0307FN

MINUTES OF THE MARCH 15, 2007 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, March 15, 2007
Starting Time: 8:30 a.m.
Concluding Time: 3:22 p.m.

Task Force Members Present:
Lawrence W. Smith (Chairman)
Mark M. Bielstein
**Frank H. Brod
Jack T. Ciesielski
Mitchell A. Danaher
Joseph Graziano
Jay D. Hanson
**Stuart H. Harden
Jan R. Hauser
David L. Holman
James A. Johnson
Carl Kampel[1]
Matthew L. Schroeder
Ashwinpaul C. (Tony) Sondhi
Lawrence E. Weinstock
James L. Kroeker (SEC Observer)

Task Force Members Absent:
James J. Leisenring (IASB Observer)

*For certain issues only.
**Participated via teleconference.

[1] Mr. Kampel also served as the AcSEC Observer.

Others at Meeting Table:
**Robert H. Herz, FASB Board Member
George J. Batavick, FASB Board Member
G. Michael Crooch, FASB Board Member
Thomas J. Linsmeier, FASB Board Member
Leslie F. Seidman, FASB Board Member
Edward W. Trott, FASB Board Member
Donald M. Young, FASB Board Member
Russell G. Golden, FASB Senior Technical Advisor
Susan M. Cosper, FASB Practice Fellow
Joseph McGrath, SEC Professional Accounting Fellow
* Paul A. Beswick, FASB Practice Fellow
* Christopher P. Bolash, FASB Practice Fellow
* Jason L. Jacobs, FASB Practice Fellow
* Richard C. Paul, FASB Practice Fellow
* John L. Sarno, FASB Practice Fellow
* Brian C. Stevens, FASB Practice Fellow
* Mark E. Trench, FASB Project Manager

* For certain issues only.
**Participated via teleconference.

ADMINISTRATIVE MATTERS

- Prior Meeting Minutes: An FASB staff member solicited objections to the final minutes of the November 16, 2006 meeting. No objections were noted.

- The Task Force discussed the report on the EITF Agenda Committee meeting held on January 29, 2007. The Agenda Committee considered three issues and took the following actions:

a. *Accounting for Ticket-Change Fees in the Airline Industry*. The Agenda Committee decided not to add this issue to the EITF agenda.

b. *Accounting for Advance Payments for Goods or Services to Be Used in Future Research and Development Activities.* The Agenda Committee decided to add this Issue to the EITF agenda. Refer to the discussion of EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities," elsewhere in these minutes.

c. *Accounting for Convertible Instruments That Require or Permit Partial Cash Settlement upon Conversion.* The Agenda Committee decided to add this Issue to the EITF agenda. Refer to the discussion of EITF Issue No. 07-2, "Accounting for Convertible Debt Instruments That Require or Permit Partial Cash Settlement upon Conversion," elsewhere in these minutes.

- Comment letters on the following Issues were reported as received:

a. EITF Issue No. 06-10, "Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements" (Comment Letters Nos. 1–3 on the draft abstract)

b. EITF Issue No. 06-11, "Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards" (Comment Letters Nos. 1 and 2 on the draft abstract)

c. EITF Issue No. 07-2, "Accounting for Convertible Debt Instruments That Require or Permit Partial Cash Settlement upon Conversion" (Comment Letters Nos. 1–7).

- At the September 7, 2006 EITF meeting, an FASB staff member reported that an initiative to harmonize transition methodologies had been broadened to consider other short-term FASB technical application and implementation activities that will be addressed initially by the Board. The FASB staff discussed this project with the Board at an administrative session held on November 27, 2006, and developed the following transition principles:

a. New standards should be applied retrospectively so that comparable information is presented.

b. New standards should be effective as of the beginning of a year to achieve consistent application and implementation of new standards.

c. Entities should not be given the option of transition methods (including an option for early adoption), as that discretion decreases the transparency of information presented.

In addition, the FASB staff discussed the transition principles with the FASB Investors Technical Advisory Committee (ITAC) at a meeting held on January 11, 2007. The ITAC agreed with the aforementioned principles and developed the following additional principles:

a. The use of hindsight should be permitted in retrospectively applying new standards, as the resulting gains in clarity and transparency more than offset any information loss that results from using hindsight.

b. To address the concerns of credit analysts, public and nonpublic entities should be subject to the same effective date of a new standard.

An FASB staff member will present these two additional principles to the Board for discussion at a future Board administrative session. An FASB staff member reported that if the Board agrees with these principles, the principles would be considered when developing transition alternatives for future EITF Issues.

- An FASB staff member reported that at the November 16, 2006 EITF meeting, the Task Force discussed EITF Issue No. 06-12, "Accounting for Physical Commodity Inventories for Entities within the Scope of the AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities*." The issues discussed were:

Issue 1— How to determine whether an entity is included within the scope of the Guide
Issue 2— Whether entities within the scope of the Guide should record physical commodity inventory at fair value.

The Task Force deferred making a decision on Issue 06-12 and recommended that the Board consider addressing the accounting for traded physical commodity inventory through the issuance of an FASB Staff Position (FSP).

At the March 14, 2007 Board meeting, the FASB added a project to its agenda to consider amending AICPA Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*, to require all entities that trade physical and nonphysical commodity inventory items with readily determinable fair values to account for them at fair value.

At a future meeting, the Task Force will evaluate whether it is necessary to continue discussing Issue 06-12 following the outcome of the Board's project.

- An FASB staff member reported that in Issue 3 of EITF Issue No. 00-18, "Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees," the Task Force was asked to consider the accounting for transactions that include a grantee performance commitment when the grantee has the contingent right to receive, upon performing as specified in the arrangement, grantor equity instruments that are issued as consideration for the grantee's future performance. Issue 00-18 has been inactive since it was last discussed at the March 20–21, 2002 EITF meeting.

At the March 2002 EITF meeting, the Task Force was not asked to reach a consensus on Issue 3 but generally agreed that the grantee should account for the arrangement as an executory contract (that is, generally no accounting before performance) in the same manner as if the grantor had agreed to pay cash (upon vesting). The Board intends to address the accounting by the grantee through the Board's project on revenue recognition.

Also at the March 2002 EITF meeting, the Task Force directed the FASB staff to further develop a measurement date approach for nonemployee share-based payment awards similar to the approach in EITF Issue No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services," and to focus on improving the guidance used to determine the date at which a commitment for counterparty performance to earn the equity instruments is reached. Since then, the Board issued FASB Statement No. 123 (revised 2004), *Share-Based Payment*. That standard was the result of the completion of the Board's first phase of a two-phase project to broadly reconsider the accounting guidance on share-based payment awards. The first phase focused on the accounting for share-based payment awards issued to employees, and the second phase is intended to address the accounting for share-based payment awards issued to nonemployees and employee share ownership plans. In March 2005, the Board decided not to begin the second phase of the share-based payment project immediately, but rather to wait for further development of the Board's liabilities and equity project.

Since the Board has on its agenda projects to reconsider the accounting for (a) revenue recognition, which is expected to resolve Issue 3 of Issue 00-18, and (b) share-based payment awards issued to nonemployees, which is expected to address the measurement date approach for nonemployees, an FASB staff member recommended that Issue 3 of Issue 00-18 and any further consideration of the measurement date approach for nonemployees be removed from the EITF agenda. The Task Force did not object to the FASB staff member's recommendation. Therefore, Issue 3 of Issue 00-18 has been removed from the EITF agenda.

- June 2007 EITF Meeting. An FASB staff member asked Task Force members to anticipate a day-and-a-half EITF meeting to be held on June 13–14, 2007. An FASB staff member reported that there would be an EITF Agenda Committee meeting in mid-April to consider issues to be discussed at the June meeting.

- An FASB staff member announced that any tentative conclusions reached by the Task Force at this meeting will be considered by the Board for ratification at the Board meeting on March 28, 2007, and then exposed for public comment. Any tentative conclusions reached at a prior meeting and affirmed as a consensus at this meeting also will be considered by the Board for ratification at the March 28, 2007 Board meeting.

- The SEC Observer announced that an amendment to *EITF Abstracts*, Topic No. D-98, "Classification and Measurement of Redeemable Securities," was made to conform with FASB

Staff Position EITF 00-19-2, "Accounting for Registration Payment Arrangements," which was issued by the FASB in December 2006, and to include the SEC staff's longstanding position regarding the relationship between Topic D-98 and EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock." Refer to the revised SEC staff announcement elsewhere in these minutes.

- The SEC Observer announced the SEC staff's position relating to the determination of whether the characteristics of a host contract related to a hybrid financial instrument issued in the form of a share are more akin to a debt instrument or more akin to an equity instrument. This SEC staff announcement is discussed in *EITF Abstracts*, Topic No. D-109, "Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133." Refer to the SEC staff announcement elsewhere in these minutes.

- An SEC staff member discussed the application of the "critical terms match" approach to applying hedge accounting for cash flow hedges under paragraph 65 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. In recent discussions regarding hedge accounting for foreign currency and commodity relationships, the SEC staff has become aware that in certain instances registrants have assumed no ineffectiveness in a hedging relationship when applying critical terms match in situations in which certain terms of the hedge and the hedged item may be different.

An SEC staff member indicated that in situations in which registrants have applied the critical terms match method when the terms of the hedge and the hedged item do not exactly match, but the other provisions of paragraph 65 have been satisfied, registrants would generally be expected to:

a. Evaluate and support the reasonableness of the original conclusion that the terms of the hedge and the hedged item matched[1]
b. Perform a quantitative assessment to confirm that the relationship was highly effective and that any ineffectiveness was de minimis.

If the results confirm that there was a reasonable basis to assert that the terms matched, that the relationship was highly effective, and that any ineffectiveness was de minimis, continued application of hedge accounting may be acceptable. For situations in which registrants assumed no ineffectiveness, but for which there was not a reasonable basis to assert that the terms matched, that the relationships were not highly effective, or that the ineffectiveness was not de minimis, the SEC staff member indicated that registrants may want to discuss the matter with the SEC's Office of the Chief Accountant.

[1] One example might be a foreign currency hedging relationship in which the settlement of the forecasted transaction and the derivative occurred within the same month but on different days.

REVISED SEC STAFF ANNOUNCEMENT

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

Date Discussed: March 15, 2007

Topic D-98 considers circumstances in which a financial instrument should be classified outside of permanent equity. EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," and FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities,* also pertain to certain financial instruments that may be within the scope of Topic D-98.

At the March 15, 2007 EITF meeting, the SEC Observer made the following announcement of the SEC staff's position (and the related transition provisions) regarding the relationship between Topic D-98 and FASB Staff Position EITF 00-19-2, "Accounting for Registration Payment Arrangements," which was issued by the FASB in December 2006 (see paragraphs 2, 9, and 33–35). In addition, the SEC staff also included its longstanding position regarding the relationship between Topic D-98 and paragraphs 12–32 of Issue 00-19 (see paragraphs 2, 6, and 24), and clarified its position (and announced the related transition provisions) regarding the relationship between Topic D-98 and paragraphs 12(a) and 60 of Statement 133 (see paragraph 36).

The SEC staff also updated certain references within Topic D-98 (see paragraphs 2, 3, 14, 25, 28, and 31), made certain technical corrections (see paragraphs 16 and 20), and added sub-captions to the applicable paragraphs in the Subsequent Developments section.

For convenience, Topic D-98 is included below in its entirety (additions are underscored and deletions are ~~struck through~~).

Topic: Classification and Measurement of Redeemable Securities

Dates Discussed: July 19, 2001; May 15, 2003; March 17–18, 2004; September 15, 2005; March 16, 2006; September 7, 2006; March 15, 2007

1. The SEC staff has received inquiries about the financial statement classification and measurement of securities subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. [Note: See Subsequent Developments section below.]

Scope

2. Rule 5-02.28 of Regulation S-X[1] requires preferred securities that are redeemable for cash or other assets to be classified outside of permanent equity if they are redeemable (1) at a fixed or determinable price on a fixed or determinable date, (2) at the option of the holder, or (3) upon the occurrence of an

event that is not solely within the control of the issuer. Although the rule specifically describes and discusses preferred securities, the SEC staff believes that Rule 5-02.28 of Regulation S-X also provides analogous guidance for other equity instruments including, for example, common stock, ~~and~~ derivative instruments, and share-based payment arrangements that are classified as equity pursuant to FASB Statement No. 123 (revised 2004), *Share-Based Payment* ~~Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."~~ [Note: See paragraphs 24–25, 28–31, and 33–35 in the Subsequent Developments section below.]

[1] Adopted in Accounting Series Release No. 268, *Presentation in Financial Statements of "Redeemable Preferred Stocks."*

3. As noted in Accounting Series Release No. 268 (ASR 268), the Commission reasoned that "[t]here is a significant difference between a security with mandatory redemption requirements or whose redemption is outside the control of the issuer and conventional equity capital. The Commission believes that it is necessary to highlight the future cash obligations attached to this type of security so as to distinguish it from permanent capital."[2] Upon a reporting entity's adoption of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, certain instruments that previously were reported as part of shareholder's equity (including temporary equity) will be reported as liabilities. [Note: See paragraphs 22–26 in the Subsequent Developments section below.] Consequently, the presentation requirements outlined in ASR 268 (Rule 5-02.28 of Regulation S-X), and the interpretive guidance in this staff announcement, do not apply to those instruments after the effective date of Statement 150. ASR 268 and the interpretive guidance in this staff announcement continue to be applicable for instruments that are not within the scope of Statement 150.

[2] See ASR 268, July 27, 1979.

Classification

4. Rule 5-02.28 of Regulation S-X requires securities with redemption features that are not solely within the control of the issuer to be classified outside of permanent equity. The SEC staff believes that all of the events that could trigger redemption should be evaluated separately and that the possibility that *any* triggering event that is not *solely* within the control of the issuer could occur—without regard to probability—would require the security to be classified outside of permanent equity.

5. The SEC staff believes that ordinary liquidation events, which involve the redemption and liquidation of all equity securities, should not result in a security being classified outside of permanent equity. In other words, if the payment of

cash is required only upon final liquidation of the company, then that potential event need not be considered when applying the rule. However, deemed liquidation events that require one or more particular class or type of equity security to be redeemed cause those securities to be classified outside of permanent equity.

6. Determining whether an equity security is redeemable at the option of the holder or upon the occurrence of an event that is solely within the control of the issuer can be complex. Accordingly, the SEC staff believes that all of the individual facts and circumstances should be considered in determining how an equity security should be classified. Some financial instruments issued in the form of shares that are not required to be classified as assets or liabilities under Statement 150 or other applicable GAAP are redeemable at the option of the holder or upon the occurrence of an event that is not solely within the control of the issuer. Upon redemption of these financial instruments in other than a final liquidation, the issuer may be required or may have a choice to settle the contract by delivery of its own shares. For these instruments, the guidance in paragraphs 12–32 of Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," should be used to evaluate whether the issuer controls the actions or events necessary to issue the maximum number of shares that could be required to be delivered under share settlement of the contract. If the issuer does not control settlement by delivery of its own shares, cash settlement of the instrument would be presumed and the instrument would be classified as temporary equity. For example, if preferred shares are redeemable at the option of the holder (that is, puttable shares) and the issuer is permitted to settle the redemption amount in cash or by delivery of a variable number of its common shares with an equivalent value, the absence of a cap on the number of common shares that could be potentially issuable upon redemption requires classification of the preferred shares outside of permanent equity.

Examples in which permanent equity classification is not appropriate

7. Assume that a preferred security has a redemption provision that states it may be called by the issuer upon an affirmative vote by the majority of its board of directors. While some might view the decision to call the security as an event that is within the control of the company, the SEC staff believes that if the preferred security holders control a majority of the votes of the board of directors through direct representation on the board of directors or through other rights, the preferred security is redeemable at the option of the holder and its classification outside of permanent equity is required. In other words, any provision that requires approval by the board of directors cannot be assumed to be within the control of the issuer. All of the relevant facts and circumstances must be considered.

8. In another example, consider a security with a deemed liquidation clause that provides that the security becomes redeemable if the stockholders of the issuing company (that is, those immediately prior to a merger or consolidation) hold, immediately after such merger or consolidation, stock representing less than a majority of the voting power of the outstanding stock of the surviving corporation. This change-in-control provision would require the security to be classified outside of permanent equity because a purchaser could acquire a majority of the voting power of the outstanding stock, without company approval, thereby triggering redemption.

9. Securities with provisions that allow the holders to be paid upon the occurrence of events that are not solely within the issuer's control should be classified outside of permanent equity. Such events include:

- The failure to have a registration statement declared effective by the SEC by a designated date [Note: See paragraphs 33–35 in the Subsequent Developments section below]
- The failure to maintain compliance with debt covenants
- The failure to achieve specified earnings targets
- A reduction in the issuer's credit rating.

Examples in which permanent equity classification is appropriate

10. Other events are solely within the control of the issuer, and, accordingly, classification as part of permanent equity would be appropriate. For example, a preferred stock agreement may have a provision that the decision by the issuing company to sell all or substantially all of a company's assets and a subsequent distribution to common stockholders triggers redemption of the preferred equity security. In this case, the security would be appropriately classified as part of permanent equity if the preferred stockholders cannot trigger or otherwise require the sale of the assets through representation on the board of directors, or through other rights, because the decision to sell all or substantially all of the issuer's assets and the distribution to common stockholders is solely within the issuer's control. In other words, if there could not be a "hostile" asset sale whereby all or substantially all of the issuer's assets are sold, and a dividend or other distribution is declared on the issuer's common stock, without the issuer's approval, then classifying the security as part of permanent equity would be appropriate.

11. As another example, a preferred stock agreement may have a provision that provides for redemption of the preferred security if the issuing company is merged with or consolidated into another company, and pursuant to state law, approval of the board of directors is required before any merger or consolidation can occur. In that case, assuming the preferred stockholders cannot control the vote of the board of directors through direct representation or through other rights, the security would be appropriately classified as part of permanent equity because the decision to merge with or consolidate into another company is within the

control of the issuer. Again, all of the relevant facts and circumstances must be considered when determining whether the preferred stockholders can control the vote of the board of directors.

12. An equity security may become redeemable upon the disability of the holder. In addition, an equity security may become redeemable upon the death of the holder, at the option of the holder's heir or estate. In this narrow, limited exception in which the redemption upon death (at the option of the holder's heir or estate) or disability will be funded from the proceeds of an insurance policy that is currently in force and which the company has the intent and ability to maintain in force, classifying the security as part of permanent equity would be appropriate. This is a narrow exception that should not be analogized to for other transactions, including circumstances in which an equity security must be redeemed upon the death of the holder.[3]

[3] Pursuant to Statement 150, shares of stock that are required to be redeemed by the issuer upon the death of the holder are classified as a liability, because redemption is required upon an event (that is, death) that is certain to occur. Mandatorily redeemable shares are classified as liabilities under Statement 150 even if an insurance policy would fund the redemption.

Measurement

13. In adopting ASR 268 in 1979, the Commission stated that it was not its "intention to deal with the conceptual issue of whether redeemable preferred stock is a liability." Further, the Commission stated that it was not its "intention to alter existing practice or authoritative guidelines relative to accounting for elements of stockholders' equity . . . (for example, the determination of the carrying value of redeemable preferred stock . . .). [ASR 268] is intended to represent only an interim solution until the FASB, in connection with its conceptual framework project, addresses the related conceptual issues."

14. In May 2003, the FASB issued Statement 150, which addresses how an issuer classifies in its statement of financial position and measures certain financial instruments that have characteristics of both liabilities and equity. [Note: See paragraphs 22–26 in the Subsequent Developments section below.] Statement 150 does not address all of the instruments to which ASR 268 (Rule 5-02.28 of Regulation S-X) and the interpretive guidance in this staff announcement had originally applied. The SEC staff has the following observations about the valuation of redeemable preferred stock that is not within the scope of Statement 150.

15. The SEC staff believes the initial carrying amount of redeemable preferred stock should be its fair value at date of issue. This SEC staff announcement does not change the accounting for derivative instruments or embedded derivatives that are within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (as amended), which must be accounted for in

accordance with the provisions of that Statement. If redeemable currently (for example, at the option of the holder), the security should be adjusted to its redemption amount at each balance sheet date. The redemption amount at each balance sheet date should include amounts representing dividends not currently declared or paid but which will be payable under the redemption features or for which ultimate payment is not solely within the control of the registrant (for example, dividends that will be payable out of future earnings). If the security is not redeemable currently (for example, because a contingency has not been met), and it is not probable that the security will become redeemable, subsequent adjustment is not necessary until it is probable that the security will become redeemable. In that case, the SEC staff would expect disclosure of why it is not probable that the security will become redeemable.

16. If it is probable that the security will become redeemable, the staff will not object to either of the following accounting methods:

a. Accrete changes in the redemption value over the period from the date of issuance (or from the date that it becomes probable that the security will become redeemable, if later) to the earliest redemption date of the security using an appropriate methodology, usually the interest method. Changes in the redemption value are considered to be changes in accounting estimates and accounted for, and disclosed, in accordance with FASB Statement No. 154, *Accounting Changes and Error Corrections* ~~APB Opinion No. 20, *Accounting Changes*~~.

b. Recognize changes in the redemption value (for example, market value) immediately as they occur and adjust the carrying value of the security to equal the redemption value at the end of each reporting period. This method would view the end of the reporting period as if it were also the redemption date for the security.

17. The SEC staff will expect consistent application of the accounting method selected, along with appropriate disclosure of the selected policy in the footnotes to the financial statements. Moreover, disclosure of the redemption value of the security as if it were redeemable is required for registrants that elect to accrete changes in redemption value over the period from the date of issuance to the earliest redemption date.

Earnings per Share

18. Regardless of the accounting method selected, the resulting increases or decreases in the carrying amount of a redeemable security other than common stock shall be treated in the same manner as dividends on nonredeemable stock and shall be effected by charges against retained earnings or, in the absence of retained earnings, by charges against paid-in capital. Increases or decreases in the carrying amount shall reduce or increase income applicable to common

stockholders in the calculation of earnings per share and the ratio of earnings to combined fixed charges and preferred stock dividends. If charges or credits are material to income, separate disclosure of income applicable to common stockholders on the face of the income statement should be provided.

19. Similarly, regardless of the accounting method selected, the resulting increases or decreases in the carrying amount of redeemable common stock shall be treated in the same manner as dividends on nonredeemable stock and shall be effected by charges against retained earnings or, in the absence of retained earnings, by charges against paid-in capital. However, increases or decreases in the carrying amount of a redeemable common stock should not affect income applicable to common shareholders. Rather, the SEC staff believes that to the extent that a common shareholder has a contractual right to receive at share redemption (other than upon ordinary liquidation events) an amount that is other than the fair value of such shares, then that common shareholder has, in substance, received a distribution different from other common shareholders. Under FASB Statement No. 128, *Earnings per Share*, paragraph 60(b), entities with capital structures that include a class of common stock with different dividend rates from those of another class of common stock but without prior or senior rights, should apply the two-class method of calculating earnings per share. Therefore, when a class of common stock is redeemable at other than fair value, increases or decreases in the carrying amount of the redeemable security should be reflected in earnings per share using a method akin to the two-class method.[4] For common stock redeemable at fair value, the SEC staff would not expect the use of a method akin to the two-class method, as a redemption at fair value does not amount to a distribution different from other common shareholders.

[4] The two-class method of computing earnings per share is addressed in Statement 128 and Issue No. 03-6, "Participating Securities and the Two-Class Method under Statement No. 128."

Transition

20. When this announcement was made in July 2001, it was to be applied retroactively in the first fiscal quarter ending after December 15, 2001, by restating the financial statements of prior periods in accordance with the provisions of paragraphs 27–30 of APB Opinion No. 20, *Accounting Changes*.

21. At the September 15, 2005 meeting, the SEC staff also clarified the impact of certain redeemable securities on earnings per share calculations in paragraph 19. The guidance in paragraph 19 should be applied in the first fiscal period beginning after September 15, 2005 (the date of the announcement). Prior period earnings per share amounts presented for comparative purposes should be retroactively adjusted to conform to the guidance.

Subsequent Developments

Statement 150

22. In May 2003, the FASB issued Statement 150, which establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or as an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. For public entities, Statement 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise effective at the beginning of the interim period beginning after June 15, 2003.

23. Statement 150 addresses three types of freestanding financial instruments that embody obligations of the issuer:

- Mandatorily redeemable financial instruments: Financial instruments issued in the form of shares that embody an unconditional obligation requiring the issuer to redeem the instruments by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur.
- Obligations to repurchase the issuer's equity shares by transferring assets: Financial instruments, other than outstanding equity shares, that at inception embody an obligation to repurchase the issuer's equity shares (or that are indexed to such an obligation) and that require or may require the issuer to settle the obligation by transferring assets. Examples include forward purchase contracts or written put options on the issuer's equity shares that are to be physically settled or net cash settled.
- Certain obligations to issue a variable number of shares: Financial instruments that embody an unconditional obligation, or financial instruments other than outstanding equity shares that embody a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares if, at inception, the monetary value of the obligation is based solely or predominantly on (a) a fixed monetary amount known at inception, (b) variations in something other than the fair value of the issuer's equity shares, or (c) variations inversely related to changes in the fair value of the issuer's equity shares. Examples include a payable settleable with a variable number of the issuer's equity shares, a financial instrument indexed to the S&P 500 and settleable with a variable number of the issuer's equity shares, and a written put option that could be net share settled.

24. Freestanding financial ~~I~~instruments within the scope of Statement 150 should be classified and measured in accordance with that Statement. ASR 268 (Rule 5-02.28 of Regulation S-X) and the interpretive guidance in this staff announcement no longer apply for those instruments after the effective date of Statement 150. Additionally, freestanding financial instruments that were previously classified as temporary equity under Issue 00-19 are no longer subject to temporary equity classification under ASR 268 and Topic D-98 because those freestanding financial instruments are now within the scope of Statement 150. However, Issue

00-19 continues to apply to embedded derivative instruments indexed to, and potentially settled in, a company's own stock. Accordingly, when a hybrid financial instrument that is not classified as an asset or liability under Statement 150 or other applicable GAAP contains an embedded derivative within the scope of Issue 00-19, the registrant must consider ASR 268 and Topic D-98 to determine whether:

- The hybrid financial instrument is required to be classified and measured as temporary equity when the embedded derivative *is not* separated under Statement 133, or
- The host contract is required to be classified and measured as temporary equity when the embedded derivative *is* separated under Statement 133.

25. At the November 12–13, 2003 meeting, the SEC Observer announced the SEC staff's position relating to the application of Topic D-98 to certain mandatorily redeemable securities for which the relevant portions of Statement 150 were recently deferred in FASB Staff Position FAS 150-3, "Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150." The SEC Observer clarified that SEC registrants with instruments that qualify for the deferral should refer to Topic D-98 for guidance related to classification and/or measurement, as applicable, for those securities that, for the time being, will not be accounted for in accordance with Statement 150.

26. 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.

Statement 123(R)

27. At the September 15, 2005 meeting, the SEC Observer announced the SEC staff's position on the impact of certain redeemable securities on earnings per share calculations. Paragraph 19 was modified to clarify the SEC staff's position and paragraph 21 was added to address the timing of the application of the position. The SEC Observer also reiterated the SEC staff's positions on several issues and provided additional guidance related to the application of Topic D-98 to share-based payment arrangements with employees. These positions are included in paragraphs 28–30 below.

28. In Staff Accounting Bulletin No. 107, *Interaction Between FASB Statement No. 123(R), and Certain SEC Rules and Regulations Regarding the Valuation of Share-Based Payment Arrangements for Public Companies,* the SEC staff clarified that registrants must evaluate whether the terms of instruments granted in conjunction with share-based payment arrangements with employees that are not classified as liabilities under ~~FASB~~ Statement~~ No.~~ 123(R~~revised~~)~~, *Share-Based Payment,*~~ result in the need to present certain amounts outside of permanent equity in accordance with ASR 268 and Topic D-98. The SEC staff expects that this guidance be applied concurrently with the adoption of Statement 123(R). Upon transition, awards previously classified as permanent equity that are now required to be classified outside of permanent equity should be reclassified at the amount required to be presented outside of permanent equity.

29. In SAB 107, the SEC staff clarified that instruments granted in conjunction with share-based payment arrangements with employees that do not by their terms require redemption for cash or other assets (at a fixed or determinable price on a fixed or determinable date, at the option of the holder, or upon the occurrence of an event that is not solely within the control of the issuer) would not be assumed by the staff to require net cash settlement for purposes of applying ASR 268 and Topic D-98 in circumstances in which paragraphs 14–18 of Issue 00-19 would otherwise require the assumption of net cash settlement.

30. Certain employee awards contain provisions for either direct or indirect repurchase of shares issued upon exercise of employee options in order to meet the employer's minimum statutory withholding requirement resulting from the exercise. Statement 123(R) does not require awards with this specific provision, described in paragraph 35, to be classified as liabilities. The SEC staff would not expect SEC registrants to classify such employee awards outside of permanent equity, if the direct or indirect repurchase of shares is done solely to satisfy the employer's minimum statutory tax withholding requirements.

31. At the March 16, 2006 meeting, the SEC Observer clarified the SEC staff's position on the application of Topic D-98 to certain share-based payment arrangements with employees. The SEC staff believes that for options or similar instruments granted in conjunction with share-based payment arrangements with

employees for which the terms may permit redemption of the option or underlying share, the initial amount classified outside of permanent equity should be based on the redemption provisions of the instrument.[5] For example, upon issuance of a fully vested option that allows the holder to put the option back to the issuer at its intrinsic value upon a change in control, an amount representing the intrinsic value of the option at the date of issuance should be presented outside of permanent equity. The guidance in paragraphs 15–17 should be followed to determine the amount of any subsequent adjustments.[6]

[5] As discussed in the Interpretive Response to Question 2 in Section E of SAB 107, the amount presented in temporary equity at each balance sheet date should take into account the proportion of consideration received in the form of employee services.

[6] Registrants should also consider the guidance in FASB Staff Position FAS 123(R)-4, "Classification of Options and Similar Instruments Issued as Employee Compensation That Allow for Cash Settlement upon the Occurrence of a Contingent Event," when evaluating the classification of options or similar instruments whose terms may permit redemption of the option or underlying share.

Statement 155

32. In February 2006, the FASB issued FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*. Statement 155 establishes standards designed to simplify accounting for certain hybrid financial instruments by permitting fair value remeasurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. Statement 155 amends paragraph 16 of Statement 133 to permit this election, while footnote 6bb of Statement 133 clarifies that the guidance applies to hybrid financial instruments that are classified as assets and liabilities and does not apply to hybrid financial instruments classified in permanent or temporary equity, which are instruments described in paragraph 8 of FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*. Therefore, the guidance in this Topic continues to be applicable for hybrid financial instruments classified in permanent or temporary stockholders' equity.

FSP EITF 00-19-2

33. In December 2006, the FASB issued FASB Staff Position EITF 00-19-2, "Accounting for Registration Payment Arrangements." FSP EITF 00-19-2 addresses the issuer's accounting for registration payment arrangements and specifies that the contingent obligation to make future payments or otherwise transfer consideration under a registration payment arrangement (as defined in the FSP), whether issued as a separate agreement or included as a provision of a financial instrument or other agreement, should be separately recognized and measured in accordance with FASB Statement No. 5, *Accounting for Contingencies.* Additionally, paragraph 8 of FSP EITF 00-19-2 states that a financial instrument subject to a registration payment arrangement should be

recognized and measured in accordance with other applicable GAAP without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement. At the March 15, 2007 meeting, the SEC Observer announced the SEC staff's position relating to the interaction of the financial statement classification and measurement guidance in Topic D-98 and the guidance for registration payment arrangements in FSP EITF 00-19-2. Consistent with the guidance in FSP EITF 00-19-2, the SEC staff believes that the guidance in Topic D-98 should be applied to a financial instrument subject to a registration payment arrangement without regard to the contingent obligation to transfer consideration pursuant to the registration payment arrangement (that is, the registration payment arrangement is considered to be a separate unit of account that does not impact the classification and measurement of the related financial instrument under Topic D-98). However, for purposes of applying Topic D-98 to a financial instrument with any other related arrangement that is outside the scope of FSP EITF 00-19-2, the SEC staff believes that a conclusion that the related arrangement is a separate unit of account should not be based on an analogy to the guidance in FSP EITF 00-19-2.

34. The SEC staff announcement in paragraph 33 should be applied following the effective date of FSP EITF 00-19-2. If upon adoption of FSP EITF 00-19-2, a registrant determines that a financial instrument subject to a registration payment arrangement should be reclassified from temporary equity to permanent equity, the registrant should reclassify the related financial instrument following the guidance in paragraph 19 of FSP EITF 00-19-2. Any difference between the carrying amount of the instrument recorded as temporary equity prior to adoption of FSP EITF 00-19-2 and the carrying amount reclassified to permanent equity upon adoption of FSP EITF 00-19-2 should be included in the cumulative effect adjustment to the opening balance of retained earnings, or other appropriate components of equity or net assets in the statement of financial position. In the period of reclassification, that difference (if any) should not be deducted from or added to net earnings available to common shareholders in the calculation of earnings per share.

35. If a registrant has adopted FSP EITF 00-19-2 and issued its financial statements prior to March 15, 2007 (the date of this staff announcement) using a reasonable methodology that is inconsistent with the staff announcement described in paragraph 34, those prior period financial statements should not be restated. However, the earnings per share amounts reported in those prior-period financial statements presented for comparative purposes in the registrant's next interim or annual financial statements should be retrospectively adjusted (if necessary) to conform to the guidance in paragraph 34.

Statement 133

36. At the March 15, 2007 meeting, the SEC Observer announced the SEC staff's position relating to the determination of whether the characteristics of a host

contract related to a hybrid financial instrument issued in the form of a share are more akin to a debt instrument or more akin to an equity instrument. This SEC staff announcement also discusses the interaction of the financial statement classification guidance in Topic D-98 and the guidance in paragraphs 12(a) and 60 of Statement 133. The SEC staff's position regarding these matters is discussed in Topic No. D-109, "Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133."

SEC STAFF ANNOUNCEMENT

Topic: *EITF Abstracts*, Topic No. D-109, "Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133"

Date Discussed: March 15, 2007

The SEC Observer made the following announcement of the SEC staff's position relating to the determination of whether the characteristics of a host contract related to a hybrid financial instrument issued in the form of a share are more akin to a debt instrument or more akin to an equity instrument.

Consistent with paragraphs 12 and 60 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, the SEC staff believes that the determination of the nature of the host contract for a hybrid financial instrument issued in the form of a share (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument) should be based on a consideration of economic characteristics and risks. The SEC staff also believes that in performing an evaluation of an embedded derivative feature under paragraph 12(a) of Statement 133, the consideration of the economic characteristics and risks of the host contract should be based on all of the stated or implied substantive terms and features of the hybrid financial instrument.[1] In evaluating the stated and implied substantive terms and features, the existence or omission of any single term or feature is not necessarily determinative of the economic characteristics and risks of the host contract (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument). Although the consideration of an individual term or feature may be weighted more heavily in the evaluation, judgment is required based upon an evaluation of all the relevant terms and features. For example, the SEC staff believes that the fact that a preferred stock contract without a mandatory redemption feature would be classified as temporary equity under Topic D-98 is not in and of itself determinative of the nature of the host contract (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument). Rather, the SEC staff believes that the nature of the host contract depends upon the economic characteristics and risks of the preferred stock contract.[2]

This staff announcement is limited to the SEC staff's position regarding the determination of whether a host contract related to a hybrid financial instrument issued in the form of a share is considered to be a debt instrument or an equity instrument for purposes of the evaluation of an embedded derivative (or multiple embedded derivatives) under paragraph 12(a) of Statement

[1] The "hybrid financial instrument" includes the terms and features pertaining to other embedded derivatives that are separately evaluated under paragraph 12 of Statement 133. However, the SEC staff understands that as an accounting policy some registrants exclude the terms and features pertaining to the individual embedded derivative being evaluated under paragraph 12 of Statement 133 in determining the nature of the host contract for that particular embedded derivative.

[2] The SEC staff does not believe the guidance pertaining to the paragraph 11(a) scope exception in Statement 133 Implementation Issue No. C2, "Application of the Exception to Contracts Classified in Temporary Equity," is applicable, by analogy, to the determination of the nature of the host contract under paragraph 12(a) of Statement 133.

133. It is not intended to address when an embedded derivative (or multiple embedded derivatives) should be separated from the host contract under Statement 133 or the accounting under Statement 133 when such separation is required. Statement 133 and the related interpretative guidance in the Statement 133 Implementation Issues provide the relevant guidance for these matters. For example, Statement 133 Implementation Issue No. B19, "Identifying the Characteristics of a Debt Host Contract," provides guidance on how an entity determines the characteristics of a debt host contract once a conclusion has been reached that the host contract is a debt instrument.

Transition

A registrant may initially apply the guidance in this staff announcement to **all** of its affected outstanding hybrid financial instruments issued in the form of shares in a manner consistent with the transition provisions for embedded derivatives contained in Question 2 of Statement 133 Implementation Issue No. K5, "Transition Provisions for Applying the Guidance in Statement 133 Implementation Issues," effective as of the first day of the first fiscal quarter beginning after June 15, 2007. In applying the guidance in this staff announcement, a registrant should report the adoption of the change in accounting principle at the beginning of the first fiscal quarter beginning after June 15, 2007, even if that period is other than the first fiscal quarter of the registrant's fiscal year.

Alternatively, the SEC staff will also not object to the application of the guidance in this staff announcement prospectively to **all** hybrid financial instrument contracts issued in the form of shares that are entered into, modified, or otherwise subject to a remeasurement (new basis) event in fiscal quarters beginning after June 15, 2007.

Earlier adoption of the aforementioned transition provisions is encouraged; however, previously issued financial statements should not be retrospectively adjusted.

Issue No. 06-10

Title: Accounting for Collateral Assignment Split-Dollar Life Insurance Arrangements

Dates Discussed: November 16, 2006; March 15, 2007

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

FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*

FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*

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

FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insuranc*e

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

APB Opinion No. 12, *Omnibus Opinion—1967*

APB Opinion No. 21, *Interest on Receivables and Payables*

AICPA Issues Paper, *Accounting for Key-Person Life Insurance*, dated October 31, 1984

International Accounting Standard 19, *Employee Benefits*

EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"

EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4"

Introduction

1. Companies purchase life insurance for various reasons that may include protecting against the loss of "key" employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. The two most common types of arrangements are endorsement split-dollar life insurance arrangements and collateral assignment split-dollar life insurance arrangements. Generally, the difference between these arrangements is dependent upon the ownership and control of the life insurance policy. In an endorsement split-dollar life insurance arrangement, the company owns and controls the insurance policy, whereas in a collateral assignment split-dollar life insurance arrangement, the employee (or the employee's estate or a trust controlled by the employee, hereinafter referred to as the "employee") owns and controls the insurance policy.

2. The Task Force reached a consensus on Issue 06-4 that for an endorsement split-dollar life insurance arrangement, an employer should recognize a liability for future benefits in accordance with Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the

substantive agreement with the employee. However, questions have been raised about whether the consensus reached in Issue 06-4 should apply to collateral assignment split-dollar life insurance arrangements. This Issue also addresses the recognition and measurement of the employer's asset in a collateral assignment split-dollar life insurance arrangement.

Issues

3. The issues are:

Issue 1— Whether an entity should recognize a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee

Issue 2— How an employer should recognize and measure the asset in a collateral assignment split-dollar life insurance arrangement.

Prior EITF Discussion

4. At the November 16, 2006 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. In determining whether a postretirement benefit has been settled by an insurance contract, the Task Force observed that an employer should analyze whether the employer remains subject to the risks or rewards associated with the underlying insurance contract (in the postretirement period) that collateralizes the employer's asset. The Task Force observed that if the employer's asset is collateralized by the employee's (or retiree's) underlying insurance contract or the recourse nature of the loan is not substantive, then a settlement has not occurred pursuant to Statement 106. The recourse nature of the loan is substantive if the employer has the intent and ability to fully recover amounts due under the collateral assignment arrangement in the event of default by the insurer. For example, if the amounts due under a collateral assignment split-dollar life insurance arrangement are full recourse to the employee (or retiree), but the employer does not intend to seek recovery beyond the life insurance policy, the full recourse collateral provisions of the arrangement would not be substantive and settlement of the postretirement benefit would not have occurred. However, in determining whether the postretirement benefit has been settled pursuant to Statement 106, an employer should evaluate all the available facts and circumstances of these arrangements.

5. On Issue 2, the Task Force reached a tentative conclusion that an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. The Task Force observed that in determining the nature and substance of the arrangement, the employer should assess what future cash flows the employer is entitled to, if any, as well as the employee's obligation and ability to repay the employer. For example, if the arrangement limited the amount the employer could recover to the amount of the cash surrender value of the insurance policy held by the employee (or retiree), and if the

employer's loan to the employee (or retiree) is greater than the cash surrender value of the insurance policy, at the balance sheet date the employer's asset would be limited to the amount of the cash surrender value of the insurance policy. Conversely, if the arrangement required the employee (or retiree) to repay the employer irrespective of the amount of the cash surrender value of the insurance policy (and assuming the employee (or retiree) is an adequate credit risk), the employer should recognize the value of the loan (including accrued interest, if applicable) considering the guidance in Opinion 21. An employer should evaluate all available information in determining the nature and substance of the collateral assignment split-dollar arrangement.

Current EITF Discussion

6. At the March 15, 2007 EITF meeting, the Task Force redeliberated this Issue in its entirety based on the comment letters received on the tentative conclusions reached at the November 16, 2006 EITF meeting.

7. The Task Force reached a consensus on Issue 1 that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 or Opinion 12 if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on the substantive arrangement with the employee. For example, if the employer has effectively agreed to maintain[1] a life insurance policy during the employee's retirement, the estimated cost of maintaining the insurance policy during the postretirement period should be accrued in accordance with either Statement 106 or Opinion 12. Similarly, if the employer has effectively agreed to provide the employee with a death benefit, the employer should accrue a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date in accordance with either Statement 106 or Opinion 12.

8. The Task Force observed that all available evidence should be considered in determining the substance of the arrangement, such as explicit written terms of the arrangement, communications made by the employer to the employee, the employer's past practices in administering the same or similar arrangements, and whether the employer is the primary obligor for the postretirement benefit. For example, if the terms of the arrangement are such that the employer has no obligation, either stated or implied, to provide loans to an employee to cover insurance policy premiums in the postretirement period, that may be an indication that there is no postretirement obligation. However, if the employer, through the collateral assignment arrangement with the employee has an obligation, either stated or implied, to provide loans to an employee to cover the experience gains and losses of the insurance company, that may indicate that the employer has a postretirement benefit obligation. In determining the appropriate measurement and attribution of the cost and obligation under any particular arrangement, employers should refer to the guidance in Statement 106 or Opinion 12, as applicable.

[1] For purposes of this Issue, an employer has agreed to maintain a life insurance policy if the employer has a stated or implied commitment to provide loans to an employee to fund premium payments on the underlying insurance policy during the postretirement period. Absent evidence to the contrary, it shall be presumed that an employer will provide loans to an employee to fund premium payments on the underlying insurance policy in the postretirement period if the employer has provided loans in the past or if the employer is currently promising to provide loans in the future.

9. In periods following the inception of the collateral assignment split-dollar life insurance arrangement, the Task Force observed that employers should continue to evaluate (pursuant to the guidance in Statement 106) whether a change in facts and circumstances (for example, an amendment to the arrangement or change from the employer's past practices) has altered the substance of the collateral assignment split-dollar life insurance arrangement, which could result in a liability or an adjustment to a previously recognized liability, for a postretirement benefit.

10. The Task Force reaffirmed as a consensus the tentative conclusion reached at the November 16, 2006 EITF meeting on Issue 2.

11. The Task Force also discussed the journal entries for a hypothetical collateral assignment split-dollar life insurance arrangement included as Exhibit 06-10B to Issue Summary Supplement No. 1,[2] which was intended solely to facilitate the Task Force's discussion of this Issue at the March 15, 2007 EITF meeting. That example should not be considered authoritative guidance in accounting for a collateral assignment split-dollar life insurance arrangement, since it was included only to illustrate the differences between the application of the individual views as stated in Issue Summary Supplement No. 1.

12. Appendix 06-10A reflects changes made to the draft abstract as a result of the above decisions (additions are <u>underscored</u> and deletions are ~~struck through~~).

Transition

13. The consensus in this Issue is effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years. Earlier application is permitted. Entities should report the effects of applying the consensus in this Issue as either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

14. If an entity chooses to apply the consensus in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings, the entity should disclose the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position.

15. If an entity chooses to apply the consensus in this Issue as a change in accounting principle through retrospective application to all prior periods, the entity should include the recognition of:

a. The cumulative effect of the change in accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented
b. The cumulative effect of the change in accounting principle on retained earnings or on other components of equity or net assets in the statement of financial position as of the beginning of the first period presented

[2] Issue Summary Supplement No. 1 was distributed to Task Force members in advance of the March 15, 2007 EITF meeting and was used as the basis for discussions at that meeting.

c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the change in accounting principle.

16. If an entity chooses to apply the consensus in this Issue as a change in accounting principle through retrospective application to all prior periods, the entity should disclose the following:

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change in accounting principle on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement caption, and any affected per-share amounts for any prior periods retrospectively adjusted
c. The cumulative effect of the change in accounting principle on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

Board Ratification

17. At its March 28, 2007 meeting, the Board [ratified] the consensus reached by the Task Force in this Issue.

Status

18. No further EITF discussion is planned.

Appendix 06-10A

***EITF ABSTRACTS* (DRAFT[*])**

Issue No. 06-10

Title: Accounting for~~ Deferred Compensation and Postretirement Benefit Aspects of~~ Collateral Assignment Split-Dollar Life Insurance Arrangements

Dates Discussed: November 16, 2006; ~~[~~March ~~14~~–15, 2007~~]~~

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

FASB Statement No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*

FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*

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

FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*

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

~~FASB Special Report, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits: Questions and Answers*~~

APB Opinion No. 12, *Omnibus Opinion—1967*

APB Opinion No. 21, *Interest on Receivables and Payables*

~~AICPA Statement of Position 96-1, *Environmental Remediation Liabilities*~~

AICPA Issues Paper, *Accounting for Key-Person Life Insurance*, dated October 31, 1984

International Accounting Standard 19, *Employee Benefits*

EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements"

EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4"

ISSUE

1. Companies purchase life insurance for various reasons that may include protecting against the loss of "key" employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. The two most common types of arrangements

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[*] **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.**

are endorsement split-dollar life insurance arrangements and collateral assignment split-dollar life insurance arrangements. Generally, the difference between these arrangements is dependent upon the ownership and control of the life insurance policy. In an endorsement split-dollar life insurance arrangement, the company owns and controls the insurance policy, whereas in a collateral assignment split-dollar life insurance arrangement, the employee (or the employee's estate or a trust controlled by the employee, hereinafter referred to as the "employee") owns and controls the insurance policy.

2. The Task Force reached a consensus on Issue 06-4 that for an endorsement split-dollar life insurance arrangement, an employer should recognize a liability for future benefits in accordance with Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee. ~~However, questions have been raised about whether the consensus reached in Issue 06-4 should apply to collateral assignment split-dollar life insurance arrangements. This Issue also addresses the recognition and measurement of the employer's asset in a collateral assignment split-dollar life insurance arrangement.~~

3. The issues are:

Issue 1— Whether an entity should recognize ~~record~~ a liability for the postretirement benefit associated with a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee ~~(consistent with the consensus reached in Issue 06-4)~~

Issue 2— How an employer should recognize and measure the asset in a collateral assignment split-dollar life insurance arrangement.

~~Scope~~

~~4. The scope of this Issue is limited to the employer's recognition of (a) the liability and the related compensation costs for collateral assignment split-dollar life insurance arrangements that provide a benefit to an employee that extends into postretirement periods and (b) the asset in collateral assignment split-dollar arrangements. However, the employer's recognition of the liability would not apply to a collateral assignment split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to that employee's active service period with an employer or that has been settled pursuant to Statement 106.~~

EITF DISCUSSION

4.~~5.~~ The Task Force reached a ~~[~~consensus~~]~~ on Issue 1 that an employer should recognize a liability for the postretirement benefit related to a collateral assignment split-dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a postretirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) if the employer has agreed to maintain a life insurance policy during the employee's retirement or provide the employee with a death benefit based on ~~a~~ the substantive agreement with the employee. For example, if the employer has effectively agreed to maintain[1] a life insurance policy during the employee's retirement, the estimated cost of maintaining the insurance policy during the postretirement period should be accrued in accordance with either Statement 106 or Opinion 12. Similarly, if the employer has effectively agreed to provide the employee with a death benefit, the employer should accrue a liability for the actuarial present value of the future death benefit as of the employee's expected retirement date, in accordance with either Statement 106 or Opinion 12. ~~In determining whether a postretirement benefit has been settled by an insurance contract, an employer should analyze whether the employer remains subject to the risks or rewards associated with the underlying insurance contract (in the postretirement period) that collateralizes the employer's asset. If the employer's asset is collateralized by the employee's (or retiree's) underlying insurance contract or the recourse nature of the loan is not substantive, then a settlement has not occurred pursuant to Statement 106. The recourse nature of the loan is substantive if the employer has the intent and ability to fully recover amounts due under the collateral assignment arrangement in the event of default by the insurer. For example, if the amounts due under a collateral assignment split-dollar life insurance arrangement are full recourse to the employee (or retiree), but the employer does not intend to seek recovery beyond the life insurance policy, the full recourse collateral provisions of the arrangement would not be substantive and settlement of the postretirement benefit would not have occurred. However, in determining whether the postretirement benefit has been settled pursuant to Statement 106, an employer should evaluate all the available facts and circumstances of these arrangements.~~

5. The Task Force observed that all available evidence should be considered in determining the substance of the arrangement, such as explicit written terms of the arrangement, communications made by the employer to the employee, the employer's past practices in administering the same or similar arrangements, and whether the employer is the primary obligor for the postretirement benefit. For example, if the terms of the arrangement are such that the employer has no obligation, either stated or implied, to provide loans to an employee to cover insurance policy premiums in the postretirement period, that may be an indication that there is no postretirement obligation. However, if the employer through the collateral assignment arrangement with the employee has an obligation, either stated or implied, to provide loans to an employee to cover the experience gains and losses of the insurance company, that may indicate that an employer has a postretirement benefit obligation. In determining the appropriate measurement and attribution of the cost and obligation under any particular arrangement, employers should refer to the guidance in Statement 106 or Opinion 12, as applicable.

6. In periods following the inception of the collateral assignment split-dollar life insurance arrangement, the Task Force observed that employers should continue to evaluate (pursuant to the guidance in Statement 106) whether a change in facts and circumstances (for example, an amendment to the arrangement or change from the employer's past practice) has altered the

[1] For purposes of this Issue, an employer has agreed to maintain a life insurance policy if the employer has a stated or implied commitment to provide loans to an employee to fund premium payments on the underlying insurance policy during the postretirement period. Absent evidence to the contrary, it shall be presumed that an employer will provide loans to an employee to fund premium payments on the underlying insurance policy in the postretirement period if the employer has provided loans in the past or if the employer is currently promising to provide loans in the future.

substance of the collateral assignment split-dollar life insurance arrangement, which could result in a liability or an adjustment to a previously recognized liability, for a postretirement benefit.

7. On Issue 2, the Task Force reached a ~~[~~consensus~~]~~ that an employer should recognize and measure an asset based on the nature and substance of the collateral assignment split-dollar life insurance arrangement. The Task Force observed that in determining the nature and substance of the arrangement, the employer should assess what future cash flows the employer is entitled to, if any, as well as the employee's obligation and ability to repay the employer. For example, if the arrangement limited the amount the employer could recover to the amount of the cash surrender value of the insurance policy held by the employee (or retiree), and if the employer's loan to the employee (or retiree) is greater than the cash surrender value of the insurance policy, at the balance sheet date the employer's asset would be limited to the amount of the cash surrender value of the insurance policy. Conversely, if the arrangement required the employee to repay the employer irrespective of the collateral assigned and the employer (a) has determined that the employee loan is collectible and (b) intends to seek recovery beyond the cash surrender value of the life insurance policy, ~~amount of the cash surrender value of the insurance policy (and assuming the employee (or retiree) is an adequate credit risk),~~ the employer should recognize the value of the loan (including accrued interest, if applicable) considering the guidance in Opinion 21. An employer should evaluate all available information in determining the nature and substance of the collateral assignment split-dollar life insurance arrangement.

Transition

8.~~7.~~ The consensus in this Issue is effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years. ~~with e~~Earlier application is permitted. Entities should recognize the effects of applying the ~~[~~consensus~~]~~ in this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

9.~~8.~~ If an entity chooses to apply the ~~[~~consensus~~]~~ in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings, the entity should disclose the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position.

10.~~9.~~ If an entity chooses to apply the ~~[~~consensus~~]~~ in this Issue as a change in accounting principle through retrospective application to all prior periods, the entity should include the recognition of:

a. The cumulative effect of the change in accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented
b. The cumulative effect of the change in accounting principle on retained earnings or on other components of equity or net assets in the statement of financial position as of the beginning of the first period presented
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the change in accounting principle.

11.~~10.~~ If an entity chooses to apply the ~~[~~consensus~~]~~ in this Issue as a change in accounting principle through retrospective application to all prior periods, the entity should disclose the following:

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change in accounting principle on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement caption, and any affected per-share amounts for any prior periods retrospectively adjusted
c. The cumulative effect of the change in accounting principle on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

Board Ratification

12.~~11.~~ At its ~~[~~March 28, 2007~~]~~ meeting, the Board ratified the ~~[~~consensus~~]~~ reached by the Task Force in this Issue.

STATUS

13.~~12.~~ No further EITF discussion is planned.

Issue No. 06-11

Title: Accounting for Income Tax Benefits of Dividends on Share-Based Payment Awards

Dates Discussed: November 16, 2006; March 15, 2007

References: FASB Statement No. 109, *Accounting for Income Taxes*

FASB Statement No. 123 (revised 2004), *Share-Based Payment*

Introduction

1. Employees may receive, as part of a share-based payment arrangement, dividends or dividend equivalents on awards of (a) nonvested equity shares and nonvested equity share units during the vesting period or (b) equity share options until they are exercised. In some cases, the payment of dividends on nonvested equity shares, nonvested equity share units, and outstanding equity share options is treated as deductible compensation for income tax purposes, even though the payment of such dividends is charged to retained earnings for awards that vest in the employer's financial statements. Questions have arisen on the accounting for income tax benefits related to the payment of dividends on equity-classified employee share-based payment awards that are charged to retained earnings under Statement 123(R).

Issue

2. The issue is how a company should recognize the income tax benefit received on dividends that are (a) paid to employees holding equity-classified nonvested shares, equity-classified nonvested share units, or equity-classified outstanding share options and (b) charged to retained earnings under Statement 123(R).

Scope

3. This Issue applies to share-based payment arrangements with dividend protection features that entitle employees to receive (a) dividends on equity-classified nonvested shares, (b) dividend equivalents on equity-classified nonvested share units, or (c) payments equal to the dividends paid on the underlying shares while an equity-classified share option is outstanding, when those dividends or dividend equivalents are charged to retained earnings under Statement 123(R) and result in an income tax deduction for the employer.

Prior EITF Discussion

4. At the November 16, 2006 EITF meeting, the Task Force reached a tentative conclusion that a realized income tax benefit from dividends or dividend equivalents that are charged to retained earnings and are paid to employees for equity classified nonvested equity shares, nonvested equity share units, and outstanding equity share options should be recognized as an increase in additional paid-in capital. The amount recognized in additional paid-in capital for the realized income tax benefit from dividends on those awards should be included in the pool of excess tax benefits available to absorb potential future tax deficiencies on share-based payment awards.

5. In reaching the tentative conclusion, the Task Force considered that dividends or dividend equivalents that are paid to employees for nonvested equity shares, nonvested equity share units,

and outstanding equity share options that are charged to retained earnings may result in a tax deduction prior to the actual realization of the related tax benefit because the employer, for example, has a net operating loss carryforward. Pursuant to the guidance in footnote 82 of Statement 123(R), the income tax benefit of those dividends would not be recognized until the deduction reduces income taxes payable. Unrealized income tax benefits from dividends on equity-classified employee share-based payment awards should be excluded from the pool of excess tax benefits available to absorb tax deficiencies on share-based payment awards.

Current EITF Discussion

6. At the March 15, 2007 EITF meeting, the Task Force discussed the tentative conclusion reached on this Issue at the November 16, 2006 EITF meeting but was not asked to reach a consensus. The Task Force also discussed whether a tax benefit from a dividend on a share-based payment award should be reclassified from additional paid-in capital to the income statement when the related award is forfeited (or is no longer expected to vest) in circumstances in which that tax benefit may have been applied against a tax deficiency on another share-based payment award. The Task Force was not asked to reach a conclusion on that issue but requested that the FASB staff provide examples illustrating the various alternatives for discussion at a future EITF meeting.

Transition

7. Previously, at the November 16, 2006 EITF meeting, the Task Force reached a tentative conclusion that this Issue should be applied prospectively to the income tax benefits of dividends on equity-classified employee share-based payment awards that are declared in fiscal years beginning after September 15, 2007. Earlier application is permitted for the income tax benefits of dividends on equity-classified employee share-based payment awards that are declared in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is prohibited. Entities shall disclose the nature of any change in their accounting policy for income tax benefits of dividends on share-based payment awards resulting from the adoption of this guidance.

Board Ratification

8. Previously, at its November 29, 2006 meeting, the Board ratified the tentative conclusions reached by the Task Force in this Issue at the November 16, 2006 EITF meeting and approved the issuance of a draft abstract for a public comment period, which ended on January 22, 2007.

Status

9. Further discussion is expected at a future meeting.

Issue No. 07-1

Title: Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property

Date Discussed: March 15, 2007

References: FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*

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

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 Joint Ventures*

SEC Regulation S-X, Rule 4-08(g)

EITF Issue No. 88-18, "Sales of Future Revenues"

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"

EITF Issue No. 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent"

EITF Issue No. 00-1, "Investor Balance Sheet and Income Statement Display under the Equity Method for Investments in Certain Partnerships and Other Ventures"

EITF Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)"

EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor"

Introduction

1. In certain industries, entities may seek partners to jointly develop and commercialize intellectual property (a collaborative arrangement). For example, in the biotechnology and pharmaceutical industries, because the development of a drug candidate into a commercially viable product may take many years, and because of the considerable number of resources required to develop a product and the financial risks involved, companies in the biotechnology or pharmaceutical industries often enter into arrangements with other companies to jointly develop, manufacture, distribute, and market a drug candidate. However, these arrangements exist in other industries, and the scope of this Issue is not limited to the biotechnology and pharmaceutical industries. Other industries that may utilize these types of arrangements include, but are not limited to, the motion picture, software, and computer hardware industries.

2. The activities associated with these arrangements are predominantly conducted by the participants without the creation of a separate legal entity (that is, the arrangement is operated as a "virtual joint venture"). However, even in arrangements that utilize a legal structure, much of the arrangement may be "virtual," such that, for example, the legal entity will not have employees, fixed assets, or any intellectual property of its own, since the participants are responsible for performing all of the activities under the arrangement. The arrangements generally provide that the participants will share, based on contractually defined calculations, the profits or losses from the associated activities.

3. The types of activities conducted under such arrangements may include research and development, marketing (including promotional activities and physician detailing), general and administrative, manufacturing, and distribution. The arrangement may provide that one participant has sole or primary responsibility for certain activities or that one or more participants have shared responsibility for certain activities. For example, a typical arrangement may provide for one participant to have primary responsibility to perform research and development related to the drug candidate, and the other participant to have primary responsibility for commercialization of the drug candidate.

4. The activities under most arrangements of this nature are accounted for on either a gross basis or a net basis in the respective participants' income statements. Some participants report revenues generated and costs incurred with third parties on a gross basis within their respective financial statements for these types of arrangements. Other participants report the net amount of revenue and expenses in the revenue line item, for example, as "alliance revenue." There are circumstances, however, in which the participants will report the activities of the arrangement as a joint venture (that is, using equity method accounting under Opinion 18 and related literature). Periodically, the participants share financial information related to product revenues generated (if any) and costs incurred that may trigger a payment from one participant to the other participant depending on the contractual terms for sharing the combined profits or losses related to the arrangement.

5. Users of financial statements have commented on the lack of comparability and transparency in the financial statements of those entities that participate in these types of arrangements. Some entities have presented research and development reimbursements from the other participant to the collaborative arrangement in revenue, while others have accounted for those payments as a contra-expense. Other entities have included research and development reimbursements as a reduction of research and development expense when there is a net debit (that is, the amount of research and development expense exceeds the amount of reimbursements), but have included research and development reimbursements on a gross basis in revenue when there is a net credit (the reimbursements exceed the research and development expense). The quality of the disclosures related to these arrangements also varies significantly among entities. Users believe that the standardization of the presentation and disclosure requirements for these types of arrangements would significantly improve financial reporting.

Issues

6. The issues are:

Issue 1— How to determine whether an arrangement constitutes a collaborative arrangement within the scope of this Issue

Issue 2— How costs incurred and revenue generated on sales to third parties should be reported by the participants in a collaborative arrangement in each of their respective income statements

Issue 3— If the Task Force reaches a consensus on Issue 2 that costs incurred and revenue generated by participants in a collaborative arrangement should be reported on the appropriate line item in each company's respective financial statement pursuant to Issue 99-19, how sharing payments made to or received by a participant pursuant to a collaborative arrangement should be presented in the income statement.

Scope

7. The scope of this Issue is not intended to include arrangements for which the accounting is specifically addressed within the scope of other authoritative literature. To the extent that the arrangement is within the scope of other authoritative literature, the arrangement should be accounted for in accordance with the relevant provisions of that literature rather than the guidance in this Issue.

Current EITF Discussion

8. At the March 15, 2007 EITF meeting, the Task Force discussed Issue 1 including the Working Group's recommendation that a collaborative arrangement subject to the guidance in this Issue be defined as an arrangement in which the parties share in the risks and rewards of the arrangement's operations from the arrangement's inception through its termination. The Task Force also discussed the Working Group's recommendation of indicators that could be used to identify a collaborative arrangement, which are as follows:

a. The participants are active contributors to the arrangement. That is, the participants are not solely financial investors, but rather they make significant contributions to directing and carrying out the joint operating activities.
b. The participants are exposed to significant risks and rewards that are dependent on the ultimate commercial success of the endeavor.[1]
c. While all participants need not be present at the inception of the endeavor, the participants financially participate in the arrangement through its eventual termination or commercialization.
d. Through the arrangement the participants have a contractual or other legal right to own, access, use, or otherwise benefit from the underlying intellectual property, for example, by holding the patent or a related license.

[1] For example, the "endeavor" in the biotechnology or pharmaceutical industries would be a drug candidate. In the entertainment industry, it would be a motion picture.

e. There is a steering committee or other mechanism to provide participating rights[2] to the participants.

The Working Group recommended that the indicators should not be considered individually presumptive or determinative; however, the relative strength of each indicator should be considered. The Task Force also observed that in addition to the indicators proposed by the Working Group, there may be other indicators that could identify the existence or nonexistence of a collaborative arrangement.

9. The Task Force was not asked to reach a conclusion on Issue 1. The Task Force requested that the FASB staff modify and expand the indicators recommended by the Working Group to clarify the scope of the Issue and the example scenarios used to illustrate this Issue to consider additional fact patterns (see Exhibit 07-1A of Issue Summary No. 1[3]). The Task Force also requested that the staff discuss the revised indicators and illustrative scenarios with the Working Group.

10. The Task Force reached a tentative conclusion on Issue 2 that transactions with third parties (that is, revenue generated and costs incurred by participants in a collaborative arrangement) should be reported gross or net on the appropriate line item in each company's respective financial statements pursuant to the guidance in Issue 99-19. In reaching that tentative conclusion, the Task Force elected not to pursue an accounting model that would be based on the equity method of accounting under Opinion 18. For example, a participant of a collaborative arrangement who is deemed to be the principal for a given transaction would record that transaction on a gross basis in its financial statements.

11. The Task Force discussed Issue 3 but was not asked to reach a conclusion. The Task Force discussed the alternative views presented to address how sharing payments made to or received by a participant pursuant to a collaborative arrangement should be presented in the statement of operations but requested that the FASB staff explore an additional view for consideration. Under this additional view, all sharing payments would be recorded on a net basis within other operating income or expense in the participant's statement of operations regardless of whether the related transactions are recorded gross or net under Issue 2. In addition, the Task Force discussed potential disclosures by participants to a collaborative arrangement under this view, including summarized information for the results of the activities of the collaborative arrangement.

Status

12. Further discussion is expected at a future meeting.

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[2] Participating rights are described in Issue 96-16 as rights that allow a minority shareholder to effectively participate in decisions that occur as part of the ordinary course of an investee's business and are significant factors in directing and carrying out the activities of the business.

[3] Issue Summary No. 1 was distributed to Task Force members in advance of the March 15, 2007 EITF meeting and was used as the basis for discussions at that meeting.

Issue No. 07-2

Title: Accounting for Convertible Debt Instruments That Require or Permit Partial Cash Settlement upon Conversion

Date Discussed: March 15, 2007

References: FASB Statement No. 84, *Induced Conversions of Convertible Debt*

FASB Statement No. 128, *Earnings per Share*

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*

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

FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*

FASB Discussion Memorandum, *Distinguishing between Liability and Equity Instruments and Accounting for Instruments with Characteristics of Both*

APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*

APB Opinion No. 21, *Interest on Receivables and Payables*

International Accounting Standard 32, *Financial Instruments: Presentation*

International Accounting Standard 39, *Financial Instruments: Recognition and Measurement*

EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion"

EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments"

EITF Issue No. 98-5, "Accounting for Convertible Debt Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios"

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

EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments"

EITF Issue No. 03-7, "Accounting for the Settlement of the Equity-Settled Portion of a Convertible Debt Instrument That Permits or Requires the Conversion Spread to Be Settled in Stock (Instrument C of Issue No. 90-19)"

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

EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option"

EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in Issue No. 00-19"

EITF Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments"

EITF Issue No. 06-7, "Issuer's Accounting for a Previously Bifurcated Conversion Option in a Convertible Debt Instrument When the Conversion Option No Longer Meets the Bifurcation Criteria in FASB Statement No. 133"

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

Introduction

1. Issue 90-19 provides accounting and earnings-per-share guidance for three types of structured convertible debt instruments. One of the instruments within the scope of that Issue, referred to as "Instrument C," is described as follows:

> Instrument C: Upon conversion, the issuer must satisfy the accreted value of the obligation (the amount accrued to the benefit of the holder exclusive of the conversion spread) in cash and may satisfy the conversion spread (the excess conversion value over the accreted value) in either cash or stock.

2. At the May 9, 1991 EITF meeting, the Task Force reached a consensus that Instrument C should be accounted for as indexed debt rather than convertible debt. Under that original consensus, an issuer was required to adjust the carrying amount of the instrument in each reporting period to reflect the current stock price, but not below the accreted value of the instrument, with the related change in the carrying amount recognized in earnings. At the January 23–24, 2002 EITF meeting, the Task Force revised the original consensus in Issue 90-19 to specify that Instrument C should be accounted for like convertible debt (that is, as a combined instrument) if the conversion spread meets the requirements of Issue 00-19. The Task Force also reached a consensus at the January 23–24, 2002 EITF meeting to revise the diluted earnings-per-share guidance in Issue 90-19 to specify that the if-converted method should not be used to determine the earnings-per-share implications of Instrument C.

3. The revised consensus in Issue 90-19 requires that Instrument C be treated as convertible debt for accounting purposes but prescribes a diluted earnings-per-share methodology that is consistent with debt issued with detachable warrants. As a result, Instrument C generally has less of a dilutive impact in the calculation of diluted earnings per share than a convertible debt instrument that requires application of the if-converted method. Prior to the revision of Issue 90-19, convertible debt instruments that required or permitted cash settlement upon conversion were relatively uncommon. After observing the proliferation of such instruments in the marketplace over the past several years since the consensus in Issue 90-19 was revised, questions have been raised as to whether the accounting guidance in Issue 90-19, as revised, appropriately reflects the

economics of those instruments. This Issue addresses whether convertible debt instruments that require or permit partial cash settlement upon conversion are within the scope of Opinion 14.

Issue

4. The issue is how an entity should account for a convertible debt instrument that requires or permits partial cash settlement upon conversion if, at issuance, the embedded conversion option is not required to be separately accounted for as a derivative under Statement 133.

Scope

5. This Issue applies to all convertible debt instruments that require or permit partial cash settlement upon conversion if the embedded conversion option is not required to be separately accounted for as a derivative under Statement 133. Convertible preferred shares that are accounted for as mandatorily redeemable financial instruments under Statement 150 shall be considered convertible debt instruments for purposes of determining whether those instruments are within the scope of this Issue. For example, convertible preferred shares that have a stated redemption date and also would require the issuer to settle the face amount of the instrument in cash upon exercise of the conversion option are mandatorily redeemable financial instruments under Statement 150 because they embody an unconditional obligation to redeem the instrument by transferring assets at a specified or determinable date (or dates) or upon an event certain to occur.

6. Convertible preferred shares that are accounted for as equity (or temporary equity for SEC registrants) are not within the scope of this Issue. For example, convertible preferred shares that have a stated redemption date and permit the issuer to settle investor conversions in any combination of shares and cash are not mandatorily redeemable financial instruments under Statement 150 because redemption by transferring assets is not unconditional.

Current EITF Discussion

7. At the March 15, 2007 EITF meeting, the Task Force discussed this Issue but was not asked to reach a conclusion. The Task Force requested that the FASB staff form a working group to discuss (a) the scope of this Issue, (b) diluted earnings-per-share considerations, and (c) other potential short-term improvements to the accounting for convertible instruments.

Status

8. Further discussion is expected at a future meeting.

Issue No. 07-3

Title: Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities

Date Discussed: March 15, 2007

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

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

Introduction

1. Entities involved in research and development activities (R&D entities) may make advance payments for goods or services that will be used in future research and development activities. These arrangements often involve one specific research and development project (for example, the development of a drug compound), and the activities to be performed under these arrangements generally do not have an alternative future use at the time the arrangements are executed. Often times, a portion of the advance payment may be refundable; however, it is common for at least some portion of the advance payment to be nonrefundable (that is, if the R&D entity is not able to advance the project to the stage at which the goods or services paid for in advance are necessary, the R&D entity will not be reimbursed for the advance payments). Questions have arisen about how an R&D entity should account for the non-refundable portion of an advance payment made for future research and development activities.

Issue

2. The issue is whether nonrefundable advance payments for goods or services that will be used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed.

Scope

3. The scope of this Issue is limited to nonrefundable advance payments for goods and services to be used or rendered in future research and development activities. Refundable advance payments for goods and services to be used in future research and development activities are excluded from the scope of this Issue. Entities should not apply any consensus in this Issue by analogy to other types of advance payments.

Current EITF Discussion

4. At the March 15, 2007 EITF meeting, the Task Force reached a tentative conclusion that nonrefundable advance payments for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the goods are delivered or the related services are performed. Entities should continue to evaluate whether they expect the goods to be delivered or services to be rendered. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense.

Transition

5. The Task Force reached a tentative conclusion that the [consensus] in this Issue should be effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years. Entities should report the effects of applying the [consensus] in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption. An entity should disclose the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position. Earlier application is not permitted.

Board Ratification

6. At its March 28, 2007 meeting, the Board ratified the tentative conclusions reached by the Task Force in this Issue and approved the issuance of a draft abstract for a public comment period. A draft abstract is included as Appendix 07-3A.

Status

7. The draft abstract will be posted to the FASB website after April 3, 2007. Comments on the draft abstract are due by May 3, 2007. Further discussion is expected at a future meeting.

Appendix 07-3A

***EITF ABSTRACTS* (DRAFT[1])**

Issue No. 07-3

Title: Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities

Dates Discussed: March 15, 2007; [June 13–14, 2007]

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

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

ISSUE

1. Entities involved in research and development activities (R&D entities) may make advance payments for goods or services that will be used in future research and development activities. These arrangements often involve one specific research and development project (for example, the development of a drug compound), and the activities to be performed under these arrangements generally do not have an alternative future use at the time the arrangements are executed. Often times, a portion of the advance payment may be refundable; however, it is common for at least some portion of the advance payment to be nonrefundable (that is, if the R&D entity is not able to advance the project to the stage at which the goods or services paid for in advance are necessary, the R&D entity will not be reimbursed for the advance payments). Questions have arisen about how an R&D entity should account for the non-refundable portion of an advance payment made for future research and development activities.

2. The issue is whether nonrefundable advance payments for goods or services that will be used or rendered for research and development activities should be expensed when the advance payment is made or when the research and development activity has been performed.

Scope

3. The scope of this Issue is limited to nonrefundable advance payments for goods and services to be used or rendered in future research and development activities. Refundable advance payments for goods and services to be used in future research and development activities are excluded from the scope of this Issue. Entities should not apply the [consensus] in this Issue by analogy to other types of advance payments.

EITF DISCUSSION

4. The Task Force reached a [consensus] that nonrefundable advance payments for future research and development activities should be deferred and capitalized. Such amounts should be recognized as an expense as the related goods are delivered or the related services are performed.

[1] **This draft abstract is being exposed for a public comment period that will end on May 3, 2007.**

Entities should continue to evaluate whether they expect the goods to be delivered or services to be rendered. If an entity does not expect the goods to be delivered or services to be rendered, the capitalized advance payment should be charged to expense.

Transition

5. The [consensus] in this Issue should be effective for fiscal years beginning after December 15, 2007, including interim periods within those fiscal years. Entities should report the effects of applying the [consensus] in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption. An entity should disclose the cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position. Earlier application is not permitted.

Board Ratification

6. At its [June 27, 2007] meeting, the Board ratified the [consensus] reached by the Task Force in this Issue.

STATUS

7. 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 Issues on the proposed agenda for the June 13-14, 2007 meeting are considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
06-11	Accounting for Tax Benefits of Dividends on Share-Based Payment Awards	10/06	11/06, 3/07	6/07	Hauser	Stevens/ Paul	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	June 13-14, 2007 EITF meeting
06-12	Accounting for Physical Commodity Inventories for Entities within the Scope of the AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities*	8/06	11/06	Not scheduled	Johnson	Fanzini/ Jacobs	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	TBD

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
07-1	Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property	8/06	3/07	6/07	Schroeder	Bolash/ Beswick	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	June 13-14, 2007 EITF meeting
07-2	Accounting for Convertible Debt Instruments That Require or Permit Partial Cash Settlement upon Conversion	1/07	3/07	6/07	Johnson	Stevens/ Sarno	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	June 13-14, 2007 EITF meeting
07-3	Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities	1/07	3/07	6/07	Hanson	Cosper/ Beswick	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	June 13-14, 2007 EITF meeting

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
00-27	Application of EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," to Certain Convertible Instruments	5/00	11/00, 1/01	Not scheduled	TBD	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A
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	Jacobs	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	11/02	N/A	Not scheduled	Lusniak	The Board's project on QSPE's is not expected to address this Issue and, therefore, the FASB staff will bring this Issue to the Agenda Committee at a future meeting to determine whether to begin discussions on this Issue or to request that the Task Force remove this Issue from the agenda.	Future Agenda Committee or EITF Meeting
05-4	The Effect of a Liquidated Damages Clause on a Financial Instrument Subject to EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"	2/05	6/05, 9/05	6/07	Stevens	The FASB staff will bring this Issue to a future EITF Meeting to request that the Task Force remove this issue from the agenda following the issuance of FSP EITF 00-19-2, "Accounting for Registration Payment Arrangements," on December 21, 2006.	June 13-14, 2007 EITF meeting

Issues Pending Further Consideration by the Agenda Committee							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
N/A	Application of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets," When a Special-Purpose Entity Holds Equity Securities and Whether an Investment That Is Redeemable at the Option of the Investor Should Be Considered an Equity Security or Debt Security	9/00	N/A	Not scheduled	Jacobs	Statement 155 did not address this Issue. Therefore, the FASB staff will bring this Issue either to the Agenda Committee at a future meeting to determine whether to begin discussions on this Issue or to a future EITF meeting to request that the Task Force remove this Issue from the agenda.	Future Agenda Committee or EITF Meeting