EXPOSURE DRAFT

PROPOSED STATEMENT OF POSITION

ACCOUNTING FOR REAL ESTATE TIME-SHARING TRANSACTIONS

FEBRUARY 20, 2003

Prepared by the Accounting Standards Executive Committee
American Institute of Certified Public Accountants

Comments should be received by April 30, 2003, and sent by electronic mail to
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February 20, 2003

Accompanying this letter is an exposure draft of a proposed AICPA Statement of Position (SOP), *Accounting for Real Estate Time-Sharing Transactions*. A summary of the proposed SOP follows this letter.

The purpose of this exposure draft is to solicit comments from preparers, auditors, and users of financial statements and other interested parties.

The proposed SOP provides guidance on accounting for real estate time-sharing transactions in financial statements prepared in conformity with generally accepted accounting principles (GAAP).

AREAS REQUIRING PARTICULAR ATTENTION BY RESPONDENTS

Comments are specifically requested on the following issues addressed by this exposure draft:

Interaction With FASB Projects

Issue 1

The Financial Accounting Standards Board (FASB) has on its agenda a project whose objective is to issue a comprehensive Statement on revenue recognition, and to amend the related guidance on revenue and liabilities in certain of the FASB Concepts Statements. The goals of the project are to (1) eliminate inconsistencies in the existing authoritative literature and accepted practices; (2) fill voids that have emerged in revenue recognition guidance in recent years; and (3) provide guidance for addressing issues in the future. The Board expects to issue an exposure draft of a Statement on revenue recognition in 2004. Although that Statement is initially planned to apply to business entities generally, the Board has noted that it might later decide that certain transactions or industries requiring additional study should be excluded from its scope and addressed separately.

The FASB also has on its agenda a project to address the feasibility of adopting a principles-based approach to U.S. standard setting to reduce the level of detail and complexity in accounting standards. Under that approach, the Board would develop accounting standards that, among other things, (1) set forth as general principles fundamental recognition, measurement, and reporting requirements derived from the conceptual framework, (2) permit few, if any exceptions or alternatives to the principles, and (3) provide less guidance for applying the principles. The Board has issued for public comment a proposal describing a principles-based approach and the implications of that approach for changes to the processes and behaviors of all participants in the U.S. financial reporting process.

Much of the guidance in the proposed SOP is guidance on sale and revenue recognition that is detailed, both principles-based and rules-based, and specific to the real estate time-sharing industry—similar to the guidance in FASB Statement of Financial Accounting Standards No. 66, *Accounting for Sales of Real Estate*. It is therefore possible that, depending on the timing of issuance by the FASB of any final pronouncements as a result of the two projects described above, certain guidance in the proposed SOP would be effective for only a limited period of time. Do you believe that issuance of a final SOP should be postponed pending resolution of either or both of those two FASB projects, and why?

Sale Recognition Criteria

Issue 2

The proposed SOP provides criteria for a real estate time-sharing transaction to be recognized as a sale. See paragraphs 18 through 21, and 83 through 87. Do you agree with those criteria? If not, what alternative criteria would you propose and why? Would you prefer recognizing revenue from all time-sharing transactions over the term of the arrangement, like an operating lease under FASB Statement No. 13, *Accounting for Leases*, and why?

Revenue Recognition for Transactions Recognized as Sales

Issue 3

As discussed in paragraph 88 of the proposed SOP, AcSEC decided to use as the principal basis for real estate time-sharing revenue recognition the fundamental principles of the retail land sales model of FASB Statement No. 66 rather than the other-than-retail-land-sales model of that Statement or revenue recognition guidance in other authoritative literature. Do you agree that the retail land sales model of that Statement is an appropriate starting point? If not, what alternative basis would you propose and why?

Issue 4

Although AcSEC used the retail land sales model of FASB Statement No. 66 as the principal basis for time-sharing revenue recognition in the proposed SOP, AcSEC made certain modifications to that model that it believes improve the model as applied to time-sharing transactions and, in some cases, make the model more consistent with current accounting literature. For each of the following modifications, do you agree that the modification is appropriate? If not, how would you propose to change it and why?

1. In paragraph 18(c) of the proposed SOP, the 10-percent test to demonstrate the buyer's commitment is based on cumulative payments of principal whereas the Statement's test is based on payments of both principal and interest.

2. In paragraph 25(b) of the proposed SOP, one of the tests to demonstrate collectibility is based on collection by the seller of cumulative payments (excluding interest) of 25 percent of the time-share sales value, whereas the Statement's test is based on collection by the seller of a 20-percent down payment.

3. In the other collectibility test of paragraph 25(b), the proposed SOP uses an 85-percent test based on notes receivable balances whereas the 90-percent test of the Statement is based on the number of contracts collected in full.

4. In paragraph A2 in Appendix A, "Description and Illustration of Methods of Revenue Recognition for Time-Sharing Transactions," of the proposed SOP, selling and marketing costs are excluded from the percentage-of-completion calculations whereas in the Statement such costs are included.

Issue 5

The proposed SOP provides criteria for recognition of revenue on a time-sharing sale under the full accrual, percentage-of-completion, cash-received, and combined methods of accounting. See paragraphs 22 through 28, and 88 through 100. Do you agree with those criteria? If not, what alternative criteria would you propose and why?

Change in Revenue Recognition Methods

Issue 6

The proposed SOP indicates that at the time the criteria for a "higher" revenue recognition method are satisfied for a transaction originally reported under the deposit method, cash-received method, or combined method, the seller should change to the applicable accounting method for that transaction. See paragraphs 29, 30, and 101.

1. Do you agree that the seller should be required to change to the applicable method, or do you believe that the seller should have an option to change, and why?

2. Do you agree that the change from the deposit method, cash-received method, or combined method should be performed on an individual transaction basis—for

example, changing from cash-received to full accrual accounting as individual contracts meet the 25-percent cumulative payments requirement of paragraph 25(b) of the proposed SOP—as prescribed in the proposed SOP, or do you believe that the change should be performed on a project or phase basis, and why?

3. Do you agree with the guidance in the proposed SOP that states that the effect should be accounted for as a change in accounting estimate, or do you believe that it should be accounted for as a change in accounting principle, and why?

Determination of Sales Value; Application of Cumulative Payments Test

Issue 7

The proposed SOP indicates that if a seller provides an incentive to a buyer in order to consummate a time-sharing transaction, the seller should reduce the sales value by the excess of the fair value of the incentive over the amount the buyer pays and the incentive should be accounted for separately. See paragraphs 33, 102, and 103. Do you agree with this accounting treatment for incentives? If not, what accounting treatment would you propose, and why?

Issue 8

Paragraphs 104 and 105 of the proposed SOP discuss that the seller's income statement display of noncash incentives differs from the consensus 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)." Do you agree with the proposed accounting, which would require amending EITF Issue No. 01-9 to include an exception, or do you believe that cash and noncash time-sharing sales incentives should be accounted for differently as currently prescribed in EITF Issue No. 01-9, and why?[1]

Issue 9

Do you agree with the method in paragraphs 106 and 107 of the proposed SOP of reducing the buyer's cumulative payments for an incentive? If not, how would you propose to allocate the buyer's payments between the interval and the incentive, and why?

Paragraph 107 of the proposed SOP states that payments, on a buyer's note, that a seller requires before delivering to the buyer a promised sales incentive should be based on the total amount of payments on the note, including both principal and interest, and that the buyer's payments would have to cover both the value of the incentive and interest on the unpaid portion of the incentive. Do you believe that there should be a "practicality cut" associated with this method, in view of the possible need for the seller to set up an additional amortization schedule with each incentive? If so, what practicality cut would you propose?

If the allocation of payments results in a period of negative amortization of the portion of the note related to the interval, should there be a limit on the period of negative amortization?

Accounting for Cost of Sales and Inventory

Issue 10

[1] Respondents should note that EITF Issue No. 01-9 prescribes the current accounting for incentives in the time-sharing industry and should be followed.

The proposed SOP indicates that the relative sales value method is the appropriate approach for recording cost of sales and inventory for time-sharing sales transactions. See paragraphs 44 and 108 through 112. Appendix A illustrates the method through examples. Do you agree that the relative sales value method is the appropriate approach? Do you find its presentation in the proposed SOP understandable? If not, how would you change the approach or the presentation and why?

Issue 11

In the application of the relative sales value method, changes in estimate (for example, changes in the cost-of-sales percentage) are applied on a fully retrospective basis via a current-period adjustment; see paragraphs 44, 109, and 110. In the application of the percentage-of-completion method, changes in estimate are similarly applied on a fully retrospective basis; see paragraph A3 in Appendix A and paragraph 111. Do you agree with that approach, or do you believe that such changes in estimate should be (1) applied on a retrospective basis via a current-period adjustment but only from the beginning of the fiscal year of change, or (2) applied on a prospective basis beginning with the period of change (for example, a quarter), and why?

Costs to Sell Time-Sharing Intervals

Issue 12

Paragraphs 48 and 49 of the proposed SOP provide criteria for the seller to capitalize costs incurred to sell time-sharing intervals. As noted in paragraph 113 of the proposed SOP, those criteria are based both on the criteria in FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*, and the more recent "incremental costs" guidance in FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*. Do you agree with the capitalization criteria in the proposed SOP? If not, what alternative criteria would you propose and why?

Accounting for Credit Losses

Issue 13

Paragraph 56 of the proposed SOP provides that the amount of sales that, from a historical and statistical perspective, are expected to result in credit losses should be recorded as estimated uncollectible receivables and shown in the seller's statement of operations as a reduction of sales revenue. Paragraph 59 of the proposed SOP provides that subsequent changes in estimated losses resulting from credit losses should also be shown as estimated uncollectible receivables and a reduction of sales revenue rather than as bad debt expense. As noted in paragraphs 116 through 120 of the proposed SOP, AcSEC discussed two alternative accounting treatments for estimated credit losses and adjustments thereto, which are to (1) record bad debt expense and (2) adjust revenue and cost of sales for the initial estimates of credit losses and record bad debt expense for subsequent increases in estimated credit losses. Do you agree with the presentation prescribed in the proposed SOP, or do you agree with either of the alternative presentations or some other presentation, and why?

Operations During Holding Periods

Issue 14

Paragraph 62 of the proposed SOP prescribes that revenue from and costs of rental and other operations during holding periods should be accounted for as incidental operations, and that time-sharing interests should be accounted for as inventory rather than fixed assets and should not be depreciated during times of rental. As noted in paragraph 125 of the proposed SOP, AcSEC discussed two alternative accounting treatments:

1. Account for all unsold inventory as fixed assets and depreciate unsold time-sharing interests.

2. Apply the proposed SOP's currently prescribed accounting for time-sharing interests expected to be sold within a year, while applying the accounting in alternative 1 for time-sharing interests not expected to be sold within one year.

Do you agree with the accounting prescribed in the proposed SOP, or either of the two alternative accounting treatments or some other accounting treatment, and why?

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

Issue 15

The proposed SOP provides that for time-sharing special purpose entity (SPE) structures that lack economic substance insofar as they are legally required in order for a developer to be able to sell, and where the SPE has no assets other than the time-shares and has no debt, the seller should present on its balance sheet as time-sharing inventory the interests not yet sold to end-users. See paragraphs 66 and 131. Do you agree with that conclusion, or do you believe that the seller should employ other methods (for example, consolidation or the equity method of accounting) to account for those kinds of time-sharing SPE structures, and why?

Issue 16

The proposed SOP indicates that if the seller, seller's affiliate, or other related party operates an exchange, points, affinity, or similar program, operation of the program constitutes continuing involvement by the seller. The proposed SOP also states that if the seller provides its program services without compensation or at compensation less than market rates, compensation should be imputed when the sale is recognized and such compensation should be recognized in income when the seller performs the services. See paragraph 67 and "Seller-Provided Management Services" in Appendix B, "Continuing Involvement." Do you agree with that approach? If not, how would you propose to change the approach, and why?

Effective Date and Transition

Issue 17

The proposed SOP would be effective for financial statements for fiscal years beginning after June 15, 2004. The proposed SOP provides that, at transition, the SOP would be applied retroactively to financial statements by means of a cumulative effect of a change in accounting principle rather than the alternatives of prospective application to new transactions only and retroactive restatement of financial statements. See paragraphs 80 and 139. Do you agree with that proposed transition requirement? If not, would you propose one of the alternatives or some other alternative, and why?

AcSEC welcomes comments or suggestions on any aspect of this exposure draft. When making comments, please include reference to specific paragraph numbers, including reasons for any comments or suggestions, and provide alternative wording where appropriate.

Comments on the exposure draft should be sent by electronic mail to **msimon@aicpa.org**, or addressed to Marc Simon, Accounting Standards, File 4210.TS, American Institute of Certified Public Accountants, 1211 Avenue of the Americas, New York, NY 10036-8775, in time to be received by April 30, 2003.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the AICPA offices after April 30, 2003, for one year.

Sincerely,

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SUMMARY

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

- For a time-sharing transaction to be accounted for as a sale, the transaction should meet the following criteria:
  - The seller transfers nonreversionary title to the time-share.
  - The transaction is consummated.
  - The buyer makes cumulative payments (excluding interest) of at least 10 percent of the sales value of the time-share.
  - Sufficient time-shares have been sold to reasonably assure that the units will not become rental property.

  If the seller does not transfer nonreversionary title, the transaction should be accounted for in the same manner as an operating lease.[2]

- If a time-sharing transaction accounted for as a sale meets certain criteria, the seller should recognize revenue immediately under the full accrual method. If a transaction accounted for as a sale does not meet those criteria, the seller should delay recognition of revenue. Delayed revenue is recognized as revenue over time, based on methods that address the criterion causing the initial delay of revenue recognition.

[2] See footnote 8 to paragraph 19 of this SOP.

- The seller should apply the full accrual method if:
    - The time-sharing receivable is not subject to future subordination.
    - The seller can demonstrate collectibility of the receivable.
    - The seller can estimate credit losses with reasonable reliability.
    - Development of the project is complete.

- The seller should apply the percentage-of-completion method if the first three conditions for full accrual accounting are met but development of the project is not complete and, in addition, the following:
    - Sales and costs of the project can be estimated with reasonable reliability.
    - Construction of the project has progressed beyond preliminary stages and completion of the planned work is indicated.

- If any of the first three conditions for full accrual accounting is not met but development is complete, the seller should apply the cash-received method. If any of the first three conditions for full accrual accounting is not met and development is not complete, the seller should apply the combined method (a combination of the percentage-of-completion and cash-received methods) in certain limited situations or the deposit method.

- If a transaction previously accounted for under the deposit, cash-received, or combined method of accounting meets the criteria for a "higher" revenue recognition method, the seller should change to the applicable accounting method for that transaction in the period in which the criteria are met.

- Certain sales incentives the seller provides a buyer to consummate a transaction should be recorded 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 and recording the incentive separately. For purposes of the 10-percent cumulative payments test for sale accounting or the 25-percent cumulative payments test for collectibility, the seller should reduce the buyer's cumulative payments 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.

- 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 or deposit methods of accounting.

- The seller should account for cost of sales and time-sharing inventory in accordance with the relative sales value method.

- The term *credit losses* should be interpreted broadly to include all situations in which, as a result of credit concerns, 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. The amount of current sales that, historically and statistically, are expected to result in a credit loss should be recorded as estimated uncollectible receivables and should be presented in the seller's statement of operations as a deduction from revenues. Subsequent changes in estimated losses resulting from credit losses should be recorded as an adjustment to estimated uncollectible receivables and as an adjustment to revenues. 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.

- 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 revenues over costs is recorded as a reduction of inventory cost.

- 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 sale and revenue 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 the developer being able to sell intervals to the class of nonresident customers to which the developer wishes to sell, 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.

- A reload transaction is considered to be a separate sale of a second interval, and the accounting for the second interval is determined via application of the sale and revenue recognition guidance of this SOP. For an upgrade transaction, the accounting for the upgraded interval is determined via application of that guidance to the incremental sales value.

- This SOP is effective for financial statements for fiscal years beginning after June 15, 2004, with earlier application encouraged.

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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 ten of AcSEC's fifteen members, and (3) a final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if at least four of the seven FASB members do not object to AcSEC undertaking the project,[3] 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.

[3] At the time AcSEC undertook this project, at least five of the seven FASB members were required to not object to AcSEC undertaking this project.

Accounting for Real Estate Time-Sharing Transactions

BACKGROUND

1. The **real estate time-sharing**[4] 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. The accounting for real estate time-sharing transactions (also referred to in this 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

   c. Relatively high selling and marketing costs

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

2. 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 Statements of Position (SOPs) whose principles were extracted in that Statement

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[4]Words or terms defined in the glossary are in **boldface type** the first time they appear in this SOP.

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.

3. 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 financing offered by the seller. Although certain financial institutions will participate in securitization or hypothecation of portfolios of time-sharing receivables, financial institutions typically will not finance the purchase of individual time-sharing intervals. A significant majority of the sales price is, therefore, 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. Sales and marketing costs are significant in relation to sales revenue, and sales incentives and inducements are common.

4. In an effort to differentiate its products and enhance sales volumes, the time-sharing industry has introduced a variety of transaction structures. 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.

5. In an effort to manage cash flow, many time-share sellers will sell, hypothecate, securitize, or otherwise monetize their receivables through a third 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).
6. 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 include criteria for and methods of revenue recognition; and accounting for **credit losses**, 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.
7. AcSEC understands that the FASB will amend FASB Statement No. 66 and FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects,* to accommodate this SOP's requirements. The FASB's amendment to FASB Statement No. 66 will exclude time-sharing transactions from the scope of that Statement and remove that Statement's references to time-sharing. The FASB will indicate in the "Costs Incurred to Sell Real Estate Projects" section of FASB Statement No. 67 that paragraphs 10 and 17 through 19 of that Statement do not apply to time-sharing transactions.

SCOPE

8. This SOP provides guidance on the accounting by a seller for all real estate time-sharing transactions.[5] 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
9. This SOP applies to both annual and interim reporting periods.

CONCLUSIONS

Sale and Revenue Recognition Framework

10. The fundamental issues in accounting for time-sharing transactions are the determination of (*a*) whether a sale has occurred and (*b*) whether, if a sale has occurred, revenue recognition should be immediate or delayed. (If a sale of the real estate has not occurred, the accounting for the transaction may be as a lease.) This

[5] 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.

section is intended to give an overview of the basic accounting framework in this SOP as it relates to those issues rather than to prescribe detailed guidance. Detailed guidance on sale and revenue recognition is addressed in paragraphs 18 through 28 of this SOP.

11. If the sale accounting criteria specified in this SOP are met, the determination should be made as to whether revenue should be recognized immediately or delayed and, if delayed, on what basis it should be recognized. If certain conditions specified in this SOP are met, revenue for a time-sharing sale transaction should be recognized immediately through the seller's application of the *full accrual method* of accounting. Under that method, the **sales value** of the time-share is recognized as revenue in the current period, less an allowance for estimated uncollectible amounts.

12. If the conditions in this SOP for full accrual accounting are not met, the seller should apply delayed revenue accounting. There may be several reasons for the application of delayed revenue accounting. If revenue recognition is delayed only because the development of the time-sharing property is not complete, the seller should apply the *percentage-of-completion method* of accounting. Under that method, the amount of revenue recognized is based on the relationship of certain costs already incurred to the total of certain costs already incurred plus certain future costs expected to be incurred. If revenue is delayed for certain other reasons, such as concerns about collectibility or the seller's inability to estimate uncollectible receivables, the seller should apply the **cash-received method** of accounting. Under that method, revenue is recognized as principal is collected and interest income is recognized as interest is collected. There are also certain conditions under which the seller should apply the

combined method, a combination of the percentage-of-completion and cash-received methods.

13. If the seller retains **continuing involvement** with a time-sharing interval that has been transferred to a purchaser, the seller may be required to modify the application of the above-described accounting for sale and revenue recognition. Paragraph 24 of this SOP addresses those modifications.

14. The reasons for application of delayed revenue accounting may be such that a sale transaction does not meet one or more of the conditions in the SOP for application of any of the above-mentioned delayed revenue methods. In that situation, the seller should delay recognition of 100 percent of the revenue. This is also referred to as the *deposit method* of accounting and can be thought of as the extreme case of a delayed revenue method.

15. If the criteria specified in this SOP for a transaction to be accounted for as a sale are not met because the seller does not transfer title, the seller should account for the transaction as if it were an operating lease.

Seller Identification of Projects and Phases

16. Throughout this SOP, reference is made to a **project** or to a **phase** of a project, both for purposes of revenue recognition and for purposes of cost allocation. 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. A time-share reseller also should account for each sale individually and should not aggregate intervals in different projects.

17. 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 under Accounting Principles Board (APB) Opinion No. 20, *Accounting Changes*. 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—for example, a decision to divide the same development of a project into more or fewer phases—should be accounted for as a change in the method of applying an accounting principle under APB Opinion No. 20, that is, by a cumulative effect of a change in accounting principle.

Sale Recognition Criteria

18. Appendix C, "Flowchart of Time-Sharing Sale and Revenue Recognition Model," summarizes the time-sharing revenue recognition accounting guidance in this SOP. In order for a time-sharing transaction to be accounted for as a sale, subject to the revenue recognition guidance in paragraphs 22 through 28 of this SOP, the transaction should meet all of the following criteria:

    a. Nonreversionary title to the time-sharing interval is transferred to the buyer or an **independent third party** by the seller no later than the time the buyer fulfills all of its obligations under the sale agreement. A **contract-for-deed** arrangement meets this criterion.

b. The transaction is consummated. A transaction should not be considered consummated until (1) the parties are bound by the terms of a contract and the **refund period** has expired, incorporating any **rescission** rights, (2) all consideration (such as cash and a note) has been exchanged, (3) any financing for which the seller is responsible has been arranged, and (4) all conditions precedent to closing have been satisfied.[6]

c. The buyer has made cumulative payments (excluding interest) equal to at least 10 percent of the sales value. The **buyer's cumulative payments** should include only (1) cash; (2) the buyer's notes supported by irrevocable letters of credit from an independent established lending institution;[7] (3) payments made by the buyer to reduce the seller's existing indebtedness in the property; and (4) other amounts paid by the buyer that are part of the sales value. Other consideration received by the seller, including other notes of the buyer, should be included as part of the buyer's cumulative payments only if that consideration is sold or otherwise converted to cash without recourse to the seller. The buyer's cumulative payments should not include (1) payment by the buyer to third parties for improvements to the property, (2) a permanent loan commitment by an independent third party to replace a loan made by the seller, or (3) any funds that have been or will be loaned, refunded, or directly or indirectly provided to the

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[6] A sale may be recognized during the process of construction even though a certificate of occupancy, which is a condition precedent to closing, has not been obtained. See paragraph 26 and Appendix A, paragraphs A2 through A4, of this SOP for a discussion of the percentage-of-completion method.

[7] An *independent established lending institution* is an unrelated institution such as a commercial bank unaffiliated with the seller.

buyer by the seller or loans guaranteed or collateralized by the seller for the buyer.

d. Sufficient time-sharing intervals have already been sold to reasonably assure that the time-sharing units (in the applicable phase) will not become rental property. In determining whether this criterion has been met, the seller should consider the requirements of local laws, the time-sharing contract, and the terms of the financing agreements.

19. Under the criterion in paragraph 18(a), the seller may not retain any reversionary interest in the time-sharing interval transferred.[8] A subsequent transfer of title (for example, upon expiration of a ground lease) to an independent third party other than the buyer, such as a municipality, does not represent a reversionary interest held by the seller and, therefore, is not considered a violation of that criterion.

20. A time-sharing transaction in which the seller does not transfer a nonreversionary interest in the time-share and thereby does not meet the criterion in paragraph 18(a) should be accounted for as if it were an operating lease[9] under FASB Statements No. 13 and No. 98, *Accounting for Leases*, and No. 91, *Accounting for Nonrefundable*

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[8] An exception may exist if the transaction comprises a nonreversionary transfer of property improvements and concurrent lease of the underlying land. In those circumstances, the two parts of the transaction are considered interdependent. The transaction does not violate the criterion in paragraph 18(a) if the term of the land lease (1) covers substantially all of the economic life of the property improvements and (2) is for a substantial period, for example, 20 years. If either condition (1) or (2) is not met, the transaction is considered to be substantially the same as a lease of both land and improvements and does not meet the criterion in paragraph 18(a).

[9] Although the transaction may not be explicitly within the scope of FASB Statement No. 13, *Accounting for Leases*, as set forth in paragraph 1 of that Statement, the transaction should nonetheless be accounted for by analogy to the lease accounting model of that Statement because that model reflects the recognition of revenue in connection with services pertaining to “right to use” property. In certain cases, a seller (for example, a reseller) might not have a dealer or developer profit and might thereby qualify for direct financing or leveraged lease accounting. But because, typically, there is a dealer or developer profit in such transactions, the lease accounting throughout this SOP is prescribed in the context of operating lease accounting.

Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases, over the stated term of the **right-to-use** arrangement (or the estimated term if the arrangement is stated as being in perpetuity).

21. For transactions that meet only the criterion in paragraph 18(a), all revenue should be delayed (the deposit method of accounting described in paragraph A8 of Appendix A, "Description and Illustration of Methods of Revenue Recognition for Time-Sharing Transactions," of this SOP) until the criteria in paragraphs 18(b), 18(c), and 18(d) are met.

Revenue Recognition for Transactions That Meet the Criteria of Paragraph 18

22. Revenue from a time-sharing transaction should be recognized using the full accrual, percentage-of-completion, cash-received, combined, or deposit method of accounting as discussed in paragraphs 24 through 28 of this SOP. Each of those methods is described or illustrated in Appendix A of this SOP.

23. A single method of revenue recognition should be applied to all transactions within a phase that meet the same subset of criteria within paragraphs 24 through 28 of this SOP.

24. If a transaction satisfies all of the criteria in paragraph 18 and either paragraph 25, 26, 27, or 28 of this SOP, but the seller retains some form of continuing involvement with the transferred time-sharing interval, the seller should apply the guidance in Appendix B, "Continuing Involvement," of this SOP to determine whether any modifications are required to the accounting that would be followed if the continuing involvement

was not present. Appendix B provides accounting guidance for different forms of continuing involvement.

25. Revenue from a time-sharing transaction that satisfies the criteria in paragraph 18 should be accounted for using the full accrual method provided that all of the following conditions are met:

   a. *The time-sharing receivable is not subject to future subordination.* The receivable from the sale should not be subject to subordination to new loans on the property.

   b. *The seller can demonstrate that its receivable related to the time-sharing sale is collectible.* Collectibility is demonstrated if at least one of the following conditions is met:

      (1) The seller has collected cumulative payments (excluding interest) equal to at least 25 percent of the sales value of the time-sharing interval.

      (2) The seller can demonstrate **adequate collection experience** for the time-sharing project in which the sale is made.

   See Appendix D, "Illustration of Use of Historical Data on Uncollectible Receivables, Including Related Disclosures," of this SOP for an illustration of the ability of an entity to demonstrate adequate collection experience. A time-share reseller typically would not be able to demonstrate adequate collection experience.

   c. *The seller can estimate credit losses with reasonable reliability.* The seller should have sufficient collection experience to demonstrate that it can measure with reasonable reliability the expected credit losses on its time-sharing receivables. Paragraphs 53 through 61 of this SOP provide further guidance on what constitutes a *credit loss* for purposes of this SOP. At a minimum, the following should be satisfied in determining the reliability of the measure of the expected credit losses:

(1) The collection experience should be based on conventional amortizing loans over the contract period.

(2) All of an entity's data that are available, reasonably reliable, and relevant should be used in determining collection experience. Collection experience should not be based on incomplete or selected data unless the entity can demonstrate that the excluded data are not relevant to the loss estimation. A rebuttable presumption exists that the entity should use at least three years of collection experience data from the project or similar projects.

(3) Collection experience with the seller's prior projects may be applied to a new project if the prior projects had predominantly the same characteristics (for example, kind of time-sharing arrangements, clientele, credit standards, contract terms, sales methods, comparable economic conditions) as the new project.

See Appendix D of this SOP for an illustration of the use of historical data to estimate credit losses.

d. *Development of the time-sharing phase is complete.* The seller is not obligated to complete improvements of time-sharing intervals sold or to construct **amenities** or other facilities conveyed with the time-sharing intervals sold. If, for a particular phase, all amenities have been completed and an interval has been sold in a completed unit, but not all units have been completed, the condition of development being complete is met for the sold interval.

26. If development of the time-sharing phase is not complete (paragraph 25(d)), but all other criteria and conditions in paragraphs 18 and 25 are satisfied, revenue should be delayed under either the percentage-of-completion or deposit method of accounting. If both of the following conditions are met, revenue should be delayed under the percentage-of-completion method:

   a. *Aggregate sales proceeds and aggregate costs related to the phase can be estimated with reasonable reliability.* Consideration should be given to sales volume, trends of time-sharing interval prices, and demand for the intervals, including seasonal factors, seller's experience, geographical location, and environmental factors. The guidance in FASB Statement No. 67 on acquisition, development, and construction costs should be considered when estimating costs.

   b. *The construction of the phase has progressed beyond a preliminary stage*[10] *and there are indications that the work will be completed according to plan.*[11] In addition, there should be no indication of significant delaying factors, such as the inability to obtain permits, contractors, personnel, or equipment.

   If either of those two conditions is not met, revenue should be delayed under the deposit method.

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[10] *Preliminary stage* does not have the same meaning here as in AcSEC's exposure draft of the proposed SOP, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*.

[11] Construction is not beyond a preliminary stage if engineering and design work, execution of construction contracts, site clearance and preparation, excavation, and completion of the building foundation are incomplete. A necessary indication that the work will be completed according to plan is that the seller is financially capable (as evidenced by its equity capitalization, borrowing

27. If a time-sharing transaction satisfies the criteria in paragraph 18 and meets the condition in paragraph 25(d) (development is complete), but does not meet one or more of the conditions in paragraph 25(a) (no future subordination), 25(b) (collectibility), or 25(c) (credit losses estimable), revenue should be delayed under the cash-received method.

28. If the criteria in paragraph 18 are met, one or more of the first three conditions in paragraph 25 are not met, and development is not complete, revenue should be delayed under either the deposit method or the combined method. The combined method is a combination of the percentage-of-completion and cash-received methods. If both conditions in paragraph 26 are met, the seller should apply the combined method by delaying revenue under the percentage-of-completion method and then further delaying revenue by applying the cash-received method. See Example 7 in Appendix A for an illustration of the combined method. If either of the conditions in paragraph 26 is not met, revenue should be delayed under the deposit method.

Change in Revenue Recognition Methods

29. If all of the criteria and conditions in paragraph 18 and either paragraph 25, 26, 27, or 28 of this SOP become satisfied for a time-sharing transaction originally reported using the deposit method, the seller should change to the applicable accounting method for that transaction. The effect should be accounted for as a change in accounting estimate in the current reporting period in accordance with paragraph 31 of APB Opinion No. 20.

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capacity, or positive cash flow from operations) of providing promised amenities, improvements, and other facilities.

30. If all of the criteria and conditions in paragraph 18 and either paragraph 25 or 26 of this SOP become satisfied for a time-sharing transaction originally reported using the cash-received or combined method, the seller should change to the applicable accounting method for that transaction. The effect should be accounted for as a change in accounting estimate in the current reporting period in accordance with paragraph 31 of APB Opinion No. 20. For transactions accounted for under the cash-received or combined method rather than the full accrual or percentage-of-completion method only because they do not meet the collectibility criterion in paragraph 25(b) of this SOP, the seller should apply the full accrual or percentage-of-completion method (whichever is applicable) to individual transactions once they satisfy the 25-percent cumulative payments test of that paragraph. If, during the time the seller is accounting for transactions under the cash-received or combined method only because they do not meet the collectibility criterion in paragraph 25(b), the adequate collection experience test of that paragraph becomes met, the seller should adopt the full accrual method or percentage-of-completion method (whichever is applicable) for all transactions in the project.

31. Once a time-sharing transaction is accounted for using either the full accrual or percentage-of-completion method, the method of accounting for that transaction should not be changed to the cash-received, combined, or deposit method unless:

    a. The change represents the correction of an error; or

    b. Either of the two conditions of paragraph 26 is no longer met.

In situation *a*, the change should be accounted for as a prior period adjustment in accordance with paragraphs 36 and 37 of APB Opinion No. 20. In situation *b*, the change should be accounted for currently as a change in accounting principle in accordance with that Opinion.

Determination of Sales Value

32. 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," for illustrations of the determination of sales value.

33. 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, is accounted for as a reduction of the costs of those products and services. For example, if a seller provides at no charge an incentive to a buyer in order to consummate a time-sharing transaction, the seller should reduce the stated sales price by the fair value of the incentive and offset the cost of the incentive. The determination of incentives excludes any that a buyer pays for, at market rates, through future maintenance charges or other separate fees.[12]

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[12] 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 for an illustration.

34. If the seller provides an incentive regardless of whether a sale is consummated (for example, providing amusement park tickets as an incentive to attend a time-sharing sales presentation), the seller should record the incentive as a selling cost in accordance with paragraphs 47 through 52 of this SOP.

35. 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 cumulative payments (see the next section of the 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 as an adjustment to the stated interest rate on the financing.

36. Sellers may have programs to accelerate collections of receivables or contract provisions that encourage prepayment, with a reduction of payments as the major incentive 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.

37. 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 Cumulative Payments Test

38. In applying the cumulative payments test in paragraph 18(c) or 25(b) of this SOP, the seller should reduce the buyer's cumulative payments by the excess described in paragraph 33, unless the incentive is conditioned on sufficient future performance (in the form of the buyer meeting its 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 its 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 cumulative payments test in paragraph 18(c) or 25(b).

39. 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 cumulative

payments under paragraph 18(c) or 25(b) 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.

40. If future performance is not sufficient, the seller should reduce the buyer's cumulative payments by the excess of the fair value of the incentive over the amount the buyer paid for the incentive, in applying the criteria in paragraph 18(c) or 25(b). 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 cumulative payments test, 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. To satisfy the 10-percent cumulative payments test in paragraph 18(c), 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).

41. 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 40—rather than toward payment on a time-sharing interval should not be included in the buyer's cumulative payments in the test in paragraph 18(c) or 25(b) of this SOP.

Accounting for Cost of Sales and Inventory

42. This section applies to all time-sharing sale transactions accounted for under the full accrual, percentage-of-completion, cash-received, or combined methods of revenue recognition. If a time-sharing transaction is accounted for under the deposit method, or in the same manner as an operating lease in accordance with paragraph 20 of this SOP, this section does not apply.

43. 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 A 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.

44. 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 inventory cost to the total remaining estimated time-sharing revenue. 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. At least quarterly, all estimates, including estimated future revenue, should be recalculated.[13] The estimates should incorporate factors such as incurred or expected credit losses, 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

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[13] 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.

time estimated future revenue is adjusted, using the new estimate of future revenue and the inventory cost reported on the balance sheet (plus estimated costs to complete that inventory, 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 A for illustrations of the relative sales value method; Examples 2 and 4 of that appendix illustrate changes in estimate.

45. As discussed in paragraph 56 of this SOP, the recording of a sales revenue adjustment for expected credit losses 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 when a time-sharing interval is repossessed or otherwise reacquired unless the repossession causes a change in expected credit losses (and estimated revenues) 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*.

46. 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.

Costs to Sell Time-Sharing Intervals

47. All costs incurred to sell time-sharing intervals should be charged to expense as incurred unless they specifically qualify for capitalization under paragraphs 48 through 50 of this SOP.

48. 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[14] 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 total number of intervals available for sale in the project or phase to which the selling costs are applicable.

[14] 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*.

49. Other costs incurred to sell time-sharing intervals should be deferred until a sale transaction occurs if the costs are (1) reasonably expected to be recovered from the sale of the time-sharing units, (2) directly associated with sales transactions that are being accounted for under the percentage-of-completion or deposit method of accounting and (3) incremental, that is, the costs would not have been incurred by the seller had a particular sale transaction not occurred. Examples of directly associated, incremental costs include (1) commissions, and salaries and associated employee benefits of sales personnel for time spent directly on successful sales efforts and (2) the following promotional costs related to successful sales transactions: direct incremental costs of meals provided to customers; costs of promotional giveaways to customers net of payments received from customers; and incremental travel, lodging, and amenities costs for customers. Under the deposit method of accounting, deferred selling costs should be limited to the nonrefundable portion of the deposits received by the seller.

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

51. Examples of costs that do not meet any of the criteria in paragraph 48 or 49 for deferral, and that should therefore be charged to expense as incurred, include all costs incurred to induce potential customers 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*.

52. In connection with paragraph 20 of this SOP, selling costs incurred in connection with time-sharing transactions that are accounted for in the same manner as operating leases should be charged to expense as incurred unless they meet the definition of initial direct costs in paragraph 24 of FASB Statement No. 91. Initial direct costs should be accounted for in accordance with paragraph 19(c) of FASB Statement No. 13.

Accounting for Credit Losses

53. Collection of notes receivable is an important function for sellers of time-sharing intervals. Time-share sellers experience some level of credit losses 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 credit losses and the associated costs.

54. Credit losses incorporate 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.

55. Collection programs result in a credit loss whenever the receivable becomes uncollectible or modified in some manner that results in less than 100 percent collection of the original note. The measurement of credit losses should be based on

actual receivables collection experience—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. A seller should be able to estimate credit losses with reasonable reliability to record time-sharing sales under the full accrual method. (See paragraph 25(c).)

56. An estimate of credit losses that, from a historical and statistical perspective, are expected to occur should be recorded as a reduction of sales revenue at the time a time-sharing sale is recognized under the full accrual or percentage-of-completion method. That estimate should incorporate all forms of credit losses (for example, note cancellations and collection programs). See Appendix D for an illustration of the determination of the reduction of revenue for estimated uncollectible receivables. Under the relative sales value method (see paragraph 44), 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 sales revenue for expected credit losses. See Appendix A for illustrations of the relative sales value method.

57. 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 uncollectible receivables, because the estimated losses were recorded against sales revenue at the time the time-share sale was recognized or were recorded

subsequently against sales revenue as a change in estimate. Incremental, direct costs associated with credit losses, such as costs of collection programs, should be charged to expense as incurred.

58. 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 a credit loss by the seller equal to the remaining investment in the original note receivable. That loss 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 revenue recognition criteria in this SOP.

59. Once an initial time-sharing sale transaction has been recorded (which includes a reduction of recognized revenue for expected credit losses), accounting for the allowance for uncollectible receivables 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*.[15] The allowance is then adjusted, with a corresponding adjustment to current-period revenue through the estimated uncollectible receivables account, which is a contra-revenue account. A corresponding adjustment is also made to cost of sales and inventory.

60. The allowance for uncollectible receivables should be determined based on consideration of credit losses by year of sale. In addition, that determination should

consider 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 for an illustration of the determination of the allowance for uncollectible receivables.

61. 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).

Operations During Holding Periods

62. 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 44 of this SOP. Incremental revenues in excess of incremental costs should be recorded as realized and such excess should not be factored into the calculations of the relative sales value method described in paragraph 44 of this SOP. Incremental costs in excess of incremental revenue should be charged to expense as incurred.

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[15] AcSEC currently has on its agenda a project to develop an SOP to provide additional guidance on credit losses. AcSEC expects to issue an exposure draft early in 2003.

63. Holding period operations include **sampler programs** and **mini-vacations** (see paragraph 68). 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.

64. 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 62), in the period in which the rental takes place.

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

65. 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 guidance in paragraphs 18 through 28 of this SOP. In making that determination, 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—and it should be assessed whether the seller has transferred nonreversionary title to a time-sharing interval, whether the

seller has continuing involvement with the buyer, and other matters with respect to meeting the other conditions and criteria of paragraphs 18 through 28. The seller should recognize revenue in the same manner and use the same revenue 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, the earnings process has not been culminated and there has been no sale.

66. 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 (*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, consolidation of controlled SPEs and SPEs in which no other entity has adequate capital at risk).[16]

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[16] FASB Interpretation No. 46, *Consolidation of Variable Interest Entities (an interpretation of ARB No. 51)*, provides guidance on whether SPEs that represent variable interest entities should be consolidated.

67. 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. 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 should be recognized as revenue as earned. If the seller is unable to evaluate whether the compensation is at prevailing market rates, the time-sharing transaction should be accounted for as if it were an operating lease until the seller is able to estimate the prevailing market rates for similar services.

Sampler Programs and Mini-Vacations

68. 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 cumulative payments. 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 cumulative payments, even if the legal documents state or suggest that the payment for the sampler program or mini-vacation is applied to the sales price.

69. See paragraphs 62 through 64 of this SOP for the accounting for amounts received for sampler programs and mini-vacations.

Upgrade and Reload Transactions

70. The guidance in paragraphs 18 through 28 of this SOP should be applied to determine the appropriate accounting for a reload interval or an upgrade interval. For a reload transaction, the seller should not include the buyer's equity in the original time-sharing interval toward the buyer's cumulative payments (see paragraphs 18(c) and 25(b) of this SOP) for the second interval. Therefore, additional cash or other qualifying consideration (see paragraph 18(c) of this SOP) is necessary to meet the cumulative payments tests of this SOP.

71. For an upgrade transaction, the sales value is the difference between the sales value of the upgraded interval and the sales value of the original interval at the date of the original sale. The guidance in paragraphs 18 through 28 of this SOP, including the cumulative payments tests in paragraphs 18(c) and 25(b), is applied to that incremental sales value. In order to record an upgrade under the full accrual method, the sale of the original interval should be on the full accrual method at the time of the upgrade.

Owners Associations

72. Time-share projects typically incur significant operating costs, such as costs of property taxes, repairs and maintenance, and reservation systems. 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 a not-for-profit 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.

73. OAs typically incur operating losses during early stages of project sellout because there are not enough dues-paying time-share interval owners to support the financial obligations of the OA. Typically, a time-share seller pays dues or maintenance fees on the time-share intervals that it owns (that is, the unsold time-share intervals in the project) and may also pay additional amounts to subsidize losses of the OA. Payments by the seller of dues or maintenance fees, except when accounted for as incidental operations during holding periods under paragraphs 62 through 64 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.

74. 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.[17]

Statement of Cash Flows

75. 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

76. A time-sharing seller should separately display sales value for sales consummated (which includes full accrual, percentage-of-completion, cash-received, and combined method sales and excludes transactions accounted for under the deposit method), an adjustment for estimated uncollectible amounts (see paragraph 56 of this SOP), an adjustment for the delayed revenue related to percentage-of-completion sales, and an adjustment for the delayed revenue related to cash-received and combined method sales. The four amounts should be displayed separately either in the seller's statement of operations or in the notes to the financial statements. The net of the four

[17] The guidance in this 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*, and related Emerging Issues Task Force (EITF) Issues provide the relevant guidance. AcSEC notes that FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, amended ARB No. 51 to remove the prior exception allowing for nonconsolidation of an entity when control is likely to be temporary.

amounts should be displayed in the seller's statement of operations as revenue from time-sharing transactions.

77. A time-share seller's balance sheet should include gross notes receivable from time-sharing sales accounted for under the full accrual, percentage-of-completion, cash-received, or combined methods, a deduction from notes receivable for the allowance for uncollectible receivables (see paragraphs 59 and 60 of this SOP), a deduction for the delayed revenue from cash-received sales, and a deduction for the delayed revenue from combined-method sales that is attributable to collection uncertainties. (See paragraph A6 in Appendix A of this SOP.) The net of those four amounts should be displayed as net time-sharing notes receivable. The four components of net time-sharing notes receivable should be displayed separately either in the seller's balance sheet or in the notes to the financial statements. For transactions accounted for under the percentage-of-completion method, delayed revenue should be shown as a liability. For transactions accounted for under the combined method, delayed revenue attributable to construction not being complete should be shown as a liability. For transactions accounted for under the deposit method, the net of delayed revenue and notes receivable should be shown as a net deposit liability, and the dollar amount of time-sharing intervals subject to a sales contract under the deposit method should be disclosed. See Notes to Examples 3, 5, and 7 (following paragraphs A4, A5, and A7, respectively) in Appendix A of this SOP.

78. As noted in paragraphs 44 and A4 of this SOP, the effects of changes in estimate in the relative sales value method or the percentage-of-completion method should be disclosed. 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, for sales accounted for under the full accrual, percentage-of-completion, cash-received, or combined methods. The total of the notes receivable balances displayed with the various maturity dates should be reconciled to the balance-sheet amount of notes receivable. Reconciling items will include delayed revenue deducted from receivables for transactions accounted for under the cash-received and combined methods.

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

c. The estimated cost, not yet recognized as a liability, to complete improvements and promised amenities.

d. The activity in the allowance for uncollectible receivables, 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 in the allowance for uncollectible receivables.

e. The activity in the account for delayed revenue on cash-received and combined method sales, including the balance at the beginning and end of each period, additions associated with current-period sales, and reductions associated with cash collections of prior- and current-period sales.

f. Any disclosures required under APB Opinion No. 20 resulting from changes in revenue recognition methods occurring under paragraphs 29 through 31 of this SOP.

EFFECTIVE DATE AND TRANSITION

79. This SOP should be applied to financial statements for fiscal years beginning after June 15, 2004. Earlier application is encouraged as of the beginning of fiscal years for which financial statements or information have not been issued.

80. Initial application of this SOP should be reported as the 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 from continuing operations and on net income (and on the related per share amounts) in 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.

BASIS FOR CONCLUSIONS

Scope

81. The scope of this 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. AcSEC determined, accordingly, that the specialized real estate revenue recognition guidance in FASB Statement No. 66 should be the principal foundation for the conclusions in this SOP. Consequently, analogies of the guidance in this SOP to non-real estate transactions may or may not be appropriate.

82. 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.

Sale Recognition Criteria

83. AcSEC concluded that the accounting for time-sharing transactions should be based on a determination first of whether a transaction is a sale and second, if it is determined to be a sale, whether revenue should be recognized immediately or on a delayed basis. If a transaction is not considered a sale, AcSEC concluded that it should be accounted for in the same manner as an operating lease[18] whether or not the transaction is explicitly within the scope of FASB Statement No. 13. See Appendix C. The criteria in paragraph 18 of this SOP for sale recognition are based on paragraph 22(c) of FASB Statement No. 98, *Accounting for Leases* (criterion 18(a));

[18] See footnote 8 to paragraph 19 of this SOP.

paragraphs 5(a) and 6 of FASB Statement No. 66 (criterion 18(b)); paragraphs 5(b), 37(b), and 45(b) of FASB Statement No. 66 (criterion 18(c)); and paragraph 37(c) of FASB Statement No. 66 (criterion 18(d)).

84. 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 for the lessor to classify the lease as a sales-type lease. AcSEC concluded, accordingly, that in order for a real estate time-sharing transaction to qualify as a sale, a nonreversionary transfer of title of the underlying real estate by the seller should take place. That conclusion led to AcSEC's rejection of models under which a sale could be recognized upon a transfer from the seller of substantially all the risks and rewards of ownership of real estate without an ultimate transfer of title. AcSEC believes, however, that without a transfer of the risks and rewards of ownership, a time-sharing transaction represents in substance a right-to-use arrangement and results in the seller maintaining a continuing involvement with the property. AcSEC believes that such a transaction should be accounted for in the same manner as an operating lease.

85. Paragraphs 18 through 21 of this SOP require two possible accounting treatments—sale accounting (including variations that delay revenue recognition) and operating lease accounting—for time-sharing transactions. In requiring only those two treatments, AcSEC observed that paragraph 22(g) of FASB Statement No. 98 states that for any sales-type lease involving real estate, the lessor should account for the transaction under the provisions of FASB Statement No. 66 "in the same manner as a *seller* of the same property." (Italics are in the original.) AcSEC's conclusion in paragraph 20 of this SOP that a perpetual right-to-use arrangement should be

accounted for over the estimated term of the arrangement is intended to permit the use of reasonable estimates of the economic life of the property. It does not permit the seller to make estimates about how long buyers will use their intervals, that is, it does not permit estimated terms shorter than the economic life of the property.

86. The cumulative payments criterion in paragraph 18(c) of this SOP is a test for the buyer's commitment that is based in part on paragraph 45(b) of FASB Statement No. 66. Paragraph 45(b) of that Statement is the 10-percent test of the retail land sales (RLS) model, but that test compares cumulative payments of principal and interest to the sales value. The test in this SOP compares cumulative payments of only principal to the sales value because the sales value represents the buyer's payments discounted at a market interest rate. AcSEC believes that it would be illogical and internally inconsistent to compare cumulative payments of principal and interest to a sales value that is computed as a discounted present value. Furthermore, AcSEC noted that only collections accounted for as reductions of principal represent an increase in the buyer's equity in the time-sharing interval.

87. AcSEC considered eliminating the bright-line 10-percent test in paragraph 18(c). Some AcSEC members believe that, once a transaction qualifies as a sale, the seller should be permitted to recognize revenue to the extent of cash received using the cash-received method and that a seller should not be prohibited from recognizing revenue simply because cash collected has not reached an arbitrary bright line amount. Those AcSEC members believe that a 10-percent bright-line test to demonstrate a buyer's commitment is a reasonable requirement for full accrual accounting but is not necessary when using a delayed revenue method. The majority

of AcSEC, however, believes that no matter which revenue recognition method is used, a real estate sale should not be recognized until the buyer has demonstrated via sufficient cash payments that it is committed to the transaction. That majority concluded that a very small down payment (for example, less than 10 percent) would not represent a sufficient demonstration of a commitment to buy.

Revenue Recognition for Transactions That Meet the Criteria of Paragraph 18

88. In considering the guidance in FASB Statement No. 66, AcSEC considered whether to use as a basis for sale and revenue recognition the fundamental principles of the other-than-retail-land-sales (OTRLS) model, or to use as a basis the fundamental principles of the RLS model of that Statement. In deciding to apply certain fundamental principles of the RLS model, AcSEC observed that the definition of RLS in paragraph 100 of that Statement indicates many similarities between the substance of retail land sales and real estate time-sharing transactions. Both are volume-based, both involve a large marketing and selling effort, both are seller-financed with relatively low down payment requirements, and both have collectibility and rescission issues. With both, an allowance for uncollectible receivables often is determined by analyzing the receivables on a pooled basis. Finally, in view of paragraph 1 of FASB Statement No. 66, which 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," the significant similarities between the sales and selling procedures for time-sharing intervals and

RLS were also considered in the decision to use certain fundamental principles of the RLS model.

89. AcSEC concluded in paragraph 23 of this SOP that a single method of revenue recognition should be applied to all transactions within a project or phase that share common characteristics with respect to revenue recognition. AcSEC was concerned that allowing sellers to select among those transactions qualifying for full accrual accounting and record some transactions under the full accrual method and some under the cash-received method could lead to inconsistencies in reporting. AcSEC observed that paragraph 44 in the RLS section of FASB Statement No. 66 states "A single method of recognizing profit shall be applied to all sales transactions within a project that have been consummated." (Footnotes are omitted.)

90. AcSEC's conclusion in paragraph 24 relating to the accounting in a situation of continuing involvement by the seller is based on paragraph 5(d) of FASB Statement No. 66. AcSEC believes that continuing involvement is one of the essential principles that should be considered in determining sale and revenue recognition in time-sharing transactions and therefore should be included in this SOP's model for time-sharing transactions. The guidance in Appendix B of this SOP on accounting for situations of continuing involvement is based on paragraphs 25 through 43 of FASB Statement No. 66.

91. The full accrual revenue recognition conditions in paragraph 25 of this SOP were based on FASB Statement No. 66, paragraph 45(d) (condition 25(a)), paragraph 45(c) (condition 25(b)), and paragraph 45(e) (condition 25(d)). The condition in paragraph 25(c) of this SOP was based on paragraph 23 of FASB Statement No. 5 and on

analogy to paragraphs 6(f) and 8 of FASB Statement No. 48, *Revenue Recognition When Right of Return Exists*.

92. The condition in paragraph 25(b) of this SOP is a test for collectibility of receivables that is partially based upon, but which AcSEC believes to be an improvement upon, the test in paragraph 45(c) of FASB Statement No. 66. Under the test in that Statement, collectibility of receivables is demonstrated if "collection experience for the project in which the sale is made or for the seller's prior projects indicates that at least 90 percent of the contracts in the project in which the sale is made that are in force 6 months after the criteria…[for applying percentage-of-completion accounting] are met will be collected in full." (Footnotes are omitted.) AcSEC believes that the underlying premise of the collectibility test in paragraph 45(c) of the Statement is sound, but that the specific requirements make the test costly and confusing. As a result, AcSEC adopted a somewhat different collectibility test that is intended to achieve similar results in a more cost-effective manner. AcSEC was informed that many retail land sales entities had struggled with applying the 90-percent-test portion of paragraph 45(c) and, consequently, had to default to the portion of that paragraph that allows a down payment of at least 20 percent to be an acceptable indication of collectibility. Furthermore, AcSEC identified the following deficiencies in the paragraph 45(c) test:

- Because the test is based on receivables that are in force six months, different practices in pursuing collections of delinquent receivables during the first six months would lead to different results. A time-sharing seller that aggressively forecloses on delinquent accounts within the first six months would have a better pool of receivables subsequent to that bright line and thereby improve its collection experience for purposes of the test.

- The accounting records of time-sharing sellers ordinarily do not distinguish receivables based on whether they were in force for six months. Gathering that data for prior projects could be cost prohibitive.
- The paragraph 45(c) test is based on numbers of contracts rather than dollar amounts. The accounting records typically would track dollars rather than contracts. Gathering the data on numbers of contracts collected in full on prior projects could be cost prohibitive. Further, AcSEC believes that dollars collected are more meaningful than contracts collected because dollars would weight large contracts more heavily than small contracts.
- The Statement provides no guidance on how to incorporate into the test the wide variety of practices today under which receivables are not "collected in full" because they are sold, hypothecated, or securitized, either without recourse or with full or limited recourse. Under those practices, the servicing of those receivables may also be transferred from the seller, with the result that the seller may not have access to the collected-in-full information.

93. The test for *adequate collection experience* in paragraph 25(b) of this SOP differs from the test in FASB Statement No. 66 in that it is based on a percent of receivables *dollars* the seller collects rather than on a percent of receivables *contracts* collected in full. The test in this SOP retains the high threshold for collectibility that is in that Statement's *90-percent* test. However, AcSEC's test requires collection of 85 percent of the contractual payments of *all* receivables, rather than 90 percent collection of

only receivables in force after six months. Because defaults, delinquencies, and foreclosures tend to be high during the first six months, AcSEC believes that the collection of at least 85 percent of the contractual payments over the life of *all* receivables (including those receivables that default or are foreclosed within the first six months) provides at least as good evidence of collectibility as the test in paragraph 45(c) of FASB Statement No. 66. AcSEC believes that basing the test on dollars collected rather than contracts collected will have similar results, because the collection of 85 percent of contractual receivables ordinarily indicates that the vast majority of contracts are collected in full, rather than that the seller collected only 85 percent of contractual payments on each receivable. Finally, AcSEC observed that one of the full-accrual profit recognition criteria in paragraph 3 of FASB Statement No. 66 is that "the profit is determinable, that is, the collectibility of the sales price is reasonably assured or the amount that will not be collectible can be estimated" and concluded that its *85-percent* test is in line with the Statement's concept of collectibility.

94. AcSEC acknowledges that many time-sharing sellers may at first use the 25 percent cumulative payments test rather than apply the adequate collection experience test. This may occur because sellers have not had a universal definition for what constitutes a “credit loss” or "default" as opposed to a sales reversal, and some sellers may have even changed their own definition over the years. Furthermore, sellers may not have maintained records that would allow them to be able to perform the adequate collection experience test or may not have been in business for a sufficient period of time to determine whether 85 percent collection has been achieved.

95. AcSEC selected a 25-percent cumulative payments test as an alternative measure of collectibility in paragraph 25(b) rather than the 20-percent down payment in paragraph 45(c) of FASB Statement No. 66. AcSEC decided for two reasons to use a test based on the buyer's cumulative payments of principal rather than a test based strictly on a down payment. First, AcSEC believes that a buyer who makes both a down payment and scheduled principal payments, and establishes a track record of meeting its obligations under the note, provides the seller with greater assurance of collectibility than a buyer who has made only a down payment. Accordingly, AcSEC believes that a cumulative payments test provides stronger evidence of collectibility. Second, one principal purpose of the cumulative payments test is to give new entrants to the time-sharing industry, or established entities that lack reliable data about collections on past projects, a reasonable alternative method of demonstrating collectibility in order to qualify for the full accrual method. A down payment in excess of 10 percent would be so at variance with the predominant terms for time-sharing transactions in the U.S. that it would likely be impracticable for sellers to achieve. Hence, a test based solely on a large down payment would fail to achieve the purpose of an alternative test for collectibility because few transactions would ever qualify.

96. AcSEC believes that a reseller of time-shares is unlikely to be able to demonstrate adequate collection experience because typically a reseller would have no project history or pool of project receivables upon which to base such experience.

97. As noted above in paragraph 91, the condition in paragraph 25(c) of this SOP for estimability of credit losses is based in part on paragraph 23 of FASB Statement No.

5, which states that "Inability to make a reasonable estimate of the amount of loss from uncollectible receivables…precludes [loss] accrual and may, if there is significant uncertainty as to collection, suggest that the installment method, the cost recovery method, or some other method of revenue recognition be used…" The condition in paragraph 25(c) of this SOP is also considered to be analogous to the ability to estimate future returns as discussed in paragraph 6(f) of FASB Statement No. 48. AcSEC observed that entities that rate the quality of securitized time-sharing receivables have in practice used conditions among their credit rating criteria that are similar to those in paragraph 25(c).

98. Paragraph 25(d) of this SOP states that in order to be able to apply full accrual accounting to a time-sharing transaction in a phase, development of the phase should be complete. The SOP clarifies that to mean that the seller should not be obligated to complete improvements of time-sharing units *sold* or to construct amenities or other facilities conveyed with the time-sharing units *sold*, which is consistent with paragraph 45(e) of FASB Statement No. 66. AcSEC believes that in circumstances in which all amenities have been completed and an interval has been sold in a completed unit, but not all units in the phase have been completed, the seller should apply full accrual accounting to the sold interval (assuming all other conditions for full accrual accounting are met) because the seller has completed its obligations to the buyer of that interval.

99. The conditions in paragraph 26 of this SOP related to criteria for applying the percentage-of-completion method of accounting are based on paragraphs 37(e) and 46 of FASB Statement No. 66. AcSEC decided (see paragraph A2 in Appendix A) that

although FASB Statement No. 66 (paragraph 73) includes selling and marketing costs in the determination of the percentage of costs incurred for purposes of determining the percentage of revenue to be recognized, selling and marketing costs should not be included in the percentage-of-completion calculations for time-sharing transactions. In view of the current focus on revenue recognition, AcSEC concluded that a developer should recognize revenue only for costs incurred that benefit the customer by bringing the time share unit closer to completion and a certificate of occupancy. Selling and marketing costs do not bring units closer to completion and so should not lead to recognition of revenue.

100. The conditions in paragraph 27 of this SOP related to criteria for applying the cash-received method of accounting are based on paragraph 47 of FASB Statement No. 66. AcSEC elected to use in this SOP the cash-received method rather than the FASB Statement No. 66 installment method because the installment method is based on the deferral of *profit* whereas the accounting model in this SOP is based on the immediate versus delayed recognition of *revenue*. AcSEC also observed that application of the installment method could result in profit margins being distorted in current periods as cash is collected on prior-period sales, because those cash collections are recorded as gross profit recognized rather than as revenue with an associated cost of sales. Under the cash-received method, because revenue recognition is delayed instead of profit being deferred, and because cost of sales is recorded as a percentage of revenue recognized (under the relative sales value method in this SOP), each dollar of revenue collected is burdened with a proportionate amount of cost of sales.

Change in Revenue Recognition Methods

101. AcSEC's conclusions in paragraphs 29 and 30 of this SOP on how to report a change from use of the deposit, cash-received, or combined method to a "higher" revenue recognition method were based on the guidance in paragraph 11 of APB Opinion No. 20 and on consideration of the guidance in paragraph 49 of FASB Statement No. 66. AcSEC deviated from the guidance in FASB Statement No. 66 in two respects. First, that Statement states that the change in accounting method should be adopted for the entire project whereas this SOP states the change should be applied to individual transactions as they meet the applicable criteria. AcSEC believes that transactions not yet qualifying for higher revenue recognition should not preclude other transactions from qualifying—for example, as they individually meet the 25-percent test for collectibility in paragraph 25(b) of the SOP. Second, the Statement states the change in accounting method (from installment to percentage-of-completion) is elective, whereas this SOP provides that a change is required if the conditions for higher revenue recognition are met. AcSEC believes that a required approach is preferable to an elective approach.

Determination of Sales Value

102. AcSEC's conclusion in paragraph 33 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 of FASB Statement No. 66.

AcSEC believes, however, that fair value is a more relevant measure than net present value for the other products and services and accordingly deviated from paragraph 7(b) of FASB Statement No. 66 in that respect. Fair value is also consistent with more recent accounting standards.

103. EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," deals with "the accounting, by a vendor, for contractual arrangements in which multiple revenue-generating activities will be performed by the vendor." AcSEC does not believe that a time-share transaction and the typical incentives that might be included as part of that transaction constitute a contractual arrangement involving multiple revenue-generating activities by a time-share developer. Accordingly, although deviating from the FASB Statement No. 66 model in one respect as described in the preceding paragraph, AcSEC concluded that time-share sales values should be determined based on analogy to that model rather than by analogy to EITF Issue No. 00-21.

104. AcSEC's conclusion about the seller's income statement display of noncash incentives to buyers differs from the consensus in EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)." Incentives are products or services that the seller of an interval provides to the buyer for stated compensation that is less than the fair value of those products or services. Some incentives represent cash consideration paid to the buyer. For example, the seller may agree to pay the buyer's first-year assessment to the owners association or the first-year fees for an exchange program. Other incentives represent noncash consideration. For example, the seller may give the buyer tickets

to an amusement park in the vicinity of the project or vouchers that can be used to obtain airline tickets at no charge. AcSEC concluded that the excess of the fair value of the products or services over the stated compensation paid by the buyer (the deemed compensation) should reduce the revenue from the sale of the interval, which is consistent with the EITF consensus. AcSEC further decided that the compensation (the sum of stated and deemed compensation) should be recorded as a reduction of the cost of the products or services. For cash consideration, this is consistent with the EITF consensus. For noncash consideration, the EITF consensus would record the compensation as a separate revenue item for the sale of the other product or service. For example, 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. Under this SOP, the seller would report revenue from the sale of the interval of $19,750 and no revenue or cost for the voucher. Under the EITF consensus, 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.

105. 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 potential buyers. The particular incentive given to a particular buyer is based on which one the seller believes will induce the buyer 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 assessments or exchange program fees. AcSEC was troubled that under the EITF consensus a time-share seller could report different revenues based on which of two incentives it gave to buyers, when the choice between incentives is so flexible and discretionary. Therefore, AcSEC concluded that the more understandable reporting would be to report the same revenues and cost of sales regardless of the form of the incentive given to buyers. AcSEC accomplished that objective by requiring the compensation from the buyer to be recorded as a reduction of the cost of the incentive rather than as a separate revenue stream.

Application of Cumulative Payments Test

106. Under this SOP, sale and revenue recognition is affected by the buyer's cumulative payments. Given AcSEC's conclusions about how to compute sales value (see paragraphs 32 through 37 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 cumulative payments, based on a 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 cumulative payments. AcSEC also considered an alternative 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 seven- 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 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 items, and only the excess (if any) subtracted from the buyer's cumulative payments. AcSEC believes that approach is consistent with practice under FASB Statement No. 66—in particular, how sellers account for their provision of management services at less than prevailing market rates.

107. 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 that approach represents a systematic and rational allocation of the cash received between the interval and other products or services.

AcSEC notes 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 cumulative payments for that negative amortization, because the buyer's continuing performance on the note provides sufficient assurance of the buyer's commitment to fulfill its obligations. 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 its obligations.

Accounting for Cost of Sales and Inventory

108. AcSEC concluded in paragraph 43 of this SOP that the relative sales value method is the appropriate method for time-sharing transactions because it is consistent with paragraph 70 of FASB Statement No. 66. 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.

109. AcSEC concluded in paragraph 44 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, *Accounting for Performance of Construction-Type and Production-Type Contracts*. The retrospective method in alternative *a* is consistent with SOP 00-2 (paragraphs 36 and 107 through 109 of SOP 00-2), *Accounting by Producers or Distributors of Films*.

110. AcSEC believes that the principal basis for the method prescribed in SOP 00-2 (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 also believes 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 diversification 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.

111. AcSEC concluded in paragraph A3 of Appendix A 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 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 44, 78, and A4 of this SOP regarding disclosure of changes in estimate are based on the first sentence of paragraph 33 of APB Opinion No. 20.

112. AcSEC's conclusion in paragraph 45 of this SOP that a seller should perform impairment testing on time-sharing inventory in accordance with FASB Statement No. 144, versus Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins*, is based on paragraphs B122 through B124 of that Statement.

Costs to Sell Time-Sharing Intervals

113. AcSEC's conclusions in paragraphs 48 and 49 of this SOP were based on paragraphs 17 through 19 of FASB Statement No. 67 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 51 that costs to induce potential customers 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.

114. Practice has been diverse as to the determination of which costs should be deferred under the percentage-of-completion and deposit methods. 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 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 revenues could vary more from period to period under the incremental approach than under the nonincremental, "directly associated" approach of FASB Statement No. 67.

115. AcSEC concluded that all selling costs should be expensed under the cash-received or combined method of accounting, because the use of those methods indicates that the seller cannot reasonably estimate the recoverability of its notes receivable. A developer recording a cash-received sale instead of a full accrual sale as a result of uncertainties about the recoverability of notes receivable would have the same uncertainties with respect to recoverability of any 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 similarly was intended to eliminate the risk of not recovering deferred selling costs in the event of a buyer default.

Accounting for Credit Losses

116. AcSEC considered the following three alternatives for the classification and display of credit losses:

a. Adjust revenues 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 credit losses and record bad debt expense for subsequent increases in estimated credit losses.

117. The first alternative AcSEC considered was to adjust revenues and cost of sales. AcSEC selected that alternative for the SOP primarily for the following reasons:

a. Some AcSEC members view time-share credit losses as having some elements of a right of return because, typically, it is not cost-effective for a time-share seller to pursue customers 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 credit loss that results from a trade receivable, the sold item (that is, the time-share interval) is repossessed in the time-share arrangement. As a result, the foreclosure is akin to a sales return that reduces revenues.

b. If credit losses 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 revenues (and cost of sales). AcSEC believes that approach overstates revenues.

c. 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, 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 credit losses 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 was sold. AcSEC chose not to debate those approaches. AcSEC's preferred solution (the alternative presented in item *a* in paragraph 116 above), through the application of the relative sales value method, does not require an assessment of fair value.

118. 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 that have been sold.

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

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

119. The second alternative AcSEC considered was to record credit losses as bad debt expense, measured as the excess of the expected defaults on receivables less 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 current practice in the time-share industry.

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 required to be disclosed in the notes but not 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 117 as advantages of AcSEC's approach.

120. Finally, AcSEC considered a hybrid approach under which estimated credit losses at time of sale and for a short time thereafter (six to twelve months) would be classified as reductions of revenue, but increases in estimated credit losses after that time would be classified as bad debt expense. The idea was that credit losses estimated at the date of sale and credit losses that occur within a short time following the sale transaction are more akin to returns, as if the buyer had a change of heart, whereas credit losses after the buyer has built some equity in the property are more akin to credit losses in other industries. AcSEC believes strongly, however, that all credit losses 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.

121. AcSEC concluded in paragraphs 53 and 55 of this SOP that the term *credit losses* should be interpreted broadly. AcSEC based its conclusion upon certain guidance in FASB Statements No. 15 and No. 114. 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.

122. Paragraph 2 of FASB Statement No. 15 states that a debt restructuring is "troubled" and therefore within the scope of the Statement "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." Paragraph 8 of FASB Statement No. 114 states that a loan is impaired 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-sharing 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 are, under this SOP, credit losses. Those situations include but are not limited to assumptions, modifications of terms, foreclosures, and downgrades. An assumption, involving the substitution of another payer for the buyer, would typically result in a loss under paragraph 42 of FASB Statement No. 15. An assumption of the kind described in EITF Issue No. 87-

19, "Substitute 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.

123. In concluding that a downgrade represents a kind of credit loss, 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 credit loss, be taken into account in determining expected and actual credit losses. 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.

124. AcSEC concluded in paragraph 57 of this SOP that incremental, direct costs associated with credit losses should be charged to expense as incurred. AcSEC analogized to paragraph 14 of FASB Statement No. 91, which indicates that costs related to a troubled debt restructuring should be charged to expense as incurred.

Operations During Holding Periods

125. AcSEC concluded in paragraph 62 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 revenues and expenses, because AcSEC believes that those rental operations are incidental to the time-sharing developer's principal business of selling intervals. Revenues from rentals help the seller defray the costs associated with holding unsold intervals, such as the maintenance fees to the 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.

126. AcSEC also concluded in paragraph 62 that incremental revenues in excess of incremental costs should be recorded as realized and 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 revenues over associated incremental rental costs, such estimate should not be anticipated in determining (reducing) inventory for purposes of calculating (reducing) the cost-of-sales percentage in the relative sales value method.

127. AcSEC observed that, in situations in which incremental rental income exceeds incremental costs, its conclusions may be perceived as differing from those in the International Accounting Standards Board's (IASB's) exposure draft "Proposed Improvements to International Accounting Standard IAS 16 – Property, Plant and Equipment." In such situations occurring during a property's development period, the proposed IASB standard would record the net rental income in earnings rather than as a reduction of inventory 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 is more consistent with U.S. GAAP—in particular, FASB Statement No. 67. AcSEC also believes that its conclusion represents preferable accounting in the specific facts and circumstances of the real estate time-sharing industry.

Special Purposes Entities, Points Systems, Vacation Clubs, and Similar Structures

128. AcSEC concluded that the accounting for a time-sharing transaction should follow the same basic principles for sale and revenue recognition for all forms of time-sharing transaction structure. AcSEC's conclusion that, for SPE structures, revenue 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.

129. 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, paragraph 18(a) of this SOP requires that those structures be accounted for in the same manner as operating leases. If, however, as noted in footnote 8 to paragraph 19 of this SOP, 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 should 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, twenty years.

If either of the conditions presented in items *a* or *b* is not met, 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.

130. 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 sale accounting (including deposit accounting) rather than operating lease accounting.

131. 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-share intervals and having no debt, and that are established to comply with legal requirements relating to the residency of the buyer, lack economic substance. 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. AcSEC's conclusion is consistent with a comment by the SEC Observer as documented in EITF Abstracts Appendix D-14:

> Also, the SEC staff has objected to a proposal in which the accounting for a transaction would change only because an SPE was placed between the two parties to the transaction.

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. AcSEC's conclusion that such an SPE should be accounted for consistent with investments in other SPE structures is based on an analogy to EITF Issue No. 90-15, "Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions."

132. AcSEC's conclusions in paragraph 67 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 the "Guidance and Comments" section under “Seller-Provided Management Services” in Appendix B of this SOP.

Upgrade and Reload Transactions

133. AcSEC's determination that a reload transaction requires an additional cash payment in order to satisfy the cumulative payments test for the buyer's commitment in paragraph 18(c) of this SOP 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 views a reload as the purchase of a second interval unrelated to the equity accumulated in the first interval.

134. With respect to an upgrade, AcSEC analogized to paragraph 9 of FASB Statement No. 66 to conclude that a buyer's equity in its original interval would not constitute

part of the buyer's cumulative payments (see paragraph 18(c) of this SOP) for the upgrade interval, and so the seller would have to receive cumulative payments of at least 10 percent of the value of the upgrade interval in order to be able to record a full accrual sale. The seller would also have to "reverse" the sale of the original interval. AcSEC believes, however, that an upgrade is in substance a sale in the amount of the difference between the sales values of the upgrade and original intervals, thus permitting the cumulative payments test to be based on that difference rather than on the full sales value of the upgrade interval. AcSEC believes that conclusion does not conflict with EITF Issue No. 88-12 and is more cost-beneficial, operational, and intuitive than the alternative involving a "reversal" as discussed above.

Owners Associations

135. AcSEC concluded in paragraph 73 of this SOP that seller subsidies to an OA, unless accounted for under certain circumstances as incidental operations, 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

136. 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

137. AcSEC's conclusions in paragraphs 76 and 77 of this SOP regarding financial statement presentations are based on the illustrative financial statement presentations in Appendix D of FASB Statement No. 66. AcSEC concluded that delayed revenue related to percentage-of-completion sales should be shown as a liability because AcSEC believes it reflects the seller's obligation to perform under its contract with the buyer. AcSEC concluded that delayed revenue for cash-received sales should be shown as an adjustment to gross notes receivable rather than separately as a liability, because AcSEC does not believe the delayed revenue meets the definition of a liability. Paragraphs 233 and 234 of FASB Statement of Concepts No. 6 support AcSEC's conclusion.

138. AcSEC concluded in paragraph 77 of this SOP that for combined-method sales, the delayed revenue attributable to collection uncertainties should be shown as a deduction from notes receivable and the delayed revenue attributable to construction not being complete should be shown as a liability. Example 7 in Appendix A of this SOP illustrates how in the combined-method calculations (as described in paragraphs

A6 and A7 of Appendix A), delayed revenue attributable to collection uncertainties is determined prior to calculating delayed revenue attributable to construction not being complete. Although total delayed revenue would be the same irrespective of the order of calculation, the two balance-sheet components would differ if the order were reversed. In the interest of consistency, and because AcSEC believes issues of collectibility should be addressed before issues of completion of construction, AcSEC decided upon the order illustrated.

139. AcSEC believes that the disclosures required under paragraph 78 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 uncollectible receivables 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

140. 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 significance of the effort and costs likely to be incurred outweighs 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.

APPENDIX A – DESCRIPTION AND ILLUSTRATION OF METHODS OF REVENUE RECOGNITION FOR TIME-SHARING TRANSACTIONS[19]

Full Accrual Method

A1. Under the full accrual method, the sales value of a time-share is recognized as revenue in the period of sale. The following two examples 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.

[19] For simplicity, certain change-in-estimate calculations in the examples are performed on an annual basis although paragraph 44 of this 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.

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	Base 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	**(3)**
	500	360	190	50	1,100		10,950,000	
Estimated uncollectible notes							(985,500)	
Estimated sales discounts							-	
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 completed, 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:

		Debit	Credit
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	**(1), (2)**
	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 Values 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 uncollectible notes							(533,250)
Estimated sales discounts							-
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:

		Debit	Credit
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 units defaulted	30	**(2)**
	# of units defaulted that are recovered	30	**(1), (2)**
	Remaining units 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 Values 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
Resale of recovered intervals		-	40	50	90	$9,500	855,000
			190	50	240		2,305,000
Estimated uncollectible notes							(207,450)
Estimated sales discounts							-
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)

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:		**Ending Inventory Calculation:**	
Sales	$1,830,000	Total expected revenue, 20X3 & future	$2,097,550
Estimated uncollectible sales	(164,700)	Net sales - 20X3	(1,665,300)
Net sales	1,665,300	Remaining expected revenue	432,250
COS %	25.09%	COS %	25.09%
Cost of sales	$417,808	Inventory balance	$108,447

12/31/20X3	Ending inventory	$108,447	**(4)**
	# of units defaulted	35	**(2)**
	# of units defaulted that are recovered	35	**(1), (2)**
	Remaining units available for sale	35	= 190 - 190 + 35

FOOTNOTES

(1) 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.

(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. 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.

(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	Base 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	**(3)**
	500	360	190	50	1,100		10,950,000	
Estimated uncollectible notes							(985,500)	
Estimated sales discounts in 20X3							-	
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:		**Ending Inventory Calculation:**	
Sales	$5,025,000	Total expected revenue, 20X1 & future	$9,964,500
Estimated uncollectible sales	(452,250)	Net sales - 20X1	(4,572,750)
Net sales	4,572,750	Remaining expected revenue	5,391,750
COS %	25.09%	COS %	25.09%
Cost of sales	$1,147,260	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	**(1), (2)**
	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	Base 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 uncollectible notes							(976,725)
Estimated sales discounts in 20X3							(50,000)
Estimated future revenue							$9,875,775

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

20X1 Adjusted Cost of Sales Calculation:		**12/31/20X1 Adjusted Inventory Calculation:**	
Sales	$5,025,000	Total expected revenue, 20X1 & future	$9,875,775
Estimated uncollectible sales	(452,250)	Net sales - 20X1	(4,572,750)
Net sales	4,572,750	Remaining expected revenue	5,303,025
COS %	25.31%	COS %	25.31%
Cost of sales	$1,157,567	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	**(1), (2)**
	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 Values 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 uncollectible notes							(524,475)
Estimated sales discounts in 20X3							(50,000)
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:		**Ending Inventory Calculation:**	
Sales	$3,620,000	Total expected revenue, 20X2 & future	$5,303,025
Estimated uncollectible sales	(325,800)	Net sales - 20X2	(3,294,200)
Net sales	3,294,200	Remaining expected revenue	2,008,825
COS %	25.31%	COS %	25.31%
Cost of sales	$833,909	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. So 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 44 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	**(1), (2)**
	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 20X1-20X2 COMBINED, USING ACTUAL 20X1-20X2 DATA:

Estimated Sales Prices and Distribution:	20X1 Actual	20X2 Actual	20X3	20X4 & Future	Total No. of Intervals	Base 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	30	40	80	$9,500	760,000
	500	360	180	40	1,080		10,760,000
Estimated uncollectible notes							(961,650)
Estimated sales discounts in 20X3							(75,000)
Estimated future revenue							$9,723,350

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

Cost of Sales Calculation (20X1-20X2):		**Ending Inventory Calculation:**	
Sales	$8,645,000	Total expected revenue, 20X1 & future	$9,723,350
Estimated uncollectible sales	(778,050)	Net sales - 20X1-20X2	(7,866,950)
Net sales	7,866,950	Remaining expected revenue	1,856,400
COS %	25.71%	COS %	25.71%
Cost of sales, 20X1-20X2	$2,022,695	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 units defaulted that are recovered	35	**(1), (2)**
	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 Values 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
Resale of recovered intervals			30	40	70	$9,500	665,000
			180	40	220		2,115,000
Estimated uncollectible notes							(183,600)
Estimated sales discounts in 20X3							(75,000)
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)

		Debit	Credit
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:		**Ending Inventory Calculation:**	
Sales	$1,660,000	Total expected revenue, 20X3 & future	$1,856,400
Estimated uncollectible sales	(149,400)	Net sales - 20X3	(1,510,600)
Net sales	1,510,600	Remaining expected revenue	345,800
COS %	25.71%	COS %	25.71%
Cost of sales	$388,395	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. So 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 44 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	**(1), (2)**
	Remaining units available for sale	50	= 195 - 180 + 35

FOOTNOTES

(1) 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.

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

(3) 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.

(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.

Percentage-of-Completion Method

A2. 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, 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[20] is incomplete, the portion of revenue related to costs not yet incurred is recognized as the costs are incurred. In applying 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. Because revenue recognition is delayed under the percentage-of-completion method, no liability should be recorded for future costs of promised or planned amenities.

A3. 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 for prior performance as well as for performance that takes place in future periods. If the adjusted total estimated cost of the

[20] *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.

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*.

A4. The effects of changes in estimate, as described in the preceding paragraph, should be included in the disclosures required under paragraph 44 of this SOP.

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	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

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

NOTE: Additional revenue and cost of sales would be recognized in subsequent periods as work progresses to complete construction of inventory. Delayed revenue would be shown as a liability on the seller's balance sheet.

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	Base 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	(3)
	500	360	190	50	1,100		10,950,000	
Est'd uncollectible notes over life of project							(985,500)	
Estimated sales discounts							-	
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 AN 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: Est'd 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	**(1), (2)**
	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:					**Selected Income Statement Accounts:**	
Cash	376,700				Sales	3,013,600
					Est'd Uncoll.	(271,224)
Notes Receivable	3,390,300	(collections not illustrated)			Net Sales	2,742,376
Less: Allowance	(339,030)					
Receivables, Net	3,051,270					
Inventory	1,311,963	(includes delayed COS of:	172,009	)	COS	688,037
Delayed Revenue	(685,594)					
	$4,054,339					$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	Base 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
Est'd uncollectible notes over life of project							(1,542,375)
Estimated sales discounts							-
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: Est'd 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	**(1), (2)**
	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:

	Sales	Sales Contra	Allowance	Cost of Sales	Delayed Rev	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:

		Debit	Credit
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
				Est'd Uncoll.	(406,836)
Notes Receivable	3,390,300	(collections not illustrated)		Net Sales	2,606,764
Less: Allowance	(508,545)				
Receivables, Net	2,881,755				
Inventory	1,340,569	(includes delayed COS of:	164,858)	COS	659,431
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 Values 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
Est'd uncollectible notes over life of project							(1,033,830)
Estimated sales discounts							-
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:

				Debit	Credit
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: Est'd 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	**(1), (2)**
	Remaining intervals available for sale	560	= 670 - 125 +15

The net effect of the entries for the full year 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
Est'd Uncoll.	(542,700)
Net Sales	3,477,300
COS	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 44 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 Values 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
Est'd uncollectible notes over life of project							(864,000)
Estimated sales discounts							-
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:

Cash	869,250	
Notes Receivable	7,823,250	(collections not illustrated)
Less: Allowance	(1,173,488)	
Receivables, Net	6,649,762	
Inventory	317,834	(includes delayed COS of: 219,913)
Delayed Revenue	(869,325)	
	$6,967,521	

Selected Income Statement Accounts:

Sales	7,687,500
Est'd Uncoll.	(1,037,813)
Net Sales	6,649,687
COS	1,682,166
	$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 ESTIMATED 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 COST 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 ADJUSTMENT TO SALES AND COST OF SALES FOR THE DIFFERENCE BETWEEN TOTAL SALES AND COST OF SALES THAT WOULD HAVE BEEN RECOGNIZED FOR THE CURRENT AND ALL PRIOR YEARS TO DATE BASED ON A PERCENT COMPLETE OF 88.89%, AND TOTAL SALES AND COST OF SALES ACTUALLY RECOGNIZED 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
			Est'd Uncoll.	(1,126,548)
Notes Receivable	7,823,250	(collections not illustrated)	Net Sales	7,218,252
Less: Allowance	(1,173,488)			
Receivables, Net	6,649,762			
Inventory	574,004	(includes delayed COS of: 76,084)	COS	1,825,996
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 Calc'n:	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:

			Debit	Credit
	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 Rev	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:

		Debit	Credit
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
			Est'd Uncoll.	(1,043,101)
Notes Receivable	7,823,250	(collections not illustrated)	Net Sales	6,683,566
Less: Allowance	(1,173,488)			
Receivables, Net	6,649,762			
Inventory	574,004	(includes delayed COS of: 228,249)	COS	1,825,996
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 44 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: Est'd 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	**(1), (2)**
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 Values 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
Resale of recovered intervals			60	75	135	$9,500	1,282,500
			210	75	285		2,732,500
Est'd uncollectible notes over life of project							(368,888)
Estimated sales discounts							-
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: Est'd costs to complete	-
Less: POC adjustments to date	(228,249)
Inventory for next period COS% calculation purposes	$168,381

12/31/20X3	Ending inventory for calculation of COS percentage	$168,381	**(4)**
	# of intervals defaulted	-	**(2)**
	# of intervals defaulted that are recovered	-	**(1), (2)**
	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 Entry:

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 pd for $700,000 construction)	Sales	10,712,500
			Est'd Uncoll.	(1,446,189)
Notes Receivable	9,641,250	(collections not illustrated)	Net Sales	9,266,311
Less: Allowance	(1,446,188)			
Receivables, Net	8,195,062			
Inventory	168,381		COS	2,531,618
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. Not all interval sales that default 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.

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

(3) 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.

(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.

Cash-Received Method

A5. The cash-received method treats each principal payment as revenue when collected. Cost of sales is determined using the relative sales value method discussed in paragraph 44 of this SOP. That is, cost of sales is recognized as a percentage of revenue recognized. Delayed cost of sales associated with delayed revenue determined under the cash-received method remains classified as inventory on the seller's balance sheet.

TIME-SHARING EXAMPLE 5 - RELATIVE SALES VALUE METHOD, CASH-RECEIVED METHOD

Assumptions for 20X1:

NOT all requirements for full accrual sale accounting are met; no adequate collection experience
Inventory is complete, with no estimated costs to complete
All requirements for cash-received method are met

Estimated Sales Prices and Distribution:	20X1	20X2	20X3	20X4 & Future	Total No. of Intervals	Base 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 *	-	-	-	-	-	$9,500	-
	500	350	150	-	1,000		10,000,000
Estimated uncollectible notes *							-
Estimated sales discounts							-
Estimated future revenue							$10,000,000

* Unable to estimate with reasonable reliability

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

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:	25.00%	($2,500,000 / $10,000,000)
Gross margin percentage	75.00%	
Cash collected during 20X1:	15%	(of total sales price; includes 10% down payment and add'l 5% collected during 20X1)

For simplicity of illustration, interest income is not considered

Summarized Accounting Entries:

		Debit	Credit	
20X1	Notes Receivable	4,522,500		
	Cash	502,500		
	Sales		5,025,000	
20X1	Cost of Sales	188,438		**(1)**
	Inventory		188,438	
20X1	Cash	251,250		**(2)**
	Notes Receivable		251,250	
20X1	Delayed Revenue, Cash-Received Sales (income statement)	4,271,250		
	Delayed Revenue (balance sheet)		4,271,250	

Cost of Sales Calculation:		**Ending Inventory Calculation:**	
Sales	$5,025,000	Total expected revenue, 20X1 & future	$10,000,000
Delayed revenue, cash-rec'd sales	(4,271,250)	Net sales - 20X1	(753,750)
Net sales	753,750	Remaining expected revenue	9,246,250
COS %	25.00%	COS %	25.00%
Cost of sales	$188,438	Inventory balance	$2,311,563

Delayed Revenue Calculation (shown two ways):

Notes receivable (beginning)	$4,522,500	Gross sales	$5,025,000
Note principal collected	(251,250)	N/R (ending)/sales	85%
Delayed revenue	$4,271,250 **(3)**	Delayed revenue	$4,271,250

FOOTNOTES

(1) Of the $188,438 cost of sales, $125,625 (corresponding to the 10% down) is recorded when the down payment is received. The remaining $62,813 (corresponding to the 5% additional cash collected during 20X1) is recorded as cash is received during the year.

(2) To record additional 5% of sales price collected in cash during 20X1 (over and above 10% down payment).

(3) In accordance with paragraph 77 of this SOP, delayed revenue would be shown as an adjustment to gross notes receivable on the seller's balance sheet.

TIME-SHARING EXAMPLE 6 - RELATIVE SALES VALUE METHOD, CASH-RECEIVED METHOD, THEN FULL ACCRUAL AFTER CONDITIONS MET

Assumptions for 20X1:

NOT all requirements for full accrual sale accounting are met; no adequate collection experience and seller initially cannot estimate credit losses with reasonable reliability.
Inventory is complete, with no estimated costs to complete.
All requirements for cash-received method are met.

Estimated Sales Prices and Distribution:	20X1	20X2	20X3	20X4 & Future	Total No. of Intervals	Base 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 *		-	-	-	-	$9,500	-
	500	350	150	-	1,000		10,000,000
Estimated uncollectible notes *							-
Estimated sales discounts in 20X3							(150,000)
Estimated future revenue							$9,850,000

* Unable to estimate with reasonable reliability

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

Initial down payment:	10%	(on all sales; no cash sales)
Subsequent annual payments:	5%	of total sales price
Forfeiture on defaulted notes:	100%	of cash paid
Inventory cost:	$2,500,000	(average: $2,500 per interval)
COS percentage:	25.38%	($2,500,000 / $9,850,000)
Gross margin percentage:	74.62%	
Cash collected during 20X1:	15%	(of total sales price; includes 10% down payment and add'l 5% collected during 20X1)

For simplicity of illustration, interest income is not considered

Summarized Accounting Entries:

		Debit	Credit	
20X1	Notes Receivable	4,522,500		
	Cash	502,500		
	Sales		5,025,000	
20X1	Cost of Sales	191,307		**(2)**
	Inventory		191,307	
20X1	Cash	251,250		**(3)**
	Notes Receivable		251,250	
20X1	Delayed Revenue, Cash-Received Sales (income statement)	4,271,250		
	Delayed Revenue (balance sheet)		4,271,250	

Cost of Sales Calculation:

Sales	$5,025,000
Delayed revenue, cash-rec'd sales	(4,271,250)
Net sales	753,750
COS %	25.38%
Cost of sales	$191,307

Ending Inventory Calculation:

Total expected revenue, 20X1 & future	$9,850,000
Net sales - 20X1	(753,750)
Remaining expected revenue	9,096,250
COS %	25.38%
Inventory balance	$2,308,693

Delayed Revenue Calculation (shown two ways):

Notes receivable (beginning)	$4,522,500	Gross sales	$5,025,000
Note principal collected	(251,250)	N/R (ending) / sales	85%
Delayed revenue	$4,271,250	Delayed revenue	$4,271,250

Selected Balance Sheet Accounts:				**Selected Income Statement Accounts:**	
Cash	753,750			Sales	5,025,000
				Delayed Rev	(4,271,250)
Notes Receivable	4,271,250			Net Sales	753,750
Delayed Revenue	(4,271,250)				
Receivables, Net	0				
Inventory	2,308,693	(incl. delayed COS of	1,084,074)	COS	1,275,381
				Delayed COS	(1,084,074)
					191,307
	$3,062,443				$562,443

(Note: Difference between $3,062,443 and $562,443 correctly equals the original $2,500,000 in Inventory at 1/1/20X1.)

12/31/20X1	Ending inventory	$2,308,693	
	# of intervals defaulted	-	**(1)**
	# of intervals defaulted that are recovered	-	
	Remaining intervals available for sale	500	= 1,000 - 500

In early 20X2, subsequent to the issuance of the seller's 20X1 financial statements, the seller's other time-share project, which began its selling period several years ago, is first able to provide reasonably reliable data on collection experience.
The seller's two projects are sufficiently similar (under paragraph 25(c)(3) of this SOP) that the seller can apply the collection experience of the other project to this project. The other project indicates collection experience of 90% of notes receivable balances.
The seller now meets all of the conditions for application of the full accrual method of accounting, including collectibility (paragraph 25(b)) and ability to estimate credit losses (paragraph 25(c)).

Under paragraph 30 of the SOP, the seller should switch to the full accrual method for all time-sharing transactions in this project:
"If (during the time the seller is accounting for transactions under the cash-received or combined method only because they do not meet the collectibility criterion in paragraph 25(b)) the adequate collection experience test of that paragraph becomes met, the seller should adopt the full accrual method or percentage-of-completion method (whichever is applicable) for all transactions in the project."

The change to the full accrual method is accounted for as a change in accounting estimate that should be accounted for in accordance with paragraph 31 of APB Opinion No. 20. The seller should reverse in 20X2 the delayed revenue previously recorded and should record an entry in 20X2 to reflect an allowance for uncollectible receivables. The seller also should record a COS adjustment corresponding to the delayed revenue reversal and to reflect the COS as what it would have been under the full accrual method, consistent with paragraph 30 of this SOP.

Assumption:
Estimated default rate: 10% of note principal

Of the $4,522,500 in notes receivable recorded during 20X1, $4,271,250 ($4,522,500 - $251,250) was outstanding as of 12/31/20X1. But the 10% is assumed to have been determined so as to be applicable to the balance of $4,522,500 that is net of the down payment but not net of the 5% cash collected in 20X1.

Early 20X2 entry to record reversal of delayed revenue and to establish allowance:

20X2	Delayed Revenue (balance sheet)	4,271,250	
	Delayed Revenue, Cash-Received Sales (income statement)		4,271,250
20X2	Sales Contra (estimated uncollectible sales)	452,250	
	Allowance for Uncollectible Notes Receivable		452,250

Determination of what the COS percentage would have been had the seller been under the full accrual method as of 1/1/20X1:

Estimated Sales Prices and Distribution:	20X1	20X2	20X3	20X4 & Future	Total No. of Intervals	Base 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		-	-	-	-	$9,500	-
	500	350	150	-	1,000		10,000,000
Estimated uncollectible notes							(886,500)
Estimated sales discounts in 20X3							(150,000)
Estimated future revenue							$8,963,500

COS percentage: 27.89% ($2,500,000 / $8,963,500)

Cost of Sales Calculation:		**Ending Inventory Calculation:**	
Sales	5,025,000	Total expected revenue, 20X1 & future	$8,963,500
Estimated uncollectible sales	(452,250)	Net sales - 20X1	(4,572,750)
Net sales	4,572,750	Remaining expected revenue	4,390,750
COS %	27.89%	COS %	27.89%
Cost of sales	$1,275,381	Inventory balance	$1,224,619

Cost of sales that would have been recorded for 20X1 under the full accrual method	$1,275,381
Cost of sales previously recorded for 20X1	191,307
Difference, to be recorded as a current-period adjustment in 20X2	$1,084,074

20X2	Cost of Sales	1,084,074	
	Inventory		1,084,074

12/31/20X1	Ending inventory	$1,224,619	
	# of intervals defaulted	-	**(1)**
	# of intervals defaulted that are recovered	-	
	Remaining intervals available for sale	500	= 1,000 - 500

Assumptions for 20X2:
Same assumptions as 20X1 under full accrual accounting, except that expected future revenue estimate excludes 20X1.

Beginning Inventory Balance $1,224,619

Estimated Sales Values 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		-	-	-	-	$9,500	-
		350	150	-	500		4,975,000
Estimated uncollectible notes							(434,250)
Estimated sales discounts in 20X3							(150,000)
Estimated future revenue							$4,390,750

Sales for 20X2 are $3,525,000 (the 350 units from above at the respective sales prices shown above)

COS percentage 27.89% ($1,224,619 / $4,390,750)

Accounting Entries:

20X2	Notes Receivable	3,172,500	
	Cash	352,500	
	Sales Contra (estimated uncollectible sales)	317,250	
	Sales		3,525,000
	Allowance for Uncollectible Notes Receivable		317,250
20X2	Cost of Sales	894,670	
	Inventory		894,670

Cost of Sales Calculation:		**Ending Inventory Calculation:**	
Sales	$3,525,000	Total expected revenue, 20X2 & future	$4,390,750
Estimated uncollectible sales	(317,250)	Net sales, 20X2	(3,207,750)
Net sales	3,207,750	Remaining expected revenue	1,183,000
COS %	27.89%	COS %	27.89%
Cost of sales	$894,670	Inventory balance	$329,949

Selected Balance Sheet Accounts:			Selected Income Statement Accounts:		
Cash	1,106,250		Sales	8,550,000	
			Est'd Uncoll.	(769,500)	
Notes Receivable	7,443,750		Net Sales	7,780,500	
Less: Allowance	(769,500)				
Receivables, Net	6,674,250				
Inventory	329,949		COS	2,170,051	
	$8,110,449			$5,610,449	**(4)**

(Note: Difference between $8,110,449 and $5,610,449 correctly equals the original $2,500,000 in Inventory at 1/1/20X1.)

12/31/20X2	Ending inventory	$329,949	
	# of units defaulted	-	**(1)**
	# of units defaulted that are recovered	-	
	Remaining units available for sale	150	= 500 - 350

FOOTNOTES

(1) For simplicity, defaults are assumed to be zero.

(2) Of the $191,307 cost of sales, $127,538 (corresponding to the 10% down) is recorded when the down payment is received. The remaining $63,769 (corresponding to the 5% additional cash collected during 20X1) is recorded as cash is received during the year.

(3) To record additional 5% of sales price collected in cash during 20X1 (over and above 10% down payment).

(4) Had the change in revenue recognition method not occurred, in 20X2 the seller would have recorded 20X2 income of $582,030 (see "As If" column below). Actual 20X2 income was $5,048,006 (see "Actual" column below), which is $4,465,976 higher than the "As If" amount. In accordance with paragraph 44 of this SOP, the seller would disclose that the 20X2 results include a $4,465,976 increase in income resulting from the change to a higher revenue recognition method (cash-received to full accrual). For simplicity, any related tax effects are ignored.

The amount to be disclosed may be determined as follows:

	20X2 - As If	20X2 - Actual	Difference
Consummated Sales			
Current Year	$3,525,000	$3,525,000	
Cash Collections on Prior Yr Sales	251,250	-	
Delayed Sales			
Current Year	(2,996,250)	-	
Sales Contra	-	(317,250)	
Change to Full Accrual Method for Prior Year Sales:			
Reversal of Delayed Sales	-	4,271,250	
Establish Allowance	-	(452,250)	
Net Sales	$780,000	$7,026,750	
Cost of Sales	$197,970	$1,978,744	
Income	$582,030	$5,048,006	$4,465,976

Combined Method (Combination of Cash-Received Method and Percentage-of-Completion Method)

A6. The combined method delays revenue both because construction is not complete and because of uncertainty about recoverability of notes receivable. The computations are performed by first determining the amount of revenue to be recorded under the cash-received method, and then delaying a portion of that revenue by applying the proportion of costs not yet incurred to total costs. That is, delayed revenue attributable to uncertainty about recoverability of notes receivable is determined prior to calculating delayed revenue attributable to construction not being complete. If the delayed revenue on combined-method sales that is attributable to construction not being complete is not significant in amount, the seller may aggregate it with the delayed revenue attributable to uncertainty about recoverability of notes receivable and show the total delayed revenue as a deduction from notes receivable.

A7. Cost of sales is determined using the relative sales value method discussed in paragraph 44 of this SOP. That is, cost of sales is recognized as a percentage of revenue recognized. Delayed cost of sales associated with delayed revenue determined under the combined method remains classified as inventory on the seller's balance sheet.

TIME-SHARING EXAMPLE 7 - RELATIVE SALES VALUE METHOD, COMBINED METHOD

Assumptions for 20X1:

NOT all requirements for full accrual sale accounting are met; no adequate collection experience and seller initially cannot estimate credit losses with reasonable reliability.

Inventory is not complete; estimated costs to complete are: $500,000

All requirements for combined method are met.

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.

Estimated Sales Prices and Distribution:	20X1	20X2	20X3	20X4 & Future	Total No. of Intervals	Base 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 *		-	-	-	-	$9,500	-
	500	350	150	-	1,000		10,000,000
Estimated uncollectible notes *							-
Estimated sales discounts							(150,000)
Estimated future revenue							$9,850,000

* Unable to estimate with reasonable reliability

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

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:	25.38%	($2,500,000 / $9,850,000)
Cash collected during 20X1:	15%	(of total sales price; includes 10% down payment and add'l 5% collected during 20X1)

For simplicity of illustration, interest income is not considered.

Summarized Accounting Entries:

These entries compute delayed revenue first under the cash-received method and then adjust for percentage of completion.

20X1	Notes Receivable	4,522,500		
	Cash	502,500		
	Sales		5,025,000	
20X1	Cost of Sales	153,046		
	Inventory		153,046	
20X1	Cash	251,250		**(1)**
	Notes Receivable		251,250	
20X1	Delayed Revenue, Cash-Received Sales (income statement)	4,271,250		
	Delayed Revenue (balance sheet)		4,271,250	

Percentage-of-completion adjustment:

20X1	Revenue (20% of revenue recordable under cash-received method)	150,750	
	Delayed Revenue (balance sheet)		150,750

Cost of Sales Calculation:			**Ending Inventory Calculation:**	
Gross sales	$5,025,000		Total expected revenue, 20X1 & future	$9,850,000
Delayed revenue, cash-rec'd sales	(4,271,250)	**(2)**		
Delayed revenue, % of completion	(150,750)		Net sales, 20X1	(603,000)
Net sales	603,000		Remaining expected revenue	9,247,000
COS %	25.38%		COS %	25.38%
Cost of sales	$153,046		Inventory balance	$2,346,954

The same *total* combined-method revenue would have been determined by starting with the revenue recordable under the percentage-of-completion method with no expected credit losses and then delaying revenue for the 85% of sales value not collected in 20X1 (see paragraph 138 of this SOP):

Revenue for 20X1 from Example 3	$3,658,200	
Add back: est'd uncollectible sales	361,800	(452,250 x 80%)
20X1 sales based on % of completion	4,020,000	(5,025,000 x 80%)
Less: Delayed rev. for 85% of sales value not collected	(3,417,000)	
Revenue under combined method	$603,000	(same as net sales figure above)

FOOTNOTES

(1) To record additional 5% of sales price collected in cash during 20X1 (over and above 10% down payment).

(2) In accordance with paragraph 77 of this SOP, on the seller's balance sheet, delayed revenue of $4,271,250 would be shown as an adjustment to gross notes receivable, and delayed revenue of $150,750 would be shown as a liability.

Deposit Method

A8. Under the deposit method, the seller does not recognize any revenue, does not record notes receivable, and continues to report in its inventory the time-sharing intervals, disclosing that those time-sharing intervals are subject to a sales contract. Cash received from the buyer, including the initial investment and subsequent collections of principal and interest, is reported as a deposit on the contract and shown as a liability in the seller's balance sheet.

A9. If a transaction ultimately meets the criteria for the full accrual, percentage-of-completion, cash-received, or combined method, the seller should record a current-period adjustment to reflect how the transaction would have been recorded if that method had been used from the beginning of the transaction.

APPENDIX B – CONTINUING INVOLVEMENT

Below are possible scenarios of continuing involvement, this Statement of Position's (SOP's) prescribed guidance with respect to those scenarios, and AcSEC's comments with respect to applicability or non-applicability of those scenarios to a time-share seller. The term *developer* is used synonymously with *seller* in this appendix. If a continuing involvement condition lapses, the seller should apply the appropriate sale and revenue recognition guidance as prescribed in this SOP.

Repurchase Option or Obligation

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[21] to the seller to repurchase the property.

Guidance and 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.

If a time-share contract does contain a repurchase obligation or an option for repurchase, the seller should account for the transaction as a financing, as a deposit, or in the same manner as an operating lease,[22] as appropriate, until the obligation or option either is exercised or expires.

Limited Partnership Arrangement

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[23] part of the sales price.

Guidance and 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

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[21] 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.
[22] See footnote 8 to paragraph 19 of this SOP.
[23] 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 resort
- *d.* The present value of a land lease when the seller is the lessor

developer provides management services to the third-party condominium/owners associations (OA) for a fee. If the developer is managing the OA for a below-market fee, a portion of the revenue on the sale should be recognized on a delayed basis in accordance with the guidance below under the “Seller-Provided Management Services” scenario. 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 does not preclude sales recognition.

If a time-share developer does partner on either a general or limited basis with the time-share interval purchaser, the seller should account for the transaction as a financing, as a deposit, or in the same manner as an operating lease, as appropriate, until the seller disposes of its partnership interest to an independent third party. The seller should appropriately account for its partnership interest by means of consolidation or the equity method.

Guaranteed Return on Investment

The seller guarantees[24] 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.

Guidance and 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.

If a time-share interval is sold with a stated or implied investment return, the seller should account for the transaction as in the “Repurchase Option or Obligation” scenario above.

Seller Support of Operations

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.

Guidance and 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 "breakeven" level. Therefore, the developer subsidy represents two items:

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[24] Guarantees by the seller may be limited to a specified period of time.

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 62 through 64 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 have 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, the seller should account for the transactions as if they were operating leases. Such subsidies would indicate 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. As discussed in paragraph 84 of this SOP, the seller should account for right-to-use arrangements in the same manner as operating leases.

Seller-Provided Management Services

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.

Guidance and 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 (non-developer) time-share management companies charge between 5 and 15 percent management fees (that is, between 5 and 15 percent of the underlying operating and other costs of management). If a developer provides management services at compensation less than prevailing market rates, part of the revenue on sales of intervals should be recognized on a delayed basis—that is, recognized as revenue as the management services are performed. In all cases, the facts and circumstances of each contract should be evaluated.

Sometimes the developer offers to pay an interval purchaser's OA maintenance fee for a fixed period of time as a sales incentive. That transaction should be accounted for in accordance with paragraphs 32 through 41 of this SOP.

Sometimes the 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. 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.

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. If the fair value of what the buyer receives in exchange exceeds the associated net rental income that the developer could earn, compensation in the amount of the excess should be imputed when the sale is recognized and recognized as revenue when the buyer makes the exchange. If the seller cannot make a reasonable estimate of how the associated net rental income compares to the fair value of what the buyer receives in exchange under the program, the seller should account for the time-sharing transaction as if it were an operating lease.

Option to Purchase
The transaction is merely an option to purchase the property. 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.

Guidance and Comments

Once the rescission period has expired, contracts for the sales of time-share intervals are binding purchase contracts and not options. Sale and revenue recognition require the expiration of the rescission period. If the buyer's cumulative payments represent less than a 10 percent investment, this SOP requires application of the deposit method. If a time-share developer sells an option, it should apply the deposit method.

Partial Sales

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. 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.

Guidance and Comments
Sales of time-sharing intervals are not partial sales, as the developer cannot record a sale without a transfer of title (see paragraph 18(a) of this SOP). In the case in which the developer transfers title to an SPE or trust in exchange for shares or beneficial interests, the developer should not recognize the sale until the share or beneficial interest is sold to the end user. (See paragraphs 65 and 66 of this SOP.)

Collection Not Reasonably Assured

The collection of the sales price is not reasonably assured.

Guidance and Comments

This SOP prescribes the cash-received, combined, or deposit method, as appropriate, if the collectibility criterion for full accrual sales accounting is not met.

Seller Support of Operations – Additional

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.

Guidance and Comments

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

Sale of Improvements, Lease of Land

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

Guidance and Comments

See footnote 8 to paragraph 19 of this SOP for guidance.

Contractual Future Requirements of the Seller

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.

Guidance and 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. The sales should be accounted for under the percentage-of-completion method, combined method, or deposit method as appropriate. (See paragraphs 26 through 28 of this SOP.)

Seller Participation in Future Resale Profits

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).

Guidance and Comments

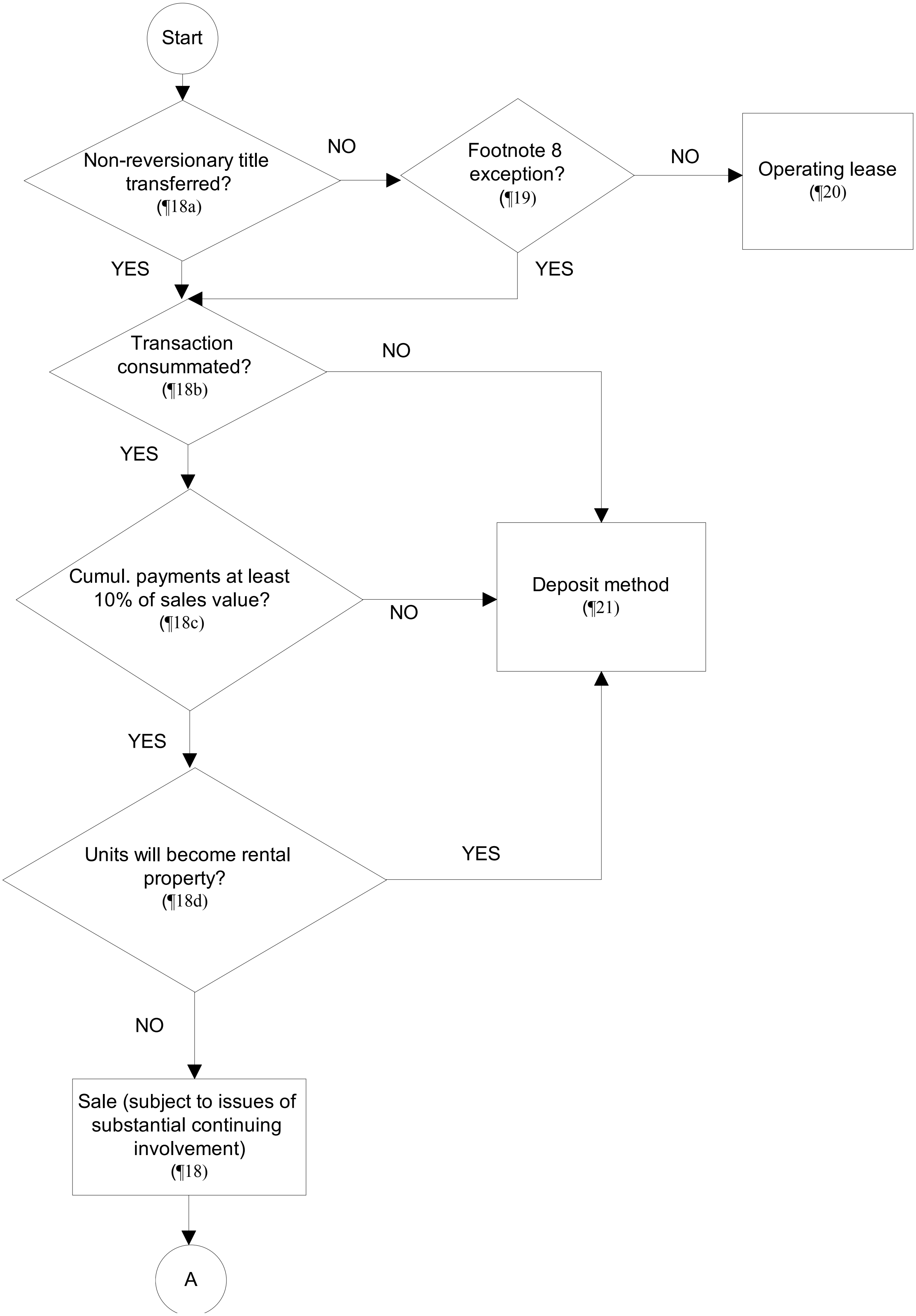
Developers typically do not participate in future profits from the resale of time-share intervals.

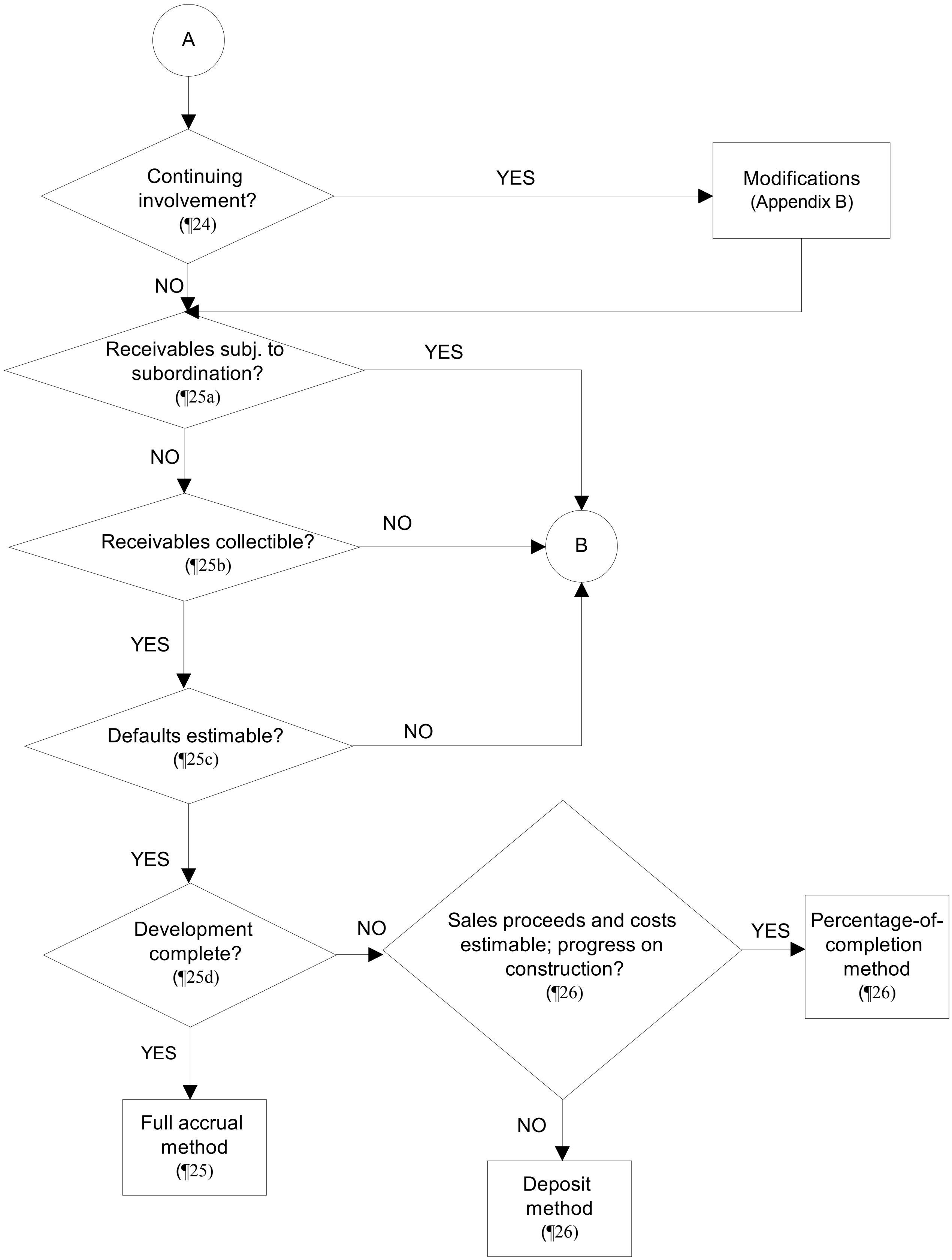
If the transaction otherwise qualifies for full accrual accounting, the seller is considered to have transferred the risks and rewards of ownership to the buyer and should apply the full accrual method without any modification resulting from this form of continuing involvement. The contingent future profits should be recognized when they are realized. All of the costs of the sale should be recognized at time of sale and none should be deferred to periods when the contingent profits are recognized.

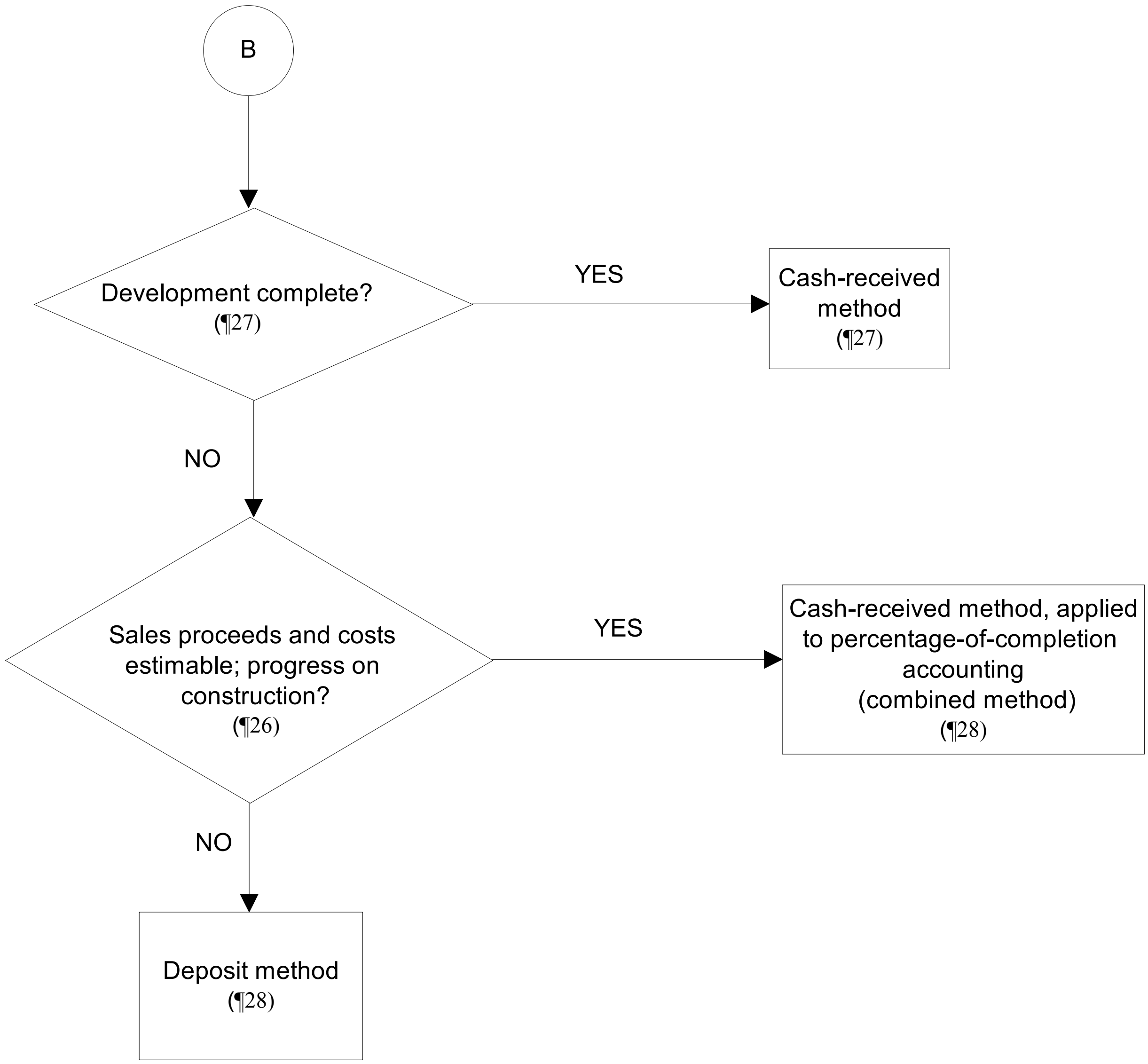
All of the preceding in this appendix discusses the time-sharing seller's continuing involvement arising from legal obligations. The seller also may have indicated a commitment, based on considerations such as business reputation, intercompany relationships, or credit standing, to provide financial support 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 by the seller to third parties of the developer's intention to provide support. If such a commitment exists, the seller should determine which kind of continuing involvement it represents under the above scenarios, and record transactions based on the relevant paragraphs in this appendix. AcSEC believes that if such a commitment exists, it is most likely to be additional support to an OA that would fall under the scenario entitled “Seller Support of Operations,” above.

APPENDIX C – FLOWCHART OF TIME-SHARING SALE AND REVENUE RECOGNITION MODEL

C1. The following flowchart is intended to illustrate the guidance in paragraphs 18 through 28 of the SOP on time-sharing sale and revenue recognition. It is intended for summary purposes only and should not be used without further reference to the SOP.


Start
Non-reversionary title transferred?
(¶18a)
NO
Footnote 8 exception?
(¶19)
NO
Operating lease
(¶20)
YES
YES
Transaction consummated?
(¶18b)
NO
YES
Cumul. payments at least 10% of sales value?
(¶18c)
NO
Deposit method
(¶21)
YES
Units will become rental property?
(¶18d)
YES
NO
Sale (subject to issues of substantial continuing involvement)
(¶18)
A


A
Continuing involvement? (¶24)
YES
Modifications (Appendix B)
NO
Receivables subj. to subordination? (¶25a)
YES
NO
Receivables collectible? (¶25b)
NO
B
YES
Defaults estimable? (¶25c)
NO
YES
Development complete? (¶25d)
NO
Sales proceeds and costs estimable; progress on construction? (¶26)
YES
Percentage-of-completion method (¶26)
YES
Full accrual method (¶25)
NO
Deposit method (¶26)


B
Development complete?
(¶27)
YES
Cash-received method
(¶27)
NO
Sales proceeds and costs estimable; progress on construction?
(¶26)
YES
Cash-received method, applied to percentage-of-completion accounting
(combined method)
(¶28)
NO
Deposit method
(¶28)

APPENDIX D – ILLUSTRATION OF USE OF HISTORICAL DATA ON UNCOLLECTIBLE RECEIVABLES, INCLUDING RELATED DISCLOSURES

This illustration shows how a time-share entity would organize its historical data about credit losses to demonstrate whether it complies with the conditions of paragraphs 25(b) (collectibility test) and 25(c) (ability to estimate credit losses) of this SOP to compute the charge to revenue for estimated uncollectible receivables on current year (2001) sales, and to assess the adequacy of the allowance for uncollectible receivables as of the end of 2001. Related illustrative disclosures are included.

HISTORICAL DATA

Sales, Net of Down Payments, by Year

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

1991	$28,000	1997	$60,000
1992	$26,000	1998	$70,000
1993	$30,000	1999	$76,000
1994	$33,000	2000	$80,000
1995	$34,000	2001	$90,000
1996	$50,000		

The following table summarizes the credit loss experience for years 1991 through 2001 for projects similar to the entity's current time-share project. The credit losses are organized into columns based on the year of sale. Thus, the column "1996 Sales" shows that of the $50,000 of sales recorded in 1996, $1,100 in receivables were deemed uncollectible in 1996, $2,000 in 1997, $900 in 1998, and so on.[25] However, the chart also can be analyzed to show receivables deemed uncollectible in each fiscal year. For example, in 2001, (see the figures inside the rectangles) there were $7,500 in total uncollectible receivables: $1,900 from 2001 sales, $2,600 from 2000 sales, $1,400 from 1999 sales, $800 from 1998 sales, $500 from 1997 sales, $200 from 1996 sales and $100 from 1995 sales. The "combined experience" column is computed two ways—one using only those sales from 1991 through 1995 for which the notes have been collected in full and the other using 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.

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

	--2001	**Sales--**	**--2000**	**Sales--**	**--1999**	**Sales--**	**--1998**	**Sales--**	**--1997**	**Sales--**	**--1996**	**Sales--**
		% of		% of		% of		% of		% of		% of
	Uncoll-ectible	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)
FY of Sale	$1,900	2.1%	$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			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					1,400	1.8%	1,300	1.9%	1,000	1.7%	900	1.8%
3 yrs after FY of sale							800	1.1%	900	1.5%	600	1.2%
4 yrs after FY of sale									500	0.8%	700	1.4%
5 yrs after FY of sale											200	0.4%
6 yrs after FY of sale												
Total uncoll. sales,												
As of Dec. 31, 2001	$1,900	2.1%	$4,400	5.6%	$5,500	7.2%	$5,600	8.0%	$5,700	9.5%	$5,500	11.0%

	--1995	Sales--	--1994	Sales--	--1993	Sales--	--1992	Sales--	--1991	Sales--	Combined	Exper-ience
		% of		% of		% of		% of		% of		
	Uncoll-ectible	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	Uncol.	sales (net of down pmnts)	**1991-1995**	**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	100	0.3%	150	0.5%	100	0.3%	75	0.3%	100	0.4%	0.3%	0.3%
Total uncoll. sales,												
As of Dec. 31, 2001	$4,550	13.3%	$4,400	13.4%	$3,750	12.4%	$3,075	11.8%	$2,475	8.9%	12.0%	11.2%

Assessment of Historical Data

The historical data show that the entity has collected more than 85% of receivables on similar projects in the past, so that it meets the condition in paragraph 25(b). Fluctuations in collection experience from year to year can be explained by economic conditions; the economy was stronger in 1998 through 2001 than in prior years, and uncollectibility rates declined modestly. The fact that the fluctuations are explainable is considered to indicate, along with other factors, that the entity can reasonably estimate credit losses, thereby meeting the condition in paragraph 25(c). As the year 2001 ends, the economy is softening. As a result, the entity concludes that the percentages from the "Combined Experience—All Years" columns above, which blend 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 uncollectible receivables on current year (2001) sales and to assess the adequacy of the allowance for uncollectible receivables at the end of 2001.

COMPUTATION OF CHARGE TO REVENUE FOR ESTIMATED UNCOLLECTIBLE RECEIVABLES ON CURRENT YEAR (2001) SALES AND BALANCE OF ALLOWANCE AT END OF 2001

The tables below illustrate the computation of the charge to revenue for estimated uncollectible receivables on current year (2001) sales and the computation of the required balance in the allowance for uncollectible receivables at the end of 2001. 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 60 of the 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 1991 to 1995 sales, on the assumption that the more recent experience is relevant to the collectibility of existing receivables.

	------------------Estimated Uncollectible by Year of Sale--------------------					
	1996	1997	1998	1999	2000	2001
Year Uncollectible						
2002	0.3%	0.5%	0.9%	1.5%	2.0%	3.7%
2003		0.3%	0.5%	0.9%	1.5%	2.0%
2004			0.3%	0.5%	0.9%	1.5%
2005				0.3%	0.5%	0.9%
2006					0.3%	0.5%
2007						0.3%
Total expected future uncollectible (%)	0.3%	0.8%	1.7%	3.2%	5.2%	8.9%
Sales, net of down pmts	$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, 2001						**$16,422**

Charge to Revenue for Current Year Sales

Sales net of down payments, 2001	$90,000
Uncollectible – Estimated and actual (%)	11.2%
Total charge for 2001 sales	10,080
Less: chargeoffs during 2001	2,070
Charge for estimated uncollectible sales*	**$8,010**

* Year-end 2001 charge to revenue for estimated uncollectible receivables on 2001 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% to 15%. The weighted average interest rates were 13.5% at December 31, 2001, and 13.6% at December 31, 2000, respectively.
2. The receivables balances were $300,800 at December 31, 2001, and $267,700 at December 31, 2000, with weighted average remaining lives of 3.2 years at both dates.

Illustrative Financial Statement Disclosures[26]

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

	12/31/2001	12/31/2000
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 uncollectible receivables was as follows:

Balance, beginning of year	$ 13,842	$ 13,382
Allowance for credit losses on current year sales	10,080	8,960
Write-offs of uncollectible receivables	(7,500)	(8,500)
Changes in estimate for prior years' sales	0	0
Balance, end of year	$ 16,422	$ 13,842

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

The disclosures that follow are not required by this SOP but would be required under AcSEC's proposed SOP on accounting for credit losses. AcSEC expects to issue an exposure draft early in 2003.

The Company assesses credit losses based on pools of receivables, because it holds large numbers of homogenous notes receivable. The Company estimates credit losses based on the historical credit losses for similar time-share notes receivable over the past 10 years. The Company uses a technique referred to as static pool analysis, which tracks the credit losses 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. When current unemployment rates differ from the rates in effect when the historical experience was generated, the Company adjusts the allowance for uncollectible receivables to reflect the expected effects of current unemployment rates on credit losses. 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 credit losses have varied by state. Within states, customer demographics and historical credit losses for projects have been substantially the same.

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 credit losses when they become 120 days past due and the Company has pursued most of its collection remedies.

The receivables portfolio and allowance for uncollectible receivables were as follows at December 31, 2001:

	Florida	California	Hawaii	Total
Gross receivables	$140,000	$101,800	$59,000	$300,800
Allowance for uncollectible receivables				
Historical loss rate component	$ 7,000	$ 5,500	$ 1,000	$ 13,500
Adjust for unemployment rates	1,390	1,330	202	2,922
Total	$ 8,390	$ 6,830	$ 1,202	$ 16,422

Illustrative Relevant Sections of Financial Statements

Balance Sheet as of December 31, 2001

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, 2001

Gross sales transactions*	$100,000
Estimated and actual uncollectible receivables	(10,080)
Revenues	89,920
Cost of sales	(22,000)
Gross profit	$ 67,920

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

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: [27]		
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

[27] 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.

Sales value	$ 9,352

Computation of Buyer's Cumulative Payments

Down payment	$1,000
Loan origination fee	150
Document preparation fee	125
Buyer's cumulative payments	$1,275

Proof of buyer's cumulative payments

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 cumulative payments	$1,275

Adequacy of Buyer's Cumulative Payments

The seller first considers whether the buyer's cumulative payments need to be allocated between the interval and the incentives. In this case, the cumulative payments do *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 value of the incentives ($387) plus interest (see paragraph 39). Accordingly, the entire cumulative payments of $1,275 are applied to the interval and exceed 10% of sales value ($935).

If the buyer did not need to make any monthly payments to receive the incentives, then the cumulative payments would be allocated $387 to the incentives and $888 to the interval. $888 is less than 10% of sales value. In this situation, the buyer's cumulative payments would not reach $935 until the seller collected $47 of principal on the note, which would occur when the seller collects the first monthly installment.

Note that, consistent with FASB Statement No. 91, the computation of sales value and buyer's cumulative payments 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%, 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.	Revenues 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 payment of incentives

Example 2

Assumptions

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

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: [28]	
Exchange company fee	(105)
Owners association assessments	(287)
Additions:	
Document preparation fee	125
Sales value	\$ 9,733

Computation of Buyer's Cumulative Payments

Down payment	\$1,000
Loan origination fee	150
Document preparation fee	125
Buyer's cumulative payments	\$1,275

Proof of buyer's cumulative payments

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 cumulative payments	\$1,275

[28] 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 Cumulative Payments

The seller first considers whether the buyer's cumulative payments need to be allocated between the interval and the incentives. In this case, the cumulative payments do *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 value of the incentives (\$392) plus interest (see paragraph 39). Accordingly, the entire cumulative payments of \$1,275 are applied to the interval and exceed 10% of sales value (\$973).

If the buyer did not need to make any monthly payments to receive the incentives, then the cumulative payments would be allocated \$392 to the incentives and \$883 to the interval. \$883 is less than 10% of sales value. In this situation, the buyer's cumulative payments would not reach \$973 until the seller collected \$90 of principal on the note, which would occur when the seller collects the second monthly installment.

Note that, consistent with FASB Statement No. 91, the computation of sales value and buyer's cumulative payments 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%, 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: [29]	
Exchange company fee	(105)
Owners association assessments	(287)
Sales value	$ 9,608

Computation of Buyer's Cumulative Payments

Down payment	$1,000
Loan origination fee	150
Buyer's cumulative payments	$1,150

Proof of buyer's cumulative payments

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 cumulative payments	$1,150	

Adequacy of Buyer's Cumulative Payments

[29] 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.

The seller first considers whether the buyer's cumulative payments need to be allocated between the interval and the incentives. In this case, the cumulative payments do *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 value of the incentives ($392) plus interest (see paragraph 39). Accordingly, the entire cumulative payments of $1,150 are applied to the interval and exceed 10% of sales value ($961).

If the buyer did not need to make any monthly payments to receive the incentives, then the cumulative payments would be allocated $392 to the incentives and $758 to the interval. $758 is less than 10% of sales value. In this situation, the buyer's cumulative payments would not reach $961 until the seller collected $203 of principal on the note, which would occur when the seller collects the third monthly installment.

Note that, consistent with FASB Statement No. 91, the computation of sales value and buyer's cumulative payments 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%, 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%.

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: [30]	
Exchange company fee	(105)
Owners association assessments	(287)
Additions:	
Document preparation fee	125
Sales value	$ 9,733

Computation of Buyer's Cumulative Payments

Down payment	$1,000
Document preparation fee	125
Buyer's cumulative payments	$1,125

Proof of buyer's cumulative payments

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 cumulative payments	$1,125	

[30] 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 Cumulative Payments

The seller first considers whether the buyer's cumulative payments need to be allocated between the interval and the incentives. In this case, the cumulative payments do *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 value of the incentives ($392) plus interest (see paragraph 39). Accordingly, the entire cumulative payments of $1,125 are applied to the interval and exceed 10% of sales value ($973).

If the buyer did not need to make any monthly payments to receive the incentives, then the cumulative payments would be allocated $392 to the incentives and $733 to the interval. $733 is less than 10% of sales value. In this situation, the buyer's cumulative payments would not reach $973 until the seller collected $240 of principal on the note, which would occur when the seller collects the fourth monthly installment.

GLOSSARY

Adequate collection experience – Collection experience for the project in which the sale is made or for the seller's prior similar time-sharing projects indicates that at least 85 percent of the notes receivable balances will be collected. The collection experience with the seller's prior projects may be applied to a new project if the prior projects:

1. Had predominantly the same characteristics (kind of time-sharing arrangements, clientele, credit standards, contract terms, sales methods, comparable economic conditions)[31] as the new project; and
2. Had a sufficiently long collection period to indicate the percentage of current sales of the new project that will be collected, and employed methods of servicing the receivables that are no more effective than the methods employed for the new project.

Collection of notes receivable includes only (1) payments made by the buyer under its original contract and (2) transfers to independent third parties (including securitizations) of receivables that qualify as sales under the applicable guidance for sales of receivables.

Affinity program - See *vacation club*.

Amenities – Examples of amenities include golf courses, utility plants, clubhouses, swimming pools, tennis courts, indoor recreational facilities, and parking facilities. See also *planned amenities*, *promised amenities*.

[31] Examples of sales methods include telephone sales, broker sales, and site-visitation sales.

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

Buyer's cumulative payments **–** 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.

Cash-received method **–** A method of recognizing revenue for time-sharing transactions under which principal payments are treated as revenue when collected and cost of sales is recognized as a percentage of revenue recognized.

Combined method **–** A method of recognizing revenue for time-sharing transactions that is a combination of the cash-received method and the percentage-of-completion method.

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

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 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 increase in 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 decrease in value of 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.[32] See Appendix B, "Continuing Involvement," of this SOP.

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.

Credit loss – A situation in which, as a result of credit concerns, (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 that the seller will not collect all contractual payments. Any sale that, as a result of credit concerns, is canceled or modified subsequent to being recorded as a sale is considered a credit loss.

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

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

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 customer 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 customer 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).

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.

Homeowners association (HOA) – See *owners association*.

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.

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*, *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 its original contractual payment obligations.

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).

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*, *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*, *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.

Refund period – The period of time after the time-sharing contract has been executed during which the buyer may cancel the contract and be entitled to the refund of all consideration paid. That period should be the longest period of those required by local law[33] (that is, the rescission period), established by the seller's policy, or specified in the contract.[34]

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 monies paid the seller.

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

[33] The buyer may be able to require a refund if, for example, a minimum status of completion of the project is required by state law and that status has not been attained.
[34] In certain states, any subsequent change in the offering documents requires the seller to offer rescission rights to prior purchasers of time-sharing intervals, and those changes may occur long

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

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after the initial purchase. This is not considered to be an open rescission period because the change in offering documents is under the seller's control (rather than as an option of the buyer).

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.

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 (RTU) arrangements such as **tenancy-for-years** arrangements, and arrangements involving SPEs.

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.

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*.