Statutory Issue Paper No. 80

Debt

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 15

5. Debt discount or premium, if any, shall be reported in the balance sheet as a direct deduction from or addition to the face amount of the note. Such discount or premium shall be amortized over the life of the note using the interest method.

6. Debt issuance costs (i.e., loan fees, legal fees, etc.) do not meet the definition of an asset as defined in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* (Issue Paper No. 4). Accordingly, such costs shall be charged to operations.

7. Debt obligations of ESOPs shall be reported as borrowed money by company sponsors, except when the ESOP has both the ability and intent to satisfy the debt from sources other than dividends on the company stock, contributions from the company or the sale or exchange of the company's securities. ESOPs are addressed in *Issue Paper No. 78—Employee Stock Ownership Plans*.

8. Debt which is subject to a troubled debt rest

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

DISCUSSION

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

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

Accounting Principles Board Opinion No. 12, paragraphs 16 and 17, Omnibus Opinion – 1967
AICPA Accounting Interpretations of APB 21, Interest on Receivables and Payables
AICPA Accounting Interpretations of APB 26, Early Extinguishment of Debt

Borrowed Money

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

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

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

Interest Payable

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

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

Debt Obligations of Employee Stock Ownership Plans (ESOP)

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

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

Borrowed Money

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

Debt Obligations of Employee Stock Ownership Plans (ESOP)

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

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

7. Borrowed Money

Instruction:

Furnish pertinent information concerning the kind of borrowing (e.g., debentures, commercial paper outstanding, bank loan, lines of credit, etc.). Indicate redemption price, if any, interest features, collateral requirements, maturity date, etc., for money borrowed by the company. Also include information regarding material loan provisions (i.e., convenants) that must be satisfied or maintained on a continuing basis and indicate if the society is in violation of any such loan provisions. Identify the terms of reverse repurchase agreements whose amounts have been included in the liability for borrowed money.

Generally Accepted Accounting Principles

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

DEBT WITH STOCK PURCHASE WARRANTS

Opinion

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

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

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

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

OTHER TYPES OF DEBT SECURITIES

Opinion

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

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

Opinion

15. Amortization of discount and premium. With respect to a note which by the provisions of this Opinion requires the imputation of interest, the difference between the present value and the face amount should be treated as discount or premium[8] and amortized as interest expense or income over the life of the note in such a way as to result in a constant rate of interest when applied to the amount outstanding at the beginning of any given period. This is the “interest” method described in and supported by paragraphs 16 and 17 of *APB Opinion No. 12, Omnibus Opinion--1967*. However, other methods of amortization may be used if the results obtained are not materially different from those which would result from the “interest” method.

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

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

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

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

Opinion

19. Reduction of alternatives. The Board concludes that all extinguishments of debt before scheduled maturities are fundamentally alike. The

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

Accounting for Terminations

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

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

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

38. If an employer reacquires the suspense s0.0005 Tc -0.0029l(APB sa881 0 Td[Eares)T6(arom)

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

Generally Accepted Accounting Principles

- *Accounting Principles Board Opinion No. 12, paragraphs 16 and 17, Omnibus Opinion – 1967*
- *Accounting Principles Board Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*
- *Accounting Principles Board Opinion No. 21, Interest on Receivables and Payables*
- *Accounting Principles Board Opinion No. 26, Early Extinguishment of Debt*
- *FASB Statement No. 4, Reporting Gains and Losses from Extinguishment of Debt*
- *FASB Statement No. 47, Disclosure of Long Term Obligations*
- *FASB Statement No. 64, Extinguishment of Debt Made to Satisfy Sinking Fund Requirements—an Amendment of FASB Statement No. 4*
- *FASB Statement No. 84, Induced Conversions of Convertible Debt*
- *AICPA Statement of Position 93-6, Employers' Accounting for Employee Stock Ownership Plans*
- *AICPA Accounting Interpretations of APB 21, Interest on Receivables and Payables*
- *AICPA Accounting Interpretations of APB 26, Early Extinguishment of Debt*
- *FASB Emerging Issues Task Force No. 84-40, Long-Term Debt Repayable by a Capital Stock*
- *FASB Emerging Issues Task Force No. 85-9, Revenue Recognition on Options to Purchase Stock of Another Entity*
- *FASB Emerging Issues Task Force No. 85-17, Accrued Interest upon Conversion of Convertible Debt*
- *FASB Emerging Issues Task Force No. 85-29, Convertible Bonds with a "Premium Put"*
- *FASB Emerging Issues Task Force No. 86-8, Sale of Bad-Debt Recovery Rights*
- *FASB Emerging Issues Task Force No. 86-15, Increasing-Rate Debt*
- *FASB Emerging Issues Task Force No. 86-18, Debtor's Accounting for a Modification of Debt Terms*
- *FASB Emerging Issues Task Force No. 86-28, Accounting Implications of Indexed Debt Instruments*
- *FASB Emerging Issues Task Force No. 86-36, Invasion of a Defeasance Trust*
- *FASB Emerging Issues Task Force No. 90-19, Convertible Bonds with Issuer Option to Settle for Cash upon Conversion*
- *FASB Emerging Issues Task Force No. 95-15, Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount*
- *FASB Technical Bulletin No. 80-1, Early Extinguishment of Debt through Exchange for Common or Preferred Stock*

State Regulations

- No additional guidance obtained from state statutes or regulations.