

**FASB Emerging Issues Task Force
Draft Abstract
EITF Issue 07-4**

Notice for Recipients of This Draft EITF Abstract
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October 1, 2007

This draft abstract for EITF Issue No. 07-4, "Application of the Two-Class Method under FASB Statement No. 128, *Earnings per Share*, to Master Limited Partnerships," addresses the following issue:

When applying the two-class method under Statement 128, how current period earnings of an MLP should be allocated to the GP, LPs, and, when applicable, IDRs.

The attached draft abstract reflects the Task Force's tentative conclusions reached at the September 11, 2007 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 scope of the Issue should include incentive distribution rights (IDRs) that are embedded in the general partner interest.
- 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 28 - 29, 2007 EITF meeting.

Responses from interested parties wishing to comment on the draft abstract must be received in writing by October 22, 2007. Interested parties should submit their comments by email to director@fasb.org, File Reference No. EITF0704. Responses should not be sent by fax.

EITF Issue No. 07-4, Application of the Two-Class Method under FASB Statement No. 128 to Master Limited Partnerships

Dates Discussed: June 14, 2007; September 11, 2007; [November 28–29, 2007]

Objective

1. The objective of this Issue is to improve the comparability of earnings per unit (EPU) calculations for master limited partnerships (MLPs) with incentive distribution rights (IDRs) in accordance with Statement 128 and its related interpretations.

<p>All paragraphs in this Issue have equal authority. Paragraphs in bold set out the main principles.</p>

Background

2. Publicly traded MLPs often issue multiple classes of securities that may participate in partnership distributions according to a formula specified in the partnership agreement. A typical MLP consists of publicly traded common units held by limited partners (LPs), a general partner (GP) interest, and IDRs. Depending on the structure of the MLP, the IDRs may be a separate class of nonvoting limited partner interest that the GP initially holds but generally may transfer or sell apart from its overall interest. Alternatively, the IDRs may be embedded in the GP interest such that they cannot be detached and transferred apart from the GP's overall interest.

3. Generally, the partnership agreement obligates the GP to distribute 100 percent of the partnership's available cash at the end of each quarter to the GP and LPs via a distribution waterfall (that is, a schedule that prescribes distributions to the GP and LPs at each threshold). When certain thresholds are met, the distribution waterfall further allocates available cash to the holder of the separate class of nonvoting limited partner interest (the IDR holder) or, when the IDR is embedded in the GP interest, to the GP. The net income (or loss) of the partnership is allocated to the capital accounts of the GP and LPs based on their respective sharing of income or losses specified in the partnership agreement, but only after taking into account any priority income allocations resulting from incentive distributions.

4. As a result of the capital structure of MLPs, the partnership is required to apply the two-class method to calculate EPU. Paragraph 61 of Statement 128 describes the two-class method as an earnings allocation formula that determines earnings per share for each class of common

¹ This draft abstract is being exposed for a public comment period that will end on October 22, 2007.

stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Undistributed earnings are allocated to the common unit(s) and participating securities as if all earnings for the period had been distributed. When applying the two-class method to the interests of the GP and LPs in MLPs, questions have been raised about the effect of IDRs on the computation of EPU.

Scope

5. This Issue applies to MLPs that are required to make incentive distributions when certain thresholds have been met that are accounted for as equity distributions.

6. An MLP may issue IDRs that are a separate class of nonvoting LP interest that the GP initially holds or IDRs that are embedded in the GP interest and therefore cannot be detached or transferred apart from the GP's overall interest. IDRs that are a separate class of non-voting limited partner interest generally may be transferred or sold apart from the GP interest. This Issue applies to all MLPs (a) that are required to make incentive distributions when certain thresholds have been met (regardless of whether the IDRs are a separate LP interest or embedded in the GP interest) and (b) have accounted for the incentive distributions as equity distributions (as opposed to compensation costs). The determination of whether the incentive distribution is an equity distribution or compensation expense is outside the scope of this Issue.

Other Presentation Matters

7. IDRs that are a separate class of LP interest are participating securities because they have a right to participate in earnings with common equity holders. Therefore, current-period earnings shall be allocated to the GP, LP, and IDR holders using the two-class method in Statement 128 to calculate EPU.

8. When calculating EPU under the two-class method for an MLP, net income (or loss) shall be reduced (or increased) by distributions to the GP, LPs, and IDR holders. The undistributed earnings, if any, shall be allocated to the GP, LPs, and IDR holder utilizing the distribution waterfall (that is, a schedule that prescribes distributions to the various interest holders at each threshold) for available cash specified in the partnership agreement. The distribution formula for available cash would not be considered a "specified threshold" as described in Example F in paragraph 16 of Issue 03-6. Any excess of distributions over earnings shall be allocated to the GP and LPs based on their respective sharing of losses specified in the partnership agreement (that is, the provisions for allocation of losses to the partners' capital accounts). If the IDR holders do not share in losses, the excess of distribution over earnings amount would not be allocated to the IDR holders. However, if the IDR holders have a contractual obligation to share in the losses of the MLP on a basis that is objectively determinable (as described in paragraphs 17 and 18 of Issue 03-6), the excess of distributions over earnings shall be allocated to the GP, LPs, and IDR holders based on their respective sharing of losses specified in the partnership agreement.

9. IDRs that are embedded in the GP interest are not separate participating securities. However, because the GP and LP interests are separate classes of equity, the two-class method shall be applied in computing EPU for the GP and LP interests.

10. When calculating EPU under the two-class method for an MLP, net income (or loss) shall be reduced (or increased) by distributions to the GP (including the distribution rights of the embedded IDRs) and LPs. Undistributed earnings, if any, shall be allocated to the GP (including the distribution rights of the embedded IDRs) and LPs utilizing the distribution waterfall for available cash specified in the partnership agreement. The excess of distributions over earnings shall be allocated to the GP and LPs based on their respective sharing of losses specified in the partnership agreement.

Transition

11. This Issue shall be effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted. This Issue shall be applied retrospectively for all financial statements presented.

<p>The provisions of this Issue need not be applied to immaterial items.</p>

References

FASB Statement No. 128, *Earnings per Share*

Proposed FSP EITF 03-6-a, "Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities"

AICPA Statement of Position 95-2, "Financial Reporting by Nonpublic Investment Partnerships"

International Accounting Standard 33, *Earnings per Share*

EITF Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128"

EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share"

EITF Abstracts, Topic No. D-72, "Effect of Contracts That May Be Settled in Stock or Cash on the Computation of Diluted Earnings per Share"

EITF Abstracts, Topic No. D-82, "Effect of Preferred Stock Dividends Payable in Common Shares on Computation of Income Available to Common Stockholders"