

**Emerging Issues Task Force
Agenda Committee Report, Part II
February 2 and 7, and March 7, 2006**

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0306REPORT-PART II

Emerging Issues Task Force Agenda Committee Decisions on Proposed Issues

4. Transactions Involving the Purchase of Financial Assets and Simultaneous Repurchase of the Same Financial Assets with the Seller

This issue deals with the accounting from the perspective of both the buyer and the seller of financial assets that are the subject of a repurchase agreement with the same parties.

Example Transaction

Company A (the buyer) purchases a financial asset (for example, mortgage loans or mortgage-backed securities (MBS)) and simultaneously enters into a repurchase agreement (repo) with an investment bank (the seller) to finance the transaction. The purchase and repo may be settled net (no gross cash movements) with the buyer paying a deposit amount, as part of the collateral requirements of the repurchase agreement, equal to a percentage (for example, 5 percent) of the principal amount of the financial asset. In other cases, the transaction may involve gross cash transfers within close proximity of each other.

Current Practice

It is believed that most buyers have accounted for the transaction in the example transaction (and similar transactions) as a purchase and subsequent financing (View B below) and that there is currently minimal diversity in this practice. Although it was first noted in the mortgage REIT industry and would have implications for the corresponding seller's accounting as well, other industries would be affected if a view other than View B below were taken. The transaction is present in a broad range of companies, including hedge funds that have prime brokerage relationships and certain community banks and other financial institutions. Some believe that, depending on the view ultimately supported by the Task Force, similar accounting issues may be raised in transactions in which the seller provides financing to the purchaser through means other

than a repurchase agreement. It is observed that a view other than View B below could have significant tax implications for certain mortgage REITs.¹

In determining the proper accounting, all of the proponents of the views expressed below believe Company A is required to apply all of the provisions in FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. They believe Statement 140 is symmetrical such that for a buyer to receive purchase treatment, the transaction must achieve sale treatment by the seller by meeting all of the criteria under paragraph 9. They agree that if the transaction does not achieve sale treatment, paragraph 12 requires that the buyer must record the transaction as a financing to the extent of the cash or other assets that it transferred.

Issue: How to apply the criterion in paragraph 9(a) of Statement 140 in accounting for transactions involving the purchase of financial assets and simultaneous repurchase of the same financial assets with the seller.

View A: The assets have not been isolated from the transferor (that is, the seller does not meet the requirements in paragraph 9(a) of Statement 140).

View A proponents believe that paragraph 9(a) of Statement 140 has not been met (that is, the transferred assets have not been legally isolated from the seller). Paragraph 27 of Statement 140 provides implementation guidance regarding isolation, it states that "the nature and extent of supporting evidence required for an assertion in financial statements that transferred financial assets have been isolated—put presumptively beyond the reach of the transferor and its creditors, either by a single transaction or a series of transactions taken as a whole—depend on the facts and circumstances." Since the seller has continuing involvement through the repo, a legal opinion will typically be required, under the auditing guidance in AU 9336, *Using the Work of a Specialist: The Use of Legal Interpretations as Evidential Matter to Support Management's Assertion that a Transfer of Financial Assets Has Met the Isolation Criterion in Paragraph 9(a)*

¹ The accounting classification of instruments held by a REIT can impact the REIT's tax exempt status. A REIT must hold at least 75% of its total assets in *qualified real estate assets* and derive at least 75% of its gross income from *real property* (for example, rent or mortgage interest). Derivative instruments are not qualified asset.

of Financial Accounting Standards Board Statement No. 140," to support legal isolation. As a repurchase agreement usually involves the legal transfer of ownership of the financial assets to the repo counterparty, the agreement will likely contain language that will cause question as to whether the assets are in fact legally isolated from the seller. View A proponents currently understand that legal counsel would not be able to provide a properly worded true sale opinion supporting legal isolation post the repo transaction (that is, that considered both the sale and repo) without substantial modification to typical repurchase agreements. View A proponents also believe that paragraph 55 of Statement 140 requires the transferred assets to be legally isolated from the seller both initially and in subsequent periods and they question how this requirement has been met.

As the criterion in paragraph 9(a) cannot be properly supported, View A proponents believe the buyer should not record a purchase of the transferred assets. In determining whether to record this portion of the transaction as a financing, View A proponents believe that the buyer should consider what cash or other assets have been transferred to the seller. If no cash or other assets have effectively been transferred, the buyer has not provided the seller with financing and should not record a receivable. In evaluating the accounting for the repurchase agreement, View A proponents believe that the buyer must first consider whether it received a financial asset that has then been transferred, thereby allowing it to apply Statement 140. The buyer should also consider whether cash has been received. In the example above, View A proponents do not believe an asset was received and therefore transferred under the repo, and do not believe that cash was effectively received from the repo counterparty (the seller). As such, they do not believe that a liability should be recorded. The buyer's resulting entry would be to record the net cash representing the deposit amount as a deposit and the forward leg of the repurchase agreement (that is, the obligation to purchase the financial asset(s) at the end of the repo term) as a derivative.

View B: The transaction meets all of the requirements in Statement 140 to be accounted for as a sale. The transactions represent a sale of financial assets if the consideration received from the transferee is a note that provides the transferor with full recourse to the transferee's general credit.

View B proponents consider the transaction to be a sale of loans or securities in return for a note receivable from the transferee. View B proponents believe that in a sale of financial assets, if the consideration received from the transferee is a note that provides the transferor with full recourse to the transferee's general credit, then the transferor would not be considered to have any continuing involvement in the transferred assets. They believe that this view would hold even if the transferred assets were pledged as collateral against the repayment of the note, because repayment of the note would be independent of the collateral's performance.

View B proponents believe that the requirements under the criterion in paragraph 9(a) must be met to support sale treatment. However, they note that, notwithstanding the legal form of repurchase agreements, Statement 140 explicitly requires that repurchase agreements that meet the requirements under paragraph 9(c)(1) should be considered borrowings with a pledge of collateral. Consequently, they believe the characterization of the repo under U.S. GAAP should govern how it impacts the legal isolation requirements under paragraph 9(a). That is, they believe the literature would support viewing the repo as not representing continuing involvement in the transferred loans. Further, View B proponents believe that the accounting for the loan transfer should be the same in a seller financed transaction whether the seller financing takes the form of a legal collateralized borrowing or a repurchase agreement.

Agenda Committee Decisions: *The Agenda Committee deferred making a decision on this potential new issue pending a decision by the Board to add to its agenda a project to provide guidance on the issue.*

Appendix to Potential New Issue No. 4 – Criteria for Adding Items to the EITF Agenda Committee

1. Does the issue have widespread relevance?

The FASB staff believes that this issue has widespread relevance. It is of particular relevance to REIT's and the transaction is also performed by banks, investment companies, hedge funds, and insurance companies.

2. Is there significant diversity in practice?

The FASB staff believes that there is limited diversity in practice. It is believed that the majority of entities account for these transactions in accordance with View B.

3. Is there conflicting guidance in existing GAAP?

The FASB staff does not believe that there is a direct conflict within existing GAAP guidance.

4. Is it likely the EITF will be able to resolve the issue in less than one year?

The FASB staff believes that the EITF will be able to resolve the issue in less than one year.

5. Is the issue related to a current FASB project? If so, is there a pressing need to provide related guidance on a more timely basis than that expected from the FASB's activities?

This issue is not related to a current FASB project.

6. Is it reasonably likely that the FASB would conclude that only one answer is acceptable?

The FASB staff believes that there is only one acceptable answer.

7. Is there an opportunity through addressing the issue to converge U. S. practices with international practices?

Currently there is not a direct conflict within existing U. S. GAAP and international practices.

**FASB EMERGING ISSUES TASK FORCE
March 16, 2006 Meeting Agenda--REVISED**

<u>Issue Number</u>	<u>Issue</u>	<u>Proposed Time</u>	<u>Staff Assigned</u>
05-1	Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option	8:30-9:30	Oakley/ Jacobs
	Administrative Matters	9:30-10:00	Geary
	- New Issues		
	- Other Matters		
	*** BREAK ***	10:00-10:15	
06-1	Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Specialized Equipment Necessary for an End-Customer to Receive a Service from the Service Provider	10:15-11:45	Casper/ Beswick
	*** LUNCH ***	12:00-1:00	
	Closed Administrative Meeting	1:00-1:30	Smith
06-3	How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)	1:30-2:30	Beswick/ Geary
	*** BREAK ***	2:30-2:45	
06-4	Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements	2:45-3:30	Moss/ Trench
06-2	Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, <i>Accounting for Compensated Absences</i>	3:30-4:15	Casper/ Moss

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues on the proposed agenda for the March 16, 2006 meeting are considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
05-1	Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option	11/04	3/05, 6/05, 9/05	3/06	Graziano	Oakley/ Jacobs	The FASB staff will prepare an Issue Summary for the next meeting.	March 2006 EITF meeting
06-1	Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Specialized Equipment Necessary for an End-Customer to Receive a Service from the Service Provider	10/05	N/A	3/06	Hauser	Cosper/ Beswick	The FASB staff will prepare an Issue Summary for the next meeting.	March 2006 EITF meeting
06-2	Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, <i>Accounting for Compensated Absences</i>	2/06	N/A	3/06	Graul	Cosper/ Moss	The FASB staff will prepare an Issue Summary for the next meeting.	March 2006 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
06-3	How Sales Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)	2/06	N/A	3/06	Bielstein	Beswick/ Geary	The FASB staff will prepare an Issue Summary for the next meeting.	March 2006 EITF meeting
06-4	Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements	11/05	N/A	3/06	Holman	Moss/ Trench	The FASB staff will prepare an Issue Summary for the next meeting.	March 2006 EITF meeting
06-D	Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, <i>Accounting for Purchases of Life Insurance</i>	2/06	N/A	TBD	TBD	Jacobs/ Trench	The FASB staff will prepare an Issue Summary for a future meeting.	TBA

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
00-18	Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees	5/00	7/00, 7/01, 11/01, 1/02, 3/02	NA	Sarno	Pending further progress on Phase II of the Board's share-based payments project.	N/A
<p><i>The remaining issue in Issue 00-18 is Issue 3: For transactions that include a grantee performance commitment, how the grantee should account for the contingent right to receive, upon performing as specified in the arrangement, grantor equity instruments that are the consideration for the grantee's future performance. The Task Force asked the FASB staff to focus on improving the guidance (originally from Issue 96-18) used to determine the date at which a commitment for counterparty performance to earn the equity instruments is reached.</i></p>							
00-27	Application of EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," to Certain Convertible Instruments	5/00	11/00, 1/01	Not scheduled	Richards	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
02-D	The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a)(1) of FASB Statement No. 133, <i>Accounting for Derivative Instruments and Hedging Activities</i>	3/02	N/A	Not scheduled	Jacobs	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	11/02	N/A	Not scheduled	Lusniak	Pending developments in the Board's project on QSPE's and reconsideration by the FASB staff as to the extent of the issue.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
03-17	Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet	5/03	11/03	Not scheduled	Moss	Issue addresses the amortization of a recognized executory contract that has periods of both positive and negative cash flows. This issue is pending the Board's consideration of how the factors in paragraph 11(d) of Statement 142 should be evaluated in determining the useful life of an intangible asset (formerly EITF Issue 03-9).	N/A
04-7	Determining Whether an Interest Is a Variable Interest in a Potential Variable Interest Entity	5/04	6/04, 9/04, 11/04, 3/05	Not scheduled	Belcher	At its March 30, 2005 meeting, the Board agreed to add a project to provide guidance on the variability that should be considered when determining whether an interest is a variable interest. The FASB staff will ask the Task Force to remove this Issue from its agenda at a future meeting.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
05-4	The Effect of a Liquidated Damages Clause on a Financial Instrument Subject to EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"	2/05	6/05, 9/05	N/A	Thuener/ Jacobs/ Richards	Pending further progress on a DIG Issue for determining whether a registration rights agreement is a derivative	N/A
Issues Pending Further Consideration by the Agenda Committee							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
N/A	Application of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets," When a Special-Purpose Entity Holds Equity Securities and Whether an Investment That Is Redeemable at the Option of the Investor Should Be Considered an Equity Security or Debt Security	9/00	N/A	Not scheduled	Jacobs	Pending consideration of an FASB project that may address the measurement of beneficial interests in securitized financial instruments.	Pending developments in a Board project