, modifications of terms, foreclosures, and downgrades. An assumption, involving the substitution of another borrower for the buyer, would typically result in a loss (that is, uncollectibility) under paragraph

42 of FASB Statement No. 15. An assumption of the kind described in EITF Issue No. 87-19, "Substituted Debtors in a Troubled Debt Restructuring," would result in the creditor recognizing a loss on the disposition of the original loan and recording an asset for the fair value of the payments to be received from the substituted debtor (which is less than the creditor's net investment in the original loan). A modification of terms or a partial satisfaction of a receivable in combination with a modification of terms would typically result in a loss under paragraphs 28 and 33 of FASB Statement No. 15 (as amended by paragraph 22(c) of FASB Statement No. 114). A foreclosure or other repossession of a time-sharing interval would typically result in a loss under paragraph 34 of FASB Statement No. 15, as modified by paragraph 22(d) of FASB Statement No. 114.

A-28. In concluding that a downgrade represents a kind of uncollectible, AcSEC considered charging directly against sales the difference between the sales prices of the new and old intervals. AcSEC believes, however, that a downgrade represents primarily a modification in terms and that any associated losses under FASB Statement No. 114 should, just as with any other kind of uncollectible, be taken into account in determining expected and actual uncollectibles. In support of that belief, AcSEC observed that the new reduced loan under a downgrade may have different terms (term of note, interest rate, payment schedule) than the original contractual financing.

A-29. AcSEC concluded in paragraph .34 of this SOP that incremental, direct costs associated with uncollectibles should be charged to expense as incurred. AcSEC analogized to paragraph 14 of FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, which indicates that costs related to a troubled debt restructuring should be charged to expense as incurred.

Accounting for Cost of Sales and Inventory

A-30. AcSEC concluded in paragraph .40 of this SOP that the relative sales value method is the appropriate method for time-sharing transactions. As discussed in paragraph A-22(*b*) of this SOP, AcSEC believes that paragraph 70 of FASB Statement No. 66 is appropriate for time-sharing transactions; specifically, paragraph 70(c) provides appropriate guidance for recording cost of sales. AcSEC also believes that treating inventory as a pool of costs is a more cost-effective approach than specific identification to account for large pools of homogeneous inventory.

A-31. AcSEC concluded in paragraph .41 of this SOP that changes in estimate under the relative sales value method should be accounted for on a fully retrospective basis using a current-period adjustment. AcSEC also considered the following two alternatives for accounting for changes in estimate:

a. Retrospectively, via a cumulative, current-period adjustment from the beginning of the fiscal year of change

b. Prospectively, beginning with the period of change (for example, a quarter)

In its deliberations, AcSEC noted that the fully retrospective method prescribed in this SOP and alternative *a* have precedent in the accounting literature, and that alternative *b* is not unlike the method prescribed in FASB Statement No. 66 (paragraph 76) for the percentage-of-completion method of accounting for retail land sales. The fully retrospective method is similar to the cumulative catch-up described in paragraph 83 of SOP 81-1 [section 10,330.83]. The retrospective method in alternative *a* is consistent with paragraphs 36 and 107 through 109 of SOP 00-2, *Accounting by Producers or Distributors of Films* [section 10,800.36 and .107 through .109].

A-32. AcSEC believes that the principal basis for the method prescribed in SOP 00-2 [section 10,800] (that is, consistency with prior accounting in the superseded FASB Statement No. 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*) is not adequate to justify that method's application to changes in estimate under the relative sales value method. AcSEC believes also that the prospective method discussed in the preceding paragraph, although appearing to represent a reasonable means of reflecting changes in estimate, would introduce a new model of accounting for changes in estimate that would result in further diversity in how such changes are accounted for. AcSEC ultimately concluded that the fully retrospective method was most appropriate because, under that approach, the current carrying amounts of inventory and net receivables in the period of change would reflect the seller's best estimates at the end of the period.

A-33. AcSEC concluded (see paragraph B-4 of Appendix B [paragraph .68] of this SOP) that changes in estimate under the percentage-of-completion method should be accounted for under the same retrospective method as that used for all other changes in estimate under the relative sales value method. This results in consistency in the relative sales value method computations. AcSEC's conclusions in paragraphs .41 and .64 of this SOP regarding disclosure of changes in estimate are based on the first sentence of paragraph 33 of Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*.

A-34. AcSEC's conclusion in paragraph .42 of this SOP that a seller should perform impairment testing on time-sharing inventory in accordance with FASB Statement No. 144 rather than ARB No. 43 is based on paragraphs B122 through B124 of that Statement.

Costs to Sell Time-Sharing Intervals

A-35. AcSEC's conclusions in paragraphs .45 and .46 of this SOP were based on paragraphs 17 through 19 of FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, but were modified to incorporate the more recent "incremental costs" guidance in paragraphs 6 and 7 of FASB Statement No. 91. AcSEC's conclusion in paragraph .48 of this SOP that tour generation costs—that is, costs to induce potential buyers to take sales tours—should be expensed as incurred is based on the guidance in paragraph 7 of FASB Statement No. 91 relating to the accounting for costs of soliciting potential borrowers.

A-36. Some respondents commented that time-share selling and marketing costs should be deferred until the related revenue is recognized. Those respondents commented that to charge those costs to expense as incurred while recognizing the related revenue during later periods is likely to distort reported results and fail to clearly and timely reflect trends, such as a downward trend in time-share sales. AcSEC believes, however, that deferred selling and marketing costs do not meet the definition of an asset and observed that similar conclusions have been drawn in other literature—for example, SOP 00-2 [section 10,800] and FASB Statement No. 2, *Accounting for Research and Development Costs*.

A-37. Some respondents commented that tour generation costs should be deferred until the tour occurs, based on analogy to the guidance on direct response advertising in SOP 93-7, *Reporting on Advertising Costs* [section 10,590]. Those respondents argued that solicited potential buyers could be shown to have responded specifically to the tour generation activity by taking a tour and purchasing a time-share interval, and that the documentation requirements in paragraph 34 of SOP 93-7 [section 10,590.34] are satisfied by the fact that time-share entities can document the response—namely, the customer name and the tour that generated the sale. AcSEC disagreed, however, based on the fact that there are significant additional sales activities (principally, the tour) involved following the tour generation activity, and that under paragraph 73 of SOP 93-7 [section 10,590.73] the costs of the tour generation activity would therefore not be considered direct response advertising. AcSEC did agree to clarify that the costs of the tour itself, for example, airline tickets, should be charged to expense in the period in which the tour occurs.

A-38. In its deliberations, AcSEC observed that similar costs to sell may be treated differently for accounting purposes depending on who the recipients are. For example, the costs of amusement park tickets given to all customers, regardless of whether or not those customers ultimately purchase a time-sharing interval, should be charged to expense as incurred as promotional items. However, if those same items are given only to customers who ultimately purchase a time-sharing interval, those items are incentives and should be accounted for as such under this SOP (see paragraphs .17 and .24 through .27).

A-39. Practice has been diverse as to the determination of which costs should be deferred as discussed in paragraph .46. It has been argued that direct commissions only, or incremental costs only, or costs fully loaded with overhead charges should be deferred. AcSEC made the determination, based on consideration of the guidance in FASB Statements No. 67 and No. 91, to defer certain selling costs only if they are both incremental and directly associated with successful sales transactions, and to expense as incurred nonincremental costs and costs associated with unsuccessful sales transactions. At the same time, AcSEC acknowledged that selling costs as a percentage of revenue could vary more from period to period under the incremental approach than under the nonincremental, "directly associated" approach of FASB Statement No. 67.

A-40. AcSEC concluded that all selling costs should be expensed under the cost recovery method of accounting because of uncertainties about the recoverability of deferred selling costs. AcSEC's conclusion to limit the amount of deferred selling costs under the deposit method to the nonrefundable portion of the deposits received by the seller was intended to eliminate the risk of not recovering deferred selling costs in the event of a buyer default.

Operations During Holding Periods

A-41. AcSEC clarified in paragraph .49 of this SOP the term *holding period* to address scenarios such as a time-sharing entity's purchase of a hotel and conversion of the units to time-shares over a multiple-year development period. Under that scenario, a particular occupancy unit would be depreciated until it was clearly held and available for sale as a time-sharing interval.

A-42. AcSEC concluded in paragraph .50 of this SOP that rental operations associated with time-sharing units during holding periods should be accounted for as incidental operations, as discussed in FASB Statement No. 67, rather than as rental revenue and expenses, because AcSEC believes that those rental operations are incidental to the time-sharing developer's principal business of selling intervals. Revenue from rentals helps the seller defray the costs associated with holding unsold intervals, such as the maintenance fees to the owners association (OA). In arriving at its conclusion, AcSEC considered and rejected two alternative accounting treatments:

a. Account for all unsold inventory as fixed assets and depreciate unsold time-sharing intervals.

b. Apply the SOP's prescribed holding-periods accounting to time-sharing intervals expected to be sold within one year, and apply the accounting in the alternative presented in item *a* to time-sharing intervals not expected to be sold within one year.

A-43. AcSEC also concluded in paragraph .50 that in recording incremental revenue in excess of incremental costs as a reduction of inventory costs, estimates of future amounts of such excess should not be factored into the calculations of the relative sales value method. AcSEC believes that because it may be impracticable to reliably estimate in advance the net of incremental rental revenue over associated incremental rental costs, such estimates should not be anticipated in determining (reducing) inventory for purposes of calculating (reducing) the cost-of-sales percentage in the relative sales value method.

A-44. AcSEC observed that, in situations in which incremental rental income exceeds incremental costs, its conclusions may be perceived as differing from those in International Accounting Standard (IAS) 16, *Property, Plant and Equipment*. Under paragraph 21 of IAS 16, in such situations occurring during a property's development period, the net rental income is recorded in earnings rather than as a reduction of the property's cost. Although AcSEC's conclusion applies to the holding period rather than the development period, that conclusion differs from the conclusion in IAS 16. AcSEC believes that its conclusion represents preferable accounting in the specific facts and circumstances of the real estate time-sharing industry. AcSEC also believes that its conclusion is more consistent with U.S. generally accepted accounting principles—in particular, FASB Statement No. 67.

Special-Purpose Entities, Points Systems, Vacation Clubs, and Similar Structures

A-45. AcSEC concluded that the accounting for a time-sharing transaction should follow the same profit recognition principles in the OTRLS sections of FASB Statement No. 66 for all forms of time-sharing transaction structures. AcSEC's conclusion that, for special-purpose entity (SPE) structures, profit should be recognizable only if the time-sharing interval has been sold to the end user is based on guidance in FASB Statement No. 66 and APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. The guidance in paragraphs 33 and 34 of FASB Statement No. 66 on accounting for "partial sales" discusses the situation in which the seller retains an equity interest in either the real estate or the buyer. If the seller has an equity interest in the buyer, the seller can recognize profits to the extent of the outside interests in the buyer. Paragraph 34 states, "If the seller controls the buyer, no profit on the sale shall be recognized until it is realized from transactions with outside parties through sale or operations of the property." Paragraph 21 of APB Opinion No. 29 states that "an exchange of a productive asset not held for sale in the ordinary course of business for a similar productive asset or an equivalent interest in the same or similar productive asset" is a nonmonetary transaction that does not culminate an earnings process. Under that guidance, a seller's initial transfer of title to time-sharing real estate to an SPE in exchange for stock, beneficial interests, or other similar instruments in the real estate is considered a nonmonetary exchange, with no gain or loss to be recorded by the seller upon that initial transfer.

A-46. AcSEC believes that its use of the partial sales guidance in FASB Statement No. 66 as a basis for a time-sharing transaction involving an SPE structure is supported by EITF Issue No. 98-8, "Accounting for Transfers of Investments That Are in Substance Real Estate." The consensus of that Issue was that "the sale or transfer of an investment in the form of a financial asset that is in substance real estate should be accounted for in accordance with Statement 66." AcSEC believes that a seller's interest in a time-sharing SPE having no economic substance (see paragraph A-47 of this SOP) is in substance both real estate and a time-sharing interval. AcSEC observed that the Issue also states, "Paragraph 4 of Statement 140 [FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*] provides that transfers of ownership interests that are in substance the sale of real estate are outside the scope of Statement 140. Therefore, these transfers should follow the guidance in Statement 66. As a result, this issue is affirmed by the issuance of Statement 140."

A-47. Upon sale of time-sharing real estate to an SPE in exchange for interests in the SPE, the seller owns 100 percent of the interests in the SPE. As the seller sells the intervals, the seller's ownership percentage in the SPE decreases. Ordinarily, a seller should consolidate an SPE in the situation of control or an SPE ownership percentage over 50 percent, apply the equity method of accounting in the situation of significant influence or an SPE ownership percentage of 20 percent to 50 percent, and apply the cost method in the situation of no significant influence or an SPE ownership percentage below 20 percent. However, AcSEC believes that SPEs having no assets other than the time-sharing intervals and having no debt, and that are established solely to comply with legal requirements relating to the residency of the buyer, are simply a mechanism for selling intervals. For such SPEs, for balance-sheet classification purposes, AcSEC believes the seller should "look through" the SPE and classify intervals held by the SPE as inventory. By contrast, some SPEs would have economic substance, because they are legally required as a means of selling interests in multiple properties to a single buyer, rather than to comply with residency restrictions in local law. SPEs not meeting the narrow definition would be accounted for in accordance with the relevant standards, including FASB Interpretation No. 46R, *Consolidation of Variable Interest Entities*; ARB No. 51, *Consolidated Financial Statements*, as amended and interpreted; and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

A-48. AcSEC discussed time-sharing SPE structures in which the buyer's ownership period expires after a period of years. If the residual interest reverts to the seller, that constitutes a reversionary transfer of title; see paragraph .13 of this SOP. If, however, the transaction was structured in accordance with paragraph 38 of FASB Statement No. 66, AcSEC believes that the prescribed sale accounting of that paragraph of the Statement would apply to time-sharing transactions. Under that paragraph, sale accounting, rather than operating lease accounting, is prescribed for a situation in which a seller sells property improvements but leases the underlying land, provided that the term of the land lease:

a. Covers substantially all of the economic life of the property improvements; and

b. Is for a substantial period, for example, 20 years.

If either of conditions *a* or *b* is not met, under FASB Statement No. 66 the transaction is considered in substance to be a lease of both land and improvements and should be accounted for in the same manner as an operating lease.

A-49. If the buyer's ownership period expires after a period of years and the residual interest reverts to a substantive third party independent of the seller, AcSEC believes that the seller has relinquished all aspects of ownership and should apply the profit recognition guidance of FASB Statement No. 66 rather than operating lease accounting.

A-50. AcSEC's conclusions in paragraph .57 of this SOP relating to the seller's accounting for exchange, points, affinity, and similar programs are based on paragraph 31 of FASB Statement No. 66. See "Seller-Provided Management Services" in Appendix C [paragraph .69] of this SOP. With respect to the provision that a seller should evaluate whether it receives compensation at prevailing market rates for providing a program, some respondents to the exposure draft commented that because items (*rewards*) to be provided by the seller in exchange for a purchaser's interval may change over time, comparing the fair value of the exchanged items and the interval may be impracticable. AcSEC modified Appendix C [paragraph .69] to clarify its intent.

Owners Associations

A-51. AcSEC concluded in paragraph .59 of this SOP that seller subsidies to an owners association (OA) should be charged to expense as incurred. AcSEC considered the alternative of capitalizing those subsidies as development costs of time-share inventory but believes that subsidies represent a cost of operations and should therefore be treated as period costs. AcSEC concluded also that all or a portion of a subsidy that is contractually recoverable from an OA should be recorded as a receivable only if recovery is probable and measurable with reasonable reliability. Generally, AcSEC perceives that to record contractually recoverable subsidy recoveries as receivables requires assumptions that may involve a significant amount of uncertainty about (*a*) future operations of the OA and (*b*) the ability of the OA to increase future assessments to time-share owners.

Statement of Cash Flows

A-52. AcSEC's conclusion that changes in time-sharing notes receivable should be reported as cash flows from operating activities is based on paragraph 22(a) of FASB Statement No. 95, *Statement of Cash Flows*. That paragraph provides as examples of cash flows from operating activities cash receipts from collection or sale of both short- and long-term notes receivable that arise from sales of products or services.

Presentation and Disclosures

A-53. AcSEC believes that the disclosures required under paragraph .64 of this SOP, many of which are similar to those required in the retail land sales model in paragraph 50 of FASB Statement No. 66, are necessary to provide users with adequate information related to the financial positions of entities with time-sharing operations. AcSEC believes that, given the importance of the allowance for uncollectibles in the financial position of such entities, requiring disclosure of the components related to the determination of the allowance provides users of financial statements with information that is helpful in assessing the risks facing such entities.

Effective Date and Transition

A-54. AcSEC concluded that the effect of initially adopting this SOP should be reported as a cumulative effect of a change in accounting principle (in accordance with the provisions of APB Opinion No. 20) and that restatement of prior financial statements should be prohibited. AcSEC recognizes the benefits of comparable financial statements but believes that the effort and costs likely to be incurred outweigh the benefits. Under retroactive restatement (but not under a cumulative effect adjustment), for example, the seller would have to reconstruct the quarterly sales accounting for phases completely sold out as of the date of adoption. AcSEC further believes that to apply this SOP prospectively to new transactions only would result in confusing financial statements that could, for several years, include transactions recorded under both pre-adoption and post-adoption accounting guidance. Accordingly, AcSEC concluded that the effect of initial application of this SOP should be reported as the cumulative effect of a change in accounting principle.

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Appendix B

Illustration of Relative Sales Value Method Under Full Accrual and Percentage-of-Completion Accounting[1]

B-1. The purpose of this appendix is to illustrate the relative sales value method and changes in estimate under that method. Examples 1 through 4 illustrate the full accrual and percentage-of-completion methods of profit recognition under Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*.

Full Accrual Method

B-2. Under the full accrual method as discussed in the other-than-retail-land-sales (OTRLS) sections of FASB Statement No. 66, profit is recognized in full when a time-share is sold (or at a later date when the criteria for application of the method are met). Examples 1 and 2 illustrate the application of the relative sales value method of this Statement of Position (SOP) under full accrual accounting. In Example 1, it is assumed that there are no year-to-year changes in the cost-of-sales percentage. In Example 2, it is assumed that the cost-of-sales percentage changes from year to year.

Percentage-of-Completion Method

B-3. A seller may not have completed improvements on time-sharing units sold or may not have completed promised amenities, **planned amenities**, or other facilities (including utilities and off-site improvements such as access roads) applicable to units sold. Under the percentage-of-completion method prescribed under paragraph 37 of FASB Statement No. 66 for time-sharing transactions, the amount of revenue recognized (based on the sales value) at the time a sale is recognized is measured by the relationship of costs already incurred to the total of costs already incurred and future costs expected to be incurred. If performance[2] is incomplete, the portion of revenue related to costs not yet incurred is recognized as the costs are incurred. As discussed in paragraph .12 of this SOP, selling and marketing costs are excluded from the percentage-of-completion calculations. The costs of amenities that relate to more than one phase should be appropriately allocated to those phases for purposes of the calculations.

B-4. Estimates of future improvement costs should be reviewed at least quarterly. Changes in those estimates should be applied on a retrospective basis. That is, if cost estimates are revised, the relationship of the costs incurred (from project inception to date) to the adjusted total estimated cost of the project should be recalculated for purposes of recognition of revenue and cost of sales

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[1] For simplicity, certain change-in-estimate calculations in the examples are performed on an annual basis although paragraph .41 of this Statement of Position (SOP) requires that they be performed at least on a quarterly basis. Additionally, although percentages (cost-of-sales percentage and percentage of completion) are displayed to two decimal places, the exact percentages are used in the computations.

[2] *Performance* means completion of the improvements, amenities, or other facilities required under the sales contract by either the seller or contractors retained by the seller. However, payments made to municipalities or other governmental organizations not under the direct or joint control of the seller constitute performance by the seller if those organizations are not financed solely by liens on property in the project and they undertake to complete the improvements without further risk or obligation of the seller.

for prior performance as well as for performance that takes place in future periods. If the adjusted total estimated cost of the project exceeds the total expected revenue, the total anticipated loss should be charged to income if it meets the criteria in paragraph 8 of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*. If anticipated losses on time-sharing intervals sold are recognized, the seller should evaluate the unsold time-share intervals for impairment under FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

B-5. The effects of changes in estimate, as described in the preceding paragraph, should be included in the disclosures required under paragraph .41 of this SOP.

B-6. Examples 3 and 4 illustrate the application of the relative sales value method of this SOP under the percentage-of-completion method. Example 4 illustrates changes in estimate.

Time-Sharing Example 1
Relative Sales Value Method, Full Accrual Method, No Year-to-Year Changes in Cost-of-Sales Percentage

Assumptions for 20X1:

All requirements for full accrual sale accounting are met.

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X	250	250	100		600	$ 9,500	$5,700,000
Type Y	200	50	50		300	$10,000	3,000,000
Type Z	50	50			100	$13,000	1,300,000
	500	350	150		1,000		10,000,000
Sale of recovered intervals		10	40	50	100	$ 9,500	950,000**(1)**
	500	360	190	50	1,100		10,950,000
Estimated sales discounts							—
Estimated uncollectible notes							(985,500)
Estimated future revenue							$9,964,500

Sales for 20X1 are $5,025,000 (the 500 units from above at the respective sales prices shown above).

Inventory is complete, with no estimated costs to complete.

Initial down payment:	10% (on all sales; no cash sales)
Forfeiture on defaulted notes:	100% of cash paid
Inventory cost:	$2,500,000
COS percentage:	25.09% ($2,500,000 / $9,964,500)
Initial estimated default rates:	10% of note principal

Accounting Entries

20X1	Notes Receivable	4,522,500	
	Cash	502,500	
	Sales Contra (estimated uncollectible sales)	452,250	
	Sales		5,025,000
	Allowance for Uncollectible Notes Receivable		452,250
20X1	Cost of Sales	1,147,260	
	Inventory		1,147,260

Cost of Sales Calculation

Sales	$5,025,000
Estimated uncollectible sales	(452,250)
Net sales	4,572,750
COS %	25.09%
Cost of sales	$1,147,260

Ending Inventory Calculation

Total expected revenue, 20X1 & future	$9,964,500
Net sales—20X1	(4,572,750)
Remaining expected revenue	5,391,750
COS %	25.09%
Inventory balance	$1,352,740

12/31/20X1	Ending Inventory	$1,352,740	
	# of intervals defaulted	20	**(2)**
	# of intervals defaulted that are recovered	20	**(2)**, **(3)**
	Remaining intervals available for sale	520	= 1,000 – 500 + 20

Assumptions for 20X2:

Same assumptions as 20X1 except expected future revenue estimate excludes 20X1.

Beginning Inventory Balance $1,352,740

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X		250	100		350	$ 9,500	$3,325,000
Type Y		50	50		100	$10,000	1,000,000
Type Z		50			50	$13,000	650,000
		350	150		500		4,975,000
Sale of recovered intervals		10	40	50	100	$ 9,500	950,000
		360	190	50	600		5,925,000
Estimated sales discounts							—
Estimated uncollectible notes							(533,250)
Estimated future revenue							$5,391,750

Sales for 20X2 are $3,620,000 (the 360 units from above at the respective sales prices shown above).

COS percentage: 25.09% ($1,352,740 / $5,391,750)

Accounting Entries

20X2	Notes Receivable	3,258,000	
	Cash	362,000	
	Sales Contra (estimated uncollectible sales)	325,800	
	Sales		3,620,000
	Allowance for Uncollectible Notes Receivable		325,800
20X2	Cost of Sales	826,484	
	Inventory		826,484

Cost of Sales Calculation

Sales	$3,620,000
Estimated uncollectible sales	(325,800)
Net sales	3,294,200
COS %	25.09%
Cost of sales	$826,484

Ending Inventory Calculation

Total expected revenue, 20X2 & future	$5,391,750
Net sales—20X2	(3,294,200)
Remaining expected revenue	2,097,550
COS %	25.09%
Inventory balance	$ 526,256

12/31/20X2	Ending Inventory	$ 526,256	
	# of intervals defaulted	30	**(2)**
	# of intervals defaulted that are recovered	30	**(2), (3)**
	Remaining intervals available for sale	190	= 520 – 360 + 30

Assumptions for 20X3:

Same assumptions as 20X1 except expected future revenue estimate excludes 20X1 and 20X2.

Beginning Inventory Balance $ 526,256

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X			100		100	$ 9,500	$ 950,000
Type Y			50		50	$10,000	500,000
Type Z						$13,000	
			150		150		1,450,000
Sale of recovered intervals			40	50	90	$ 9,500	855,000
			190	50	240		2,305,000
Estimated sales discounts							—
Estimated uncollectible notes							(270,450)
Estimated future revenue							$2,097,550

Sales for 20X3 are $1,830,000 (the 190 units from above at the respective sales prices shown above).

COS percentage: 25.09% ($526,256 / $2,097,550)

Accounting Entries

20X3	Notes Receivable	1,647,000	
	Cash	183,000	
	Sales Contra (estimated uncollectible sales)	164,700	
	Sales		1,830,000
	Allowance for Uncollectible Notes Receivable		164,700
20X3	Cost of Sales	417,808	
	Inventory		417,808

Cost of Sales Calculation

Sales	$1,830,000
Estimated uncollectible sales	(164,700)
Net sales	1,665,300
COS %	25.09%
Cost of sales	$417,808

Ending Inventory Calculation

Total expected revenue, 20X3 & future	$2,097,550
Net sales—20X3	(1,665,300)
Remaining expected revenue	432,250
COS %	25.09%
Inventory balance	$ 108,447

12/31/20X3	Ending Inventory	$ 108,447	**(4)**
	# of intervals defaulted	35	**(2)**
	# of intervals defaulted that are recovered	35	**(2)**, **(3)**
	Remaining intervals available for sale	35	= 190 – 190 + 35

FOOTNOTES

(1) For simplicity purposes only. It is likely that the seller may not be able to sell all remaining units, as some units will be undesirable or the sales effort will not be cost-effective.

(2) Amount is a given for this example and is not derived from any assumptions. Of the 100 units expected to default and be recovered, only 85 occur during 20X1–20X3. The remaining 15 defaults are expected to occur and become available for sale after 20X3.

(3) For simplicity purposes only. Normally, not all interval sales that default will result in recovery of inventory by the seller, as a result of issues such as significant legal (foreclosure) costs and marketability of particular units. In determining estimated future revenue, the seller should take into account the effect of those intervals that would not be recovered versus the effect of those that would. To simplify the illustration, that effect has not been reflected.

(4) As part of its process of assessment of assets for impairment, the seller should evaluate ending inventory in view of the potentially prohibitive cost of marketing such a small quantity of units. Paragraph 34 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, would require that the inventory be measured, for purposes of determining a possible impairment, at the lower of carrying amount or fair value less cost to sell.

Time-Sharing Example 2
Relative Sales Value Method, Full Accrual Method, Year-to-Year Changes in Cost-of-Sales Percentage—Fully Retrospective

Assumptions for 20X1:

All requirements for full accrual sale accounting are met.

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X	250	250	100		600	$ 9,500	$5,700,000
Type Y	200	50	50		300	$10,000	3,000,000
Type Z	50	50			100	$13,000	1,300,000
	500	350	150		1,000		10,000,000
Sale of recovered intervals		10	40	50	100	$9,500	950,000**(1)**
	500	360	190	50	1,100		10,950,000
Estimated sales discounts							—
Estimated uncollectible notes							(985,500)
Estimated future revenue							$9,964,500

Sales for 20X1 are $5,025,000 (the 500 units from above at the respective sales prices shown above).

Inventory is complete, with no estimated costs to complete.

Initial down payment:	10% (on all sales; no cash sales)
Forfeiture on defaulted notes:	100% of cash paid
Inventory cost:	$2,500,000
COS percentage:	25.09% ($2,500,000 / $9,964,500)
Initial estimated default rates:	10% of note principal

Assume 100% of intervals defaulting on first-time sales are resold over the life of the project; no resales in 20X1.

Assume none of intervals defaulting on second-time sales are resold (for simplicity of illustration).

Accounting Entries

20X1	Notes Receivable	4,522,500	
	Cash	502,500	
	Sales Contra (estimated uncollectible sales)	452,250	
	Sales		5,025,000
	Allowance for Uncollectible Notes Receivable		452,250
20X1	Cost of Sales	1,147,260	
	Inventory		1,147,260

Cost of Sales Calculation

Sales	$5,025,000
Estimated uncollectible sales	(452,250)
Net sales	4,572,750
COS %	25.09%
Cost of sales	$1,147,260

Ending Inventory Calculation

Total expected revenue, 20X1 & future	$9,964,500
Net sales—20X1	(4,572,750)
Remaining expected revenue	5,391,750
COS %	25.09%
Inventory balance	$1,352,740

12/31/20X1	Ending inventory	$1,352,740	
	# of units defaulted	20	**(2)**
	# of units defaulted that are recovered	20	**(2)**, **(3)**
	Remaining units available for sale	520	= 1,000 – 500 + 20

During the first quarter of 20X2, and subsequent to the issuance of the 20X1 financial statements, the seller changes its estimate of 20X3 sales discounts, originally $0, to $50,000. Also, the seller estimates that only 35 intervals, versus the original estimate of 40, will be resold in 20X3, due to economic conditions. Under the SOP's retrospective treatment, a current-period adjustment is recorded to reflect the changes in estimate.

Redo the 20X1 COS %, using actual 20X1 data:

Estimated Sales Prices and Distribution

	20X1 Actual	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X	250	250	100		600	$ 9,500	$5,700,000
Type Y	200	50	50		300	$10,000	3,000,000
Type Z	50	50			100	$13,000	1,300,000
	500	350	150		1,000		10,000,000
Sale of recovered intervals		10	35	50	95	$ 9,500	902,500
	500	360	185	50	1,095		10,902,500
Estimated sales discounts in 20X3							(50,000)
Estimated uncollectible notes							(976,725)
Estimated future revenue							$9,875,775

COS percentage: 25.31% ($2,500,000 / $9,875,775)

20X1 Adjusted Cost of Sales Calculation

Sales	$5,025,000
Estimated uncollectible sales	(452,250)
Net sales	4,572,750
COS %	25.31%
Cost of sales	$1,157,567

12/31/20X1 Adjusted Inventory Calculation

Total expected revenue, 20X1 & future	$9,875,775
Net sales—20X1	(4,572,750)
Remaining expected revenue	5,303,025
COS %	25.31%
Inventory balance	$1,342,433

Entry to record cost of sales and inventory relief should have been recorded as:

20X1	Cost of Sales	1,157,567	
	Inventory		1,157,567

12/31/20X1	Ending inventory	$1,342,433	
	# of units defaulted	20	**(2)**
	# of units defaulted that are recovered	20	**(2)**, **(3)**
	Remaining units available for sale	520	= 1,000 – 500 + 20

Calculation of 20X1 adjustment to be recorded in 20X2 financial statements:

Cost of sales	1,157,567	
As originally recorded	1,147,260	
Adjustment	10,307	An increase in COS would be recorded for 20X1 in 20X2.

Accounting Entry

20X2	Cost of Sales	10,307	
	Inventory		10,307

Assumptions for 20X2:

Same assumptions as 20X1, incorporating the changes in estimate, except expected future revenue estimate excludes 20X1.

Beginning Inventory Balance $1,342,433

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X		250	100		350	$ 9,500	$3,325,000
Type Y		50	50		100	$10,000	1,000,000
Type Z		50			50	$13,000	650,000
		350	150		500		4,975,000
Sale of recovered intervals		10	35	50	95	$ 9,500	902,500
		360	185	50	595		5,877,500
Estimated sales discounts in 20X3							(50,000)
Estimated uncollectible notes							(524,475)
Estimated future revenue							$5,303,025

Sales for 20X2 are $3,620,000 (the 360 units from above at the respective sales prices shown above).
COS percentage: 25.31% ($1,342,433 / $5,303,025)

Accounting Entries

20X2	Notes Receivable	3,258,000	
	Cash	362,000	
	Sales Contra (estimated uncollectible sales)	325,800	
	Sales		3,620,000
	Allowance for Uncollectible Notes Receivable		325,800
20X2	Cost of Sales	833,909	
	Inventory		833,909

Cost of Sales Calculation

Sales	$3,620,000
Estimated uncollectible sales	(325,800)
Net sales	3,294,200
COS %	25.31%
Cost of sales	$ 833,909

Ending Inventory Calculation

Total expected revenue, 20X2 & future	$5,303,025
Net sales—20X2	(3,294,200)
Remaining expected revenue	2,008,825
COS %	25.31%
Inventory balance	$ 508,524

Had there not been a change in estimate for 20X2, the COS % would have remained at 25.09% in 20X2, and the 20X2 cost of sales would have been $3,294,200 x 25.09%, or $826,484. Therefore, there is an increase of $7,425 ($833,909 less $826,484) in 20X2 cost of sales attributable to the change in estimate. In accordance with paragraph 41 of this SOP, the seller would disclose that the 20X2 results include a $17,732 decrease ($10,307 for 20X1 plus $7,425 for 20X2) in income (ignoring related tax effects, for simplicity) resulting from changes in estimate in the relative sales value method.

12/31/20X2	Ending inventory	$ 508,524	
	# of units defaulted	35	**(2)**
	# of units defaulted that are recovered	35	**(2)**, **(3)**
	Remaining units available for sale	195	= 520 – 360 + 35

During the first quarter of 20X3, and subsequent to the issuance of the 20X2 financial statements, the seller changes its estimate of 20X3 sales discounts from $50,000 to $75,000. Also, the seller estimates that only 30 intervals, versus the prior estimate of 35, will be resold in 20X3. The seller also estimates that only 40 intervals, versus the original estimate of 50, will be resold after 20X3. Under the SOP's retrospective treatment, a current-period adjustment is recorded to reflect the changes in estimate.

Redo the COS % for the 20X1–20X2 combined, using actual 20X1–20X2 data:

Estimated Sales Prices and Distribution

	20X1 Actual	*20X2 Actual*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X	250	250	100		600	$ 9,500	$5,700,000
Type Y	200	50	50		300	$10,000	3,000,000
Type Z	50	50			100	$13,000	1,300,000
	500	350	150		1000		10,000,000
Sale of recovered intervals		10	30	40	80	$9,500	760,000
	500	360	180	40	1,080		10,760,000

Estimated sales discounts in 20X3	(75,000)
Estimated uncollectible notes	(961,650)
Estimated future revenue	$9,723,350

COS percentage: 25.71% ($2,500,000 / $9,723,350)

Cost of Sales Calculation (20X1–20X2)

Sales	$8,645,000
Estimated uncollectible sales	(778,250)
Net sales	7,866,950
COS %	25.71%
Cost of sales, 20X1–20X2	$2,022,695

Ending Inventory Calculation

Total expected revenue, 20X1 & future	$9,723,350
Net sales—20X1–20X2	(7,866,950)
Remaining expected revenue	1,856,400
COS %	25.71%
Inventory balance, 12/31/20X2	$ 477,305

Entry to record cost of sales and inventory relief for 20X1–20X2 should have been recorded in total as:

20X1–20X2	Cost of Sales	2,022,695	
	Inventory		2,022,695

12/31/20X2	Ending inventory	$ 477,305	
	# of units defaulted	35	**(2)**
	# of intervals defaulted that are recovered	35	**(2)**, **(3)**
	Remaining units available for sale	195	= 1,000 – 500 + 20 – 360 + 35

Calculation of 20X1–20X2 adjustment to be recorded in 20X3 financial statements:

Cost of sales	2,022,695	
As originally recorded	1,991,476	Includes 20X1 retro-adjusted COS
Adjustment	31,219	An increase in COS would be recorded for 20X1–20X2 in 20X3.

Accounting Entry

20X1	Cost of Sales	31,219	
	Inventory		31,219

Assumptions for 20X3:

Same assumptions as 20X1–20X2, incorporating the changes in estimate, except expected future revenue estimate excludes 20X1 and 20X2.

Beginning Inventory Balance	$ 477,305

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X			100		100	$ 9,500	$ 950,000
Type Y			50		50	$10,000	500,000
Type Z						$13,000	
			150		150		1,450,000
Sale of recovered intervals			30	40	70	$ 9,500	665,000
			180	40	220		2,115,000
Estimated sales discounts in 20X3							(75,000)
Estimated uncollectible notes							(183,600)
Estimated future revenue							$1,856,400

Sales for 20X3 are $1,660,000 (the 180 units from above at the respective sales prices, less sales discounts).

COS percentage: 25.71% ($477,305 / $1,856,400)

Accounting Entries

20X3	Notes Receivable	1,494,000	
	Cash	166,000	
	Sales Contra (estimated uncollectible sales)	149,400	
	Sales		1,660,000
	Allowance for Uncollectible Notes Receivable		149,400
20X3	Cost of Sales	388,395	
	Inventory		388,395

Cost of Sales Calculation

Sales	$1,660,000
Estimated uncollectible sales	(149,400)
Net sales	1,510,600
COS %	25.71%
Cost of sales	$ 388,395

Ending Inventory Calculation

Total expected revenue, 20X3 & future	$1,856,400
Net sales—20X3	(1,510,600)
Remaining expected revenue	345,800
COS %	25.71%
Inventory balance	$ 88,910

Had there not been a change in estimate for 20X3, the COS % would have remained at 25.31% in 20X3, and the 20X3 cost of sales would have been $1,510,600 x 25.31%, or $382,400. Therefore, there is an increase of $5,995 ($388,395 less $382,400) in 20X3 cost of sales attributable to the change in estimate. In accordance with paragraph 41 of this SOP, the seller would disclose that the 20X3 results include a $37,214 decrease ($31,219 for 20X1-20X2 plus $5,995 for 20X3) in income (ignoring related tax effects, for simplicity) resulting from changes in estimate in the relative sales value method.

12/31/20X3	Ending inventory	$ 88,910	**(4)**
	# of units defaulted	35	**(2)**
	# of units defaulted that are recovered	35	**(2)**, **(3)**
	Remaining units available for sale	50	= 195 – 180 + 35

FOOTNOTES

(1) For simplicity purposes only. It is likely that the seller may not be able to sell all remaining units, as some units will be undesirable or the sales effort will not be cost-effective.

(2) Amount is a given for this example and is not derived from any assumptions.

(3) For simplicity purposes only. Normally, not all interval sales that default will result in recovery of inventory by the seller, as a result of issues such as significant legal (foreclosure) costs and marketability of particular units. In determining estimated future revenue, the seller should take into account the effect of those intervals that would not be recovered versus the effect of those that would. To simplify the illustration, that effect has not been reflected.

(4) As part of its process of assessment of assets for impairment, the seller should evaluate ending inventory in view of the potentially prohibitive cost of marketing such a small quantity of units. Paragraph 34 of FASB Statement No. 144 would require that the inventory be measured, for purposes of determining a possible impairment, at the lower of carrying amount or fair value less cost to sell.

Time-Sharing Example 3
Relative Sales Value Method, Percentage-of-Completion Method

Assumptions for 20X1:

All requirements for full accrual sale accounting are met EXCEPT inventory is not complete. Requirements for percentage-of-completion accounting are met.

Inventory costs incurred:	$2,000,000
Estimated costs to complete inventory:	$ 500,000

Sales and Cost of Sales amounts are from Example 1.

Percent complete calculation:		
Inventory cost	$2,000,000	
Cost to complete	500,000	
Total estimated cost	$2,500,000	
Percent complete	80.0%	($2,000,000 / $2,500,000)

Sales and marketing costs are not considered in the percent complete calculation.

Accounting Entries

20X1	Inventory	2,000,000	
	Cash		2,000,000
20X1	Notes Receivable	4,522,500	
	Cash	502,500	
	Sales Contra (estimated uncollectible sales)	452,250	
	Sales		5,025,000
	Allowance for Uncollectible Notes Receivable		452,250
	Cost of Sales	1,147,260	
	Inventory		1,147,260
Percent complete adjustments:			
20X1	Sales	914,550	
	Delayed Revenue (20% of net sales)		914,550
	Delayed Cost of Sales (Inventory account)	229,452	
	Cost of Sales		229,452

The following entries for 20X2 and 20X3 are provided solely to illustrate the recording of completion of project construction and do not include the relevant sales and cost of sales entries for units sold in 20X2 or 20X3.

Assumption for 20X2: $200,000 is spent towards completion of inventory

Accounting Entries

20X2	Inventory	200,000	
	Cash		200,000
Percent complete adjustments:			
20X2	Delayed Revenue	365,820	
	Sales		365,820
	Cost of Sales	91,781	
	Delayed Cost of Sales (Inventory account)		91,781

To record adjustments for delayed revenue and delayed cost of sales for intervals sold in 20X1.

Assumption for 20X3: $300,000 is spent to complete the inventory

Accounting Entries

20X3	Inventory	300,000	
	Cash		300,000

Percent complete adjustments:

20X3	Delayed Revenue	548,730	
	Sales		548,730
	Cost of Sales	137,671	
	Delayed Cost of Sales (Inventory account)		137,671

To record adjustments for delayed revenue and delayed cost of sales for intervals sold in 20X1.

Time-Sharing Example 4
Relative Sales Value Method, Percentage-of-Completion Method, With Changes in Estimate

Assumptions for 20X1:

All requirements for full accrual sale accounting are met EXCEPT inventory is not complete. Requirements for percentage-of-completion accounting are met.

Est'd costs to complete inventory as of 12/31/20X1:
$500,000 (assume constant throughout 20X1)

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X	250	250	100		600	$ 9,500	$5,700,000
Type Y	200	50	50		300	$10,000	3,000,000
Type Z	50	50			100	$13,000	1,300,000
	500	350	150		1,000		10,000,000
Sale of recovered intervals		10	40	50	100	$ 9,500	950,000**(1)**
	500	360	190	50	1,100		10,950,000
Estimated sales discounts							—
Estimated uncollectible notes							(985,500)
Estimated future revenue							$9,964,500

Sales for 20X1 are $5,025,000 (the 500 intervals from above at the respective sales prices shown above), sold evenly throughout the 4 quarters of 20X1.

Initial down payment:	10% (on all sales; no cash sales)
Forfeiture on defaulted notes:	100% of cash paid
Inventory cost, including $500,000 est'd costs to complete:	$2,500,000
COS percentage:	25.09% ($2,500,000 / $9,964,500)
Percent complete:	80% ($2,000,000 / $2,500,000)
Initial estimated default rates:	10% of note principal

Assume 100% of intervals defaulting on first-time sales are resold over the life of the project; no resales in 20X1.

Assume none of intervals defaulting on second-time sales are resold (for simplicity of illustration).

Assume 50 defaults estimated in 20X1, 50 defaults estimated in 20X2, none in other years.

Note: For the year 20X1, sales are shown separately for the first three quarters combined and the 4th quarter. This is to illustrate the accounting, under the fully retrospective method in the SOP, for a change in estimate that occurs at the beginning of the 4th quarter. (Under the SOP, changes in estimate are reflected at least quarterly, but for simplicity the other examples in this appendix have all been accounted for on an annual rather than a quarterly basis.)

Accounting entries for sales recorded throughout the first three quarters of 20X1

20X1	Notes Receivable	3,390,300	
	Cash	376,700	
	Sales Contra (estimated uncollectible sales)	339,030	
	Sales		3,767,000
	Allowance for Uncollectible Notes Receivable		339,030
20X1	Cost of Sales	860,046	
	Inventory		860,046

Percentage-of-completion adjustments:

20X1	Sales	753,400	
	Sales Contra (estimated uncollectible sales)		67,806
	Delayed Revenue (20% of net sales)		685,594
	Delayed Cost of Sales (inventory account)	172,009	
	Cost of Sales (20% of 860,046)		172,009

Cost of Sales Calculation

Sales	$3,767,000
Estimated uncollectible sales	(339,030)
Net sales	3,427,970
COS %	25.09%
Cost of sales (before POC adj.)	$ 860,046

Ending Inventory Calculation

Inventory per books, 1/1/20X1	$2,000,000
Inventory sold in current period	(860,046)
POC adjustment in current period	172,009
Inventory per books, 9/30/20X1	1,311,963
Add: Estimated costs to complete	500,000
Less: POC adjustments to date	(172,009)
Inventory for next period COS % calculation purposes	$1,639,954

9/30/20X1	Ending inventory for calculation of Q4 20X1 COS percentage	$1,639,954	
	# of intervals defaulted in Q1-Q3 20X1	45	**(2)**
	# of intervals defaulted in Q1-Q3 20X1 that are recovered	45	**(2)**, **(3)**
	Remaining intervals available for sale	670	= 1,000 – 375 + 45

The net effect of the entries for the first three quarters of 20X1 is:

Selected Balance Sheet Accounts

Cash	$ 376,700
Notes Receivable	3,390,300
(collections not illustrated)	
Less: Allowance	(339,030)
Receivables, Net	$3,051,270
Inventory	1,311,963
(includes delayed COS of 172,009)	
Delayed Revenue	(685,594)
	$4,054,339

Selected Income Statement Accounts

Sales	$3,013,600
Estimated uncollectible sales	(271,224)
Net sales	2,742,376
Cost of Sales	688,037
	$2,054,339

(Note: Difference between $4,054,339 and $2,054,339 correctly equals the original $2,000,000 in Inventory at 1/1/20X1.)

Assume that during the 4th quarter of 20X1 and subsequent to the issuance of the 3rd quarter 20X1 financial statements, estimated defaults are re-estimated at 15%, versus the initial estimate of 10% based on an assessment of 20X1 experience to date and an economic downturn. Under the SOP's fully retrospective treatment of changes in estimate under the relative sales value method, a cumulative adjustment for January–September 20X1 is recorded in the 4th quarter of 20X1.

Redo the 20X1 COS %, using actual data for the first three quarters of 20X1 and estimates for the 4th quarter of 20X1. (Note: Sales of recovered intervals are assumed to increase as a result of the increase in estimated defaults.)

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X	250	250	100		600	$ 9,500	$5,700,000
Type Y	200	50	50		300	$10,000	3,000,000
Type Z	50	50			100	$13,000	1,300,000
	500	350	150		1,000		10,000,000
Sale of recovered intervals		15	60	75	150	$ 9,500	1,425,000
	500	365	210	75	1,150		11,425,000
Estimated sales discounts							—
Estimated uncollectible notes							(1,542,375)
Estimated future revenue							$9,882,625

COS percentage: 25.30% ($2,500,000 / $9,882,625)

Accounting entries for sales recorded throughout the first three quarters of 20X1 should have been recorded as

20X1	Notes Receivable	3,390,300	
	Cash	376,700	
	Sales Contra (estimated uncollectible sales)	508,545	
	Sales		3,767,000
	Allowance for Uncollectible Notes Receivable		508,545
20X1	Cost of Sales	824,289	
	Inventory		824,289

Percentage-of-completion adjustments:

20X1	Sales	753,400	
	Sales Contra (estimated uncollectible sales)		101,709
	Delayed Revenue (20% of net sales)		651,691
	Delayed Cost of Sales (inventory account)	164,858	
	Cost of Sales (20% of 824,289)		164,858

Cost of Sales Calculation

Sales	$3,767,000
Estimated uncollectible sales	(508,545)
Net sales	3,258,455
COS %	25.30%
Cost of sales (before POC adj.)	$ 824,289

Ending Inventory Calculation

Inventory per books, 1/1/20X1	$2,000,000
Inventory sold in current period	(824,289)
POC adjustment in current period	164,858
Inventory per books, 9/30/20X1	1,340,569
Add: Estimated costs to complete	500,000
Less: POC adjustments to date	(164,858)
Inventory for next period COS % calculation purposes	$1,675,711

9/30/20X1	Ending inventory for calculation of Q4 20X1 COS percentage	$1,675,711	
	# of intervals defaulted in Q1-Q3 20X1	45	**(2)**
	# of intervals defaulted in Q1-Q3 20X1 that are recovered	45	**(2), (3)**
	Remaining intervals available for sale	670	= 1,000 – 375 + 45

Calculation of current-period cumulative adjustments for the first three quarters of 20X1, to be recorded in 20X1 4th quarter financial statements:

Estimated Sales Prices and Distribution

	Sales	*Sales Contra*	*Allowance*	*Cost of Sales*	*Delayed Revenue*	*Inventory*	*Delayed COS*
As redetermined	3,013,600	406,836	508,545	659,431	651,691	1,175,711	164,858
As orig. recorded	3,013,600	271,224	339,030	688,037	685,594	1,139,954	172,009
Retro adjustment	0	135,612	169,515	(28,606)	(33,903)	35,757	(7,151)

Accounting Entries

20X1	Sales Contra	135,612	
	Delayed Revenue	33,903	
	Allowance for Uncollectible Notes Receivable		169,515
20X1	Inventory	35,757	
	Delayed Cost of Sales (Inventory account)		7,151
	Cost of Sales		28,606

The net effect of the entries, including adjustment entries, for the first three quarters of 20X1 is:

Selected Balance Sheet Accounts		**Selected Income Statement Accounts**	
Cash	$ 376,700	Sales	$3,013,600
Notes Receivable	3,390,300	Estimated uncollectible sales	(406,836)
(collections not illustrated)			
Less: Allowance	(508,545)	Net sales	2,606,764
Receivables, Net	2,881,755		
Inventory	1,340,569	Cost of Sales	659,431
(includes delayed COS of 164,858)			
Delayed Revenue	(651,691)		
	$3,947,333		$1,947,333

(Note: Difference between $3,947,333 and $1,947,333 correctly equals the original $2,000,000 in Inventory at 1/1/20X1.)

Assumptions for 4th Quarter of 20X1:

Same as initial 20X1 assumptions except expected future revenue estimate is updated based on the increased estimated default rate of 15%.

Beginning Inventory Balance $1,675,711 including estimated costs to complete; excludes POC adjustments

Estimated Sales Prices and Distribution

	Q4 of 20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X	62	250	100		412	$ 9,500	$3,914,000
Type Y	50	50	50		150	$10,000	1,500,000
Type Z	13	50			63	$13,000	819,000
	125	350	150		625		6,233,000
Sale of recovered intervals		15	60	75	150	$9,500	1,425,000
	125	365	210	75	775		7,658,000
Estimated sales discounts							—
Estimated uncollectible notes							(1,033,830)
Estimated future revenue							$6,624,170

Sales for the 4th quarter of 20X1 are $1,258,000 (the 125 intervals from above at the respective sales prices shown above).

COS percentage: 25.30% ($1,675,711 / $6,624,170)

Accounting entries for sales recorded throughout Q4 of 20X1

20X1	Notes Receivable	1,132,200	
	Cash	125,800	
	Sales Contra (estimated uncollectible sales)	169,830	
	Sales		1,258,000
	Allowance for Uncollectible Notes Receivable		169,830
20X1	Cost of Sales	275,274	
	Inventory		275,274
Percentage-of-completion adjustments:			
20X1	Sales	251,600	
	Sales Contra (estimated uncollectible sales)		33,966
	Delayed Revenue (20% of net sales)		217,634
	Delayed Cost of Sales (inventory account)	55,055	
	Cost of Sales (20% of 275,274)		55,055

Cost of Sales Calculation

Sales	$1,258,000
Estimated uncollectible sales	(169,830)
Net sales	1,088,170
COS %	25.30%
Cost of sales (before POC adj.)	$ 275,274

Ending Inventory Calculation

Inventory per books, 9/30/20X1	$1,340,569
Inventory sold in current period	(275,274)
POC adjustment in current period	55,055
Inventory per books, 12/31/20X1	1,120,350
Add: Estimated costs to complete	500,000
Less: POC adjustments to date	(219,913)
Inventory for next period COS % calculation purposes	$1,400,437

9/30/20X1	Ending inventory for calculation of 20X2 COS percentage	$1,400,437	
	# of intervals defaulted in Q4 20X1	15	**(2)**
	# of intervals defaulted that are recovered in Q4 20X1	15	**(2)**, **(3)**
	Remaining intervals available for sale	560	= 670 - 125 + 15

The net effect of the entries for the full year of 20X1 is:

Selected Balance Sheet Accounts

Cash	$ 502,500
Notes Receivable	4,522,500
(collections not illustrated)	
Less: Allowance	(678,375)
Receivables, Net	3,844,125
Inventory	1,120,350
(includes delayed COS of 219,913)	
Delayed Revenue	(869,325)
	$4,597,650

Selected Income Statement Accounts

Sales	$4,020,000
Estimated Uncollectible sales	(542,700)
Net sales	3,477,300
Cost of Sales	879,650
	$2,597,650

(Note: Difference between $4,597,650 and $2,597,650 correctly equals the original $2,000,000 in Inventory at 1/1/20X1.)

Had the change in estimated defaults not occurred, in 20X1 the seller would have recorded income of $2,740,392 (see "As If" column below). Actual 20X1 income was $2,597,650 (see "Actual" column below), which is $142,742 lower than the "As If" income. In accordance with paragraph 41 of this SOP, the seller would disclose that the 20X1 4th quarter results include a $142,742 decrease in income in quarters 1 to 3 resulting from the change in estimated defaults in the relative sales value method. For simplicity, any related tax effects are ignored.

The amount to be disclosed is determined as follows:

	20X1—As If	*20X1—Actual*	*Difference*
Sales before POC adjustment	$5,025,000	$5,025,000	
Sales Contra	(452,250)	(678,375)	
Net Sales before POC adjustment	4,572,750	4,346,625	
POC adjustment (20%)	914,550	869,325	
Net Sales after POC adjustment	3,658,200	3,477,300	
Cost of Sales	917,808	879,650	
Income	$2,740,392	$2,597,650	($142,742)

Assumptions for 20X2:

Same assumptions as Q4 of 20X1, reflecting the increased estimated default rate of 15%.

Beginning Inventory Balance $1,400,437 including estimated costs to complete; excludes POC adjustments

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X		250	100		350	$ 9,500	$3,325,000
Type Y		50	50		100	$10,000	1,000,000
Type Z		50			50	$13,000	650,000
		350	150		500		4,975,000
Sale of recovered intervals		15	60	75	150	$ 9,500	1,425,000
		365	210	75	650		6,400,000
Estimated sales discounts							—
Estimated uncollectible notes							(864,000)
Estimated future revenue							$5,536,000

Sales for 20X2 are $3,667,500 (the 365 intervals from above at the respective sales prices shown above).

COS percentage: 25.30% ($1,400,437 / $5,536,000)

Accounting entries for sales recorded throughout 20X2

20X2	Notes Receivable	3,300,750	
	Cash	366,750	
	Sales Contra (estimated uncollectible sales)	495,113	
	Sales		3,667,500
	Allowance for Uncollectible Notes Receivable		495,113
20X2	Cost of Sales	802,516	
	Inventory		802,516

Cost of Sales Calculation

Sales	$3,667,500
Estimated uncollectible sales	(495,113)
Net sales	3,172,387
COS %	25.30%
Cost of sales (before POC adj.)	$ 802,516

The net effect of the entries for the full years 20X1 and 20X2, before any 20X2 POC adjustments, is:

Selected Balance Sheet Accounts		Selected Income Statement Accounts	
Cash	$ 869,250	Sales	$7,687,500
		Estimated Uncollectible Sales	(1,037,813)
Notes Receivable	7,823,250	Net sales	6,649,687
(collections not illustrated)			
Less: Allowance	(1,173,488)		
Receivables, Net	6,649,762		
Inventory	317,834	Cost of Sales	1,682,166
(includes delayed COS of 219,913)			
Delayed Revenue	(869,325)		
	$6,967,521		$4,967,521

(Note: Difference between $6,967,521 and $4,967,521 correctly equals the original $2,000,000 in Inventory at 1/1/20X1.)

Assume that during 20X2, the seller incurs $400,000 towards completion of the project but then estimates at 12/31/20X2 that $300,000 additional is needed to complete. Because the seller has been recording sales throughout 20X2, percentage-of-completion adjustments would have been recorded based on the original estimate total costs of $2,500,000 and POC of 96% ($2,400,000/ $2,500,000) at 12/31/20X2. For simplicity in illustrating the effect of the change in estimate, this example assumes that the $200,000 increase in estimated costs to complete occurs at the end of 20X2, at which time the seller recalculates the POC as 88.89% ($2,400,000 / $2,700,000). The seller then records a current-period adjustments to sales and cost of sales for the difference between total sales and costs of sales that would have been reorganized for the current and all prior years to date based on a percent complete of 88.89%, and total sales actually reorganized to date.

Recording of $400,000 costs incurred in 20X2 toward completion of the project:

20X2	Inventory	400,000	
	Cash		400,000

Recording of POC adjustments for 20X2, based on the original estimated costs to complete of $2,500,000:

Percent complete: 96.00% ($2,400,000 / $2,500,000)

20X2	Sales	146,700	
	Sales Contra (estimated uncollectible sales)		19,805
	Delayed Revenue (4% of net sales)		126,895
	Delayed Cost of Sales (Inventory account)	32,101	
	Cost of Sales (4% of 802,516)		32,101
	To adjust 20X2 results for percent complete of 96%.		
20X2	Sales Contra (estimated uncollectible sales)	108,540	
	Delayed Revenue	695,460	
	Sales		804,000
	Cost of sales	175,930	
	Delayed Cost of Sales (Inventory account)		175,930
	To adjust 20X1 results for increase in percent complete from 80% to 96%.		

The net effect of the above entries, before recording the effect of the change in estimated total costs to complete, is:

Selected Balance Sheet Accounts		Selected Income Statement Accounts	
Cash	$ 469,250	Sales	$8,344,800
		Estimated Uncollectible Sales	(1,126,548)
Notes Receivable	7,823,250	Net Sales	7,218,252
(collections not illustrated)			
Less: Allowance	(1,173,488)		
Receivables, Net	6,649,762		
Inventory	574,004	Cost of Sales	1,825,996
(includes delayed COS of 76,084)			
Delayed Revenue	(300,760)		
	$7,392,256		$5,392,256

(Note: Difference between $7,392,256 and $5,392,256 correctly equals the original $2,000,000 in Inventory at 1/1/20X1.)

Recording of current-period adjustments for increase to $2,700,000 of total estimated costs to complete:

COS percentage: 27.32% ($2,700,000 / $9,882,625)

(The denominator in this percentage is based on actual revenue to date plus estimated future revenue, excluding POC adjustments.)

Cost of Sales Calculation	20X1–20X2 (excluding POC adjustments)
Sales	$8,692,500
Estimated uncollectible sales	(1,173,488)
Net sales	7,519,012
COS %	27.32%
Cost of sales	$2,054,245

Percent complete—revised: 88.89% ($2,400,000 / $2,700,000)

As-if entries for 20X1–20X2 combined, based on $2,700,000 estimated total cost

Notes Receivable	7,823,250	
Cash	469,250	
Sales Contra (estimated uncollectible sales)	1,173,488	
Sales		8,692,500
Allowance for Uncollectible Notes Receivable		1,173,488
Cost of Sales	2,054,245	
Inventory		1,654,245
Percentage-of-completion adjustments:		
Sales	965,833	
Sales Contra (estimated uncollectible sales)		130,387
Delayed Revenue (11.11% of net sales)		835,446
Delayed Cost of Sales (Inventory account)	228,249	
Cost of Sales (11.11% of 2,054,245)		228,249

Cumulative adjustments for 20X1–20X2 to reflect change in estimated costs from $2,500,000 to $2,700,000 to be recorded in 20X2 financial statements:

	Sales	*Sales Contra*	*Cash*	*Cost of Sales*	*Delayed Revenue*	*Inventory*	*Delayed COS*
As redetermined	7,726,667	1,043,101	469,250	1,825,996	835,446	345,755	228,249
As orig. recorded	8,344,800	1,126,548	469,250	1,825,996	300,760	497,920	76,084
Retro adjustment	(618,133)	(83,447)	0	0	534,686	(152,165)	152,165

Accounting Entries

20X2	Sales	618,133	
	Delayed Cost of Sales (Inventory account)	152,165	
	Inventory		152,165
	Delayed Revenue		534,686
	Sales Contra		83,447

The net effect of all of the entries to date (12/31/20X2), including POC adjustments and effects of changes in estimate, is:

Selected Balance Sheet Accounts		Selected Income Statement Accounts	
Cash	$ 469,250	Sales	$7,726,667
		Estimated Uncollectible Sales	(1,043,101)
Notes Receivable	7,823,250	Net Sales	6,683,566
(collections not illustrated)			
Less: Allowance	(1,173,488)		
Receivables, Net	6,649,762		
Inventory	574,004	Cost of Sales	1,825,996
(included delayed COS of 228,249)			
Delayed Revenue	(835,446)		
(= 965,833 delayed Sales less 130,387 delayed Sales Contra)			
	$6,857,570		$4,857,570

(Note: Difference between $6,857,570 and $4,857,570 correctly equals the original $2,000,000 in Inventory at 1/1/20X1.)

In accordance with paragraph 41 of this SOP, the seller would disclose that the 20X2 results include a $534,686 decrease in income as a result of the change in the project's estimated percentage of completion due to the revised estimated total cost to complete ($534,686 = $618,133 decrease in Sales less $83,447 decrease in Sales Contra). For simplicity, any related tax effects are ignored.

Ending Inventory Calculation

Inventory per books, 1/1/20X1	$2,000,000	
Inventory costs incurred in 20X2	400,000	
Inventory sold in 20X1–20X2	(2,054,245)	
POC adjustments, 20X1–20X2	228,249	
Inventory per books, 12/31/20X2	574,004	
Add: Estimated costs to complete	300,000	
Less: POC adjustments to date	(228,249)	
Inventory for next period COS % calculation purposes	$ 645,755	
Ending inventory for calculation of 20X3 COS percentage	$ 645,755	
# of intervals defaulted	90	**(2)**
# of intervals defaulted that are recovered	90	**(2)**, **(3)**
Remaining intervals available for sale	285	= 560 – 365 + 90

Assumptions for 20X3:

No change in assumptions except expected future revenue estimate and percent complete are updated.

In January 20X3, the seller spends the estimated $300,000 to complete, and thereby completes the project construction.

Beginning Inventory Balance	$ 645,755	including estimated costs to complete; excludes POC adjustments

Estimated Sales Prices and Distribution

	20X1	*20X2*	*20X3*	*20X4 & Future*	*Total No. of Intervals*	*Sales Price*	*Expected Future Revenue*
Type X			100		100	$ 9,500	$ 950,000
Type Y			50		50	$10,000	500,000
Type Z						$13,000	
			150		150		1,450,000
Sale of recovered intervals			60	75	135	$ 9,500	1,282,500
			210	75	285		2,732,500
Estimated sales discounts							—
Estimated uncollectible notes							(368,888)
Estimated future revenue							$2,363,612

Sales for 20X3 are $2,020,000 (the 210 intervals from above at the respective sales prices shown above).

COS percentage: 27.32% ($645,755 / $2,363,612)

Accounting entries for sales recorded throughout 20X3

20X3	Notes Receivable	1,818,000	
	Cash	202,000	
	Sales Contra (estimated uncollectible sales)	272,700	
	Sales		2,020,000
	Allowance for Uncollectible Notes Receivable		272,700
20X3	Cost of Sales	477,374	
	Inventory		477,374

Cost of Sales Calculation

Sales	$2,020,000
Estimated uncollectible sales	(272,700)
Net sales	1,747,300
COS %	27.32%
Cost of sales	$ 477,374

Ending Inventory Calculation

Inventory per books, 1/1/20X3	$574,004
Inventory costs incurred in 20X3	300,000
Inventory sold in current period	(477,374)
POC adjustment in current period	—
Inventory per books, 12/31/20X3	396,630
Add: Estimated costs to complete	—
Less: POC adjustments to date	(228,249)
Inventory for next period COS% calculation purposes	$168,381

12/31/20X1	Ending inventory for calculation of COS percentage	$ 168,381	**(4)**
	# of intervals defaulted	—	**(2)**
	# of intervals defaulted that are recovered	—	**(2), (3)**
	Remaining intervals available for sale in 20X4 and future	75	= 285 – 210

Because the project construction is complete as of 12/31/20X3, the seller now recognizes any remaining Delayed Revenue and Delayed Cost of Sales that were delayed under the percentage-of-completion method:

Accounting Entries

20X3	Delayed Revenue	835,446	
	Sales Contra	130,387	
	Sales		965,833
	Cost of Sales	228,249	
	Delayed Cost of Sales (Inventory account)		228,249

The net effect of all of the entries to date (12/31/20X3) is:

Selected Balance Sheet Accounts		Selected Income Statement Accounts	
Cash	$ 371,250 (assumes cash paid for $700,000 construction)	Sales	$10,712,500
		Estimated Uncollectible Sales	(1,446,188)
		Net Sales	9,266,312
Notes Receivable	9,641,250 (collections not illustrated)		
Less: Allowance	(1,446,188)		
Receivables, Net	8,195,062		
Inventory	168,381	Cost of Sales	2,531,619
Delayed Revenue	0		
	$8,734,693		$6,734,693

(Note: Difference between $8,734,693 and $6,734,693 correctly equals the original $2,000,000 in Inventory at 1/1/20X1.)

FOOTNOTES

(1) For simplicity purposes only. It is likely that the seller may not be able to sell all remaining units, as some units will be undesirable or the sales effort will not be cost-effective.

(2) Amount is a given for this example and is not derived from any assumptions.

(3) For simplicity purposes only. Normally, not all interval sales that default will result in recovery of inventory by the seller, as a result of issues such as significant legal (foreclosure) costs and marketability of particular units. In determining estimated future revenue, the seller should take into account the effect of those intervals that would not be recovered versus the effect of those that would. To simplify the illustration, that effect has not been reflected.

(4) As part of its process of assessment of assets for impairment, the seller should evaluate ending inventory in view of the potentially prohibitive cost of marketing such a small quantity of units. Paragraph 34 of FASB Statement No. 144 would require that the inventory be measured, for purposes of determining a possible impairment, at the lower of carrying amount or fair value less cost to sell.

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Appendix C

Continuing Involvement

Below are scenarios related to a seller's continuing involvement discussed in paragraphs 25 through 43 of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*, and comments with respect to whether those scenarios typically apply or do not apply to a time-share seller.

Repurchase Option or Obligation (FASB Statement No. 66, paragraph 26)

The seller has an obligation to repurchase the property, or the terms of the transaction allow the buyer to compel the seller or give an option[1] to the seller to repurchase the property.

1. A right of first refusal based on a bona fide offer by a third party ordinarily is not an obligation or an option to repurchase.

Comments: Time-share contracts typically do not contain repurchase obligations or options for repurchase. Buyer upgrade programs should not be considered as options for repurchase because both buyer and seller must agree to an upgrade transaction. Neither has a unilateral right to compel the other.

Limited Partnership Arrangement (FASB Statement No. 66, paragraph 27)

The seller is a general partner in a limited partnership that acquires an interest in the property sold (or has an extended, noncancelable management contract requiring similar obligations) and holds a receivable from the buyer for a significant[2] part of the sales price.

2. For this purpose, a significant receivable is a receivable in excess of 15 percent of the maximum first-lien financing that could be obtained from an independent established lending institution for the property. It includes:

   a. A construction loan made or to be made by the seller to the extent that it exceeds the minimum funding commitment for permanent financing from a third party that the seller will not be liable for

   b. An all-inclusive or wraparound receivable held by the seller to the extent that it exceeds prior-lien financing for which the seller has no personal liability

   c. Other funds provided or to be provided directly or indirectly by the seller to the buyer

   d. The present value of a land lease when the seller is the lessor

Comments: A time-share developer typically does not partner on either a general or limited basis with the time-share interval purchaser. In many cases, the developer or an entity related to the developer provides management services to the third-party condominium/owners association (OA) for a fee. Time-share management contracts generally extend for three to ten years with renewals at the option of the OA. The management contracts generally contain various cancellation clauses that allow either the manager or the OA to cancel the contract under prescribed conditions. Under those contracts, the continuing involvement typically would not preclude profit recognition under FASB Statement No. 66.

Guaranteed Return on Investment (FASB Statement No. 66, paragraph 28)

The seller guarantees[3] the return of the buyer's investment or a return on that investment for a limited or extended period. For example, the seller guarantees cash flows, subsidies, or net tax benefits.

3. Guarantees by the seller may be limited to a specified period of time.

Comments: Time-share intervals typically are not sold with any stated or implied investment return and, accordingly, developers do not provide any such investment return guaranty for any period of time.

Seller Support of Operations (FASB Statement No. 66, paragraphs 29 and 30)

The seller is required to initiate or support operations or continue to operate the property at its own risk, or may be presumed to have such a risk, for an extended period, for a specified limited period, or until a specified level of operations has been obtained, for example, until rentals of a property are sufficient to cover operating expenses and debt service.

Comments: Time-share developers typically subsidize the operations of a phase during the development or during the initial period of operations. During the sales process, the quoted maintenance fee, which contractually may remain level or increase with inflation, represents the maintenance fee at completion. Typically, during the early stages of a phase, the phase operates at a deficit given the normal operational costs and the fact that the number of units registered with the OA may not yet have reached the break-even level. Therefore, the developer subsidy represents two items:

1. *Developer's payment of maintenance fees for intervals committed to (that is, enrolled in) the time-share plan, for which the developer retains title.* See paragraphs .49 through .52 of this SOP.

2. *Developer subsidy paid to the OA during the start-up period of operations.* In many cases, time-share developers will begin phase operations with a minimal number of units committed to the time-share plan; therefore, the developer has to subsidize the operations until a sufficient number of units has been committed.

Typically, the duration of both kinds of payments lasts through the sellout of the time-share phase. Developer payments typically diminish as intervals are sold.

However, if the subsidies extend past the sellout period or do not diminish as intervals are sold, this is an indication that the seller has not transferred substantially all the risks and rewards of ownership of real estate and that transactions occurring during the subsidy period are in substance **right-to-use** arrangements.

Seller-Provided Management Services (FASB Statement No. 66, paragraph 31)

. . . the sales contract requires the seller to provide management services relating to the property after the sale without compensation or at compensation less than prevailing market rates for the service required . . . or on terms not usual for the services to be rendered . . .

Comments: Management services typically are not required under time-sharing sales contracts. Developers often provide management services to OAs on a cost-plus-management-fee basis that is billed and collected separately from the sale of the time-share interval. As an indication of a reasonable fee, independent (nondeveloper) time-share management companies charge between 5 percent and 15 percent management fees (that is, between 5 percent and 15 percent of the underlying operating and other costs of management).

Sometimes a developer offers to pay an interval purchaser's OA maintenance fee for a fixed period of time as a sales incentive. Sometimes a developer operates an internal exchange program whereby a time-share buyer can exchange his or her interval for a given year for another unit or week (or both) in the developer's network of time-sharing properties. Under paragraph 31 of

FASB Statement No. 66, if the seller provides the exchange service at less than prevailing market rates for the service, compensation should be imputed when the sale is recognized and recognized as revenue as the exchange services are performed. The fees of independent time-sharing exchange companies should be considered in determining prevailing market rates, but it should be recognized that the services of an independent exchange company may be more complex than the services of an internal exchange program.

A developer may operate a vacation club or affinity program under which a time-share buyer can exchange his or her interval (for example, one week) for a given year for such items as cruises, hotel stays, airline tickets, or car rentals. Pursuant to the exchange, the developer gets back the unit-week and any associated income from rental of the unit for that week. The developer frequently has to purchase from independent third parties those items the buyer receives in exchange. Often, a seller reserves the right to change the rewards at any time, allowing the seller to match the rewards at a given time to the net rental income that can be generated from a particular interval. Thus, if a particular interval becomes less popular over time, for example, the seller can reduce the rewards that the purchaser of such interval could obtain in exchange for the interval. If the seller retains such flexibility, the seller is likely to assure that the value of the services the buyer receives does not exceed the rental income that can be generated from the interval. Conversely, if the seller does not have that flexibility, the seller likely will be unable to estimate the relationship between the value of the services the buyer receives and the rental income that can be generated from the interval.

Option to Purchase (FASB Statement No. 66, paragraph 32)

The transaction is merely an option to purchase the property. [*Next sentence paraphrased.*] For example, an interval may be sold under terms that call for a very small initial investment by the buyer and postponement of additional payments until contingencies specified in the sales agreement are satisfactorily resolved.

Comments: Once the **rescission** period has expired, contracts for the sales of time-share intervals are binding purchase contracts and not options.

Partial Sales (FASB Statement No. 66, paragraphs 33 and 34)

The seller has made a partial sale. A sale is a partial sale if the seller retains an equity interest in the property or has an equity interest in the buyer. [*Next sentence paraphrased.*] Additionally, the buyer may not be independent of the seller—for example, if the seller holds or acquires an equity interest in the buyer—or the seller may control the buyer.

Comments: Sales of time-sharing intervals are not partial sales, as the developer cannot record profit without a transfer of title (see paragraph .13 of this SOP). In the case in which the developer transfers title to a special-purpose entity (SPE) or trust in exchange for shares or beneficial interests, the developer should not recognize profit until the share or beneficial interest is sold to the end user (see paragraph .55 of this SOP).

Collection Not Reasonably Assured (FASB Statement No. 66, paragraph 35)

. . . collection of the sales price is not reasonably assured.

Comments: Paragraph 35 of FASB Statement No. 66 prescribes the cost recovery or installment method of recognizing profit if collection of the sales price is not reasonably assured.

Seller Support of Operations After the Sale (FASB Statement No. 66, paragraph 36)

. . . the seller is required to support the operations of the property after the sale . . . For example, the seller may retain an interest in the property sold and the buyer may receive preferences as to profits, cash flows, return on investment, and so forth.

Comments: Time-share developers typically are not obligated to support the time-share resorts after the sale except in the circumstances described above under the scenarios entitled "Seller Support of Operations" and "Seller-Provided Management Services."

Sale of Improvements, Lease of Land (FASB Statement No. 66, paragraphs 38 and 39)

The seller sells property improvements and leases the underlying land to the buyer of the improvements.

Comments: See paragraph A-48 of this SOP.

Contractual Future Requirements of the Seller (FASB Statement No. 66, paragraphs 41 and 42)

The sales contract or an accompanying agreement requires the seller to develop the property in the future, to construct facilities on the land, or to provide off-site improvements or amenities. The seller is involved with future development or construction work if the buyer is unable [or not required] to pay amounts due for that work or has the right under the terms of the arrangement to defer payment until the work is done.

Comments: In situations in which developers sell intervals prior to the completion of the facilities, improvements, or amenities, the sales do not qualify for the full accrual method of profit recognition under FASB Statement No. 66.

Seller Participation in Future Resale Profits (FASB Statement No. 66, paragraph 43)

The seller will participate in future profit from the property without risk of loss (such as participation in operating profits or residual values without further obligation).

Comments: Developers typically do not participate in future profits from the resale of time-share intervals.

All of the preceding in this appendix discusses the time-sharing seller's continuing involvement arising from legal obligations. The seller also may have indicated a commitment, based on considerations such as business reputation, intercompany relationships, or credit standing, to provide financial support or other services to a time-share project beyond the seller's legal obligations. Such a commitment might be indicated by previous support provided by the seller to the same or other time-sharing projects or statements to third parties by the seller of its intention to provide support. If such a commitment exists, the seller should determine which kind(s) of continuing involvement it represents under the above scenarios, and record transactions based on the relevant paragraphs in FASB Statement No. 66. Often, such a commitment represents additional support to an OA that would fall under the scenario entitled "Seller Support of Operations" above.

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Appendix D

Illustration of Use of Historical Data on Uncollectibles, Including Related Disclosures

This illustration shows how a time-share entity may organize its historical data about uncollectibles in order to determine the charge to revenue for estimated uncollectibles on current-year (2006) sales, and to assess the adequacy of the allowance for uncollectibles as of the end of 2006. Related illustrative disclosures are included.

Historical Data

Table D1. Sales, Net of Down Payments, by Year

(For projects with characteristics similar to the entity's current project)

1996	$28,000	2002	$60,000
1997	$26,000	2003	$70,000
1998	$30,000	2004	$76,000
1999	$33,000	2005	$80,000
2000	$34,000	2006	$90,000
2001	$50,000		

Table D2 summarizes the uncollectibles experience for years 1996 through 2006 for projects similar to the entity's current time-share project. The uncollectibles are organized into columns based on the year of sale. Thus, the column "2001 Sales" shows that of the $50,000 of sales recorded in 2001, $1,100 in receivables were deemed uncollectible in 2001, $2,000 in 2002, $900 in 2003, and so on.[1] However, Table D2 also can be analyzed to show receivables deemed uncollectible in each fiscal year. For example, in 2006, as shown by the figures inside rectangles, there were $7,670 in total uncollectible receivables, specifically, $2,070 from 2006 sales, $2,600 from 2005 sales, $1,400 from 2004 sales, $800 from 2003 sales, $500 from 2002 sales, $200 from 2001 sales, and $100 from 2000 sales. The "Combined Experience" column is computed two ways—one using only those sales from 1996 through 2000, "1996-2000," for which the notes have been collected in full, and the other, "All Years," using the uncollectibility experience for all years. The combined experience is calculated as a simple average here for illustration purposes. A weighted average also would be appropriate.

Assessment of Historical Data

Fluctuations in collection experience from year to year can be explained by economic conditions; the economy was stronger in 2003 through 2006 than in prior years,[2] and uncollectibility rates declined modestly. As the year 2006 ends, the economy is softening. As a result, the entity concludes that the percentages from the "Combined Experience," "All Years" column in Table D2, which blends the strong economic conditions of recent years and the weaker conditions of earlier years, should be applied to compute the charge to revenue for estimated uncollectibles on current year (2006) sales and to assess the adequacy of the allowance for uncollectibles at the end of 2006.

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[1] That is, $1,100 of individually identified notes receivable were past due and there was no expectation of subsequent collectibility.

[2] Economic conditions discussed in this appendix are hypothetical and for illustrative purposes only. They are not intended to reflect actual economic conditions existing during the indicated years.

Table D2

	2006 Sales		2005 Sales		2004 Sales		2003 Sales		2002 Sales		2001 Sales	
	Uncollectible	*% of sales (net of down pmnts)*	*Uncollectible*	*% of sales (net of down pmnts)*	*Uncollectible*	*% of sales (net of down pmnts)*	*Uncollectible*	*% of sales (net of down pmnts)*	*Uncollectible*	*% of sales (net of down pmnts)*	*Uncollectible*	*% of sales (net of down pmnts)*
FY of Sale	$\boxed{\$2,070}$	2.3%	$1,800	2.3%	$1,400	1.8%	$1,300	1.9%	$1,300	2.2%	$1,100	2.2%
1 yr after FY of sale			$\boxed{2,600}$	3.3%	2,700	3.6%	2,200	3.1%	2,000	3.3%	2,000	4.0%
2 yrs after FY of sale					$\boxed{1,400}$	1.8%	1,300	1.9%	1,000	1.7%	900	1.8%
3 yrs after FY of sale							$\boxed{800}$	1.1%	900	1.5%	600	1.2%
4 yrs after FY of sale									$\boxed{500}$	0.8%	700	1.4%
5 yrs after FY of sale											$\boxed{200}$	0.4%
6 yrs after FY of sale												
Total uncol. sales as of Dec. 31, 2006	$2,070	2.3%	$4,400	5.6%	$5,500	7.2%	$5,600	8.0%	$5,700	9.5%	$5,500	11.0%

Table D2—(continued)

	2000 Sales		1999 Sales		1998 Sales		1997 Sales		1996 Sales		Combined Experience	
	Uncol-lectible	% of sales (net of down pmnts)	Uncol-lectible	% of sales (net of down pmnts)	Uncol-lectible	% of sales (net of down pmnts)	Uncol-lectible	% of sales (net of down pmnts)	Uncol-lectible	% of sales (net of down pmnts)	1996-2000	All Years
FY of Sale	$1,000	2.9%	$ 800	2.4%	$ 750	2.5%	$ 700	2.7%	$ 500	1.8%	2.5%	2.3%
1 yr after FY of sale	1,500	4.4%	1,400	4.2%	1,300	4.3%	1,000	3.8%	900	3.2%	4.0%	3.7%
2 yrs after FY of sale	900	2.6%	850	2.6%	700	2.3%	550	2.1%	450	1.6%	2.3%	2.0%
3 yrs after FY of sale	600	1.8%	700	2.1%	500	1.7%	400	1.5%	300	1.1%	1.6%	1.5%
4 yrs after FY of sale	300	0.9%	250	0.8%	250	0.8%	250	1.0%	150	0.5%	0.8%	0.9%
5 yrs after FY of sale	150	0.4%	250	0.8%	150	0.5%	100	0.4%	75	0.3%	0.5%	0.5%
6 yrs after FY of sale	$\boxed{100}$	0.3%	150	0.5%	100	0.3%	75	0.3%	100	0.4%	0.3%	0.3%
Total uncol. sales as of Dec. 31, 2006	$4,550	13.3%	$4,400	13.4%	$3,750	12.4%	$3,075	11.8%	$2,475	8.9%	12.0%	11.2%

Computation of Charge to Revenue for Estimated Uncollectibles on Current Year (2006) Sales, and Balance of Allowance at End of 2006

Tables D3 and D4 illustrate the computation of the charge to revenue for estimated uncollectibles on current-year (2006) sales and the computation of the required balance in the allowance for uncollectibles at the end of 2006. For simplicity, this illustration assumes that there is no evidence that the existing receivables are different from the receivables covered by the historical data above. As discussed in paragraph .37 of this Statement of Position (SOP), the allowance should consider such factors as the aging of the receivables, economic conditions, and recent collection history. This illustration uses the historical data for all years, rather than just the data for 1996 to 2000 sales, on the assumption that the more recent experience is relevant to the collectibility of existing receivables.

Table D3. Estimated Uncollectible by Year of Sale

Year Uncollectible	*2001*	*2002*	*2003*	*2004*	*2005*	*2006*
2007	0.3%	0.5%	0.9%	1.5%	2.0%	3.7%
2008		0.3%	0.5%	0.9%	1.5%	2.0%
2009			0.3%	0.5%	0.9%	1.5%
2010				0.3%	0.5%	0.9%
2011					0.3%	0.5%
2012						0.3%
Total expected future uncollectible (%)	0.3%	0.8%	1.7%	3.2%	5.2%	8.9%
Sales, net of down payments	$50,000	$60,000	$70,000	$76,000	$80,000	$90,000
Total expected future uncollectible ($)	$ 150	$ 480	$ 1,190	$ 2,432	$ 4,160	$ 8,010
Total allowance needed at December 31, 2006						$16,422

Table D4. Charge to Revenue for Current Year Sales

Sales net of down payments, 2006	$90,000
Uncollectible — estimated and actual (%)	11.2%
Total charge for 2006 sales	10,080
Less: Chargeoffs during 2006	2,070
Charge for Estimated Uncollectible Sales*	$ 8,010

* Year-end 2006 charge to revenue for estimated uncollectibles on 2006 sales.

Assume the following in addition to the above:

1. Seller finances substantially all sales with notes with a seven-year term and interest rates of 12 percent to 15 percent. The weighted-average interest rates were 13.5 percent at December 31, 2006, and 13.6 percent at December 31, 2005, respectively.
2. The receivables balances were $300,800 at December 31, 2006, and $267,700 at December 31, 2005, with weighted-average remaining lives of 3.2 years at both dates.

Illustrative Financial Statement Disclosures[3]

The entity in this illustration (the Company) finances substantially all sales of time-sharing intervals with seven-year mortgage notes. Buyers are required to make a down payment of at least 10 percent of the sales price, with the balance payable in level monthly installments including interest at 12 percent to 15 percent per year. All sales are recorded using the full accrual method of accounting, under which revenue, net of expected uncollectibles, and cost of sales are recorded at the date of the sale to the buyer. The maturities of the receivables are as follows:

	12/31/2006	*12/31/2005*
Due in 1 year	$ 61,400	$ 54,600
Due in 2 years	60,300	53,700
Due in 3 years	56,100	49,900
Due in 4 years	48,900	43,500
Due in 5 years	38,700	34,400
Due beyond 5 years	35,400	31,600
Total receivables	$300,800	$267,700
Total receivables per balance sheet	$300,800	$267,700
Weighted average interest rates	13.5%	13.6%

The activity in the allowance for uncollectibles was as follows:

Balance, beginning of year	$ 14,012	$ 13,552
Allowance for uncollectibles on current year sales	10,080	8,960
Write-offs of uncollectible receivables	(7,670)	(8,500)
Changes in estimate for prior years' sales	0	0
Balance, end of year	$ 16,422	$ 14,012

In June 2003, the Accounting Standards Executive Committee (AcSEC) issued an exposure draft of a proposed SOP, Allowance for Credit Losses. *The disclosures that follow do not include those that may be required under that proposed SOP. Readers should be alert to any final pronouncement.*

The Company assesses uncollectibles based on pools of receivables, because it holds large numbers of homogenous notes receivable. The Company estimates uncollectibles based on historical uncollectibles for similar time-share notes receivable over the past 10 years. The Company uses a technique referred to as static pool analysis, which tracks uncollectibles for each year's sales over the entire life of those notes. The Company considers whether the historical economic conditions are comparable to current economic conditions, with particular reference to unemployment rates. If current unemployment rates differ from the rates in effect when the historical experience was generated, the Company adjusts the allowance for uncollectibles to reflect the expected effects of current unemployment rates on uncollectibility. The Company currently groups all receivables in three pools for analytical purposes—Florida, California, and Hawaii. Although the Company's credit policies are identical in all locations, the customer demographics and historical uncollectibility have varied by state. Within states, customer demographics and historical uncollectibility for projects have been substantially the same.

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[3] If the company had sold receivables with recourse, it would also disclose the activity on receivables sold in the allowance for uncollectible receivables.

The Company's accounting policy is to stop accruing interest income on individual notes when they become 60 days past due, and to charge off notes to the allowance for uncollectibles when they become 120 days past due and the Company has pursued most of its collection remedies.

Illustrative Relevant Sections of Financial Statements

Balance Sheet as of December 31, 2006	
Gross notes receivable	$300,800
Allowance for uncollectible notes receivable	(16,422)
Net notes receivable	$284,378

Income Statement for the year ended December 31, 2006	
Gross sales transactions*	$100,000
Estimated and actual uncollectible receivables	(10,080)
Revenue	89,920
Cost of sales	(22,000)
Gross profit	$ 67,920

* Includes down payments, or portions thereof, recognized as sales.

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Appendix E

Illustration of Determination of Sales Value of Time-Share Interval

Example 1

Assumptions

Stated sales price		$10,000
Buyer's down payment		$ 1,000
Face amount of note		$ 9,000
Stated interest rate on note		10%
Effective interest rate on note after loan origination fee		10.54%
Market interest rate on note		12%
Terms of note	84 equal monthly installments of	$149.41
Fees payable by buyer to seller at closing:		
Loan origination fee (charged only to buyers who receive seller financing)		$ 150
Document preparation fee (charged to all buyers)		$ 125
Incentives from seller to buyer at no additional cost to buyer: (Buyer must make six monthly payments to receive incentives)		
First year's fee to independent exchange company		$ 110
First year's owners association assessments		$ 300

Present-Value Computations

Present value of 84 monthly installments of $149.41 at market discount rate of 12%	$ 8,464
Fair value of incentives at date of sale:[1]	
First year's fee to independent exchange company	$ 104
First year's owners association assessments	$ 283

Note that if the market interest rate was lower than the stated interest rate on the note, the note would not be increased to an amount in excess of its carrying amount of $8,850.

Computation of Sales Value

Stated sales price	$10,000
Subtractions:	
Discount to state receivable at present value	(386)
Fair value of incentives in excess of amount paid by buyer:	
Exchange company fee	(104)
Owners association assessments	(283)
Additions:	
Document preparation fee	125
Sales value	$ 9,352

[1] The estimated fair value of an incentive at the date of sale equals the present value of the nominal amount discounted at the market interest rate on the note.

Computation of Buyer's Initial Investment

Down payment	$ 1,000
Loan origination fee	150
Document preparation fee	125
Buyer's initial investment	$ 1,275
Proof of buyer's initial investment:	
Sales value	$ 9,352
Plus: incentives	
Exchange company fee	104
Owners association assessments	283
Less: seller's net investment in note receivable	(8,464)
Buyer's initial investment	$ 1,275

Adequacy of Buyer's Initial Investment

The seller first considers whether the buyer's initial investment needs to be allocated between the interval and the incentives. In this case, the initial investment does not need to be allocated, because the buyer must make six monthly payments to receive the incentives. The six monthly payments total $896, which is more than enough to pay for the fair value of the incentives ($387) plus interest (see paragraph .25 of this SOP). Accordingly, the entire initial investment of $1,275 is allocated to the interval.

If the buyer did not need to make any monthly payments to receive the incentives, then the initial investment would be allocated first to the incentives ($387) and the remainder ($888) to the interval.

The adequacy of the buyer's initial investment would then be determined in accordance with paragraph 5(b) of Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*.

Note that, consistent with FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, the computation of sales value and buyer's initial investment is exactly the same as if the buyer provided the seller a note with a face amount of $8,850, requiring 84 monthly payments of $149.41 with an effective interest rate of 10.54 percent, a required down payment of $1,150, and no loan origination fee.

Illustrative Journal Entries

At date of sale:

Dr.		Cash	$1,275	
		Note receivable	8,464	
	Cr.	Revenue from sale of interval		$9,352
		Liability for incentives		387

To record sale of interval and liability to provide incentives at end of six months.

Month 1:

Dr.		Cash	$149	
	Cr.	Note receivable		$64
		Interest income		85
Dr.		Interest expense	4	
	Cr.	Liability for incentives		4

To record accrual of interest income on note receivable, interest expense on liability for incentive, and collection on note receivable.

Months 2 through 6:

Dr. Cash		$747	
Cr.	Note receivable		$334
	Interest income		413
Dr. Interest expense		19	
Cr.	Liability for incentives		19

To record accruals of interest income on note receivable, interest expense on liability for incentive, and collections on note receivable.

End of Month 6:

Dr. Liability for incentives		$410	
Cr.	Cash		$410

To record seller's payment of exchange company fee and owners association assessments.

Example 2

Assumptions

Same as Example 1 except that market interest rate on note is 9 percent.

Present-Value Computation

Present value of 84 monthly installments of $149.41 at market discount rate of 9%	$ 9,286

Because the market interest rate is lower than the effective interest rate on the note, the note is not increased to an amount in excess of the seller's carrying amount of $8,850.

Computation of Sales Value

Stated sales price	$10,000
Subtractions:	
Fair value of incentives in excess of amount paid by buyer:[2]	
Exchange company fee	(105)
Owners association assessments	(287)
Additions:	
Document preparation fee	125
Sales value	$ 9,733

Computation of Buyer's Initial Investment

Down payment	$ 1,000
Loan origination fee	150
Document preparation fee	125
Buyer's initial investment	$ 1,275
Proof of buyer's initial investment:	
Sales value	$ 9,733
Plus: incentives	
Exchange company fee	105
Owners association assessments	287
Less: carrying amount of seller's note receivable	(8,850)
Buyer's initial investment	$ 1,275

[2] The estimated fair value of an incentive at the date of sale equals the present value of the nominal amount discounted at the market interest rate on the note.

Adequacy of Buyer's Initial Investment

The seller first considers whether the buyer's initial investment needs to be allocated between the interval and the incentives. In this case, the initial investment does not need to be allocated, because the buyer must make six monthly payments to receive the incentives. The six monthly payments total $896, which is more than enough to pay for the fair value of the incentives ($392) plus interest (see paragraph .25 of this SOP). Accordingly, the entire initial investment of $1,275 is allocated to the interval.

If the buyer did not need to make any monthly payments to receive the incentives, then the initial investment would be allocated first to the incentives ($392) and the remainder ($883) to the interval.

The adequacy of the buyer's initial investment would then be determined in accordance with paragraph 5(b) of FASB Statement No. 66.

Note that, consistent with FASB Statement No. 91, the computation of sales value and buyer's initial investment is exactly the same as if the buyer provided the seller a note with a face amount of $8,850, requiring 84 monthly payments of $149.41 with an effective interest rate of 10.54 percent, a required down payment of $1,150, and no loan origination fee.

Example 3

Assumptions

Same as Example 2 except that seller does not charge a document preparation fee.

Present-Value Computation

Present value of 84 monthly installments of $149.41 at market discount rate of 9%	$ 9,286

Because the market interest rate is lower than the effective interest rate on the note, the note is not increased to an amount in excess of the seller's carrying amount of $8,850.

Computation of Sales Value

Stated sales price	$10,000
Subtractions:	
Fair value of incentives in excess of amount paid by buyer:[3]	
Exchange company fee	(105)
Owners association assessments	(287)
Sales value	$ 9,608

Computation of Buyer's Initial Investment

Down payment	$1,000
Loan origination fee	150
Buyer's initial investment	$1,150
Proof of buyer's initial investment:	
Sales value	$9,608
Plus: incentives	
Exchange company fee	105
Owners association assessments	287
Less: carrying amount of seller's note receivable	(8,850)
Buyer's initial investment	$1,150

[3] The estimated fair value of an incentive at the date of sale equals the present value of the nominal amount discounted at the market interest rate on the note.

Adequacy of Buyer's Initial Investment

The seller first considers whether the buyer's initial investment needs to be allocated between the interval and the incentives. In this case, the initial investment does not need to be allocated, because the buyer must make six monthly payments to receive the incentives. The six monthly payments total $896, which is more than enough to pay for the fair value of the incentives ($392) plus interest (see paragraph .25 of this SOP). Accordingly, the entire initial investment of $1,150 is allocated to the interval.

If the buyer did not need to make any monthly payments to receive the incentives, then the initial investment would be allocated first to the incentives ($392) and the remainder ($758) to the interval.

The adequacy of the buyer's initial investment would then be determined in accordance with paragraph 5(b) of FASB Statement No. 66.

Note that, consistent with FASB Statement No. 91, the computation of sales value and buyer's initial investment is exactly the same as if the buyer provided the seller a note with a face amount of $8,850, requiring 84 monthly payments of $149.41 with an effective interest rate of 10.54 percent, a required down payment of $1,150, and no loan origination fee.

Example 4

Assumptions

Same as Example 2 except that seller charges no loan origination fee. Therefore, effective interest rate on note equals the stated rate of 10 percent.

Present-Value Computation

Present value of 84 monthly installments of $149.41 at market discount rate of 9%	$9,286

Because the market interest rate is lower than the effective interest rate on the note, the note is not increased to an amount in excess of the seller's carrying amount of $9,000.

Computation of Sales Value

Stated sales price	$10,000
Subtractions:	
Fair value of incentives in excess of amount paid by buyer:[4]	
Exchange company fee	(105)
Owners association assessments	(287)
Additions:	
Document preparation fee	125
Sales value	$ 9,733

[4] The estimated fair value of an incentive at the date of sale equals the present value of the nominal amount discounted at the market interest rate on the note.

Computation of Buyer's Initial Investment

Down payment	$1,000
Document preparation fee	125
Buyer's initial investment	$1,125
Proof of buyer's initial investment:	
Sales value	$9,733
Plus: incentives	
Exchange company fee	105
Owners association assessments	287
Less: carrying amount of seller's note receivable	(9,000)
Buyer's initial investment	$1,125

Adequacy of Buyer's Initial Investment

The seller first considers whether the buyer's initial investment needs to be allocated between the interval and the incentives. In this case, the initial investment does not need to be allocated, because the buyer must make six monthly payments to receive the incentives. The six monthly payments total $896, which is more than enough to pay for the fair value of the incentives ($392) plus interest (see paragraph .25 of this SOP). Accordingly, the entire initial investment of $1,125 is allocated to the interval.

If the buyer did not need to make any monthly payments to receive the incentives, then the initial investment would be allocated first to the incentives ($392) and the remainder ($733) to the interval.

The adequacy of the buyer's initial investment would then be determined in accordance with paragraph 5(b) of FASB Statement No. 66.

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Glossary

Affinity Program. See *vacation club*.

Amenities. Features that enhance the attractiveness or perceived value of a time-sharing interval. Examples of amenities include golf courses, clubhouses, swimming pools, tennis courts, indoor recreational facilities, and parking facilities. See also *planned amenities* and *promised amenities*.

Assumption. The substitution of one debtor for another, whereby the second debtor agrees to assume the debt obligation of the original debtor.

Common Costs. Costs that relate to two or more phases within a time-sharing project.

Continuing Investments. The sum of the buyer's payments to date (down payment, fees retained by the seller, and principal payments subsequent to the down payment) towards the purchase of a time-sharing interval. Payments of interest are excluded.

Continuing Involvement. A situation in which the seller has not transferred substantially all of the benefits and risks incident to the ownership of real estate. Benefits include but are not limited to the right to occupy the property, the transferability of the time-sharing interval without restrictions from the seller, the right to insurance proceeds and condemnation awards, the right to participate in making decisions regarding management of the property, the control over rental of the time-sharing interval, and the right to any increase in the value of the time-sharing interval. Risks include but are not limited to the responsibility for payment of applicable taxes, repairs, utilities, maintenance, insurance, and improvements; the responsibility for management of the property; legal liabilities; setting aside of replacement reserves; casualty losses; and exposure to any decrease in the value of the time-sharing interval. In time-sharing transactions, it is common for certain of the benefits and risks to be transferred to an owners association or similar entity that acts on behalf of the owners of time-sharing intervals. See Appendix C, "Continuing Involvement" [paragraph .69] of this Statement of Position.

Contract-for-Deed. A purchase contract by which the seller agrees at some future point, when the purchaser has paid a specified portion of the price of the time-sharing interval, to convey title to the purchaser. The transfer of title may not be dependent on other factors or contingencies.

Deferment. The postponement of some or all of a debtor's payment obligations.

Deposit Method. A method of accounting for time-sharing transactions under which cash received from the buyer is reported as a deposit and shown as a liability in the seller's balance sheet.

Downgrade. A transaction under which, as a result of credit concerns, the holder of a time-sharing interval returns the interval to the seller in exchange for a lower-valued interval (and a corresponding reduction in contractual payment obligation). The determination of whether the value is lower is based on a comparison of the sales value of the new interval with the original sales value of the original interval.

Exchange. The trading, by a purchaser of a time-sharing interval, of that time-sharing interval for a given year for another time interval, another location, or another kind of privilege of ownership. Such trading is often effected through the buyer's membership in an exchange company. Many developers also offer an internal exchange program. Buyers typically pay a fee for exchange privileges.

Fixed Time. A time-sharing arrangement in which ownership is passed through a deed and the buyer purchases a specific period (generally, a specific week) during the year.

Floating Time. A time-sharing arrangement in which ownership is passed through a deed but the buyer is not limited to a specific period (generally, a specific week) during the year.

Fractional Interest. A partial ownership interest in real estate that typically includes larger blocks of time on an annual basis (for example, three weeks or more).

Full Accrual Method. A method of recognizing profit for time-sharing transactions under which profit is recognized in full provided the applicable criteria in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*, are met. Those conditions may be met at the time a time-share is sold or at some later date.

Holding Period. The period during which a time-sharing interval is held for sale. Sellers may offer time-sharing units for rent during such holding periods.

Incentive. A product or service that the seller of a time-sharing interval provides to the buyer for stated compensation (often, for no compensation) that is less than the fair value of that product or service. See also *inducement*.

Incidental Operations. Revenue-producing activities, such as rentals, engaged in during the holding or development period to reduce the cost of holding or developing the property for use as time-sharing units, as distinguished from activities designed to generate a profit or return from the use of the property.

Independent Third Party. A party unrelated to the seller of a time-sharing interval.

Inducement. A product or service that a time-share seller provides to a potential buyer for stated compensation (often, no compensation) that is less than the fair value of that product or service. A typical example of an inducement is a complementary stay at a time-share resort in exchange for the potential buyer's agreement to take a guided tour of the resort. The difference between an *inducement* and an *incentive* is the conditions for receipt and the timing of the offer. An inducement is offered to potential buyers regardless of whether a consummated sale occurs, whereas an incentive is typically offered at the point of sale and is provided only to buyers of time-sharing intervals.

Interval. The specific period (generally, a specific week) during the year that a time-sharing unit is specified by agreement to be available for occupancy by a particular customer. Also denoted *time-sharing interest* or *time-share*.

Mini-Vacation. A marketing program under which a time-share developer offers, for a fee, a short (typically, two to three days) visit to a destination where the developer operates a project. The developer typically subsidizes the fee to the customer for the mini-vacation in exchange for the customer attending a sales presentation at the project. The mini-vacation may include room accommodations, entertainment tickets, and similar items of value. The customer typically accepts the offer of the fee subsidy in exchange for his or her attending the sales presentation.

Modification. A change in the terms of the financing agreement between buyer and seller, typically to accommodate a situation in which the buyer is unable to meet his or her original contractual payment obligations.

Other Than Retail Land Sales (OTRLS). Refers to other-than-retail-land-sales transactions as discussed in FASB Statement No. 66.

Owners Association (OA). A body of owners formed to administer the rules and regulations of a time-sharing project. Also denoted *homeowners association* (HOA), *interval owners association* (IOA), *property owners association* (POA), or *vacation owners association* (VOA).

Percentage-of-Completion Method. A method of recognizing profit for time-sharing transactions under which the amount of revenue recognized (based on the sales value) at the time a sale is recognized is measured by the relationship of costs already incurred to the total of costs already incurred and future costs expected to be incurred.

Phase. A contractually or physically distinguishable portion of a time-sharing project. That portion is distinguishable from other portions based on shared characteristics such as (1) units a developer has declared or legally registered to be for sale, (2) units linked to an owners association, (3) units to be constructed during a particular time period, or (4) how a developer plans to build the time-sharing project.

Planned Amenities. Amenities that a developer is planning to construct but is not obligated to construct under the terms of time-sharing contracts with purchasers. See also *amenities* and *promised amenities*.

Points. Purchased vacation credits that a buyer may redeem for occupancy at various sites. The number of points redeemed depends on such factors as unit type and size, site location, and season.

Project. A time-sharing development; some projects may be completed in a single phase, such as a single, one-story building containing several time-sharing units. Other projects may be completed in several phases, for example (1) a hotel that is being converted to time-sharing units one floor at a time while the unconverted units continue to be rented or (2) a number of buildings, each containing several time-sharing units, being built on a piece of property over an extended period of time.

Promised Amenities. Amenities that a developer is obligated to construct under the terms of time-sharing contracts with purchasers. See also *amenities* and *planned amenities*.

Real Estate Time-Sharing. See *time-sharing*.

Recourse. The right of a transferee of receivables to receive payment from the transferor of those receivables for (1) failure of debtors to pay when due, (2) the effects of prepayments, or (3) adjustments resulting from defects in the eligibility of the transferred receivables.

Relative Sales Value Method. A method of allocating inventory cost and determining cost of sales in conjunction with a time-sharing sale. Cost of sales is calculated as a percentage of net sales by applying a cost-of-sales percentage, determined as the ratio of inventory cost to total remaining estimated time-sharing revenue to be collected from sales of the inventory. The inventory balance reported in the balance sheet is considered to be a pool of costs that will be charged against future revenue.

Reload. A time-sharing transaction whereby a customer obtains a second time-sharing interval from the same seller but does not relinquish the right to the first—for example, obtaining an additional unit, an additional interval, or additional points (see *vacation club*).

Rescission. Statutory right of the buyer to cancel a sales contract within a certain defined time period and obtain a return of all consideration paid to the seller.

Right-to-Use (RTU). A time-sharing arrangement in which the ownership of the real estate remains with the seller.

Sales Value. A calculated amount that approximates the amount at which a time-sharing interval would be sold in an all-cash sale, without financing or incentives. Sales value is determined by adjusting the stated sales price to add or subtract the following amounts:

1. Subtracting from the stated sales price a discount to reduce the receivable to its present value using an appropriate interest rate not less than the rate stated in the note. The objective is to value the note at an amount not greater than the amount at which it could be sold without recourse by the seller at the date of the sales contract.
2. Adding to the stated sales price any fees paid by the buyer to the seller that are unrelated to financing—for example, sales document preparation fees—to consummate a sales transaction.
3. Subtracting from the stated sales price the excess of the fair value of incentives provided to the buyer over the stated amount the buyer pays for the incentives.
4. Subtracting from the stated sales price the excess of the fair value of services provided by the seller over the stated amount the buyer pays for the services. If similar services are provided by entities other than the seller, the fair value of the services should be determined as the prevailing market rates for such services.

Sampler Program. A marketing program under which a time-share developer offers a customer, who has previously toured one of the developer's projects, a stay at one of the projects at a reduced rate. In exchange, the customer agrees to take another, subsequent tour of the project selected under the sampler program during the customer's stay at that project. If the subsequent tour results in a sale, the developer may allow the customer to apply some or all of the amount paid for the sampler toward the purchase of a time-share, as a part of the down payment. Also referred to as *exit program*.

Seller Subsidy. An amount that a seller pays to an owners association to cover net losses that may be incurred by the association.

Special-Purpose Entity. See *time-sharing special-purpose entity*.

Tenancy-for-Years. A time-sharing arrangement in which a customer has a qualified right to possession and use of a time-sharing interval for a certain number of years, after which it reverts to the seller or a third party. Also known as *estate-for-years* or *term-for-years*.

Time-Share. See *interval*.

Time-Sharing. An arrangement in which a seller sells or conveys the right to occupy a dwelling unit for specified periods in the future. Forms of time-sharing arrangements covered by this SOP include but are not limited to fixed and floating time, interval ownership, **undivided interests**, points programs, vacation clubs, right-to-use arrangements such as **tenancy-for-years** arrangements, and arrangements involving special-purpose entities.

Time-Sharing Interest. See *interval*.

Time-Sharing Special-Purpose Entity (SPE). An entity, typically a corporation or a trust, to which a seller transfers time-sharing real estate in exchange for the entity's stock, membership interests, or beneficial interests.

Uncollectibility. A situation in which, as a result of credit issues, (1) the time-share seller is unable to collect all amounts due (both principal and interest) according to the contractual terms of a note receivable from a buyer, or (2) a time-share receivable has not been written off but facts and circumstances indicate that it is probable[1] that the seller will not collect all contractual payments. Any sale that, as a result of credit issues, is canceled or modified subsequent to being recorded as a sale is considered *uncollectible*.

Undivided Interest (UDI). A time-sharing arrangement that involves a tenant-in-common interest in a condominium unit or entire improved property, and in which the interest holder is assigned a specific period (generally, a specific week). The interest holder is also assigned a specific unit if the undivided interest is in the entire improved property.

Unit. The physical space in a time-sharing project that a customer is specified by agreement to occupy for a specific time interval (generally, a specific week) during the year.

Upgrade. A time-sharing transaction whereby a customer relinquishes the right to a currently held time-sharing interval and obtains a higher-priced time-sharing interval from the same seller.

Vacation Club. A time-sharing arrangement whereby a buyer receives the right to use accommodations at all resorts belonging to the club. Membership may include a priority reservation right to the member's home resort. Other typical attributes include finite term of membership; use of points to obtain accommodations or other benefits; the privilege of being able to use different kinds of lodging, such as time-sharing units, condominiums, hotels, and campgrounds; the privilege of being able to exchange one's yearly interval for cruises, hotel stays, airline tickets, or car rentals; and benefits other than lodging, such as travel services, hotel discounts, golf packages, or health club memberships. May also be termed *affinity program*.

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[1] *Probable* is defined in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, as "likely to occur" and is used in the same sense in this definition.

Accounting Standards Executive Committee (2002-2003)

AICPA Staff

Time-Sharing Task Force

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