

AN ALERT FROM THE BDO NATIONAL ASSURANCE PRACTICE

BDO FLASH REPORT

FASB



► SUBJECT

FASB ISSUES ASU ON RECLASSIFICATION OF RESIDENTIAL REAL ESTATE COLLATERALIZED CONSUMER MORTGAGE LOANS UPON FORECLOSURE

► SUMMARY

On January 17, 2014, the FASB issued ASU 2014-04.¹ It clarifies that a creditor is considered to have physical possession of residential real estate that is collateral for a residential mortgage loan when it obtains legal title to the collateral or a deed in lieu of foreclosure or similar legal agreement is completed. Consequently, it should reclassify the loan to other real estate owned at that time. The new guidance is intended to resolve the diversity in current practice as to when a creditor should reclassify a loan to real estate on the balance sheet. The ASU is available [here](#).

► SCOPE, EFFECTIVE DATE AND TRANSITION

ASU 2014-04 applies to all creditors who obtain physical possession resulting from an in substance repossession or foreclosure of residential real estate property collateralizing a consumer mortgage loan in satisfaction of a receivable. The ASU does not apply to commercial real estate loans, as the foreclosure processes and applicable laws for those assets are significantly different from residential real estate.

The ASU is effective for public business entities for annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For all other entities, the amendments in this Update are effective for annual periods

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¹ *Reclassification of Residential Real Estate Collateralized Consumer Mortgage Loans upon Foreclosure (a consensus of the FASB Emerging Issues Task Force)*

beginning after December 15, 2014, and interim periods within annual periods beginning after December 15, 2015. Early adoption is permitted.

An entity has the option to adopt the amendments in the ASU using either a modified retrospective transition method or a prospective transition method. Upon adoption, the modified retrospective transition method will result in a cumulative-effect adjustment to residential consumer mortgage loans and foreclosed residential real estate properties existing as of the beginning of the annual period. The measurement of assets that are reclassified as a result of applying this method depends upon whether they are reclassified from loans to real estate or vice versa. Assets reclassified from real estate to loans will be measured at the carrying value of the real estate upon adoption. Assets reclassified from loans to real estate will be based on the lower of the net amount of the loan or the real estate's fair value less costs to sell at the time of adoption.

▶ MAIN PROVISIONS

U.S. GAAP requires a creditor to reclassify a collateralized mortgage loan such that the loan is derecognized and the collateral asset recognized when it determines that there has been in substance repossession or foreclosure by the creditor, i.e., the creditor has taken physical possession of the debtor's assets regardless of whether formal foreclosure proceedings take place. However, the terms "in substance a repossession or foreclosure" and "physical possession" are not currently defined.

The objective of ASU 2014-04 is to reduce differing interpretations of those terms by clarifying that a creditor is considered to have received physical possession of residential real estate property collateralizing a consumer mortgage loan only upon either of the following:

- a. The creditor obtains legal title to the residential real estate property upon completion of a foreclosure. A creditor may obtain legal title to the residential real estate property even if the borrower has redemption rights that provide the borrower with a legal right for a period of time after a foreclosure to reclaim the real estate property by paying certain amounts specified by law.
- b. The borrower conveys all interest in the residential real estate property to the creditor to satisfy the loan through completion of a deed in lieu of foreclosure or through a similar legal agreement. The deed in lieu of foreclosure or similar legal agreement is completed when agreed terms and conditions have been satisfied by both the borrower and the creditor.

The ASU also establishes new interim and annual disclosure requirements related to the state of foreclosure proceedings. Entities must disclose the carrying amount of foreclosed residential real estate properties held at period end as a result of obtaining physical possession of the properties, as well as the recorded investment of consumer mortgage loans secured by residential real estate properties for which foreclosure proceedings are in process.

▶ ON THE HORIZON

On the same day, the FASB also released an exposure draft for a closely related issue. Under the proposal, a reporting entity would derecognize a residential mortgage loan and recognize a separate receivable (distinct from loans) upon foreclosure when two conditions are met: the loan has a government guarantee, such as those issued by the Federal Housing Administration, that is not separable from the loan and the lender has both the intent and ability to recover the full unpaid principal balance through the guarantee. The separate receivable would be measured as the current amount of the loan balance expected to be recovered under the guarantee. The exposure draft is available [here](#) and is open for public comment through April 30, 2014.

Material discussed in this report is meant to provide general information and should not be acted on without professional advice tailored to your firm's individual needs.