

workpapers from the loan loss allowance review function. Additional documentation often includes the summary findings of the independent reviewer. The staff normally would expect that, if the methodology is changed based upon the findings of the validation process, documentation that describes and supports the changes would be maintained.<sup>2</sup>

#### Topic 7: Real Estate Companies

##### A. Deleted by SAB 103

##### B. Deleted by SAB 103

##### C. Schedules of Real Estate and Accumulated Depreciation, and of Mortgage Loans on Real Estate

**Facts:** Whenever investments in real estate or mortgage loans on real estate are significant, the schedules of such items (see Rules 12-28 and 12-29 of Regulation S-X) are required in a prospectus.

**Question:** Is such information also required in annual reports to shareholders?

**Interpretive Response:** Although Rules 14a-3 and 14c-3 permit the omission of financial statement schedules from annual reports to shareholders, the staff is of the view that the information required by these schedules is of such significance within the real estate industry that the information should be included in the financial statements in the annual report to shareholders.

##### D. Income Before Depreciation

**Facts:** Occasionally an income statement format will contain a subtitle or caption titled "Income before depreciation and depletion."

**Question:** Is this caption appropriate?

**Interpretive Response:** The staff objects to this presentation because in the staff's view the presentation may suggest to the reader that the amount so captioned represents cash flow for the period, which is rarely the case (see ASR 142).

#### Topic 8: Retail Companies

##### A. Sales of Leased or Licensed Departments

**Facts:** At times, department stores and other retailers have included the sales of leased or licensed departments in the amount reported as "total revenues."

**Question:** Does the staff have any objection to this practice?

**Interpretive Response:** In November 1975 the staff issued SAB 1 that addressed this issue. In that SAB the staff did not object to retailers presenting sales of leased or licensed departments in the amount reported as "total revenues" because of industry practice. Subsequently, in November 1976 the FASB issued Statement 13. In June 1995, the AICPA staff amended its Technical Practice Aid (TPA) section 5100.16 based upon an interpretation of Statement 13 that leases of departments within a retail establishment are leases of tangible assets within the scope of Statement 13.<sup>1</sup> Consistent with the interpretation in TPA section 5100.16, the staff believes that Statement 13 requires department stores and other retailers that lease or license store space to account for rental income from leased departments in accordance with Statement 13. Accordingly, it would be inappropriate for a department store or other retailer to include in its revenue the sales of the leased or licensed departments. Rather, the department store or other retailer should include the rental income as part of its gross revenue. The staff would not object to disclosure in the footnotes to the financial statements of the amount of the lessee's sales from leased departments. If the arrangement is not a lease but rather a service arrangement that provides for payment of a fee or commission, the retailer should recognize the fee or commission as revenue when earned. If the retailer assumes the risk of bad debts associated with the lessee's merchandise sales, the

retailer generally should present bad debt expense in accordance with Rule 5-03(b)(5) of Regulation S-X.

##### B. Finance Charges

**Facts:** Department stores and other retailers impose finance charges on credit sales.

**Question:** How should such charges be disclosed?

**Interpretive Response:** As a minimum, the staff requests that the amount of gross revenue from such charges be stated in a footnote and that the income statement classification which includes such revenue be identified. The following are examples of acceptable disclosure:

##### Example 1

###### Consumer Credit Operations:

The results of the Consumer Credit Operations which are included in the Statement of Earnings as a separate line item are as follows for the fiscal year ended January 31, 20x0:

Service charges .....	\$167,000,000
Operating expenses	
Interest .....	60,000,000
Payroll .....	35,000,000
Provision for uncollected accounts .....	29,000,000
All other credit and collection expenses .....	32,000,000
Provision for Federal income taxes .....	5,000,000
Total operating expenses .....	161,000,000
Consumer credit operations earnings .....	6,000,000

##### Example 2

Service charges on retail credit accounts are netted against selling, general and administrative expense. The cost of administering retail credit program continued to exceed service charges on customer receivables as follows:

(in millions)	20x2	20x1	Percent increase (decrease)
Costs:			
Regional office operations .....	\$45	\$42	9
Interest .....	51	44	13
Provision for doubtful accounts .....	21	15	34
Total .....	\$117	\$102	15
Less service charge income .....	96	79	22
Net cost of credit .....	\$21	\$23	(10)

<sup>2</sup> See paragraph 7.39 of the Audit Guide.

<sup>1</sup> Statement 13, paragraph 1 defines a lease as "the right to use property, plant, or equipment (land

or depreciable assets or both) usually for a stated period of time."