

FASB Emerging Issues Task Force
Draft Abstract
EITF Issue 08-8

Notice for Recipients of This Draft EITF Abstract
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October 1, 2008

This draft abstract for EITF Issue No. 08-8, "Accounting for an Instrument (or an Embedded Feature) with a Settlement Amount That Is Based on the Stock of an Entity's Consolidated Subsidiary," addresses the following issue:

Whether freestanding financial instruments (or embedded features) within the scope of this Issue are precluded from being considered indexed to the entity's own stock in the consolidated financial statements of the parent.

The attached draft abstract reflects the consensus-for-exposure reached by the Task Force at the September 10, 2008 EITF meeting. The Task Force invites individuals and organizations to send written comments on all matters within this draft abstract. Comments are requested from those who agree with the provisions in this draft abstract as well as from those who do not. Comments are most helpful if they identify the issue and the specific paragraph or group of paragraphs to which they relate and clearly explain the issue or question. Those who disagree with the consensus-for-exposure presented in this draft abstract are asked to describe their suggested alternatives, supported by specific reasoning.

The Task Force specifically requests that constituents provide comments on:

- a. Whether the guidance in this Issue is operational and provides a principle that could be applied consistently
- b. Whether the proposed transition and effective date are appropriate and provide sufficient time for constituents to understand and apply the requirements of the draft abstract.

New Format for FASB Documents

This draft abstract has been written in a new format intended to improve its understandability. Notable changes from previous formats include the use of bold text at the beginning of each section to convey the accounting principle for that section and the inclusion of examples in the

body of the standard to illustrate the proposed accounting guidance for certain paragraphs, when applicable.

Comments will be considered by the Task Force at the November 13, 2008 EITF meeting.

Responses from interested parties wishing to comment on the draft abstract must be received in writing by October 22, 2008. Interested parties should submit their comments by email to director@fasb.org, File Reference No. EITF0808. Responses should not be sent by fax.

EITF ABSTRACTS (DRAFT*)

Issue No. 08-8

Title: Accounting for an Instrument (or an Embedded Feature) with a Settlement Amount That Is Based on the Stock of an Entity's Consolidated Subsidiary

Dates Discussed: September 10, 2008; [November 13, 2008]

References: FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

FASB Statement No. 154, *Accounting Changes and Error Corrections*

AICPA Accounting Research Bulletin No. 51, *Consolidated Financial Statements*

EITF Issue No. 99-1, "Accounting for Debt Convertible into the Stock of a Consolidated Subsidiary"

EITF Issue No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary"

EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"

EITF Issue No. 07-5, "Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity's Own Stock"

Objective

1. The objective of this Issue is to clarify whether a financial instrument for which the payoff to the counterparty is based, in whole or in part, on the stock of an entity's consolidated subsidiary is indexed to the reporting entity's own stock and therefore should not be precluded from qualifying for the first part of the scope exception in paragraph 11(a) of Statement 133 or from being within the scope of Issue 00-19.

**All paragraphs in this Issue have equal authority.
Paragraphs in bold set out the main principles.**

* This draft abstract is being exposed for a public comment period that will end on October 22, 2008.

Background

2. An entity or its consolidated subsidiary may enter into a freestanding financial instrument (or an embedded feature) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary. Examples of freestanding contracts include written call or put options (and warrants) on the stock of the consolidated subsidiary, purchased call or put options on the stock of the consolidated subsidiary, and forward sales or purchase contracts on the stock of the consolidated subsidiary. Examples of embedded features include debt that is convertible into the stock of the consolidated subsidiary, issued by the entity or its consolidated subsidiary.

3. Paragraph 11(a) of Statement 133 provides that a reporting entity shall not consider a contract to be a derivative if it is both (a) indexed to its own stock and (b) classified in stockholders' equity in its statement of financial position. Issue 07-5 requires that if a financial instrument (or embedded feature) is not considered to be indexed to an entity's own stock, equity classification would be precluded and the instrument would not be within the scope of Issue 00-19.

Scope

4. **This Issue applies to freestanding financial instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated. This Issue applies to those instruments (and embedded features) in the consolidated financial statements of the parent, whether the instrument was entered into by the parent or the subsidiary.**

Recognition

5. **Freestanding financial instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary are not precluded from being considered indexed to the entity's own stock in the consolidated financial statement of the parent if the subsidiary is a substantive entity. If the subsidiary is not a substantive entity, the instrument or embedded feature would not be considered indexed to the entity's own stock. The SEC Observer reiterated the SEC staff's longstanding position that written options that do not qualify for equity classification should be reported at fair value and subsequently marked to fair value through earnings.**

6. If the subsidiary is considered a substantive entity, the consensus in Issue 07-5 shall be applied to the freestanding financial instrument (or an embedded feature) within the scope of this Issue in order to determine whether it is indexed to the entity's own stock and should be considered in conjunction with other applicable generally accepted accounting principles (GAAP) (for example, Issue 00-19) in determining the classification of the freestanding financial instrument (or embedded feature) in the financial statements of the entity.

Other Presentation Matters

7. An equity-classified instrument (including an embedded feature that is separately recorded in equity under applicable GAAP) within the scope of this Issue shall be presented as a component of noncontrolling interest in the consolidated financial statements, whether the instrument was entered into by the parent or the subsidiary. However, if an equity-classified instrument within the scope of this Issue was entered into by the parent and expires unexercised,

the carrying amount of the instrument shall be reclassified from the noncontrolling interest to the controlling interest.

Transition

8. This Issue is effective for fiscal years beginning on or after December 15, 2008, and interim periods within those fiscal years. Early adoption is not permitted. The consensus shall be applied to outstanding instruments as of the beginning of the fiscal year in which this Issue is initially applied. The fair value of an outstanding contract that was previously classified as a derivative asset or liability shall become its net carrying amount at that date. The net carrying amount shall be reclassified to noncontrolling interest. Gains or losses recorded during the period that the contract was classified as a derivative asset or liability shall not be reversed.

9. The transition disclosures in paragraphs 17 and 18 of Statement 154 shall be provided.

Amendments to Other Literature

10. ARB 51, paragraph 27, is amended as follows: [Added text is underlined and deleted text is ~~struck out~~.]

Only the following a financial instrument issued by a subsidiary that is classified as equity in the subsidiary's financial statements can be a noncontrolling interest in the consolidated financial statements:-

- a. A financial instrument issued by a subsidiary that is classified as equity in the subsidiary's financial statements
- b. A financial instrument (or an embedded feature) issued by a parent or a subsidiary for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary, that is considered indexed to the entity's own stock in the consolidated financial statements of the parent and that is classified as equity.

A financial instrument issued by a subsidiary that is classified as a liability in the subsidiary's financial statements based on the guidance in other standards is not a noncontrolling interest because it is not an ownership interest.

11. Issue 99-1 and Issue 00-6 are superseded.

12. Issue 00-19 is amended as follows:

a. Paragraph 3:

This Issue applies only to freestanding derivative financial instruments (for example, forward contracts, options, and warrants). This Issue applies to security price guarantees or other financial instruments indexed to, or otherwise based on, the price of the company's stock that are issued in connection with a purchase business combination and that are accounted for as contingent consideration only if those instruments meet the criteria in Issue No. 97-8, "Accounting for Contingent Consideration Issued in a Purchase Business Combination," for recording as part of the cost of the business

acquired in a purchase business combination (see discussion of Issue 97-8 in paragraph 58 of the STATUS section). This Issue does not address the accounting for either the derivative component or the financial instrument when the derivative component is embedded in and not detachable from the financial instrument. This Issue also does not address the accounting for contracts that are issued (a) to compensate employees or (b) to acquire goods or services from nonemployees when performance has not yet occurred. However, this Issue applies to contracts issued to acquire goods or services from nonemployees when performance has occurred. This Issue does not address the accounting for a written put option and a purchased call option embedded in the shares of a noncontrolling interest of a consolidated subsidiary ~~contracts that are indexed to, and potentially settled in, the stock of a consolidated subsidiary~~ (see discussion of Issue No. 00-6, "~~Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary,~~" and Issue No. 00-4, "Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary," in paragraphs 62 ~~and 63~~ of the STATUS section).

b. Paragraph 63:

~~The Task Force discussed another related issue in t Issue No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary." Issue 00-6 addresses how freestanding derivative instruments entered into by a parent company that are indexed to, and potentially settled in, the stock of a consolidated subsidiary should be classified and measured in the consolidated financial statements. [Note: Issue 00-6 has been partially nullified by Statement 150. See STATUS section of Issue 00-6 for details.]~~

The provisions of this Issue need not be applied to immaterial items.