FannieMae

MEMORANDUM

Subject:	Accounting for Cumulative Preferred Stock Dividends on our Treasury Preferred Stock Agreement
Date:	November 1, 2012
APG Report Id:	Equity-2013-22
Status:	**FINAL**
Prepared by:	Kavitha Hichkad, Accounting Policy
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Legal:	Paul Martin
D&T:	October 31, 2012
Primary Interpretive Guidance:	▪ Accounting Standards Codification 260, *Earnings Per Share* (ASC 260) ▪ Accounting Standards Codification 505, *Equity* (ASC 505) ▪ AICPA Technical Practice Aid, Section 4210, *Dividends* (TPA 4210)
Fannie Mae Interpretive Guidance:	None
Accounting Policy Guide:	N/A
Attachments:	Attachment 1 – Order Regarding Declaration and Direction of Payment of Dividend for the Senior Preferred Stock for the Period April 1, 2012 through June 30, 2012[1]
Closing Meeting:	*Date: ; Attendees:*

[1] **D&T Note:** See Deloitte wp **9018. 2L.3** *Accounting for Cumulative Preferred Stock Dividends for PSPA Attachment 1.*

I. PURPOSE

The purpose of this memo is to document the accounting for cumulative preferred stock dividends associated with our Treasury Preferred Stock Purchase Agreement.

II. BACKGROUND

On September 6, 2008, the Director of the Federal Housing Finance Agency ("FHFA") appointed FHFA as Fannie Mae's conservator. As a result, FHFA, in its capacity as conservator, has succeeded to obtain (1) all rights, titles, powers and privileges of Fannie Mae (the "Company"), and of any shareholder, officer or director of the Company with respect to the Company and its assets, and (2) title to the books, records and assets of any other legal custodian of the Company. FHFA has since delegated specified authorities to the Company's Board of Directors, which in turn delegated to management the authority to conduct our day-to-day operations.

On September 7, 2008, the Company, acting through FHFA as conservator, entered into a senior preferred stock purchase agreement (the "Agreement") with the United States Department of the Treasury (the "Treasury"). The Agreement was amended on September 26, 2008, May 6, 2009, December 24, 2009 and August 17, 2012.

The Treasury, as holder of the senior preferred stock, is entitled to receive, when, and if declared by the Board of Directors, in its sole discretion, out of funds legally available thereof, cumulative quarterly cash dividends. For each dividend period from the date of initial issuance of the senior preferred stock through and including December 31, 2012, cumulative cash dividends will be paid at the annual rate of 10% per year on the current liquidation preference of the senior preferred stock. If at any time during this period, the Company does not pay the cash dividends in a timely manner, then all dividend periods thereafter until the dividend period following the date on which the Company has paid in cash full cumulative dividends (through and including December 31, 2012), the annual dividend rate will be 12%.

On August 17, 2012, the Company, through FHFA, in its capacity as conservator, and the Treasury entered into an amendment to the Agreement between Fannie Mae and the Treasury. The amendment modified certain terms of the agreement, including the dividend provisions. Specifically, for each Dividend Period from January 1, 2013, through and including December 31, 2017, the dividend amount for a dividend period means the amount, if any, by which the net worth amount at the end of the immediately preceding fiscal quarter, less the applicable capital reserve amount, exceeds zero. The applicable capital reserve amount is $3 billion for 2013 and will be reduced by $600 million each year until it reaches zero on January 1, 2018. For each dividend period beginning in 2018, the dividend amount will be the entire amount of our net worth, if any, as of the end of the immediately preceding fiscal quarter.

Dividends will accrue and be payable in arrears when and if declared by the Board of Directors (FHFA, acting in capacity as conservator, has retained the authority to declare dividends) quarterly on March 31, June 30, September 30 and December 31 of each year (each, a "Dividend Payment Date"). If a Dividend Payment Date is not a business day, the related dividend will be paid no later than the next business day, without any increase to account for the period from the Dividend Payment Date to the actual payment date.

The example below provides an illustrative timeline of key dates of the declaration and payment of dividends for the senior preferred stock for the period from April 1, 2012 through June 30, 2012 (refer to Attachment 1 for order regarding declaration and direction of dividend payment from FHFA):

- March 31, 2012 – End of first quarter 2012

- May 9, 2012 – Q1 2012 unaudited financial statements filed with the SEC
- June 2012 (prior to June 15, 2012) – Dividend calculation provided by FHFA and confirmed by Fannie Mae with Fannie Mae's own calculation. Any differences between the calculations are reconciled prior to the dividend being declared.
- June 15, 2012 – Dividends declared by FHFA
- June 29, 2012 – Dividends paid by the Company to the Treasury

This memo specifically addresses whether the cumulative preferred dividends related to the senior preferred stock should be accrued prior to being declared.

III. TECHNICAL ANALYSIS

Question: *When should the Company accrue cumulative preferred dividends on the senior preferred stock with the Treasury?*

The cumulative preferred dividends should not be accrued until declared by FHFA, acting in its capacity as conservator.

Analysis:

TPA 4210.04 addresses whether a corporation should accrue a cumulative preferred dividend that is in arrears. The conclusion reached by the AICPA is that since dividends do not become a corporate liability until declared, no accrual is needed. However, ASC 505-10-50-5(b) requires entities to disclose in its financial statements the aggregate and per-share amounts of arrearages in cumulative preferred dividends. Furthermore, dividends accumulated for the period on cumulative preferred stock (whether earned or not) should be deducted from income from continuing operations and also from net income when computing earnings per share[2]. If there is a loss from continuing operations or a net loss, the amount of the loss should be increased by those preferred dividends.

In addition to the above analysis, Fannie Mae reviewed the 2008 audited financial statements of Bank of America, Citigroup and JP Morgan as well as the 2009 Q1 unaudited financial statement of JP Morgan to determine how each of these financial institutions accounted for the cumulative preferred stock dividend to the Treasury pursuant to the Troubled Asset Relief Program (TARP) Capital Purchase Program. Based on our review and analysis of each of the filings, it does not appear that the financial institutions noted above accrued cumulative preferred stock dividends prior to the declaration of such dividends. Specifically, we noted that the amount of preferred dividends declared in the Statement of Shareholders' Equity ("SSE") was less than the amount of preferred dividends disclosed in the Earnings Per Share ("EPS") footnote. In addition, per review of the 2008 audited financial statements of Bank of America, we noted that per footnote (1) in the Earnings Per Common Share table in **Note 14 – Shareholders' Equity and Earnings Per Common Share**, there were fourth quarter 2008 cumulative preferred stock dividends of $130 million that were not declared as of year-end, but were included in the preferred stock dividends being deducted from net income in the EPS calculation; whereas the amount disclosed in the SSE excluded the amount of fourth quarter dividends that were not declared as of year-end. If the dividends had been accrued prior to being declared, the amount of preferred divi-

[2] ASC 260-10-45-11

dends in the SSE would have been the same as the amount of preferred dividends that was disclosed in the EPS footnote. This analysis of the financial institutions noted above further supports our conclusion that dividends should not be accrued until declared.