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FINANCIAL ACCOUNTING STANDARDS BOARD
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116
Telephone: 203-847-0700 *Fax*: 203-849-9470
Internet address: eitf@fasb.org or smcosper@fasb.org

September 26, 2006

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the September 7, 2006 meeting of the FASB Emerging Issues Task Force and an inventory of open issues for the next EITF meeting. Also included is a confidential version of the minutes that has been marked for changes from the September 21 draft. After your review, please discard the confidential marked version of the minutes.

September Meeting Time and Location
The next EITF meeting will be held on **November 15–16, 2006,** at the FASB offices in Norwalk, Connecticut. (However, if no additional issues are added to the EITF agenda, the EITF Chairman may elect to only hold a one-day meeting on Thursday, November 16, 2006.) Based on our preliminary thoughts, the meeting will begin on Wednesday, November 15, at 1:00 p.m. and conclude no later than 5:00 p.m. On Wednesday, the FASB will host a dinner at a location to be announced later. On Thursday, November 16, the meeting will begin at 8:00 a.m. and end no later than 4:00 p.m. Coffee will be available and lunch will be provided.

Minutes
We will make minutes available **after 4:00 p.m.** on the following days:

Draft minutes available	**November 21, 2006**
Final minutes available	**December 7, 2006**

Agenda Committee Meeting
The next Agenda Committee meeting will be held on October 11. Materials for any potential new issues should be submitted as soon as possible.

Please call me at extension 283 if you have any questions.

Sincerely,

Susan M. Cosper
Practice Fellow
smcosper@fasb.org
(203) 956-5283

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MINUTES OF THE SEPTEMBER 7, 2006 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, September 7, 2006
Starting Time: 8:00 a.m.
Concluding Time: 2:40 p.m.

Task Force Members Present:
Lawrence W. Smith (Chairman)
Mark M. Bielstein
Frank H. Brod
Jack T. Ciesielski
Leland E. Graul
Joseph F. Graziano
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
Scott A. Taub (SEC Observer)

Task Force Members Absent:
Mitchell A. Danaher

[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
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
Shelly C. Luisi, SEC Senior Associate Chief Accountant
Walter Ielusic for Mr. Danaher
* Sheri E. Akinlade, FASB Practice Fellow
* Paul A. Beswick, FASB Practice Fellow
* Jason L. Jacobs, FASB Practice Fellow
* Stuart J. Moss, FASB Practice Fellow
* Christopher E. Roberge, FASB Project Manager
* Brian C. Stevens, FASB Practice Fellow
* Mark E. Trench, FASB Project Manager

* For certain issues only.

ADMINISTRATIVE MATTERS

- Prior Meeting Minutes. An FASB staff member solicited objections to the final minutes of the June 15, 2006 meeting. No objections were noted.

- The Task Force discussed the report on the EITF Agenda Committee meeting held on August 3, 2006. The following decisions were made by the Agenda Committee:

a. *Reporting the Elimination of Previously Existing Differences between the Fiscal Year-End of a Parent Company and Those of Its Consolidated Subsidiaries.* The Agenda Committee decided to add this Issue to the EITF agenda. Refer to the discussion of EITF Issue No. 06-9, "Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee," elsewhere in these minutes.

b. *Application of the Assessment of a Continuing Investment in Paragraph 12 of FASB Statement No. 66,* Accounting for Sales of Real Estate, *to a Sale of a Condominium.* The Agenda Committee decided to add this Issue to the EITF agenda. Refer to the discussion of EITF Issue No. 06-8, "Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66, *Accounting for Sales of Real Estate,* for Sales of Condominiums," elsewhere in these minutes.

c. *Application of AICPA Audit and Accounting Guide,* Brokers and Dealers in Securities, *to Entities That Engage in Commodity Trading Activities.* The Agenda Committee decided to add this Issue to the EITF agenda.

d. *Accounting for Joint Development, Manufacturing, and Marketing Arrangements in the Biotechnology and Pharmaceutical Industries.* The Agenda Committee decided to add this Issue to the EITF agenda. An FASB staff member asked Task Force members to submit nominations for a working group on this Issue.

e. *Accounting for Stock Options and Warrants in the Determination of Basic Earnings per Share Pursuant to Paragraph 10 of FASB Statement No. 128,* Earnings per Share. The Agenda Committee deferred making a decision on this issue pending its recommendation that the FASB and the IASB consider including this Issue as part of the short-term international convergence project on earnings per share.

f. *Application of FASB Statement No. 123 (revised 2004),* Share-Based Payment, *to Book Value Employee Stock Purchase Plans When a Nonpublic Entity Becomes a Public Entity.* The Agenda Committee did not add this Issue to the EITF agenda but recommended that the Board consider issuing an FASB Staff Position to address this Issue.

g. *Accounting for the Deferred Compensation and Postretirement Aspects of Collateral Assignment Split-Dollar Life Insurance Arrangements*. The Agenda Committee agreed to defer making a decision on this potential new issue pending the outcome of EITF Issue No.

06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangement." Refer to the discussion of Issue 06-4 elsewhere in these minutes.

h. *Subsequent Accounting for Executory Contracts Acquired in a Business Combination Initially Recorded at Fair Value under EITF Issue No. 03-17, "Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet."* The Agenda Committee recommended that the Task Force continue its redeliberations on this Issue.

- An FASB staff member discussed EITF Issue No. 03-17, "Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet." The Task Force had classified Issue 03-17 as inactive pending developments on EITF Issue No. 03-9 "Determination of the Useful Life of Renewable Intangible Assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets*." The Task Force was unable to reach a consensus on Issue 03-9, which resulted in the Board adding a project to its agenda to address the amortization of renewable intangible assets. Issue 03-17 remained inactive while the Board deliberated its project on the amortization of intangible assets. At its May 31, 2006 meeting, the Board decided to remove the project from the FASB agenda. The Task Force observed that Issue 03-17 no longer appears to be a practice issue and decided to remove it from the EITF agenda.

- An FASB staff member announced that the FASB staff had an initiative underway to harmonize transition methodologies that would be broadened to consider other short-term FASB technical application and implementation activities that will be initially considered by the Board.

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

a. EITF Issue No. 06-1, "Accounting for Consideration Given by a Service Provider to a Manufacturer or Reseller of Equipment Necessary for an End-Customer to Receive Service from the Service Provider" (Comment Letters 1 and 2 on the draft abstract)

b. EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (Comment Letters 1–122 on the draft abstract and one additional comment letter on Issue Summary Supplement No. 2)

c. 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, *Accounting for Purchases of Life Insurance"* (Comment Letters 1–9 on the draft abstract and one additional comment letter on Issue Summary Supplement No. 1).

- The SEC Observer announced nullifications and amendments to certain Topics discussed in *EITF Abstracts*, Appendix D. See Revised SEC Staff Announcement section elsewhere in these minutes.

- The Task Force made a recommendation that the Board consider a short-term project to address the accounting, including the earnings per share effects, for convertible debt instruments separate from the Board's current project on financial instruments: liabilities and equity.

- The Task Force Chairman announced that Mr. Thomas J. Linsmeier joined the FASB in July 2006 as a member of the Board.

- 2007 EITF Meeting Date. An FASB staff member formally confirmed that the date of the September 2007 meeting would be September 10 and 11, 2007.

- November 2006 EITF Meeting. An FASB staff member asked Task Force members to anticipate a day-and-a-half EITF meeting to be held on November 15 and 16, 2006.

- An FASB staff member announced that any tentative conclusion reached by the Task Force at this meeting will be considered by the Board for ratification at the Board meeting on September 20, 2006, and then exposed for public comment. Any tentative conclusion reached at a prior meeting and affirmed as a consensus at this meeting also will be considered by the Board for ratification at the September 20, 2006 Board meeting.

REVISED SEC STAFF ANNOUNCEMENT

Topic: *EITF Abstracts*, Topic No. D-63, "Call Options 'Embedded' in Beneficial Interests Issued by a Qualifying Special-Purpose Entity"

Date Discussed: September 7, 2006

The SEC staff announced the nullification of Topic D-63 as the SEC staff does not plan to provide additional guidance following the issuance of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities.* As noted in the *Subsequent Developments* section of Topic D-63, paragraphs 9(c), 48, 50, and 85–88 of Statement 140 address the issues raised in Topic D-63.

REVISED SEC STAFF ANNOUNCEMENT

Topic: *EITF Abstracts*, Topic No. D-73, "Reclassification and Subsequent Sales of Securities in Connection with the Adoption of FASB Statement No. 133"

Date Discussed: September 7, 2006

The SEC staff announced the nullification of Topic D-73 because with the issuance of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, which was generally implemented in 2001 for public and private companies, the issues addressed by Topic D-73 have been resolved and, therefore, there is no longer a continuing need for the guidance.

REVISED SEC STAFF ANNOUNCEMENT

Topic: *EITF Abstracts*, Topic No. D-88, "Planned Major Maintenance Activities"

Date Discussed: September 7, 2006

The SEC staff announced the nullification of Topic D-88 predicated upon the issuance of an FASB Staff Position (FSP) on planned major maintenance activities that would amend the AICPA Industry Audit Guide, *Audits of Airlines*, and APB Opinion No. 28, *Interim Financial Reporting*. The FASB staff plans to issue the FSP prior to the end of the third quarter of 2006. The FSP as proposed will address the issues raised in Topic D-88 and therefore, presuming the FSP is issued as planned, there is no longer a continuing need for the guidance.

REVISED SEC STAFF ANNOUNCEMENT

Topic: *EITF Abstracts*, Topic No. D-53, "Computation of Earnings per Share for a Period That Includes a Redemption or an Induced Conversion of a Portion of a Class of Preferred Stock"

Date Discussed: September 7, 2006

Topic D-53 contains references to AICPA Accounting Interpretation 44, "If Converted Method at Actual Conversion," which is an interpretation of the superseded APB Opinion No. 15, *Earnings per Share*. While FASB Statement No. 128, *Earnings per Share*, supersedes Opinion 15, it does not address the issues considered in Topic D-53. Therefore, the SEC staff announced the deletion of the references to Interpretation 44 and Opinion 15 and the addition of a reference to Statement 128. For convenience, Topic D-53 is included below in its entirety (additions are underscored and deletions are ~~struck through~~).

Topic No. D-53

Topic: Computation of Earnings per Share for a Period That Includes a Redemption or an Induced Conversion of a Portion of a Class of Preferred Stock

Dates Discussed: September 18–19, 1996; September 7, 2006

The SEC Observer made the following announcement of the SEC staff's position on the computation of earnings per share (EPS) for a period that includes a redemption or an induced conversion of a portion of a class of preferred stock.

As summarized in *EITF Abstracts*, Appendix D, Topic No. D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock," the SEC staff has taken the position that the excess of the fair value of the consideration transferred to holders of preferred stock over the carrying amount of the preferred stock (excess consideration) represents a return to the preferred stockholders. Topic D-42 also sets forth the staff's position that the excess of the fair value of the consideration transferred to holders of preferred stock, pursuant to an inducement offer, over the fair value of securities issuable pursuant to the original conversion terms (excess consideration) represents a return to the preferred stockholders. In both cases, the excess consideration is treated in a manner similar to the treatment of dividends paid to the holders of preferred stock in the computation of EPS. Topic D-42 further expresses the staff's view that when the excess consideration is a negative amount (that is, when a redemption or conversion is effected at a discount to the carrying amount or original terms of the preferred security), the computation of EPS should reflect that negative amount.

When a registrant effects a redemption or induced conversion of only a portion of the outstanding securities of a class of preferred stock, the SEC staff believes that any excess consideration should be attributed to those shares that are redeemed or converted. Accordingly, ~~consistent with the guidance provided in AICPA Accounting Interpretation 44, " If Converted Method at Actual Conversion," of APB Opinion No. 15, *Earnings per Share*,~~ the staff believes that, for the purpose of determining whether the "if-converted" method is dilutive for the period, the shares redeemed or converted should be considered separately from those shares that are not redeemed or converted. The staff does not believe that it is appropriate to aggregate securities with differing effective dividend yields when determining whether the "if-converted" method is dilutive, which would be the result if a single, aggregate computation was made for the entire series of preferred stock.

To illustrate the SEC staff's application of Topic D-42 to a partial redemption, assume that a registrant has shares of common stock and 100 shares of convertible preferred stock outstanding at the beginning of the period. The convertible preferred stock was issued at fair value, which was equal to its par value of $10 per share, and has a stated dividend of 5 percent, and each share of preferred stock is convertible into 1 share of common stock. During the period, 20 preferred shares were redeemed by the registrant for $12 per share.

In this example, the SEC staff believes that the registrant should determine whether conversion is dilutive (1) for 80 of the preferred shares by applying the "if-converted" method from the beginning of the period to the end of the period using the stated dividend of 5 percent and (2) for 20 of the preferred shares by applying the "if-converted" method from the beginning of the period to the date of redemption using both the stated dividend of 5 percent and the $2 per share redemption premium.

Accordingly, assuming that the dividend for the period for the preferred stock was $0.125 per share, a determination of whether the 20 redeemed shares are dilutive should be made by comparing the $2.125 per-share effect of assuming those shares are not converted to the effect of assuming those 20 shares were converted into 20 shares of common stock, weighted for the period for which they were outstanding. The determination of the "if-converted" effect of the 80 shares not redeemed should be made separately, by comparing the EPS effect of the $0.125 per-share dividend to the effect of assuming conversion into 80 shares of common stock.

Subsequent Developments

FASB Statement No. 128, *Earnings per Share*, was issued in February 1997. Statement 128 supersedes APB Opinion No. 15, *Earnings per Share*, and AICPA Accounting Interpretation 44, "If Converted Method at Actual Conversion"; however, Statement 128 does not address how to determine whether a convertible security is anti-dilutive when there has been a partial redemption or conversion (refer to paragraph 172). Therefore, the guidance in this Topic continues to be applicable.

REVISED SEC STAFF ANNOUNCEMENT

Topic: *EITF Abstracts*, Topic No. D-86, "Issuance of Financial Statements"

Date Discussed: September 7, 2006

Footnote 4 of Topic D-86 references examples included in previously deleted EITF Issues No. 95-18, "Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements," and No. 99-11, "Subsequent Events Caused by Year 2000." Since these references were added as examples only and do not contribute to the ultimate conclusion, the SEC staff announced that the footnote would be deleted. For convenience, Topic D-86 is included below in its entirety (additions are underscored and deletions are ~~struck through~~).

Topic No. D-86

Topic: Issuance of Financial Statements

Dates Discussed: January 19–20, 2000; September 7, 2006

The SEC staff has received a number of inquiries regarding when financial statements are considered to have been issued. In considering this issue, the SEC staff observed that Rules 10b-5 and 12b-20 under the Securities Exchange Act of 1934 and General Instruction C(3) to Form 10-K specify that financial statements must not be misleading as of the date they are filed with the Commission. For example, assume that a registrant widely distributes its financial statements but, before filing them with the Commission, the registrant or its auditor becomes aware of an event or transaction that existed at the date of the financial statements that causes those financial statements to be materially misleading. If a registrant does not amend those financial statements so that they are free of material misstatement or omissions when they are filed with the Commission, the registrant will be knowingly filing a false and misleading document. In addition, registrants are reminded of their responsibility to, at a minimum, disclose subsequent events,[1] while independent auditors are reminded of their responsibility to assess subsequent events[2] and evaluate the impact of the events or transactions on their audit report.[3]

[1] See AICPA Codification of Statements on Auditing Standards, AU Section 560, *Subsequent Events,* paragraphs 5 and 8.

[2] See AU 560 and AU Section 561, *Subsequent Discovery of Facts Existing at Date of the Auditor's Report.*

[3] See AU Section 530, *Dating of the Independent Auditor's Report,* and AU 560, paragraph 9.

A registrant and its independent auditor have responsibilities with regard to post-balance-sheet-date subsequent events, as well as the application of authoritative literature applicable to such events.[~~4~~] Referring to AICPA Statement on Auditing Standards No. 1, *Subsequent Events* (SAS 1 or AU 560), paragraph 3 states:

> The first type [of subsequent event] consists of those events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.

Generally, the staff believes that financial statements are "issued" as of the date they are distributed for general use and reliance in a form and format that complies with generally accepted accounting principles (GAAP) and, in the case of annual financial statements, that contain an audit report that indicates that the auditors have complied with generally accepted auditing standards (GAAS) in completing their audit. Issuance of financial statements then would generally be the earlier of when the annual or quarterly financial statements are widely distributed to all shareholders and other financial statement users[~~4~~5] or filed with the Commission. Furthermore, the issuance of an earnings release does not constitute issuance of financial statements because the earnings release would not be in a form and format that complies with GAAP and GAAS.

[~~4~~] ~~For example, see Issues No. 95-18, "Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements," and No. 99-11, "Subsequent Events Caused by Year 2000."~~

[~~4~~5] Posting financial statements to a registrant's web site would not be considered wide distribution to all shareholders and other financial statement users as not all such parties necessarily have the ability to access a registrant's web site or be aware that such a posting had occurred.

REVISED SEC STAFF ANNOUNCEMENT

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

Date Discussed: September 7, 2006

Topic D-98 considers circumstances in which a specific shareholder has received a "preferential" dividend relative to the remaining shareholders. However, the SEC staff has encountered the reverse circumstance, where remaining shareholders actually received the "preferential" dividend. Therefore, the SEC staff announced that the term *preferential distribution* would be changed to *a distribution different from other common shareholders* to accommodate such situations.

The SEC staff also announced the addition of a new paragraph to Topic D-98 to highlight the notion set forth in FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, that hybrid financial instruments that are classified in stockholders' equity are not included in the scope of Statement 155 and therefore the guidance in Topic D-98 continues to be applicable.

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

Topic No. D-98

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

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

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

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 that are classified as equity pursuant to Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

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 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.

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.

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

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.

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
- 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]

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

[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.

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 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 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 ~~preferential distribution~~. 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 ~~preferential distribution~~.

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 Opinion 20.

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

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.

[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."

- 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. 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.

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 FSP 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.

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 (revised 2004), *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. In February 2006, the FASB issued 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 the 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.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 06-1

Title: Accounting for Consideration Given by a Service Provider to a Manufacturer or Reseller of Equipment Necessary for an End-Customer to Receive Service from the Service Provider

Dates Discussed: March 16, 2006; June 15, 2006; September 7, 2006

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

Introduction

1. Certain companies provide services to their customers that require the customers to purchase equipment in order to utilize those services. The equipment required is often manufactured and distributed by third-parties and sold to end-customers through resellers without the direct involvement of the service provider. Accordingly, a service provider may provide certain incentives to a third-party manufacturer or reseller to reduce the selling price of the equipment in order to stimulate end-customer demand and, inherently, increase the demand for the service provider's service.

2. Issue 01-9 provides guidance on the accounting for consideration given by a vendor to a customer. While some diversity exists, the incentives given by a service provider to a third-party manufacturer or reseller that ultimately benefits a service provider's customer have generally been considered outside the scope of Issue 01-9 because the third-party manufacturers and resellers are believed to be outside of the service provider's distribution chain.

Issues

3. The issues are:

Issue 1— Whether the consideration given by a service provider to a manufacturer or reseller (that is not a customer of the service provider) that in turn provides a benefit to the service provider's customer should be characterized as "cash consideration" or "other than cash" consideration for purposes of applying Issue 01-9

Issue 2— Whether the consideration given by a service provider to a manufacturer or a reseller of equipment that benefits a customer of both the service provider and the equipment manufacturer or reseller and where the equipment is necessary for a customer to receive a service from the service provider is, in substance, the same as the service provider giving the consideration directly to the end-customer

Issue 3— Whether the consideration given by a service provider to a manufacturer or a reseller (that is not a customer of the service provider) of equipment, when the equipment is necessary for an end-customer to receive a service from the service provider, and where the consideration can be linked to the benefit received by the service provider's customer, should be accounted for in accordance with the model used in Issue 01-9.

Prior Task Force Discussion

4. The original issue brought to the Task Force at the March 16, 2006 EITF meeting was as follows:

> Whether the consideration given by a service provider to a manufacturer or a reseller of equipment that reduces the price of the equipment to an end-customer and is necessary for an end-customer to receive a service from the service provider should be accounted for pursuant to Issue 01-9.

5. At the March meeting, the Task Force discussed this Issue but was not asked to reach any conclusions. Some Task Force members stated that they believe that there could be circumstances in which consideration paid to a third-party manufacturer or a reseller should be accounted for pursuant to Issue 01-9. However, those Task Force members also expressed concerns over the practicability of determining linkage between the consideration given by the service provider to the equipment manufacturer or reseller and consideration received by the service provider's end-customer.

6. Task Force members also discussed how the consensus in Issue 01-9 might be applied and whether the model in Issue 01-9 is appropriate for the arrangements discussed in this Issue, since Issue 01-9 does not specifically provide guidance on these types of arrangements. As a result, the Task Force asked the FASB staff to further explore the factors used in determining whether the consideration paid by the service provider to equipment manufacturers or resellers was, in substance, given to the end-customer and to explore the development of a separate model that could be used to account for these types of arrangements. In addition, the Task Force requested that the FASB staff reconcile any model pursuant to this Issue with the model used in Issue 01-9 and highlight differences for consideration at a future meeting.

7. At the June 15, 2006 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that the service provider should characterize the consideration given to a third-party manufacturer or reseller (that is not a customer of the service provider) based on the form of consideration directed by the service provider to be provided to the service provider's customer. If the form of the consideration is stipulated to be anything other than "cash consideration," (as defined in Issue 01-9) then the form of consideration should be characterized as "other than cash" consideration for purposes of applying Issue 01-9. If the service provider does not ultimately control the form of consideration provided to the service provider's customer, the consideration should be characterized as "other than cash" consideration for purposes of applying Issue 01-9. In reaching this tentative conclusion, Task Force members observed that consideration paid by a service provider that results in a customer receiving a reduced price on equipment purchased from a manufacturer or reseller should be characterized as "other than cash" consideration.

8. However, some Task Force members felt that the consideration given by a service provider to a third-party manufacturer or a reseller should always be treated as "other than cash" consideration unless the incentive provided to the service provider's customer exceeded the price

paid by the end-customer to purchase the equipment. In those instances, Task Force members believe that the excess should be characterized as "cash consideration" for purposes of applying Issue 01-9. Other Task Force members expressed concern about the operationality of such a model and its inconsistency with the existing model in Issue 01-9 and requested that the FASB staff request input from constituents on this alternative approach.

9. The Task Force also reached a tentative conclusion on Issue 2 that if the consideration given by a service provider to a manufacturer or reseller (that is not a customer of the service provider) can be linked contractually to the service provider's customer, it is in substance the same as consideration given by a service provider to the service provider's customer.

10. The Task Force reached a tentative conclusion on Issue 3 that the consideration given by a service provider to a manufacturer or a reseller (that is not a customer of the service provider) that can be contractually linked to the benefit received by the service provider's customer should be accounted for in accordance with the model in Issue 01-9. Based on the discussions surrounding Issue 1 and Issue 2, Task Force members were generally not supportive of exploring a different model for these types of arrangements since a new model would likely be inconsistent with the existing model in Issue 01-9 and Task Force members were not supportive of revisiting Issue 01-9.

11. The Task Force asked the FASB staff to prepare a draft abstract reflecting the tentative conclusions that were reached by the Task Force at the June 15, 2006 EITF meeting and to post that draft abstract to the FASB website for public comment. The draft abstract was posted to the FASB website on July 6, 2006, for a 30-day comment period.

Current EITF Discussion

12. At the September 7, 2006 EITF meeting, the Task Force considered the comment letters on the draft abstract and affirmed as a consensus the tentative conclusions reached at the June 15, 2006 EITF meeting.

13. Appendix 06-1A reflects changes made to the draft abstract as a result of the Task Force discussion (additions are <u>underscored</u> and deletions are ~~struck through~~).

Disclosure

14. The Task Force also reached a consensus that entities should disclose (a) the nature of the incentive programs and (b) the amounts recognized in the statement of operations for those incentive programs and their related classification for each period presented, if significant.

Transition

15. The consensus in this Issue is effective for the first annual reporting period beginning after June 15, 2007. Earlier application is permitted for financial statements that have not yet been issued. Entities should recognize the effects of applying the consensus in this Issue as a change in accounting principle through retrospective application to all prior periods unless it is impracticable to do so. That recognition should include:

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 other components of equity or net assets in the statement of financial position
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 the cumulative effect of applying the change in accounting principle to all prior periods can be determined but it is impracticable to determine the period-specific effects of that change on all prior periods presented, the cumulative effect of the change in accounting principle shall be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the change in accounting principle can be applied. An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period.

17. Upon application of this consensus, the following should be disclosed:

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change in accounting principle on revenue, cost of sales, 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
d. If retrospective application to all prior periods is impracticable, the reasons therefore, and a description of the method used to report the change should be made.

Board Ratification

18. At its September 20, 2006 meeting, the Board [ratified] the consensus reached by the Task Force on this Issue.

Status

19. No further EITF discussion is planned.

Appendix 06-1A

EITF ABSTRACTS (DRAFT[*])

Issue No. 06-1

Title: Accounting for Consideration Given by a Service Provider to a Manufacturer~~s~~ or Reseller~~s~~ of Equipment Necessary for an End-Customer to Receive Service from the Service Provider

Dates Discussed: March 16, 2006; June 15, 2006; ~~[~~September 7, 2006~~]~~

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

ISSUE

1. Certain companies provide services to their customers that require the customers to purchase equipment in order to utilize those services. The equipment required is often manufactured and distributed by third-parties and sold to end-customers through resellers without the direct involvement of the service provider. Accordingly, a service provider may provide certain incentives to a third-party manufacturer~~s~~ or reseller~~s~~ ~~of the equipment~~ to reduce the selling price of the equipment in order to stimulate end-customer demand and, inherently, increase the demand for the service provider's service.

2. Issue 01-9 provides guidance on the accounting for consideration given by a vendor to a customer. While some diversity exists, the incentives given by a service provider~~s~~ to a third-party manufacturer~~s~~ or reseller~~s~~ that ultimately benefits a service provider's customer have generally been considered outside the scope of Issue 01-9 because the third-party manufacturers and resellers are believed to be outside of the service provider's distribution chain.

3. The issues are:

Issue 1— Whether the consideration given by a service provider to a manufacturer or reseller (that is not a customer of the service provider) that in turn provides a benefit to the service provider's customer should be characterized as "cash consideration" or "other than cash" consideration for purposes of applying Issue 01-9

Issue 2— Whether the consideration given by a service provider to a manufacturer or a reseller of equipment that benefits a customer of both the service provider and the equipment manufacturer or reseller and where the equipment is necessary for a customer to

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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.**

receive a service from the service provider is, in substance, the same as the service provider giving the consideration directly to the end-customer

Issue 3— Whether the consideration given by a service provider to a manufacturer or a reseller (that is not a customer of the service provider) of equipment, when the equipment is necessary for an end-customer to receive a service from the service provider, and where the consideration can be linked to the benefit received by the service provider's customer, should be accounted for in accordance with the model used in Issue 01-9.

EITF DISCUSSION

4. The Task Force reached a ~~[~~consensus~~]~~ on Issues 1–3 that if the consideration given by a service provider to a manufacturer or reseller (that is not a customer of the service provider) can be linked contractually to the benefit received by the service provider's customer, a service provider should use the guidance in Issue 01-9 to determine ~~account for~~ the characterization of the consideration (that is, "cash consideration" or "other than cash" consideration)~~in accordance with Issue 01-9~~. Issue 01-9 presumes that an entity should characterize "cash consideration" as a reduction of revenue unless an entity meets the requirements of paragraph 9 of Issue 01-9. Under Issue 01-9 "other than cash" consideration should be characterized as an expense. In applying that guidance, ~~T~~the service provider should characterize the consideration given to a third-party manufacturer or reseller based on the form of consideration directed by the service provider to be provided to the service provider's customer. If the form of the consideration is ~~stipulated~~ directed to be anything other than "cash consideration" (as defined in Issue 01-9), then the form of the consideration should be characterized as "other than cash" consideration~~ for purposes of applying Issue 01-9~~. If the service provider does not control the form of the consideration provided to the service provider's customer, the consideration should be characterized as "other than cash" consideration~~ for purposes of applying Issue 01-9~~. In reaching this conclusion, Task Force members observed that consideration paid by a service provider that results in a customer receiving a reduced price on equipment purchased from a manufacturer or reseller should be characterized as "other than cash" consideration for purposes of applying Issue 01-9. Examples of the application of this~~e~~ ~~tentative conclusion~~consensus ~~reached on this Issue~~ are provided in Exhibit 06-1A.

Disclosure

5. The Task Force also reached a consensus that entities should disclose (a) the nature of the incentive programs and (b) the amounts recognized in the statement of operations for those incentive programs and their related classification for each period presented, if significant.

Transition

6~~5~~. The ~~Task Force reached a [~~consensus~~] that~~ in this Issue ~~should be~~ is effective for the first annual reporting period beginning after June 15, 2007. Earlier application is permitted for financial statements that have not yet been issued. Entities should recognize the effects of applying the consensus ~~o~~in this Issue as a change in accounting principle through retrospective application to all prior periods unless it is impracticable to do so. That~~is~~ recognition 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 other components of equity or net assets in the statement of financial position
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the change in accounting principle.

7~~6~~. If the cumulative effect of applying the change in accounting principle to all prior periods can be determined but it is impracticable to determine the period-specific effects of that change on all prior periods presented, the cumulative effect of the change in accounting principle shall be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the change in accounting principle can be applied. An offsetting adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period.

8~~7~~. Upon application of this ~~[~~consensus~~]~~, the following should be disclosed:

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change in accounting principle on revenue, cost of sales, 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
~~d. A description of the nature of these programs including the amounts recognized in the statement of operations and their related classification for each period presented, where significant~~
d~~e~~. If retrospective application to all prior periods is impracticable, the reasons therefore, and a description of the method used to report the change should be made.

Board Ratification

9~~8~~. At its ~~[~~September 20, 2006~~]~~ meeting, the Board ~~[~~ratified~~]~~ the ~~[~~consensus~~]~~ reached by the Task Force in this Issue.

STATUS~~tatus~~

10~~9~~. No further EITF discussion is planned.

Exhibit 06-1A

EXAMPLES OF THE APPLICATION OF THE ~~[~~CONSENSUS~~]~~ ON ISSUE 06-1

The following examples are provided to illustrate the application of the ~~[~~consensus~~]~~ in Issue 06-1. The application of this ~~[~~consensus~~]~~ depends on the relative facts and circumstances and requires significant judgment. The application of that judgment in a given fact pattern is based on the assumed facts; accordingly, judgment will vary in differing fact patterns.

1. Service provider gives a cash incentive to a third-party manufacturer that results in a rebate to the service provider's customer.

Scenario: A service provider of satellite radio services has a contractual arrangement with a third-party that manufactures the equipment that is necessary for customers to receive its programming. The contractual arrangement ~~stipulates~~ <u>directs</u> ~~that~~ the service provider ~~will~~ <u>to</u> give a $50 incentive to the third-party manufacturer for each unit produced if the end-customer who purchases the equipment enters into a contract for satellite radio service from the service provider. The contractual arrangement between the service provider and the third-party manufacturer requires that the third-party manufacturer must pass this incentive ~~along~~ to the end-customer in the form of a mail-in rebate honored by the third-party manufacturer.

Evaluation: The service provider should characterize the incentive as "cash consideration" for purposes of applying Issue ~~01-9~~<u>06-1</u> because the service provider has directed through a contractual arrangement that the benefit received by the service provider's customer must be in the form of cash (through a mail-in rebate). <u>There is a presumption that "cash consideration" is characterized as a reduction of revenue unless the criteria described in paragraph 9 of Issue 01-9 have been met.</u>

2. Service provider gives a cash incentive to a third-party manufacturer that results in a price reduction on equipment sold to the service provider's customers.

Scenario: A service provider of satellite radio services has a contractual arrangement with a third-party that manufactures the equipment that is necessary for customers to receive its programming. The contractual arrangement directs ~~that~~ the service provider ~~will~~ <u>to</u> give a $50 incentive to the third-party manufacturer for each unit produced if the end-customer who purchases the equipment enters into a contract for satellite radio service from the service provider. The contractual arrangement between the service provider and the third-party manufacturer requires that the third-party manufacturer must pass this incentive ~~along~~ to the end-customer in the form of a price reduction on the equipment sold by the third-party manufacturer to the end-customer. (Assume for purposes of this example that the manufacturer sells directly to the end-customer.)

Evaluation: The service provider should characterize the incentive paid to the third-party manufacturer as "other than cash" consideration for purposes of applying Issue ~~01-9~~<u>06-1</u> because the service provider has directed through a contractual arrangement that the benefit received by the service provider's customer must be in the form of a price reduction on equipment purchases. <u>"Other than cash" consideration should be characterized as an expense.</u>

Issue No. 06-4

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

Dates Discussed: March 16, 2006; June 15, 2006; September 7, 2006

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

FASB Statement No. 95, *Statement of Cash Flows*

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

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

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*

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

International Accounting Standard 19, *Employee Benefits*

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. One form of this insurance is split-dollar life insurance. The structure of split-dollar life insurance arrangements can be complex and varied.

2. 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 the ownership and control of the life insurance policy. For 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 owns and controls the insurance policy. Diversity in practice exists primarily in accounting for the deferred compensation and postretirement aspects of typical endorsement split-dollar life insurance arrangements. A typical endorsement split-dollar life insurance arrangement may have the following terms:

> An employer purchases a life insurance policy to insure the life of an employee and pays a single premium at inception of the policy. Based on the insurance carrier's experience (for example, mortality) it can either charge or credit the policyholder for the negative or positive experience, respectively. The additional premium or credit is typically effectuated through an adjustment to the cash surrender value of the policy. The employer enters into a separate agreement that splits the policy benefits between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the insurance policy (and, in turn, the policy benefits promised to the employee). To effect the

split-dollar arrangement, the employer endorses a portion of the death benefits to the employee (the employee designates a beneficiary for this portion of the death benefits). Upon the death of the employee, the employee's beneficiary typically receives the designated portion of the death benefits directly from the insurance company and the employer receives the remainder of the death benefits.

The employee's portion of the death benefits is commonly based on one of the following:

a. Amounts that exceed the gross premiums paid by the employer
b. Amounts that exceed the sum of the gross premiums paid by the employer and an additional fixed or variable investment return on those premiums
c. The net insurance at the date of death (that is, the face amount of the death benefit under the policy, less the cash surrender value)
d. Amounts equal to a multiple of the employee's base salary at retirement or death (for example, twice the employee's base salary).

Issue

3. The issue is whether the postretirement benefit associated with an endorsement split-dollar life insurance arrangement is effectively settled in accordance with either Statement 106 or Opinion 12 upon entering into such an arrangement.

Scope

4. The scope of this Issue is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance arrangements that provide a benefit to an employee that extends to postretirement periods. Therefore, this Issue would not apply to a split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer.

Prior EITF Discussion

5. The original issue brought to the Task Force at the March 16, 2006 EITF meeting was as follows:

> How an employer should account for the deferred compensation or postretirement or postemployment benefit aspects of a split-dollar life insurance arrangement that is in substance an endorsement type of policy.

6. At the March 16, 2006 EITF meeting, the Task Force was unable to reach a consensus on the issue of whether a liability should be recognized for the deferred compensation and postretirement benefit aspects of a typical endorsement split-dollar life insurance arrangement. At that meeting, however, Task Force members acknowledged that for a typical endorsement split-dollar life insurance arrangement, an employer has provided an employee with a postretirement benefit that is within the scope of Statement 106 (or Opinion 12 if the arrangement does not constitute a plan).

7. The Task Force disagreed, however, on whether the employer should record a liability for the obligation associated with the postretirement benefit that is being provided. Certain Task Force members believed that while a postretirement benefit has been provided in accordance

with Statement 106 or Opinion 12, the purchase of the endorsement split-dollar life insurance policy effectively settles this obligation.

8. At the June 15, 2006 EITF meeting, the Task Force reached a tentative conclusion that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with Statement 106 or Opinion 12 (depending on whether a substantive plan is deemed to exist) based on the substantive agreement with the employee. The Task Force noted that it believes that a liability for the benefit obligation under Statement 106 or Opinion 12 has not been settled through the purchase of a typical endorsement split-dollar life insurance arrangement. The Task Force also noted that it believes that the purchase of an endorsement type policy does not constitute a settlement since the policy does not qualify as non-participating because the policyholders are subject to the favorable and unfavorable experience of the insurance company.

9. The Task Force requested that the staff research collateral assignment split-dollar life insurance arrangements and present the accounting for these arrangements to the EITF Agenda Committee to determine whether a new issue should be added to the EITF agenda.

Current EITF Discussion

10. At the September 7, 2006 EITF meeting, the Task Force redeliberated this Issue in its entirety since the majority of comment letters received on this Issue disagreed with the tentative conclusion reached at the June 15, 2006 EITF meeting.

11. The Task Force reaffirmed as a consensus the tentative conclusions reached at the June 15, 2006 EITF meeting, but requested that certain clarifying language be included in the final abstract. The Task Force believes that 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. For example, if the employer has effectively agreed to maintain a life insurance policy during the employee's retirement, the cost of the insurance policy during postretirement periods 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, over the service period, 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.

12. The Task Force observed that all available evidence should be considered in determining the substance of the arrangement, such as the explicit written terms of the arrangement, communications made by the employer to the employee, and the determination of whether the employer or the insurer is the primary obligor for the postretirement benefit. For example, if the employer agrees to provide a death benefit to the employee even in the event of default by the insurance company, that would provide an indication that the promise made to the employee is to provide a postretirement death benefit. If the amount of the death benefit is not explicitly tied to an insurance policy, then the amount of the postretirement benefit should also be the amount of the death benefit promised to the employee. Conversely, if the terms of the arrangement are such that the employer has no obligation to the employee upon default of the insurance company, that

would provide an indication that the postretirement benefit promise is to maintain a life insurance policy during the employee's retirement. 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.

13. The Task Force also discussed the example included in Exhibit 06-4B to Issue Summary Supplement No. 2, which was provided to the Task Force solely to facilitate discussion of this Issue at the September 7, 2006 EITF meeting. That example should not be considered authoritative guidance in accounting for an endorsement split-dollar life insurance arrangement since it was included only to illustrate the differences between the application of the individual views.

14. Appendix 06-4A reflects changes made to the draft abstract as a result of the Task Force discussion (additions are underscored and deletions are ~~struck through~~).

Transition and Disclosure

15. At the September 7, 2006 EITF meeting, the Task Force reached a consensus that this Issue should be applied to fiscal years beginning after December 15, 2007, with earlier application 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.

16. 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.

17. 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
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the change in accounting principle.

18. 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 following should be disclosed:

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 on 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

19. At its September 20, 2006 meeting, the Board [ratified] the consensus reached by the Task Force in this Issue.

Status

20. No further EITF discussion is planned.

Appendix 06-4A

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

Issue No. 06-4

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

Dates Discussed: March 16, 2006; June 15, 2006; ~~[~~September 7, 2006~~]~~

References: 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 Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*~~

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

International Accounting Standard 19, *Employee Benefits*

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. One form of this insurance is split-dollar life insurance. The structure of split-dollar life insurance arrangements can be complex and varied.

2. The two most common types of arrangements are endorsement split-dollar life insurance ~~policies~~arrangements and collateral assignment split-dollar life insurance ~~policies~~ arrangements. Generally, the difference between these arrangements is the ownership and control of the life insurance policy. For an endorsement split-dollar life insurance ~~policy~~ arrangement, the company owns and controls the insurance policy, whereas in a collateral assignment split-dollar life insurance ~~policy~~ arrangement, the employee owns and controls the insurance policy. Diversity in practice exists primarily in accounting for the deferred compensation and postretirement aspects of typical endorsement split-dollar life insurance arrangements. A typical endorsement split-dollar life insurance ~~policy~~ arrangement may have the following terms:

[*] **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.**

An employer purchases a life insurance policy to insure the life of an employee and pays a single premium at inception of the policy. Based on the insurance carrier's experience (for example, mortality) it can either charge or credit the policyholder for the negative or positive experience, respectively. The additional premium or credit is typically effectuated through an adjustment to the cash surrender value of the policy. The employer enters into a separate agreement that splits the policy benefits between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the insurance ~~arrangement~~ policy (and, in turn, the policy benefits promised to the employee). To effect the split-dollar arrangement, the employer endorses a portion of the death benefits to the employee (the employee designates a beneficiary for this portion of the death benefits). Upon the death of the employee, the employee's beneficiary typically receives the designated portion of the death benefits ~~and the employer receives the remainder of the death benefits. Depending on how the policy is structured, the beneficiary's proceeds are received~~ directly ~~either~~ from the insurance company ~~or from~~ and the employer receives the remainder of the death benefits~~(who remits the beneficiary's proportionate share once payment is received from the insurance company)~~.

The employee's portion of the death benefits is commonly based on one of the following:

a. Amounts that exceed the gross premiums paid by the employer
b. Amounts that exceed the sum of the gross premiums paid by the employer and an additional fixed or variable investment return on those premiums
c. The net insurance at the date of death (that is, the face amount of the death benefit under the policy, less the cash surrender value)
d. Amounts equal to a multiple of the employee's base salary at retirement or death (for example, twice the employee's base salary).

3. The issue is whether the postretirement benefit associated with an endorsement split-dollar life insurance arrangement is effectively settled in accordance with either Statement 106 or Opinion 12 upon entering into such an arrangement.

Scope

4. The scope of this Issue is limited to the recognition of a liability and related compensation costs for endorsement split-dollar life insurance ~~policies~~arrangements that provide a benefit to an employee that extends to postretirement periods. Therefore, this Issue would not apply to a split-dollar life insurance arrangement that provides a specified benefit to an employee that is limited to the employee's active service period with an employer.

EITF DISCUSSION

5. The Task Force reached a ~~[~~consensus~~]~~ that for an endorsement split-dollar life insurance arrangement within the scope of this Issue, 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~~depending upon whether a substantive plan is deemed to exist~~) based on the substantive agreement with the employee. The Task Force believed that a liability for the benefit obligation

under Statement 106 or Opinion 12 has not been settled through the purchase of a~~n~~ typical endorsement split-dollar life insurance arrangement~~ type policy~~. ~~The Task Force believed that the purchase of an endorsement type policy does not constitute a settlement since the policy does not qualify as non-participating because the policyholders are subject to the favorable and unfavorable experience of the insurance company.~~ For example, if the employer has effectively agreed to maintain a life insurance policy during the employee's retirement, the cost of the insurance policy during postretirement periods 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, over the service period, 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.

6. The Task Force observed that all available evidence should be considered in determining the substance of the arrangement, such as the explicit written terms of the arrangement, communications made by the employer to the employee, and the determination of whether the employer or the insurer is the primary obligor for the postretirement benefit. For example, if the employer agrees to provide a death benefit to the employee even in the event of default by the insurance company, that would provide an indication that the promise made to the employee is to provide a postretirement death benefit. If the amount of the death benefit is not explicitly tied to an insurance policy, then the amount of the postretirement benefit should also be the amount of the death benefit promised to the employee. Conversely, if the terms of the arrangement are such that the employer has no obligation to the employee upon default of the insurance company, that would provide an indication that the postretirement benefit is a promise to maintain a life insurance policy during the employee's retirement. 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.

Transition

7~~6~~. The ~~reached a [~~consensus~~]~~ ~~that~~ in this Issue is effective for fiscal years beginning after December 15, 200~~6~~7, with earlier application 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.

8~~7~~. If an entity chooses to apply the ~~[~~consensus~~]~~ ~~reached~~ in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings, 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.

9~~8~~. If an entity chooses to apply the ~~[~~consensus~~]~~ ~~reached~~ in this Issue as a change in accounting principle through retrospective application to all prior periods, ~~an~~the entity should include the recognition of:

a. The cumulative effect of the change ~~to the new~~ 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
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the ~~new~~ change in accounting principle.

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

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 ~~line item~~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

11~~0~~. At its ~~[~~September 20, 2006~~]~~ meeting, the Board ratified the ~~[~~consensus~~es]~~ reached by the Task Force in this Issue.

STATUS

12~~1~~. No further EITF discussion is planned.

Issue No. 06-5

Title: Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*

Dates Discussed: June 15, 2006; September 7, 2006

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

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

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

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

International Accounting Standard 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

AICPA Audit and Accounting Guide, *Life and Health Insurance Entities*

Introduction

1. Life insurance policies are purchased by entities for a variety of purposes, including funding the cost of providing employee benefits and protecting against the loss of "key persons." These types of policies have generally been known as corporate-owned life insurance (COLI) or bank-owned life insurance (BOLI). One of the primary benefits to using an insurance policy as a funding mechanism is the ability for an entity to receive the death benefits tax free. Investment income is accumulated tax free through the internal build-up of the cash surrender value. In the event that a policy is surrendered early, the policyholder will be responsible for paying the tax on the previously unrecognized investment income. The tax on the cash surrender value can be significant if the policies have been held for a number of years.

2. COLI/BOLI arrangements are established utilizing several different insurance products including universal-life, variable-life, and whole-life policies. There are a few basic structures currently used as a framework for most policies in the marketplace. However, these structures can be combined and modified in many different ways and, therefore, can be quite complex. For purposes of this Issue, consider the following insurance policy structures:

a. *Individual-Life Policy*—The individual-life policy generally has one contract value component and, in some cases, a surrender charge. The amount that could be realized for this policy upon surrender is the amount reported by the insurance company as the cash surrender value.

b. *Multiple Individual-Life Policies*—Many entities purchase separate individual-life policies for each employee. Similar to the individual-life policy, each policy has only one contract value component and in some cases a surrender charge. If one or more, but not all, policies are surrendered, the policyholder will incur the surrender charges on those policies surrendered. This will result in a permanent loss of asset value to the extent of the surrender charge. However, a rider (or a contractual stipulation) can be obtained for the insurance policy that will waive the surrender charges on each individual policy if all of the policies are surrendered at the same time. The cost of the rider will vary depending on the individual facts and circumstances.

c. *Group-Life Policy*—The group-life policy constitutes the legal contract with the insurance company that covers individual-life insurance for multiple employees. Each individual in the group policy is issued a certificate. If the group policy is cancelled, each of the individual certificates is terminated. While certificates are issued pursuant to the policy and form part of the policy, the group-life policy contract is the controlling document. Under the group-life policy, individual-life insurance certificates can be surrendered separately and the cash surrender value for the certificate is received by the policyholder for the full surrender amount of that certificate.

3. Additionally, a number of policies include certain provisions that can make them more attractive to the policyholder (for example, a provision allowing for the recovery of certain costs). However, many provisions limit the amount that is realized and may necessitate the meeting of certain criteria in order to recover any of those amounts. Some of the more typical examples of limitations that exist are the prohibition against a change of control or a restructuring occurring within the last 24 months; a planned restructuring within the next 12 months; or the extent to which the policyholder is in a net operating loss (NOL) carryforward position. The amount associated with the termination of the policy may be received over an extended period of time subsequent to the surrender of the insurance policy or certificate.

4. Technical Bulletin 85-4 requires that "the amount that could be realized under the insurance contract as of the date of the statement of financial position should be reported as an asset." Subsequent to the issuance of Technical Bulletin 85-4 there has been diversity in the calculation of *the amount that could be realized under the insurance contract.* Generally, these types of contracts are either (a) multiple individual policies with a separate, group-level rider agreement, (b) multiple individual policies with a contractual stipulation in each individual policy referencing the other policies as a group, or (c) a group-life policy that has multiple certificates (individual life insurance for multiple employees). These contracts may provide the policyholder with an amount that upon surrender is greater if all individual policies are surrendered at the same time rather than if the individual policies are surrendered over a period of time. The amount that can be realized under the insurance contract (that is, converted into cash) is dependent on how the contract is assumed to be hypothetically settled and, if surrendered, whether the insurance policies are surrendered at the individual or group level.

Issues

5. The issues are:

Issue 1— Whether a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract in accordance with Technical Bulletin 85-4.

Issue 2— Whether a policyholder should consider the contractual ability to surrender all of the individual-life policies (or certificates in a group policy) at the same time in determining the amount that could be realized under the insurance contract in accordance with Technical Bulletin 85-4.

Prior EITF Discussion

6. At the June 15, 2006 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract. The Task Force agreed that contractual limitations should be considered when determining the realizable amounts. Those amounts that are recoverable by the policyholder at the discretion of the insurance company should be excluded from the amount that could be realized under the insurance contract. The Task Force also agreed that amounts that are recoverable by the policyholder in periods beyond one year from the surrender of the policy should be discounted in accordance with Opinion 21.

7. The Task Force also reached a tentative conclusion on Issue 2 that a policyholder should determine the amount that could be realized under the insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). The Task Force also noted that any amount that is ultimately realized by the policyholder upon the assumed surrender of the final policy (or final certificate in a group policy) shall be included in the "amount that could be realized under the insurance contract."

Current EITF Discussion

8. At the September 7, 2006 EITF meeting, the Task Force discussed the FASB staff's analysis of the comment letters received on the draft abstract. The Task Force considered the following additional issue as a result of the comment letters received on the draft abstract.

Issue 3— Whether the cash surrender value component of the amount that could be realized under the insurance contract in accordance with Technical Bulletin 85-4 should be discounted in accordance with Opinion 21, when contractual limitations on the ability to surrender a policy exist.

9. The Task Force reached a consensus that a policyholder should not discount the cash surrender value component of the amount that could be realized under the insurance contract when contractual restrictions on the ability to surrender a policy exist, as long as the holder of the policy continues to participate in the changes in the cash surrender value as it had done prior to the surrender request.. The Task Force observed that if, however, the contractual restrictions prevent the policyholder from participating in changes to the cash surrender value component, then the amount that could be realized under the insurance contract at a future date should be discounted in accordance with Opinion 21. The Task Force noted that Internal Revenue Code Section 1035 exchanges (Sec. 1035 exchanges) do not constitute a "cash" surrender as contemplated by Technical Bulletin 85-4.

10. The Task Force affirmed the tentative conclusions reached at the June 15, 2006 EITF meeting as a consensus including the transition and effective dates.

11. Appendix 06-5A reflects changes made to the draft abstract as a result of the above decisions (additions are underscored and deletions are ~~struck through~~).

Disclosure

12. The Task Force reached a consensus that a policyholder should disclose when contractual restrictions on the ability to surrender a policy exist.

Transition

13. The Task Force reached a consensus that this Issue should be effective for fiscal years beginning after December 15, 2006. Earlier application is permitted as of the beginning of a fiscal year for periods in which interim or annual financial statements have not yet been issued. The Task Force reached a consensus that this Issue should be effective 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.

14. If a policyholder chooses to apply the consensus in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings, a policyholder 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 a policyholder chooses to apply the consensus in this Issue as a change in accounting principle through retrospective application to all periods, a policyholder 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
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 a policyholder chooses to apply the consensus in this Issue as a change in accounting principle through retrospective application to all prior periods, the following should be disclosed:

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 September 20, 2006 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

18. No further EITF discussion is planned.

Appendix 06-5A

EITF ABSTRACTS (DRAFT[*])

Issue No. 06-5

Title: Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4

Dates Discussed: June 15, 2006; ~~[~~September 7, 2006~~]~~

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

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

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

AICPA Audit and Accounting Guide, *Life and Health Insurance Entities*

ISSUE

1. Life insurance policies are purchased by entities for a variety of purposes, including funding the cost of providing employee benefits and protecting against the loss of "key persons." These types of policies have generally been known as corporate-owned life insurance (COLI) or bank-owned life insurance (BOLI). One of the primary benefits to using an insurance policy as a funding mechanism is the ability for an entity to receive the death benefits tax free. Investment income is accumulated tax free through the internal build-up of the cash surrender value. In the event that a policy is surrendered early, the policyholder will be responsible for paying the tax on the previously unrecognized investment income. The tax on the cash surrender value can be significant if the policies have been held for a number of years.

2. COLI/BOLI arrangements are established utilizing several different insurance products including universal-life, variable-life, and whole-life policies. There are a few basic structures currently used as a framework for most policies in the marketplace. However, these structures can be combined and modified in many different ways and, therefore, can be quite complex. For purposes of this Issue, consider the following insurance policy structures:

a. *Individual-Life Policy*—The individual-life policy generally has one contract value component and, in some cases, a surrender charge. The amount that could be realized for this policy upon surrender is the amount reported by the insurance company as the cash surrender value.

[*] **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.**

b. *Multiple Individual-Life Policies*—Many entities purchase separate individual-life policies for each employee. Similar to the individual-life policy, each policy has only one contract value component and in some cases a surrender charge. If one or more, but not all, policies are surrendered, the policyholder will incur the surrender charges on those policies surrendered. This will result in a permanent loss of asset value to the extent of the surrender charge. However, a rider (or a contractual stipulation) can be obtained for the insurance policy that will waive the surrender charges on each individual policy if all of the policies are surrendered at the same time. The cost of the rider will vary depending on the individual facts and circumstances.

c. *Group-Life Policy*—The group-life policy constitutes the legal contract with the insurance company that covers individual-life insurance for multiple employees. Each individual in the group policy is issued a certificate. If the group policy is cancelled, each of the individual certificates is terminated. While certificates are issued pursuant to the policy and form part of the policy, the group-life policy contract is the controlling document. Under the group-life policy, individual-life insurance certificates can be surrendered separately and the cash surrender value for the certificate is received by the policyholder for the full surrender amount of that certificate.

3. Additionally, a number of policies include certain provisions that can make them more attractive to the policyholder (for example, a provision allowing for the recovery of certain costs). However, many provisions limit the amount that is realized and may necessitate the meeting of certain criteria in order to recover any of those amounts. Some of the more typical examples of limitations that exist are the prohibition against having a change of control or a restructuring occurring within the last 24 months; a planned restructuring within the next 12 months; or the extent to which the policyholder is in a net operating loss (NOL) carryforward position. The amount associated with the termination of the policy may be received over an extended period of time subsequent to the surrender of the insurance policy or certificate.

4. Technical Bulletin 85-4 requires that "the amount that could be realized under the insurance contract as of the date of the statement of financial position should be reported as an asset." Subsequent to the issuance of Technical Bulletin 85-4 there has been diversity in the calculation of *the amount that could be realized under the insurance contract*. ~~For instance, some contracts provide the policyholder with an amount that upon surrender is greater if all individual policies are surrendered at the same time rather than if the individual policies are surrendered over a period of time.~~ Generally, these types of contracts are either (a) multiple individual policies with a separate, group-level rider agreement, (b) multiple individual policies with a contractual stipulation in each individual policy referencing the other policies as a group, or (c) a group-life policy that has multiple certificates (individual life insurance for multiple employees). These contracts may provide the policyholder with an amount that upon surrender is greater if all individual policies are surrendered at the same time rather than if the individual policies are surrendered over a period of time. The amount that can be realized under the insurance contract (that is, converted into cash) is dependent on how the contract is assumed to be hypothetically settled and, if surrendered, whether the insurance policies are surrendered at the individual or group level.

5. The issues are:

Issue 1— Whether a policyholder should consider any additional amounts included in the contractual terms of the insurance policy other than the cash surrender value in determining the amount that could be realized under the insurance contract in accordance with Technical Bulletin 85-4.

Issue 2— Whether a policyholder should consider the contractual ability to surrender all of the individual-life policies (or certificates in a group policy) at the same time in determining the amount that could be realized under the insurance contract in accordance with Technical Bulletin 85-4.

Issue 3— Whether the cash surrender value component of the amount that could be realized under the insurance contract in accordance with Technical Bulletin 85-4 should be discounted in accordance with Opinion 21, when contractual limitations on the ability to surrender a policy exist.

EITF DISCUSSION

6. The Task Force reached a ~~[~~consensus~~]~~ on Issue 1 that a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the amount that could be realized under the insurance contract. When it is probable[1] that contractual terms would limit the amount that could be realized under the insurance contract, ~~T~~the Task Force agreed that these contractual limitations should be considered when determining the realizable amounts. Those amounts that are recoverable by the policyholder at the discretion of the insurance company should be excluded from the amount that could be realized under the insurance contract. The Task Force ~~also agreed~~ observed that ~~fixed~~ amounts that are recoverable by the policyholder in ~~future~~ periods ~~in excess of~~ beyond one year from the surrender of the policy should be ~~recognized at their present value~~ discounted in accordance with Opinion 21.

7. The Task Force also reached a ~~[~~consensus~~]~~ on Issue 2 that a policyholder should determine the amount that could be realized under the insurance contract assuming the surrender of an individual-life by individual-life policy (or certificate by certificate in a group policy). The Task Force also noted that any amount that ultimately would be ~~is ultimately~~ realized by the policyholder upon the assumed surrender of the final policy (or final certificate in a group policy) shall be included in the "amount that could be realized under the insurance contract." See illustration in Exhibit 06-5A.

8. The Task Force reached a consensus on Issue 3 that a policyholder should not discount the cash surrender value component of the amount that could be realized under the insurance contract when contractual restrictions on the ability to surrender a policy exist, as long as the holder of the policy continues to participate in the changes in the cash surrender value as it had done prior to the surrender request. The Task Force observed that if, however, the contractual restrictions prevent the policyholder from participating in changes to the cash surrender value component, then the amount that could be realized under the insurance contract at a future date

[1] As defined in Statement 5.

should be discounted in accordance with Opinion 21. The Task Force noted that Internal Revenue Code Section 1035 exchanges (Sec. 1035 exchanges) do not constitute a "cash" surrender as contemplated by Technical Bulletin 85-4.

9. Finally, the Task Force noted that if a group of individual-life policies or a group policy only allows for the surrender of all of the individual-life policies or certificates as a group, then the policyholder shall determine the amount that could be realized under the insurance contract on a group basis.

10~~8~~. Exhibit 06-5A illustrates the above ~~[~~consensus~~]~~. Exhibit 06-5B contains definitions of key terms used in this Issue.

Disclosure

11. The Task Force reached a consensus that a policyholder should disclose when contractual restrictions on the ability to surrender a policy exist.

Transition

12~~9~~. The consensus in this Issue is effective for fiscal years beginning after December 15, 2006. Earlier application is permitted as of the beginning of a fiscal year for periods in which interim or annual financial statements have not yet been issued. The ~~Task Force reached a [~~consensus~~]~~ ~~that~~ in this Issue should be ~~effective~~ adopted 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.

13~~0~~. If a policyholder chooses to apply the ~~[~~consensus~~] reached~~ in this Issue as a change in accounting principle through a cumulative-effect adjustment to retained earnings, a policyholder 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.

14~~1~~. If a policyholder chooses to apply the ~~[~~consensus~~] reached~~ in this Issue as a change in accounting principle through retrospective application to all periods, a policyholder 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
c. Adjustments to financial statements for each individual prior period presented to reflect the period-specific effects of applying the new accounting principle.

15~~2~~. If a policyholder chooses to apply the ~~[~~consensus~~] reached~~ in this Issue as a change in accounting principle through retrospective application to all prior periods, the following should be disclosed:

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.

~~Effective Date~~

~~13. The Task Force reached a [consensus] that this Issue should be effective for fiscal years beginning after December 15, 2006. Earlier adoption is permitted as of the beginning of a fiscal year for periods in which interim or annual financial statements have not yet been issued.~~

Board Ratification

16~~4~~. At its ~~[~~September 20, 2006~~]~~ meeting, the Board ratified the ~~[~~consensus~~es]~~ reached by the Task Force in this Issue.

STATUS

17~~5~~. No further EITF discussion is planned.

Exhibit 06-5A

EXAMPLE OF THE APPLICATION OF THE [CONSENSUS] ON ISSUE 06-5

The following example illustrates the application of the [consensus] in this Issue.

On January 1, 19X7, TKO Incorporated (TKO) purchases a group variable life policy on 20 executives of TKO. The insurance company issued an individual certificate for each executive when the policy was purchased. The entire policy was funded with an initial single premium of $10,000,000. TKO will be paid the stated death benefit of the certificate when the insured dies. The policy contains a surrender charge of $50,000 per certificate if a certificate is surrendered. If all of the certificates are surrendered at once (that is, if the group policy is surrendered) the surrender charge is waived. The policy includes a Claims Stabilization Reserve (CSR) account and a provision that allows for the recovery of the upfront Deferred Acquisition Costs (DAC) tax over 11 years on a certificate-by-certificate basis even when an individual certificate is surrendered. The remaining balance in the CSR is paid out in cash to TKO upon surrender of the final certificate. At December 31, 20X5, the individual components of TKO's policy have the following values:

Policy Account Balance = $9,700,000
Cash Surrender Value (CSV) = $8,700,000
CSR = $500,000
DAC tax (on a discounted basis) = $250,000

The following is an illustration of the amounts to be included in TKO's financial statements at December 31, 20X5, under this Issue:

Cash Surrender Value	$ 8,700,000
CSR	500,000
DAC Tax	250,000
	$ 9,450,000

Evaluation:

In determining the amount that could be realized under the insurance contract, TKO considers the CSV (Policy Account Balance of $9,700,000 less surrender charge of $1,000,000), the CSR, and the DAC tax as each of these amounts is realizable based on the contractual terms and is not dependant on surrendering all of the policies at once. The CSR is included in the amount that could be realized because the CSR will be recovered when the final policy is surrendered and is not dependent on the surrender of all of the policies at once. The surrender charge of $1,000,000 (20 certificates at $50,000 per certificate) is not assumed to be waived because the waiver of those charges requires the surrender of all of the certificates at once.

Exhibit 06-5B

DEFINITIONS OF KEY TERMS

Definitions of the following terms are included for purposes of clarifying the Task Force's ~~[~~consensus~~]~~ and the related examples of the application of the ~~[~~consensus~~]~~. The terms are not consistently used among contracts. When determining the applicability of one of these terms, the economic substance of the item shall ~~should~~ be taken into consideration.

Cash Surrender Value (CSV)—The AICPA Audit and Accounting Guide, *Life and Health Insurance Entities*, defines cash surrender value as "the amount of cash that may be realized by the owner of a life insurance contract or annuity contract upon discontinuance and surrender of the contract prior to its maturity." The CSV may be different from the policy account balance due to outstanding loans (including accrued interest) and surrender charges (as defined below).

Certificates—An insurance company issues to each individual in a group contract a "certificate of insurance" for each person insured under the group contract. The certificate is merely a summary of the rights, duties, and benefits available under a group policy. If there is any conflict between the certificate and a group policy, the group policy is the controlling document.

Claims Stabilization Reserve (CSR)—The CSR is established through deductions from the Policy Account Balance (see below) through the cost of insurance charge and is sometimes held in a general account (that is, an account that is intermingled with the insurance company's assets) as opposed to a legally segregated account (sometimes referred to as a separate account). The amounts are accumulated in this account until a death benefit is paid. The death benefit represents a combination of the policy account balance and the CSR based on the contractual terms. The cost of insurance is recalculated periodically based on actual experience of the insured class. Annually, the CSR is reviewed and an experience credit may be issued back to the policyholder if the experience has been favorable. The balance in the CSR will be reviewed annually and to the extent the balance is greater than the forecasted or expected amount, an experience refund would get credited to the entity's policy account balance. An entity's CSR will generally be realized through the collection of death benefits or an experience refund that gets credited to the policyholder's policy account balance or upon surrender of the group policy. A CSR is included in a policy as a mechanism for the policyholder and the insurance company to share in the mortality risk, which in this case is the risk that the deaths will occur sooner than originally expected. Absent a CSR, the policyholder's net cost of insurance would typically be higher than in a policy without a CSR. The CSR is sometimes referred to as a "mortality reserve" or a "mortality retention reserve."

Deferred Acquisition Costs (DAC) Tax—Section 848 of the Internal Revenue Code requires insurance companies to capitalize certain policy acquisition costs and defer deducting them in determining the insurer's tax liability. These costs are known as the DAC tax and are based on a percentage of the premium received as specified by the Internal Revenue Code.~~, and~~ The initial DAC tax is deducted from a policyholder's policy account balance when the premium is paid. The DAC tax is credited back to the policyholder's policy account balance as the tax deduction is recognized in the insurer's tax return.

Insurance Policy—The legal agreement between the policyholder and the insurance company that states the terms of the arrangement. The term *insurance policy* includes all riders, attachments, side agreements, and other related documents that are either directly or indirectly part of the contractual arrangement.

Policy Account Balance—At any point in time, this is the amount held by the insurance company on behalf of the policyholder. This balance may be held in a general account, a separate account (a legally segregated account), or a combination of both on the insurance company's balance sheet. This account includes premiums received from the policyholder, plus any credited income, less any relevant charges (acquisition costs, cost of insurance, and so forth).

Surrender Charge—A contractual fee imposed by the insurance company when a policyholder surrenders the insurance policy that typically decreases over the life of the policy. The surrender charge represents a recovery of costs incurred by the insurance company in originating the policy. It may or may not be explicitly called a surrender charge and can be embedded in other agreements besides the insurance contract.

Issue No. 06-6

Title: Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments

Dates Discussed: June 15, 2006; September 7, 2006

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

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

APB Opinion No. 26, *Early Extinguishment of Debt*

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

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. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"

Introduction

1. Issue 05-7 addresses (a) whether the change in the fair value of an embedded conversion option that results from a modification of a convertible debt instrument should be included in the analysis of whether there has been a substantial change in the terms of a debt instrument to determine if a debt extinguishment has occurred pursuant to Issue 96-19 and (b) how an issuer should account for modifications that do not result in a debt extinguishment pursuant to Issue 96-19. At the September 15, 2005 EITF meeting, the Task Force reached the following consensus on Issue 05-7:

Issue 1— An entity should include, upon the modification of a convertible debt instrument, the change in fair value of the related embedded conversion option as a current period cash flow in the analysis to determine whether a debt instrument has been extinguished pursuant to Issue 96-19.

Issue 2— The modification of a convertible debt instrument should affect subsequent recognition of interest expense for the associated debt instrument for changes in the fair value of the embedded conversion option.

Issue 3— The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification of a convertible debt instrument.

2. At the March 16, 2006 EITF meeting, the Task Force agreed to clarify the scope of Issues 05-7 and 96-19 by adding a paragraph to the abstract of each Issue that clarifies that the consensus in Issue 05-7 also applies to a modification of a debt instrument that either adds or

eliminates an embedded conversion option that is not bifurcated from its host contract pursuant to Statement 133. The Task Force also agreed that the scope of Issue 05-7 does not include the modification of debt instruments that either adds or eliminates an embedded conversion option that is required to be bifurcated by the issuer from the host contract pursuant to Statement 133 because the Task Force did not discuss those circumstances in its deliberations on Issue 05-7.

3. Subsequent to the consensus in Issue 05-7, a number of practice issues were raised that were not specifically discussed by the Task Force in its original deliberations of that Issue. As a result, the Task Force was asked to consider the redeliberation of Issue 05-7.

Issues

4. The issues are:

Issue 1— How a modification of a debt instrument (or an exchange of debt instruments) that affects the terms of an embedded conversion option should be considered in the issuer's analysis of whether debt extinguishment accounting should be applied.

Issue 2— Accounting for a modification of a debt instrument (or an exchange of debt instruments) that affects the terms of an embedded conversion option when extinguishment accounting is not applied.

Scope

5. This Issue applies to modifications and exchanges of debt instruments that (a) either add or eliminate an embedded conversion option or (b) affect the fair value of an existing embedded conversion option. The scope of this Issue does not address modifications or exchanges of debt instruments in circumstances in which the embedded conversion option is separately accounted for as a derivative under Statement 133 prior to the modification, subsequent to the modification, or both prior to and subsequent to the modification.

Prior EITF Discussion

6. The original issues brought to the Task Force at the June 15, 2006 EITF meeting were as follows:

Issue 1— Whether the modification of a convertible debt instrument that changes the fair value of an embedded conversion option affects subsequent recognition of interest expense for the associated debt instrument when the modification does not result in a debt extinguishment pursuant to Issue 96-19.

Issue 2— Whether an issuer should recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification if the debt does not result in an extinguishment under Issue 96-19, the conversion option is in-the-money, and the intrinsic value of the conversion option has increased.

7. At the June 15, 2006 EITF meeting, the Task Force discussed this Issue but was not asked to reach any conclusions. Some Task Force members reaffirmed their support for the original consensus on Issue 05-7, while others acknowledged their concern that the current application of

Issue 2 of Issue 05-7 allows entities to reduce the value of (or eliminate) a conversion option by providing the debt holder with equal consideration resulting in no subsequent impact on interest expense (since the change in the fair value of the embedded conversion option offsets the change in the present value of the cash flows under the terms of the new debt instrument).

8. Task Force members also discussed the consensus on Issue 1 of Issue 05-7. The Task Force observed that under the current consensus, when a change in the fair value of a conversion option is given in exchange for other consideration (including consideration in the form of changes to the debt instrument), few extinguishments result because the change in the fair value of the conversion option is offset by other changes in cash flows and, accordingly, a substantial modification does not occur under Issue 96-19. Some Task Force members believe that when a debt instrument is modified to add (or eliminate) a conversion option, contrary to the existing guidance in Issue 96-19 (as amended by Issue 05-7), a substantial modification occurs, which should result in extinguishment accounting for the existing debt instrument.

9. The Task Force discussed alternative methods for determining whether a substantial modification has occurred including (a) assessing each change individually, (b) assessing the changes in the equity and non-equity components separately, or (c) assessing the combined total change in value.

10. The Task Force requested that the FASB staff further explore alternative methods of determining whether a substantial modification has occurred under Issue 96-19 (as amended by Issue 05-7). The Task Force also agreed that the existing consensus in Issue 05-7 remains in effect until additional guidance is provided.

Current EITF Discussion

11. At the September 7, 2006 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that the change in the fair value of an embedded conversion option resulting from an exchange of debt instruments or a modification in the terms of an existing debt instrument should not be included in the cash flow test of whether the terms of the new debt instrument are *substantially different* from the terms of the original debt instrument under Issue 96-19. However, a separate analysis must be performed if the cash flow test under Issue 96-19 does not result in a conclusion that a substantial modification or exchange has occurred. Under that separate analysis, a substantial modification or exchange has occurred and the issuer should apply extinguishment accounting if the change in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) is at least 10 percent of the carrying amount of the original debt instrument immediately prior to the modification or exchange. Additionally, a modification or an exchange of debt instruments that adds a substantive conversion option or eliminates a conversion option that was substantive at the date of the modification or exchange would always be considered *substantial* and debt extinguishment accounting would be required in those circumstances. The Task Force decided that for purposes of evaluating whether an embedded conversion option was substantive on the date it was added to or eliminated from a debt instrument, the factors described in paragraphs 7–9 of Issue 05-1 should be considered.

12. In reaching its tentative conclusion, the Task Force observed that a modification or an exchange of debt instruments may change the fair value of an embedded conversion option with a substantially offsetting change in the present value of the instrument's cash flows. In those circumstances, extinguishment accounting might not result if the change in the fair value of an embedded conversion option were treated as a current period cash flow under Issue 96-19, even though the overall changes to the terms of the instrument may appear to embody a substantial modification because (a) the revised cash flows of the instrument are significantly different from the original cash flows as a result of the modification and/or (b) the overall risk profile of the instrument has been significantly altered due to the shift in value between its debt and equity components. Accordingly, the Task Force concluded that the two-step analysis required by this tentative conclusion is appropriate when evaluating whether a modification or an exchange that affects the terms of an embedded conversion option should be accounted for as a debt extinguishment.

13. The Task Force also reached a tentative conclusion on Issue 2 that when a convertible debt instrument is modified or exchanged in a transaction that is not accounted for as an extinguishment, an *increase* in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) should reduce the carrying amount of the debt instrument (increasing a debt discount or reducing a debt premium) with a corresponding increase in additional paid-in capital. However, a *decrease* in the fair value of an embedded conversion option resulting from a modification or an exchange should not be recognized. The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon a modification or exchange of convertible debt instruments in a transaction that is not accounted for as an extinguishment. In reaching its tentative conclusion that an increase in the fair value of an embedded conversion option should reduce the carrying amount of the debt with a corresponding increase in additional paid-in capital, the Task Force observed that this treatment is not inconsistent with Opinion 14 because Opinion 14 only pertains to the accounting at issuance for convertible debt instruments and does not address the accounting for modifications to convertible debt instruments.

14. If these tentative conclusions are affirmed as a consensus at a future EITF meeting and ratified by the Board, the guidance in Issue 05-7 would be nullified and Issue 96-19 would be amended to (a) eliminate the guidance that was previously added as a result of Issue 05-7 and (b) include the guidance in this Issue in determining whether an entity has a substantial modification. However, the existing consensus in Issue 05-7 continues to apply until such time as it is superseded by a consensus on this Issue at a future meeting that is subsequently ratified by the Board.

Transition

15. The Task Force reached a tentative conclusion that this Issue should be applied to modifications or exchanges of debt instruments beginning in the first interim or annual reporting period after Board ratification. Earlier application of this Issue is permitted for modifications or exchanges of debt instruments in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.

Board Ratification

16. At the September 20, 2006 Board meeting, the Board ratified the tentative conclusions reached by the Task Force on this Issue and approved the issuance of a draft abstract for a public comment period. A draft abstract is included as Appendix 06-6A. A draft of amendments to Issue 96-19 is included in Appendix 06-6B.

Status

17. The draft abstract will be posted to the FASB website after September 25, 2006. Comments on the draft abstract are due by October 13, 2006. Further discussion is expected at a future meeting.

Appendix 06-6A

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

Issue No. 06-6

Title: Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments

Dates Discussed: June 15, 2006; September 7, 2006; [November 15–16, 2006]

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

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

APB Opinion No. 26, *Early Extinguishment of Debt*

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

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. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"

ISSUE

1. Issue 05-7 addresses (a) whether a change in the fair value of an embedded conversion option that results from a modification of a convertible debt instrument should be included in the analysis of whether there has been a substantial change in the terms of a debt instrument to determine if a debt extinguishment has occurred pursuant to Issue 96-19, and (b) how an issuer should account for modifications that do not result in a debt extinguishment pursuant to Issue 96-19. At the September 15, 2005 EITF meeting, the Task Force reached the following consensus on Issue 05-7:

Issue 1— An entity should include, upon the modification of a convertible debt instrument, the change in fair value of the related embedded conversion option as a current-period cash flow in the analysis to determine whether a debt instrument has been extinguished pursuant to Issue 96-19.

Issue 2— The modification of a convertible debt instrument should affect subsequent recognition of interest expense for the associated debt instrument for changes in the fair value of the embedded conversion option.

[1] **This draft abstract is being exposed for a public comment period that will end on October 13, 2006.**

Issue 3— The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification of a convertible debt instrument.

2. At the March 16, 2006 EITF meeting, the Task Force agreed to clarify the scopes of Issues 05-7 and 96-19 by adding a paragraph to the abstract of each Issue that clarifies that the consensus in Issue 05-7 also applies to a modification of a debt instrument that either adds or eliminates an embedded conversion option that is not bifurcated from its host contract pursuant to Statement 133. The Task Force also agreed that the scope of Issue 05-7 does not include the modification of debt instruments that either adds or eliminates an embedded conversion option that is required to be bifurcated by the issuer from the host contract pursuant to Statement 133 because the Task Force did not discuss those circumstances in its deliberations on Issue 05-7.

3. Subsequent to the consensus in Issue 05-7, a number of practice issues were raised that were not specifically discussed by the Task Force in its original deliberations of that Issue. As a result, the Task Force was asked to consider the redeliberation of Issue 05-7.

4. The issues are:

Issue 1— How a modification of a debt instrument (or an exchange of debt instruments) that affects the terms of an embedded conversion option should be considered in the issuer's analysis of whether debt extinguishment accounting should be applied

Issue 2— Accounting for a modification of a debt instrument (or an exchange of debt instruments) that affects the terms of an embedded conversion option when extinguishment accounting is not applied.

Scope

5. This Issue applies to modifications and exchanges of debt instruments that (a) either add or eliminate an embedded conversion option or (b) affect the fair value of an existing embedded conversion option. The scope of this Issue does not address modifications or exchanges of debt instruments in circumstances in which the embedded conversion option is separately accounted for as a derivative under Statement 133 prior to the modification, subsequent to the modification, or both prior to and subsequent to the modification.

EITF DISCUSSION

6. The Task Force reached a [consensus] on Issue 1 that the change in the fair value of an embedded conversion option resulting from an exchange of debt instruments or a modification in the terms of an existing debt instrument should not be included in the cash flow test of whether the terms of the new debt instrument are *substantially different* from the terms of the original debt instrument under Issue 96-19. However, a separate analysis must be performed if the cash flow test under Issue 96-19 does not result in a conclusion that a substantial modification or an exchange has occurred. Under that separate analysis, a substantial modification or an exchange has occurred and the issuer should apply extinguishment accounting if the change in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) is at least 10 percent of the carrying value of the original debt instrument immediately prior to the

modification or exchange. Additionally, a modification or an exchange of debt instruments that adds a substantive conversion option or eliminates a conversion option that was substantive at the date of the modification or exchange would always be considered *substantial*, and debt extinguishment accounting would be required in those circumstances. The Task Force decided that for purposes of evaluating whether an embedded conversion option was substantive on the date it was added to or eliminated from a debt instrument, the factors described in paragraphs 7–9 of Issue 05-1 should be considered.

7. The Task Force reached a [consensus] on Issue 2 that when a convertible debt instrument is modified or exchanged in a transaction that is not accounted for as an extinguishment, an *increase* in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) should reduce the carrying amount of the debt instrument (increasing a debt discount or reducing a debt premium) with a corresponding increase in additional paid-in capital. However, a *decrease* in the fair value of an embedded conversion option resulting from a modification or an exchange should not be recognized. The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon a modification or exchange of convertible debt instruments in a transaction that is not accounted for as an extinguishment.

8. The guidance in Issue 05-7 is [superseded] by the consensus in this Issue. The Task Force agreed to amend Issue 96-19 to replace the guidance from Issue 05-7 with the guidance from this Issue.

Transition

9. The [consensus] in this Issue should be applied to modifications or exchanges of debt instruments beginning in the first interim or annual reporting period after Board ratification [(November XX, 2006)]. Earlier application of this Issue is permitted for modifications or exchanges of debt instruments in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.

Board Ratification

10. At its [November XX, 2006] meeting, the Board ratified the [consensus] reached by the Task Force on this Issue.

STATUS

11. No further EITF discussion is planned.

Appendix 06-6B

EITF ABSTRACTS (DRAFT[1])

Issue No. 96-19

Title: Debtor's Accounting for a Modification or Exchange of Debt Instruments

Dates Discussed: September 18–19, 1996; November 14, 1996; January 23, 1997; March 13, 1997; May 21–22, 1997; July 23–24, 1997; July 23, 1998; September 15, 2005, March 16, 2006; September 7, 2006; [November 15–26, 2006]

References: FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*

FASB Statement No 76, *Extinguishment of Debt*

FASB Statement No. 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*

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

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

FASB Statement No. 145, *Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections*

APB Opinion No. 26, *Early Extinguishment of Debt*

APB Opinion No. 30, *Reporting the Results of Operations-Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*

SEC Staff Accounting Bulletin No. 94, *Recognition of a Gain or Loss on Early Extinguishment of Debt*

ISSUE

Issue No. 86-18, "Debtor's Accounting for a Modification of Debt Terms," addresses circumstances under which existing debt should be considered extinguished, resulting in recognition by the debtor of an extraordinary gain or loss. [Note: See STATUS section.] In that Issue, the Task Force reached a consensus that an exchange of a new noncallable debt instrument for an older callable debt instrument should be accounted for as an extinguishment by the debtor. Many Task Force members agreed that substantive modifications of debt (that is, modifications to principal, interest rate, maturity, or call provisions) should be accounted for as the extinguishment of that debt and the creation of new debt, although no consensus was reached on

[1] **This draft abstract is being exposed for a public comment period that will end on October 13, 2006.**

that issue. Other Task Force members said that extinguishment accounting should be applied only to those debt instruments meeting the conditions for extinguishment under Statement 76.

Statement 125, which superseded Statement 76 on January 1, 1997, limits derecognition of a liability to extinguishments. It limits extinguishments to situations in which the debtor pays the creditor and is relieved of its obligation or is legally released as the primary obligor either judicially or by the creditor.

The issues are:

1. How a debtor should account for an exchange of debt instruments with substantially different terms
2. How a debtor should account for a substantial modification in the terms of an existing debt agreement (other than a troubled debt restructuring)
3. If a gain or loss is recognized from an exchange or modification, whether the gain or loss should be classified as extraordinary.

EITF DISCUSSION

The Task Force reached a consensus that an exchange of debt instruments with substantially different terms is a debt extinguishment and should be accounted for in accordance with paragraph 16 of Statement 125. The Task Force observed that a debtor could achieve the same economic effect by making a substantial modification of terms of an existing debt instrument. Accordingly, the Task Force reached a consensus that a substantial modification of terms should be accounted for like, and reported in the same manner as, an extinguishment.

The Task Force also reached the following consensuses regarding (1) when an exchange or modification is considered *substantial*, (2) how to account for fees paid or received by a debtor and costs incurred by a debtor with third parties as part of an exchange or modification, and (3) the impact of the consensuses reached in this Issue on other related EITF Issues.

From the debtor's perspective, an exchange of debt instruments between or a modification of a debt instrument by a debtor and a creditor in a nontroubled debt situation is deemed to have been accomplished with debt instruments that are *substantially different* if any of the following three conditions are met:

1. ~~t~~The present value of the cash flows ~~(including changes in the fair value of an embedded conversion option[1] upon modification of a convertible debt instrument)~~ under the terms of the new debt instrument is at least *10 percent* different from the present value of the remaining cash flows under the terms of the original instrument.

> For purposes of determining the change in the present value of cash flows, the Task Force observed that cash flows can be affected by changes in principal amounts, interest rates,

[1] ~~The change in the fair value of an embedded conversion option is calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification. [Note: See STATUS section.]~~

or maturity. They can also be affected by fees exchanged between the debtor and creditor to effect changes in:

- Recourse or nonrecourse features
- Priority of the obligation
- Collateralized (including changes in collateral) or noncollateralized features
- Debt covenants and/or waivers
- The guarantor (or elimination of the guarantor)
- Option features.

If the terms of a debt instrument are changed or modified in any of the ways described above and the cash flow effect on a present value basis is less than 10 percent, the debt instruments are *not* considered to be *substantially different*, except as discussed in the following paragraphs.

2. A modification or an exchange that affects the terms of an embedded conversion option, where the change in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) is at least 10 percent of the carrying value of the original debt instrument immediately prior to the modification or exchange.

3. A modification or an exchange of debt instruments that adds a substantive conversion option or eliminates a conversion option that was substantive at the date of the modification or exchange.[2]

With respect to the second and third condition, this guidance does not address modifications or exchanges of debt instruments in circumstances in which the embedded conversion option is separately accounted for as a derivative under Statement 133 prior to the modification, subsequent to the modification, or both prior and subsequent to the modification. [Note: See STATUS Section]

The following guidance is to be used to calculate the present value of the cash flows for purposes of applying the 10 percent cash flow test.

1. The cash flows of the new debt instrument include all cash flows specified by the terms of the new debt instrument plus any amounts paid by the debtor to the creditor less any amounts received by the debtor from the creditor as part of the exchange or modification.
2. If the original debt instrument and/or the new debt instrument has a floating interest rate, then the variable rate in effect at the date of the exchange or modification is to be used to calculate the cash flows of the variable-rate instrument.
3. If either the new debt instrument or the original debt instrument is callable or puttable, then separate cash flow analyses are to be performed assuming exercise and nonexercise of the

[2] For purposes of evaluating whether an embedded conversion option was substantive on the date it was added to or eliminated from a debt instrument, the factors described in paragraphs 7-9 of Issue No. 05-1 "Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option," should be considered.

call or put. The cash flow assumptions that generate the smaller change would be the basis for determining whether the 10 percent threshold is met.

4. If the debt instruments contain contingent payment terms or unusual interest rate terms, judgment should be used to determine the appropriate cash flows.

~~5. If the debt instrument contains an embedded conversion option, the change in the fair value of the embedded conversion option that results from a modification of the debt instrument, should be included in a manner that is similar to the manner in which a current period cash flow would be included. [Note: See STATUS section.]~~

5~~6~~. The discount rate to be used to calculate the present value of the cash flows is the effective interest rate, for accounting purposes, of the original debt instrument.

6~~7~~. If within a year of the current transaction the debt has been exchanged or modified without being deemed to be substantially different, then the debt terms that existed a year ago should be used to determine whether the current exchange or modification is substantially different.

If it is determined that the original and new debt instruments are *substantially different*, then the calculation of the cash flows related to the new debt instrument at the effective interest rate of the original debt instrument is *not* used to determine the initial amount recorded for the new debt instrument or to determine the debt extinguishment gain or loss to be recognized. The new debt instrument should be initially recorded at fair value, and that amount should be used to determine the debt extinguishment gain or loss to be recognized and the effective rate of the new instrument.

If it is determined that the original and new debt instruments are *not* substantially different, then a new effective interest rate is to be determined based on the carrying amount of the original debt instrument, adjusted for an increase (but not a decrease) in the fair value of an embedded conversion option resulting from the modification, and the revised cash flows~~ including any change in the fair value of an embedded conversion option~~.

Fees paid by the debtor to the creditor or received by the debtor from the creditor (fees may be received by the debtor from the creditor to cancel a call option held by the debtor or to extend a no-call period) as part of the exchange or modification are to be accounted for as follows:

- If the exchange or modification is to be accounted for in the same manner as a debt extinguishment [Note: See STATUS section.] and the new debt instrument is initially recorded at fair value, then the fees paid or received are to be associated with the extinguishment of the old debt instrument and included in determining the debt extinguishment gain or loss to be recognized.

- If the exchange or modification is not to be accounted for in the same manner as a debt extinguishment, then the fees are to be associated with the replacement or modified debt instrument and, along with any existing unamortized premium or discount, amortized as an adjustment of interest expense over the remaining term of the replacement or modified debt instrument using the interest method.

Costs incurred with third parties directly related to the exchange or modification (such as legal fees) are to be accounted for as follows:

- If the exchange or modification is to be accounted for in the same manner as a debt extinguishment [Note: See STATUS section.] and the new debt instrument is initially recorded at fair value, then the costs are to be associated with the new debt instrument and amortized over the term of the new debt instrument using the interest method in a manner similar to debt issue costs.

- If the exchange or modification is not to be accounted for in the same manner as a debt extinguishment, then the costs should be expensed as incurred.

The consensus in Issue No. 95-15, "Recognition of Gain or Loss When a Binding Contract Requires a Debt Extinguishment to Occur at a Future Date for a Specified Amount," is superseded by the consensus in this Issue. The transaction described in Issue 95-15 deals with when a debtor enters into a binding contract with a holder of its debt obligation to redeem the debt security at a future date for a specified amount greater than (or less than) the debtor's carrying amount of the debt for financial reporting purposes. The future date of the exchange specified in the contract will occur within one year of the date that the contract becomes binding to the parties. The debtor's accounting for this transaction is to be accounted for based on the consensus in this Issue.

The guidance in Issue 86-18 for the transaction described below is not affected by the consensus reached in this Issue. In the context of its deliberations on Issue 86-18, the Task Force discussed a specific transaction in which a borrower, instead of acquiring debt securities directly, loans funds to a third party, who in turn acquires the borrower's original debt securities. The borrower and third party agree that they may settle their respective receivables and obligations by right of setoff as payments become due, contingent upon the third party's continued retention of the borrower's original debt. The Task Force reached a consensus in Issue 86-18 that the borrower should not account for the original debt securities as extinguished and that those securities should not be offset against the receivable from the third party in the borrower's financial statements.

Implementation Guidelines

The Task Force reached a consensus that:

1. The exchange of cash by the debtor or the debtor's agent to acquire or settle debt is an extinguishment of debt under paragraph 16 of Statement 125. Therefore, such transactions involving the exchange of cash between a debtor and a creditor or creditors are not covered by the scope of this Issue. However, transactions involving contemporaneous exchanges of cash between the same debtor and creditor in connection with the issuance of a new debt obligation and satisfaction of an existing debt obligation by the debtor would only be accounted for as debt extinguishments if the debt instruments have substantially different terms, as defined in this Issue.

2. In transactions involving a third-party intermediary acting as agent on behalf of a debtor, the actions of the intermediary should be viewed as those of the debtor in order to determine whether there has been an exchange of debt instruments or a modification of terms between a debtor and a creditor. Stated another way, when a third-party intermediary acts as agent, the analysis should "look through" the intermediary.

3. In transactions involving a third-party intermediary acting as principal, the intermediary should be viewed as a third-party creditor similar to any other creditor in order to determine whether there has been an exchange of debt instruments or a modification of terms between a debtor and a creditor. Stated another way, when a third-party intermediary acts as principal, the analysis should not "look through" the intermediary.

4. Transactions among debt holders do not result in a modification of the original debt's terms or an exchange of debt instruments between the debtor and the debt holders and do not impact the accounting by the debtor.

5. Transactions between a debtor and a third-party creditor should be analyzed based on the guidance in paragraph 16 of Statement 125 and the consensus in this Issue to determine whether gain or loss recognition is appropriate. Transactions entered into between a debtor or a debtor's agent and a third party that is not the creditor are not included in the scope of this Issue.

The Task Force noted that application of those guidelines may require determination of whether a third-party intermediary is an agent or a principal and that consideration of legal definitions may be helpful in making that determination. The Task Force noted that, generally, an agent acts for and on behalf of another party. Therefore, a third-party intermediary is an agent of a debtor if it acts on behalf of the debtor. In addition, the Task Force noted that an evaluation of the facts and circumstances surrounding the involvement of the third-party intermediary should be performed. The Task Force observed that the following indicators should be considered in that evaluation:

1. If the intermediary's role is restricted to placing or reacquiring debt for the debtor without placing its own funds at risk, that would indicate that the intermediary is an agent. For example, that may be the case if the intermediary's own funds are committed and those funds are not truly at risk because the intermediary is made whole by the debtor (and therefore is indemnified against loss by the debtor). If the intermediary places and reacquires debt for the debtor by committing its funds and is subject to the risk of loss of those funds, that would indicate that the intermediary is acting as principal.

2. In an arrangement where an intermediary places notes issued by the debtor, if the placement is done under a best-efforts agreement, that would indicate that the intermediary is acting as agent. Under a best-efforts agreement, an agent agrees to buy only those securities that it is able to sell to others; if the agent is unable to remarket the debt, the issuer is obligated to pay off the debt. The intermediary may be acting as principal if the placement is done on a firmly committed basis, which requires the intermediary to hold any debt that it is unable to sell to others.

3. If the debtor directs the intermediary and the intermediary cannot independently initiate an exchange or modification of the debt instrument, that would indicate that the intermediary is an agent. The intermediary may be a principal if it acquires debt from or exchanges debt with another debt holder in the market and is subject to loss as a result of the transaction.

4. If the only compensation derived by an intermediary from its arrangement with the debtor is limited to a preestablished fee, that would indicate that the intermediary is an agent. If the intermediary derives gains based on the value of the security issued by the debtor, that would indicate that the intermediary is a principal.

The Task Force reached a consensus that transactions involving the modification or exchange of debt instruments can only result in gain or loss recognition by the debtor if the conditions for extinguishment of debt described in paragraph 16 of Statement 125 are satisfied or if the consensus in this Issue requires that accounting. Accordingly, the guidance in Issue No. 87-20, "Offsetting Certificates of Deposit against High-Coupon Debt," related to loss recognition is superseded by the consensus in this Issue. The general principles outlined above would apply to the transaction described in Issue 87-20.

The examples in Exhibit 96-19A illustrate the application of the above implementation guidelines.

STATUS

Statement 140 was issued in September 2000 and superseded Statement 125. Statement 140 does not change the guidance dealing with accounting for extinguishments of liabilities.

Statement 145, issued in April 2002, supersedes Statement 4. Statement 4 required that all gains and losses from extinguishment of debt be classified as extraordinary items. Statement 145 removes the extraordinary item classification requirement but does not preclude gains and losses from extinguishment of debt that meet the criteria in Opinion 30 from being classified as extraordinary items.

~~Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," which was discussed at the September 15, 2005 meeting, amends this Issue to include the change in the fair value of an embedded conversion option resulting from the modification of a convertible debt instrument in the analysis of whether there has been a substantial change in the terms of a convertible debt instrument to determine if a debt extinguishment has occurred. In addition, Issue 05-7 requires the change in the fair value of the embedded conversion option that results from a modification of the convertible debt instrument (that does not result in an extinguishment), to be accounted for as an additional debt discount or premium (similar to other fees paid to creditors) resulting in an effect on the subsequent recognition of interest expense for the associated debt instrument. At its meeting on September 28, 2005, the Board ratified the consensus modifications reached by the Task Force in this Issue.~~

~~At the March 16, 2006 meeting, the Task Force agreed to clarify that the consensus in Issue 05-7 also applies to a modification of a debt instrument that either adds or eliminates an embedded conversion option that is not bifurcated from its host contract pursuant to Statement 133. The Task Force also agreed that the scope of Issue 05-7 does not include the modification of debt instruments that either add or eliminate an embedded conversion option that is required to be bifurcated by the issuer from the host contract pursuant to Statement 133 because the Task Force did not discuss those circumstances in its deliberations on Issue 05-7.~~

Issue No. 06-6, "Debtor's Accounting for a Modification (or Exchange) of Convertible Debt Instruments," which was discussed at the September 7, 2006 meeting, supersedes Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," and amends the guidance in this Issue to clarify that the change in the fair value of an embedded conversion option resulting from a modification in the terms of an existing debt instrument or an exchange of debt instruments should not be included in the cash flow test of whether the terms of the new debt instrument are substantially different from the terms of the original debt instrument under Issue 96-19. However, a separate analysis must be performed if the cash flow test under Issue 96-19 does not result in a conclusion that a substantial modification or an exchange has occurred. Under that separate analysis, a substantial modification or an exchange has occurred, and the issuer should apply extinguishment accounting if the change in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) is at least 10 percent of the carrying value of the original debt instrument immediately prior to the modification or exchange. Additionally, a modification or an exchange of debt instruments that adds a substantive conversion option or eliminates a conversion option that was substantive at the date of the modification or exchange would always be considered substantial, and debt extinguishment accounting would be required in those circumstances. In addition, Issue 06-6 requires that when a convertible debt instrument is modified or exchanged in a transaction that is not accounted for as an extinguishment, an increase in the fair value of the embedded conversion option (calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification or exchange) should reduce the carrying amount of the debt instrument (increasing a debt discount or reducing a debt premium) with a corresponding increase in additional paid-in capital. However, a decrease in the fair value of an embedded conversion option resulting from a modification or an exchange should not be recognized. At its meeting on [November XX, 2006], the Board ratified this amendment.

No further EITF discussion is planned.

Issue No. 06-7

Title: 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, *Accounting for Derivative Instruments and Hedging Activities*

Date Discussed: September 7, 2006

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

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

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

Statement 133 Implementation Issue No. K5, "Miscellaneous: Transition Provisions for Applying the Guidance in Statement 133 Implementation Issues"

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

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

EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"

Introduction

1. An entity may issue convertible debt with an embedded conversion option that is required to be bifurcated under Statement 133 if all of the conditions of paragraph 12 in that Statement are met. An embedded conversion option that initially requires separate accounting as a derivative under Statement 133 may subsequently no longer meet the conditions that would require separate accounting as a derivative. A reassessment of whether an embedded conversion option must be bifurcated under Statement 133 is required each reporting period. When an entity is no longer required to bifurcate a conversion option pursuant to Statement 133, there are differing views on how an entity should recognize that change.

Issue

2. The issue is how an issuer should account for a previously bifurcated conversion option in a convertible debt instrument if that conversion option no longer meets the bifurcation criteria in Statement 133.

Current EITF Discussion

3. At the September 7, 2006 EITF meeting, the Task Force reached a tentative conclusion that an issuer should account for a previously bifurcated conversion option in a convertible debt instrument if the embedded conversion option no longer meets the bifurcation criteria in Statement 133 by reclassifying the carrying value of the liability for the conversion option (that is, its fair value on the date of reclassification) to shareholders' equity. Any debt discount

recognized when the conversion option was bifurcated from the convertible debt instrument should continue to be amortized.

4. The Task Force observed that when an embedded conversion option is no longer required to be bifurcated under Statement 133, an entity should continue to recognize the issuer's economic borrowing costs related to a convertible debt instrument by requiring continued recognition of the proportion of the borrowing costs related to the debt discount recorded at issuance. The Task Force discussed whether this consensus is inconsistent with Opinion 14 (which generally does not permit separate recognition of an embedded conversion option). The Task Force did not believe that the consensus on this Issue was inconsistent with Opinion 14 because the initial bifurcation was required pursuant to Statement 133. The Task Force believes that Opinion 14 only addresses the accounting at issuance for convertible debt instruments and does not address accounting for changes to convertible debt instruments subsequent to issuance. The Task Force also observed that the guidance in DIG Issue K5 does not apply to this Issue since it is specifically intended to address situations in which an embedded derivative is not required to be accounted for separately under Statement 133 as a result of newly issued Statement 133 implementation guidance.

Disclosure

5. At the September 7, 2006 EITF meeting, the Task Force reached a tentative conclusion that an issuer shall disclose the following information when an embedded conversion option previously accounted for as a derivative under Statement 133 no longer meets the bifurcation criteria under that standard:

a. A description of the principal changes causing the embedded conversion option to no longer require bifurcation under Statement 133
b. The amount of the liability for the conversion option reclassified to stockholders' equity.

Transition

6. At the September 7, 2006 EITF meeting, the Task Force reached a tentative conclusion that this Issue should be applied to all previously bifurcated conversion options in convertible debt instruments that no longer meet the bifurcation criteria in Statement 133 in interim or annual periods beginning after December 15, 2006, regardless of whether the debt instrument was entered into prior or subsequent to the effective date of this Issue. Earlier application of this Issue is permitted in periods for which financial statements have not yet been issued. Retrospective application pursuant to Statement 154 to previously issued financial statements is permitted.

Board Ratification

7. At its September 20, 2006 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 06-7A.

Status

8. The draft abstract will be posted to the FASB website after September 25, 2006. Comments on the draft abstract are due by October 13, 2006. Further discussion is expected at a future meeting.

Appendix 06-7A

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

Issue No. 06-7

Title: 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

Dates Discussed: September 7, 2006; [November 15–16, 2006]

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

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

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

Statement 133 Implementation Issue No. K5, "Miscellaneous: Transition Provisions for Applying the Guidance in Statement 133 Implementation Issues"

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

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

EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"

ISSUE

1. An entity may issue convertible debt with an embedded conversion option that is required to be bifurcated under Statement 133 if all of the conditions in paragraph 12 of that Statement are met. An embedded conversion option that initially requires separate accounting as a derivative under Statement 133 may subsequently no longer meet the conditions that would require separate accounting as a derivative. A reassessment of whether an embedded conversion option must be bifurcated under Statement 133 is required each reporting period. When an entity is no longer required to bifurcate a conversion option pursuant to Statement 133, there are differing views on how an entity should recognize that change.

2. The issue is how an issuer should account for a previously bifurcated conversion option in a convertible debt instrument if that conversion option no longer meets the bifurcation criteria in Statement 133.

[1] **This draft abstract is being exposed for a public comment period that will end on October 13, 2006.**

EITF DISCUSSION

3. The Task Force reached a [consensus] that an issuer should account for a previously bifurcated conversion option in a convertible debt instrument if the embedded conversion option no longer meets the bifurcation criteria in Statement 133 by reclassifying the carrying value of the liability for the conversion option (that is, its fair value on the date of reclassification) to shareholders' equity. Any debt discount recognized when the conversion option was bifurcated from the convertible debt instrument should continue to be amortized. The Task Force discussed whether this consensus is inconsistent with Opinion 14 (which generally does not permit separate recognition of an embedded conversion option). The Task Force did not believe that the consensus on this Issue was inconsistent with Opinion 14 because the initial bifurcation was required pursuant to Statement 133. The Task Force believes that Opinion 14 only addresses the accounting at issuance for convertible debt instruments and does not address accounting for changes to convertible debt instruments subsequent to issuance. The Task Force also observed that the guidance in DIG Issue K5 does not apply to this Issue since it is specifically intended to address situations in which an embedded derivative is not required to be accounted for separately under Statement 133 as a result of newly issued Statement 133 implementation guidance.

Disclosure

4. The Task Force also reached a [consensus] that an issuer shall disclose the following information when an embedded conversion option previously accounted for as a derivative under Statement 133 no longer meets the separation criteria under that Statement:

a. A description of the principal changes causing the embedded conversion option to no longer require bifurcation under Statement 133
b. The amount of the liability for the conversion option reclassified to stockholders' equity.

Transition

5. The [consensus] in this Issue should be applied to all previously bifurcated conversion options in convertible debt instruments that no longer meet the bifurcation criteria in Statement 133 in interim or annual periods beginning after December 15, 2006, irrespective of whether the debt instrument was entered into prior or subsequent to the effective date of this Issue. Earlier application of this Issue is permitted in periods for which financial statements have not yet been issued. Retrospective application pursuant to Statement 154 to previously issued financial statements is permitted.

Board Ratification

6. At its [November 29, 2006] meeting, the Board ratified the [consensus] reached by the Task Force on this Issue.

STATUS

7. No further EITF discussion is planned.

Issue No. 06-8

Title: Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66, *Accounting for Sales of Real Estate,* for Sales of Condominiums

Date Discussed: September 7, 2006

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

Introduction

1. Paragraph 37 of Statement 66 provides the criteria that must be met to recognize profit under the percentage-of-completion method for individual units in a condominium project that are being sold separately. One criterion is that the sales price is collectible (paragraph 37(d) of Statement 66). To provide guidance on how entities should assess the collectibility of the sales price, paragraph 37(d) of Statement 66 parenthetically references paragraph 4 of Statement 66.

2. Under paragraph 4 of Statement 66, "…collectibility of the sales price is demonstrated by the buyer's commitment to pay, which in turn is supported by substantial initial and continuing investments that give the buyer a stake in the property sufficient that the risk of loss through default motivates the buyer to honor its obligation to the seller." Questions have been raised about whether the continuing investment test in paragraph 12 of Statement 66 should be applied to conclude that the sales price is collectible and to recognize profit under the percentage-of-completion method for sales of individual condominium units.

Issue

3. The issue is whether, in a sale of an individual condominium unit, an entity needs to evaluate the adequacy of the buyer's continuing investment pursuant to paragraph 12 of Statement 66 to recognize profit under the percentage-of-completion method.

Scope

4. The scope of this Issue is limited to the sale of individual units in a condominium project.

Current EITF Discussion

5. At the September 7, 2006 EITF meeting, the Task Force reached a tentative conclusion that in assessing the collectibility of the sales price pursuant to paragraph 37(d) of Statement 66, an entity should evaluate the adequacy of the buyer's initial and continuing investment to conclude that the sales price is collectible. The Task Force agreed that an entity can meet the continuing investment criterion in paragraph 12 of Statement 66 by requiring the buyer to either (a) make additional payments during the construction term at least equal to the level annual payments that would be required to fund principal and interest on a customary mortgage for the remaining purchase price of the property or (b) increase the minimum initial investment by an equivalent aggregate amount. The remaining purchase price should be determined by reference to the sales price of the property. The Task Force believes that the test should be performed using a hypothetical loan between the seller and the buyer. The Task Force ultimately concluded that

because paragraph 12 of Statement 66 refers to the buyer's "debt for the purchase price of the property," using the remaining purchase price would be consistent with Statement 66.

6. Based on the Task Force's tentative conclusion, for transactions within the scope of this Issue, if an entity is unable to meet the criteria in paragraph 37, including an assessment of collectibility using the initial and continuing investment tests described in paragraphs 8–12 of Statement 66, then the entity should apply the deposit method as described in paragraphs 65–67 of Statement 66.

Transition and Disclosure

7. The Task Force reached a tentative conclusion that this Issue should be effective for the first annual reporting period beginning after March 15, 2007. Earlier application is permitted as of the beginning of a fiscal year. The Task Force requested that the FASB staff specifically request input from constituents in the notice for recipients as to whether the effective date and transition provisions are practical.

8. Entities that have not accounted for sales of condominiums in a manner that is consistent with the tentative conclusion on this Issue should recognize the effect of the tentative conclusion on 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 at the beginning of the year of adoption. Further, entities 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.

Board Ratification

9. At its September 20, 2006 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 06-8A.

Status

10. The draft abstract will be posted to the FASB website after September 25, 2006. Comments on the draft abstract are due by October 13, 2006. Further discussion is expected at a future meeting.

Appendix 06-8A

EITF ABSTRACTS (DRAFT[1])

Issue No. 06-8

Title: Applicability of the Assessment of a Buyer's Continuing Investment under FASB Statement No. 66 for Sales of Condominiums

Dates Discussed: September 7, 2006; [November 15–16, 2006]

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

ISSUE

1. Paragraph 37 of Statement 66 provides guidance on what criteria must be met to recognize profit under the percentage-of-completion method for individual units in a condominium project that are being sold separately. One criterion is that the sales price is collectible (paragraph 37(d) of Statement 66). To provide guidance on how entities should assess the collectibility of the sales price, paragraph 37(d) of Statement 66 parenthetically references paragraph 4 of Statement 66.

2. Under paragraph 4 of Statement 66, "…collectibility of the sales price is demonstrated by the buyer's commitment to pay, which in turn is supported by substantial initial and continuing investments that give the buyer a stake in the property sufficient that the risk of loss through default motivates the buyer to honor its obligation to the seller." Questions have been raised about whether the continuing investment test in paragraph 12 of Statement 66 should be applied in order to conclude that the sales price is collectible and to recognize profit under the percentage-of-completion method.

3. The issue is whether an entity needs to evaluate the adequacy of the buyer's continuing investment pursuant to paragraph 12 of Statement 66 to recognize profit under the percentage-of-completion method.

Scope

4. The scope of this Issue is limited to the sale of individual units in a condominium project.

EITF DISCUSSION

5. The Task Force reached a [consensus] that in assessing the collectibility of the sales price pursuant to paragraph 37(d) of Statement 66, an entity should evaluate the adequacy of the buyer's initial and continuing investment to conclude that the sales price is collectible. An entity

[1] **This draft abstract is being exposed for a public comment period that will end on October 13, 2006.**

can meet the continuing investment criterion in paragraph 12 of Statement 66 by requiring the buyer to either (a) make additional payments during the construction term at least equal to the level annual payments that would be required to fund principal and interest on a customary mortgage for the remaining purchase price of the property or (b) increase the minimum initial investment by an equivalent aggregate amount. The remaining purchase price should be determined based on the sales price of the property. The Task Force believes that the test should be performed using a hypothetical loan between the seller and the buyer. The Task Force ultimately concluded that because paragraph 12 of Statement 66 refers to the buyer's "debt for the purchase price of the property," using the remaining purchase price would be consistent with Statement 66.

6. If an entity is unable to meet the criteria in paragraph 37, including an assessment of collectibility using the initial and continuing investment tests described in paragraphs 8–12 of Statement 66, then the entity should apply the deposit method as described in paragraphs 65–67 of Statement 66.

Transition

7. The [consensus] in this Issue is effective for the first annual reporting period beginning after March 15, 2007. Earlier application is permitted as of the beginning of an entity's fiscal year. Entities that have not accounted for sales of condominiums in a manner that is consistent with the [consensus] in this Issue should recognize the effect of 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 at the beginning of the year of adoption. Further, entities 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.

Board Ratification

8. At its [November 29, 2006] meeting, the Board ratified the [consensus] reached by the Task Force in this Issue.

STATUS

9. No further EITF discussion is planned.

Issue No. 06-9

Title: Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee

Date Discussed: September 7, 2006

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

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

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

Introduction

1. To allow for more timely preparation of consolidated financial statements, ARB 51 and Opinion 18 allow an entity to consolidate the results of an entity's operations (or recognize changes in the net assets of an equity method investment) as of, and for a period ending not more than three months prior to the parent's or investor's fiscal year-end. In practice, questions have arisen as to how a parent or investor should recognize a change to the reporting year-end of either a consolidated entity or an equity method investee. That change may include a change in or the elimination of the previously existing difference (lag period) due to the parent's or investor's ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the parent or investor.

Issue

2. The issue is how a parent should recognize the effect of a change to (or the elimination of) an existing difference between the parent's reporting period and the reporting period of a consolidated entity or between the reporting period of an investor and the reporting period of an equity method investee.

Scope

3. The scope of this Issue applies to all entities that change (or eliminate) a previously existing difference between the reporting periods of a parent and a consolidated entity or an investor and an equity method investee. This Issue does not apply in situations in which a parent company changes its fiscal year-end.

Current EITF Discussion

4. At the September 7, 2006 EITF meeting, the Task Force reached a tentative conclusion that a parent or an investor should report a change to (or the elimination of) a previously existing difference between the parent's reporting period and the reporting period of a consolidated entity or between the reporting period of an investor and the reporting period of an equity method investee in the parent's or investor's consolidated financial statements as a change in accounting principle in accordance with the provisions of Statement 154. The Task Force noted that while Statement 154 generally requires voluntary changes in accounting principles to be reported retrospectively, retrospective application is not required if it is impracticable pursuant to

paragraph 11 of Statement 154. In reaching this decision, the Task Force believes that the change or elimination of a lag period represents a change in accounting principle as defined in Statement 154.

Disclosure

5. The Task Force also reached a tentative conclusion that an entity should make the disclosures required pursuant to Statement 154.

Transition

6. The Task Force reached a tentative conclusion that this Issue should be effective for future changes beginning in the first interim or annual reporting periods following Board ratification. Earlier application of this guidance is permitted in periods for which financial statements have not yet been issued.

Board Ratification

7. At its September 20, 2006 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 06-9A.

Status

8. The draft abstract will be posted to the FASB website after September 25, 2006. Comments on the draft abstract are due by October 13, 2006. Further discussion is expected at a future meeting.

Appendix 06-9A

EITF ABSTRACTS (DRAFT[1])

Issue No. 06-9

Title: Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee

Dates Discussed: September 7, 2006; [November 15–16, 2006]

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

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

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

ISSUE

1. To allow for more timely preparation of consolidated financial statements, ARB 51 and Opinion 18 allow an entity to consolidate the results of a entity's operations (or recognize changes in the net assets of an equity method investment) as of, and for a period ending not more than three months prior to the parent's or investor's fiscal year-end. In practice, questions have arisen as to how a parent or investor should recognize a change to the reporting year-end of either a consolidated entity or an equity method investee. That change may include a change in or the elimination of the previously existing difference (lag period) due to the parent's or investor's ability to obtain financial results from a reporting period that is more consistent with, or the same as, that of the parent or investor.

2. The issue is how a parent should recognize the effect of a change to (or the elimination of) an existing difference between the parent's reporting period and the reporting period of a consolidated entity or between the reporting period of an investor and the reporting period of an equity method investee.

Scope

3. The scope of this Issue applies to all entities that change (or eliminate) a previously existing difference between the reporting periods of a parent and a consolidated entity or an investor and an equity method investee. This Issue does not apply in situations in which a parent company changes its fiscal year-end.

[1] **This draft abstract is being exposed for a public comment period that will end on October 13, 2006.**

EITF DISCUSSION

4. The Task Force reached a [consensus] that a parent or an investor should report a change to (or the elimination of) a previously existing difference between the parent's reporting period and the reporting period of a consolidated entity or between the reporting period of an investor and the reporting period of an equity method investee in the parent's or investor's consolidated financial statements as a change in accounting principle in accordance with the provisions of Statement 154. The Task Force noted that while Statement 154 generally requires voluntary changes in accounting principles to be reported retrospectively, retrospective application is not required if it is impracticable pursuant to paragraph 11 of Statement 154. In reaching its decision, the Task Force believes that the change or elimination of a lag period represents a change in accounting principle as defined in Statement 154.

Disclosure

5. The Task Force reached a [consensus] that an entity should make the disclosures required pursuant to Statement 154.

Transition

6. The [consensus] in this Issue should be effective for future changes beginning in the first interim or annual reporting periods following Board ratification. Earlier application of this guidance is permitted in periods for which financial statements have not yet been issued.

Board Ratification

7. At its [November 29, 2006] meeting, the Board ratified the [consensus] reached by the Task Force in this Issue.

STATUS

8. No further EITF discussion is planned.

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues on the proposed agenda for the November 15–16, 2006 meeting are considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
06-6	Application of EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"	6/06 and 5/06	6/06 and 9/6	11/06	Holman	Stevens/ Jacobs	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	November 2006 EITF meeting
06-7	Accounting for a Previously-Bifurcated Conversion Option in Convertible Debt That No Longer Meets the Bifurcation Criteria in Paragraph 12 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*	5/06	9/06	11/06	Johnson	Roberge/ Stevens	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	November 2006 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
06-8	Application of the Assessment of a Continuing Investment in Paragraph 12 of FASB Statement No. 66, *Accounting for Sales of Real Estate*, to a Sale of a Condominium	8/06	9/06	11/06	Bielstein	Akinlade/ Beswick	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	November 2006 EITF meeting
06-9	Reporting a Change in (or the Elimination of) a Previously Existing Difference between the Fiscal Year-End of a Parent Company and That of a Consolidated Entity or between the Reporting Period of an Investor and That of an Equity Method Investee	8/06	9/06	11/06	Graul	Cosper/ Beswick	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	November 2006 EITF meeting
06-H	Application of AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities*, to Entities That Engage in Commodity Trading Activities	8/06	N/A	11/06	TBD	Fanzini/ Jacobs	The FASB staff will prepare an Issue Summary for a future meeting.	November 2006 EITF meeting
06-I	Accounting for Joint Development, Manufacturing, and Marketing Arrangements in the Biotechnology and Pharmaceutical Industries	8/06	N/A	3/07	Schroeder	Beswick/ Bolash	The FASB staff will prepare an Issue Summary for a future meeting.	March 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**
00-18	Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees	5/00	7/00, 7/01, 11/01, 1/02, 3/02	N/A	Sarno	Phase II of the Board's share-based payments project will not be initiated in the foreseeable future 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 Meeting
	The remaining issue in Issue 00-18 is Issue 3: For transactions that include a grantee performance commitment, how the grantee should account for the contingent right to receive, upon performing as specified in the arrangement, grantor equity instruments that are the consideration for the grantee's future performance. The Task Force asked the FASB staff to focus on improving the guidance (originally from Issue 96-18) used to determine the date at which a commitment for counterparty performance to earn the equity instruments is reached.						
00-27	Application of EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," to Certain Convertible Instruments	5/00	11/00, 1/01	Not scheduled	Richards	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
02-D	The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a)(1) of FASB Statement No. 133, *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
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 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**
05-4	The Effect of a Liquidated Damages Clause on a Financial Instrument Subject to EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"	2/05	6/05, 9/05	N/A	Thuener/ Jacobs/ Richards	Pending further progress on a DIG Issue for determining whether a registration rights agreement is a derivative	N/A

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