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## LIABILITY ACCOUNTS

Every liability account should be supported by subsidiary ledgers for each payable item in the accounts. These subsidiary ledgers should reflect the initial credit to the account, date established, periodic debits and the remaining balance of each item in the particular General Ledger control accounts. These subsidiary ledgers need to be totaled and balanced to the respective General Ledger control accounts each month. For example, assume that "Accrued Expenses" has a month-end balance of \$4,300 due to the accrual of salary expense not yet paid and employee benefits not yet paid. The subsidiary ledger balance for "Accrued Salaries" totals \$2,600 and the subsidiary ledger for "Accrued Employee Benefits" (including sick leave, annual leave, etc.) total \$1,700. These subsidiary ledgers, when totaled, balance to the General Ledger control for "Accrued Expenses".

## BORROWED FUNDS

### NOTES PAYABLE

#### Notes Payable-Other

This account reflects the liability of the credit union for funds borrowed. Such borrowings must be in accordance with the Federal Credit Union Act.

#### *Entries in the Journal and Cash Record*

This account is credited as a "Miscellaneous-Credit" with the amount of notes payable which have been executed and delivered to creditors, including notes to other credit unions. The account is debited as a "Miscellaneous-Debit" when the liability is wholly or partially liquidated.

#### *Posting to the General Ledger*

The debit and credit items to this account entered as "Miscellaneous" in the Journal and Cash Record are posted individually to the General Ledger. Each note and any payments thereon should be specifically identified in the "Explanatory Remarks" column.

#### *Subsidiary of General Ledger Account*

If the credit union borrows funds from two or more sources, it should maintain subsidiary records that clearly identify transactions for each Note Payable. If subsidiary records are maintained, it will not be necessary to complete the "Explanatory Remarks" column of the General Ledger account.

#### *Illustrative Entries*

a) When the credit union executes and delivers a note payable to others:

Dr.-Cash	\$3,000	
Cr.-Notes Payable-Other		\$3,000

b) To record principal and interest payments made to liquidate notes payable:

Dr.-Notes Payable-Other	\$1,000	
Dr.-Interest on Borrowed Money	30	
Cr.-Cash		\$1,030

c) When the credit union borrows money on its note and interest is deducted in advance by the creditor (1-year note at 10 percent):

Dr.-Cash	\$900	
Dr.- Interest on Borrowed Money	100	
Cr.- Notes Payable-Other		\$1,000

### ***Detailed Transactions***

Credit:

a) With principal amounts of notes payable issued.

Debit:

a) With principal repayments made to liquidate notes payable.

## **CERTIFICATES OF INDEBTEDNESS**

### **PROMISSORY NOTES**

Some credit unions borrow money from members or nonmembers and issue promissory notes, formerly called certificates of indebtedness or a similar name. Issuance of promissory notes is governed by Section 701.38 of the NCUA Rules and Regulations. The offering of promissory notes will necessitate the maintenance of a subsidiary ledger. If the note provides for payment of interest

less frequently than the credit union's accounting period, consideration should be given to accruing the interest not less frequently than the end of each accounting period so that the cost of the borrowed money can be allocated to the periods during which the expense is incurred. The accruals should be recorded as "Accrued Interest Payable". Among the items to be considered for inclusion on the note are:

- Certificate number, pre-numbered for control purposes.
- Date of issue.
- Credit union name and location, and name and address of lender.
- Amount of the certificate or space to record the amount.
- Interest rate and method and time of payment of interest. Also, whether there would be any penalty for early redemption and whether interest will continue to accrue after maturity.
- Maturity date. Conditions for early redemption, including but not limited to where and how it may be redeemed.
- Provisions for signature of the treasurer and countersignature of the president.

### ***Illustrative Entries***

a) When the credit union executes and delivers a promissory note payable to others:

Dr.-Cash	\$25,000	
Cr.-Notes Payable- Promissory Note Payable		\$25,000

b) To record principal and interest payments made to liquidate a promissory note payable:

Dr.-Notes Payable- Promissory Note Payable	\$400	
Dr.-Interest on Borrowed Money	84	
Cr.-Cash		\$484

### ***Detailed Transactions***

Credit:

a) With principal amounts of promissory notes payable issued.

Debit:

a) With principal repayments made to liquidate promissory notes payable.

### ***MORTGAGES PAYABLE***

#### **Mortgage Notes Payable**

This account reflects the unpaid principal balance of mortgage loans owed by the credit union and secured by real estate owned by the credit union.

Upon acquisition of real estate, the amount of any mortgage loan should be recorded in this account. As periodic payments are made, this account should be debited for the principal amounts paid.

#### ***Entries in the Journal and Cash Record***

All entries affecting this account should be entered as "Miscellaneous" in the Journal and Cash Record.

#### ***Illustrative Entries***

a) When real estate is acquired subject to a mortgage loan. Assume the purchase of real estate for \$60,000, with land value at \$15,000, cash paid of \$20,000, and mortgage note payable of \$40,000:

Dr.-Land	\$15,000	
Dr.-Building	45,000	
Cr.-Cash		\$20,000
Cr.-Mortgage Notes Payable		40,000

b) When monthly payments are made in settlement of each mortgage installment:

Dr.-Interest on Borrowed Money	\$275.00	
Dr.-Mortgage Note Payable		83.33
Cr.-Cash		\$358.33

---

### ***Detailed Transactions***

Credit:

a) With principal amount of mortgage notes payable when the liability is incurred.

Debit:

a) With amounts of principal payments to reduce (liquidate) the liability recorded in this account.

### ***OBLIGATIONS UNDER CAPITAL LEASES***

This account is used to record the liability that arises from a lease that is classified as a capital lease. In general, a lease that transfers substantially all the benefits and risks inherent in the ownership of property qualifies as a capital lease. Such leases should be accounted for by the lessee as the acquisition of an asset and the incurrence of a liability. For additional guidance and accounting procedures for "Capital Leases", consult an independent accountant.

### ***FEDERAL FUNDS PAYABLE***

#### **Federal Funds Purchased**

This account is used to record borrowed Federal Funds. Federal funds purchased generally consist of 1-day loans that are in the form of balances at (or checks drawn on) Federal Reserve banks. They are loans of superior money or bank reserves, as compared to the ordinary money or deposits at commercial banks. A credit union's management must be willing, however, to meet the interest rates determined each day by the Federal Funds market.

Total borrowings must not exceed 50 percent of the federal credit union's paid-in and unimpaired capital (Section 107(9) of the Federal Credit Union Act).

#### ***Entries in the Journal and Cash Record***

This account is credited as "Miscellaneous-Credit" with the amount of notes payable which have been executed and delivered to creditors, including notes to other credit unions. The account is debited in as "Miscellaneous-Debit" when the liability is wholly or partially liquidated.

**Posting to the General Ledger**

The debit and credit items to this account entered as "Miscellaneous" in the Journal and Cash Record are posted individually to the General Ledger. Each borrowing and any payments thereon should be specifically identified in the "Explanatory Remarks".

**Illustrative Entries**

a) To record borrowed Fed Funds:

Dr.-Cash	\$50,000	
Cr.-Fed Funds Payable		\$50,000

b) To record the repayment of borrowed Fed Funds and one day's interest @ 10%:

Dr.-Fed Funds Payable	\$50,000.00	
Dr.-Other Interest on Borrowed Money		13.70
Cr.-Cash		\$50,013.70

**Detailed Transactions**

Credit:

a) With principal amounts of notes payable issued.

Debit:

a) With principal repayments made to liquidate notes payable.

**LETTERS OF CREDIT**

Letters of credit (often referred to as "standby credits") are versatile instruments commonly used

as a type of guarantee. They are often used in lieu of surety-ship contracts and arrangements that call for some guarantee of performance or payment. Further discussion of this topic is outside the scope of this manual. Credit unions involved in issuing letters of credit should seek the guidance of an independent accountant.

**REVERSE REPURCHASE AGREEMENTS**

Reverse repurchase agreements are agreements to sell and repurchase identical securities within a specified time at a specified price. This agreement represents an uninsured borrowing. Refer to the "Investments" section of this manual for further explanation and illustrative entries.

**ACCRUED INTEREST PAYABLE**

Accrued interest payable is often a significant liability in the financial statements of credit unions unless interest is paid on the financial statement date. Federal law and some state statutes, prohibit declaring interest until the end of the dividend period. A liability for interest earned by the share account holders should be recognized at each financial statement date.

**Dividends Payable**

Under Article XII, Dividends, of the standard Federal Credit Union Bylaws, the board of directors is authorized to establish dividend periods and declare dividends permitted by the Federal Credit Union Act, as amended. The dividend periods must be established so that the last dividend period in any calendar year ends on December 31, unless the cost of dividends is accrued by debiting "Dividends" and crediting "Accrued Dividends Payable". Dividends may be declared by the board for an established dividend period, from Earnings available after provision for reserves required by the Act and regulations, and after eliminating any existing deficit in Undivided Earnings. Dividends may be declared only during the last month of the dividend period or the first month following the close of the period. However, if the dividend period is monthly, dividends may be declared during the month. If the dividend period is more



frequent than monthly, the board may declare the dividend during the previous month.

All dividend declarations shall include the establishment of a date on which such declared dividends will be distributed or posted to the accounts of the members.

Under the requirement that dividends be shown as an element of expense in Statements of Income, it is most important that dividends be recorded as current charges of the fiscal period to which they apply. Thus, when dividends are declared by the board during the first month following the close of the dividend period, they should be recorded as of the close of the applicable dividend period by a debit to "Dividends" and a credit to this account "Dividends Payable". Also, of course, dividends declared in the last month of the dividend period should be recorded in the same manner. The dividends will thus be shown on the Statement of Income prepared for the dividend period to which they apply.

When the dividends liability credited to this account is liquidated, this account should be debited and the offsetting credit should be to "Cash" or to the share accounts.

This account should be used only at the end of dividend periods to reflect the actual or estimated amount of a dividend which is due and payable to the members. Credit unions which accrue dividend expenses on a more frequent basis than the actual dividend period should record the liability in "Accrued Dividends Payable". For example, a credit union which declares and pays quarterly dividends but accrues dividend expense monthly would record the liability in account "Accrued Dividends Payable" in between actual dividend periods. On financial statements for those months at the end of each dividend period (March, June, September and December) the liability should be transferred from account "Accrued Dividends Payable" to this account (Dividends Payable) in those cases where the dividend is not credited to members' accounts until the month following the end of the dividend period. Where the dividend is credited to members' accounts on the last day of the dividend period, the entry should be a debit to account "Accrued Dividends Payable" and a credit

to "Shares" and the financial report for the end of the quarter should have no balance in either account "Dividends Payable" or account "Accrued Dividends Payable".

### *Entries in the Journal and Cash Record*

All entries affecting these accounts should be recorded as "Miscellaneous" in the Journal and Cash Record.

### *Illustrative Entries*

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a) To record the estimated dividend liability for the months of July, August and September when the credit union is on a quarterly dividend period and dividends are credited to members' accounts on the first day of the next dividend period, assuming one class of shares. The following entries would be made at the end of each month:

Dr.-Dividend Expense	\$1,000	
Cr.-Accrued Dividends Payable		\$1,000

The balance of account "Accrued Dividends Payable" would then be \$3,000 at the end of September.

b) When the dividend is distributed to members' accounts on September 30, and the actual amount of the dividend is \$2,900:

Dr.-Accrued Dividends Payable	\$3,000	
Cr.-Shares		\$2,900
Cr.-Dividend Expense		100

c) Same example as (a.) above, except that dividends are credited to members' accounts on the first day following the end of the dividend period:

Entries for each month would be the same as (a.) above.

d) To record the dividend payable as of September 30 for example (c.) above:

Dr.-Accrued Dividends Payable	\$3,000	
-------------------------------	---------	--

Dr.-Dividends Payable                      \$3,000

e) When dividend for (c.) and (d.) above is credited to members' accounts on October 1, and the actual dividend amounts to \$2,900:

Dr.-Dividends Payable	\$3,000
Cr.-Shares	\$2,900
Cr.-Dividend Expense	100

---

### ***Detailed Transactions***

Credit:

- a) To record the amount of dividends either declared or estimated during an accounting period.
- b) With the excess of actual dividends, if any, over the amount previously recorded.

Debit:

- a) To liquidate the amount of dividend liability upon distribution to the shareholder.
- b) With the amount or difference, if any, between the accrued amount and the actual amount of dividends payable.

### ***Dividend Calculation Methods***

The dividend calculation method is the method by which dividends are determined. The NCUA R&Rs Part 707, *Truth In Savings*, allows two dividend calculation methods; 1) the daily balance method, and 2) the average daily balance method. Section 707.2(d) and (h), *Definitions*, defines both methods.

Examples of each method are provided using account activity for a month based on the "end of day" balance in the account. The dividend calculation must be based on a point in time for determining the balance in the account; such as "beginning of day balance", "end of day balance", and "close of business day balance".

Account Activity – Based on End of Day Balance

			<b>BALANCE</b>
Balance:	December 31, 20X4		\$1,000
Deposit:	January 1, 20X5	200	1,200
Withdrawal:	January 2, 20X5	100	1,100
Withdrawal:	January 10, 20X5	400	700
Deposit:	January 15, 20X5	200	900
Withdrawal:	January 16, 20X5	1,000	-100
Deposit:	January 18, 20X5	300	200
Deposit:	January 21, 20X5	700	900
Withdrawal:	January 31, 20X5	100	800

---

EXAMPLE 1

The daily balance method is the application of a daily dividend rate to the full amount of principal in the account each day. For the days the account is overdrawn, a zero balance should be used to calculate dividends.

Assume a dividend rate of 5.00%, a daily rate of 1/365, a monthly compounding period, and a monthly crediting period. The daily dividend rate would be .00013698630 (.05\*(1/365)). (See “Daily Rates” for the daily dividend rate formula). Dividends would be calculated as follows:

BALANCE x RATE x NUMBER OF DAYS	1	8	5	1	2	3	10	1	31	DIVIDEND AMOUNT
1/1/X5	\$1,200 x .00013698630 x									\$0.164383562
1/2/X5 to 1/9/X5	1,100 x .00013698630 x									1.205479452
1/10/X5 to 1/14/X5	700 x .00013698630 x									0.479452055
1/15/X5	900 x .00013698630 x									0.123287671
1/16/X5 to 1/17/X5	0 x .00013698630 x									0.000000000
1/18/X5 to 1/20/X5	200 x .00013698630 x									0.082191781
1/21/X5 to 1/30/X5	900 x .00013698630 x									1.232876712
1/31/X5	800 x .00013698630 x									0.109589041
<b>TOTAL</b>										<b>3.397260274</b>

For the month of January, 20X5, using the daily balance method to calculate dividends, a dividend amount of \$3.40 would be credited to the member’s account. If the compounding period was daily, there would be 31 (the number of days in the compounding period) separate dividend calculations performed. The first day’s accrued but uncredited dividends of \$0.164383562 would be considered in the second day’s balance of \$1,100 (and every day’s balance

thereafter) to determine the second day’s dividend (and every day’s dividend thereafter).

EXAMPLE 2:

The average daily balance method is the application of a periodic dividend rate to the average daily balance in the account for the period. The average daily balance is determined by adding the full amount of principal in the account for each day of

the period and dividing that figure by the number of days in the period.

Assume a dividend rate of 5.00%, a daily rate of 1/365, a monthly compounding period, and a monthly crediting period. The

periodic dividend rate would be .00424657534  $((.05*(1/365))*31)$ . (See “Daily Rates” for the periodic dividend rate formula). Dividends would be calculated as follows:

BALANCE x NUMBER OF DAYS	ACCUMULATED BALANCE	
1/1/X5	\$1,200 x	1 \$1,200
1/2/X5 to 1/9/X5	1,100 x	8 8,800
1/10/X5 to 1/14/X5	700 x	5 3,500
1/15/X5	900 x	1 900
1/16/X5 to 1/17/X5	0 x	2 0
1/18/X5 to 1/20/X5	200 x	3 600
1/21/X5 to 1/30/X5	900 x	10 9,000
1/31/X5	800 x	1 800
TOTAL		<u>24,800</u>

Dividing the accumulated “end of day” balances of \$24,800 by 31 (the total number of days in the divi-

dend period), the average daily balance is \$800.00000.

The average daily balance should be rounded to five or more decimals. As an example, an average daily balance of \$800.12345678 would be rounded to no less than \$800.12346. The fifth decimal place should be rounded up if the sixth decimal place is five or more. The sixth decimal place of \$800.12345678 is a “6”, thereby the fifth decimal place would be rounded up from “5” to “6”.

The periodic dividend rate times the average daily balance results in a dividend amount of \$4.497260274. For the month of January, 20X5, using the average daily balance method to calculate dividends, a dividend amount of \$3.40 would be credited to the member’s account.

If the compounding period was daily, there would be 31 (the number of days in the compounding period) separate dividend calculations performed. However, a daily dividend rate instead of the periodic dividend rate would be used to calculate each

day’s dividend. The first day’s accrued but uncredited dividends of \$0.109589041  $((.05*(1/365))*$800)$  would be considered in the second day’s average daily balance of \$800 (and every day’s balance thereafter) to determine the second day’s dividend (and every day’s dividend thereafter). Although daily compounding is not commonly used when the average daily balance dividend calculation method is used, it is permissible. The NCUA R&Rs Part 707, *Truth In Savings*, allows any frequency of compounding to be used (regardless of the dividend calculation method used).

***Dividend Periods***

The dividend period is the span of time established by the board of directors at the end of which shares in a member’s account earn dividend credit. In other words, a dividend period is the frequency with which accrued but uncredited dividends are

earned by the member. As an example, assume dividend rates are declared quarterly and the board of directors has established the dividend period as monthly.

A member closing their account during the second month of the quarter would be entitled to the first month's accrued but uncredited dividends but not to the second month's accrued but uncredited dividends. If the board of directors had established the dividend period as quarterly, the member would not be entitled to any accrued but uncredited dividends. Although a dividend period is commonly established at the same frequency with which dividends are credited or at the frequency with which dividend rates are declared by the board of directors, a dividend period may be at any frequency; i.e., daily, weekly, bi-weekly, monthly, semi-monthly, quarterly, semi-annually, annually, etc. The dividend period may be different for each type of share account but each type of share account must have a dividend period.

Dividend periods need not agree with calendar periods. As an example; a monthly dividend period could begin March 15 and end April 14. However, if the last dividend period in any calendar year does not end on December 31, the cost of the dividends accrued but uncredited must be reflected on the financial statements; by debiting "Dividends Expense" and crediting a payable.

### ***Dividend Declaration Dates***

The dividend declaration date is the date that the board of directors declares a dividend for the preceding dividend period. For credit unions with bi-monthly or longer dividend periods (such as quarterly, semiannually, or annually) the dividend rate must be determined: 1) during the last month of the dividend period, or 2) during the first month following the close of the dividend period. If the dividend rate is determined prior to the end of the dividend period (during the last month of the dividend period), the dividend rate is not declared but rather anticipated (projected or prospective) contingent upon current income and available earnings, after required

transfers to statutory reserves. Upon the board of directors determining that current income and available earnings exist after required transfers to statutory reserves, the board of directors should ratify the dividend rate(s) (more than likely the anticipated (projected or prospective) dividend rate(s)). The day the dividend rate is ratified is the dividend declaration date.

If a credit union has established dividend periods which are monthly or more frequently (such as daily or weekly dividend periods) the board of directors may determine the dividend rate: 1) during the preceding month, 2) during the last month of the dividend period, or 3) during the month following the month in which the dividend period(s) ended. Again, if the dividend rate is determined prior to the end of the dividend period (during the preceding month or during the last month of the dividend period), the dividend rate is not declared but rather anticipated (projected or prospective) contingent upon current income and available earnings, after required transfers to statutory reserves. The board of directors must ratify a dividend rate once current income and available earnings, after required transfers to statutory reserves, are determined to exist.

An anticipated (projected or prospective) dividend rate contingent upon current income and available earnings after required transfers to statutory reserves should be disclosed as such and not as the dividend rate for the last dividend declaration date.

If the board of directors does not declare a dividend for certain dividend periods (perhaps because of the lack of sufficient earnings), it may not, at a later date, declare a dividend for the dividend periods missed. Alternatives in this situation might be to establish a lengthier dividend period (by a change-in-terms notice under Section 707.5(a)) in anticipation that sufficient earnings could be generated to pay a dividend for the extended dividend period or to declare an extraordinary

dividend. Extraordinary dividends are most commonly referred to as “bonus dividends”. NCUA R&Rs Part 707.2(m), *Definitions*, defines *extraordinary dividends* as a non-repetitive dividend paid at an irregular time from funds legally available for such distribution.

### ***Compounding Periods***

The compounding period is the frequency that earned dividends are added to the principal in the account on which dividends then accrue. The compounding period can be based on any frequency; i.e., daily (a.k.a. “continuously”), weekly, bi-weekly, monthly, semi-monthly, quarterly, semi-annually, annually, none (“no compounding” or “at maturity”), etc. The compounding period may be different for each type of share account but each type of share account must have a compounding period.

### ***Crediting Periods***

The crediting period is the frequency that earned dividends are posted or paid to the account, or provided to the member by check or transfer to another account. The crediting period can be based on any frequency; i.e., daily, weekly, bi-weekly, monthly, semi-monthly, quarterly, semi-annually, annually, at maturity, etc. The crediting period may be different for each type of share account but each type of share account must have a crediting period. Only declared dividends may be posted to an account, not anticipated (projected or prospective) dividends.

### ***Dividend Distribution Dates***

The dividend distribution date is the date the dividend is made available by credit to the account, or provided to the member by check or transfer to another account. The dividend distribution date for non-term share accounts is usually the last day of or the day following the crediting period. As an example, if the crediting period is monthly, January 31st could be the dividend distribution date (last day of) or February 1st could be the dividend distribution date (the day following). For term share accounts,

the dividend distribution date may be on the anniversary dates (such as the 17th of each month). The dividend distribution date may be different for each type of share account but each type of share account must have a dividend distribution date. Regardless of the dividend distribution date, the date dividends are posted or paid is the date dividends must be available to the members. As an example, a dividend cannot be posted to a member’s account on December 31st if it cannot be withdrawn until January 1st.

### **Daily Rates**

Permissible daily rates for a 365-day year are 1/360 and 1/365. Permissible daily rates for a 366-day year (leap year) are 1/360, 1/365, and 1/366. If a daily rate of 1/366 is used, the account must earn dividends for February 29. The daily rate may be different for each type of share account but each type of share account must have a daily rate. The daily rate is used in the daily dividend rate formula, the periodic rate formula, and the periodic dividend rate formula. Each formula is as follows:

Daily Dividend Rate = Daily Rate x Nominal Rate  
Periodic Rate = Daily Rate x Number of Days in the Compounding Period.

Periodic Dividend Rate = Periodic Rate (Daily Rate = Number of Days in the Compounding Period) x Nominal Rate

The nominal rate is the dividend rate (expressed as a percent) divided by 100 or the dividend rate expressed as a decimal. As an example, the nominal rate is .0525 for a dividend rate of 5.25%.

A credit union should round the daily rate to five or more decimals. A 1/365 daily rate of .002739726 would be rounded to no less than .00274. The fifth decimal place should be rounded up if the sixth decimal place is five or more. The sixth decimal place of .002739726 is a "9", thereby the fifth decimal place would be rounded up from "3" to "4".

### **Dividend Credit Determination Dates (When a Share Purchase Begins Earning Dividend Credit)**

The dividend credit determination date is the date dividends begin to accrue. Section 707.7(c) of the NCUA Rules and Regulations requires dividends to begin accruing no later than the day specified in section 606 of the *Expedited Funds Availability Act* and its implementing *Regulation CC*. Therefore, a credit union could use either the collected balance method or the ledger balance method.

*An illustration of the collected balance method is as follows:* Assume a member makes a \$5,100 non local check deposit on April 7, 20X5. When the collected balance method is used to accrue or pay dividends, the time frames as to when funds are available for withdrawal by the member are different than the time frames for accruing dividends. Based on the availability for withdrawal by the member, the first \$100 must be made available the next day (April 8, 20X5). At least \$4,900 must be made available no later than the fifth business day following the banking day on which funds were deposited (April 12, 20X5). Due to the deposit being over \$5,000 (a large deposit) an extension of up to six business days (April 18, 20X5) may be placed on the remaining \$100. See *Regulation CC, Notice of Exception*, if no longer extensions are allowed by the credit union's policy.

Section 229.14, *Payment of Interest in Regulation CC* requires dividends to begin accruing on dividend-bearing accounts no later than the day on which the credit union receives credit for the funds deposited. It may be difficult for a credit union to track which day it receives credit for specific checks in order to accrue dividends properly on the account to which the check is deposited. Therefore, for the purpose of the dividend-accrual requirement, a credit union may rely on an availability schedule from its correspondent to determine when it receives credit. As an example, if a credit union receives credit on 20 percent of the funds deposited in the credit union by check as of the business day of deposit, 70 percent as of the business day following deposit, and 10 percent on the second business day following deposit, the credit union can apply these percentages to determine the day dividends must begin to accrue on check deposits to all dividend-bearing accounts.

*An illustration of the ledger balance method is as follows:* dividends would begin to accrue on the full \$5,100 the date of deposit (April 7, 20X5). Assume the board of directors established that dividends would be accrued and paid based on a "close of business day" balance, i.e., 3:00 p.m. If the deposit was made after 3:00 p.m., dividends would begin to accrue on the full \$5,100 the day following the date of deposit (April 8, 20X5).

Dividends must begin to accrue on payroll deductions share deposits when the member is entitled to receive the funds. When a credit union receives the detailed distribution of share payments, a member's account must be credited immediately and dividends begin to accrue. If a crediting delay occurs for any reason other than not having the detailed distribution of share payments, the credit union should ensure dividends begin to accrue based on when the member was entitled to receive the funds.

### ***Minimum Balances Associated With Dividends***

A minimum balance can be required before an account earns dividends. The method used to determine the minimum balance to earn dividends must be the same method used to determine the balance on which dividends are calculated. As an example, if the daily balance method is used to determine dividends, then the daily balance method must also be used to determine the minimum balance. An alternative method may be used if it is unequivocally beneficial to the member. As an example, a credit union using the daily balance method to calculate dividends and requiring a \$500 minimum daily balance could choose to pay dividends on the account for those days of the month that did not meet the \$500 minimum daily balance provided the member maintained an average daily balance throughout the month of \$400. Other minimum balance requirements, such as to open an account, to avoid a fee, etc., can be based on any method.

Section 707.7, *Payment of Dividends*, identifies several restrictions regarding minimum balances to earn dividends:

- A credit union cannot require that both a daily minimum balance and an average daily balance be maintained to earn dividends.

- A credit union cannot pay dividends only on the balance portion over the minimum balance. As an example, if the member has \$500 and the required minimum balance is \$200, dividends cannot be paid only on \$300 (the amount over the minimum balance of \$200).
- A credit union cannot require a minimum balance to be maintained for the entire period to earn dividends for that period.

### ***Dividend Reductions and Penalties***

Penalties may be issued by the board of directors according to its prescribed policies. The board of directors may impose a penalty on any share account or term share account for failure of the member to comply with any terms or conditions of the account. One of the most common penalties used is the early withdrawal penalty. An early withdrawal penalty can be assessed when the member withdraws his/her funds from an account prior to the account's maturity. There are no requirements as to the method in which an early withdrawal penalty can be determined. The most commonly used early withdrawal penalties are: 1) the forfeiture of accrued dividends, or 2) a percentage of the amount withdrawn. NCUA R&Rs Part 707, also considers a withdrawal of some funds to trigger a change in the account's dividend rate and APY that is paid, or a change in the compounding or crediting frequency that those terms must be disclosed as early withdrawal penalties.

Early withdrawal penalties are most often associated with term share accounts. Term share accounts are most commonly referred to as "share certificates" or "certificates of deposit". Section 707.2(x), *Definitions*, defines term share accounts as being any share certificate, certificate of deposit, or other account with a maturity of at least seven days in which the member generally does not have the right to make withdrawals for six days after the



account is opened, or the account is subject to an early withdrawal penalty of at least seven days dividends on amounts withdrawn. A term share account could also include a club account; such as Christmas Club Account, Vacation Club Account, Youth Club Account, etc. If the terms of the club account meet the definition of a term share account (even if the account does not have a stated maturity but instead has a disbursement date), the club account must be treated as a term share account. Any early withdrawal penalties must be disclosed as such, and subsequent disclosure requirements would have to be followed.

### ***Dividend Entitlement on Closed Accounts***

NCUA R&Rs Part 707, *Truth In Savings*, permits accrued but uncredited dividends to be forfeited if the account is closed. If this is permitted by the credit union's policy, Section 707.4, *Account Disclosures*, requires the forfeiture of dividends to be disclosed.

Members who close their accounts prior to the dividend distribution date (or the end of the crediting period) are entitled to dividends up until the end of the last dividend period. However, the credit union may delay the payment of these dividends until the scheduled dividend distribution date. The following examples are based on dividend periods which are monthly or more frequently. (See "Dividend Declaration Dates" for determining dividend rates (anticipated (projected or prospective) or declared) based on the length of the dividend period). Example 1 typifies the situation when the dividend rate is anticipated (projected or prospective) during the preceding month and would be ratified by the board of directors at the close of the dividend period contingent upon current income and available earnings, after required transfers to statutory reserves. Example 2 typifies the situation when the dividend rate is declared during the month following the month in which the dividend period ended.

#### **EXAMPLE 1:**

Assume the board of directors credits dividends monthly and the dividend period is semimonthly. The dividend rate for the semi-monthly periods are anticipated

(projected or prospective) during the preceding month. If a member closes his/her account on January 22, 20X5, he/she would be entitled to dividends for 7 days (the days after the last dividend period of January 15, 20X5). On January 22, the amount of dividends due this former member may be paid to him/her, or remain (in the form of a credit union liability) as a dividend payable to a former member. Since the dividend rate is anticipated (projected or prospective) in the preceding month it may, with proper wording in the account disclosures, be posted to the account at the time the account is closed. When the dividend rate is anticipated (projected or prospective) in the preceding month, the credit union's policy should require that written projections be on file to illustrate the existence of current income, undivided earnings, and required transfers to reserves to the end of the month for which the dividend rate is anticipated (projected or prospective). This is necessary to comply with the provision for the required transfers to statutory reserves. In other words, the projected information will support that funds are/will be available to meet the reserve transfer requirement and pay the anticipated (projected or prospective) dividend (that which the board of directors will ratify at the close of the dividend period); closing the books prior to the dividend distribution date will fulfill the "projection" requirement.

#### **EXAMPLE 2:**

Assume the board of directors credits dividends quarterly and the dividend period is monthly. The dividend rate for the monthly periods are declared during the month (on the 5th) following the month in which the dividend period(s) ended. If a member on January 22, 19X5 closes his/her account of \$5,000 with accrued but uncredited dividends of \$15.07, on January 22 the credit union can disburse

the member's principal of \$5,000, but cannot post or disburse the accrued but uncredited dividends of \$15.07 until the board of directors declares on February 5th the dividend rate for the month of January.

No dividend can be paid in excess of available current income and prior earnings without the written approval of the NCUA Board.

### ***Withdrawal of Funds***

Dividends must accrue up to the day funds are withdrawn. As an example, assume dividends are accrued and paid based on the ledger balance method and the "end of day" balance. (See "Dividend Credit Determination Date" for discussion on the ledger balance method). The ending balance of January 1, 20X5 is \$1,000. A withdrawal of \$500 is made on January 5, 20X5, a deposit of \$200 is made on January 7, 20X5, and no other withdrawals or deposits are made for the month. Dividends must be accrued on \$1,000 from January 1, 20X5 to January 4, 20X5 (4 days), on \$500 from January 5, 20X5 to January 6, 20X5 (2 days), and on \$700 from January 7, 20X5 to January 31, 20X5 (25 days).

Instead, assume the member closed the account on January 10, 20X5 and accrued but uncredited dividends are not forfeited. Dividends would accrue the same as above up until January 6, 20X5. From January 7, 20X5 to January 9, 20X5 (3 days) dividends would accrue on \$700. Also, the average daily balance used in the APYE formula would be based only on the number of days the account was open (9 days).

### ***Dividend Accrual***

Whenever a dividend rate on any type of account is specified in advance (whether the dividend rate is as of the last dividend declaration date or an anticipated (projected or prospective) dividend rate

for non-term share accounts, or within the most recent seven calendar days for term share accounts), dividend expense should be accrued monthly or at the end of the shortest dividend period if all dividend periods are longer than monthly. Dividend accruals may be based on either the collected balance method or the ledger balance method. Illustrations of the collected balance method and ledger balance are contained in "Dividend Credit Determination Dates". The balance method used in dividend accruals should be the balance method used in paying dividends. If the collected balance method is used, see "*Dividend Period Length Versus Statement Period Length for the APYE*" for information regarding the average daily balance used in the APYE formula.

### ***Term Share Account Dividend Rate***

A federal credit union may make, in advance, an agreement to pay a specific dividend rate on a term share account. Since a federal credit union cannot honor a dividend rate promised in advance if current income and available earnings are insufficient, it is recommended that officials exercise extreme caution before making an agreement to pay a specific dividend rate. Any agreed upon rate should be evidenced by a signed written contract between the federal credit union and the member.

Agreeing to pay a dividend rate which cannot be met can cause members to lose faith in their credit union as well as civil liability for implied contracts. When credibility is lost, an outflow of shares is almost a certainty. For this reason, it is recommended that agreed upon dividend rates be restricted to term share accounts. Advance agreement for a dividend rate does not eliminate the need for a formal declaration of dividends by the board of directors.

### ***Determining Maximum Dividend Rate***

The maximum dividend rate can be determined by:

- a. Dividing the amount available for dividends by the total shares for all members that are eligible for the dividend amount; then
- b. Multiplying the above result by the number of periods in a year. The number of periods in a year are determined by the number of periods the divided amount is available for, i.e., a month, a quarter, etc.

As an example, assume the amount available for dividends for the period is \$3,280. The total of shares for all members that are eligible for the \$3,280 dividend amount is \$384,000. Dividing \$3,280 by \$384,000 equals .008541667. Multiply .008541667 by 12 (if the period is monthly) and by 4 (if the period is quarterly) to determine the maximum dividend rate. The maximum dividend rate which would be paid for a monthly period is 10.25% annually and for a quarterly period is 3.42%.

### ***Methods of Distribution and Use of Dividend Record for Hand Posted Credit Unions***

*Credit of dividends to the share accounts of the members:* Under this method the amount need not be entered in "Posted to Share Ledger" column of the *Dividend Record* form since a record of the amount has already been entered in the "Amt. of Dividend" column. A check mark is placed in the "Posted to Shares Ledger" column as each share account is posted for the dividend. A check mark or the poster's initials should also be placed in the "Posted to Passbook" column when the amounts are posted to the passbooks of the members. This column should be left blank by those credit unions using statements of account in lieu of passbooks. The last column shows passbooks in which dividends have not been recorded. The date reflecting the posting to the individual account and the passbooks should be the date on which the dividend is payable. This date is established by the board of directors.

*Payment by individual check to each member:* The name of the member is entered in the "Name" column of the *Dividend Record* form and the number of each check issued in the "Number"

column under the "Payment by Check" section. The amount of each check need not be entered unless dividends are paid to some members by check and to others by credit to shares. The return of checks by the bank when paid may be noted in the "Check Mark" column of the Record. If dividends are paid by check to each member, no entries are made in the Individual Share Loan Ledgers and the passbooks or statements of account.

Payment may not be made in cash or by drawing one check for the entire amount and disbursing the amounts due members in cash.

*Payment in part by check and in part by credit to share accounts of the members:* This procedure may be followed, for example, when the credit union desires to avoid writing checks of less than \$1.00 and therefore decides to credit all dividends of less than \$1.00 to the share accounts and to issue individual checks to members for dividends of \$1.00 or more. When this procedure is followed, the member's name is entered in the "Name" column of the *Dividend Record* for each check issued. The check number and the amount of each check are entered in the "Number" and "Amount" columns, respectively. When the credits to shares are posted to the members' accounts in the Individual Share and Loan Ledger as of the date established by the directors, the amounts are checked in the "Check Mark" column.

As indicated for the first method, the "Posted to Passbook" column is either initialed or checked when the members passbook is posted, as of the established date, with the amount of the dividend credited to shares. The total of the "Amount" column in the "Payment by Check" section and the amounts in the "Posted to Shares Ledger" column should agree with the total of the "Amt. of Dividend" column.

### ***Reporting Dividends to Internal Revenue Service***

The required forms to report dividends paid and some bonuses to members on non-term share accounts and term share accounts are available from the Internal Revenue Service or a local supplier. Any questions about the reporting

requirements or procedures should be directed to the local Director of Internal Revenue.

### **Annual Percentage Yield (APY)**

NCUA R&Rs Appendix A, Part I of Part 707, *Truth In Savings*, provides the APY formula that is to be used in account disclosures and for advertising purposes. The APY is based on a hypothetical situation and does not take into consideration fluctuations during the period, such as deposits and withdrawals.

### **Dividend Formulas in Determining Dividends Using the APY Calculation**

There are two simple dividend formulas that can be used to determine dividends on an account. These two formulas should provide the same result as a credit union's automated system. The formulas and examples of dividend calculations are provided to assist in calculating the APY.

#### FORMULA 1:

$$\text{Dividends} = \text{Principal} * \left[ \left( 1 + \frac{\text{Nominal Rate}}{\text{Compounding Period}} \right)^{\text{Compounding Periods in Term}} - 1 \right]$$

- *Nominal rate* is determined by dividing the dividend rate (not expressed as a percent) by 100 or the dividend rate expressed as a decimal.
- *Compounding Period* stands for compounding period. Use the following based on the compounding period: Daily - 360, 365, and 366 in a leap year if dividends will be earned February 29; Weekly - 52; Bi-Weekly - 26; Semi-Monthly - 24; Monthly - 12; Quarterly - 4; Semi-annually - 2; Annually - 1.
- *Compounding Periods in Term* stands for compounding periods in term. If a daily compounding period is used; the term is expressed in the number of days. If a compounding period other than daily is used, the term is expressed as the same

number that was expressed for the compounding period: Weekly - 52; Bi-Weekly - 26; Semi-Monthly - 24; Monthly - 12; Quarterly - 4; Semi-annually - 2; Annually - 1.

- Principal is the amount of funds assumed to have been deposited at the beginning of the account.

#### FORMULA 2:

$$\text{Dividends} = \text{Principal} * \text{Daily Dividend Rate} * \text{Days in Term}$$

- *Principal* is the amount of funds assumed to have been deposited at the beginning of the account.
- *Daily Dividend Rate* is the nominal rate (dividend rate (not expressed as a percent) divided by 100 or the dividend rate expressed as a decimal) times the daily rate of 1/360, 1/365, or 1/366 for a 366 day year (leap years) if the account will earn dividends for February 29th. A daily rate of 1/360 has to be applied to 365 days a year and 366 days a year for leap years.
- *Days in Term* is the number of days in the compounding period.

### **Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation**

The dividend amounts from the examples provided in this section have been used in the APY calculation examples provided in "APY Calculation". The dividend calculation examples are based on a non-term share account and a term share account.

#### EXAMPLE 1 - Using Dividend Calculation

Formula 1:

Assume the account is a non-term share account; a regular share account with no stated maturity. Principal is \$1,000. The credit union compounds

monthly. The dividend rate is 5.00%. The daily rate is 1/365. Placing the numbers in Formula 1 of the dividend calculation, the dividend amount for the year is \$51.16190. (See “APY Calculation for a

*Non-Term Share Account*” for the APY calculation).

$$\text{Dividends} = \text{Principal} * [(1 + \text{Nominal Rate}/\text{Compounding Period})^{(\text{Compounding Periods in Term})} - 1]$$

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 divided by 12	Result:	.004166667
Step 3:	.004166667 plus 1	Result:	1.004166667
Step 4:	1.004166667 raised to the exponent of 12	Result:	1.051161898
Step 5:	1.051161898 minus 1	Result:	.051161898
Step 6:	.051161898 times \$1,000	Result:	\$51.161898
Step 7:	Round \$51.161898	Result:	\$51.16190

(See “Rounding Rules for Dividends Used in the APY Calculation” for rounding rules for the dividend amount).

Formula 2 of the dividend calculation method could also be used for this example. However, to calculate the yearly dividend amount, the dividend amount for each compounding period in a year will have to be calculated. In this example, the number of compounding periods in a year is 12. Therefore, the dividend amount will have to be calculated 12 times. Each dividend amount will need to be added to the principal to arrive at the next month’s principal. If two conditions are met, the APY calculation based on a single compounding period could be used. (See “Short-Cuts to the APY Calculation”, Short-Cut Illustration 2).

EXAMPLE 2 - Using Dividend Calculation Formula 2:

Assume the account is a term share account; a 6 month share certificate for \$1,000. The credit union compounds monthly. The actual number of days in the share certificate is 184 (from March 1, 19X5 to August 31, 20X5). The number of days for any actual sequence of 6 months ranges from 181 to 184. The dividend rate is 5.00%. The daily rate is 1/365. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for the year is \$25.47167. (See “APY Calculation for a Term Share Account” for the APY calculation).

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Dividends = Principal \* Daily Dividend Rate \* Days in Term

Month of March, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,000	Result:	\$4.246575342
Step 5:	Round \$4.246575342	Result:	\$4.24658
Step 6:	\$4.24658 plus \$1,000	Result:	\$1,004.24658

Month of April, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 30	Result:	.004109589
Step 4:	.004109589 times \$1,004.24658	Result:	\$4.127040740
Step 5:	Round \$4.127040740	Result:	\$4.12704
Step 6:	\$4.12704 plus \$1,004.24658	Result:	\$1,008.37362

Month of May, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.00446575 times \$1,008.37362	Result:	\$4.282134551
Step 5:	Round \$4.282134551	Result:	\$4.28213
Step 6:	\$4.28213 plus \$1,008.37362	Result:	\$1,012.65575

Month of June, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 30	Result:	.004109589
Step 4:	.004109589 times \$1,012.65575	Result:	\$4.161598973
Step 5:	Round \$4.161598973	Result:	\$4.16160
Step 6:	\$4.16160 plus \$1,012.65575	Result:	\$1,016.81735

Month of July, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,016.81735	Result:	\$4.317991486
Step 5:	Round \$4.317991486	Result:	\$4.31799
Step 6:	\$4.31799 plus \$1,016.81735	Result:	\$1,021.13534

Month of August, 20X5

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,021.13534	Result:	\$4.336328156
Step 5:	Round \$4.336328156	Result:	\$4.33633
Step 6:	\$4.33633 plus \$1,021.13534	Result:	\$1,025.47167

(See "Rounding Rules for Dividends Used in the APY Calculation: for rounding rules for the dividend amounts).

Another way of calculating dividends on this 6-month share certificate is by assuming each compounding period has an equal number of days, except the last period which has enough days to account for the remaining term of the share certificate. As an example, assume month 1 through month 5 has 30 days (for a total of 150 days) and month 6 has 34 days (the actual number of days of 184 minus 150). If two conditions are met, the APY calculation based on a single compounding period could be used. (See "*Short-Cuts to the APY Calculation*", Short-Cut Illustration 2).

Formula 1 of the dividend calculation method could not be used for this example. Using Formula 1 of the dividend calculation method would result in an erroneous APY since the compounding period for this example is monthly and the term is less than a year. *Formula 1 of the dividend calculation*

*method for term share accounts less than a year can only be used when the compounding period is daily.*

**EXAMPLE 3** - Using Dividend Calculation Formula 2:

Assume the same facts in Example 1 of this section: the account is a regular share account with no stated maturity. Principal is \$1,000. The credit union compounds monthly. The dividend rate is 5.00%. The daily rate is 1/365. The days in the month are 31 days. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for a single month in the year is \$4.24658. (See "*Short-Cuts to the APY Calculation*", Short-Cut Illustration 2, Example 1 for the APY calculation).

---

Dividends = Principal \* Daily Dividend Rate \* Days in Term

Month with 31 days

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,000	Result:	\$4.246575342
Step 5:	Round \$4.246575342	Result:	\$4.24658

#### EXAMPLE 4 - Using Dividend Calculation

Formula 2:

Assume the same facts in Example 2 of this section: a 6 month share certificate for \$1,000. The credit union compounds monthly. The dividend rate is 5.00%. The days in the month are 31 days. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for a single month in the 6-month term share certificate is \$4.24658 (as in Example 3 of this section). (See “*Short-Cuts to the APY Calculation*”, Short-Cut Illustration 2, Example 1 for the APY calculation).

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#### ***Rounding Rules for Dividends Used in the APY Calculation***

A credit union should round dividends to five or more decimals. As an example, yearly dividends earned of \$51.161897920 (5.00% for a 1/365 daily rate on \$1,000, compounded monthly) would be rounded to no less than \$51.16190 in determining the APY calculation. The fifth decimal place should be rounded up if the sixth decimal place is five or more. To illustrate, the sixth decimal place of \$51.161897920 is a “7”, thereby the fourth and fifth decimal place were rounded up from “89” to “90”.

The dividend amount of \$51.16190 would be used in calculating the APY. (See “Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation”, Example 1, and the example in “APY Calculation for a Non-Term Share Account” for the use of this dividend amount).

#### ***APY Formula***

Section 707.2(c), *Definitions*, defines the APY as a percentage rate that reflects the total amount of dividends paid on an account, based on the dividend rate and frequency of compounding for a 365-day period and calculated according to the rules in Appendix A, Part I of Part 707, *Truth In Savings*. The APY formula is as follows:

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

- *Dividends* are the total dollar amount of dividends earned on the Principal for the term of the account.
- *Principal* is the amount of funds assumed to have been deposited at the beginning of the account.
- *Days in Term* are the actual number of days in the term of the account.

#### ***APY Calculation***

The dividend amounts from the examples provided in “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*” have been used in the APY examples provided in this section. APY examples have been provided for a non-term share account, a term share account, a stepped-rate account, a tiered-rate account, and a non-compounding multi-year term share account. Also provided are illustrations and examples of APY short-cuts.



### ***APY Calculation for a Non-Term Share Account***

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#### **EXAMPLE:**

Assume the same facts of Example 1, i.e., the account is a regular share account with no stated

maturity. Principal is \$1,000. The credit union compounds monthly. The dividend rate is 5.00%. Dividend amount for the year is \$51.16190. (See “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*”, Example 1 for the dividend calculation.) Placing the numbers in the APY formula, the APY is 5.12%.

---

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$51.16190 divided by \$1,000	Result:	.05116190
Step 2:	.05116190 plus 1	Result:	1.05116190
Step 3:	1.05116190 raised to the exponent of 365 divided by 365	Result:	1.05116190
Step 4:	1.05116190 minus 1	Result:	.05116190
Step 5:	.05116190 times 100	Result:	5.116190
Step 6:	Round 5.116190	Result:	5.12%

Step 3 may be omitted if the “Days in Term” are 365. In other words, if the term is one year or the account has not stated maturity; such as regular shares, share drafts, etc., step 3 may be omitted. If step 3 is required, the calculating equipment, i.e., calculator, must have an exponent function as illustrated below. (See Rounding and Accuracy Rules for the APY” for rounding rules for APY).

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#### **EXPONENT FUNCTION: $Y^X$**

The APY reflects only dividends and does not include the value of any bonus and it excludes any amounts that are determined by circumstances that may or may not occur. The APY can be calculated using an anticipated (projected or prospective) dividend rate or the dividend rate at the last dividend declaration date. If an APY is based on anticipated (projected or prospective) dividends, this must be disclosed as such in the account disclosures and advertisements.

### ***APY Calculation for a Term Share Account***

The APY for term share accounts may be based on either the actual number of days during the applicable period, or the number of days that would occur for any actual sequence of that many calendar months. However, the same number of

days, “Days in Term”, used to calculate the dividend amount must also be used to calculate the APY.

#### **EXAMPLE:**

Assume the same facts of Example 2, i.e., a 6-month share certificate for \$1,000. The credit union compounds monthly. The actual number of days in the share certificate is 184 (from March 1, 20X5 to August 31, 20X5). The number of days for any actual sequence of 6 months ranges from 181 to 184. The dividend rate is 5.00%. The dividend amount for 6 months on 184 days (actual number of days) is \$25.47167. (See “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*”, Example 3 for the dividend calculation.) Placing the numbers in the APY formula, the APY is 5.12%.

---


$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$25.47267 divided by \$1,000	Result:	..02547167
Step 2:	.02547167 plus 1	Result:	1.02547167
Step 3:	1.02547167 raised to the exponent of 365 divided by 184	Result:	1.051160979
Step 4:	1.051160979 minus 1	Result:	.051160979
Step 5:	.051160979 times 100	Result:	5.1160979
Step 6:	Round 5.1160979	Result:	5.12%

In step 3, 365 is divided by 184 (actual number of days) versus 181, 182, or 183 (the number of days for actual sequence of 6 months) because the dividend amount of \$25.47 is based on 184 days. If the dividend amount was based on 181 days, step 3 would be 365 divided by 181. (See “Rounding and Accuracy Rules for the APY” for rounding rules for the APY).

---

The illustrations above are shown per the definition of the APY; dividends are based on the term of the account. The term for the regular share account, in “*APY Calculation for a Non-Term Share Account*” is 365 days since non-term share accounts are assigned a “term” of 365. The term for the 6-month share certificate, in the example of this section can be 181, 182, 183, or 184 days. However, since both examples were of monthly compounding, the APY results were the same: 5.12%.

### ***Short-Cuts to the APY Calculation***

#### Short-Cut Illustration 1:

A short-cut for calculating the APY without first calculating the dividend amount can be used on accounts with a single dividend rate (no stepped-rate accounts or pure/split-rate tiered-rate accounts) and a 365-day term or no term, i.e., regular share accounts and share draft accounts. This short-cut formula cannot be used in a leap year.

The short-cut is Formula 1 of the dividend calculation method with one difference: “Principal” is replaced by 100 in the formula. (See “*APY Formula*” for Formula 1 of the dividend calculation method).

$$APY = 100 * [(1 + (\text{Comp'ding Periods} / \text{Term})^{(\text{Nominal Rate}/\text{Comp'ding Period})} - 1)]$$

- *Nominal rate* is determined by dividing the dividend rate (not expressed as a percentage) by 100 or the dividend rate expressed as a decimal.
- *Comp'ding Period* stands for a compounding period. Use the following based on the compounding period: Daily - 360 or 365, Weekly - 52, Bi-Weekly - 26, Semi-Monthly - 24, Monthly - 12, Quarterly - 4, Semi-annually - 2, Annually - 1.
- *Comp'ding Periods in Term* stands for compounding periods in term. If a daily compounding period is used, i.e., 360 or 365, the term is expressed in the number of days: 365. If a compounding period other than daily is used, the term is expressed as the same number that was expressed for the compounding period: Weekly - 52, Bi-Weekly - 26, Semi-Monthly - 24, Monthly - 12, Quarterly - 4, Semi-annually - 2, Annually - 1.

Short-Cut Illustration 2:

A short-cut where the dividend amount used in the APY calculation can be based on a single compounding period within the term or year can be used if two conditions are met. The two conditions are: 1) the same dividend rate is applicable to all the periods within the year/step (for non-term share accounts and stepped-rate accounts), or within the term (for term share accounts) (no pure/split-rate tiered-rate accounts), and 2) if a term share account is greater than a year, the compounding period is other than none (no compounding or at maturity).

If different dividend rates exist within a term/step or a year, or the compounding period is none (no compounding or at maturity) for a term share account that is greater than one year the APY calculation must be based on dividends for the full term or year of the account rather than on a single compounding period within the term or year of the account.

This short-cut can be used when the dividend rate is 10.00% or less without an erroneous APY resulting. However, since the higher dividend rates may result in an erroneous APY when this short-cut is used, this short-cut should not be used when the dividend rate is greater than 10.00% (the APY calculation must be based on dividends for the full term or year of the account).

EXAMPLE 1:

Assume the same facts of Example 1, except that the dividend amount is \$4.24658 which is based on a single month in the year. The days in the month are 31 days. (See “*Examples of Dividend Calculations in Determining Dividends Used in the APY Calculation*”, Example 3 for the dividend calculation). Placing the numbers in the formula, the APY is 5.12%.

---

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$4.24658 divided by \$1,000	Result:	.00424658
Step 2:	.00424658 plus 1	Result:	1.00424658
Step 3:	1.00424658 raised to the exponent of 365 divided by 31	Result:	11.05119867
Step 4:	1.051159867 minus 1	Result:	.051159867
Step 5:	.051159867 times 100	Result:	5.1159867
Step 6:	Round 5.1159867	Result:	5.12%

(See “Rounding and Accuracy Rules for the APY” for rounding rules for the APY).

---

EXAMPLE 2:

Assume the same facts of Example 2, except that the dividend amount is \$4.24658 which is based on a single month in the 6-month share certificate. The days in the month are 31 days. Placing the numbers in the APY formula, the APY is 5.12%. The illustration of the APY calculation in Example 1 of this section is the

same illustration that would be used for this example.

***APY Calculation for a Stepped Rate Account***

Section 707.2(w), *Definitions*, defines a stepped-rate account as an account that has two or more dividend rates that take effect in a succeeding period and are known when the account is

opened. For stepped-rate accounts a single composite APY must be disclosed.

EXAMPLE:

Assume the dividend rate for the first month of a 6-month share certificate is 5.00% and the dividend rate for the remaining 5 months is 4.75%. The compounding period is monthly. The principal amount is \$1,000. Since both

conditions of Short-Cut Illustration 2 of “*Short-Cuts to the APY Calculation*” are met, the APY for the two steps can be based on a single compounding period. Placing the numbers in Formula 2 of the dividend calculation, the dividend amount for the first step’s first month of 31 days is \$4.24658 and the dividend amount for the second step’s first month of 28 days is \$3.65931.

Dividends = Principal \* Daily Dividend Rate \* Days in Term

Month with 31 days

Step 1:	5.00 divided by 100	Result:	.05
Step 2:	.05 times 1/365	Result:	.000136986
Step 3:	.000136986 times 31	Result:	.004246575
Step 4:	.004246575 times \$1,000	Result:	\$4.246575342
Step 5:	Round \$4.246575342	Result:	\$4.24658

Month with 28 days

Step 1:	4.75 divided by 100	Result:	.0475
Step 2:	.0475 times 1/365	Result:	.000130137
Step 3:	.000130137 times 28	Result:	.003643836
Step 4:	.003643836 times \$1,004.24658	Result:	\$3.659309456
Step 5:	Round \$3.659309456	Result:	\$3.65931

(See “Rounding Rules for Dividends Used in the APY Calculation” for rounding rules for the dividend amounts).

Placing the numbers in the APY formula, the composite APY is 4.99%.

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$4.24658 + \$3.65931	Result:	\$7.90589
Step 2:	.00790589 + 1	Result:	1.00790589
Step 3:	1.00790589 raised to the exponent of 365 divided by 59	Result:	1.04988522
Step 4:	1.04988522 minus 1	Result:	.04988522
Step 5:	.04988522 times 100	Result:	4.988522
Step 6:	Round to 2 decimal places	Result:	4.99

(See “Rounding and Accuracy Rules for the APY” for rounding rules for the APYs).

### ***APY Calculation for Tiered Rate Account***

Section 707.2(y), *Definitions*, defines a tiered-rate account as an account that has two or more dividend rates that are applicable to specific balances. There are two types of tiered-rate accounts: pure/split-rate and the hybrid/plateau tiered-rate account. Example 1 is based on a pure/split-rate tiered-rate account where the dividend rate is paid only on the portion of the share account balance that falls within each tier. Example 2 is a hybrid/plateau tiered-rate account where a dividend rate is paid based on the entire amount in the account.

#### **EXAMPLE 2: Pure/Split-rate Tiered-rate Account**

Assume the dividend rate for amounts from \$0.1 to \$2,500 is 5.00%, for amounts from \$2,500.01 to \$10,000 is 5.25%, and for amounts from \$10,000.01 and greater is 5.50%. If a member has \$11,000 on deposit; a dividend rate of 5.00% would be applied to \$2,500, a dividend rate of 5.25% would be applied to \$1,000 (\$11,000 minus \$10,000). For pure/split-rate tiered-rate accounts, two APYs must be disclosed for each tier except for the first tier. Therefore a total of five APYs would be disclosed; one APY for the first tier (dividend rate of 5.00%), two APYs for the second tier (dividend rate of 5.25%), and two APYs for the third tier (dividend rate of 5.50%). The two APYs disclosed in the second and third tiers are based on the tier's lower limit (\$2,500.01 for the second tier and \$10,000.01 for the third tier) and the tier's higher limit (\$10,000 for the second tier and \$100,000 for the third tier). If the board of directors has not determined a maximum amount for the third tier's higher limit, it is recommended that the insured limit of \$100,000 be used.

The APY for the first tier would be based on a principal amount of \$2,500 at 5.00%. The APYs for the second and third tiers are based on two different principal amounts; a principal amount that meets the tier's lower limit and a principal amount that meets the tier's higher limit. Illustrations of the principal amounts and the dividend calculations are as follows:

#### Second Tier's:

- Lower Limit - Principal amount is \$2,500.01. Multiply \$2,500 by 5.00% and multiply \$.01 by 5.25%. Add up the two dividend amounts and place it in the APY formula. The result will be the APY for the second tier's lower limit.
- Higher Limit - Principal amount is \$10,000. Multiply \$2,500 by 5.00% and multiply \$7,500 (\$10,000 minus \$2,500) by 5.25%. Add up the two dividend amounts and place it in the APY formula. The result will be the APY for the second tier's higher limit.

#### Third Tier's:

- Lower Limit - Principal amount is 10,000.01. Multiply \$2,500 by 5.00%, multiply \$7,500 (\$10,000 minus \$2,500) by 5.25%, and multiply \$.01 by 5.50%. Add up the three dividend amounts and place it in the APY formula. The result will be the APY for the third tier's lower limit.
- Higher Limit - Principal amount is \$100,000. Multiply \$2,500 by 5.00%, multiply \$7,500 by 5.25%, and multiply \$90,000 by 5.50%. Add up the three dividend amounts and place it in the APY formula. The result will be the APY for the third tier's higher limit.

#### **EXAMPLE 1: Hybrid/Plateau Tiered-rate Account**

Assume the same facts of Example 1 of this section: the dividend for amounts from \$.01 to \$2,500 is 5.00%, for amounts from \$2,500.01 to \$10,000 is 5.25%, and for amounts from \$10,000.01 and greater is 5.50%. If a member has \$5,050.00 on deposit, a dividend rate of 5.25% would be applied to \$5,050.00. If a member has \$11,000 on deposit, a dividend rate of 5.50% would be applied to \$11,000.

### ***APY Calculation for a Non-compounding Multi-Year Term Share Account***

This section provides guidance on calculating the APY on term share accounts with a maturity greater than one year. Term share accounts with a maturity greater than one year that do not compound “no compounding or at maturity” will result in an APY that seems anomalous. For term share accounts with terms less than one year, the APY formula results in a rate greater than the dividend rate, even for accounts that do not compound. That’s because the formula assumes that dividends are compounded at maturity, and the results are “annualized”. As can be illustrated, the APY for a non-compounding term share account with terms less than one year is the same APY that would result if the term was equated to a compounding period. The APY for a 3-month non-compounding share certificate at a 5% dividend rate is 5.09%. The APY for a 12-month, quarterly compounding share certificate at

a 5% dividend rate is 5.09%. Equating the 3-month term to quarterly compounding, the APY result is the same.

For term share accounts with maturities longer than one year that do not compound at least annually, the APY is less than the dividend rate. That’s because these accounts are also annualized.

EXAMPLE 1:

Assume a two-year (730-day) non-compounding share certificate for \$1,000. The dividend rate is 5.00%. The daily rate is 1/365. The dividend amount over the two year term is \$100 (.05\*(1/365)\*\$1,000). Placing the numbers in the APY formula, the APY is 4.88%.

$$APY = 100[(1 + \text{Dividends/Principal})^{(365/\text{Days in Term})} - 1]$$

Step 1:	\$100 divided by \$1,000	Result:	.1
Step 2:	.1 plus 1	Result:	1.1
Step 3:	1.1 raised to the exponent of 365 divided by 730	Result:	1.048808848
Step 4:	1.04880884 minus 1	Result:	.048808848
Step 5:	.048808848 times 100	Result:	4.8808848
Step 6:	Round 4.8808848	Result:	4.88%

(See “Rounding and Accuracy Rules for the APY” for rounding rules for the APY).

EXAMPLE 2:

To understand how the APY on a two-year (730-day) non-compounding share certificate is less than the dividend rate of 5.00%, assume the following: a member opened a one-year annual compounding share certificate with a dividend

rate of 4.88088% (should be expressed to five decimal places) and then rolled the principal and dividends into another identical one-year annual compounding share certificate with a dividend rate of 4.88088% (When expressed to five decimal places). The dividend amount for the two years is the same: \$100.00

**Year One**

Step 1:	4.88088 divided by 100	Result:	.0488088
Step 2:	\$1,000 times .0488088	Result:	\$48.8088
Step 3:	Round \$48.8088	Result:	\$48.81

**Year Two**

Step 4:	\$1,000 plus \$48.81	Result:	\$1,048.81
Step 5:	\$1,048.81 times .0488088	Result:	\$51.191157528
Step 6:	\$51.191157528 plus \$1,048.81	Result:	\$1,100.0011575 3
Step 7:	\$1,100.001157543 minus \$1,000	Result:	\$100.00115753
Step 8:	Round \$100.00115753	Result:	\$100.00

Thereby, terms being equal, the dividend rate of an annual compounding term share account is equivalent to the APY of a multi-year non-compounding term share account. (See “Rounding Rules for Dividends Used in the APY Calculation” for rounding rules for the dividend amount.)

***Rounding and Accuracy Rules for the APY***

Section 707.3, General Disclosure Requirements, outlines the rounding and accuracy requirements for the APY.

Rounding rules require APYs to be rounded to the nearest 1/100 of 1% (.01% or .0001) and expressed to two decimal places. As an example, an APY of 5.116% would be rounded to 5.12%. The second decimal place should be rounded up if the third decimal place is five or more. To illustrate, the third decimal place of 5.116 is “6”, thereby the second decimal place would be rounded up from a “1” to a “2”.

The tolerance rate for APY accuracy is not more than 1/20 of 1% (.05% or .0005) above or below the APY as determined in Appendix A, Part I of Part 707, *Truth In Savings*.

***Annual Percentage Yield Earned (APYE)***

Appendix A, Part II of Part 707, *Truth In Savings*, provides the APYE formula that is to be used in periodic statements. Section 707.2(t), Definitions, defines periodic statements as statements that set forth information about an account (other than a term share account or passbook account) and are provided to a member on a regular basis four or more times a year. Regulation E identifies when statements must be provided and when they need not be provided if certain conditions are met. There are no APYE disclosure requirements for passbook accounts or term share accounts. Section 707.2(s), Definitions, defines passbook accounts as accounts in which the member retains a book or other document in which the credit union records transactions on the account. Section 707.2, Definitions, defines term share accounts as being any share certificate, certificate of deposit, or other account with a maturity of at least seven days in which the member generally does not have the right to make withdrawals for six days after the account is opened, or the account is subject to an early withdrawal penalty of at least seven days dividends on amounts withdrawn. A

term share account could also include a club account, i.e., Christmas Club Account, Vacation Club Account, Youth Club Account, etc., if the terms of the club account meet the definition of a term share account.

The APYE is member specific and thereby takes into account an account's fluctuations during the period, such as deposits and withdrawals. The APYE is similar to the APY in that both calculations show the relationship of dividends to a balance, for purposes of comparing an account's yield. However, the two calculations are different; among the differences are:

- The APYE looks backward instead of forward. The APYE formula uses dividends actually earned, not dividends projected to be earned.
- The APYE uses the average daily balance of an account during the period, instead of an initial principal amount, i.e., \$1,000.

Because of these differences, an APYE disclosed on a member's periodic statement will not necessarily equal the APY that was disclosed to the member when the account was opened, even if the dividend rate remains the same over that period.

#### ***Rounding Rules for Dividends Used in the APYE Calculation***

Dividends should be rounded to two decimals for calculating the APYE. For boards of directors that elect to disclose an anticipated (projected or prospective) dividend amount and APYE on statements sent more frequently than the crediting period, the credit union does not have to round accrued anticipated (projected or prospective) dividends to two decimals for calculating the anticipated (projected or prospective) APYE on the statements that are sent more frequently than the crediting period. However, for the statement that is sent at the end of the crediting period, the

dividend earned figure must reflect the amount actually paid. As an example, if dividends earned for the statement, that is sent at the end of the crediting period, is \$15.08717 and the credit union pays the member \$15.09, the credit union must use \$15.09 (not \$15.08717) to calculate the APYE.

#### ***APYE Formula***

The APYE formula is in Appendix A, Part II of Part 707, Truth In Savings. The APYE formula is as follows:

$$\text{APY} = \frac{100[(1 + \frac{\text{Dividends earned}}{\text{Balance}})^{(365/\text{Days in Term})} - 1]}{1}$$

- *Dividends earned* is the actual amount of dividends accrued or paid and credited to the account for the period.
- *Balance* is the average daily balance in the account for the period.
- *Days in Period* is the actual number of days over which the dividends disclosed on the statement were earned.

Fees, bonuses, interest refunds, and extraordinary dividends are not included in the dividend figure for the APYE calculation. If an extraordinary dividend is declared, a separate dividend amount must be calculated and disclosed. An APYE based on the extraordinary dividends may be calculated and disclosed.

#### ***Average Daily Balance Calculation***

The "balance" in the APYE calculation is defined as the average daily balance in the account for the period. The following illustration of a member's account activity for a month is from "Dividend Calculation Methods":



		BALANCE
Balance: December 31, 20X4		\$1,000
Deposit: January 1, 20X5	200	1,200
Withdrawal: January 2, 20X5	100	1,100
Withdrawal: January 10, 20X5	400	700
Deposit: January 15, 20X5	200	900
Withdrawal: January 16, 20X5	1,000	-100
Deposit: January 18, 20X5	300	200
Deposit: January 21, 20X5	700	900
Withdrawal: January 31, 20X5	100	800

**EXAMPLE 1:**

The following illustrates how the average daily balance is determined based on the member's account activity:

	BALANCE x NUMBER OF DAYS	ACCUMULATED BALANCE
1/1/X5	\$1,200 x 1	\$1,200
1/2/X to 1/9/X5	1,100 x 8	8,800
1/10/X5 to 1/14/X5	700 x 5	3,500
1/15/X5	900 x 1	900
1/16/X5 to 1/17/X5	0 x 2	0
1/18/X5 to 1/20/X5	200 x 3	600
1/21/X5 to 1/30/X5	900 x 10	9,000
1/31/X5	800 x 1	800
<b>TOTAL</b>	<b>31</b>	<b>24,800</b>

Dividing the accumulated "end of day" balances of \$24,800 by 31 (the total number of days in the dividend period), the average daily balance is \$800.00000. For overdrawn accounts, use zero as the balance. Negative balances cannot be used in determining the average daily balance.

A credit union should round the average daily balance to five or more decimals. An average daily balance of \$800.12345678 would be rounded to no less than \$800.12346. The fifth decimal place should be rounded up if the sixth decimal place is five or more. The sixth decimal place of

\$800.12345678 is a "6", thereby the fifth decimal place would be rounded up from "5" to "6".

**APYE Calculations**

**EXAMPLE 1:**

Assume that \$3.40 of dividends is earned during the period using the daily balance method. The dividend rate is 5.00% using a daily rate of 1/365. The compounding period is monthly. The crediting period is monthly. The statement period is monthly. The account activity is from "Average Daily Balance Calculation".

BALANCE x RATE x NUMBER OF DAYS	DIVIDEND AMOUNT
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1/1/X5	\$1,200 x .00013698630 x 1	\$0.164383562
1/2/X to 1/9/X5	1,100 x .00013698630 x 8	.205479452
1/10/X5 to 1/14/X5	700 x .00013698630 x 5	.479452055
1/15/X5	900 x .00013698630 x 1	.123287671
1/16/X5 to 1/17/X5	0 x .00013698630 x 2	0.000000000
1/18/X5 to 1/20/X5	200 x .00013698630 x 3	0.082191781
1/21/X5 to 1/30/X5	900 x .00013698630 x 10	1.232876712
1/31/X5	800 x .00013698630 x 1	0.109589041
TOTAL	31	3.397260274

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Placing the numbers in the APYE formula, the APYE is 5.12%. The “balance” (average daily balance) of \$800.00 is based on Example 1 of “Average Daily Balance Calculation”.

$$APY = 100[(1 + \text{Dividends earned}/\text{Balance})^{(365/\text{Days in Term})} - 1]$$

Step 1:	Round \$3.397260274	Result:	\$3.40
Step 2:	\$3.40 divided by \$800.00000	Result:	.004250000
Step 3:	.004250000 plus 1	Result:	1.004250000
Step 4:	1.004250000 raised to the exponent of 365 divided by 31	Result:	1.051202017
Step 5:	1.051202017 minus 1	Result:	.051202017
Step 6:	.051202017 times 100	Result:	5.120201670
Step 7:	Round 5.120201670	Result:	5.12

In this example, since the dividend earned figure is the amount actually paid (statements are not sent more frequently than dividends are credited or compounded), the credit union must round the dividends to two decimals for calculating the APYE. (See “Rounding Rules for Dividends Used in the APYE Calculation” for rounding rules for the dividend amount used in the APYE formula and see “Rounding and Accuracy Rules for the APYE” for rounding rules for the APYE).

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### ***Special APYE Formula***

The special formula is used when a credit union using the daily balance method to accrue dividends sends periodic statements more often than the period for which dividends are compounded. As an example, an account that receives quarterly statements (since the compounding period is quarterly) and is subject to Regulation E’s rule (calling for monthly statements when an electronic fund transfer has occurred). A credit union may, but need not, use this formula to calculate the APYE for the quarterly statement when no monthly statements

are issued for the quarter. However, this special APYE formula must be used to calculate an APYE that is disclosed on the monthly statements issued for the quarter. Also, if the dividend period is monthly, the dividend amount and APYE (that is based on the special APYE formula) will be “earned but uncredited”. If the dividend period is quarterly, the dividend amount and APYE (that is based on the special APYE formula) will be an anticipated (projected or prospective) dividend amount and APYE. The special APYE formula in Appendix A, Part II (B) of Part 707, *Truth In Savings* is:

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$$APYE = 100 \left[ \left( 1 + \frac{\text{Dividends earned/Balance}}{\text{Days in Period (Compounding)}} \right)^{(365/\text{Compounding})} - 1 \right]$$

- *Dividends earned* is the actual amount of dividends accrued or paid and credited to the account for the period.
- *Balance* is the average daily balance in the account for the period.
- *Days in Period* is the actual number of days over which the dividends disclosed on the statement were earned.
- *Compounding* is the actual number of days in each compounding period.

### **Special APYE Calculation**

Assume the same facts as in “Average Daily Balance Calculation” and in Example 1 of “APYE Calculations”, except the account compounds quarterly. Also, assume dividends are credited quarterly, this is the first month of the quarter, there are 31 days in the first month, and 91 days in the quarter. Placing the numbers in the special APYE formula, the anticipated APYE is 5.09%.

$$APYE = 100 \left[ \left( 1 + \frac{\text{Dividends earned/Balance}}{\text{Days in Period (Compounding)}} \right)^{(365/\text{Compounding})} - 1 \right]$$

Step 1:	Round to five, \$3.397260274	Result:	\$3.39726
Step 2:	Round to five, \$800.00000	Result:	\$800.00000
Step 3:	3.39726 divided by \$800.00000	Result:	.004246575
Step 4:	.004246575 divided by 31	Result:	.000136986
Step 5:	.000136986 times 91	Result:	.012465752
Step 6:	.012465752 plus 1	Result:	1.012465752
Step 7:	1.012465752 raised to the exponent of 365 divided by 91	Result:	1.050946264
Step 8:	1.050946264 minus 1	Result:	.050946218
Step 9:	.050946218 times 100	Result:	5.094621775
Step 10:	Round 5.094621775	Result:	5.09%

Since the compounding and crediting period is quarterly, if a monthly statement is sent, the credit union does not have to round accrued dividends to two decimals for calculating the anticipated (projected or prospective) APYE for the months that statements are sent more frequently than dividends are compounded (the first monthly statement and the second

monthly statement issued during the quarter). However, on the quarterly statement, the dividends earned figure used in the APYE formula must reflect the amount actually paid. As an example, if dividends earned for a statement period is \$15.08717 and the credit union pays the member \$15.09, the credit union must use \$15.09 (not \$15.08717) to calculate the APYE.

***Dividend Period Length Versus Statement Period Length for the APYE***

A credit union can choose to disclose APYEs based on the length of the dividend period. As an example, a credit union that compounds and credits dividends monthly but issues quarterly statements can show on the quarterly statement a single APYE for the entire quarter, or three APYEs (one for each crediting period in the statement

period). Generally speaking, other things being equal, the APYE will be higher (or at least no lower) if the credit union chooses to disclose for a shorter period.

**EXAMPLE 1:**

The following illustrates three monthly APYEs and one quarterly APYE. The dividend calculation method is based on the average daily balance.

	<u>January</u>	<u>February</u>	<u>March</u>
Dividend Rate _____	5.00%	5.00%	5.00%
Dividends _____	\$4.25	\$3.85	\$4.28
Average daily balance _____	1,000.00	1,004.25	1,008.10
Days in Period _____	31	28	31
APYE _____	5.12%	5.11%	5.11%

If instead, the credit union based the APYE on the entire quarter, the result would be:

Dividends _____	\$12.38
Average daily balance _____	1,000.00
Days in Period _____	90
APYE _____	5.11%

**EXAMPLE 2:**

Assume the same facts as in Example 1 of this section, except the dividend rates are different for each month.

	January	February	March
Dividend Rate _____	5.00%	5.25%	5.50%
Dividends _____	\$4.25	\$4.04	\$4.71
Average daily balance _____	1,000.00	1,004.25	1,008.29
Days in Period _____	31	28	31
APYE _____	5.12%	5.37%	5.64%

If instead, the credit union based the APYE on the entire quarter, the result would be:

Dividends _____	\$13.00
Average daily balance _____	1,000.00
Days in Period _____	90
APYE _____	5.38%

### ***APYE Requirements When the Collected Balance Method is Used to Accrue and Pay Dividends***

Credit unions that accrue or pay dividends on non-cash items; such as checks, must base the balance in the APYE calculation on the same balance method used to calculate dividends. As an example, a credit union that accrues or pays dividends on non-cash items using the collected balance must use the collected balance to calculate the “average daily balance” in the APYE formula.

The choice of accruing or paying dividends on the “collected” balance versus the “ledger” balance may affect a member’s dividend amount. Other things being equal, a credit union that pays on the ledger balance will pay more in dividends than a credit union that pays on the collected balance (since the ledger balance is at least as large as the collected balance). Therefore, in order to accurately reflect the APYE and provide useful information to the member, the “balance” (average daily balance) used to calculate the APYE must be the same balance method that was used to calculate dividends.

### ***APYE on Closed Accounts***

When members close their accounts during a dividend period and contractually forfeit their accrued dividends, those forfeited dividends should not be included in the APYE calculation for the period nor in the anticipated (projected or prospective) APYE calculation for the period (where statements are sent more frequent than dividends are credited). When members close their accounts during the dividend period and do not forfeit their accrued dividends, and when members open an account during the dividend period, the “balance” (average daily balance) used in the APYE calculation should only reflect the number of days the account was open versus the number of days in the period.

### ***Rounding and Accuracy Rules for the APYE***

Section 707.3, *General Disclosure Requirements*, outline the rounding and accuracy requirements for APYE.

Rounding rules require the APYE to be rounded to the nearest 1/100 of 1% (.01%) and expressed to two decimal places. As an example, an APYE of 5.116% would be rounded to 5.12%. The second decimal should be rounded up if the third decimal is five or more. To illustrate, the third

decimal of 5.116 is a “6”, thereby the second decimal would be rounded up from a “1” to a “2”.

The tolerance range for APYE accuracy is no more than 1/20 of 1% (.05%) above or below the APYE as determined in *Truth In Savings*, Appendix A, Part II of Part 707.

### **Interest Refunds Payable**

Section 701.24 of the NCUA's Rules and Regulations for federal credit unions sets forth the authority for federal credit unions to refund interest to members. Under the requirements of 701.24(g), interest refunds should be shown as a reduction of interest income on the credit union's books. Also, on the credit union's Statement of Income, interest refunds should be recorded as current changes in the fiscal period to which they apply. Thus, when interest refunds are declared by the board during the first month following the close of the dividend period, they should be recorded as of the close of the dividend period by a debit to "Interests Refunds" and credit to "Interest Refunds Payable".

Interest refunds declared in the last month of the dividend period should be recorded in the same manner. The interest refunds thus will be shown on the Statement of Income prepared at the close of the period to which they apply. When the interest refunds liability credited to this account is liquidated, this account should be debited and the offsetting credit should be to "Shares" or "Cash".

### ***Computation and Distribution of Interest Refunds***

The following is a summary of the major factors involved when an interest refund is considered or authorized by the officials:

- a) An interest refund can be made at the end of a dividend period only if dividends are declared and paid for that period. Only members of record at the close of business on the last day of the dividend period will be eligible for a refund of interest.
- b) The interest refund shall be determined as a percentage of the total interest paid by the

member. The board of directors may determine that certain loan categories, which have not made significant contributions to interest income, may be excluded from the refund. An exclusion of the refund on loans that are delinquent 2 or more months is also permitted.

The board will need to determine the rate of the refund. This should depend on the amount of funds available as well as the reserve position of the credit union. The interest refund percentage can be determined by dividing the amount available for refund by the total interest paid by eligible borrowers. For example, if \$100,000 in interest income has been collected, and \$10,000 is available for the refund (after consideration of dividends, other operating and non-operating expenses, required reserve transfers, and any other additions to reserves), the interest refund rate is 10 percent ( $\$10,000 \div \$100,000 = .10$  or 10 percent).

When the board determines that certain loan classifications are not considered eligible for receiving a refund, the interest refund is calculated by subtracting income earned by those loans from total income earned. The same would apply when the board of directors has determined that various loan categories will receive interest refunds at different rates. The interest income must be broken down into categories based on the different loan categories in order to determine the total interest refund.

In any case, interest income should be adjusted to delete income from borrowers who cease to be members before the close of business on the last day of the dividend period when the refund is declared. However, borrowers who have paid off their loans, but are still members, must be considered in the determination of an interest refund.

c) The refund of interest cannot be made unless it is authorized at the end of the period where a dividend on shares has also been declared and paid. But at that time, the refund can be authorized for prior periods where dividends were declared and paid but interest refunds were not declared. This prior period authorization may only be within the calendar year.

d) After the procedures for refunding interest have been established (a. - c. above), record the total amounts of loan interest paid as determined from the members' individual share and loan ledgers. This should include interest paid by current members who paid off a loan in the period included in the interest refund authorization.

e) The amount of interest recorded is multiplied by the applicable interest refund rate, as approved by the board. The amount should either be credited to the members' savings accounts, paid by check, or a combination of both. It is suggested that the interest refund calculation worksheet be filed with the dividend record.

***Entries in the Journal and Cash Record***

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

***Illustrative Entries***

- 
- a) To record interest refunds declared:
 

Dr.-Interest Refunds	\$750	
Cr.-Interest Refunds Payable		\$750
  
  - b) To record the liquidation of the interest refunds liability by credits to shares and by cash payments:
 

Dr.-Interest Refunds Payable	\$750	
Cr.-Shares		\$625
Cr.-Cash		125
- 

Note: When the amount recorded as an interest refund liability was based on an estimate, the difference between the total actual amount and

the estimate originally recorded will require an adjusting entry. If the total actual distribution exceeded the estimate, the difference should be charged as of the liquidation date to "Interest Refunds" and credited to "Interest Refunds Payable". If the estimate exceeded the total actual amount distributed, the reverse entry should be made as of the liquidation date, debiting the difference to "Interest Refunds Payable" and crediting "Interest Refunds".

***Detailed Transactions***

Credit:

- a) To record the amount of interest refunds declared.
  
- b) For the excess, if any, of actual interest refunds distributed at the authorized rate over the amount recorded in the credit entry above.

Debit:

- a) To record the amount of interest refunds distributed to members.
  
- b) For the excess, if any, of interest refunds recorded in the entry above, over the actual interest refunds distributed to members based on the authorized rate.

**Alternative Interest Refund Procedures**

Federal credit unions that pay dividends more frequently than annually may wish to employ one of the following alternatives in recording and paying interest refunds. Interest refunds may be authorized for a specific regular share account dividend period, but the payment of the interest refunds may be deferred and paid in conjunction with the closing of a regular share account dividend period later in the year. It is at that time that the board of directors decides whether the anticipated interest refunds are to be authorized and paid based upon available earnings. If so, the amount in interest refunds payable should be cleared at this time.

A credit union paying dividends quarterly or semiannually, but wishing to pay

interest refunds only one time a year for all regular share account dividend periods during the year, may do so by following one of the following alternatives.

***First Alternative***

At the end of each regular share account dividend period during the year, the board of directors may authorize a refund of interest for that dividend period to be paid later in the year. The interest refund should be set up in the liability account, "Interest Refunds Payable". The corresponding debit should be to "Interest Refunds" for the entire amount of interest to be refunded. If the exact amount of interest to be refunded is not known, an estimate can be determined by multiplying the total interest received during the accounting period by the percentage figure selected by the board of directors to be refunded. The result obtained from this calculation will be the maximum amount of interest that can be refunded and this amount should be set up in the account, "Interest Refunds Payable". By authorizing the interest refund, the board of directors has gone on record that an interest refund for that dividend period will be paid. In its resolution, the board should also designate the date upon which the interest refund is to be paid to the members or credited to their accounts.

***Second Alternative***

The second alternative involves the anticipation of the payment of an interest refund. For example, the board of directors may set aside earnings at the end of a regular share account dividend period which would be earmarked for the possible payment of interest refunds at a later date in the year. In this case, the amount of the anticipated interest refund would be recorded as a debit to "Interest Refunds" and a credit to "Interest Refunds Payable".

**Accrued Interest Payable (On Borrowed Funds)**

For credit unions following the accrual basis of accounting, this account reflects the accrued unpaid liability of the credit union for interest on

borrowed funds. The account is not required for credit unions following the modified cash basis of accounting.

Accruals should be recorded at the close of each accrual period to reflect the interest cost for the period on borrowed funds. When interest payments are made, the amounts paid should be debited to this account and credited to "Cash". Interest should be computed on borrowed funds based on the loan interest rate applied to the unpaid principal amounts of the loan liability outstanding during the accrual period. This accrual may be accomplished by applying an appropriate interest factor to the aggregate daily balances of principal outstanding at each effective interest rate.

***Entries in the Journal and Cash Record***

All entries affecting this account should be entered in the "Miscellaneous" columns of the Journal and Cash Record.

***Illustrative Entries***

- a) To accrue interest liability at the close of each accrual period:

Dr.-Interest on Borrowed Money	\$100	
Cr.-Accrued Interest Payable		\$100

- b) When interest is paid:

Dr.-Accrued Interest Payable	\$300	
Cr.-Cash		\$300

***Detailed Transactions***

Credit:

- a) With interest accrued during the accrual period.

Debit:

- a) With interest payments made.



## **ACCRUED EXPENSES AND OTHER LIABILITIES**

### **ACCOUNTS PAYABLE**

Accounts payable in the financial statements of a credit union typically relate to routine operating expenses. Accounts payable may also include liabilities for unclaimed or dormant share accounts and unrepresented checks. State escheat laws sometimes require that these amounts be remitted to the state after a specified period of time.

#### **Accounts Payable**

This account reflects the open account liabilities of the credit union. Examples of such items are shown below. Separate accounts should be established if there is a large number of activity relating to any one item or if outstanding balances are material relating to any one item. The separate accounts would be numbered so they could be individually identified.

#### ***Invoices For Which Prompt Payment Will not be Made***

An expense item for which prompt payment will not be made may be credited to this account with an offsetting debit to the appropriate expense classification of accounts.

#### ***Cash Advances***

When cash is advanced to the credit union for a specific purpose and such advance is expected to be repaid at some future date, the amount of this advance should be credited to this account with an offsetting debit to "Cash".

#### ***Unrepresented Checks***

Checks issued by the credit union which have not been presented for payment after a reasonable period has elapsed (90 days or more) should be credited to this account with an offsetting debit to "Cash". The amount disbursed should be retained in this account until the statutory period prescribed for presentation of checks has expired in accordance with state escheat or abandoned property laws except for disbursed share withdrawals and loans. Disbursements of the latter type should be reversed, returning the amount paid to their source accounts. It may then be cleared by debiting this account and crediting "Other Miscellaneous Operating Income". In the event, however, that state abandoned property law provides for escheating outstanding checks, such items should be carried in "Accounts Payable" until the period provided by such law has expired, after which an amount equivalent to the total of such checks must be turned over to the state.

Most states have enacted an escheat or abandoned property law. Under this law, property which becomes dormant for a certain period of time must be reported and released to the state. Dormant accounts, unrepresented checks, and other abandoned items can become escheatable under a state law. State authorities may thus conduct limited inspections of the credit union's records to determine compliance with abandoned property laws. The value of this abandoned property should be carried in "Accounts Payable" until reported and released to the state.

#### ***Accounts of Deceased or Terminated Members***

Amounts in share accounts of deceased or terminated members are transferred to this account. Refer to the Federal Credit Union Standard Bylaws, Article III, Section 5(d), regarding the period of time during which an account for a deceased or terminated member could be kept open until transferred to this account.

**Entries in the Journal and Cash Record**

This account should be credited as "Miscellaneous-Credit" when a liability item is set up. It should be debited as "Miscellaneous-Debit" when the item is paid or other disposition is made.

Substantial expense items due and payable should be recorded promptly and at least at the end of a dividend period.

**Posting to the General Ledger**

The debit and credit items for Accounts Payable in "Miscellaneous" are posted individually to the General Ledger. "Explanatory Remarks" should show clearly the necessary details of the entries posted to this account, such as to whom the account is payable and the purpose. In the case of unrepresented checks, a notation should be made of the check number, date of the check and the payee.

**Illustrative Entries**

a) When an expense is incurred for purchase of supplies and payment is not immediately made:

Dr.-Stationery and Supplies	\$50	
Cr.-Accounts Payable		\$50

b) When payment is made of liabilities previously recorded in this account:

Dr.-Accounts Payable	\$50	
Cr.-Cash		\$50

**Detailed Transactions**

Credit:

- a) With open accounts and other liabilities recorded as Accounts Payable.
- b) With credit union checks issued after they have been outstanding a reasonable period (90 days or more).

Debit:

- a) With payments made of liabilities recorded in this account.
- b) With the amount of unrepresented credit union checks upon expiration of the statutory period for presentation of checks. Offsetting credit should be to "Other Miscellaneous Operating Income", or if escheat to the state as required, to "Cash".

**Accounts Payable - Traveler's Checks And Money Orders Sold**

This account is used when the credit union is acting as an agent for the sale of checks or money orders for another institution or organization. This account shows the liability to the particular vendor or other party for checks and money orders sold. The account must be supported by accurate subsidiary records to identify the specific items sold. Separate accounts payable may be established for each vendor, or each item (traveler's checks or money orders).

**Entries in the Journal and Cash Record**

This account should be credited as "Miscellaneous-Credit" when checks or money orders are sold by the credit union for a third party (an agent). The credit union is only liable for the amount due to the agent, which should include the face amount of the item sold plus fees owed to the agent. Any fees collected by the credit union as part of the transaction should be entered as "Miscellaneous Fee Income."

**Illustrative Entries**

- a) When a credit union sells a check acting as an agent for the vendor, and fees are collected which are due both to the vendor and the credit union:

Dr.-Cash	\$100.50
Cr.-Accounts Payable - Traveler's Checks and Money Orders - (For \$100 face amount of item sold, with a \$.50 fee charged, half of which is due to the vendor.)	\$100.25
Cr.-Miscellaneous Fee Income (The portion of the \$.50 fee collected, which is due to the credit union.	.25

b) When the funds collected from the sale of an item are remitted to the vendor, including fees due to the vendor:

Dr.-Accounts Payable - Traveler's Checks and Money Orders	\$100.25
Cr.-Cash	\$100.25

#### Accounts Payable-Undistributed Payments

This account is provided for use by credit unions to record payments received when a delay will occur before the amounts of the credits to the particular accounts are determined. The account is specifically established for those credit unions using the "total payment vendor" system.

When the credit union uses a computer or other mechanical equipment to compute interest on loans, this account should be credited with the amount of undistributed loan payments received. When the computer output record (generally the Transaction Register) is received showing the distribution of loan payments to principal and interest, this account should be debited with offsetting credits being made to loans and interest. This account should be used similarly when the distribution of the payments received on shares, loan principal and interest is made by the computer.

Where the credit union's record keeping is performed manually and in the event the breakdown of payments received to "Shares", "Loans", "Interest", etc., is not developed in time to provide the distribution to each General Ledger

account affected, the total payments may be credited to this account and cleared when the distribution is determined.

#### *Entries in the Journal and Cash Record*

Entries affecting this account should be recorded as "Miscellaneous" unless, because of the volume of these entries, the credit union designates separate grouping for this purpose.

#### *Illustrative Entries*

a) When loan repayments are received:

Dr.-Cash	\$1,525.00
Cr.-Accounts Payable - Undistributed Payments	\$1,525.00

b) When transaction details have been determined:

Dr.-Accounts Payable - Undistributed Payments	\$1,525
Cr.-Loans	\$1,215
Cr.-Interest on Loans	200
Cr.-Shares	110

#### *Detailed Transactions*

Credit:

a) With amounts of loan repayments received for which the detailed distribution to particular general ledger accounts has not been determined.

Debit:

a) With amounts of loan repayment transactions applied to the appropriate general ledger accounts affected.

## Accounts Payable-Undistributed Payroll Deductions Or Allotments

This account is to be used when the credit union receives payroll deduction checks and the individual deductions have not yet been posted to member accounts.

Truth in Savings (TIS) requires undistributed payroll deductions to be considered part of a member's account balance upon which dividends will be calculated, unless a written contract exists between the member and the credit union. The contract must indicate, the credit union may hold the funds without adding it to the share account balance, and by doing so, the member may forfeit any dividends due them under TIS. If the deduction is for a loan payment, Truth in Lending (TIL) may impact the treatment of these accounts. To avoid any TIL violations, the deduction should be voluntary, and the member should have access to the funds.

### *Entries in the Journal and Cash Record*

Entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

### *Illustrative Entries*

- a) When collections are received representing payroll deductions or allotments:

Dr.-Cash	\$4,000	
Cr.-Accounts Payable- Undistributed payroll Deductions or Allotments		\$4,000

- b) When distribution details have been determined based on computer processing:

Dr.- Accounts Payable- Undistributed payroll Deductions or Allotments	\$4,000	
Cr.-Loans		\$3,300
Cr.-Interest on Loans		300
Cr.-Shares		400

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### *Detailed Transactions*

Credit:

- a) With amounts of undistributed payroll deductions or allotments received which have been or will be sent to the computer for processing.

Debit:

- a) With amounts of payroll deductions or allotments processed by the computer and applied to appropriate other accounts affected.

## Accounts Payable-Check Transmittal Service

This account is for use only by federal credit unions which provide check transmittal services to their members. The balance in the account should represent the total amount of undistributed members' paychecks payable by the credit union to the members' bank accounts. This account should be cleared by remittances to the members' banks on the day the funds are received by the credit union or as promptly as possible thereafter.

### *Entries in the Journal and Cash Record*

All entries affecting this account should be recorded as "Miscellaneous" unless, because of volume, the credit union assigns a separate grouping for credits to this account.

### *Subsidiary Accounts Payable Record*

The credit union must establish and maintain subsidiary accounts payable records for each depository bank to which amounts are owed.

### *Illustrative Entries*

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a) A member presents his paycheck for a loan payment to the credit union with the remainder to be transmitted to his checking account:

Dr.-Cash	\$300	
Cr.-Loans		\$45
Cr.-Interest on Loans		5
Cr.-Accounts Payable- Check		
Transmittal Service		250

b) A credit union sends a check to the member's bank checking account to forward the member's net paycheck:

Dr.- Accounts Payable- Check	Transmittal	
Service		\$250
Cr.-Cash		\$250

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### ***Detailed Transactions***

Credit:

a) With amounts due member's depository bank for portion of paychecks not applied to credit union accounts.

Debit:

a) With amounts remitted to depository banks to clear this account.

### **Accounts Payable-Drafts Authorized**

This account represents the liability of the credit union for drafts authorized to be drawn on it, where it has been legally determined that a real liability is created by the authorization. This account should not be used where a liability for drafts authorized does not arise prior to the actual acceptance of the draft by the credit union, since the drafts ordinarily will be paid concurrently with acceptance.

When a legal liability exists upon authorization of drafts, this account should be credited when authority is issued to draw drafts on the credit

union: the offsetting debit should be to the appropriate asset account, e.g., "Loans."

### ***Entries in the Journal and Cash Record***

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

### ***Detailed Transactions***

Credit:

a) With amounts of drafts authorized for which the credit union has a legal liability.

Debit:

a) With amounts of authorized drafts previously recorded in this account when presented for payment and paid or when the authorization is canceled.

### **Accounts Payable--Installment Payments On U.S. Bonds**

This account reflects the federal credit union's liability for installment payments received toward the purchases of U.S. Savings Bonds pending sufficient funds being available for issuance of the bonds.

Section 121 of the Federal Credit Union Act provides that federal credit unions may act as agents of the U.S. Treasury Department for the sale of U.S. Savings Bonds. Only those federal credit unions that have applied to the U.S. Treasury and have been approved as issuing and/or paying agents may engage in savings bonds transactions.

When installment payments are received on bond purchases, this account should be credited with the liability for the funds pending issuance of U.S. Savings Bonds to the purchaser. When a bond is fully paid for and is issued, the purchase cost should be cleared from this account and transferred to "Accounts Payable--U.S. Savings Bond Remittance".

### ***Illustrative Entries***

a) When payments are received on installment purchase of U.S. Savings Bonds:

Dr.-Cash or Cash-U.S. Bond Installment Payment	\$12.50
Cr.-Accounts Payable- Installment Payments on U.S. Bonds	\$12.50

b) When a bond is fully paid and is issued:

Dr.- Accounts Payable- Installment Payments on U.S. Bonds	\$150.00
Cr.-Accounts Payable-U.S Savings Bond Remittances	\$150.00

c) When an authorization is canceled and a subscriber withdraws the balance on his installment account:

Dr.- Accounts Payable- Installment Payments on U.S. Bonds	\$12.50
Cr.- Cash or Cash-U.S. Bond Installment Payment	\$12.50

d) When remittance is made to the Federal Reserve Bank for bonds issued under the installment payment plan:

Dr.- Accounts Payable- U.S Savings Bond Remittances	\$150.00
Cr.- Cash or Cash-U.S. Bond Installment Payments	\$150.00

**Detailed Transactions**

Credit:

a) With installment payments received.

Debit:

a) With installment payments withdrawn upon cancellation of a subscription.

b) With installment amounts used for bond issuances (transfer liability to "Accounts Payable U.S. Savings Bond Remittances").

**Accounts Payable-U.S. Savings Bond Remittances**

This account reflects the federal credit union's liability for U.S. Savings Bonds issued pending transmittal of the funds collected to the Federal Reserve Bank.

Section 121 of the Federal Credit Union Act provides that federal credit unions may act as agents of the U.S. Treasury Department for the sale of U.S. Savings Bonds. Only those federal credit unions that have applied to the U.S. Treasury and have been approved as issuing and/or paying agents may engage in savings bonds transactions.

This account should be credited with the cash payments received covering the issue of all U.S. Savings Bonds issued by the credit union. When sufficient funds are available for the issuance of a bond to installment purchasers, the bond issue price should be transferred to this account from "Accounts Payable-Installment Payments on U.S. Bonds". Likewise, when cash is received covering the entire purchase of a U.S. Savings Bond or note purchased by installment payments, this account should be credited with the total amount received pending transmittal of the funds to the Federal Reserve Bank. When proceeds from the sales of Savings Bonds are remitted to the Federal Reserve Bank, this account should be debited.

**Illustrative Entries**

a) To record the daily total cash received from the sale of Savings Bonds:

Dr.- Cash	\$75
Cr.-Accounts Payable-U.S Savings Bond Remittances	\$75

b) To record the remittance of savings bond sales to the Federal Reserve Bank:

Dr.- Accounts Payable-		
U.S Savings Bond		
Remittances	\$75	
Cr.-Cash		\$75

---

### Notes Payable Commitment Fees

This account should reflect commitment fees paid on term notes. The fees should be amortized based on the interest method. The periodic amortization should be recorded as interest on borrowed funds. See Assets Section 300 "Accounting Entries, Loans and the Interest Method" for a detailed discussion of the interest method.

### Taxes Payable

#### Federal Withholding Taxes Payable State Withholding Taxes Payable City Withholding Taxes Payable

Federal credit unions that pay salaries are subject to the withholding provisions of the law relating to federal, state, and local income taxes. If salaries are paid it is essential that the proper forms be obtained from each employee and kept on file. If any taxes are required to be withheld, the instructions issued by the Internal Revenue Service or other taxing authority for reporting and remitting taxes should be carefully followed. The necessary forms and instructions should be obtained from the local Director of Internal Revenue or other taxing authority.

Many states and cities have provisions in their tax laws for the withholding of income taxes similar to the federal income tax law. In these instances, forms and instructions should be obtained from the local tax officials. Where a credit union has employees for which it withholds state or city income taxes residing in more than one state, additional accounts for State Withholding Taxes Payable should be established.

Each time salaries are paid, the amount of income tax withheld from the salary is credited to this account in the "Miscellaneous Credit" column of the Journal and Cash Record. The account is debited in the "Miscellaneous Debit" column when the amounts withheld are remitted in accordance with instructions. If the credits to this account are numerous, it is suggested that one (or more) of the blank columns of the Journal and Cash Record or the continuation sheet be used to accumulate these entries. If this is done the column(s) should be headed "Federal Withholding Taxes Payable-Cr-" (if state or city taxes are involved the column(s) should be appropriately labeled).

#### *Employees Withholding Exemption Certificate (Form W-4)*

At the time the treasurer is appointed or an employee is hired, an Employee Withholding Exemption Certificate (Form W-4) should be obtained. Blank copies of Form W-4 may be secured from the local Director of Internal Revenue. This certificate, which should be signed by the employee involved, should indicate the exemptions he is claiming. The deductions made from his salary will be governed by his exemptions. Employees Withholding Exemption Certificates (Form W-4) for each employee should be retained in the files of the credit union. The appropriate Withholding Exemption Certificate should be obtained when state or city income taxes are withheld.

#### *Posting to the General Ledger*

The items entered as "Miscellaneous" are posted individually to the General Ledger. In the event one (or more) of the blank Journal and Cash Record columns is used, the total of this column(s) is posted as a credit to the General Ledger at the end of the month.

#### *Illustrative Entries*

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a) When salaries are paid and social security and federal income taxes are withheld:

Dr.-Salaries	\$100.00
--------------	----------

Cr.-Cash	\$86.37
Cr.-Federal Withholding Taxes Payable	10.00
Cr.-Social Security Taxes Payable	3.63

b) When federal taxes withheld are remitted in accordance with instructions of the Internal Revenue Service, together with employer's social security tax:

Dr.-Federal Withholding Taxes Payable	\$30.00
Dr.-Social Security Taxes Payable	21.78
Cr.-Cash	\$51.78

---

### ***Detailed Transactions***

Credit:

a) With amount of income taxes withheld.

Debit:

a) With amount of income taxes remitted to the federal, state or city tax authorities, as applicable for each account.

### **Social Security Taxes Payable**

Federal credit unions are required to withhold social security taxes on certain salaries paid. Information as to the specific requirements and procedures, including the rates currently in effect, can be obtained from the nearest field office of the Social Security Administration or the local Director of Internal Revenue.

Deductions, according to the current rate, should be made from salaries and should be accumulated in "Social Security Taxes Payable". Remittances of these deductions, together with the proper amount to cover the employer's (credit union's) tax, should be made in accordance with the instructions. Both the employees' deductions and the credit union's tax liability should be set up in the Social Security Taxes Payable each time salaries are paid. The credit union should apply to the local Director of Internal Revenue for an

employer's identification number on Form SS-4. Forms on which to make this application as well as report forms and instructions regarding their use will be supplied by the local Director upon request. The credit union must have a record of the Social Security account numbers of its employees. Any employee who does not have a number should obtain one by applying for the social security number on Form SS-4 at the nearest Social Security Field Office.

A suggested form of individual payroll ledger sheet is illustrated above. This form will help maintain control over both the employee's and employer's social security taxes, as well as deductions or withholdings made from the employee's salary for federal income tax, savings bonds, credit union, etc.

### ***Entries in the Journal and Cash Record***

When salaries are paid, the amount of social security tax required is withheld from the salary due each qualifying employee and credited to this account as a "Miscellaneous-Credit" in the Journal and Cash Record. At the same time, the employer's (credit union's) social security tax on such salaries is charged to "Social Security Taxes (Employer's Share)" and credited to this account as a "Miscellaneous Credit". When the remittance is made, this account is debited as a "Miscellaneous-Debit".

If the credits to this account are numerous, you may wish to identify the entries as "Social Security Taxes Payable-Cr."

### ***Posting to the General Ledger***

The items entered as "Miscellaneous" are posted individually to the General Ledger.

### ***Illustrative Entries***

a) When salaries are paid and social security and income taxes are withheld for later remittance to the Director of Internal Revenue:

Dr.-Salaries	\$100.00	
Cr.-Cash		\$86.37



Cr.-Federal Withholding Taxes Payable	10.00
Cr.-Social Security Taxes Payable	3.63

b) When salaries are paid, liability for the credit union's portion of social security tax is recorded:

Dr.-Social Security Taxes (Employer's Share)	\$3.63
Cr.- Social Security Taxes Payable	\$3.63

c) When taxes withheld from salaries are remitted to the Director of Internal Revenue together with employer's social security tax:

Dr.-Federal Withholding Taxes Payable	\$30.00
Dr.-Social Security Taxes Payable	21.78
Cr.-Cash	\$51.78

Note: When income tax withholdings affect state or city income taxes all entries should be recorded similar to the credits and debits to account, "Social Security Taxes Payable", as shown in the first and third entries above, except that the appropriate account should be credited or debited.

***Detailed Transactions***

Credit:

- a) With amounts of social security taxes withheld from employees' salaries.
- b) With the credit union's share of social security taxes charged to expense "Social Security Taxes (Employer's Share)", (Account No. 222).

Debit:

- a) With amount of social security taxes paid (Employees' and Employer's Shares).

**Federal Unemployment Compensation Tax Payable and State Unemployment Compensation Tax Payable**

These two accounts reflect the amounts of the credit union's unpaid liabilities for federal and state unemployment compensation taxes payable.

The Federal Unemployment Tax Act imposes a tax on employers who employ one or more persons in covered employment based on a certain number of weeks during the current or preceding calendar year, or who paid wages of at least a certain dollar amount during a calendar quarter in the current or preceding calendar year. Refer to FUTA for current requirements.

Unemployment compensation insurance coverage is applicable to practically all federal credit unions. Amounts paid for Unemployment Compensation Insurance are expenses to the credit union and are recorded when the liabilities are incurred.

In most states, the full tax is paid by the employer (credit union), however, in a few states the employees also contribute by a deduction from the wages. In these cases, the accounting treatment for Unemployment Compensation Insurance will be similar to that for social security taxes payable.

Report forms and instructions should be obtained from the State Employment Security Agency (State Tax) and Internal Revenue Service (Federal Tax).

***Entries in the Journal and Cash Record***

Expenses for Unemployment Compensation Insurance may be recorded when paid. However, the expense and the liability may be recorded on a monthly basis for more accurate financial reporting. This can be done by computing the expense monthly and charging it to "Unemployment Compensation Taxes" with a corresponding credit to "Federal Unemployment Compensation Tax Payable" or "State Unemployment Compensation Tax Payable", as appropriate. The expense is computed by applying the required percentage to taxable wages during this month.

***Postings to the General Ledger***

The items entered as "Miscellaneous" are posted individually to the General Ledger.

**Illustrative Entries**

---

a) At the end of the month when the liability is recorded for unemployment compensation taxes:

Dr.-Unemployment		
Compensation Taxes	\$6.00	
Cr.-Federal Unemployment		
Compensation Tax Payable		\$2.00
Cr.-State Unemployment		
Compensation Tax Payable		4.00

b) When taxes are remitted to State Employment Security Agency:

Dr.- State Unemployment		
Compensation Tax	\$4.00	
Payable		
Cr.-Cash		\$4.00

---

**Detailed Transactions**

Credit:

a) With amount for unemployment taxes charged to "Unemployment Compensation Taxes".

Debit:

a) With remittances made to pay the total liability for unemployment taxes to the respective taxing authorities.

**Other Taxes Payable**

This account reflects the current liability of the credit union for miscellaneous taxes due but unpaid, including real estate taxes, personal property taxes, etc.

**Entries in the Journal and Cash Record**

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

**Illustrative Entries**

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a) To record the liability for real estate taxes which have become due and payable:

Dr.-Real Estate Taxes	\$500	
Cr.-Other Taxes Payable		\$500

b) To record payment of taxes for which a liability has been established in this account:

Dr.- Other Taxes Payable	\$500	
Cr.-Cash		\$500

---

**Detailed Transactions**

Credit:

a) With the actual liability for miscellaneous unpaid taxes with an offsetting charge to the appropriate operating expense account.

Debit:

a) With miscellaneous taxes previously credited to this account when paid.

## **ACCRUED EXPENSES**

Amounts recorded in these accounts are not yet due but are so recorded to allocate the expense to the period incurred. The use of the accrual basis of accounting is preferred because it matches expenses to the period incurred, rather than when paid, and income is recorded in the period earned, rather than when received. Even those credit unions using the modified cash basis of accounting should accrue for those expenses that would significantly distort the Statement of Income if they were recorded on the cash basis.

### **Accrued Salaries**

The amount of salaries earned but not yet paid may, if material in amount, be recorded in "Accrued Salaries" with offsetting charges to the appropriate expense classifications (Salaries, Social Security Taxes, Unemployment Compensation Taxes). This accrued liability would be applicable, for example, where salaries are paid on a biweekly basis and the pay period overlaps at month-end.

### **Accrued Employee Benefits**

When expenses for employee benefits are material in amount, the cost may be accrued by periodic charges to expenses each accrual period with an offsetting credit to "Accrued Employee Benefits". An example might be the cost of employee group life insurance where payments of the expense are made at times not conforming to the accrual periods adopted by the credit union.

### ***Accounting for Compensated Absences***

A credit union, acting as an employer, should accrue the amount of its liability for employees' compensation of future absences. The accrual need not include compensated leave that would be used in the current calendar year. The accrual should be made when all of the following conditions exist:

a) The credit union is obligated for compensation that is attributable to services that have already been provided by its employees, such as an accumulation of "annual leave";

b) The credit union has an obligation to make payment for the accrued leave or rights to compensation, even though an employee terminates;

c) Payment of the accrued compensation is probable; and

d) The amount can be reasonably estimated.

### **Accrued Cost Of Space Occupied**

When the credit union owns its building, the expense for real estate taxes may be accrued periodically by charges to "Real Estate Taxes" and credit to "Accrued Cost of Space Occupied". Other periodic costs relating to space may be significant and may justify recognition as expenses in each accrual period by periodic charges to expense and credits to "Accrued Cost of Space Occupied".

### **Accrued Dividends Payable**

The cost of funds is a material expense for credit unions and should be accrued by periodic charges to expense each accrual period. The accrued expense for dividends should be recorded as a debit to "Dividends" and as a credit to "Accrued Dividends Payable". Dividends that have been declared and are payable should be recorded by a debit to "Accrued Dividends Payable" and a credit to "Dividends Payable". See Illustrative Entries under account "Dividends Payable".

### **Accrued Accounting Service Cost**

This account is used to record unpaid expenses for accounting services that are provided by an outside person or firm. It should also be used to record unpaid expenses incurred in conjunction with a jointly owned accounting service center. The accrual may be necessary if the payment is not remitted to the processor until the middle of the subsequent month. It may also be used to accrue the cost of issuing members' quarterly statements so that the costs are evenly distributed during the accounting period.

The illustrative entries, entries in the Journal and Cash Record, and the detailed transactions will be similar to those for "Other Accrued Expenses", therefore, reference should be made to that account.

**Other Accrued Expenses**

When a credit union has other types of unpaid expenses of material amounts that should be spread over several accrual periods, they may be allocated to expense in the periods to which they apply with an offsetting credit to "Other Accrued Expense".

***Entries in the Journal and Cash Record***

The entries to these accounts should be made as "Miscellaneous" in the Journal and Cash Record. The offsetting charges to expenses when the accruals are established should be separately designated for operating expense debits.

***Illustrative Entries***

a) To establish the accrual for salaries unpaid at period end:

Dr.-Salaries	\$300.00	
Dr.-Social Security Taxes (Employer's Share)	7.50	
Cr.-Accrued Salaries		\$307.50

b) To charge real estate taxes to expense monthly during the year based on an annual estimated cost of \$600.00:

Dr.-Real Estate Taxes	\$50.00	
Cr.-Accrued Cost of Space Occupied		\$50.00

***Detailed Transactions***

Credit:

a) With amounts of periodic charges to expense representing unpaid costs in order to allocate such costs over the period to which they apply.

Debit:

a) With amounts recorded in these accounts when the actual expenses are paid. Adjustments to record differences between the accrual amounts and the actual amounts should be charged or credited, as applicable, to current operating expenses.

***BORROWERS' TAXES AND INSURANCE ESCROWS***

**Escrow Account**

This account is used if a nonmember assumes a member's real estate loan and an escrow account is required. A subsidiary ledger should be established for each nonmember for whom an escrow account is maintained. An escrow account maintained for a nonmember bears interest at a rate equal to the dividend rate paid on regular share accounts. The interest paid on such accounts should be added to the escrow account payable at the end of each accounting period (or more often if desired) by debiting "Other Miscellaneous Operating Expenses" and crediting this account. The interest paid should be recorded on each nonmember subsidiary ledger and should be identified as interest.

The escrow account should provide for the accumulation of funds to pay for 1 year's taxes, assessments, insurance premiums, or other charges that could affect the credit union's first lien position.

At the time the account is opened, the nonmember should be asked to sign a blanket withdrawal authorization which permits the FCU to use the funds to make the required payments. The FCU should also arrange with each nonmember for whom an escrow account is maintained to promptly submit to the FCU for payment, any statements received relating to taxes, assessments, insurance premiums and other fees which are to be paid from the escrow account. Any disbursement made from an escrow account should be supported by such documents. Withdrawals of amounts in excess of the amount

required to pay the fees for which the account was established are permissible at any time. Other withdrawals, except to pay the fees for which the account was established, should be prohibited.

## **OTHER LIABILITIES**

### **Other Liabilities**

This account reflects miscellaneous liabilities of the credit union for which no specific general ledger account is provided.

#### ***Entries in the Journal and Cash Record***

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

#### ***Postings to General Ledger***

Postings should be made currently as transactions occur to the General Ledger Account. The nature of the liability and the identification of the person or organization to whom the liability is owed and an explanation of all liquidating entries should be written in "Explanatory Remarks" of the General Ledger account.

### **Liability Under Pension Cost**

This account is used to record an accumulated pension liability that occurs when post service pension costs are amortized over a period that is less than the funding period. A full discussion of pension plan accounting is beyond the scope of this Manual – seek the assistance of an independent accountant who can inform you concerning accounting rules under generally accepted accounting principles.

### **Undisbursed Loan Proceeds**

This account is used to record the proceeds of loans that have been recorded on the credit union's records, but not yet disbursed.

### **Subordinated CDCU Debt**

This account is used to record the declining scale for its corresponding capital account "Uninsured Secondary Capital." A regulatory accounting position (RAP)\*\* has been taken to establish these accounts and to recognize them as secondary capital. These accounts are subordinated debt and the account holder does not have voting or ownership rights. Credit unions should record the amount of secondary capital in the equity section of the balance sheet, although any secondary capital that has a remaining maturity of less than 5 years will be split into capital and liability components based on the sliding scale in the Interim Final Rule.

\*\*-- To be consistent with generally accepted accounting principles (GAAP), the credit union's outside auditor may recognize accounts established as secondary capital as subordinated debt, and for financial statement presentation purposes, may reflect the entire balance in these accounts in the liability section of the balance sheet.

The credit union should record the secondary capital and use the new accounts as set forth in the following examples.

#### ***Illustrative Entries***

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**EXAMPLE #1:** A low-income designated credit union accepted a secondary capital account of \$100,000 with a 6-year maturity from a nonnatural person investor. The account should be recorded:

Dr.- Cash	\$100,000	
Cr.-Uninsured Secondary Capital		\$100,000

**EXAMPLE #2:** When the remaining maturity of the above account is between 4 and 5 years the following adjusting entry should be recorded to

reflect only 80 percent of the account as secondary capital:

Dr.- Uninsured	
Secondary Capital	\$20,000
Cr. - Subordinated CDCU	
Debt	\$20,000

---

In the event that a low-income credit union has depleted its reserves and undivided earnings and incurs an operating loss, the loss will be distributed pro rata among the current secondary capital account holders.

For example, a credit union has 5 secondary capital investors, each depositing \$100,000 for total secondary capital of \$500,000. The credit union incurs an operating loss of \$120,000; each account will be debited for \$24,000. The remaining balance in each account will be \$76,000, with a total remaining secondary capital of \$380,000. A credit union that has funds split between “Uninsured Secondary Capital” and “Subordinated CDCU Debt” should first absorb any pro rata loss from “Subordinated CDCU Debt”, with any remaining loss carried over to “Uninsured Secondary Capital”.

If a secondary capital account holder wishes to withdraw the investment at maturity, the credit union must determine losses as of the previous month end and allocate the loss, again on a pro rata basis to all account holders, prior to releasing the funds. Keep in mind that all funds will continue to be at risk to cover losses that exceed reserves and undivided earnings regardless of their capital values based on their final maturities.

The Interim Final Rule requires that the credit union adopt a written plan for use of the funds in the accounts and subsequent liquidity needs to meet repayment requirements upon maturity. The credit union should consider reasonableness and with risk assessment in mind.

The secondary capital accounts may not be established as share accounts and, therefore, will

be considered a form of subordinated debt, in effect a borrowing. In most cases of borrowed funds, the stated interest rate is guaranteed contrary to dividends on share deposits for credit unions which are limited to the amount of funds available from earnings, both current and accumulated. The credit union should consider its ability to meet the interest payment obligation in light of its current and accumulated earnings. Interest payable on these accounts must be accrued at least monthly. The credit union should consider the effect on regular members’ dividends when setting the interest rate or index for these accounts.

Section 107(9) of the Federal Credit Union Act limits a credit union’s borrowing to 50 percent of its paid-in and unimpaired capital and surplus. The amount held in secondary capital accounts held by low-income credit unions is to be included in total borrowings for purposes of this limitation. Secondary capital accounts, plus any other borrowings by the low-income credit union will not exceed the 50 percent limit.

Part 705 of the NCUA Rules and Regulations addresses the Community Development Revolving Loan Program for Credit Unions. A credit union participating in the program may receive up to \$300,000 in the form of a loan. A matching requirement encourages credit unions to develop a permanent source of *member shares* within one year of loan approval.

Accounts established as secondary capital by low-income designated credit unions may not be used as a source of matching funds for this program. First, secondary capital is not a *member share* and second, the regulation requires that the credit union maintain the increase in the total amount of *share deposits* for the duration of the loan from the program. The preamble to the Interim Final Rule clearly states that these accounts “may not be offered as share accounts.”

The Rule states that since secondary capital accounts are not share accounts, they are not subject to Section 701.32 limitations.

## DEFERRED CREDITS

These accounts are the counterparts to deferred charges, and accordingly, are used to carry forward to future accounting periods such items as income received but not yet earned and deferred gains on the disposition of assets.

### Unearned Interest On Loans

This account represents the balance of discounts established as deferred income when FHA Title I Property Improvement Loans are disbursed by credit unions if the credit union elects to follow FHA policies and procedures in handling such loans. The account should not be used by credit unions electing to provide for the application of an interest rate on the unpaid balance of Title I FHA loans in the conventional credit union manner.

Federal credit unions desiring to do so may adopt the FHA "discount" or "add-on" method for Title I loans. Under this method, the entry to record disbursement of the loan would be as follows (\$1,000 disbursed on "\$5 discount per \$100", loan payable in 24 equal monthly installments):

#### Illustrative Entries

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Dr.-Loans	\$1,101.22	
Cr.-Cash		\$1,000.00
Cr.-Unearned Interest on Loans		101.22

---

This account should be adjusted for the following basic conditions, although other adjustments may be needed as circumstances dictate:

a) Periodic transfers, generally monthly, to "Interest on Loans" to record earned interest. Any reasonable and logical method of recording earned interest may be used provided it is based on loan payments received, as opposed to loan payments that should have been received. It would be best if the transfer was based on a computation applied to each Title I loan individually, but if a federal credit union has numerous Title I loans, the earned interest may be

computed by grouping all Title I loans. In such a case the federal credit union should keep in mind that if interest refunds are to be made, the earned interest should be recorded individually for each borrower.

b) Prepayment of the loan. Federal credit unions must make a rebate to the extent of the full unearned interest.

c) Charge off of the loan. The unearned interest should be adjusted in both this account and the individual loan account. The amount that should then be charged off will be the amount remaining in the individual loan account after applying the amount of the interest collected.

#### Entries in the Journal and Cash Record

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

#### Illustrative Entries

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a) For recording original transaction for disbursing an FHA Title I loan:

Dr.-Loans	\$1,101.22	
Cr.-Cash		\$1,000.00
Cr.-Unearned Interest on Loans		101.22

b) For transferring unearned interest to income as the interest is earned:

Dr.- Unearned Interest on Loans	\$10.00	
Cr.-Interest on Loans		\$10.00

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#### Detailed Transactions

Credit:

a) With amounts of unearned interest on FHA loans when loans are disbursed.

Debit:

a) Periodically as interest on FHA loans is earned, with amount transferred to "Interest on Loans".

b) With refunds of unearned interest in the case on loan repayments.

c) With unearned interest when a loan is charged off; transfer to "Loans" and charge off the net unpaid balance to "Allowance for Loan Losses".

### **Deferred Credits-Insurance Premium Rebate**

This account represents the amount of dividends on life savings and borrowers' protection insurance applicable to future periods.

When credit union life savings and borrowers' protection insurance policies provide for the payment of dividends at the discretion of the insurance company based on prior years' premiums, the period that benefits is the year after the dividends are earned (i.e., the year in which the dividends are actually received). Since the entire year benefits, it is logical to reason that each of the remaining accounting periods benefit equally. Therefore, a credit union that receives an insurance dividend credit in the first part of the year may distribute this credit evenly over the remaining periods of the year. When dividends are received by the credit union by check, the charge for the entire amount is to "Cash" or to "Other Prepaid Insurance". Expense accounts such as "Life Savings Insurance" and "Borrowers' Insurance" or "Other Miscellaneous Operating Income" should be credited, as appropriate, with only one-twelfth, one-fourth or one-half of the amount of the dividend, depending upon the frequency of accrual periods, and the remainder of the dividend should be credited to this account. During the subsequent accounting periods in the calendar year, this account should be debited and expenses or other income should be credited for the applicable proportionate parts of the deferred amount.

### ***Entries in Journal and Cash Record***

All entries affecting this account should be recorded in the "Miscellaneous" columns of the Journal and Cash Record.

### ***Illustrative Entries***

a) When advice of dividend credit is received and the credit union decides to spread the credit by monthly entries offsetting expenses over the entire calendar year (assume the dividend is for \$600, and 60 percent applies to life savings insurance and 40 percent applies to borrowers' insurance):

Dr.-Other Prepaid Insurance	\$600	
Cr.-Life Savings Insurance		\$30
Cr.-Borrowers' Insurance		20
Cr.-Deferred Credits-Insurance Premium Rebates		550

b) Each month, to record the write-off of deferred insurance dividends as offsets to expenses during the year:

Dr.- Deferred Credits- Insurance Premium Rebates	\$50	
Cr.-Life Savings Insurance		\$30
Cr.-Borrowers' Insurance		20

### ***Detailed Transactions***

Credit:

a) With the portion of dividend credits received which are to be prorated as offsetting credits to operating expenses for the remainder of the calendar year.

Debit:

a) With periodic entries (monthly, quarterly or semiannually) to prorate the deferred credit over the calendar year.

### **Unamortized Discount On Sale Of Assets**

This account is used when a sale of assets occurs and the purchaser offers a note as partial payment. When this account is used, the note



will generally have an interest rate that is lower than the current rate of interest that would be charged to the purchaser if he or she borrowed the funds elsewhere. The Effective Interest Rate Method (simple interest applied to the unpaid balance) is thus used to discount the interest rate on the note to the current market interest rate for the transaction.

This process is used to determine the amount of recognized gain that can be realized during the current accounting period. The unrecognized gain (Unamortized Discount) is credited to this account and is amortized as income over the note's maturity.

**Illustrative Entries**

On January 1, 20X0, HEM FCU sells a computer to RAM FCU which originally cost \$600,000. It has total depreciation of \$300,000. RAM FCU gave HEM

FCU a non-interest bearing note of \$400,000 in payment. The note was payable 3 years later. Assume that current interest rate for the first and second year would be as illustrated below:

*January 1, 20X0.*

Dr.-Notes and Contracts Receivable	\$400,000
Dr.- Allowance for Depreciation of Furniture and Equipment	300,000
Cr.-Furniture and Equipment	\$600,000
Cr.-Gain (Loss) on Disposition of Assets	17,532
Cr.-Unamortized Discount on Sale of Assets	82,468

*Computation of Gain or Loss on Disposition*

Step #1 Note	x	Present value factor for 8% for 3 periods	=	Discount Present Value
\$400,000	x	.79383		\$317,532
Step #2 Note	-	Discount Present Value	=	Unamortized Discount
\$400,000	-	\$317,532		\$82,468

Step #3: Compute resulting Gain or Loss \$400,00-(\$600,000 - \$300,000)-\$82,468 = \$17,532

*Computation and Recording of Interest Income December 31, 20x0:*

Step #1:

Discounted PV x Current Interest Rate = Interest Income.

$$\$317,532 \times 8\% = \$25,402.56$$

Step #2 Entry:

Dr.- Unamortized Discount on Sale of Assets	25,402.56
Cr.-Other Non-Operating Income	25,402.56

*December 31, 20X1:*

Step #1: Discounted Present Value of Note, 12/31/x0, + Discount Amortization, 12/31/x0, x Current Interest Rate at Time of Sale = Interest Income

$$\$317,532 + \$25,402.56 = \$342,934.56 \times 8\% = \$27,434.76$$

Step #2: Entry:

Dr.- Unamortized Discount on Sale of Assets	27,434.76
Cr.-Other Non-Operating Income	27,434.76

**Deferred Credit-Insurance Premium Stabilization Reserve**

This account may be used by credit unions that are participating in risk rating plans for loan protection and life savings insurance. These insurance plans vary greatly.

Normally, when a credit union receives a premium refund, the refund represents a reduction of the premium and it should be treated as such by crediting the appropriate expense account. If the refund is for a prior period and the amount is material, then the financial statements for the prior period should be restated. On the other hand, if the credit memo that is received by the credit union actually represents a prepayment, the "Insurance Premium Stabilization Reserve" should be debited with an offsetting credit to this account. Periodically, the deferred credit should be amortized to expense over the period benefited. Interest received, if any, on the deposit left with the insurance company should be recorded in "Other Miscellaneous Operating Income".

***Entries in the Journal and Cash Record***

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

***Illustrative Entries***

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a) When the insurance company advises the credit union of a refund or dividend on past premiums which is to be retained and credited to the credit union's reserve account; assume the dividend is for \$600, and 60 percent applies to life savings insurance and 40 percent applies to borrowers' insurance:

Dr.-Insurance Premiums	
Stabilization Reserve	\$600
Cr.-Deferred Credits-Insurance	
Premium Stabilization Reserve	\$600

b) Each month, to record the write-off of the deferred credit as offsets to expenses:

Dr.-Deferred Credits-Insurance	
Premium Stabilization Reserve	\$50
Cr.-Life Savings Insurance	\$30
Cr.-Borrowers' Insurance	20

---

### ***Detailed Transactions***

Credit:

a) With refunds or dividends on past premiums when the refund or dividend is to be retained by the insurance company and credited to the credit union's reserve account.

Debit:

a) With periodic entries (monthly, quarterly or semiannually) to prorate the deferred credit over the calendar year.

## **Other Deferred Credits**

This account represents the balance of income deferred by the credit union for which no provision is made in other accounts in this series.

### ***Entries in the Journal and Cash Record***

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

### ***Detailed Transactions***

Credit:

- a) With amounts of miscellaneous income determined to be proper for deferred treatment.
- b) With deferred income recorded in this account, when transferred to income, or when written off with the approval of the board of directors.

## **Deferred Credits-Net Origination Fees (Costs)-Lines Of Credit To Members**

If the criteria for immateriality outlined in "Origination Fees (Costs)-Consumer Credit Transactions", are met, the fees on lines of credit should be taken directly into income and the direct costs expensed as incurred. However, if the criteria are not met, the net fees (costs) should be amortized and recognized as income using the straight-line method of amortization over the life of the credit plan. If the borrower pays all borrowings and cannot re-borrow under the contract, any unamortized net fees or costs should be recognized in income upon payment.

If the agreement provides for the option of converting a revolving line of credit to a term loan, the federal credit union should recognize the net fees or costs using the straight-line method over the combined life of the line of credit and the term loan. If the option is exercised, the net unamortized fees (costs) are transferred to the appropriate loan contra account for net origination fees (costs). The net fees (costs) should then be treated as an adjustment of yield using the interest method. If the option is not exercised and the revolving line of credit expires and all borrowings are extinguished, the net unamortized fees (costs) should be recognized as income on the termination date.

Although there are no statutory or regulatory limitations regarding maturity, sound business practice dictates that a termination date should be built into the line of credit loan agreement. A termination date provides the lender an opportunity to reevaluate the borrower's financial position and the borrower, to reassess his or her credit needs. Termination dates establish a point at which the equity line will automatically end. The life of a home equity line of credit should be short (i.e., 5 to 10 years) again to enable the periodic reevaluation of the loan plan and to permit members to reassess their credit needs.

### ***Entries in the Journal and Cash Record***

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

### ***Illustrative Entries***

- 
- a) To record the net origination fees (costs):

Dr.-Cash	\$1,000.00
Cr.-Deferred Credits-Net	
Origination Fees (Costs)-	
Lines of Credits to Members	\$1,000.00

b) To record the monthly amortization at the end of the accounting period:

Dr.- Deferred Credits-Net	
Origination Fees (Costs)-	
Lines of Credits to	
Members	\$41.67
Cr.-Other Miscellaneous	
Operating Income	\$41.67

---

### ***Detailed Transactions***

Credit:

- a) With the fees received.
- b) With the amortization of net costs.
- c) With the unamortized net costs transferred to "Line of Credit to Members- Credit Cards".

Debit:

- a) With the direct costs incurred.
- b) With the amortization of net fees.
- c) With the unamortized net fees transferred to "Line of Credit to Members- Credit Cards".

### **Deferred Credits-Net Origination Fees (Costs)-Home Equity Lines Of Credit**

### **Deferred Credits-Net Commitment Fees (Costs)-Lines Of Credit To Members**

Fees charged for entering into an agreement to make a loan, i.e., letters of credit, should be credited to this account. Direct loan origination costs incurred to make a commitment to originate a loan should be debited to this account. The net commitment fees should be deferred. If the commitment is exercised, the net fees should be amortized into income on a straight-line basis over the life of the contract. Account "Service Income-Net Commitment Fees" should be used to recognize this income. If the commitment expires unexercised, the net fees should be recognized in income upon expiration.

If the enterprise's experience with similar arrangements indicates that the likelihood is slight that the commitment will be exercised, the net fees should be recognized over the commitment period on a straight-line basis as service fee income. If the commitment is subsequently exercised, the remaining unamortized fees should be amortized on a straight-line basis over the contract period.

If the borrower pays all borrowings and cannot re-borrow under the contract, any unamortized net fees should be recognized in income upon payment. If the borrower has the option of converting the line of

credit to a term loan, the straight-line method should be applied to the combined life of the line of credit and term loan. If the option is exercised the unamortized net fees should be transferred to "Net Commitment Fees (Costs)Loans to Members."

Once in the contra account, the net fees should be amortized into income based on the interest method. If the option is not exercised and no borrowings are outstanding, the net fees should be recognized in income.

If the commitment fee is determined retrospectively as a percentage of the line of credit available but unused in a previous period, if that percentage is nominal in relation to the stated interest rate on any related borrowing, and if that borrowing will bear a market interest rate at the date the loan is made, the commitment fee should be recognized as service income as of the determination date.

### ***Entries in the Journal and Cash Record***

All entries affecting this account should be recorded as "Miscellaneous" in the Journal and Cash Record.

### ***Illustrative Entries***

- 
- a) To record the net commitment fees received from a member:

Dr.-Cash	\$1,000	
Cr.-Deferred Credit-Com-		
mitment Fees (Costs)-	Lines	
of Credit to Members		\$1,000

- b) Assuming the commitment is exercised, the periodic amortization would be recorded as follows:

Dr.- Deferred Credit-Com- mitment Fees (Costs)- Lines of Credit to Members	\$100
Cr.-Service Income-Net Commitment Fees (Costs)	\$100

c) Assuming the commitment expires unexercised, the entry would be:

Dr.- Deferred Credit-Com- mitment Fees (Costs)- Lines of Credit to Members	\$1,000.00
Cr.-Service Income-Net Commitment Fees (Costs)	\$1,000.00

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### ***Detailed Transactions***

Credit:

a) With the amount of fees received.

Debit:

a) With the amount of direct costs incurred.

b) With the period amortization of net fees.

c) With the amount of net fees when the commitment expires unexercised.

d) With the amount of unamortized net fees when the option to convert to a term loan is exercised.

### **Deferred Credits-Net Commitment Fees (Costs)-Loans To Members**

Fees charged for entering into an agreement to make a loan should be credited to this account. Direct loan origination costs incurred to make a commitment to originate a loan should be debited to this account. The net commitment fees should be deferred. If the commitment is exercised, this account should be debited and the appropriate loan contra account for net commitment fees should be credited. The net fees should then be recognized as income over the life of the loan using the interest method. If the commitment expires unexercised, the net fees should be recognized as income upon expiration.

If the enterprise's experience with similar arrangements indicates that the likelihood is slight that the commitment will be exercised, the net fees should be recognized over the commitment period on a straight-line basis as service fee income. If the commitment is subsequently exercised, the remaining unamortized fees should be transferred to "Net Commitment Fees (Costs)-Loans to Members" and recognized as income over the life of the loan using the interest method.

### **SUSPENSE ACCOUNTS**

#### **Unapplied Data Processing Exceptions**

The accounts in this series are provided for credit unions using computers for the processing of accounting transactions. The accounts are used to show the amount of unprocessed transactions rejected by the computer because of error or invalid input data. Examples are transactions bearing incorrect account numbers or names, an incorrect transaction date, a transaction designated as a loan repayment when no outstanding loan to the member is contained in the computer files, etc.

Two accounts are provided in this series for processing exceptions relating to receipt and disbursement transactions, respectively. As an alternative both unapplied disbursements may be recorded in "Unapplied Data Processing Exceptions". Exceptions must be corrected and submitted promptly for posting after a listing of exceptions has been received.

### **Unapplied Data Processing Exceptions (Receipts)**

This account reflects amounts of transactions rejected by the computer representing receipts which have not yet been applied. When the credit union receives an exception listing, an adjusting entry should be recorded in the Journal and Cash Record. The amount of unapplied receipts should be entered in the Journal and Cash Record as a credit to this account. The offsetting debit should be to the account(s) to which the rejected transactions were originally credited, which in some cases could be to the "Undistributed" accounts under "Accounts Payable".

When the unapplied exception is corrected, the adjustments made upon receipt of the exception listing should be reversed in the Journal and Cash Record as of the date of re-submittal to the computer.

#### ***Entries in the Journal and Cash Record***

All entries to this account should be recorded as "Miscellaneous" in the Journal and Cash Record unless the credit union establishes separate columns for such transactions because of the volume of debits and credits affecting this account.

#### ***Illustrative Entries***

- a) Upon receipt of an exception showing unapplied collections:

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Dr.-Loans	\$1,400		
Dr.-Interest on Loans	45		
Cr.-Unapplied	Data		
Processing	Exceptions	\$1,445	
(Receipts)			

Note: If the credit union credits items sent to the computer for processing to an "Undistributed" account in the Accounts Payable series, the debit above would be to that account.

- b) When exceptions are corrected and resubmitted to the computer, the entry shown above should be reversed.

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#### ***Detailed Transactions***

Credit:



a) With amounts of unprocessed receipt transactions rejected by the computer and shown on exception listings.

Debit:

a) With amounts of rejected receipt transactions resubmitted to the computer for processing.

### **Unapplied Data Processing Exceptions (Disbursements)**

This account is used to record disbursement transactions that were rejected by the computer. When the credit union receives an exception listing, this account is debited and the offsetting credit goes to reverse the original entry or entries. When the unapplied exceptions are corrected, which should be timely, the entries made above should be reversed as of the date resubmitted to the computer.

#### ***Entries in the Journal and Cash Record***

All entries to this account should be recorded as "Miscellaneous" in the Journal and Cash Record unless the credit union establishes separate column(s) for such transactions because of the volume of transactions affecting this account.

#### ***Illustrative Entries***

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a) Upon receipt of an exception listing showing unapplied disbursements:

Dr.- Unapplied Data Processing Exceptions (Disbursements)	\$310	
Cr.-Loans		\$250
Cr.-Shares		60

b) When exceptions are corrected and resubmitted to the computer, the entry shown above should be reversed.

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#### ***Detailed Transactions***

Debit:

a) With amounts of unprocessed disbursement transactions rejected by the computer and shown on exception listings.

Credit:

a) With amounts of rejected disbursements transactions resubmitted to the computer for processing.

## **COMMITMENTS AND CONTINGENT LIABILITIES**

## Accrued Loss Contingencies

This account is used to accrue a loss from a loss contingency when both of the following conditions exist:

- a) It is probable that an asset has been impaired or a liability has been incurred; and
- b) The amount of the loss can be reasonably estimated.

A loss contingency is defined as an existing condition, situation, or group of circumstances that involve uncertainty as to possible gain or loss to a credit union. It is resolved when one or more future events takes place or fails to occur. When the uncertainty is removed, it may confirm the purchase of an asset or the reduction of a liability or the incidence of a loss, impairment of an asset, or a liability. Examples of such contingencies would be:

- a) Pending or threatened litigation;
- b) Guarantees of indebtedness to others;
- c) Risk of loss or damage to credit union property by fire, explosion, flood, or other hazards which are not insurable;
- d) Agreements to repurchase loans, property, or other receivables that have been sold;
- e) Obligations of credit unions under standby letters of credit; and
- f) Actual possible claims and assessments.

### *Entries in the Journal and Cash Record*

The entries to this account are recorded as "Miscellaneous" in the Journal and Cash Record. The offsetting changes to expenses should be recorded in the separate column designated for operating expense debits.

### *Illustrative Entries*

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- a) To record an accrual for a loss contingency that will result from uninsured medical expenses of a credit union member. The member fell on the icy outside steps of the credit union office and has filed a lawsuit against the credit union to recover medical expenses. The credit union's attorney believes that the credit union will incur the loss. The credit union's uninsured portion of the loss will be \$10,000. The court case is expected to be finalized in three months. The entry to record estimable or probable loss would be:

Dr.-Miscellaneous		
Operating Expenses	\$10,000	
Cr.-Accrued Losses		
Contingencies		\$10,00000

The above entry would be made as of the balance sheet date.

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### *Detailed Transactions*

Credit:

a) With amounts of periodic changes to expenses representing unpaid costs in order to allocate such costs over the period to which they apply.

Debit:

a) With the amounts recorded to this account when the losses are paid; adjustments to the accrual amounts should be charged or credited as applicable to this account and the appropriate expense account.