0304FN

MINUTES OF THE MARCH 17-18, 2004 OPEN MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Wednesday, March 17, 2004

Starting Time:	10:00 a.m.
Concluding Time:	4:50 p.m.

Thursday, March 18, 2004

Starting Time:	8:00 a.m.
Concluding Time:	3:30 p.m.

Task Force Members Present:
Lawrence W. Smith (Chairman)
Frank H. Brod
Jack T. Ciesielski
Mitchell A. Danaher
Leland E. Graul
Joseph F. Graziano
John M. Guinan
* Stuart H. Harden
David L. Holman
James A. Johnson
David B. Kaplan
Louis W. Matusiak, Jr.
Ashwinpaul C. (Tony) Sondhi
Richard H. Stock
Mark M. Bielstein (AcSEC Observer)
Scott A. Taub (SEC Observer)

Task Force Members Absent:
None

* For certain issues only.

Others at Meeting Table:
Robert H. Herz, FASB Board Member
George J. Batavick, FASB Board Member
G. Michael Crooch, FASB Board Member
Gary S. Schieneman, FASB Board Member
Katherine Schipper, FASB Board Member
Leslie F. Seidman, FASB Board Member
Edward W. Trott, FASB Board Member
Russell G. Golden, FASB Senior Technical Advisor
Patrick G. Durbin, FASB Practice Fellow
Russell Hodge, SEC Professional Accounting Fellow
Shelly C. Luisi, SEC Senior Associate Chief Accountant
* Richard Graff, Mining Industry Working Group Representative
* Christopher J. Larson, FASB Practice Fellow
* Paul G. Laurenzano, FASB Practice Fellow
* Kevin T. McBride, FASB Industry Fellow
* Lisa M. Munro, FASB Practice Fellow
* Gerard M. O'Callaghan, FASB Practice Fellow
* Matthew H. Pinson, FASB Industry Fellow
* Randall S. Sogoloff, FASB Practice Fellow
* Landon B. Westerlund, FASB Practice Fellow

* For certain issues only.

ADMINISTRATIVE MATTERS

- Prior Meeting Minutes. The Task Force Chairman solicited objections to the final minutes of the November 12–13, 2003 meeting. No objections were noted.

- The Task Force discussed the reports on the EITF Agenda Committee meetings held on December 8, 2003, and February 17, 2004. The following decisions and recommendations were made by the Agenda Committee:

a. Accounting for Liabilities with Non-Issuer-Specific Risk. The Agenda Committee decided <u>not</u> to add this issue to the EITF's agenda. An FASB Board Member noted that the Board intends to address the questions raised by this proposed issue in its project on Liabilities and Equity during the first half of 2004 and that many of those questions may have implications beyond the specific transactions described in the proposed issue.

b. Accounting for Preexisting Contracts between the Parties to a Purchase Business Combination. The Agenda Committee decided to add this Issue to the EITF's agenda and to include the issues described in the Agenda Committee Report prepared in conjunction with the November 12–13, 2004 EITF meeting. An FASB Board Member indicated that in developing the appropriate scope of this Issue, the FASB staff should consider the guidance in paragraphs 11 and 18 of FASB Statement No. 45, *Accounting for Franchise Fee Revenue*, as it relates to the reacquisition of franchise rights. (Refer to discussion of EITF Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Purchase Business Combination," elsewhere in these minutes).

c. Accounting for Endorsement Split-Dollar Life Insurance Arrangements. The Agenda Committee decided <u>not</u> to add this issue to the EITF's agenda. The Task Force Chairman indicated that the FASB staff will explore further how or whether this issue is related to a life insurance agenda request recently considered by the FASB. An FASB Board Member noted similarities between this issue and the life insurance agenda request considered by the Board because both raise concerns about the prescribed accounting for investments in life insurance under FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*.

d. Accounting for Postretirement Cost of Insurance Charges in Modified Endowment Contracts. The Agenda Committee decided <u>not</u> to add this issue to the EITF's agenda. However, the FASB staff noted that in many situations, the life insurance arrangements in question are used to fund a postretirement benefit arrangement. The postretirement benefit arrangement should be accounted for separately from the life insurance arrangement pursuant to applicable generally accepted accounting principles (for example, FASB Statement No. 87, *Employers' Accounting for Pensions*, or APB Opinion No. 12, *Omnibus Opinion—1967*).

e. Status Update on EITF Issue No. 03-15, "Interpretation of Constraining Conditions of a Transferee in a Collateralized Debt Obligation (CDO) Structure." The FASB staff recommended deferral of Issue 03-15 from the EITF agenda until an amendment of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, is finalized. The Agenda Committee was not asked to make a recommendation to the Task Force regarding whether to remove this Issue from the EITF Agenda.

- The following comment letters were reported as received:

a. EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (1 comment letter).[1]

b. EITF Issues No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets"; No. 04-3, "Mining Assets: Impairment and Business Combinations"; No. 04-4, "Allocation of Goodwill to Reporting Units for a Mining Enterprise" (2 comment letters).[1]

- 2004 EITF Meeting dates. The Task Force Chairman formally confirmed the following EITF meeting dates:

a. June 30–July 1, 2004. One-and-a-half or two-day meeting
b. September 29–30, 2004. One-and-a-half or two-day meeting.

The Task Force Chairman also indicated that the November meeting would be held on November 11 or November 18, 2004, depending on Task Force member availability. A final date will be communicated in the near future.

- An FASB staff member announced that, beginning in June 2004, EITF discussion materials (Issue Summaries, Issue Summary Supplements, Working Group Reports, and comment letters) will be made available to constituents free of charge via posting to the FASB website (www.fasb.org). Minutes will also be made available following each meeting. Postings will coincide with distributions to Task Force members.

[1] Discussion of comment letters occurred during the discussion of the related Issue.

SEC STAFF ANNOUNCEMENT

Topic: ***EITF Abstracts*, Topic No. D-98, "Classification and Measurement of Redeemable Securities"**

Date discussed: March 17–18, 2004

As a result of the issuance of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and its related implementation and transition guidance, the SEC staff has prepared the following addendum to the Subsequent Developments section of Topic D-98.

> At the March 17-18, 2004 meeting, the SEC Observer clarified the SEC staff's position relating to the interaction of Topic D-98 and Statement 150 for conditionally redeemable preferred shares. If a company issues preferred shares that are conditionally redeemable, for example, at the holder's option or upon the occurrence of an uncertain event not solely within the company's control, the shares are not within the scope of Statement 150 because there is no unconditional obligation to redeem the shares by transferring assets at a specified or determinable date or upon an event certain to occur. If the uncertain event occurs, the condition is resolved, or the event becomes certain to occur, then the shares become mandatorily redeemable under Statement 150 and would require reclassification to a liability. Paragraph 23 of that Statement requires the issuer to measure that liability initially at fair value and reduce equity by the amount of that initial measure, recognizing no gain or loss. This reclassification of shares to a liability is akin to the redemption of such shares by issuance of debt. Similar to the accounting for the redemption of preferred shares (refer to Topic No. D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock"), to the extent that the fair value of the liability differs from the carrying amount of the preferred shares, upon reclassification that difference should be deducted from or added to net earnings available to common shareholders in the calculation of earnings per share.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 02-14

Title: Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means

Dates Discussed: September 11–12, 2002; November 21, 2002; January 23, 2003; March 20, 2003; November 12–13, 2003; March 17–18, 2004

References: FASB Statement No. 94, *Consolidation of All Majority-Owned Subsidiaries*

FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

FASB Statement No. 128, *Earnings per Share*

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

FASB Interpretation No. 35, *Criteria for Applying the Equity Method of Accounting for Investments in Common Stock*

FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*

FASB Concepts Statement No. 6, *Elements of Financial Statements*

Proposed FASB Statement, *Consolidated Financial Statements: Purpose and Policy*, dated February 23, 1999

Proposed FASB Statement, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*, dated October 27, 2000

FASB Special Report, *Reporting Interests in Joint Ventures and Similar Arrangements*

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

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

APB Opinion No. 20, *Accounting Changes*

AICPA Accounting Interpretation 2, "Investments in Partnerships and Ventures," of APB Opinion No. 18

AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*

AICPA Practice Bulletin 1, *Purpose and Scope of AcSEC Practice Bulletins and Procedures for Their Issuance*, Exhibit I, "ADC Arrangement"

Proposed AICPA Statement of Position, *Accounting for Investors' Interests in Unconsolidated Real Estate Investments,* dated November 21, 2000

AICPA Statement on Auditing Standards No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities*

International Accounting Standard 27, *Consolidated Financial Statements and Accounting for Investments in Subsidiaries*

International Accounting Standard 28, *Accounting for Investments in Associates*

Standards Interpretations Committee 12, *Consolidation—Special Purpose Entities*

Standards Interpretations Committee 20, *Equity Accounting Method—Recognition of Losses*

Standards Interpretations Committee 33, *Consolidation and Equity Method—Potential Voting Rights and Allocation of Ownership Interests*

Introduction

1. In March 1971, the Accounting Principles Board issued Opinion 18 to prescribe accounting standards for common stock investments under the equity method. Paragraph 17 of Opinion 18 states, "… the equity method of accounting for an investment in common stock should also be followed by an investor whose investment in *voting stock* gives it the ability to exercise significant influence over operating and financial policies of an investee even though the investor holds 50% or less of the voting stock" (emphasis added). Paragraph 2 of Opinion 18 states that "the Opinion also does not apply to investments in common stock other than those described in the Opinion." By inference, the scope of Opinion 18 is restricted to voting common stock. The scope of Opinion 18 was soon questioned, and, in November 1971, the AICPA issued Interpretation 2 of Opinion 18, which reemphasized that "APB Opinion No. 18 applies only to investments in common stock of corporations…."[1]

2. Since 1971, the type and form of investment vehicles have proliferated beyond those in voting common stock; such investment vehicles include convertible debt, preferred equity securities, options, warrants, interests in unincorporated entities, complex licensing and management arrangements, as well as a host of other idiosyncratic financial instruments. These investment vehicles are designed to maximize an investor's return on investment and reduce the cost of capital for an investee; furthermore, they can convey—by contract, articles of incorporation, indenture, or other means—any combination of rights, privileges, or preferences including (a) the right to vote with common stockholders, (b) the right to appoint members of the board of directors, (c) substantive participating rights as described in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights," (d)

[1] However, the Interpretation also states that "many of the provisions of the Opinion would be appropriate in accounting for investments in these unincorporated entities [partnerships and unincorporated joint ventures]. . . ."

protective rights as described in Issue 96-16, (e) cumulative and participating dividends, and (f) liquidation preferences.

3. As a result of rights received through an investment vehicle, an investor may gain the ability to exercise significant influence over the operating and financial policies of an investee[2] without holding an investment in voting common stock of the investee. Some believe that existing authoritative literature already addresses an investor's accounting for a number of those arrangements (for example, Statement 115, Statement 133, and SOP 78-9).

4. A similar issue was discussed by the Task Force during the administrative session of the July 23, 1998 EITF meeting. At that time, the Task Force discussed the following question: "If an entity owns noncommon voting securities that provide it with the ability to exert significant influence over an investee, is that entity required to follow the guidance in Opinion 18 (that is, is the equity method of accounting required for an investment in voting preferred stock that provides for a 30 percent voting interest and commensurate board of directors representation)?"[3] At that meeting, the Task Force was not asked to reach a consensus on that issue; rather, it was asked if this, as well as other Opinion 18 implementation questions, should be addressed by the Board in a comprehensive project on unconsolidated investments or by AcSEC as part of its project on unconsolidated real estate investments. No further action was taken by the Task Force; the Opinion 18 implementation questions were incorporated into AcSEC's project on investments in real estate ventures.

Issues

5. The issues are:

Issue 1— Whether the equity method of accounting applies when an investor does not have an investment in voting common stock of an investee but exercises significant influence through other means

Issue 2— If the equity method of accounting applies to investments in other than common stock, how the equity method should be applied to those investments

Issue 3— For securities with a readily determinable fair value, how the scope provisions of Opinion 18 and Statement 115 interact.

Prior EITF Discussion

6. At the September 11–12, 2002 EITF meeting, the Task Force requested that the FASB staff develop views regarding (a) the meaning of in-substance common stock for purposes of applying the equity method of accounting and (b) the meaning of other-than-temporary impairment and its application to certain investments carried at cost.

7. At the November 21, 2002 EITF meeting, the Task Force discussed the meaning of in-substance common stock for purposes of applying the equity method of accounting. Certain Task Force members expressed the view that the concept of residual interest should be

[2] Refer to paragraph 17 of Opinion 18 and paragraph 4 of Interpretation 35.
[3] EITF Agenda Committee background material for May 1998.

considered separately from voting rights when evaluating whether the equity method should be applied. The Task Force requested that the FASB staff further develop its views.

8. The Task Force also discussed the meaning of other-than-temporary impairment and its application to certain investments carried at cost. The Task Force requested that the FASB staff consider other impairment models within the framework of generally accepted accounting principles when developing its views. The Task Force also requested that the scope of the impairment issue be expanded to include equity method investments and investments subject to Statement 115 and that that issue be addressed by the Task Force as a separate EITF Issue. [Refer to EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments."]

9. At the January 23, 2003 EITF meeting, the Task Force continued its discussion of the concept of residual interest and how that concept interacts with significant influence. The Task Force agreed that an investor should first determine if its investment is subject to Opinion 18 and then determine if significant influence exists.

10. The Task Force viewed the concept of residual interest as key in evaluating whether an investment is subject to Opinion 18. It was noted that an investor should first determine if its investment has characteristics of a residual interest and, if so, then the investor should determine if it exercises significant influence through any available means. Certain views developed by the FASB staff described certain characteristics of a residual interest—it is an ownership interest conveying certain rights; it is dependent on the enterprise's profitability for distributions of enterprise assets (for example, dividends); and it does not obligate the enterprise to transfer something of value to holders except in the case of liquidation or by formal act. The Task Force requested that the FASB staff refine its views on those characteristics by better defining the type of investment that would qualify as a residual interest subject to the equity method. Task Force members agreed that liquidation preferences and participation rights would be important factors to consider in making that determination. As a consequence of that discussion, a majority of the Task Force agreed that the equity method should not be strictly limited to investments in voting common stock.

11. Certain Task Force members observed that an investor would first have to evaluate the investee and its investment in the investee under the provisions of Interpretation 46 before applying the provisions of Opinion 18. The Task Force indicated that any guidance provided in this Issue should consider and provide clarification regarding the interaction of this Issue with Interpretation 46.

12. At the March 20, 2003 EITF meeting, the Task Force reached a tentative conclusion on the following model to be applied in determining whether an investment is subject to the equity method of accounting in Opinion 18.

Step 1: Determine if the investor's economic interest[4] is subject to consolidation under ARB 51 or its related interpretations. If the investor's economic interest is deemed to be a controlling financial interest, then the investor would consolidate the investee in accordance with ARB 51 or its related interpretations. If the investor's economic interest is not deemed to be a controlling financial interest, then the investor's economic interest is evaluated under Step 2.

Step 2: Determine if the investor's economic interest meets the residual interest category definition stated below:

> <u>Residual-Interest Category Definition</u>: an ownership interest or a residual interest, or both,[5] that does not obligate,[6] in and of itself or in combination with other financial instruments, the investee to transfer something of value (for example, assets or ownership interests) to the interestholder (or investor) at a nonspecious future date[7] except in the event of the enterprise's liquidation unless the enterprise formally acts to distribute something of value to owners, for example, by declaring a dividend. Common stock, voting and nonvoting, is an economic interest satisfying this definition; it represents both an ownership interest and a residual interest, and it does not obligate the enterprise to transfer something of value to the interest holder at a future date. However, puttable common stock may or may not obligate the enterprise to transfer something of value at a nonspecious future date depending upon the terms of the embedded put option. Preferred stock—voting or nonvoting, participating or nonparticipating, convertible or nonconvertible—is an economic interest that satisfies this definition: it represents both an ownership interest and a residual interest,[8] and it does not obligate the enterprise to transfer something of value to the interestholder.[9] Redeemable preferred stock may or may not obligate the enterprise to transfer something of value at a nonspecious future date; it depends on the facts and circumstances of the arrangement.

If the investor's economic interest is not a residual interest (because it does not meet the definition above), then the investor's economic interest is not subject to the equity

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[4] Economic interests comprise all types and forms of investment vehicles that an investee could issue or be a party to, including equity securities; financial instruments with characteristics of equity, liabilities, or both; long-term debt and other debt-financing arrangements; leases; and contractual arrangements such as management contracts, service contracts, or intellectual property licenses.

[5] Refer to paragraph 60 of Concepts Statement 6.

[6] *Obligate* is used here in the same sense as in footnote 22 of Concepts Statement 6 and indicates that the enterprise has little or no discretion to avoid (for example, the event is outside the control of the enterprise).

[7] *Specious* is defined as "plausible, apparently sound or convincing, but in reality sophistical or fallacious" (*Oxford English Dictionary*, 1971). The term *nonspecious future date* is included here to preclude certain instruments, such as mandatorily redeemable preferred stock with a 100-year redemption date, from being designed solely to achieve a certain accounting treatment.

[8] Refer to paragraph 62 of Concepts Statement 6.

[9] While convertible preferred stock would require an entity to issue something of value (issuance of common stock upon conversion of the convertible preferred stock), the potential to convert one form of economic interest that meets the residual interest category definition into another form of economic interest that meets the residual interest category definition would not cause an economic interest to not meet the residual interest category definition.

method of accounting (refer to paragraph 13). If the investor's economic interest is a residual interest, then the investor's economic interest is evaluated under Step 3.

Step 3: Determine if the investor exercises significant influence, by virtue of any means, over operating and financial policies of an investee. The intent of the phrase "by virtue of any means" is that the investor is required to analyze all of its economic interests, including all of its contractual relationships with the investee, regardless of form (for example, side arrangements, oral agreements, and so forth), to determine if the investor exercises significant influence. If the investor does not exercise significant influence, then the investor's residual interest is not subject to the equity method of accounting. If the investor exercises significant influence, then the investor's residual interest is subject to the equity method of accounting.

13. Economic interests that do not meet the residual-interest category definition under the above model generally would not be subject to the equity method of accounting. However, the Task Force also observed that certain economic interests that do not meet the residual-interest category definition might be a result of financial structuring designed to avoid the equity method of accounting. For instance, rather than buying a 30 percent interest in common stock of an investee that would subject the investor to the equity method of accounting, an investor may choose to buy deep-in-the-money warrants (that would convert to a 30 percent interest in common stock of an investee) because warrants would not pass the residual-interest category definition (warrants obligate an investee to transfer something of value[10]). Consequently, if such economic interests are substantially similar to an economic interest that meets the residual-interest category definition in terms of expected residual returns and expected losses and certain other rights, those economic interests would be subject to the equity method of accounting. That determination will be based on the facts and circumstances surrounding the acquisition of the economic interest by the investor.

14. The Task Force directed the FASB staff to develop views on the interaction of the scopes of Statement 115 and Opinion 18 for the purpose of clarifying the scope of this Issue. In particular, the Task Force directed the FASB staff to develop views on whether economic interests (other than voting common stock, which is specifically within the scope of Opinion 18) that meet the residual interest definition in Step 2, above, but that also meet the definition of marketable equity securities under Statement 115, should be accounted for in accordance with Statement 115 rather than this Issue.[11] In addition, the Task Force directed the FASB staff to develop views on the application of the equity method of accounting to investments that meet the residual-interest category definition (except for voting common stock).

15. At the November 12–13, 2003 EITF meeting, the FASB staff recommended that the Task Force remove this Issue from the EITF's agenda based on (a) a literal reading of Opinion 18 that

[10] Generally, holders of warrants are not entitled to distributions of enterprise assets. When warrants are converted to common stock, the holder would become entitled to distributions of enterprise assets. In contrast, convertible preferred stock is different from a warrant because regardless of exercise, it entitles the holder to distributions of enterprise assets.

[11] This requested scope clarification is not intended to amend in any way the consensus reached in EITF Issue No. 98-13, "Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee."

the equity method applies to voting common stock and (b) procedural conflicts that would arise for common stock investors currently applying the equity method procedures under Opinion 18 when those procedures are applied to other classes of securities in addition to common stock. The FASB staff also presented its view that the interaction of Opinion 18 and Statement 115 precludes an investor from applying Statement 115 if the investment is subject to the equity method of accounting.

16. Some Task Force members observed that other authoritative literature (such as Accounting Interpretation 2 of Opinion 18; SOP 78-9; EITF Issues No. 95-6, "Accounting by a Real Estate Investment Trust for an Investment in a Service Corporation," No. 98-13, "Accounting by an Equity Method Investor for Investee Losses When the Investor Has Loans to and Investments in Other Securities of the Investee," and No. 99-10, "Percentage Used to Determine the Amount of Equity Method Losses"; and *EITF Abstracts*, Topic No. D-46, "Accounting for Limited Partnership Investments") requires the equity method of accounting for investments in instruments other than voting common stock. Those Task Force members also believe that applying the equity method to investments other than voting common stock does not create procedural conflicts for common stock investors. Therefore, the Task Force decided not to remove this Issue from the EITF's agenda but agreed to form a working group to further explore the issues raised by the Task Force for discussion at a future meeting.

17. Pending further development of this Issue, the SEC Observer stated that registrants should continue to use the equity method of accounting when the registrant has significant influence over an investee and holds an investment that is in-substance common stock.

Current EITF Discussion

18. At the March 17–18, 2004 EITF meeting, the FASB staff presented the Working Group's recommendation, which was consistent with the Task Force's prior tentative conclusion on Issue 1, that the equity method should be applied to investments in common stock and residual interest category investments other than common stock. However, the Task Force was unable to reach a consensus on that prior tentative conclusion and the Working Group recommendation and decided to discontinue further discussion of the residual interest category approach.

19. The Task Force discussed the alternative view to Issue 1, that the equity method should be applied to investments in common stock and in-substance common stock. For purposes of that discussion, the Task Force considered the following revised definition of in-substance common stock:

> An economic interest that has a fair value that is substantially similar to the fair value of common stock. The following characteristics would lead an investor to believe that the economic interest's fair value is substantially similar to the fair value of common stock:
>
> (a) Substantially similar subordination characteristics to those of the common shareholders. For example, a *de minimus* liquidation preference or other non-substantive liquidation preferences would provide substantially similar subordination characteristics to those of the common shareholders.

(b) Expected participation in the investee's earnings that is substantially similar to that of the common shareholders.

(c) The right to convert to common stock.[12]

20. The Task Force was unable to reach a consensus that the equity method should be applied to in-substance common stock category investments, based on the revised definition of in-substance common stock. The Task Force again considered whether to remove this Issue from the agenda but was unable to reach a consensus. Instead, the Task Force asked the FASB staff to further clarify the definition of in-substance common stock, particularly with respect to the notion that "in-substance common stock has a fair value that is substantially similar to the fair value of common stock." The Task Force asked the FASB staff to clarify that *changes* in the fair value of in-substance common stock should be expected to be substantially similar to the changes in the fair value of common stock.

21. Pending further development of this Issue, the SEC Observer reiterated the earlier observation that registrants should continue to use the equity method of accounting when the registrant has the ability to exercise significant influence over an investee and holds an investment that is in-substance common stock. However, the SEC Observer noted that, pending further refinements to the definition of in-substance common stock presented in this Issue, the determination of what constitutes in-substance common stock should be based on an evaluation of all relevant facts and circumstances on a case-by-case basis.

22. The Task Force did not discuss Issues 2 and 3.

23. The illustrations of alternative approaches of applying the equity method to investments in other than common stock (Issue 2) that were presented in Exhibit 02-14A and Exhibit 02-14B to Working Group Report No. 1, for the March 17–18, 2004 EITF meeting, were prepared solely for purposes of discussion by the Task Force. Neither the Task Force nor the FASB staff has concluded that any of those approaches are acceptable or unacceptable applications of generally accepted accounting principles.

Status

24. Further discussion is expected at a future meeting.

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[12] Although paragraph 18 of Opinion 18 precludes measuring equity method income or losses based on potentially convertible shares, conversion rights should be considered in determining whether the investor’s participation in the investee’s earning is substantially similar to the common shareholders.

Issue No. 03-1

Title: The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments

Dates Discussed: September 11–12, 2002; November 21, 2002 (discussed as part of Issue 02-14); January 23, 2003; March 20, 2003; May 15, 2003; July 31, 2003; November 12–13, 2003; March 17–18, 2004

References: FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*

FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*

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

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

FASB Special Report, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

AICPA Statement of Position No. 03-3, *Accounting for Loans or Certain Debt Securities Acquired in a Transfer*

AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*

AICPA Accounting and Auditing Guide, *Health Care Organizations*

SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities*

Issue

1. The issue is to determine the meaning of other-than-temporary impairment and its application to investments classified as either available-for-sale or held-to-maturity under

Statement 115 (including individual securities and investments in mutual funds), and investments accounted for under the cost method or the equity method.

Prior EITF Discussion

2. EITF Issue No. 02-14, "Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means," is a scope issue related to Opinion 18. In responding to that Issue, the FASB staff developed a view that recommended that the Task Force define *other-than-temporary* impairment and provide additional guidance on how other-than-temporary impairment should be applied to certain investments accounted for by the cost method under Opinion 18. At the September 11–12, 2002 EITF meeting, the Task Force requested that the FASB staff develop views regarding the meaning of other-than-temporary impairment and its application to certain investments carried at cost.

3. At the November 21, 2002 EITF meeting, the Task Force discussed the meaning of other-than-temporary impairment and its application to certain investments carried at cost. The Task Force requested that the FASB staff consider other impairment models within the framework of generally accepted accounting principles when developing its views. The Task Force also requested that the scope of the impairment issue be expanded to include equity method investments and investments subject to Statement 115 and that the issue be addressed by the Task Force separately from Issue 02-14.

4. At the January 23, 2003 EITF meeting, the Task Force noted that several complex issues surround the application of other-than-temporary impairment. In light of those complex issues, the Task Force requested that a working group be established to develop an approach for assessing other-than-temporary impairment that would be appropriate for different types of investments.

5. At the March 20, 2003 EITF meeting, the Task Force discussed proposed guidance for assessing other-than-temporary impairment that was recommended by the Working Group. That proposed guidance would apply to investments accounted for under the cost method or the equity method, investments classified as either available-for-sale or held-to-maturity under Statement 115 (including individual securities and mutual funds), and investments accounted for under Statement 124. It would not apply to investments within the scope of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." The proposed guidance includes the following:

Step 1: Determine whether an investment is impaired
Step 2: Determine whether an impairment is other than temporary
Step 3: Recognize an impairment loss equal to the difference between the investment's carrying amount and its fair value (measured as of the balance sheet date).

6. Step 1 of the proposed guidance generally states that an investment is considered impaired if its fair value is less than its amortized cost basis (hereinafter referred to as its carrying amount).

7. Step 2 of the proposed guidance includes the following underlying principle for determining whether an impairment is other than temporary: an impairment should be deemed other than temporary unless positive evidence indicating that an investment's carrying amount is recoverable within a reasonable period of time outweighs negative evidence to the contrary. Under the proposed guidance, the longer the investment's fair value is below its carrying amount, the more unlikely it becomes that sufficient objective and verifiable positive evidence would be available to support the recoverability of the investment's carrying value to overcome the extent of the negative evidence, except for certain investments with noncontingent contractual future cash flows. In attempting to clarify that notion, the model proposed at the March 20, 2003 EITF meeting included a rebuttable presumption that an impairment would be considered other than temporary after one year.

8. The Task Force generally supported the proposed guidance with respect to its application to equity securities but asked that the Working Group further refine some of the specific guidance within each of the steps of the impairment model. The Task Force also requested that the Working Group further explore the application of Step 2 of the proposed guidance to certain debt securities, including the impact of an investor's ability and/or intent to hold an investment when it is not probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security that was not impaired at acquisition and the decline in its fair value is due only to interest rate fluctuations.

9. The Task Force also requested that the Working Group further consider the accounting for the investment after an impairment is recognized under Step 3 of the proposed model, specifically focusing on investments accounted for under the equity method.

10. At the May 15, 2003 EITF meeting, the Task Force discussed additional Working Group recommendations regarding the refinement of the proposed guidance for assessing other-than-temporary impairment. The Task Force expressed concern over the applicability and feasibility of a single impairment model for all types of investments. Consequently, the Task Force directed the FASB staff to consider whether the characteristics of different types of investments (for example, Statement 115 available-for-sale equity securities, Statement 115 available-for-sale and held-to-maturity debt securities, and investments subject to Opinion 18) require different models for evaluating whether or when an impairment is considered other than temporary.

11. At the July 31, 2003 EITF meeting, the Task Force discussed separate impairment models proposed by the FASB staff for each of the following categories of investments: (a) Statement 115 and Statement 124 equity securities, (b) Statement 115 and Statement 124 debt securities, (c) cost method investments (that is, equity securities that are not subject to the scope of Statement 115 and not accounted for under the equity method), and (d) equity method investments. Those models were generally consistent with the three-step approach proposed at the March meeting with the following exceptions:

- Under the models for cost method investments and equity method investments without a readily determinable fair value, Step 1 was modified to include certain triggers for when an impairment test should be performed

- Under each of the models, Step 2 was tailored to the nature of the investment. For example, the proposed model for debt securities includes a consideration of the probability of collection of contractual cash flows.

12. The Task Force generally supported the underlying principles in each of the proposed impairment models for equity securities, debt securities, and cost method investments. However, the Task Force suggested further refinement to those models to, among other things:

a. Eliminate the rebuttable presumption that an impairment is considered other than temporary after a one-year period of impairment

b. Further emphasize the notion that the weight of evidence indicating an other-than-temporary impairment increases as the length of time that an investment's fair value is below its carrying amount increases and that, therefore, greater positive evidence will be required to conclude that an impairment is temporary as the duration of impairment increases

c. Require the investor to disclose in its financial statements information about unrealized holding losses that have not been recognized as other-than-temporary impairments. Some Task Force members suggested disclosures about the aging of those unrealized losses, and some suggested disclosures about the evidence supporting the conclusion that the investments to which those losses relate are not other-than-temporarily impaired.

13. In addition, the Task Force suggested that the proposed impairment model for debt securities be further refined to clarify the intent and operation of the considerations in the proposed model for determining other-than-temporary impairment for investments in debt securities with noncontingent contractual cash flows. In particular, the Task Force agreed on the general principle that impairments due to deterioration in credit that result in a conclusion that noncollection is probable should be considered other than temporary. Other declines in fair value (for example, due to interest rate changes, sector credit rating changes, or company-specific rating changes that do not result in a conclusion that noncollection of contractual principal and interest is probable) may not result in a conclusion that an other-than-temporary impairment has occurred, subject to the other considerations in the proposed model. Therefore, the Task Force asked the Working Group to further refine Step 2 of the model for debt securities to differentiate those securities for which noncollection is probable from those securities for which collection is probable but which, based on other considerations, may be considered other-than-temporarily impaired. The Task Force also requested that the Working Group develop further guidance for determining what constitutes "noncontingent contractual cash flows."

14. For cost method investments, because fair value is not readily determinable, the Task Force generally agreed that investments should be tested for impairment annually, or more frequently if certain indicators are present, rather than at each reporting date. However, certain Task Force members expressed concerns that because information necessary to estimate the fair value of a cost method investment may not be readily available to the investor, even limiting the impairment test to an annual evaluation may not be practical. Therefore, the FASB staff will explore an alternative model that would require an impairment test only when certain indicators are present.

15. The Task Force agreed to consider further development of an impairment model for the fourth category of investments discussed—equity method investments—after the impairment models for other types of investments have been further refined.

16. In addition, the Task Force requested that, as the other models are refined, the FASB staff consider further the implications of including within or excluding from the scope of this Issue (a) investments of not-for-profit organizations and (b) beneficial interests in transferred financial assets subject to the scope of Issue 99-20. Some Task Force members also requested clarification of the classification, for purposes of this Issue, of investments in mutual funds that invest in debt securities and suggested that the classification follow the guidance in Question 5 of the Special Report on Statement 115, which indicates that an investor should not "look through" the form of an investment to the underlying investments of the investment vehicle.

17. At the November 12–13, 2003 EITF meeting, the Task Force discussed several of the recommendations set forth by the Working Group on the proposed models for evaluating impairment of equity securities and debt securities but was not asked to reach a consensus. However, the Task Force expressed support in general for the underlying principles and asked the FASB staff to consider the following refinements to certain of the elements in those models:

a. Recombine the separate models for (1) equity securities, (2) debt securities, and (3) cost method investments into a single model with unique steps or analyses where appropriate (for example, the trigger-based approach in Step 1 of the cost method model or the special guidance on subsequent accounting in the debt securities model).

b. Consider whether the other-than-temporary impairment considerations in this Issue that are incremental to the impairment considerations in Issue 99-20 should be incorporated directly into Issue 99-20.

c. Reconcile the principle of considering the relative weight of evidence in its entirety with the guidance that suggests a recent but precipitous decline in market value or a slight but protracted decline in market value could individually lead to a conclusion that an impairment is other than temporary. Some Task Force members expressed concern that the guidance regarding a recent but precipitous decline or a slight but protracted decline in market value, as currently presented, takes precedence over the entire evidence-based analysis.

d. In developing an evidence-based judgment about a forecasted market price recovery, the model should emphasize that the investor must consider and give appropriate and unbiased weighting to all reasonably available third-party information (as opposed to reliance on selected information).

e. For debt securities that cannot be contractually prepaid or otherwise contractually settled in such a way that the investor would not recover substantially all of its amortized cost, clarify whether collateral should be considered a guarantee or other credit enhancement for purposes of determining whether it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the debt security.

f. Eliminate the reference to "a reasonable period of time" from the model for debt securities that cannot be contractually prepaid or otherwise contractually settled in such a way that the investor would not recover substantially all of its amortized cost. The Task Force believes that the "reasonable period of time" provision is irrelevant because the investor must assert its ability and intent to hold the investment until the earlier of (1) maturity or (2) a market price recovery.

18. Although the Task Force requested further revisions to the underlying impairment models, at the November 12–13, 2003 EITF meeting, the Task Force reached a consensus that certain quantitative and qualitative disclosures should be required for debt and marketable equity securities classified as available-for-sale or held-to-maturity under Statements 115 and 124 that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized. The consensus on quantitative and qualitative disclosures was effective for fiscal years ending after December 15, 2003. The Board ratified the consensus reached by the Task Force at its November 25, 2003 meeting.

Current EITF Discussion

19. At the March 17–18, 2004 EITF meeting, the Task Force reached a consensus that the guidance in the draft abstract, included as Appendix 03-1A, should be used to determine whether an investment within the scope of this Issue is other-than-temporarily impaired.

20. The Task Force discussed whether an investor with cost method investments, as defined in the attached draft abstract, should estimate the fair value of those investments annually for purposes of applying Step 1 of the impairment model, or whether the investor should estimate fair value when an impairment indicator is present. The Task Force reached a consensus that the investor should estimate the fair value of a cost method investment when an impairment indicator is present. A list of potential impairment indicators is included in the attached draft abstract. The Task Force also noted that those indicators are relevant only for cost method investments for which the investor is not otherwise required to estimate the fair value on an annual basis (for example, under the disclosure requirements of Statement 107). The Task Force also discussed disclosure requirements for cost method investments and reached a consensus that the investor should provide certain quantitative and qualitative disclosures for cost method investments that are impaired at the balance sheet date but for which an other-than-temporary impairment has not been recognized and certain quantitative information about cost method investments not tested for impairment under Step 1 of the impairment model.

21. The Task Force also discussed certain refinements to the draft abstract, including (a) eliminating the requirement to disclose the amount of interest income attributable to amortization of the incremental discount resulting from an other-than-temporary impairment of a debt security, and (b) referring to SOP 03-3 for the accounting for a debt security subsequent to an other-than-temporary impairment. These refinements are reflected in the draft abstract.

22. The Task Force also reached a consensus that the following should be added to the Status section of Issue 99-20 in *EITF Abstracts*:

> At the March 17-18, 2004 EITF meeting, the Task Force reached a consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." Issue 03-1 provides guidance for determining when an investment is other-than-temporarily impaired that is incremental to the considerations in this Issue—specifically, whether an investor has the ability and intent to hold an investment until recovery. In addition, Issue 03-1 contains disclosure requirements that provide useful information about impairments that have not been recognized as other than temporary for investments within the scope of this Issue. Therefore, in instances in which an investor determines that an investment with a fair value less than cost is not other-than-temporarily impaired under the guidance in this Issue, the investor should also assess its ability and intent to hold the investment as described in paragraph 12 [of the draft abstract] of Issue 03-1. In addition, the investor should disclose the information required by paragraph 21 of Issue 03-1 for investments with unrealized losses that have not been recognized as other-than-temporary impairments.

Transition

23. The guidance for evaluating whether an investment is other-than-temporarily impaired should be applied in other-than-temporary impairment evaluations made in reporting periods beginning after June 15, 2004. The disclosures are effective in annual financial statements for fiscal years ending after December 15, 2003, for investments accounted for under Statements 115 and 124. For all other investments within the scope of this Issue, the disclosures are effective in annual financial statements for fiscal years ending after June 15, 2004. The additional disclosures for cost method investments are effective for fiscal years ending after June 15, 2004. Comparative information for periods prior to initial application is not required.

Board Ratification

24. At its March 31, 2004 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

Status

25. At the March 17–18, 2004 EITF meeting, the Task Force decided to discontinue discussion of an impairment model for investments subject to the equity method of accounting. No further EITF discussion is planned. The SEC Observer stated that registrants should continue to rigorously assess equity method investments for impairment and indicated that the SEC staff will continue to object to inappropriate impairment analyses for such investments, for example a Statement 144 undiscounted cash flow approach.

APPENDIX 03-1A

EITF Abstracts (DRAFT[1])

Issue No: 03-1

Title: The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments

Dates Discussed: September 11–12, 2002; November 21, 2002 (discussed as part of Issue 02-14); January 23, 2003; March 20, 2003; May 15, 2003; July 31, 2003; November 12–13, 2003; March 17–18, 2004

References: FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*

FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*

FASB Statement No. 126, *Exemption from Certain Required Disclosures about Financial Instruments for Certain Nonpublic Entities*

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

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

FASB Special Report, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

AICPA Statement of Position No. 03-3, *Accounting for Loans or Certain Debt Securities Acquired in a Transfer*

[1] This draft abstract was prepared to facilitate discussion of the guidance on which the Task Force reached its consensus and contains all substantive aspects of the consensus. The final abstract, which will be included in the next update for *EITF Abstracts*, may contain nonsubstantive editorial revisions.

AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*

AICPA Accounting and Auditing Guide, *Health Care Organizations*

SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities*

ISSUE

1. The impairment methodology for various types of investments accounted for in accordance with the provisions of Opinion 18 and Statement 115 is predicated on the notion of other than temporary. Some believe that the authoritative literature discussing the notion of other than temporary is ambiguous and has led to inconsistent application.

2. While investments accounted for in accordance with Opinion 18 and Statement 115 share certain similarities, they are also different in many respects. In spite of such differences, the Task Force believes a common approach to evaluating other-than-temporary impairment to all such investments would reduce that ambiguity and inconsistent application.

3. The issue is to determine the meaning of other-than-temporary impairment and its application to debt and equity securities within the scope of Statement 115, certain debt and equity securities within the scope of Statement 124, and equity securities that are not subject to the scope of Statement 115 and not accounted for under the equity method of accounting.

EITF DISCUSSION

4. For investments that meet the scope of this Issue, the Task Force reached a consensus that the application guidance in paragraphs 6-20 should be used to determine when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. The guidance also includes accounting considerations subsequent to the recognition of an other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-temporary impairments. A flowchart summarizing the application guidance is included in Exhibit 03-1A, examples illustrating the application guidance are included in Exhibit 03-1B, and an example of disclosures about unrealized losses that have not been recognized is included in Exhibit 03-1C.

Scope[2]

5. This impairment model is applicable for investments in:

[2]For investments accounted for under Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets," the investor should first apply the provisions of that Issue. If the security is not other-than-temporarily impaired under Issue 99-20, the investor should then determine whether the investment is impaired under the guidance in paragraph 12 of this Issue. In addition, an investor should provide the disclosures described in paragraph 21 of this Issue for unrealized losses that have not been recognized as other than temporary under Issue 99-20 or the incremental guidance in this Issue.

a. Debt and equity securities that are within the scope of Statement 115[3,4,5]
b. Debt and equity securities that are within the scope of Statement 124 and that are held by an investor that reports a "performance indicator" as defined by the health care Guide
c. Equity securities that are not subject to the scope of Statement 115 and not accounted for under the equity method under Opinion 18 and related interpretations (hereinafter referred to as "cost method investments").

Application Guidance

Step 1: Determine Whether an Investment Is Impaired

6. An investment is impaired if the fair value of the investment is less than its cost.[6] Except as provided in paragraph 8, the investor should assess whether an investment is impaired for each reporting period.[7]

7. For investments other than cost method investments (refer to paragraph 5(c)), if the fair value of the investment is less than its cost, proceed to Step 2.

8. Because the fair value of cost method investments is not readily determinable, the evaluation of whether an investment is impaired should be determined as follows:

a. If an investor has estimated the fair value of a cost method investment (for example, for Statement 107 disclosure), that estimate should be used to determine if the investment is impaired for the reporting periods in which the investor estimates fair value. If the fair value of the investment is less than its cost, proceed to Step 2.
b. For reporting periods in which an investor has not estimated the fair value of a cost method investment,[8] the investor should evaluate whether an event or change in circumstances has occurred in that period that may have a significant adverse effect on the fair value of the investment (an "impairment indicator"). Impairment indicators include, but are not limited to:

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[3] As indicated in paragraph 127 of Statement 115, insurance companies are required to report equity securities at fair value even if they do not meet the scope criteria in paragraph 3 of Statement 115. Therefore, this model would apply to all equity securities held by insurance companies.
[4] Investors should not "look through" the form of their investment to the nature of the securities held by an investee. For example, an investment in shares of a mutual fund that invests in debt securities would be assessed for impairment as an equity security under this Issue.
[5] Some investments may require bifurcation and separate accounting for the host instrument and embedded derivative if certain criteria are met under paragraph 12 of Statement 133. The bifurcated host instrument would be evaluated for other-than-temporary impairment in accordance with this proposed guidance if the bifurcated host instrument meets the scope of this Issue.
[6] *Cost* includes adjustments made to the cost basis of an investment for accretion, amortization, previous other-than-temporary impairments, foreign exchange, and hedging.
[7] For entities that issue interim financial statements, each interim period is a reporting period.
[8] For example, an investor may not estimate the fair value of a cost method investment during a reporting period for Statement 107 disclosure because: (a) Statement 107 only requires disclosure for annual reporting periods, (b) the investor determined that, in accordance with paragraphs 14 and 15 of Statement 107, it is not practicable to estimate the fair value of the investment, or (c) the investor is exempt from providing the disclosure under Statement 126.

- A significant deterioration in the earnings performance, credit rating, asset quality, or business prospects of the investee
- A significant adverse change in the regulatory, economic, or technological environment of the investee
- A significant adverse change in the general market condition of either the geographic area or the industry in which the investee operates
- A bona fide offer to purchase (whether solicited or unsolicited), an offer by the investee to sell, or a completed auction process for the same or similar security for an amount less than the cost of the investment
- Factors that raise significant concerns about the investee's ability to continue as a going concern, such as negative cash flows from operations, working capital deficiencies, or noncompliance with statutory capital requirements or debt covenants.

In addition, if an investment was tested for impairment under Step 2 and the investor concluded that the investment was not other than temporarily impaired, the investor should continue to evaluate whether the investment is impaired (that is, should estimate the fair value of the investment) in each subsequent reporting period until either (a) the investment experiences a recovery of fair value up to (or beyond) its cost or (b) the investor recognizes an other-than-temporary impairment loss.

9. If an impairment indicator is present, the investor should estimate the fair value of the investment. If the fair value of the investment is less than its cost, proceed to Step 2.

Step 2: Evaluate Whether an Impairment Is Other Than Temporary[9]

10. For equity securities (including cost method investments) and debt securities that can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost (refer to paragraph 16 for all other debt securities), an impairment should be deemed other than temporary unless:

a. The investor has the ability and intent to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value up to (or beyond) the cost of the investment, and
b. Evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary.

11. The investor should make an evidence-based judgment about a recovery of fair value up to (or beyond) the cost of the investment by considering the severity and duration of the impairment in relation to the forecasted recovery of fair value.

12. *Investor's Ability and Intent*. An impairment should be deemed other than temporary unless the investor has the ability and intent to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value up to (or beyond) the cost of the investment. The investor should consider whether its cash or working capital requirements and contractual or regulatory obligations indicate that the investment may need to be sold before the forecasted

[9] *Other than temporary* does not mean permanent.

recovery of fair value occurs. In addition, in assessing its ability to hold an investment for a reasonable period of time sufficient for a forecasted recovery of fair value up to (or beyond) the cost of the investment, the FASB staff observes that the investor should consider the *issuer's* ability to settle the security (for example, pursuant to a call provision) during the forecasted recovery period. Although not presumptive, a pattern of selling investments prior to the forecasted recovery of fair value may call into question the investor's intent.

13. *Severity of the Impairment.* To evaluate the severity of the impairment, the investor should assess (a) the extent to which fair value is below cost and (b) the nature of the event (or events) that gave rise to the impairment. An other-than-temporary impairment may occur in a very short period of time after the initial investment or establishment of a new cost basis if, based on all available evidence, the cost of the investment is not recoverable within a reasonable period of time. As the severity of an impairment increases, greater evidence about a forecasted recovery of fair value will be required to conclude that an impairment is not other than temporary.

14. *Duration of the Impairment.* Duration refers to the period of time that a security has been impaired. As the duration of the impairment increases, greater evidence about a forecasted recovery of fair value up to (or beyond) the cost of the investment will be required to conclude that an impairment is not other than temporary.

15. *Forecasted Recovery of Fair Value*. The investor should develop an evidence-based judgment about a forecasted recovery of fair value. There are practical limitations on the period of time an investor can incorporate into its forecasted recovery of fair value, notwithstanding its ability or intent to hold an investment for an indefinite future period. As the forecasted recovery period lengthens, the uncertainties inherent in the investor's estimate increase, which impacts the reliability of that estimate. Therefore, greater evidence about a forecasted recovery of fair value will be required to conclude that an impairment is not other than temporary the further the expected recovery of fair value is from the point of the initial impairment. The investor's evidence-based judgment should give an appropriate and unbiased weighting to all reasonably available information, such as:

- The fair value of the investment after the balance sheet date but before the financial statements are issued[10]
- The regulatory, economic, or technological environment of the investee
- The general market condition of either the geographic area or the industry in which the investee operates
- Forecasts about the investee's financial performance and near-term prospects, such as earnings trends, dividend payments, asset quality, and analysts' or industry specialists' forecasts.

16. For debt securities that are not within the scope of paragraph 10, an impairment should be deemed other than temporary if (a) the investor does not have the ability and intent to hold an investment until a forecasted recovery of fair value up to (or beyond) the cost of the investment, which in certain cases may mean until maturity, or (b) it is probable that the investor will be

[10] The investor should consider the guidance in Topic No. D-86, "Issuance of Financial Statements," for determining when financial statements are considered to have been issued.

unable to collect all amounts due according to the contractual terms of the debt security. In making the determination about collectibility, the investor should consider all information available, including evidence from rating agencies, about fair value fluctuations due to factors other than interest rates. Although not presumptive, a pattern of selling investments prior to the forecasted recovery of fair value may call into question the investor's intent.

17. The investor should consider a guarantee or other credit enhancement in determining whether it is probable that the investor will be unable to collect all amounts due according to the contractual terms of the debt security only if (a) the guarantee or other credit enhancement provides for payments to be made (or assets transferred) solely to reimburse the investor for failure of the investee to satisfy its required payment obligations, and (b) the guarantee or other credit enhancement is contractually included in the terms of the purchased debt security.[11] Similarly, an investor should not combine separate contracts (the debt security and the guarantee or other credit enhancement) for purposes of determining whether a debt security can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost.

18. If the investor determines that an impaired cost method investment is not other-than-temporarily impaired, the investor should continue to estimate the fair value of the investment each reporting period and provide an evidence-based judgment supporting the conclusion that the investment is not other-than-temporarily impaired until the investment is no longer impaired (due to either a recovery of fair value up to or beyond the cost of the investment or the recognition of an other-than-temporary impairment).

Step 3: If the Impairment Is Other Than Temporary, Recognize an Impairment Loss Equal to the Difference between the Investment's Cost and Its Fair Value

19. If it is determined in Step 2 that the impairment is other than temporary, then an impairment loss should be recognized in earnings equal to the difference between the investment's cost and its fair value at the balance sheet date of the reporting period for which the assessment is made. The fair value of the investment would then become the new cost basis of the investment and should not be adjusted for subsequent recoveries in fair value.

Accounting for Debt Securities Subsequent to an Other-Than-Temporary Impairment

20. In periods subsequent to the recognition of an other-than-temporary impairment loss, the investor should apply the provisions of SOP 03-3 in determining the amount and timing of income recognition.

Disclosures

21. For all investments in an unrealized loss position for which other-than-temporary impairments have not been recognized, the investor should disclose the following in its annual financial statements:

[11] Collateral is one form of a guarantee or other credit enhancement, and should be considered in the impairment evaluation of a debt security if conditions (a) and (b) of paragraph 17 are met.

a. As of each date for which a statement of financial position is presented, quantitative information, aggregated by category of investment—each category of investment that the investor discloses in accordance with Statements 115 and 124 (refer to paragraph 5(b)) and cost method investments—in tabular form:

    (1) The aggregate amount of unrealized losses (that is, the amount by which cost or amortized cost exceeds fair value) and
    (2) The aggregate related fair value of investments with unrealized losses.

    The disclosures in (1) and (2) above should be segregated by those investments that have been in a continuous unrealized loss position for less than 12 months and those that have been in a continuous unrealized loss position for 12 months or longer.[12]

b. As of the date of the most recent statement of financial position, additional information, in narrative form, that provides sufficient information to allow financial statement users to understand the quantitative disclosures and the information that the investor considered (both positive and negative) in reaching the conclusion that the impairments are not other than temporary.[13] This disclosure could include:

    (1) The nature of the investment(s)
    (2) The cause(s) of the impairment(s)
    (3) The number of investment positions that are in an unrealized loss position
    (4) The severity and duration of the impairment(s)
    (5) Other evidence considered by the investor in reaching its conclusion that the investment is not other-than-temporarily impaired, including, for example, industry analyst reports, sector credit ratings, volatility of the security's fair value, and/or any other information that the investor considers relevant.

22. For cost method investments, the investor should disclose the following additional information, if applicable, as of each date for which a statement of financial position is presented in its annual financial statements:

a. The aggregate carrying amount of all cost method investments,
b. The aggregate carrying amount of cost method investments that the investor did not evaluate for impairment, and
c. The fact that the fair value of a cost method investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment, and

[12] The reference point for determining how long an investment has been in a continuous unrealized loss position is the balance sheet date of the reporting period in which the impairment is identified. For enterprises that do not prepare interim financial information, the reference point would be the annual balance sheet date of the period during which the impairment was identified. The continuous unrealized loss position ceases upon either (a) the recognition of an other-than-temporary impairment or (b) the investor becoming aware of a recovery of fair value up to (or beyond) the cost of the investment during the period.

[13] The application of paragraph 21(b) should provide insight into the investor’s rationale for concluding that significant unrealized losses are not other-than-temporary impairments. Those disclosures may be aggregated by investment categories, but individually significant unrealized losses generally should not be aggregated.

(1) The investor determined, in accordance with paragraphs 14 and 15 of Statement 107, that it is not practicable to estimate the fair value of the investment, or
(2) The investor is exempt from estimating fair value under Statement 126.

Transition

23. The recognition and measurement guidance in paragraphs 6-20 of this Issue should be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. For investments accounted for under Statement 115 and for investments accounted for under Statement 124 that are within the scope of this Issue (refer to paragraph 5(b)), the disclosure requirements in paragraph 21 of this Issue are effective for annual financial statements for fiscal years ending after December 15, 2003. For all other investments within the scope of this Issue, the disclosure requirements in paragraph 21 are effective for annual financial statements for fiscal years ending after June 15, 2004. The disclosure requirements for cost method investments in paragraph 22 are effective for annual financial statements for fiscal years ending after June 15, 2004. Comparative information for periods prior to initial application is not required.

Board Ratification

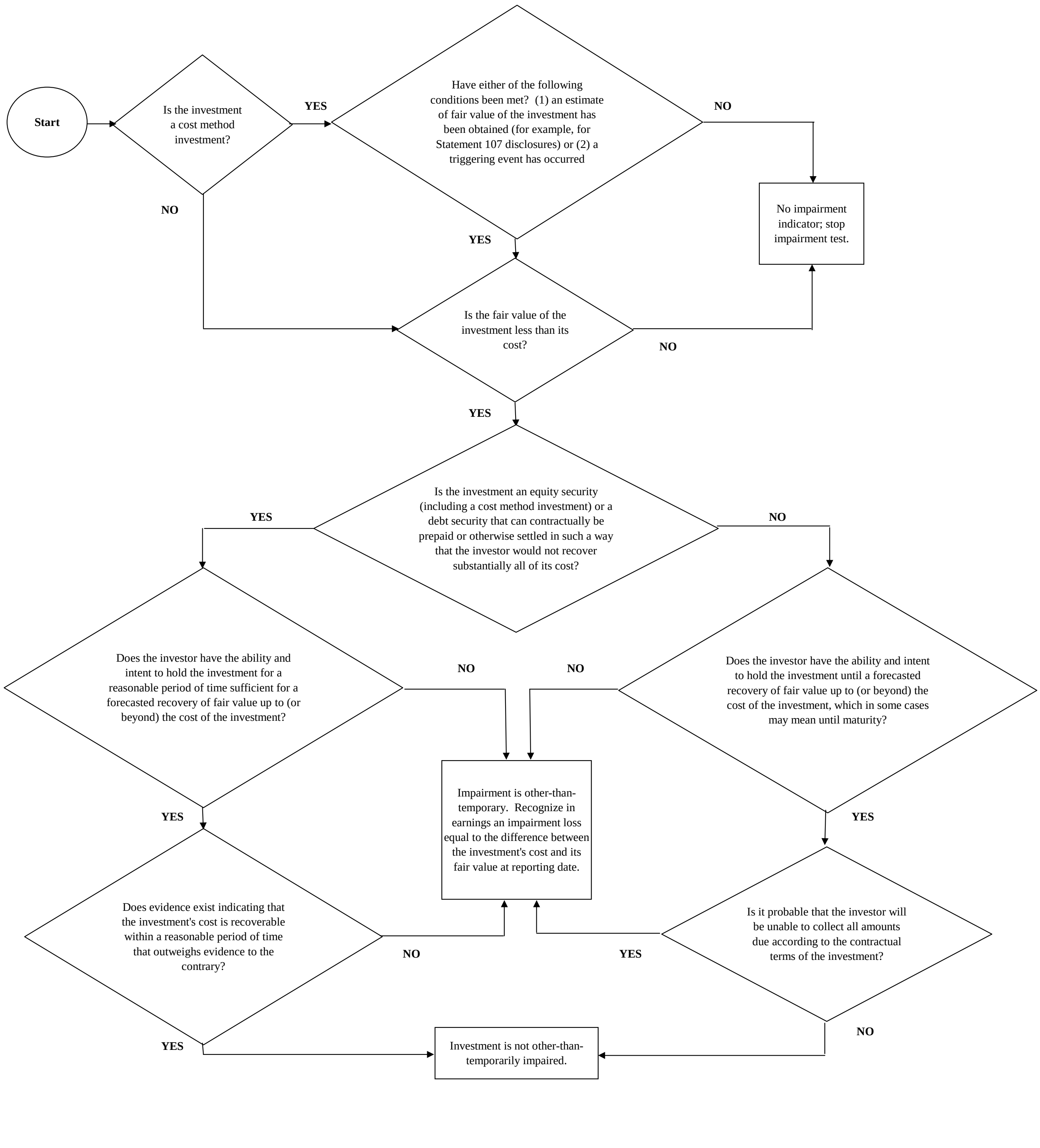
24. At its November 25, 2003 meeting, the Board ratified the consensus reached by the Task Force on the disclosures described in paragraph 21 for investments accounted for under Statement 115 and for investments accounted for under Statement 124 that are within the scope of this Issue (refer to paragraph 5(b)). At its March 31, 2004 meeting, the Board ratified the consensuses reached by the Task Force on (a) the application guidance described in paragraphs 6–20, (b) the applicability of the disclosures in paragraph 21 to all other investments within the scope of this Issue, (c) the disclosures described in paragraph 22, and (d) the transition and effective date guidance described in paragraph 23.

STATUS

25. At the March 17–18, 2004 EITF meeting, the Task Force decided to discontinue discussion of an impairment model for investments subject to the equity method of accounting. No further EITF discussion is planned. The SEC Observer stated that registrants should continue to rigorously assess equity method investments for impairment and indicated that the SEC staff will continue to object to inappropriate impairment analyses for such investments, for example a Statement 144 undiscounted cash flow approach.

Exhibit 03-1A

DETERMINING WHETHER AN IMPAIRMENT IS OTHER THAN TEMPORARY[14]



[14] This diagram represents an overview of the provisions of this Issue and should be reviewed in conjunction with the entire consensus.

Exhibit 03-1B

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON THE MODEL TO BE USED TO DETERMINE WHEN AN IMPAIRMENT IS OTHER THAN TEMPORARY

The following examples illustrate the application of several concepts included in the model, including:

- The determination of whether evidence indicating that the investment's cost is recoverable within a reasonable period of time outweighs evidence to the contrary
- The determination of whether a security can contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its amortized cost
- The application of the model when the investor has certain types of guarantees or other credit enhancements associated with debt securities.

Determination of Whether Evidence Indicating That the Investment's Cost Is Recoverable within a Reasonable Period of Time Outweighs Evidence to the Contrary

Example 1

XYZ is developing a product that is highly anticipated by the market. On January 1, 20X2, Investor purchased 200,000 shares of XYZ stock at a cost of $20 per share. On May 1, 20X2, a regulatory body informed XYZ that the product did not meet certain regulatory requirements and, therefore, would not receive the regulatory approval required to sell the product. On May 2, 20X2, XYZ issued a press release announcing the regulator's decision. XYZ also reiterated its belief that XYZ will ultimately obtain regulatory approval. However, no evidence exists to support its assertion at this time. XYZ's share price immediately declined from $22 per share to $11 per share, and traded in the $10 to $12 range through June 30, 20X2. No information is available to support a recovery of fair value up to (or beyond) the cost of the investment. Investor has the ability and intent to hold the investment for an indefinite period.

Evaluation: Despite Investor's ability and intent to hold the investment for an indefinite period, Investor should deem the investment other-than-temporarily impaired given:

- The severity of the decline
- The cause of the decline (that is, failure to obtain regulatory approval of a product)
- The absence of evidence to support a recovery of fair value up to (or beyond) the cost of the investment within a reasonable period of time.

Example 2

Assume the same facts and circumstances as Example 1, with the following exception: On June 15, 20X2, XYZ announced that it had identified a way to modify the product in order to satisfy the regulatory requirements, while maintaining the capabilities of the original product specification. In that announcement, XYZ stated that it intended to resubmit the product for regulatory approval and that the regulator was expected to rule on the modification. XYZ's share price immediately increased to $17 per share and traded in the $15 to $18 per share range through June 30, 20X2.

Evaluation: If, based on Investor's judgment, the announcement supports a recovery of fair value up to (or beyond) the cost of the investment within a reasonable period of time, Investor would deem that the investment is not other-than-temporarily impaired at June 30, 20X2.

Determination of Whether a Security Can Contractually Be Prepaid or Otherwise Settled in Such a Way That the Investor Would Not Recover Substantially All of Its Amortized Cost

Example 3
Investor purchases $100 million of 5-year debt at par. The bond pays a semiannual fixed coupon of 8 percent per annum. Principal is due at maturity. Issuer can contractually call the debt at any time after the three-year anniversary of its issuance. However, if Issuer exercises its option to call the debt, it must pay the principal amount plus any accrued but unpaid interest. Since this instrument was acquired at par, it cannot contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of the amortized cost.[15]

Example 4
Investor purchases $100 million of 5-year debt at par. The bond pays interest semiannually. The interest rate resets every 6 months based on 6-month LIBOR plus 2 percent. Principal is due at maturity, and the bond is not prepayable. Although the interest payments vary based on changes in six-month LIBOR, this instrument could not contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its amortized cost.

Example 5
Investor purchases an existing mortgage-backed security ("MBS") on the secondary market. The security is backed by 30-year fixed rate mortgages, each mortgage paying a fixed rate of 8 percent. The mortgages were originated two years ago, and the MBS was also issued two years ago. Due to the decreases in interest rates since the issuance of the security, Investor purchased the security at a price of $111 (par is $100). Each of the mortgages in the trust contains a prepayment option for the borrower.[16] In the event mortgages are prepaid, the holder of the MBS is contractually entitled to its share of the cash flows relating to the principal.

The holder of the MBS is entitled to its share of the stated amount of the underlying loans. This instrument can contractually be prepaid or otherwise settled in such a way that the holder would not recover substantially all of its amortized cost (Investor would receive $100 of its $111 cost).

The Application of the Model When the Investor Has Certain Types of Guarantees or Other Credit Enhancements Associated With Debt Securities

Example 6
Investor purchases Series E Debentures issued by Company A. The contractual terms of the Debentures requires that Company A use the Debenture proceeds to purchase specified assets, and that the purchased assets serve as collateral to satisfy the Debentures in the event of

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[15] If the instrument was purchased at a premium, the investor would have to evaluate whether the prepayment risk coupled with the premium could result in the investor not recovering substantially all of its amortized cost.
[16] Assume that the prepayment option is not required to be bifurcated under Statement 133.

Company A's failure to satisfy its required payment obligations. The contractual terms of the purchased debt security meet both criteria of paragraph 17 because (a) the collateral provides for assets to be transferred solely to reimburse the investor for failure of the investee to satisfy its required payment obligations and (b) the collateral is included in the contractual terms of the purchased debt security. Therefore, Investor should consider the collateral in determining whether it is probable that it will be unable to collect all amounts due according to the contractual terms of the debt security.

Example 7

Metropolis has an A credit rating and obtains credit insurance from Company F in order to enhance the credit rating of the municipal bonds to AAA. The contractual payments under the municipal bonds are guaranteed by Company F. The contractual terms of the debt security include the guarantee by Company F. Investor purchases a Metropolis municipal bond with the attached insurance. The contractual terms of the debt security meet both criteria of paragraph 17 because (a) the guarantee provides for payments to be made solely to reimburse the investor for failure of the investee to satisfy its required payment obligations and (b) the guarantee is included in the contractual terms of the purchased debt security. Therefore, Investor should consider the guarantee in determining whether it is probable that it will be unable to collect all amounts due according to the contractual terms of the debt security.

Example 8

Investor purchases a corporate bond from Company Z and purchases a credit enhancement from Bank Y to cover the credit risk associated with Company Z. The credit enhancement provides for payments to be made solely to reimburse the guaranteed party (investor) for failure of the debtor (Company Z) to satisfy its required payment obligations. In this example, the credit enhancement is not included in the contractual terms of the purchased debt security and, therefore, does not meet criteria (b) of paragraph 17. Accordingly, Investor may not consider the credit enhancement in determining whether it is probable that it will be unable to collect all amounts due according to the contractual terms of the debt security.

Exhibit 03-1C

EXAMPLE OF THE APPLICATION OF THE EITF CONSENSUS ON DISCLOSURES ABOUT INVESTMENTS IN AN UNREALIZED LOSS POSITION THAT ARE NOT OTHER-THAN-TEMPORARILY IMPAIRED[17]

The following table shows the gross unrealized losses and fair value of Company's investments with unrealized losses that are not deemed to be other-than-temporarily impaired (in millions), aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at December 31, 20X3.[18]

	Less than 12 months		**12 months or Greater**		**Total**	
Description of Securities	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
US Treasury obligations and direct obligations of US Government agencies	$ 172	$ 2	$ 58	$ 1	$ 230	$ 3
Federal agency mortgage backed securities	367	5	18	1	385	6
Corporate bonds	150	7	0	0	150	7
Marketable equity securities	44	8	0	0	44	8
Investments in equity securities carried at cost	20	1	0	0	20	1
Total	$ 753	$ 23	$ 76	$ 2	$ 829	$ 25

U.S. Treasury Obligations. The unrealized losses on the Company's investments in U.S. Treasury obligations and direct obligations of U.S. Government agencies were caused by interest rate increases. The contractual terms of these investments do not permit the issuer to settle the securities at a price less than the amortized cost of the investment. Because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

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[17] This example illustrates the application of paragraphs 21 and 22 and, in doing so, describes the investor's rationale for not recognizing all unrealized losses presented in the table as other than temporary impairments. In the application of paragraph 21(b), the investor should provide meaningful disclosure about individually significant unrealized losses.

[18] To facilitate the narrative disclosures and for simplicity, this example presents only the quantitative information as of the date of the latest statement of financial position. However, pursuant to paragraph 21, that information is required as of each date for which a statement of financial position is presented, except in the period of initial application of this consensus.

Federal Agency Mortgage Backed Securities. The unrealized losses on the Company's investment in federal agency mortgage backed securities were caused by interest rate increases. The Company purchased these investments at a discount relative to their face amount, and the contractual cash flows of these investments are guaranteed by an agency of the U.S. government. Accordingly, it is expected that the securities would not be settled at a price less than the amortized cost of the Company's investment. Because the decline in market value is attributable to changes in interest rates and not credit quality and because the Company has the ability and intent to hold these investments until a recovery of fair value, which may be maturity, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

Corporate Bonds. The Company's unrealized loss on investments in corporate bonds relates to a $150 investment in Manufacturing Company's Series C Debentures. The unrealized loss was primarily caused by (a) a recent decrease in profitability and near-term profit forecasts by industry analysts resulting from intense competitive pricing pressure in the manufacturing industry, and (b) a recent sector downgrade by several industry analysts. The contractual terms of these investments do not permit Manufacturing Company to settle the security at a price less than the amortized cost of the investment. While Manufacturing Company's credit rating has decreased from A to BBB (S&P), the Company currently does not believe that it is probable that it will be unable to collect all amounts due according to the contractual terms of the investment. Therefore, it is expected that the debentures would not be settled at a price less than the amortized cost of the investment. Because the Company has the ability and intent to hold this investment until a recovery of fair value, which may be maturity, it does not consider the investment in Manufacturing Company's debentures to be other-than-temporarily impaired at December 31, 20X3.

Marketable Equity Securities. The Company's investments in marketable equity securities consist primarily of investments in common stock of companies in the consumer tools and appliances industry ($17 of the total fair value and $2 of the total unrealized losses in common stock investments) and the air courier industry ($27 of the total fair value and $6 of the total unrealized losses in common stock investments). Within the Company's portfolio of common stocks in the consumer tools and appliances industry, all of which are in an unrealized loss position, approximately 26 percent of the total fair value and 21 percent of the Company's total unrealized losses are in Company R. The remaining fair value and unrealized losses are distributed in six companies. The severity of the impairment (fair value is approximately 5 percent to 12 percent less than cost) and the duration of the impairment (less than 3 months) correlate with the weak 20X3 year-end sales experienced within the consumer tools and appliance industry, as reflected in lower customer transactions and lower-than-expected performance in traditional gift categories like hardware and power tools. The Company evaluated the near-term prospects of the issuer in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

The Company's portfolio of common stocks in the air courier industry consists of investments in 4 companies, of which 3 (or 78 percent of the total fair value of the investments in the air courier industry) are in an unrealized loss position. The air courier industry and the Company's investees are susceptible to changes in the U.S. economy and the industries of their customers. A substantial number of their principal customers are in the automotive, personal computer, electronics, telecommunications, and related industries, and their business has been adversely affected by the slow-down of the U.S. economy, particularly during the second half of 20X3 when the Company's investments became impaired. In addition, the credit rating of nearly all companies in the portfolio has decreased from A to BBB (S&P or equivalent designation). The severity of the impairments in relation to the carrying amounts of the individual investments (fair value is approximately 17 percent to 23 percent less than cost) is consistent with those market developments. The Company evaluated the near-term prospects of the issuers in relation to the severity and duration of the impairment. Based on that evaluation and the Company's ability and intent to hold these investments for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider these investments to be other-than-temporarily impaired at December 31, 20X3.

Investments in Equity Securities Carried at Cost. The aggregate cost of the Company's cost method investments totaled $45 at December 31, 20X3. Investments with an aggregate cost of $10 were not evaluated for impairment because (a) the Company did not estimate the fair value of those investments in accordance with paragraphs 14 and 15 of Statement 107 and (b) the Company did not identify any events or changes in circumstances that may have had a significant adverse effect on the fair value of those investments. Of the remaining $35 of investments, the Company estimated that the fair value exceeded the cost of investments (that is, the investments were not impaired) with an aggregate cost of $14.

The remaining $21 of cost method investments consists of one investment in a privately owned company in the consumer tools and appliance industry. That investment was evaluated for impairment because of an adverse change in the market condition of companies in the consumer tools and appliance industry. As a result of that evaluation, the Company identified an unrealized loss of $1. The severity of the impairment (fair value is approximately 5 percent less than cost) and the duration of the impairment (less than 3 months) correlates with the weak 20X3 year-end sales experienced within the consumer tools and appliance industry, as reflected by lower customer transactions and lower-than-expected performance in traditional gift categories like hardware and power tools. Based on the Company's evaluation of the near-term prospects of the investee and the Company's ability and intent to hold the investment for a reasonable period of time sufficient for a forecasted recovery of fair value, the Company does not consider this investment to be other-than-temporarily impaired at December 31, 20X3.

Issue No. 03-6

Title: Participating Securities and the Two-Class Method under FASB Statement No. 128, *Earnings per Share*

Dates Discussed: May 15, 2003; July 31, 2003; November 12–13, 2003; March 17–18, 2004

References: FASB Statement No. 107, *Disclosure about Fair Value of Financial Instruments*

FASB Statement No. 123, *Stock-Based Compensation*

FASB Statement No. 128, *Earnings per Share*

FASB Statement No. 129, *Disclosure of Information about Capital Structure*

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

FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

Proposed FASB Statement, *Earnings per Share and Disclosure of Information about Capital Structure*, issued January 1996

APB Opinion No. 15, *Earnings per Share*

APB Opinion No. 25, *Accounting for Stock Issued to Employees*

AICPA Accounting Interpretation 85, "EPS Treatment of Two-Class and Participating Securities," of APB Opinion No. 15

AICPA Accounting Interpretation 86, "Two-Class Method for Nonconvertible Securities," of APB Opinion No. 15

AICPA Accounting Interpretation 87, "Two-Class Method for Convertible Securities," of APB Opinion No. 15

Introduction

1. Statement 128 provides guidance on the calculation and disclosure of earnings per share (EPS). Statement 128 defines EPS as "the amount of earnings attributable to each share of common stock" and indicates that the objective of EPS is to measure the performance of an entity over the reporting period. In its deliberations of Statement 128, the Board decided to require the use of the two-class method of computing EPS for those enterprises with participating securities or multiple classes of common stock.

2. Paragraph 60(a) of Statement 128 provides the following description of participating securities:

> Securities that may participate in dividends with common stocks according to a predetermined formula (for example, two for one) with, at times, an upper limit on the extent of participation (for example, up to, but not beyond, a specified amount per share).

Paragraph 61 of Statement 128 adds the following:

> The if-converted method shall be used for those securities that are convertible into common stock if the effect is dilutive. For those securities that are not convertible into a class of common stock, the "two class" method of computing earnings per share shall be used. The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings. Under that method:
>
> a. Income from continuing operations (or net income) shall be reduced by the amount of dividends declared in the current period for each class of stock and by the contractual amount of dividends (or interest on participating income bonds) that must be paid for the current period (for example, unpaid cumulative dividends).[25]
> b. The remaining earnings shall be allocated to common stock and participating securities to the extent that each security may share in earnings as if all of the earnings for the period had been distributed. The total earnings allocated to each security shall be determined by adding together the amount allocated for dividends and the amount allocated for a participation feature.
> c. The total earnings allocated to each security shall be divided by the number of outstanding shares of the security to which the earnings are allocated to determine the earnings per share for the security.
> d. Basic and diluted EPS data shall be presented for each class of common stock.
>
> For the diluted EPS computation, outstanding common shares shall include all potential common shares assumed issued. Illustration 6 in Appendix C provides an example of that provision.
>
> ---
> [25]Dividends declared in the current period do not include dividends declared in respect of prior-year unpaid cumulative dividends. Preferred dividends that are cumulative only if earned are deducted only to the extent that they are earned.

3. Subsequent to the issuance of Statement 128, the FASB staff issued *EITF Abstracts*, Topic No. D-95, "Effect of Participating Convertible Securities on the Computation of Basic Earnings per Share," to address the effect of participating convertible securities on the computation of basic EPS. Topic D-95 clarifies that participating securities that are convertible into common stock be included in the computation of basic EPS if the effect is dilutive. Topic D-95 states that the determination of how participating convertible securities should be included in the computation of basic EPS (that is, using either the if-converted method or the two-class method) is an accounting policy decision; however, the dilutive effect on basic EPS cannot be less than that which would result from the application of the two-class method that would be required if the same security were not convertible.

4. Consider the following example:

> Company ABC has 10,000 shares of common stock and 5,000 shares of convertible preferred stock outstanding. Each share of preferred stock is convertible into one share of common stock. The preferred stock participates in any dividends on a 1:1 per share ratio with common stock. That is, the preferred stock receives dividends at a rate that results in a per share amount that is equivalent to the per share amount paid on common stock. Company ABC had net income of $50,000 for 20X3 and paid no dividends during 20X3. Company ABC has an accounting policy that preferred stock will be included in its computation of basic EPS using the if-converted method as long as the dilutive effect on basic EPS is at least as great as the effect of the two-class method.

Company ABC could not compute basic EPS excluding the convertible participating securities ($5.00 per share[1]), as the effect of the convertible preferred stock is dilutive. Instead, Company ABC would compute basic EPS using the if-converted method ($3.33 per share[2]), as the dilutive effect that would result from including the effect of the convertible preferred stock under the if-converted method is no less than that which would result from the application of the two-class method if the preferred stock were not convertible ($3.33 per share[3]).

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[1] *Computation of basic EPS excluding the convertible preferred stock:*

$$\frac{\text{Net income available to common shareholders}}{\text{Outstanding shares}} = \text{Basic EPS}$$

$$\frac{\$50{,}000}{10{,}000 \text{ shares}} = \$5.00 \text{ per share}$$

[2] *Computation of basic EPS using if-converted method:*

$$\frac{\$50{,}000}{15{,}000 \text{ shares}} = \$3.33 \text{ per share}$$

Note: Conversion of the preferred stock results in 15,000 shares of common stock outstanding.

[3] *Computation of basic EPS using two-class method:*

$$\text{Undistributed 20X3 earnings} = \text{Net income} - \text{Dividends}$$

$$\$50{,}000 = \$50{,}000 - \$0$$

Allocation of undistributed earnings:

To common stock:

$$\frac{(10{,}000)}{[(5{,}000) + (10{,}000)]} \times \$50{,}000 = \$33{,}333$$

$$\frac{\$33{,}333}{10{,}000 \text{ shares}} = \$3.33 \text{ per share}$$

To preferred stock:

$$\frac{(5{,}000)}{[(5{,}000) + (10{,}000)]} \times \$50{,}000 = \$16{,}667$$

$$\frac{\$16{,}667}{5{,}000 \text{ shares}} = \$3.33 \text{ per share}$$

	Common	Preferred
Distributed earnings	$0.00	$0.00
Undistributed earnings	3.33	3.33
Totals	$3.33	$3.33

5. The Issues are:

Issue 1— Whether the two-class method requires the presentation of basic and diluted EPS for all participating securities

Issue 1(a)— If the two-class method does not require the presentation of basic and diluted EPS for all participating securities, when the presentation of basic and diluted EPS is appropriate

Issue 2— How a participating security that requires application of paragraph 61 of Statement 128 should be defined

Issue 2(a)— Whether all potential common shares, that is, securities or other contracts that may entitle their holders to obtain common stock (such as options, warrants, forwards, convertible debt, and convertible preferred stock), may be participating securities

Issue 2(b)(i)— Whether dividends or dividend equivalents paid to the holder of a convertible security that are applied to either reduce the conversion price or increase the conversion ratio of the security represent participation rights

Issue 2(b)(ii)— Whether an issuing entity should recognize a dividend equivalent that is applied to reduce the conversion price or increase the conversion ratio of a convertible security in its financial statements and, if so, how those dividend equivalents should be recognized in the financial statements

Issue 2(b)(iii)— If the Task Force reaches a consensus in Issue 2(b)(i) that the dividends or dividend equivalents in question represent participation rights, how convertible securities that participate in dividends via a reduction in the conversion price or an increase in the conversion ratio should be considered by the issuer in the computation of basic EPS

Issue 3— How undistributed earnings should be allocated to a participating security

Issue 4— Whether an entity that allocated undistributed earnings to a nonconvertible participating security would continue to do so in a period of net loss even though the effect would be to decrease the loss per share of common stock

Issue 5— Whether a convertible participating security would be excluded from the computation of basic EPS if an entity has a net loss from continuing operations

Issue 6— How a convertible participating security is included in the computation of diluted EPS

Issue 7— Whether the guidance in Topic D-95 should be amended to require that the two-class method be used for including participating convertible securities in the computation of basic EPS in all cases and, therefore, eliminate the option for an entity to establish use of the if-converted method as its accounting policy

Issue 8— Whether the guidance included in Topic D-95 should be expanded to address other forms of participating securities or whether it should continue to address only convertible participating securities.

Prior EITF Discussion

6. At the May 15, 2003 EITF meeting, the Task Force discussed those issues but was not asked to reach a consensus. Members of the Task Force requested that the FASB staff organize an advisory group that would explore the Issue further and create a revised Issue Summary for discussion at a future meeting. The Task Force requested that the advisory group specifically address conditions under which a participating security requires (a) the use of the two-class method, (b) an adjustment to earnings available to common shareholders, or (c) disclosure in accordance with Statement 129. The Task Force requested that the advisory group provide specific examples of securities for which participation may be ambiguous or for which participation rights are contingent (for example, a warrant with an exercise price that changes based on dividends).

7. At the July 31, 2003 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that the two-class method is an earnings allocation formula that treats a participating security as having rights to earnings that otherwise would have been available to common shareholders but does not require the presentation of basic and diluted EPS for securities other than common stock. However, the Task Force observed that the presentation of basic and diluted EPS for a participating security other than common stock is not precluded.

8. The Task Force decided to discontinue its discussion on Issue 1(a), noting that although the presentation of basic and diluted EPS for a participating security other than a class of common stock may be desirable in some cases, it is not required by Statement 128.

9. The Task Force reached a tentative conclusion on Issue 2 that, for purposes of applying paragraphs 60 and 61 of Statement 128, a participating security is a security that may participate in undistributed earnings with common stock, whether that participation is conditioned upon the occurrence of a specified event or not. The Task Force observed that the form of such participation does not have to be a dividend—that is, any form of participation in undistributed earnings would constitute participation by that security, regardless of whether the payment to the security holder was referred to as a dividend.

10. The Task Force discussed but was not asked to reach a consensus on Issue 2(a). Some Task Force members noted a preference for the view that a potential common share that has a current right to participate in earnings would be a participating security and that basic and diluted EPS should be calculated as the more dilutive of the two-class method or the method prescribed by Statement 128 or related authoritative guidance (for example, the treasury stock method or the reverse treasury stock method). The Task Force asked the FASB staff to further explore Issue 2(a) with the Advisory Group and prepare examples for discussion at a future meeting.

11. The Task Force discussed but was not asked to reach a consensus on Issue 3. However, the Task Force generally preferred the view that undistributed earnings for a period should be allocated to a participating security based on the *contractual* participation rights of the security to share in those current earnings. If the terms of a security do not specify objectively determinable, nondiscretionary participation rights, then undistributed earnings would not be allocated based on arbitrary assumptions. Also, if an entity could avoid distributions of undistributed earnings to participating security holders, then no allocation of that period's earnings to the participating security would be made. Participation rights that are contingent on or subject to the discretion of the company should be fully disclosed in accordance with paragraph 4 of Statement 129.

12. The Task Force reached a tentative conclusion on Issue 4 that an entity would continue to allocate undistributed earnings/losses to a nonconvertible participating security in periods of net loss even if the effect is antidilutive. The Task Force observed that losses that reduce the undistributed earnings in which a participating security has a right to share should be allocated to that participating security.

13. The Task Force did not discuss Issues 2(b), 5, or 6. The Task Force also asked the staff to develop alternative views, for discussion at a future meeting, as to how EPS calculations would be affected by participation features that take the form of a derivative that is marked to market through the income statement in accordance with authoritative guidance such as Statement 133.

14. At the November 12–13, 2003 EITF meeting, the Task Force discussed the tentative conclusions previously reached on Issues 1 and 2 at the July 31, 2003 EITF meeting and reaffirmed those tentative conclusions. However, the Task Force was not asked to reach a consensus.

15. The Task Force decided to defer further discussion on Issue 2(a) and requested that the FASB staff explore a reconsideration of the guidance in Topic D-95 to address other forms of participating securities, including potential common stock securities such as the options and warrants addressed in Issue 2(a).

16. The Task Force reached a tentative conclusion on Issue 2(b)(i) that dividends or dividend equivalents transferred to the holder of a convertible security in the form of a reduction to the conversion price or an increase in the conversion ratio of the security do not represent participation rights. The Task Force noted that while this Issue was discussed in the context of a convertible security, the tentative conclusion would apply similarly to other contracts (securities) to issue an entity's common stock if these contracts (securities) provide for an adjustment to the exercise price that is tied to the declaration of dividends by the issuer.

17. The Task Force reached a tentative conclusion on Issue 2(b)(ii) that the issuing entity should consider a dividend equivalent that is applied to reduce the conversion price or increase the conversion ratio of a convertible security in its financial statements as a contingent beneficial conversion feature. The contingent beneficial conversion feature should be recognized in the issuing entity's financial statements in accordance with the guidance in EITF Issues No. 98-5,

"Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," and No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments." Specifically, the issuing entity should look to Issue 7 of Issue 00-27, by analogy, in determining how and when to recognize the terms of a contingent conversion option in its financial statements.

18. The Task Force decided to discontinue discussion on Issue 2(b)(iii), noting that the tentative conclusion reached in Issue 2(b)(i) obviates the question of how to treat those securities under the two-class method for EPS purposes.

19. The Task Force reached a tentative conclusion on Issue 3 that undistributed earnings for a period should be allocated to a participating security based on the contractual participation rights of the security to share in those current earnings as if all of the earnings for the period had been distributed. If the terms of the participating security do not specify objectively determinable, nondiscretionary participation rights, then undistributed earnings would not be allocated based on arbitrary assumptions. For example, if an entity could avoid distribution of earnings to a participating security, even if all of the earnings for the year were distributed, then no allocation of that period's earnings to the participating security would be made.

20. The Task Force observed that paragraph 61(b) of Statement 128 states that under the two-class method "the remaining earnings shall be allocated to common stock and participating securities to the extent that each security may share in earnings *as if all of the earnings for the period had been distributed*" (emphasis added). The Task Force noted that the tentative conclusion on Issue 3 is based on that guidance in Statement 128, despite the pro forma nature of this allocation and that it may not reflect the economic probabilities of actual distributions to the participating security holders.

21. To illustrate application of the tentative conclusion reached on Issue 3, consider the following examples. (Note: In all cases set forth below, the participation rights of the securities may be required to be disclosed in accordance with the provisions of Statement 129, regardless of whether undistributed earnings are allocated to the participating security.)

> **Example A:** A participating security that provides the holder with the ability to participate in all dividends declared with the holders of common stock on a 1:1 per-share basis.
>
> **Evaluation:** The undistributed earnings should be allocated between the common stock and the participating security on a 1:1 per-share basis.
>
> **Example B:** A participating security that provides the holder with the ability to participate with the holders of common stock in dividends declared contingent upon the occurrence of a specified event, the occurrence of which is subject to management discretion or is not objectively determinable (for example, liquidation of the company or management determination of an "extraordinary" dividend).

Evaluation: The terms of the participating security in this scenario do not specify objectively determinable, nondiscretionary participation rights; therefore, undistributed earnings would not be allocated to the participating security.

Example C: A participating security that provides the holder with the ability to participate with the holders of common stock in earnings for a period in which a specified event occurs, regardless of whether a dividend is paid during the period (for example, achievement of a target market price of a security or achievement of a certain earnings level).

Evaluation: Undistributed earnings would be allocated to common stock and the participating security based on the assumption that all of the earnings for the period are distributed. Undistributed earnings would be allocated to the participating security if the contingent condition would have been satisfied at the reporting date, irrespective of whether an actual distribution was made for the period.

Example D: A participating security that provides the holder with the ability to participate in extraordinary dividends. The classification of dividends as extraordinary is predetermined by a formula, for example, any dividend per common share in excess of 5 percent of the current market price of the stock is defined as extraordinary.

Evaluation: Undistributed earnings would be allocated to common stock and the participating security based on the assumption that all of the earnings for the period are distributed. If earnings for a given period exceed the specified threshold above which the participating security would participate (that is, earnings for the period are in excess of 5 percent of the current market price of the stock), undistributed earnings would be allocated to the participating security according to its terms.

Example E: A participating security that provides the holder with the ability to participate in extraordinary dividends. The classification of dividends as extraordinary is within the sole discretion of the board of directors.

Evaluation: Undistributed earnings would be allocated only to common stock. Since the classification of dividends as extraordinary is within the sole discretion of the board of directors, undistributed earnings would not be allocated to the participating security as the participation in the undistributed earnings would not be objectively determinable.

Example F: A participating security that provides the holder with the ability to participate in all dividends up to a specified threshold. For example, the security participates in dividends per common share up to 5 percent of the current market price of the stock.

Evaluation: Undistributed earnings would be allocated to common stock and the participating security based on the assumption that all of the earnings for the period are distributed. In this example, undistributed earnings would be allocated to common stock and to the participating security up to 5 percent of the current market price of the common stock, as the amount of the threshold for participation by the participating security is objectively determinable. The remaining undistributed earnings for the period would be allocated to common stock.

22. The Task Force discussed the tentative conclusion previously reached on Issue 4 and tentatively concluded that an entity would allocate losses to a nonconvertible participating security in periods of net loss if, based on the contractual terms of the participating security, the security had not only the right to participate in the earnings of the issuer, but also a contractual obligation to share in the losses of the issuing entity on a basis that was objectively determinable. Determination of whether a participating security holder has an obligation to share in the losses of the issuing entity in a given period must be made on a period-by-period basis, based on the contractual rights and obligations of the participating security.

23. The Task Force reached a tentative conclusion on Issue 5 that a convertible participating security should be included in the computation of basic EPS in periods of net loss if, based on its contractual terms, the convertible participating security has the contractual obligation to share in the losses of the issuing entity on a basis that is objectively determinable. The Task Force agreed that the basis for the tentative conclusion reached in Issue 4 would also apply to the inclusion of convertible participating securities in basic EPS, irrespective of the differences that may exist between convertible and nonconvertible securities. That is, an entity should not automatically exclude a convertible participating security from the computation of basic EPS if an entity has a net loss from continuing operations. Determination of whether a participating security holder has an obligation to share in the losses of the issuing entity in a given period must be made on a period by period basis, based on the contractual rights and obligations of the participating security.

24. The Task Force decided to discontinue its discussion on Issue 6 noting that convertible participating securities should be included in the computation of diluted EPS using the if-converted method, subject to the antidilution provisions of Statement 128.

Current EITF Discussion

25. At the March 17–18, 2004 EITF meeting, the Task Force discussed the tentative conclusions previously reached at the July 31 and November 12–13, 2003 EITF meetings and affirmed as a consensus, without modification, the tentative conclusions reached on Issues 1, 2, and 3.

26. The Task Force decided to discontinue discussion of Issue 2(a) noting that potential common shares, that is, securities or other contracts that may entitle their holders to obtain common stock (such as options, warrants, forwards, or other contracts to issue common stock), may be participating securities if they meet the definition of a participating security in their current form (that is, prior to exercise or settlement) as set forth in Issue 2. However, the Task Force reached a consensus that stock-based compensation subject to the provisions of Opinion 25 and Statement 123, including options and non-vested stock, that contain a right to receive dividends declared on the common stock of the issuer, are not subject to the guidance in this Issue until such time as those options or shares are fully vested.

27. The Task Force discussed the tentative conclusion reached at the November meeting on Issue 2(b)(i). Specifically, the Task Force considered whether, in a forward contract to issue an entity's own equity shares, a provision that reduces the contract price per share when dividends are declared on the issuing entity's common stock represents a participation right. The Task Force concluded that such a provision constitutes a participation right because it results in a noncontingent transfer of value to the holder of the forward contract for dividends declared during the forward contract period. That is, the forward contract holder has a *right* to participate in the undistributed earnings of the issuing entity because a dividend declaration by the issuing entity results in a transfer of value to the holder of the forward contract through a reduction in the forward purchase price per share. Because that value transfer is not contingent—as opposed to a similar reduction in the *exercise* price of an option or warrant—the forward contract is a participating security, regardless of whether, during the period the contract is outstanding, a dividend is declared. Therefore, in affirming as a consensus the tentative conclusion reached at the November meeting on Issue 2(b)(i), the Task Force noted that the scope of that consensus excludes forward contracts to issue an entity's own equity shares.

28. The Task Force discussed the tentative conclusion reached at the November meeting on Issue 2(b)(ii) and affirmed that tentative conclusion as a consensus. The Task Force requested that the consensus clarify that the issuing entity should consider *whether* a dividend equivalent that is applied to reduce the conversion price or increase the conversion ratio of a convertible security represents a contingent beneficial conversion feature. The tentative conclusion contained a definitive statement that such a feature should be considered a beneficial conversion feature. The Task Force noted that determination of whether a dividend equivalent that is applied to reduce the conversion price or increase the conversion ratio of a convertible security represents a contingent beneficial conversion feature should be made by reference to the guidance in Issues 98-5 and 00-27.

29. The Task Force discussed the tentative conclusions reached at the November meeting on Issues 4 and 5 and affirmed those tentative conclusions as consensuses, and provided additional guidance as to what constitutes "a contractual obligation of the holder to share in the losses of the issuing entity." The Task Force determined that the holder of a participating security would have a contractual obligation to share in the losses of the issuing entity if either of the following conditions is present:

a. The holder is obligated to fund the losses of the issuing entity (that is, the holder is obligated to transfer assets to the issuer in excess of the holder's initial investment in the participating security without any corresponding increase in the holder's investment interest).
b. The contractual principal or mandatory redemption amount of the participating security is reduced as a result of losses incurred by the issuing entity.

30. The Task Force reached a consensus on Issue 7 that convertible participating securities should be included in the computation of basic earnings per share using the two-class method. This consensus nullifies the guidance previously included in Topic D-95. The following examples illustrate the application of the two-class method of computing basic earnings per share

for (a) an entity that has participating convertible preferred stock and (b) an entity that has participating convertible bonds:

Example A—Participating Convertible Preferred Stock

Assume that Company XYZ had 10,000 shares of Class A common stock and 5,000 shares of preferred stock outstanding during 20X1, and reported net income of $65,000 for 20X1. Each share of preferred stock is convertible into two shares of Class A common stock. The preferred stock is entitled to a noncumulative annual dividend of $5 per share. After Class A has been paid a dividend of $2 per share, the preferred stock then participates in any additional dividends on a 40:60 per share ratio with Class A. For 20X1, the Class A shareholders have been paid $26,000 (or $2.60 per share), and the preferred shareholders have been paid $27,000 (or $5.40 per share). Basic earnings per share under the two-class method for 20X1 would be computed as follows:

Net income		$65,000
Less dividends paid:		
Class A common	$26,000	
Preferred stock	27,000	53,000
Undistributed 20X1 earnings		$12,000

Allocation of undistributed earnings:

To preferred:

$0.4(5{,}000) \div [.4(5{,}000) + 0.6(10{,}000)] \times \$12{,}000 = \$3{,}000$

$\$3{,}000 \div 5{,}000$ shares = $0.60 per share

To common:

$0.6(10{,}000) \div [.4(5{,}000) + 0.6(10{,}000)] \times \$12{,}000 = \$9{,}000$

$\$9{,}000 \div 10{,}000$ shares = $0.90 per share

Basic earnings per share amounts:

	Preferred	Class A
Distributed earnings	$5.40	$2.60
Undistributed earnings	0.60	0.90
Totals	$6.00	$3.50

NOTE: In Examples A and B, application of the two-class method presents an EPS calculation for both the Class A common stock and the participating security (convertible preferred stock in the case of Example A). This presentation is for illustrative purposes only. The presentation of EPS is only required for each class of common stock (as clarified by Issue 1, herein). However, the presentation of basic and diluted EPS for a participating security other than common stock is not precluded.

Example B—Participating Convertible Debt Instrument:
Assume that Company XYZ had 10,000 shares of Class A common stock outstanding during 20X1 and reported net income of $65,000 for the year. On January 1, 20X1, Company XYZ Issues 1,000 30-year convertible bonds with an aggregate par value of $1,000,000. Each bond is convertible into 8 shares of Class A common stock and carries a coupon rate of 3 percent. After Class A has been paid a dividend of $2 per share, the bondholders then participate in any additional dividends on a 40:60 per share ratio with Class A shareholders. The bondholders receive common stock dividends based on the number of shares of common stock that the bonds are convertible into. The bondholders do not have any voting rights prior to conversion into common stock. For 20X1, the Class A shareholders have been paid $20,000 (or $2.00 per share). Basic earnings per share under the two-class method for 20X1 would be computed as follows:

Net income		$65,000
Less dividends paid:		
Class A common	$20,000	20,000
Undistributed 20X1 earnings		$45,000

Allocation of undistributed earnings:

To convertible bonds:
0.4(8,000) ÷ [.4(8,000) + 0.6(10,000)] × $45,000 = $15,652
$15,652 ÷ 8,000 shares = $1.96 per share

To common:
0.6(10,000) ÷ [.4(8,000) + 0.6(10,000)] × $45,000 = $29,348
$29,348 ÷ 10,000 shares = $2.93 per share

Basic earnings per share amounts:

	Conv. Bonds	Class A
Distributed earnings	$ 0.00	$2.00
Undistributed earnings	1.96	2.93
Totals	$1.96	$4.93

31. The Task Force reached a consensus on Issue 8 that all securities that meet the definition of a participating security in Issue 2, irrespective of whether the securities are convertible, non-convertible, or potential common stock securities, should be included in the computation of basic earnings per share using the two-class method. The following example illustrates the application of the two-class method of computing basic earnings per share for an entity that has participating warrants:

Example C
Assume that Company XYZ had 10,000 shares of common stock and warrants to purchase 5,000 shares of common stock outstanding during 20X1, and reported net income of $65,000 for the year. Each warrant entitles the holder to purchase 1 share of common stock at $10 (fair value at date of grant) per share. In addition, the warrant holders receive dividends on the underlying common stock to the extent they are declared. For 20X1, common shareholders have been paid $26,000 (or $2.60 per share), and the warrant holders have been paid $13,000 (or, also, $2.60 per share). Basic earnings per share under the two-class method for 20X1 would be computed as follows:

Net income		$65,000
Less dividends paid:		
Common stock	$26,000	
Warrants	13,000	39,000
Undistributed 20X1 earnings		$26,000

Allocation of undistributed earnings:

To warrants:
$0.5(5{,}000) \div [.5(5{,}000) + 0.5(10{,}000)] \times \$26{,}000 = \$8{,}667$
$\$8{,}667 \div 5{,}000$ shares = $1.73 per share

To common:
$0.5(10{,}000) \div [.5(5{,}000) + 0.5(10{,}000)] \times \$26{,}000 = \$17{,}333$
$\$17{,}333 \div 10{,}000$ shares = $1.73 per share

Or, to simplify, since the common shareholders and the warrant holders share in dividends on a 1:1 basis, undistributed earnings could also be calculated as follows:

$\$26{,}000 \div 15{,}000$ shares = $1.73 per common share and warrant.

Basic earnings per share amounts:

	Common	Warrants
Distributed earnings	$2.60	$2.60
Undistributed earnings	1.73	1.73
Totals	$4.33	$4.33

Transition
32. The consensuses reached by the Task Force in this Issue are effective for fiscal periods beginning after the date of Board ratification. Prior period earnings per share amounts presented for comparative purposes should be restated to conform to the consensus guidance.

Board Ratification

33. At its March 31, 2004 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

Status

34. No further EITF discussion is planned.

Issue No. 03-9

Title: Interaction of Paragraphs 11 and 12 of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, Regarding Determination of the Useful Life and Amortization of an Intangible Asset

Dates Discussed: July 31, 2003; November 12–13, 2003; March 17–18, 2004

References: FASB Statement No. 141, *Business Combinations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

Introduction

1. The useful life of an intangible asset is defined in Appendix F of Statement 142 as follows:

> The period over which an asset is expected to contribute directly or indirectly to future cash flows.

2. Paragraph 11 of Statement 142 provides the following guidance for estimating the useful life of an intangible asset:

> The accounting for a recognized intangible asset is based on its useful life to the reporting entity. An intangible asset with a finite useful life is amortized; an intangible asset with an indefinite useful life is not amortized. The useful life of an intangible asset to an entity is the period over which the asset is expected to contribute directly or indirectly to the future cash flows of that entity.[9] The estimate of the useful life of an intangible asset to an entity shall be based on an analysis of all pertinent factors, in particular:
>
> a. The expected use of the asset by the entity
> b. The expected useful life of another asset or a group of assets to which the useful life of the intangible asset may relate (such as mineral rights to depleting assets)
> c. Any legal, regulatory, or contractual provisions that may limit the useful life
> d. Any legal, regulatory, or contractual provisions that enable renewal or extension of the asset's legal or contractual life without substantial cost (provided there is evidence to support renewal or extension and renewal or extension can be accomplished without material modifications of the existing terms and conditions)
> e. The effects of obsolescence, demand, competition, and other economic factors (such as the stability of the industry, known technological advances, legislative action that results in an uncertain or changing regulatory environment, and expected changes in distribution channels)
> f. The level of maintenance expenditures required to obtain the expected future cash flows from the asset (for example, a material level of required

maintenance in relation to the carrying amount of the asset may suggest a very limited useful life).[10]

If no legal, regulatory, contractual, competitive, economic, or other factors limit the useful life of an intangible asset to the reporting entity, the useful life of the asset shall be considered to be indefinite. The term *indefinite* does not mean infinite. Appendix A includes illustrative examples of different intangible assets and how they should be accounted for in accordance with this Statement, including determining whether the useful life of an intangible asset is indefinite.

[9] The useful life of an intangible asset shall reflect the period over which it will contribute to the cash flows of the reporting entity, not the period of time that it would take that entity to internally develop an intangible asset that would provide similar benefits.

[10] As in determining the useful life of depreciable tangible assets, regular maintenance may be assumed but enhancements may not.

3. In applying the guidance in paragraph 11, questions have arisen in practice as to how the pertinent factors in paragraph 11(d) should be interpreted and applied. In particular, those questions surround the evaluation of "substantial cost" and "material modifications" in determining whether or not an intangible asset has an indefinite useful life and, if not, the appropriate useful life for the intangible asset. Statement 142 provides only limited guidance on how to apply those concepts—by way of illustrative examples and some discussion in its basis for conclusions.

4. The concepts of *useful life* and *fair value* of an intangible asset, from an economic standpoint, are inextricably linked. Statements 141 and 142 both indicate that the useful life of an intangible asset is related to the period over which the asset is expected to generate cash flows. In some cases, however, the guidance in Statement 142 regarding *useful life* appears to be more restrictive than the guidance provided in Statement 141 with respect to considering the period over which an intangible asset is likely to contribute to an entity's cash flows for the purpose of determining the intangible asset's fair value.

5. On the one hand, paragraph B46 of Statement 142 indicates that the useful life of an intangible asset that is based on legal or contractual rights is constrained by the duration of those legal or contractual rights. Therefore, the useful life cannot extend beyond the expiration of the legal rights. However, the Board also acknowledged, in paragraph B47, that certain intangible assets may be routinely renewed at little or no cost (that is, without substantial cost) and that marketplace transactions often indicate that renewal is implied in the value of certain intangible assets. For those types of assets, the useful life is not necessarily limited to the legal or contractual life. On the other hand, the guidance in paragraph B174 of Statement 141 (in the context of initial recognition of intangible assets) appears to permit, or perhaps even require, a more expansive view of useful life of an intangible asset by indicating that judgment is required in determining the period over which cash flows should be expected for purposes of determining the fair value of an intangible asset. Estimates should incorporate assumptions that marketplace participants would use in making estimates of fair value, such as assumptions about future contract renewals. In cases in which contractual or legal rights are routinely renewed, estimates

of future cash flows should extend beyond the remaining contractual or legal term. Statement 141 does not limit the consideration of renewal to only those cases in which renewal can be effected with little or no cost.

6. The relevant examples in Appendix A of Statement 142 (Examples 4–6) provide only limited insight into this question because the examples assume that minimal costs are involved in renewal and that there will be no change to the terms of the arrangements. Furthermore, those examples generally illustrate the distinction between assets with a finite life limited to the contractual period and those with an indefinite life. There is no illustration of how to evaluate situations in which the life may be greater than the contractual life but not indefinite. Because many contractual arrangements or legal rights may be renewed, the issue of determining when such renewal is deemed to occur "without substantial cost" or "without material modification to the terms and conditions" is particularly relevant in assessing the useful life and, in turn, the fair value of intangible assets.

7. In addressing those issues, the FASB staff noted that it is important to consider the interaction of paragraphs 11(c) and 11(d) of Statement 142. Paragraph 11(c) requires consideration of legal or contractual *limits* to the useful life of an intangible asset, whereas paragraph 11(d) addresses situations in which the existing terms and conditions underlying the intangible asset *enable* renewal of the right giving rise to the intangible asset and that, *provided that evidence of renewal exists*, warrant consideration of a useful life that is greater than the existing contractual or legal life. Specifically, whether the *substantial cost* or *material modification* questions will need to be considered is only relevant if evidence of renewal exists.

Issue

8. The issues are:

Issue 1— When considering whether renewal of a contractual or legal right giving rise to an intangible asset requires "substantial cost" pursuant to paragraph 11(d) of Statement 142, the expenditures that should be considered to be a "cost" of the renewal or extension

Issue 2— When analyzing the pertinent factors contained in paragraph 11(d) of Statement 142, the "existing terms and conditions" that may be subject to change upon renewal or extension that are subject to the "material modifications" consideration

Issue 3— Whether limiting factors exist that could result in a useful life for amortization purposes that is shorter than the useful life for asset valuation purposes

Issue 3(a)— If there are limiting factors that could result in a shorter useful life for amortization purposes than those used for asset valuation purposes, *how* those limiting factors should be taken into consideration in the determination of the intangible asset's useful life

Issue 4— Whether the intangible asset that is recognized apart from goodwill pursuant to paragraph 39 of Statement 141 is appropriately defined.

Prior EITF Discussion

9. At the July 31, 2003 EITF meeting, the Task Force discussed Issue 1 and generally agreed that the analysis of whether the useful life of an intangible asset should extend beyond its contractual term should be based on assumptions of renewal or nonrenewal that are consistent with assumptions of marketplace participants. The Task Force noted that the useful life—the period over which an intangible asset is expected to contribute to an entity's cash flows—for amortization purposes should be consistent with the estimated useful life considerations used in the determination of the fair value of that asset.

10. Task Force members noted that, in many cases, the fair value of the intangible asset is determined using probability-weighted expected future cash flows and, therefore, it may be difficult to discern a single point estimate for the useful life for amortization purposes. Some Task Force members also observed that it also may be difficult to differentiate an intangible asset with a relatively long, but *finite*, life from an intangible asset with an *indefinite* life. In the course of that discussion, some Task Force members also noted that linking the amortization period to the estimated useful life considerations used in the valuation model may indicate that straight-line amortization does not best reflect the pattern in which the economic benefits of the intangible asset are consumed. The Task Force directed the FASB staff to further explore these issues for discussion at a future meeting.

11. The Task Force did not discuss Issue 2.

12. At the November 12–13, 2003 EITF meeting, the Task Force considered an example fact pattern that was prepared by the FASB staff along with various valuation scenarios that were designed to illustrate the application of the "pattern-of-economic-benefit" amortization method for renewable intangible assets. Those illustrations indicate that for the same intangible asset, depending on the pattern of economic benefits implied by the valuation of the asset, the amount and timing of the amortization of the cost of the asset could be dramatically different. However, the FASB staff believes that such a result is consistent with the provisions of paragraph 12 of Statement 142, which states, in part:

> The method of amortization shall reflect the pattern in which the economic benefits of the intangible asset are consumed or otherwise used up. If that pattern cannot be reliably determined, a straight-line amortization method shall be used.

13. The FASB staff's proposed approach suggests that for purposes of determining the *pattern in which the economic benefits of the intangible asset are consumed*, the undiscounted cash flows included in the valuation model for any given period would be compared to the sum of the undiscounted cash flows over that same period to develop the ratio of the fair value of the asset that would be amortized during that period. Otherwise, the time value of money would impact the amortization pattern resulting in a downward-sloping amortization curve even when the pattern of benefit is uniform.

14. The Task Force was not asked to reach a consensus on the FASB staff's proposed model noting that the proposed approach would result in most intangible assets subject to amortization

being amortized using the "pattern of economic benefit" method rather than the straight-line method. The Task Force also noted that the implication of that approach is that the guidance in paragraph 11 of Statement 142 is, in many cases, obviated by the decisions that are required in determining the fair value of intangible assets pursuant to Statement 141.

15. As a result of those concerns, the Task Force requested that the FASB staff form a working group to explore further those issues that have arisen in practice. In particular, those issues surround (a) the determination of the useful life of an intangible asset that is subject to legal, regulatory, or contractual limits, (b) the determination of when an intangible asset may be determined to have an indefinite life, and (c) how to interpret the provisions of paragraph 12 of Statement 142 regarding the determination of *the pattern in which the economic benefits are consumed* and whether that pattern can be *reliably determined*.

Current EITF Discussion

16. At the March 17–18, 2004 EITF meeting, the FASB staff presented the practice issue identified by the Working Group: determining the useful life of intangible assets that have contractual provisions that enable renewal or extension. The Working Group also identified three possible approaches to addressing that issue: (a) set the useful life of the intangible asset for amortization purposes equal to the period over which the entity projects that the intangible asset will contribute to its cash flows, (b) refine the definition of the intangible asset that is recognized apart from goodwill under Statement 141 (Issue 4), and (c) restrict the useful life of the intangible asset for amortization purposes to a period shorter than the period over which the entity projects that the intangible asset will contribute to its cash flows based on the probability that the asset may not be renewed (Issues 3 and 3(a)).

17. The Task Force discussed Issue 4 and questioned whether the practice issue is caused by (a) a difficulty in distinguishing indefinite-lived intangible assets from finite-lived intangible assets and/or (b) an inability to determine whether the intangible asset consists of a single asset (for example, the contractual right to use a patented technology for the contractual term of the license agreement remaining at the date of acquisition) or multiple assets including the base contractual asset and one or more additional intangible assets (for example, the supplier relationship—that is, rights to negotiate renewals at the end of each contractual term—and/or renewal options). The Task Force was not asked to reach a consensus on Issue 4 but directed the FASB staff to consider those questions for further discussion by the Task Force.

18. The Task Force did not discuss Issue 3 or Issue 3(a).

Status

19. Further discussion is expected at a future meeting.

Issue No. 03-13

Title: Applying the Conditions in Paragraph 42 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* in Determining Whether to Report Discontinued Operations

Dates Discussed: November 12–13, 2003; March 17–18, 2004

Reference: FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

Introduction

1. The FASB staff established a Working Group to assist in the development of a model for evaluating (a) which cash flows are to be considered in determining whether cash flows have been or will be eliminated and (b) what types of continuing involvement constitute significant continuing involvement. The Working Group generally agreed that current practice with respect to applying the criteria in paragraph 42 of Statement 144 has not resulted in broadening the reporting of discontinued operations, which appears to have been the Board's intent in Statement 144. The requirement to *eliminate* all cash flows of the component from the ongoing operations of the entity has been interpreted in a very restrictive fashion, which the Working Group believes is primarily due to a lack of guidance to assist in the determination of what constitutes "cash flows of the component." The difficulty in determining what cash flows constitute the cash flows of the component can arise, for instance, when the seller engages in activities with the component after its disposal. Often, those activities generate continuing cash flows to the seller, which may or may not be considered cash flows of the component. The Working Group has agreed that the evaluation of what cash flows are to be considered in determining whether cash flows have been or will be eliminated and what types of continuing involvement constitute significant continuing involvement should be based on many factors.

2. With respect to significant continuing involvement, the Working Group generally believes that paragraph 42(b) of Statement 144 is intended to address situations in which the seller continues to have significant involvement in the operations of a component after it is sold and is not intended to apply to other types of involvement in the disposal component. The Working Group generally agreed that the evaluation of whether an entity has significant continuing involvement in the operations of the component should be based on significance from the perspective of the disposed component and on relevant facts and circumstances.

3. The Working Group noted that the cash flows of the component include gross cash flows (cash inflows and cash outflows) that are directly associated with revenue-producing and cost-generating activities of the component, that is, cash flows directly associated with the operations of the component. Situations in which the seller engages in activities with the component after its disposal often result in continuing cash flows to the seller. The Working Group noted that the activities that generate continuing cash flows may or may not have similar characteristics as compared with the activities that generated the cash flows prior to the disposal of the component.

4. The Working Group generally agreed that the determination of whether the "continuing cash flows" constitute "cash flows of the component" should be based on an evaluation of whether the characteristics of the activities that generate the continuing cash flows are similar to the characteristics of the activities that generated the cash flows of the component prior to its disposal.

5. The Working Group discussed the characteristics that should be included in this evaluation, of which the following were noted:

- Whether the nature of the products sold and services provided are similar
- Whether the customers who purchase the products sold and services provided are similar
- Whether the geographic region in which products are sold and services are provided are similar
- Whether the methods used to distribute products and provide services are similar
- Whether the extent of decision-making ability over the operations is similar
- Whether degree of involvement in the activities is similar (passive versus active)
- Whether degree of financial interest is similar (obligation to absorb losses and ability to receive residual returns).

6. The Working Group agreed that the determination of whether the entity has significant continuing involvement in the operations of the component after the disposal transaction should be based on facts and circumstances. The Working Group further agreed that any guidance should provide indicators of significant continuing involvement along with examples that will assist preparers and auditors in evaluating the indicators. The Working Group believes that the Task Force should consider whether the proposed model should include a bright-line test to assist in the determination as to what constitutes "significant."

7. The Working Group generally agreed that an evaluation of significant continuing involvement should be based on both a quantitative and qualitative assessment and should be from the perspective of the disposed component. The Working Group discussed indicators of significant continuing involvement, of which the following were noted:

a. The entity retains an interest in the disposal component sufficient to enable it to exert significant influence over the component's operating and financial policies.
b. The entity and the buyer are parties to a significant contract or agreement, such as the relationship between a customer and a supplier, when one entity provides management services to another, or when two entities enter into a transitional support agreement that involves the disposal component. The determination as to whether this constitutes significant continuing involvement should be based on the following factors:

    (1) Significance of the contract or agreement to the overall operations of the disposed component,
    (2) The rights conveyed by the contract to each party, and
    (3) Whether the contract was carried out on an arm's-length basis.

Each factor should be evaluated in determining whether a contract or agreement would constitute significant continuing involvement.

c. The entity participates significantly in future profits of the disposal component. The determination as to whether this constitutes significant continuing involvement should be based on the following factors: (1) the extent to which the entity is involved in the operations of the disposal component; (2) the significance of the cash that may be received to the overall cash flows from the operations of the entity disposed of; and (3) term/length of the profit participation.

8. The Working Group discussed the assessment period with respect to determining when the criteria in paragraph 42 of Statement 144 have been met and formulated the following three views:

a. The assessment of whether an entity meets the criteria of paragraph 42 should be made during the period that includes the point at which the component initially meets the criteria to be classified as held for sale and the date the component is actually disposed of.
b. The assessment of whether an entity meets the criteria of paragraph 42 should be made during the period that includes the point at which the component initially meets the criteria to be classified as held for sale and one year after the date the component is actually disposed of.
c. The assessment of whether an entity meets the criteria of paragraph 42 should be made beginning when the component initially meets the criteria to be classified as held for sale and should be on-going.

Issue

9. The issues are:

Issue 1— Which cash flows should be considered in the determination of whether cash flows of the disposal component have been or will be eliminated from the ongoing operations of the entity

Issue 2— The types of continuing involvement that constitute significant continuing involvement in the operations of the disposal component

Issue 3— The appropriate (re)assessment period in determining whether the criteria in paragraph 42 have been met.

Prior EITF Discussion

10. At the November 12–13, 2003 EITF meeting, the Task Force discussed the Working Group's proposed approach for assessing whether the criteria in paragraph 42 of Statement 144 have been met for purposes of classifying the results of operations of a component of an entity that either has been disposed of or is classified as held for sale as discontinued operations. That proposed guidance focuses on (a) the cash flows that constitute "cash flows of the component" and (b) the continuing involvement that constitutes significant continuing involvement.

11. The Task Force agreed with the general direction of the Working Group's proposed approach but asked the Working Group to further refine and articulate the principles set forth in the proposed approach and to provide examples of the application of the proposed approach to specific fact patterns.

12. With respect to the appropriate assessment period, the Task Force reached a tentative conclusion that the appropriate assessment period should include the point at which the component initially meets the criteria to be classified as held for sale and one year after the date the component is actually disposed of. The assessment should be based on all facts and circumstances, including management's intent and ability to eliminate the cash flows of the disposal component from its operations and management's intent and ability not to have significant continuing involvement in the operations of the disposal component. If at any time during that assessment period the criteria in paragraph 42 are not expected to be met within one year after the disposal date, the component's operations should be reclassified from discontinued operations. If at any time during the assessment period the criteria in paragraph 42 are met or are expected to be met within one year after the disposal date, the component's operations should be classified as discontinued operations. The Task Force observed that events or circumstances beyond an entity's control may extend the period over which cash flows of the disposal component continue or over which significant continuing involvement in the disposal component remains. Therefore, the Task Force also agreed that an exception to the one-year period should apply in situations described in paragraph 31 of Statement 144.

Current EITF Discussion

13. At the March 17–18, 2004 EITF meeting, the Task Force discussed the Working Group's proposed approach for assessing whether the criteria in paragraph 42 of Statement 144 have been met for purposes of classifying the results of operations of a component of an entity that either has been disposed of or is classified as held for sale as discontinued operations.

14. The proposed approach for assessing whether cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity focuses on whether continuing cash flows are direct or indirect cash flows. Cash flows of the component would not be eliminated if the continuing cash flows are considered direct cash flows. The determination as to whether the continuing cash flows are direct or indirect is based on an evaluation of a set of indicators. That set of indicators focuses on the characteristics of the cash inflows and cash outflows to (from) the entity following the disposal. The indicators specifically address (a) the customers that purchase products or services of the entity that are similar to products or services of the disposed component, (b) the costs associated with the similar products or services sold, and (c) the nature of the products or services sold to or purchased from the disposed component. The relative strength of each indicator is considered in relation to the other indicators to determine whether the cash flows are direct or indirect cash flows of the disposed component.

15. The proposed approach for assessing whether the entity will have any significant continuing involvement in the operations of the component after the disposal transaction focuses on whether the entity has (a) the ability to influence the operating and/or financial policies of the disposed component, (b) retained risk associated with the operations of the disposed component, or (c) the ability to restrict other third parties from obtaining benefits from the disposed component. The

determination as to whether the entity has significant continuing involvement is based on a quantitative and qualitative assessment from the perspective of the disposed component and should take into consideration all types of continuing involvement, individually and in the aggregate. The proposed approach provides two categories of relationships that should be considered in determining whether an entity has significant continuing involvement in the operations of the entity: (a) the entity retains an interest in the disposal component sufficient to enable it to exert significant influence over the component's operating and financial policies or (b) the entity and the buyer are parties to a contract or agreement that, based on a consideration of several factors, constitutes significant continuing involvement.

16 The Task Force discussed and expressed general support for the direction of the Working Group's proposed approach. The Task Force asked the FASB staff to further refine and articulate the principles set forth in the proposed approach and provide more guidance on the application of the proposed approach to the specific examples. Additionally, the Task Force requested that the FASB staff develop additional examples for specific fact patterns raised by some Task Force members.

Status

17. Further discussion is expected at a future meeting.

Issue No. 03-16

Title: Accounting for Investments in Limited Liability Companies

Dates Discussed: November 12–13, 2003; March 17–18, 2004

References: FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*

FASB Statement No. 111, *Rescission of FASB Statement No. 32 and Technical Corrections*

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

APB Opinion No. 20, *Accounting Changes*

AICPA Accounting Interpretation 2, "Investments in Partnerships and Ventures," of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*

AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*

Proposed AICPA Statement of Position, *Accounting for Investor's Interests in Unconsolidated Real Estate Investments,* issued in November 2000

Introduction

1. Opinion 18 prescribes the accounting for investments in the common stock of corporations that are not consolidated. Opinion 18 specifies that investments that allow the investor to exercise significant influence over the operating and financial policies of an investee should be accounted for using the equity method. Further, Opinion 18 establishes a presumption of significant influence for investments that represent 20 percent or more of the investee's outstanding voting stock.

2. Interpretation 2 indicates that while Opinion 18 does not apply to partnerships, "many of the provisions of the Opinion would be appropriate in accounting" for partnerships. Although no authoritative accounting literature broadly addresses the accounting for limited partnerships, SOP 78-9 addresses the accounting for real estate partnerships, and that accounting is applied by analogy to partnerships that are not real estate ventures. SOP 78-9 requires noncontrolling investments in limited partnerships (LPs) to be accounted for using the equity method as described in Opinion 18 unless the limited partner's interest is "so minor that the limited partner may have virtually no influence over partnership operating and financial policies . . . . and, accordingly, accounting for the investment using the cost method may be appropriate." In *EITF Abstracts*, Topic No. D-46, "Accounting for Limited Partnership Investments," the SEC staff clarified its view that limited partnership investments of more than 3 to 5 percent are considered to be more than minor and, therefore, should be accounted for using the equity method. As a

result of the above guidance, the accounting for an investment in, for example, 10 percent of the outstanding common stock of a corporation may be accounted for differently than an investment at a similar level in a limited partnership.

3. Limited liability companies (LLCs) have characteristics of both corporations and partnerships but are dissimilar from both in certain respects. The following discussion compares characteristics typical of many LLC structures with characteristics of corporations or partnerships; however, those characteristics may not be present in all LLC structures. Like a corporation, the members (that is, owners) of an LLC generally are not personally liable for the liabilities of the LLC. However, like a partnership, the members of an LLC—rather than the entity itself—are taxed on their respective shares of the LLC's earnings. Unlike a limited partnership, it is generally not necessary for one owner (for example, the general partner in an LP) to be liable for the liabilities of the LLC. Also, unlike an LP in which the general partner manages the partnership, or a corporation in which the Board of Directors and its Committees control the operations, owners may participate in the management of an LLC. Members may participate in an LLC's management but generally do not forfeit the protection from personal liability afforded by the LLC structure. In contrast, the general partner of a limited partnership has control but also has unlimited liability, whereas the limited partners have limited liability like the members of an LLC. Additionally, all partners in a general partnership have unlimited liability. Like a partnership, financial interests in most LLCs may be assigned only with the consent of all of the LLC members. Like a partnership, most LLCs are dissolved by death, bankruptcy, or withdrawal of a member. Due to these similarities and differences between LLCs and corporations/partnerships, diversity in practice exists with respect to accounting for noncontrolling investments in LLCs.

Issue

4. The issue is whether an LLC should be viewed as similar to a corporation or similar to a partnership for purposes of determining whether noncontrolling investments in an LLC should be accounted for using the cost method or the equity method.

Prior EITF Discussion

5. At the November 12–13, 2003 EITF meeting, the Task Force reached a tentative conclusion that investments in an LLC that maintains a "specific ownership account" for each investor—similar to a partnership capital account structure—should be viewed as similar to a limited partnership for purposes of determining whether noncontrolling investments in an LLC should be accounted for using the cost method or the equity method of accounting. Therefore, the provisions of SOP 78-9 and related guidance also would apply to such LLCs. The guidance provided by the SEC staff in Topic D-46 would similarly apply to such LLCs.

6. Specific ownership account structures are described in the AICPA's November 2000 proposed Statement of Position on accounting for investors' interests in unconsolidated real estate investments as structures in which each owner has a specific ownership account in the entity to which the owner's share of profits and losses, contributions, and distributions accrues directly. In reaching the tentative conclusion, the Task Force observed that specific ownership accounts represent the LLC member's claim on the net assets of the LLC in the same manner that they represent a limited partner's claim on the net assets of an LP.

7. The Task Force asked the FASB staff to further research the various legal structures of LLCs to determine if circumstances exist in which the specific ownership accounts do not represent a claim on the net assets of the LLC and, therefore, the analogy to partnerships may not be appropriate.

Current EITF Discussion

8. At the March 17–18, 2004 EITF meeting, the Task Force reached a consensus that an investment in an LLC that maintains a "specific ownership account" for each investor—similar to a partnership capital account structure—should be viewed as similar to an investment in a limited partnership for purposes of determining whether a noncontrolling investment in an LLC should be accounted for using the cost method or the equity method. Therefore, the provisions of SOP 78-9 and related guidance, including Topic D-46, also apply to such LLCs. A Task Force member observed that specific ownership account structures may be present in other forms of organization. Although the Task Force did not consider any other characteristics of other organizational forms that might be relevant in determining whether to apply the equity method, some Task Force members have indicated that it may be appropriate to analogize to the guidance in this Issue for other entities with specific ownership account structures.

9. The Task Force agreed that the scope of this consensus should exclude investments in LLCs that are required to be accounted for as debt securities pursuant to paragraph 14 of Statement 140. The Task Force observed that certain securitization vehicles take the form of an LLC and that certain equity interests in those LLCs are subject to the income and impairment recognition guidance established by EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." As a result of the scope exclusion, the accounting for those LLC interests is not affected by the consensus in this Issue.

10. The Task Force also observed that the statement in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholder or Shareholders Have Certain Approval or Veto Rights," that LLCs with governing provisions that are the functional equivalent of regular corporations are analogous to corporations is based on a different analysis of an LLC's characteristics than the consensus reached in this Issue. To avoid an inappropriate application of the guidance in either Issue, the Task Force agreed to the following status update to Issue 96-16:

> In EITF Issue No. 03-16, "Accounting for Investments in Limited Liability Companies," the Task Force reached a consensus that an investment in an LLC that maintains a "specific ownership account" for each investor should be viewed as similar to an investment in a limited partnership for determining whether a noncontrolling investment in an LLC should be accounted for using the cost or equity method. That conclusion does not affect the guidance in this Issue.

Transition

11. Subject to the scope exception for certain LLCs described in paragraph 9, the consensus in this Issue applies to all investments in LLCs and is effective for reporting periods beginning after

June 15, 2004. The effect of adopting the consensus should be reported as the cumulative effect of a change in accounting principle pursuant to the guidance in Statement 3 and Opinion 20. If the determination of the cumulative effect of retroactive application is impracticable, the cumulative effect should be determined as the difference between the investor's carrying amount of the investment and the investor's share of the net assets of the LLC as of the date of initial application of this consensus. The investor's share of the net assets of the LLC is the investor's specific ownership account balance determined in accordance with generally accepted accounting principles.

Board Ratification

12. At its March 31, 2004 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

13. No further EITF discussion is planned.

Issue No. 04-1

Title: Accounting for Preexisting Relationships between the Parties to a Purchase Business Combination

Date Discussed: March 17–18, 2004

References: FASB Statement No. 2, *Accounting for Research and Development Costs*

FASB Statement No. 45, *Accounting for Franchise Fee Revenue*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Interpretation No. 4, *Applicability of FASB Statement No. 2 to Business Combinations Accounted for by the Purchase Method*

Introduction

1. This Issue applies when two parties that have a preexisting relationship enter into a business combination. Specifically, the Issue is whether consummation of a business combination between two parties that have a preexisting relationship should be evaluated to determine if a settlement of a preexisting relationship exists, thus requiring accounting separate from the business combination.

Issues

2. The issues are:

Issue 1— Whether consummation of a business combination between two parties that have a preexisting relationship should be evaluated to determine if a settlement of a pre-existing contractual relationship exists, thus requiring accounting separate from the business combination

Issue 2— If separate accounting is required for the settlement of a preexisting relationship between two parties to a business combination, the measurement of the settlement amount

Issue 3— If it is determined that assets of the acquired entity that are related to a preexisting relationship with the acquiring entity should be recognized as part of the business combination, whether the acquiring entity should recognize those assets as intangible assets apart from goodwill.

Current EITF Discussion

3. At the March 17–18, 2004 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that consummation of a business combination between two parties that have a preexisting relationship should be evaluated to determine if a settlement of a preexisting relationship exists. The Task Force observed that a business combination between two parties that have a pre-existing relationship could be viewed as a multi-element transaction with one element being the business combination and the other element being the settlement of the preexisting relationship.

4. The Task Force discussed Issue 2 but was not asked to reach a consensus. The Task Force directed the FASB staff to explore further alternative views on the recognition and measurement of the settlement of the preexisting relationship.

5. The Task Force did not discuss Issue 3.

Status

6. Further discussion is expected at a future meeting.

Issue No. 04-2

Title: Whether Mineral Rights are Tangible or Intangible Assets

Date Discussed: March 17–18, 2004

References: FASB Statement No. 13, *Accounting for Leases*

FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*

FASB Statement No. 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*

FASB Statement No. 66, *Accounting for Sales of Real Estate*

FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*

FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*

FASB Statement No. 89, *Financial Reporting and Changing Prices*

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

FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

FASB Concepts Statement No. 6, *Elements of Financial Statements*

APB Opinion No. 20, *Accounting Changes*

Proposed AICPA Statement of Position, *Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment*, issued June 29, 2001

Securities Act Industry Guide 7, *Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations*

IAS 38, *Intangible Assets*

IAS ED 3, *Business Combinations*

IAS ED 6, *Exploration for and Evaluation of Mineral Resources*

International Accounting Standards Committee, *Extractive Industries: An Issues Paper Issued for Comment by the IASC Steering Committee on Extractive Industries*

Introduction

1. Statement 141 requires the acquirer in a business combination to allocate the cost of the acquisition to the acquired assets and liabilities. Paragraph 37 of Statement 141 lists assets and liabilities that an acquirer should consider in its allocation of purchase price. Natural resources are listed as an example of other assets and are separate from intangible assets in that list.

2. Appendix A of Statement 141 provides examples of intangible assets. Those examples include *mineral rights* as an example of an intangible asset that should be recognized apart from goodwill.

3. Mining entities generally did not change their practice of accounting for mineral rights as tangible assets upon adoption of Statements 141 and 142. That is, they believe that mineral rights are tangible assets. However, others believe that mineral rights are intangible assets. Because of those differing views, an issue has arisen in practice as to whether mineral rights are tangible or intangible assets. That distinction is important not only for classification in the statement of financial position but also for subsequent recognition of amortization and impairment.

Scope

4. This Issue applies to mining entities. Mining entities include entities involved in finding and removing wasting natural resources—other than oil- and gas-producing entities that are within the scope of Statement 19.

Definition and Examples of Mineral Rights

5. For the purpose of this Issue, the term, *mineral rights* is defined as the legal right to explore, extract, and retain at least a portion of the benefits from mineral deposits.

6. To provide context to the definition of mineral rights, the following is an excerpt from the IASC Issues Paper (Section 2.13):

> In the mining industry, rights to explore for, develop, and produce minerals are often acquired by purchase of either the mineral rights alone (which does not include ownership of the land surfaces) or by purchase of both mineral rights and surface rights. In other cases, they are acquired through the **right to mine contract**, which grants the enterprise the rights to develop and mine the property and may call for a payment at the time the contract becomes effective and subsequent periodic payments. In the mining industry, rights to explore, develop, and produce minerals may also be acquired by mineral leases from private owners or from the government. A mineral lease contract usually calls for a payment (usually called a **signature bonus**) at the time the contract is signed and a royalty to be paid to the lessor once production commences. As a rule, both in the petroleum and mining industries, the payment of signature bonus is done in the acquisition phase. The royalty is expressed in terms of a percentage of sales proceeds or value of minerals produced, or a specified amount per tonne of ore mined during each period.

7. Mineral rights include prospecting and exploration permits if they include an option for the entity to acquire the rights to extract and retain at least a portion of the benefits from the mineral deposits. Mineral rights also include royalty interests and other non-operating interests if the interests do not meet the definition of a financial asset in Statement 140 or a derivative instrument in Statement 133.

Issues

8. The issues are:

Issue 1— Whether mineral rights are tangible or intangible assets

Issue 2— If certain mineral rights are intangible assets, whether mineral rights are finite or indefinite-lived intangible assets

Current EITF Discussion

9. At the March 17–18, 2004 EITF meeting, the Task Force reached a consensus on Issue 1 that mineral rights, as defined in this Issue, are tangible assets, and, accordingly, an entity should account for mineral rights as tangible assets. The Task Force also concluded that an entity should report the aggregate carrying amount of mineral rights as a separate component of property, plant, and equipment either on the face of the financial statements or in the notes to the financial statements.

10. As a result of the consensus on Issue 1, the Task Force did not discuss Issue 2.

Transition

11. The consensus reached by the Task Force in this Issue is effective for the first reporting period beginning after the Board ratification of the consensus becomes effective (refer to paragraph 12). Prior period amounts should be reclassified to conform to the requirements of this consensus. Any effects on the amortization or depreciation of mineral rights should be accounted for prospectively. Early application of this consensus is permitted in periods for which financial statements have not been issued.

Board Ratification

12. At its March 31, 2004 meeting, the Board ratified the consensus reached by the Task Force in this Issue. However, the effective date of that ratification is pending resolution of an inconsistency between characterization of mineral rights as tangible assets in this consensus and the characterization of mineral rights as intangible assets in Statements 141 and 142. In order to resolve this inconsistency, the Board directed the FASB staff to prepare an FASB Staff Position (FSP) that will amend Statements 141 and 142 to acknowledge the consensus in this Issue that certain mineral rights are tangible assets. The consensus will be effective when the FSP is finalized.

Status

13. No further EITF discussion is planned.

Issue No. 04-3

Title: Mining Assets: Impairment and Business Combinations

Date Discussed: March 17–18, 2004

References: FASB Statement No. 5, *Accounting for Contingencies*

FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*

FASB Statement No. 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*

FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*

FASB Statement No. 89, *Financial Reporting and Changing Prices*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

FASB Concepts Statement No. 6, *Elements of Financial Statements*

FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*

Securities Act Industry Guide 7, *Description of Property by Issuers Engaged or to be Engaged in Significant Mining Operations*

International Accounting Standards Committee, *Extractive Industries: An Issues Paper Issued for Comment by the IASC Steering Committee on Extractive Industries*

Introduction

1. When testing mining assets for impairment under Statement 144, some mining entities exclude estimated cash flows associated with the economic value of a mining asset[1] beyond that asset's proven and probable reserves, and those estimated cash flows may also exclude the effects of anticipated fluctuations in the future market price of minerals over the period of cash flows. As a result, some mining entities also disregard those factors when allocating the purchase price of a business combination to acquired mining assets. The primary concern is that an acquired mining asset may be subject to a day-two impairment if the value beyond proven and probable reserves (VBPP) and anticipated future market price increases are considered in the purchase price allocation but subsequently excluded in cash flow analyses used in an impairment test under Statement 144. The fair value of a mining asset generally includes both VBPP and an estimate of the future market price of the minerals.

[1] Mining assets include mineral properties and rights.

2. Questions have arisen as to whether an entity should include VBPP and the effects of anticipated fluctuations in the future market price of minerals when (a) allocating the purchase price of a business combination and (b) testing a mining asset for impairment.

Scope

3. This Issue applies to mining entities. Mining entities include entities involved in finding and removing wasting natural resources—other than oil- and gas-producing entities that are within the scope of Statement 19.

Value beyond Proven and Probable Reserves (VBPP)

4. Economic value exists in a mining asset beyond the value attributable to *proven* and *probable* reserves. Industry Guide 7 defines proven and probable reserves[2] as follows:

> (1) *Proven Reserves.* Reserves for which (a) quantity is computed from dimensions revealed in outcrops, trenches, workings or drill holes; grade and/or quality are computed from the results of detailed sampling and (b) the sites for inspection, sampling and measurement are spaced so closely and the geologic character is so well defined that size, shape, depth and mineral content of reserves are well-established.
>
> (2) *Probable Reserves.* Reserves for which quantity and grade and/or quality are computed from information similar to that used for proven reserves, but the sites for inspection, sampling, and measurement are farther apart or are otherwise less adequately spaced. The degree of assurance, although lower than that for proven (measured) reserves, is high enough to assume continuity between points of observation.

As indicated in the above definitions, the distinction between the categories of reserves relates to the level of geological evidence and, therefore, confidence in the reserve estimates. In addition to geological evidence, the SEC requires that an economic feasibility study be completed before mining assets are considered proven and probable reserves.

Issues

5. The issues are:

Issue 1(a)— Whether VBPP should be considered when an entity allocates the purchase price of a business combination to mining assets

Issue 1(b)— Whether the effects of anticipated fluctuations in the future market price of minerals should be considered when an entity allocates the purchase price of a business combination to mining assets

[2] Statement 89 provides less-specific definitions of proved reserves and probable reserves than those provided by Industry Guide 7.

Issue 2— Whether an entity should consider the future cash flows associated with VBPP in the cash flow analysis used to test mining assets for impairment under Statement 144

Issue 3— Whether an entity should consider the effects of anticipated fluctuations in the future market price of minerals in the cash flow analysis used to test mining assets for impairment under Statement 144.

Current EITF Discussion

6. At the March 17–18, 2004 EITF meeting, the Task Force reached a consensus on Issue 1(a) that an entity should include VBPP in the value allocated to mining assets in a purchase price allocation to the extent that a market participant would include VBPP in determining the fair value of the asset.

7. On Issue 1(b), the Task Force reached a consensus that an entity should include the effects of anticipated fluctuations in the future market price of minerals in determining the fair value of mining assets in a purchase price allocation in a manner that is consistent with the expectations of marketplace participants. Generally, an entity should consider all available information including current prices, historical averages, and forward pricing curves. Those marketplace assumptions typically should be consistent with the acquiring enterprise's operating plans with respect to developing and producing minerals. The Task Force observed that it generally would be inappropriate for an entity to use a single factor, such as the current price or a historical average, as a surrogate for estimating future prices without considering other information that a market participant would consider.

8. On Issue 2, the Task Force reached a consensus that an entity should include the cash flows associated with VBPP in estimates of future cash flows (both undiscounted and discounted) used for determining whether a mining asset is impaired under Statement 144. The Task Force noted that estimated cash flows also should include the estimated cash outflows required to develop and extract the VBPP.

9. On Issue 3, the Task Force reached a consensus that an entity should consider the effects of anticipated fluctuations in the market price of minerals when estimating future cash flows (both undiscounted and discounted) used for determining whether a mining asset is impaired under Statement 144. The Task Force noted that estimates of those effects should be consistent with estimates of a market participant. Generally, an entity should consider all available information including current prices, historical averages, and forward pricing curves. Those marketplace assumptions typically should be consistent with a company's operating plans and financial projections underlying other aspects of the impairment analysis (for example, amount and timing of production). The Task Force observed that it generally would be inappropriate for an entity to use a single factor, such as the current price or a historical average, as a surrogate for estimating future prices without considering other information that a market participant would consider.

Transition

10. The consensuses reached by the Task Force in Issues 1(a) and 1(b) should be applied prospectively to business combinations completed and goodwill impairment tests performed in

reporting periods beginning after Board ratification of the consensuses. Early application is permitted in periods for which financial statements have not been issued. Any impairment charge recognized upon initial application of this guidance or subsequently should be recorded as a component of income from continuing operations.

11. The consensuses reached by the Task Force in Issues 2 and 3 should be applied prospectively to asset impairment tests performed in reporting periods beginning after Board ratification of the consensuses. Early application is permitted in periods for which financial statements have not been issued.

Board Ratification

12. At its March 31, 2004 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

Status

13. No further EITF discussion is planned.

Issue No. 04-4

Title: Allocation of Goodwill to Reporting Units for a Mining Enterprise

Date Discussed: March 17–18, 2004

References: FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*

FASB Statement No. 141, *Business Combinations*

FASB Statement No. 142, *Goodwill and Other Intangible Assets*

FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*

Introduction

1. The acquisition of a mining company may result in the recognition of goodwill.

2. Statement 142 requires an entity to test goodwill for impairment at the reporting unit level. A reporting unit is an operating segment under Statement 131 or one level below an operating segment. Statement 131, paragraph 10, defines an operating segment as follows:

> An *operating segment* is a component of an enterprise:
>
> a. That engages in business activities from which it may earn revenues and incur expenses…,
> b. Whose operating results are regularly reviewed by the enterprise's chief operating decision maker to make decisions about resources to be allocated…, and
> c. For which discrete financial information is available.

3. Many mining entities report individual mines as operating segments. For those entities, the chief operating decision maker receives discrete financial information for the individual mines. Further, the operating mine also meets the definition of a reporting unit. However, an individual operating mine is not a typical "going-concern" business because of the finite life of its reserves—that is, an operating mine is a wasting asset.

4. Statement 142 requires an entity to assign goodwill in a business combination to reporting units, which for mining companies may be individual operating mines. Some argue that assigning goodwill to an operating mine results in a day-two impairment of the goodwill. That is, the fair value of the reporting unit only consists of the fair value of the operating mine (primarily mineral deposits) and, accordingly, there is no additional fair value in the reporting unit to support the recognition of goodwill. Others acknowledge that any goodwill assigned to an operating mine ultimately will be impaired because an operating mine is a wasting asset. Some argue that goodwill represents the premium for the exploration and development activities and relates to the enterprise's overall ability to sustain and replicate itself as a going concern entity and, therefore, goodwill should not be assigned to individual operating mines.

Issue

5. The issue is whether an entity in the mining industry should assign goodwill to a reporting unit that consists of an individual operating mine.

Current EITF Discussion

6. At the March 17–18, 2004 EITF meeting, the Task Force discussed this Issue and observed that the guidance in Statement 142 is clear—goodwill should be allocated to reporting units and an individual operating mine may constitute a reporting unit. Further, the Task Force acknowledged that the allocation of goodwill to an individual operating mine likely will result in an eventual goodwill impairment due to the wasting nature of the primary asset of the reporting unit and could result in a "day-two" goodwill impairment. However, the Task Force agreed that because the guidance in Statements 131 and 142 is clear, the Task Force cannot resolve this Issue. Accordingly, the Task Force agreed to discontinue discussion of this Issue and to remove it from the Task Force's agenda.

7. The Task Force observed that the International Accounting Standards Board (IASB) currently has an extractive industries project on its agenda and recommended that the Board monitor that project for international convergence opportunities for the extractive industries.

Status

8. No further EITF discussion is planned.

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 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	FASB Staff	Immediate Plans	Due Date - Next Deliverable
02-14	Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means	3/02	9/02, 11/02, 1/03, 3/03, 11/03, 3/04		McBride Laurenzano	FASB staff to refine the definition of in-substance common stock for consideration by the Task Force prior to the June meeting.	April distribution to Working Group.

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
03-9	Interaction of Paragraphs 11 and 12 of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, Regarding Determination of the Useful Life and Amortization of an Intangible Asset	5/03	7/03, 11/03, 3/04		McBride Durbin Pinson	FASB staff and Working Group to reconvene to consider the issue of how to determine when an intangible asset should be determined to have an indefinite life, and whether additional guidance is necessary in defining the asset(s) existing at the date of acquisition (for example, the base contract and an option to renew or "supplier relationship").	June-July meeting materials.
03-13	Applying the Conditions in Paragraph 42 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, in Determining Whether to Report Discontinued Operations	5/03	11/03, 3/04		Sogoloff Larson	FASB staff to further refine and articulate the direct/indirect cash flow model and develop additional examples illustrating the application of that model.	June-July meeting materials.
04-1	Accounting for PreExisting Contracts between the Parties to a Purchase Business Combination	01/04	3/04		Munro McBride	FASB staff preparing revised Issue Summary based on Task Force input.	Mayl preliminary distribution to Task Force.

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
04-2	Whether Mineral Rights Are Tangible or Intangible Assets	11/03	3/04	N/A	Westerlund O'Callaghan	The effective date of the consensus reached at the March 2004 meeting is pending the completion of an FSP that amends Statements 141 and 142.	FASB Staff Position, April 2004
03-R	Accounting for Certain Costs, Including Deferred Stripping Costs, in the Mining Industry	11/03	N/A	06/04	Larson Westerlund	Reconvene Mining Industry Working Group to develop an Issue Summary for Task Force consideration.	04/04 or 05/04 Working Group meeting.

<table>
<tr><th colspan="8">Inactive Issues Pending Developments in Board Projects / Other EITF Issues</th></tr>
<tr><td rowspan="2">00-18</td><td>Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees</td><td>5/00</td><td>7/00,
7/01,
11/01,
1/02,
3/02</td><td>Not scheduled</td><td>Munro

Durbin</td><td>Pending further progress in the Board's active project on share-based payment, which is expected to include recognition and measurement for share-based transactions with non-employees.</td><td>Summer 2004</td></tr>
<tr><td colspan="7">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. The measurement date issues, as well as several of the other issues and subissues of Issue 00-18 (also related to Issues 96-18 and 00-8), are presently under consideration in the Board's share-based payment project.</td></tr>
<tr><td>00-27</td><td>Application of EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," to Certain Convertible Instruments</td><td>5/00</td><td>11/00,
1/01</td><td>Not scheduled</td><td>Laurenzano

Richards</td><td>Pending further progress on Phase II of the Board's liabilities and equity project.</td><td>2004</td></tr>
</table>

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, *Accounting for Derivative Instruments and Hedging Activities*	3/02	N/A	Not scheduled	Laurenzano Sogoloff	Pending deliberations during Phase II of the Board's liabilities and equity project.	2004
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	9/00 (AC) 11/02 (TF)	N/A	Not scheduled	Laurenzano Lusniak	Pending developments in the Board's project on QSPE's and reconsideration by the FASB staff of the extent of the issue.	First half of 2004
03-17	Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet	5/03	11/03	Not scheduled	McBride O'Callaghan	Issues identified at the November meeting with respect to executory contracts that are partially recognized based on a differential value compared to a benchmark (for example, market price at date of acquisition) and the possibility of negative amortization to be explored by the Working Group on Issue 03-9.	Pending develop-ments in Issue 03-9.

03-S	Application of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, to Oil and Gas Companies	11/03	N/A	Not Scheduled	Larson Westerlund	The FASB staff is considering alternatives for addressing the practice issue raised in Issue 03-S based on the consensus reach in Issue 04-2.	May/June Agenda Committee meeting
Issues Pending Further Consideration by the Agenda Committee							
	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	Laurenzano	Pending consideration of an FASB project that may address the measurement of beneficial interests in securitized financial instruments.	