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FINANCIAL ACCOUNTING STANDARDS BOARD
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July 1, 2008

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the June 12, 2008 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 June 27 Fatal Flaw draft. After your review, please discard the confidential marked version of the minutes.

September Meeting
The next EITF meeting will be held on **September 10, 2008,** at the FASB offices in Norwalk, Connecticut. Please plan for the meeting to begin on Wednesday, September 10, at 11:00 a.m. and conclude no later than 5:00 p.m. The meeting times are tentative and may change. Coffee will be available and lunch will be provided. On Tuesday, September 9, the FASB will host a dinner at a location to be announced later.

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

Draft minutes available	**September 16, 2008**
Final minutes available	**September 30, 2008**

Please call me at 203.956.5231 if you have any questions.

Sincerely,

Shea H. Malcolm
Practice Fellow
shmalcolm@fasb.org

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MINUTES OF THE JUNE 12, 2008 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, June 12, 2008
Starting Time: 9:00 a.m.
Concluding Time: 3:35 p.m.

Task Force Members Present:
Russell G. Golden (Chairman)
Mark M. Bielstein
Mitchell A. Danaher
Joseph Graziano
Jay D. Hanson[1]
Stuart H. Harden
Jan R. Hauser
David L. Holman
Carl Kampel
Mark LaMonte
*Matthew L. Schroeder
*Ashwinpaul C. (Tony) Sondhi
Robert Uhl
Lawrence E. Weinstock
James L. Kroeker (SEC Observer)

Task Force Members Absent:
James G. Campbell

* For certain issues only.

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

Others at Meeting Table:
*Robert H. Herz, FASB Board Member
George J. Batavick, FASB Board Member
G. Michael Crooch, FASB Board Member
Thomas J. Linsmeier, FASB Board Member
*Leslie F. Seidman, FASB Board Member
Larry W. Smith, FASB Board Member
R. Harold Schroeder, Carlson Capital (incoming Task Force member)
Susan M. Cosper, FASB Senior Practice Fellow
Richard C. Paul, FASB Practice Fellow
Shelly C. Luisi, SEC Senior Associate Chief Accountant
Shea H. Malcolm, FASB Practice Fellow
* David B. Elsbree, Jr., FASB Practice Fellow
* David C. Leverenz, FASB Industry Fellow
* Ronald W. Maples, FASB Practice Fellow
* Jeffery T. Nickell, FASB Practice Fellow
* Jill M. Switter, FASB Project Manager
* Brian C. Stevens, FASB Practice Fellow
* Jeffrey T. Wilks, FASB Academic Fellow
* Stacy E. Zecher, FASB Associate Practice Fellow

* For certain issues only.

ADMINISTRATIVE MATTERS

- The Task Force Chairman introduced Mr. R. Harold Schroeder of Carlson Capital, who will replace Mr. Joseph Graziano as a member of the Task Force beginning with the September 2008 meeting. The Chairman thanked Mr. Graziano for his service.

- The Task Force Chairman formally introduced Mr. Mark LaMonte as a member of the Task Force.

- Prior EITF meeting minutes. An FASB staff member solicited objections to the final minutes of the March 12, 2008 meeting. No objections were noted.

- The Task Force discussed the report on the EITF Agenda Committee meeting held on May 6, 2008. The Agenda Committee discussed two potential issues. Based on the recommendations of the Agenda Committee and input from the Board members, the FASB Chairman made the following decisions:

    a. *Determining What Constitutes a Mine When Accounting for Stripping Costs Incurred during Production*. This issue was not added to the EITF agenda.

    b. *Fair Value of a Liability with a Third-Party Guarantee*. This issue was added to the EITF agenda. Refer to the discussion of EITF Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement," elsewhere in these minutes.

- Comment letters on the following Issues were reported as received and distributed to the Task Force:

    a. Five comment letters on EITF Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock." Refer to the discussion of Issue 07-5 elsewhere in these minutes for Task Force consideration of those comment letters.

    b. Two comment letters on EITF Issue No. 08-2, "Lessor Revenue Recognition for Maintenance Services." Refer to the discussion of Issue 08-2 elsewhere in these minutes for Task Force consideration of those comment letters.

    c. Three comment letters on EITF Issue No. 08-3, "Accounting by Lessees for Maintenance Deposits." Refer to the discussion of Issue 08-3 elsewhere in these minutes for Task Force consideration of those comment letters.

    d. One comment letter on EITF Issue No. 08-4, "Transition Guidance for Conforming Changes to EITF Issue No. 98-5, 'Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios.'" Refer to the discussion of Issue 08-4 elsewhere in these minutes for Task Force consideration of that comment letter.

- September 2008 EITF meeting. An FASB staff member asked the Task Force to anticipate a one-day EITF meeting to be held on September 10, 2008.

- 2009 EITF Meeting Dates. An FASB staff member announced the following EITF meeting dates for 2009:

  January 15, 2009
  March 18–19, 2009
  June 17–18, 2009
  September 9–10, 2009
  November 18–19, 2009

- An FASB staff member announced that any consensuses-for-exposure reached at this meeting will be considered by the Board for ratification and exposure for public comment at the Board meeting on Wednesday, June 25, 2008. Any consensuses-for-exposure reached at prior meetings that are affirmed as consensuses at this meeting will also be considered by the Board for ratification at the Board meeting on Wednesday, June 25, 2008.

- The Task Force held a closed administrative session.

Issue No. 07-5

Title: Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock

Dates Discussed: September 11, 2007; November 29, 2007; March 12, 2008; June 12, 2008

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

FASB Statement No. 128, *Earnings per Share*

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

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

FASB Technical Bulletin No. 85-6, *Accounting for a Purchase of Treasury Shares at a Price Significantly in Excess of the Current Market Price of the Shares and the Income Statement Classification of Costs Incurred in Defending against a Takeover Attempt*

Statement 133 Implementation Issue No. C8, "Derivatives That Are Indexed to both an Entity's Own Stock and Currency Exchange Rates"

Proposed Statement 133 Implementation Issue No. C21, "Whether Options (Including Embedded Conversion Options) Are Indexed to both an Entity's Own Stock and Currency Exchange Rates"

International Accounting Standard 32, *Financial Instruments: Disclosure and Presentation*

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

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

EITF Issue No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock'"

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

Introduction

1. Paragraph 11(a) of Statement 133 specifies that a contract that would otherwise meet the definition of a derivative under that Statement issued or held by the reporting entity that is **both** (a) indexed to its own stock and (b) classified in stockholders' equity in its statement of financial position should not be considered a derivative financial instrument for purposes of applying that Statement. If a freestanding financial instrument (for example, a stock purchase warrant) meets the scope exception in paragraph 11(a) of Statement 133, it is classified as an equity instrument and is not accounted for as a derivative instrument.

2. Paragraph 12 of Statement 133 requires that an embedded derivative instrument be separated from the host contract and accounted for as a derivative instrument pursuant to that Statement if certain criteria are met. One of those criteria, set forth in paragraph 12(c), is that a separate instrument with the same terms as the embedded derivative instrument would, pursuant to paragraphs 6–11 of that Statement, be a derivative instrument subject to the requirements of Statement 133. Consequently, if an embedded feature (for example, the conversion option embedded in a convertible debt instrument) meets the scope exception in paragraph 11(a) of Statement 133, it would not be separated from the host contract and accounted for as a derivative by the issuer.

3. This Issue addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which is the first part of the scope exception in paragraph 11(a) of Statement 133. If an instrument (or an embedded feature) that has the characteristics of a derivative instrument under paragraphs 6–9 of Statement 133 is indexed to an entity's own stock, it is still necessary to evaluate whether it is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). For example, a net-cash-settled stock purchase warrant may be indexed to an entity's own stock, but it is not classified in stockholders' equity. Other applicable authoritative accounting literature, including Issues 00-19 and 05-2, provides guidance for determining whether an instrument (or an embedded feature) is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). This Issue does not address that second part of the scope exception in paragraph 11(a) of Statement 133.

4. In addition, some instruments that are potentially subject to the guidance in Issue 00-19 do not have all the characteristics of a derivative instrument under paragraphs 6–9 of Statement 133. For example, a physically settled forward contract to issue an entity's own equity shares in exchange for cash would not meet the net-settlement characteristic of a derivative instrument, as described in paragraphs 6(c) and 9 of Statement 133, if the underlying equity shares are not readily convertible to cash. If the forward contract is considered to be indexed to the entity's own stock, it would be evaluated under Issue 00-19 to determine whether it should be classified in equity or as an asset or a liability. However, if the terms of that forward contract are such that it is not considered to be indexed to the entity's own stock, equity classification would be precluded and the instrument would not be within the scope of Issue 00-19 (that Issue provides accounting guidance for instruments that are **indexed to**, and potentially settled in, the issuer's own stock). Consequently, for certain freestanding instruments that do not have all the characteristics of a derivative instrument under paragraphs 6–9 of Statement 133 but are potentially settled in an entity's own equity shares, this Issue would apply for evaluating whether they are within the scope of Issue 00-19.

5. Issue 01-6 provides guidance on evaluating whether certain instruments and embedded features are indexed to an entity's own stock. Specifically, Issue 01-6 applies to instruments and embedded features containing one or more defined contingencies provided that once a contingency has occurred, the instrument's settlement amount is based solely on the issuing company's own stock. The consensus in Issue 01-6 specifies that instruments within the scope of that Issue are considered indexed to a company's own stock provided that (1) the contingency provisions are not based on (a) an observable market, other than the market for the issuer's stock

(if applicable), or (b) an observable index, other than those measured solely by reference to the issuer's own operations, and (2) once the contingent events have occurred, the instrument's settlement amount is based solely on the issuer's own stock. A final consensus on this Issue will supersede the guidance in Issue 01-6.

Scope

6. This Issue applies to any freestanding financial instrument or embedded feature that has all the characteristics of a derivative in paragraphs 6–9 of Statement 133, for purposes of determining whether that instrument or embedded feature qualifies for the first part of the scope exception in paragraph 11(a) of Statement 133. This Issue also applies to any freestanding financial instrument that is potentially settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative in paragraphs 6–9 of Statement 133, for purposes of determining whether the instrument is within the scope of Issue 00-19.

7. This Issue does not apply to share-based payment awards within the scope of Statement 123(R) for purposes of determining whether instruments are classified as liability awards or equity awards under that Statement. Equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options are not within the scope of Statement 123(R) themselves. Consequently, this Issue applies to such market-based employee stock option valuation instruments for purposes of making the determinations described in the preceding paragraph.

Prior EITF Discussion

8. The original issues brought to the Task Force at the September 11, 2007 EITF meeting were how an entity should determine whether the following types of instruments or embedded features are indexed to its own stock.

Issue 1— Instruments and embedded features for which exercisability is based on one or more defined contingencies provided that once a contingency has occurred, the instrument's settlement amount is based solely on the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price.

Issue 2— Instruments and embedded features for which (a) the settlement amount is always based on the entity's stock price and one or more other variables or (b) the party receiving shares at settlement has a noncontingent option to deliver noncash consideration whose fair value is affected by one or more variables other than the entity's stock price.

Issue 3— Instruments and embedded features for which the settlement amount is based solely on the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price unless a defined contingency occurs or specified condition is met (including a condition relating to the issuer's share price at settlement). Upon occurrence of the contingent event or other condition, there is an adjustment to the number of shares used to calculate the settlement amount, the strike price, or both.

9. At the September 11, 2007 EITF meeting, the Task Force reached a tentative conclusion on

Issue 1 that contingent exercise provisions do not preclude an instrument or embedded feature from being indexed to an entity's own stock, provided that those provisions are not based on (a) an observable market, other than the market for the entity's stock (if applicable), or (b) an observable index, other than those calculated solely by reference to the entity's own operations (for example, sales revenue of the entity, EBITDA [earnings before interest, taxes, depreciation, and amortization] of the entity, net income of the entity, or total equity of the entity). This tentative conclusion reaffirms the existing guidance in Issue 01-6 for purposes of evaluating contingent exercise provisions.

10. The Task Force discussed Issue 2 but was not asked to reach a tentative conclusion.

11. The Task Force reached a tentative conclusion on Issue 3 that an entity must presume the occurrence of a contingent event or other condition that would adjust the settlement terms of that instrument or embedded feature when evaluating whether an instrument or embedded feature is indexed to its own stock.

12. The Task Force requested that the FASB staff form a working group to assist in developing a framework for evaluating whether the instruments and embedded features addressed in Issues 2 and 3 are indexed to an entity's own stock. The Task Force recommended that the Working Group focus on developing a framework under which an instrument or embedded feature would be considered indexed to an entity's own stock if its ultimate settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price. An instrument or embedded feature for which the number of shares used to calculate the settlement amount, the strike price, or both, may vary would not be indexed to an entity's own stock unless the only variables that could affect the settlement amount would be inputs to a fair value measurement of any option or forward contract on equity shares (for example, interest rates). However, under that approach, standard antidilution provisions would not preclude an instrument or embedded feature from being indexed to an entity's own stock.

13. Task Force members observed that the tentative conclusions reached on Issues 1 and 3 may be reconsidered after the Working Group provides the Task Force with its recommendations on Issue 2.

14. Based on the tentative conclusions of the Task Force at the September 11, 2007 EITF meeting and after consideration of the input received from the Working Group members, the following two-step approach for determining whether an instrument or embedded feature is indexed to an entity's own stock was developed for the Task Force's consideration at the November 29, 2007 EITF meeting:

Step 1: Evaluate the instrument's contingent exercise provisions, if any.

Step 2: Evaluate the instrument's settlement provisions.

15. Based on the Task Force's tentative conclusion reached at the September 11, 2007 EITF meeting, the existing guidance in Issue 01-6 would be applied under Step 1. If the evaluation of Step 1 would not preclude an instrument from being considered indexed to the entity's own

stock, the analysis would proceed to Step 2 and an evaluation of the instrument's settlement provisions would be performed. At the November 29, 2007 EITF meeting, the Task Force was asked to discuss the following issues, related to Issues 2 and 3 discussed at the September 11, 2007 meeting, on the evaluation of settlement provisions for purposes of determining whether an instrument or embedded feature is indexed to an entity's own stock (Step 2 above).

Issue 4(a)—How an entity should evaluate settlement provisions for purposes of determining whether an instrument or embedded feature is indexed to its own stock.

Issue 4(b)—How an entity should evaluate whether instruments (or embedded features) are indexed to its own stock if either (a) the monetary consideration to be exchanged at settlement (that is, the strike price) is not denominated in the entity's functional currency or (b) the shares to be exchanged at settlement are traded only on exchanges (or other established marketplaces) on which trades are not executed in the currency in which the strike price is denominated. This Issue was addressed in proposed Statement 133 Implementation Issue No. C21, which has been put on hold pending the Task Force's deliberations of this Issue.

Issue 4(c)—Whether an exception to the settlement approach should be developed for purposes of evaluating equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options (market-based employee stock option valuation instruments).

16. At the November 29, 2007 EITF meeting, the Task Force discussed Issue 4(a) but was not asked to reach a tentative conclusion. The Task Force asked the FASB staff to conduct further research on alternative views and to solicit additional input from the Working Group for discussion at a future meeting. Issues 4(b) and 4(c) were not discussed.

17. The following Issues were presented to the Task Force for discussion at the March 12, 2008 EITF meeting:

Issue 4(a)—How an entity should evaluate whether an instrument (or embedded feature) is indexed to its own stock

Issue 4(a)(1)—For purposes of applying guidance developed under Issue 4(a), how the term "standard antidilution provisions" should be defined

Issue 4(a)(2)—If the Task Force reaches a conclusion on Issue 4(a)(1) that differs from the definition of "standard antidilution provisions" in Issue 05-2, whether a conforming amendment should be made to change the definition of standard antidilution provisions in Issue 05-2

Issue 4(b)—How the currency in which the strike price of an equity-linked financial instrument (or embedded feature) is denominated affects the determination of whether the instrument is indexed to an entity's own stock

Issue 4(c)—How an issuer should account for market-based employee stock option valuation instruments.

18. At the March 12, 2008 EITF meeting, the Task Force reached a consensus-for-exposure on Issue 4(a) that an entity should evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock using the following two-step approach:

Step 1: Evaluate the instrument's contingent exercise provisions, if any.
Step 2: Evaluate the instrument's settlement provisions.

19. The Task Force reached a consensus-for-exposure that the guidance in Issue 01-6 should be carried forward to this Issue for purposes of evaluating contingent exercise provisions (Step 1). An exercise contingency would not preclude an instrument (or embedded feature) from being considered indexed to an entity's own stock provided that it is not based on (a) an observable market, other than the market for the issuer's stock (if applicable), or (b) an observable index, other than an index calculated or measured solely by reference to the issuer's own operations (for example, sales revenue of the issuer, EBITDA of the issuer, net income of the issuer, or total equity of the issuer). If the evaluation of Step 1 does not preclude an instrument (or embedded feature) from being considered indexed to the entity's own stock, the analysis would proceed to Step 2.

20. For purposes of applying Step 2, an instrument (or embedded feature) would be considered indexed to an entity's own stock if its settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed amount of cash or another financial asset. An issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond would be considered indexed to an entity's own stock. An instrument's strike price or the number of shares used to calculate the settlement amount are not fixed if its terms provide for any potential adjustment, regardless of the probability of such adjustment(s) or whether such adjustments are in the entity's control. In cases in which the instrument's strike price or the number of shares used to calculate the settlement amount are not fixed, the Task Force reached a consensus-for-exposure that the instrument would still be considered indexed to an entity's own stock if the only variables that could affect the settlement amount would be inputs to the fair value of a "fixed-for-fixed" forward or option on equity shares.

21. A fixed-for-fixed forward or option on equity shares has a settlement amount that is equal to the difference between the price of a fixed number of equity shares and a fixed strike price. The fair value inputs of a fixed-for-fixed forward or option on equity shares may include the entity's stock price and additional variables, including the strike price of the instrument, term of the instrument, expected dividends or other dilutive activities, stock borrow cost, interest rates, stock price volatility, the entity's credit spread, and the ability to maintain a standard hedge position in the underlying shares. Determinations and adjustments related to the settlement amount (including the determination of the ability to maintain a standard hedge position) must be commercially reasonable. An instrument (or embedded feature) would not be considered indexed to the entity's own stock if its settlement amount is affected by variables that are extraneous to the pricing of a fixed-for-fixed option or forward contract on equity shares. If an instrument's

settlement calculation incorporates variables other than those used to determine the fair value of a fixed-for-fixed forward or option on equity shares, or if the instrument contains a feature (such as a leverage factor) that increases exposure to the additional variables listed above in a manner that is inconsistent with a fixed-for-fixed forward or option on equity shares, the instrument (or embedded feature) would not be considered indexed to the entity's own stock.

22. Standard pricing models for equity-linked financial instruments contain certain implicit assumptions. One such assumption is that the stock price exposure inherent in those instruments can be hedged by entering into an offsetting position in the underlying equity shares. For example, the Black-Scholes-Merton option-pricing model assumes that the underlying shares can be sold short without transaction costs and that stock price changes will be continuous. Accordingly, for purposes of applying Step 2, fair value inputs include adjustments to neutralize the effects of events that can cause stock price discontinuities. For example, a merger announcement may cause an immediate jump (up or down) in the price of shares underlying an equity-linked option contract. A holder of that instrument would not be able to continuously adjust its hedge position in the underlying shares due to the discontinuous stock price change. As a result, changes in (a) the fair value of an equity-linked instrument and (b) the fair value of an offsetting hedge position in the underlying shares will differ, creating a gain or loss for the instrument holder as a result of the merger announcement. Therefore, inclusion of provisions that adjust the terms of the instrument to offset the net gain or loss resulting from a merger announcement or similar event do not preclude an equity-linked instrument (or embedded feature) from being considered indexed to an entity's own stock.

23. Some equity-linked financial instruments contain provisions that provide an entity with the ability to unilaterally modify the terms of the instrument at any time, provided that such modification benefits the counterparty. For example, the terms of a convertible debt instrument may explicitly permit the issuer to reduce the conversion price at any time to induce conversion of the instrument. For purposes of applying Step 2, such provisions do not affect the determination of whether an instrument (or embedded feature) is considered indexed to an entity's own stock.

24. The Task Force observed that Issue 4(a) is intended to replace the guidance in Issue 2 of Issue 01-6. Therefore, if the Task Force reaches a consensus on Issue 07-5 that is consistent with its consensus-for-exposure, Issue 01-6 will be nullified. The guidance in Issue 1 of Issue 01-6, which was unaffected by this Issue, will be carried forward and codified in the abstract for this Issue.

25. The Task Force agreed that the Notice to Recipients included with the draft abstract should include a question regarding whether the guidance in Issue 4(a) is operational and provides a principle that could be applied consistently.

26. The Task Force discussed Issues 4(a)(1) and 4(a)(2), but was not asked to reach a consensus-for-exposure. Some Task Force members were concerned with defining *standard antidilution provisions* in a manner that is inconsistent with the description of antidilution provisions in paragraph A156 of Statement 123(R). Other Task Force members asserted that generally, contractual provisions providing for an adjustment to maintain the value of an equity-

linked financial instrument in the event of (a) an equity restructuring transaction (as defined in Statement 123(R)), (b) ordinary dividends, (c) issuances of an entity's shares for an amount that is less than the current fair value of those shares, or (d) repurchases of an entity's shares for an amount that exceeds the current fair value of those shares would not preclude an instrument from being considered indexed to an entity's own stock when assessed using the consensus-for-exposure reached on Issue 4(a). Therefore, it may be unnecessary for the guidance in Issue 4(a) to explicitly state that standard antidilution provisions do not affect the determination of whether an instrument is indexed to an entity's own stock. Those Task Force members observed that Issue 4(a)(1) is not relevant to this Issue if the guidance in Issue 4(a) does not refer to standard antidilution provisions. The Task Force agreed that the Notice to Recipients included with the draft abstract should include a question regarding whether it is necessary for Issue 4(a) to specify that standard antidilution provisions do not affect the determination of whether an instrument is indexed to an entity's own stock and, if so, how that term should be defined.

27. The Task Force reached a consensus-for-exposure on Issue 4(b) that an equity-linked financial instrument (or embedded feature) would not be considered indexed to the entity's own stock if the strike price is denominated in a currency other than the issuer's functional currency (including a conversion option embedded in a convertible debt instrument that is denominated in a currency other than the issuer's functional currency). The determination of whether an equity-linked financial instrument is indexed to an entity's own stock is not affected by the currency (or currencies) in which the underlying shares trade.

28. The Task Force reached a consensus-for-exposure on Issue 4(c) that market-based employee stock option valuation instruments are not considered indexed to the entity's own stock under the guidance in Issue 4(a) and that an exception to Issue 4(a) should not be provided. Consequently, they do not qualify for the scope exception in paragraph 11(a) of Statement 133. Additionally, such instruments are not within the scope of Statement 123(R), so they do not qualify for the scope exception in paragraph 11(b) of Statement 133. Provided that such instruments (a) have the characteristics of a derivative instrument specified in paragraphs 6–9 of Statement 133 and (b) do not qualify for any other scope exception in that Statement, they should be accounted for as derivative liabilities. (Refer to Example 20 in Appendix 07-5A of the abstract attached to these minutes for an illustration of market-based employee stock option valuation instruments.)

29. The tentative conclusions reached on Issues 1 and 3 at the September 11, 2007 EITF meeting have been incorporated into the consensus-for-exposure on Issue 4(a). Consequently, the Task Force was not asked to reach separate consensuses on those Issues.

Current EITF Discussion

30 At the June 12, 2008 EITF meeting, the Task Force discussed (a) the comment letters received on the draft abstract and (b) various application questions relating to the consensus-for-exposure on Issue 4(a). The Task Force affirmed as a consensus the consensuses-for-exposure reached at the March 12, 2008 EITF meeting on Issues 4(a), 4(b), and 4(c).

31. The Task Force also approved clarifying language and the inclusion of three additional illustrative examples to this Issue (Examples 8, 9, and 16). Paragraph 14 was added to clarify that an exercise contingency is a provision that entitles the entity (or the counterparty) to exercise

an equity-linked financial instrument (or embedded feature) based on changes in an underlying. Provisions that accelerate the ability to exercise or extend the length of time that an instrument is exercisable are examples of exercise contingencies. Paragraph 15 was edited to clarify that an instrument with a settlement amount that will equal the difference between a fixed monetary amount and a fixed quantity of a financial instrument issued by a third-party would not be considered indexed to the entity's own stock.

32. Appendix 07-5A reflects changes made to the draft abstract as a result of the above decisions (added text is <u>underlined</u> and deleted text ~~struck out~~).

Transition and Effective Date

33. The Task Force reached a consensus that this Issue should be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

34. The Task Force reached a consensus that this Issue shall be applied to outstanding instruments as of the beginning of the fiscal year in which this Issue is initially applied. The cumulative effect of the change in accounting principle shall be recognized as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately. The cumulative-effect adjustment is the difference between the amounts recognized in the statement of financial position before initial application of this Issue and the amounts recognized in the statement of financial position at initial application of this Issue. The amounts recognized in the statement of financial position at initial application of this Issue shall be determined based on the amounts that would have been recognized if the guidance in this Issue had been applied from the issuance date of the instrument(s). However, in circumstances in which a previously bifurcated embedded conversion option in a convertible debt instrument no longer meets the bifurcation criteria in Statement 133 as a result of initial application of this Issue, the carrying amount of the liability for the conversion option (that is, its fair value on the date of adoption) shall be reclassified to shareholders' equity. Any debt discount that was recognized when the conversion option was initially bifurcated from the convertible debt instrument shall continue to be amortized.

35. The Task Force observed that the guidance in Step 1 of Issue 4(a) should not result in a transition adjustment at the effective date of this Issue because that guidance is consistent with the existing guidance in Issue 01-6.

36. The Task Force reached a consensus that the transition disclosures in paragraphs 17 and 18 of Statement 154 should be provided.

Board Ratification

37. At its June 25, 2008 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

38. No further EITF discussion is planned.

Appendix 07-5A

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

Issue No. 07-5

Title: Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock

Dates Discussed: September 11, 2007; November 29, 2007; March 12, 2008; ~~[~~June ~~11~~ 12, 2008~~]~~

References: FASB Statement No. 123 (revised 2004), *Share-Based Payment*
FASB Statement No. 128, Earnings per Share
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*
FASB Statement No. 154, *Accounting for Changes and Error Corrections*
Statement 133 Implementation Issue No. C8, "Derivatives That Are Indexed to both an Entity's Own Stock and Currency Exchange Rates"
Statement 133 Implementation Issue No. K1, "Determining Whether Separate Transactions Should Be Viewed as a Unit"
EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"
EITF Issue No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock'"
EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in Issue No. 00-19"

Objective

1. **The objective of this Issue is to provide guidance for determining whether an equity-**

[*] **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.**~~This draft abstract is being exposed for a public comment period that will end on May 5, 2008.~~

linked financial instrument (or embedded feature) is indexed to an entity's own stock.

All paragraphs in this Issue have equal authority. **Paragraphs in bold set out the main principles.**

Background

2. Paragraph 11(a) of Statement 133 specifies that a contract that would otherwise meet the definition of a derivative under that Statement issued or held by the reporting entity that is **both** (a) indexed to its own stock and (b) classified in stockholders' equity in its statement of financial position shall not be considered a derivative financial instrument for purposes of applying that Statement. If a freestanding financial instrument (for example, a stock purchase warrant) meets the scope exception in paragraph 11(a) of Statement 133, it is classified as an equity instrument and is not accounted for as a derivative instrument.

3. Paragraph 12 of Statement 133 requires that an embedded derivative instrument be separated from the host contract and accounted for as a derivative instrument pursuant to that Statement if certain criteria are met. One of those criteria, set forth in paragraph 12(c), is that a separate instrument with the same terms as the embedded derivative instrument would, pursuant to paragraphs 6–11 of that Statement, be a derivative instrument subject to the requirements of Statement 133. Consequently, if an embedded feature (for example, the conversion option embedded in a convertible debt instrument) meets the scope exception in paragraph 11(a) of Statement 133, it would not be separated from the host contract and accounted for as a derivative by the issuer.

4. This Issue addresses the determination of whether an instrument (or an embedded feature) is indexed to an entity's own stock, which is the first part of the scope exception in paragraph 11(a) of Statement 133. If an instrument (or an embedded feature) that has the characteristics of a derivative instrument under paragraphs 6–9 of Statement 133 is indexed to an entity's own stock, it is still necessary to evaluate whether it is classified in stockholders' equity (or would be classified in stockholders' equity if it were a freestanding instrument). For example, a net-cash-settled stock purchase warrant may be indexed to an entity's own stock, but it is not classified in stockholders' equity. Other applicable authoritative accounting literature, including Issues 00-19 and 05-2, provides guidance for determining whether an instrument (or an embedded feature) is classified in stockholders' equity (or would be classified in stockholders' equity if it were a

freestanding instrument). This Issue does not address that second part of the scope exception in paragraph 11(a) of Statement 133.

5. In addition, some instruments that are potentially subject to the guidance in Issue 00-19 do not have all the characteristics of a derivative instrument under paragraphs 6–9 of Statement 133. For example, a physically settled forward contract to issue an entity's own equity shares in exchange for cash would not meet the net-settlement characteristic of a derivative instrument, as described in paragraphs 6(c) and 9 of Statement 133, if the underlying equity shares are not readily convertible to cash. If the forward contract is considered to be indexed to the entity's own stock, it would be evaluated under Issue 00-19 to determine whether it should be classified in equity or as an asset or a liability. However, if the terms of that forward contract are such that it is not considered to be indexed to the entity's own stock, equity classification would be precluded and the instrument would not be within the scope of Issue 00-19 (that Issue provides accounting guidance for instruments that are **indexed to**, and potentially settled in, the issuer's own stock). Consequently, for certain freestanding instruments that do not have all the characteristics of a derivative instrument under paragraphs 6–9 of Statement 133 but are potentially settled in an entity's own equity shares, this Issue would apply for evaluating whether they are within the scope of Issue 00-19.

6. Issue 01-6 is nullified by this Issue. However, some of the guidance previously contained in Issue 01-6 has been carried forward and codified in paragraphs 12 and 13 of this Issue.

7. The guidance in this Issue shall be applied to the appropriate unit of accounting, as determined under other applicable U.S. GAAP. For example, if an entity issues two freestanding financial instruments and concludes that those two instruments are required to be accounted for separately, then the guidance in this Issue would be applied separately to each instrument. In contrast, if an entity issues two freestanding financial instruments and concludes that those two instruments are required to be linked and accounted for on a combined basis as a single financial instrument (for example, pursuant to the guidance in Statement 133 Implementation Issue K1), then the guidance in this Issue would be applied to the combined financial instrument.

Scope

8. **This Issue applies to any freestanding financial instrument or embedded feature that has all the characteristics of a derivative in paragraphs 6–9 of Statement 133, for purposes of determining whether that instrument or embedded feature qualifies for the first part of the scope exception in paragraph 11(a) of Statement 133. This Issue also applies to any freestanding financial instrument that is potentially settled in an entity's own stock, regardless of whether the instrument has all the characteristics of a derivative in**

paragraphs 6–9 of Statement 133, for purposes of determining whether the instrument is within the scope of Issue 00-19.

9. This Issue does not apply to share-based payment awards within the scope of Statement 123(R) for purposes of determining whether instruments are classified as liability awards or equity awards under that Statement. Equity-linked financial instruments issued to investors for purposes of establishing a market-based measure of the grant-date fair value of employee stock options are not within the scope of Statement 123(R) themselves. Consequently, this Issue applies to such market-based employee stock option valuation instruments for purposes of making the determinations described in the preceding paragraph.

10. The guidance in paragraph 12 of this Issue applies to both the issuer and the holder of instruments within the scope of this Issue (as set forth in paragraphs 8 and 9).

Recognition

11**. An entity shall evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock using the following two-step approach:**

Step 1: Evaluate the instrument's contingent exercise provisions, if any.

Step 2: Evaluate the instrument's settlement provisions.

12. Outstanding instruments within the scope of this Issue are always considered issued for accounting purposes, except as discussed in the remainder of this paragraph. In some cases, parties to a business combination exchange contingently exercisable options to purchase equity securities of the other entity, at favorable prices, to encourage successful completion of that combination. If the merger is consummated as proposed, the options expire unexercised. If, however, a specified event occurs that interferes with the planned business combination, the options become exercisable. Such "lock-up options" are not considered issued for accounting purposes unless and until the options become exercisable.

Evaluation of Contingent Exercise Provisions (Step 1)

13. An exercise contingency would not preclude an instrument (or embedded feature) from being considered indexed to an entity's own stock provided that it is not based on (a) an observable market, other than the market for the issuer's stock (if applicable), or (b) an observable index, other than an index calculated or measured solely by reference to the issuer's own operations (for example, sales revenue of the issuer, EBITDA [earnings before interest, taxes, depreciation, and amortization] of the issuer, net income of the issuer, or total equity of the

issuer). If the evaluation of Step 1 does not preclude an instrument from being considered indexed to the entity's own stock, the analysis would proceed to Step 2.

14. For purposes of applying the guidance in this Issue, an *exercise contingency* is a provision that entitles the entity (or the counterparty) to exercise an equity-linked financial instrument (or embedded feature) based on changes in an underlying,[1] including the occurrence (or nonoccurrence) of a specified event. Provisions that accelerate the timing of the entity's (or the counterparty's) ability to exercise an instrument and provisions that extend the length of time that an instrument is exercisable are examples of exercise contingencies. If an instrument's strike price or the number of shares used to calculate the settlement amount would be adjusted upon the occurrence of an exercise contingency, the exercise contingency would be evaluated under Step 1 and the potential adjustment to the instrument's settlement amount would be evaluated under Step 2.

Evaluation of Settlement Provisions (Step 2)

~~14~~15. An instrument (or embedded feature) would be considered indexed to an entity's own stock if its settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed ~~amount of cash~~monetary amount or ~~another financial asset~~a fixed amount of a debt instrument issued by the entity. For example, ~~A~~an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond issued by the entity would be considered indexed to ~~an~~the entity's own stock. An instrument's strike price or the number of shares used to calculate the settlement amount are not fixed if its terms provide for any potential adjustment, regardless of the probability of such adjustment(s) or whether such adjustments are in the entity's control. If the instrument's strike price or the number of shares used to calculate the settlement amount are not fixed, the instrument (or embedded feature) would still be considered indexed to an entity's own stock if the only variables that could affect the settlement amount would be inputs to the fair value of a "fixed-for-fixed" forward or option on equity shares.

~~15~~16. A fixed-for-fixed forward or option on equity shares has a settlement amount that is equal to the difference between the price of a fixed number of equity shares and a fixed strike price. The fair value inputs of a fixed-for-fixed forward or option on equity shares may include the entity's stock price and additional variables, including the strike price of the instrument, term

[1] Statement 133 defines an underlying as "A specified interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable (including the occurrence or nonoccurrence of a specified event such as a scheduled payment under a contract). An underlying may be a price or rate of an asset or liability but is not the asset or liability itself."

of the instrument, expected dividends or other dilutive activities, stock borrow cost, interest rates, stock price volatility, the entity's credit spread, and the ability to maintain a standard hedge position in the underlying shares. Determinations and adjustments related to the settlement amount (including the determination of the ability to maintain a standard hedge position) must be commercially reasonable. An instrument (or embedded feature) would not be considered indexed to the entity's own stock if its settlement amount is affected by variables that are extraneous to the pricing of a fixed-for-fixed option or forward contract on equity shares. If an instrument's settlement calculation incorporates variables other than those used to determine the fair value of a fixed-for-fixed forward or option on equity shares, or if the instrument contains a feature (such as a leverage factor) that increases exposure to the additional variables listed above in a manner that is inconsistent with a fixed-for-fixed forward or option on equity shares, the instrument (or embedded feature) would not be considered indexed to the entity's own stock.

~~16~~<u>17</u>. Standard pricing models for equity-linked financial instruments contain certain implicit assumptions. One such assumption is that the stock price exposure inherent in those instruments can be hedged by entering into an offsetting position in the underlying equity shares. For example, the Black-Scholes-Merton option-pricing model assumes that the underlying shares can be sold short without transaction costs and that stock price changes will be continuous. Accordingly, for purposes of applying Step 2, fair value inputs include adjustments to neutralize the effects of events that can cause stock price discontinuities. For example, a merger announcement may cause an immediate jump (up or down) in the price of shares underlying an equity-linked option contract. A holder of that instrument would not be able to continuously adjust its hedge position in the underlying shares due to the discontinuous stock price change. As a result, changes in (a) the fair value of an equity-linked instrument and (b) the fair value of an offsetting hedge position in the underlying shares will differ, creating a gain or loss for the instrument holder as a result of the merger announcement. Therefore, inclusion of provisions that adjust the terms of the instrument to offset the net gain or loss resulting from a merger announcement or similar event do not preclude an equity-linked instrument (or embedded feature) from being considered indexed to an entity's own stock.

~~17~~<u>18</u>. Some equity-linked financial instruments contain provisions that provide an entity with the ability to unilaterally modify the terms of the instrument at any time, provided that such modification benefits the counterparty. For example, the terms of a convertible debt instrument may explicitly permit the issuer to reduce the conversion price at any time to induce conversion of the instrument. For purposes of applying Step 2, such provisions do not affect the determination of whether an instrument (or embedded feature) is considered indexed to an entity's own stock.

Evaluation of Settlement Provisions (Step 2) When the Strike Price of an Equity-Linked Financial Instrument Is Denominated In a Foreign Currency

~~18~~19. The issuer of an equity-linked financial instrument incurs an exposure to changes in currency exchange rates if the instrument's strike price is denominated in a currency other than the functional currency of the issuer. An equity-linked financial instrument (or embedded feature) would not be considered indexed to the entity's own stock if the strike price is denominated in a currency other than the issuer's functional currency (including a conversion option embedded in a convertible debt instrument that is denominated in a currency other than the issuer's functional currency). The determination of whether an equity-linked financial instrument is indexed to an entity's own stock is not affected by the currency (or currencies) in which the underlying shares trade.

Transition

~~19~~20. This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

~~20~~21. The guidance in this Issue shall be applied to outstanding instruments as of the beginning of the fiscal year in which this Issue is initially applied. The cumulative effect of the change in accounting principle shall be recognized as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately. The cumulative-effect adjustment is the difference between the amounts recognized in the statement of financial position before initial application of this Issue and the amounts recognized in the statement of financial position at initial application of this Issue. The amounts recognized in the statement of financial position ~~at~~as a result of the initial application of this Issue shall be determined based on the amounts that would have been recognized if the guidance in this Issue had been applied from the issuance date of the instrument(s). However, in circumstances in which a previously bifurcated embedded conversion option in a convertible debt instrument no longer meets the bifurcation criteria in Statement 133 at initial application of this Issue, the carrying amount of the liability for the conversion option (that is, its fair value on the date of adoption) shall be reclassified to shareholders' equity. Any debt discount that was recognized when the conversion option was initially bifurcated from the convertible debt instrument shall continue to be amortized.

~~21~~22. Paragraphs 12 and 13 of this Issue shall not result in a transition adjustment at the effective date because that guidance is consistent with guidance previously contained in Issue 01-6, which is nullified by this Issue.

~~22~~23. The transition disclosures in paragraphs 17 and 18 of Statement 154 shall be provided.

The provisions of this Issue need not be applied to immaterial items.

Exhibit 07-5A

ILLUSTRATIVE EXAMPLES OF ISSUE 07-5

The following examples illustrate the application of this Issue for purposes of determining whether an instrument (or embedded feature) is indexed to an entity's own stock, which is the first part of the scope exception in paragraph 11(a) of Statement 133. These examples do not address whether the instrument (or embedded feature) is classified in equity (or would be classified in equity if freestanding), which is the second part of the scope exception in paragraph 11(a) of Statement 133. These examples also do not address whether the instrument is within the scope of other accounting literature such as Statement 150 or whether the instrument would be subject to the two-class method under Statement 128.

Example 1

Company A issues warrants that permit the holder to buy 100 shares of its common stock ~~at~~for $10 per share. The warrants have 10-year terms; however, they only become exercisable if Company A completes an initial public offering.

Analysis: The warrants are considered indexed to Company A's own stock based on the following evaluation:

Step 1: The exercise contingency (that is, the initial public offering) is not an observable market or an observable index, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.

Step 2: Upon exercise, the ~~settlement consideration~~settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share).

Example 2

Company A issues warrants that permit the holder to buy 100 shares of its common stock ~~at~~for $10 per share. The warrants have 10-year terms; however, they only become exercisable after Company A accumulates $100~~,000,000~~ million in sales to third parties.

Analysis: The warrants are considered indexed to Company A's own stock based on the following evaluation:

Step 1: The exercise contingency (that is, the accumulation of $100~~,000,000~~ million in sales to third parties) is an observable index. However, it can only be calculated or measured by reference to Company A's sales, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.

Step 2: Upon exercise, the ~~settlement consideration~~settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share).

Example 3

Company A issues warrants that permit the holder to buy 100 shares of its common stock ~~at~~for $10 per share. The warrants have 10-year terms; however, they only become exercisable if the S&P 500 index increases 500 points within any given calendar year during that 10-year period.

Analysis: The warrants are not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The exercise contingency (that is, the increase of 500 points in the S&P 500 index) is based on an observable index that is not measured solely by reference to the issuer's own operations. It is not necessary to evaluate Step 2.

Step 2: N/A

Example 4

Company A issues warrants that permit the holder to buy 100 shares of its common stock in exchange for one ounce of gold. The warrants have 10-year terms; however, they only become exercisable if Company A completes an initial public offering.

Analysis: The warrants are not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The exercise contingency (that is, the initial public offering) is not an observable market or an observable index, so the evaluation of Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount would not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. Although the number of shares that would be issued at settlement is fixed, the strike price varies based on the price of one ounce of gold. The price of gold is not an input to the fair value of a "fixed-for-fixed" option on equity shares.

Example 5

Company A issues warrants that permit the holder to buy 100 shares of its common stock ~~at~~for

$10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that if there is an announcement of a merger involving Company A, the strike price of the warrants will be adjusted to offset the effect of the merger announcement on the net change in the fair value of (a) the warrants and (b) an offsetting hedge position in the underlying shares. The strike price adjustment must be determined using commercially reasonable means based on an assumption that the counterparty has entered into a hedge position in the underlying shares to offset the share price exposure from the warrants. That strike price adjustment is not affected by the counterparty's actual hedging position (for example, the strike price adjustment does not differ in circumstances when the counterparty is over-hedged or under-hedged).

Analysis: The warrants are considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instruments do not contain an exercise contingency. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share), unless there is a merger announcement. If there is a merger announcement, the ~~settlement consideration~~settlement amount would be adjusted to offset the effect of the merger announcement on the fair value of the warrants. In that circumstance, the only variables that could affect the settlement amount would be inputs to the fair value of a ~~"~~fixed-for-fixed~~"~~ option on equity shares. Refer to paragraphs 16 and 17 of this Issue for further discussion.

Example 6

Company A issues warrants that permit the holder to buy 100 shares of its common stock for an initial price of $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that the strike price is reduced by $0.50 after any year in which Company A does not achieve revenues of at least $100 million.

Analysis: The warrants are not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instruments do not contain an exercise contingency. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount would not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. Although the number of shares that would be issued at settlement is fixed, the strike price would be adjusted after any year in which Company A does not achieve revenues of at least $100 million. The amount of an entity's annual revenues is not an input to the fair value of a "fixed-for-fixed" option on equity shares.

Example 7

Company A purchases net-settled call options that permit it to buy 100 shares of its common stock for $10 per share. However, the maximum appreciation on the call options is capped when Company A's stock price reaches $15 per share (that is, the counterparty's maximum obligation is $500 [($15 − $10) × 100 shares]). The call options have 10-year terms and are exercisable at any time.

Analysis: The call options are considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instruments do not contain an exercise contingency. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price when Company A's stock price is between the $10 stated exercise price and the $15 price cap. However, whenever Company A's stock price exceeds $15, the strike price of the call options increases and decreases in amounts equal to the corresponding increases and decreases in Company A's stock price, such that the intrinsic value of each call option always equals $5. Because the only variable that can affect the settlement amount is the entity's stock price, which is an input to the fair value of a "fixed-for-fixed" option contract, the call options are considered indexed to the entity's own stock.

Example 8

Company A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that (a) if the entity sells shares of its common stock for an amount less than $10 per share, the strike price of the warrants is reduced to equal the issuance price of those shares, and (b) if the entity issues an equity-linked financial instrument with a strike price below $10 per share, the strike price of the warrants is reduced to equal the strike price of the newly issued equity-linked financial instrument.

Analysis: The warrants are not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instruments do not contain an exercise contingency. Proceed to Step 2.

Step 2: The settlement amount would not equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price. The strike price would be adjusted if Company A (a) sells shares of its common stock for an amount less than $10 per share or (b) issues an equity-linked financial instrument with a strike price below $10 per share. Consequently, the settlement amount of the warrants can be affected by (a) future equity offerings undertaken by Company A at the then-current market price of the related shares or (b) the contractual terms of other equity-linked financial instruments issued in a subsequent period. The occurrence of a sale of common stock by the entity at market is not an input to the fair value of a fixed-for-fixed option on equity shares. Similarly, the occurrence of a sale of an equity-linked financial instrument is not an input to the fair value of a fixed-for-fixed option on equity shares, if the transaction was priced at market.

Example 9

Company A issues warrants that permit the holder to buy 100 shares of its common stock for $10 per share. The warrants have 10-year terms and are exercisable at any time. However, the terms of the warrants specify that if Company A does not obtain regulatory approval of a particular drug compound within 5 years, the holder can surrender the warrants to Company A for $2 per warrant (settleable in shares).

Analysis: The contingently puttable warrants are not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instruments do not contain an exercise contingency. Proceed to Step 2.

Step 2: The settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($10 per share), unless regulatory approval of a particular drug compound is not obtained within 5 years. If that approval is not obtained within the allotted time period, the holder could elect to surrender the warrants to Company A in exchange for $2 per warrant. The contingent obligation to settle the warrants by transferring consideration with a fixed monetary value if regulatory approval of a particular drug compound is not obtained within a specified time period does not represent an input to the fair value of a fixed-for-fixed option on equity shares. A freestanding equity-linked instrument that provides for a fixed payoff upon the occurrence of a contingent event which is not based on the issuer's share price is not indexed to an entity's own stock.

Example ~~8~~10

Company A, whose functional currency is U.S. dollars (US$), issues warrants with a strike price denominated in Canadian dollars (CAN$). The warrants permit the holder to buy 100 shares of its common stock for CAN$10 per share. Company A's shares trade on an exchange on which trades are denominated in CAN$. The warrants have 10-year terms and are exercisable at any time.

Analysis: The warrants are not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instruments do not contain an exercise contingency. Proceed to Step 2.

Step 2: The strike price of the warrants is denominated in a currency other than the entity's functional currency, so the warrants are not considered indexed to the entity's own stock.

Example ~~9~~11

Company A enters into a forward contract to sell 100 shares of its common stock for $10 per share in 1 year. Historically, Company A has paid a dividend of $0.10 per quarter on its common shares. Under the terms of the forward contract, if dividends per common share differ from $0.10 during any 3-month period, the strike price of the forward contract will be adjusted to offset the effect of the dividend differential (actual dividend versus $0.10) on the fair value of the instrument. Additionally, the terms of the forward contract provide for an adjustment to the strike price, using commercially reasonable means, to offset the effect of any increased cost of borrowing Company A's shares in the stock loan market on the fair value of the instrument.

Analysis: The forward contract is considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instrument does not contain an exercise contingency. Proceed to Step 2.

Step 2: The only circumstances in which the ~~settlement consideration~~settlement amount will not equal the difference between the fair value of 100 shares and $1,000 ($10 per share) are (a) if dividends per common share differ from $0.10 during any 3-month period or (b) there is an increased cost of borrowing Company A's shares in the stock loan market. The adjustments to the strike price resulting from those events are intended to offset their effects on the instrument's fair value. In those circumstances, the only variables that could affect the settlement amount (dividends and stock borrow cost) would be inputs to the fair value of a "fixed-for-fixed" forward contract on equity shares.

Example ~~10~~12

Company A enters into a net-settleable forward contract to sell 100 shares of its common stock in 1 year for an amount equal to $10 per share plus interest calculated at a variable interest rate (Federal Funds rate plus a fixed spread). The share price used to determine the settlement amount is based on the volume-weighted average daily market price of Company A's common stock for the 30-day period prior to the settlement date.

Analysis: The forward contract is considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instrument does not contain an exercise contingency. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. However, the only variables that cause~~s~~ the ~~settlement consideration~~settlement amount to differ from a fixed-for-fixed settlement amount ~~is~~are the 30-day volume-weighted average daily market price of Company A's common stock and an interest rate index. ~~and t~~The pricing inputs of a fixed-for-fixed forward contract include the entity's stock price and interest rates. Additionally, the floating interest rate feature does not introduce a leverage factor or otherwise increase the effects of interest rate changes on the instrument's fair value.

Example ~~11~~13

Company A enters into a forward contract to sell 100 shares of its common stock in 1 year for an amount equal to $10 per share plus interest calculated at a variable interest rate that varies inversely with changes in the London Interbank Offered Rate (LIBOR) (similar to an "inverse floater," as described in paragraph 178 of Statement 133).

Analysis: The forward contract is not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instrument does not contain an exercise contingency. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price. Although the number of shares that would be issued at settlement is fixed, the strike price varies inversely with changes in an interest rate index. The inverse floating interest rate feature increases the effects of interest rate changes on the instrument's fair value (that is, the feature increases the instrument's fair value exposure to interest rate changes), when compared to the exposure to interest rate changes of a fixed-for-fixed forward contract.

Example ~~12~~14

Company A enters into a net-settled forward contract to sell 100 shares of its common stock in 1 year for $1,000. However, the maximum amount payable to the counterparty at maturity is capped when Company A's stock price is greater than or equal to $15 per share (that is, Company A's maximum obligation is $500 [($15 − $10) × 100 shares]). Additionally, the maximum amount receivable from the counterparty at maturity is capped when Company A's stock price is less than or equal to $5 per share (that is, the counterparty's maximum obligation is $500 [($5 − $10) × 100 shares]).

Analysis: The forward contract is considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instrument does not contain an exercise contingency. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price ($1,000) when Company A's stock price is between $5 and $15. However, whenever Company A's stock price is greater than or equal to $15 at maturity, the amount payable to the counterparty always equals $500. Additionally, whenever Company A's stock price is less than or equal to $5 at maturity, the amount receivable from the counterparty always equals $500. Because the only variable that can affect the settlement amount is the entity's stock price, which is an input to the fair value of a "fixed-for-fixed" forward contract, the instrument is considered indexed to the entity's own stock.

Example ~~13~~15

Company A enters into a forward contract to sell a variable number of its common shares in 1 year for $1,000. If Company A's stock price is equal to or less than $10 at maturity, Company A will issue 100 shares of its common stock to the counterparty. If Company A's stock price is greater than $10 but equal to or less than $12 at maturity, Company A will issue a variable number of its common shares worth $1,000. Finally, if the share price is greater than $12 at maturity, Company A will issue 83.33 shares of its common stock.

Analysis: The forward contract is considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instrument does not contain an exercise contingency. Proceed to Step 2.

Step 2: The ~~settlement consideration~~settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price ($1,000). Although the strike price to be received at settlement is fixed, the number of shares to be issued to the counterparty varies based on the entity's stock price on the settlement date. Because the only variable that can affect the settlement amount is the entity's stock price, which is an input to the fair value of a "fixed-for-fixed" forward contract on equity shares, the instrument is considered indexed to the entity's own stock.

Example 16

Company A enters into a forward contract to sell 100 shares of its common stock for $10 per share in 1 year. Under the terms of the forward contract, if Company A (a) distributes a stock dividend or ordinary cash dividend, (b) executes a stock split, spinoff, rights offering, or recapitalization through a large, nonrecurring cash dividend, (c) issues shares for an amount below the then-current market price, or (d) repurchases shares for an amount above the then-current market price, the strike price of the forward contract would be adjusted to offset the resulting dilution (except for issuances and repurchases that occur upon settlement of outstanding option or forward contracts on equity shares). [Note: This term adjusts for the dilution to the forward contract counterparty resulting from the occurrence of specified dilutive events. The adjustment to the strike price of the forward contract is based on a mathematical calculation that determines the direct effect that the occurrence of such dilutive events should have on the price of the underlying shares; it does not adjust for the actual change in the market price of the underlying shares upon the occurrence of those events, which may increase or decrease for other reasons.]

Analysis: The forward contract is considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instrument does not contain an exercise contingency. Proceed to Step 2.

Step 2: The only circumstances in which the settlement amount will not equal the difference between the fair value of 100 shares and $1,000 ($10 per share) are upon the (a) distribution of a stock dividend or ordinary cash dividend, (b) execution of a stock split, spinoff, rights offering, or recapitalization through a large, nonrecurring cash dividend, (c) issuance of shares for an amount below the then-current market price, or (d) repurchase of shares for an amount above the then-current market price. An implicit assumption in standard pricing models for equity-linked financial instruments is that such events will not occur (or that the strike price of the instrument will be adjusted to offset the dilution caused by such events). Therefore, the only variables that could affect the settlement amount in this example would be inputs to the fair value of a fixed-for-fixed option on equity shares.

Example ~~14~~17

Company A, whose functional currency is US$, enters into a forward contract that requires Company A to sell 100 shares of its common stock for 120 euros (EUR) per share in 1 year.

Analysis: The forward contract is not considered indexed to Company A's own stock based on the following evaluation:

Step 1: The instrument does not contain an exercise contingency. Proceed to Step 2.

Step 2: The strike price of the forward contract is denominated in a currency other than the entity's functional currency, so the forward contract is not considered indexed to the entity's own stock.

Example ~~15~~18

Company A issues a contingently convertible debt instrument (CoCo) with a par value of $1,000 that is convertible into 100 shares of its common stock. The convertible debt instrument has a 10-year term and is convertible at any time after one of the following events occurs: (a) Company A's stock price exceeds $13 per share (market price trigger), (b) the convertible debt instrument trades for an amount that is less than 98 percent of its if-converted value (parity provision), or (c) there is an announcement of a merger involving Company A. The terms of the convertible debt instrument also include a "make whole" provision. Under that provision, if Company A is acquired for cash before a specified date, the holder of the convertible debt instrument can convert into a number of shares equal to the sum of (a) the fixed conversion ratio (100 shares per bond) and (b) the make-whole shares. The number of make-whole shares is determined by reference to a table with axes of stock price and time. That table was designed such that the aggregate fair value of the shares deliverable (that is, the fair value of 100 shares per bond plus the make-whole shares) would be expected to approximate the fair value of the convertible debt instrument at the settlement date, assuming no change in relevant pricing inputs (other than stock price and time) since the instrument's inception.

Analysis: The embedded conversion option is considered indexed to Company A's own stock based on the following evaluation:

Step 1: The market price trigger and parity provision exercise contingencies are based on observable markets; however, those contingencies relate solely to the market prices of the entity's own stock and its own convertible debt. Also, the merger announcement exercise contingency is not an observable market or an index. Therefore, Step 1 does not preclude the warrants from being considered indexed to the entity's own stock. Proceed to Step 2.

Step 2: An acquisition for cash prior to the specified date is the only circumstance in which the ~~settlement consideration~~settlement amount will not equal the difference between the fair value of 100 shares and a fixed strike price ($1,000 fixed par value of the debt). The ~~settlement consideration~~settlement amount if Company A is acquired for cash prior to the specified date is equal to the sum of (a) the fixed conversion ratio (100 shares per bond) and (b) the ~~"~~make-whole~~"~~ shares. The number of make-whole shares is determined based on a table with axes of stock price and time, which would both be inputs in a fair value measurement of a ~~"~~"fixed-for-fixed~~"~~" option on equity shares.

Example ~~16~~19

Company A, whose functional currency is the Chinese yuan (CNY), issues a debt instrument denominated in CNY with a par value of CNY1,000 that is convertible into 100 shares of its common stock. Company A's shares only trade on an exchange in which trades are denominated in US$. Those shares do not trade on an exchange (or other established marketplace) in which trades are denominated in CNY. The convertible debt instrument has a 10-year term and is convertible at any time.

Analysis: The embedded conversion option is considered indexed to Company A's own stock based on the following evaluation:

Step 1: The embedded conversion option does not contain an exercise contingency. Proceed to Step 2.

Step 2: Upon exercise of the embedded conversion option, the ~~settlement consideration~~settlement amount would equal the difference between the fair value of a fixed number of the entity's equity shares (100 shares) and a fixed strike price denominated in its functional currency (CNY1,000 fixed par value of the debt). The determination of whether the embedded conversion option is indexed to the entity's own stock is not affected by the currency (or currencies) in which the underlying shares trade.

Example ~~17~~20

Company A issues a security to investors for purposes of establishing a market-based measure of the grant-date fair value of a grant of employee stock options. Under the terms of that market-based employee stock option valuation instrument, Company A is obligated to make variable quarterly payments to the investors that are a function of the net intrinsic value received by a pool of Company A's employees, based on actual stock option exercises by those employees each period. The market-based employee stock option valuation instrument has a 10-year term, consistent with the contractual term of the underlying employee stock options.

Analysis: The market-based employee stock option valuation instrument is not considered indexed to Company A's own stock based on the following evaluation:

Step 1: ~~The instrument does not contain an exercise contingency. Proceed to Step 2.~~ The analysis of the exercise contingency (or contingencies) depends on the particular terms and features of the instrument. However, as indicated in Step 2 below, a market-based employee stock option valuation instrument would not be considered indexed to the entity's own stock.

Step 2: The ~~settlement consideration~~settlement amount will not equal the difference between the fair value of a fixed number of the entity's equity shares and a fixed strike price. The instrument provides for variable quarterly payments to investors that are based on actual employee stock option exercises for the period. Because a variable that affects the instrument's settlement amount is employee stock option exercise behavior, which is not an input to the fair value of a "fixed-for-fixed" option or forward contract on equity shares, the instrument is not considered indexed to the entity's own stock.

Issue No. 08-1

Title: Revenue Recognition for a Single Unit of Accounting

Dates Discussed: March 12, 2008; June 12, 2008

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

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

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

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

FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Interest Guarantees of Indebtedness of Others*

FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*

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

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

AICPA Statement of Position 97-2, *Software Revenue Recognition*

AICPA Statement of Position 00-2, *Accounting by Producers or Distributors of Films*

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition*

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables"

Introduction

1. Entities often enter into revenue arrangements that provide for multiple payment streams for a single unit of accounting. For example, a service provider may receive an up-front payment upon signing a service contract with a customer and then receive additional payments as services are provided to that customer. Other examples can be more complex, such as in biotechnology and pharmaceutical research and development arrangements involving multiple deliverables, up-front payments, payments for specific services, and payments upon achievement of certain clinical milestones. If delivery of a single unit of accounting spans multiple accounting periods, an entity needs to determine how to allocate the multiple payment streams (arrangement consideration) attributable to that unit of accounting to those accounting periods.

2. The ultimate objective of attributing arrangement consideration to a single unit of accounting is to determine when the arrangement consideration should be recognized as revenue. The fundamental goals of recognition, as set forth in Concepts Statement 5, paragraph 83, are that "recognition involves consideration of two factors, (a) being realized or realizable and (b) being earned, with sometimes one and sometimes the other being the more important

consideration." Generally, revenue is considered both earned and realizable when all of the following four conditions[1] are met:

a. Persuasive evidence of an arrangement exists
b. The arrangement fee is fixed or determinable
c. Delivery or performance has occurred
d. Collectibility is reasonably assured.

3. For purposes of this Issue, it is assumed that all of the conditions have been met except for the occurrence of delivery or performance. As an entity evaluates what attribution model to apply to its specific facts and circumstances, it must consider when delivery or performance will occur and not when it will receive arrangement consideration. The issues of when and whether the entity will receive arrangement consideration, including whether it will receive additional payments that are not fixed or determinable upon consummation of the arrangement, relates to whether the arrangement consideration is fixed or determinable and whether collectibility is reasonably assured, neither of which is addressed by this Issue. This Issue addresses the revenue recognition pattern associated with the fixed or determinable arrangement consideration.

4. Furthermore, this Issue does not address whether an arrangement is comprised of one or more deliverables or whether multiple deliverables within an arrangement meet the separation requirements of Issue 00-21. This Issue only addresses the revenue recognition pattern appropriate for a single deliverable or multiple deliverables accounted for as a single unit of accounting in accordance with Issue 00-21.

5. Generally, delivery or performance of a deliverable is considered to have occurred when the seller has fulfilled its obligations related to that deliverable and the customer has realized the value of the deliverable. Constituents have adopted various accounting methods to address the issue of when delivery has occurred and, consequently, when revenue should be recognized. This Issue does not address which method is appropriate in any particular circumstance but, rather, addresses whether a multiple attribution model may be appropriate in certain circumstances. This Issue addresses the issue of whether a multiple attribution model can be used for an arrangement consisting of a single deliverable or for a single unit of accounting consisting of multiple deliverables.

6. Under a single attribution model, all arrangement consideration is recognized using a single method, such as either a systematic basis over the term of the arrangement or a per unit basis, but not both. Under a multiple attribution model, arrangement consideration may be recognized using multiple methods, such as both a systematic basis and a per unit basis (for example, an up-front payment may be recognized on a straight-line basis over the term of the arrangement, while a price paid per unit may be recognized as units are delivered) for the single unit of accounting.

[1] References to the four conditions can be found in SAB Topic 13A1; SOP 97-2, paragraph 8; SOP 00-2, paragraph 7, and other revenue recognition accounting literature.

Issues

7. The Issues are:

Issue 1— Whether, under certain facts and circumstances, it may be acceptable to use a multiple attribution model to account for a single unit of accounting consisting of a single deliverable

Issue 2— Whether, under certain facts and circumstances, it may be acceptable to use a multiple attribution model to account for a single unit of accounting consisting of multiple deliverables.

Scope

8. The guidance in this Issue applies to a single unit of accounting (consisting of either a single deliverable or multiple deliverables) within a revenue arrangement, unless all of the deliverables within that unit of accounting are within the scope of other authoritative literature that provides attribution guidance.

Prior EITF Discussion

9. At the March 12, 2008 EITF meeting, the Task Force discussed this Issue but was not asked to reach a conclusion. The Task Force requested that the FASB staff perform additional research on the transactions that give rise to the practice concern addressed by this Issue.

Current EITF Discussion

10. At the June 12, 2008 EITF meeting, the Task Force was informed that a Working Group had been formed to provide recommendations to the Task Force on this Issue. The Task Force discussed the initial findings of the Working Group but was not asked to reach a conclusion. The Task Force instructed the staff to continue to develop this Issue with the assistance of the Working Group for discussion at a future Task Force meeting.

Status

11. Further discussion is expected at a future meeting.

Issue No. 08-2

Title: Lessor Revenue Recognition for Maintenance Services

Dates Discussed: March 12, 2008; June 12, 2008

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

FASB Statement No. 29, *Determining Contingent Rentals*

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

FASB Staff Position AUG AIR-1, *Accounting for Planned Major Maintenance Activities*

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

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition*

International Accounting Standard 17, *Leases*

International Financial Reporting Interpretations Committee Interpretation 4, "Determining whether an Arrangement contains a Lease"

EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables"

EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease"

Introduction

1. Certain leasing arrangements require the lessor to maintain the leased asset during the lease term. The maintenance services can range from janitorial services in an office space lease to planned major maintenance for an aircraft lease. The portion of the lease payments that is attributed to the maintenance services may or may not be explicitly stated in the lease agreement, and the timing of those payments may not coincide with the performance of the maintenance services. Statement 13 provides that executory costs such as maintenance, insurance, and taxes, together with any profit thereon, shall be excluded from minimum lease payments. However, Statement 13 provides no guidance on the accounting for executory costs, other than excluding them from the determination of minimum lease payments. At issue is how a lessor should account for payments it receives in connection with performing maintenance services to the leased item, in lease agreements or other arrangements accounted for as leases (hereinafter referred to as "maintenance services").

2. The issue exists in the airline, utility, and real estate industries, and may exist in other industries. Lessors bill for maintenance services in various ways. For example, in a "gross lease" of office space, maintenance is included in the base rent billed to the lessee. In other situations, maintenance is billed separately as a common area maintenance (CAM) charge based on an agreed upon fixed rate per square foot. In some situations, maintenance is invoiced by the lessor to the lessee as services are performed by the lessor. The accounting for maintenance services varies among lessors. For example, some lessors recognize revenue from maintenance service on a straight-line basis as part of the related rental income. Others record maintenance income as it is billed (which may or may not coincide with the performance of the maintenance services).

3. Existing accounting literature is unclear as to how lessors should recognize revenue for maintenance services that are considered executory costs in Statement 13.

Issues

4. The issues are:

Issue 1— Whether this Issue should apply to a particular type of maintenance services that are executory costs under Statement 13

Issue 2— How a lessor should recognize revenue related to maintenance services.

Scope

5. The guidance in this Issue applies to maintenance services that are considered executory costs.

Prior EITF Discussion

6. At the March 12, 2008 EITF meeting, the Task Force discussed how a lessor should recognize revenue related to maintenance services by discussing the following two issues:

> Issue 1—Whether the scope of this Issue should include all payments for maintenance services in an arrangement accounted for as a lease
>
> Issue 2—How a lessor should recognize revenue related to maintenance services.

7. The Task Force discussed Issue 1 but was not asked to reach a conclusion. The Task Force requested that the FASB staff perform additional research and analysis to further define the types of maintenance services this Issue would apply to and to refine the scope of this Issue for Task Force consideration.

8. The Task Force reached a tentative conclusion on Issue 2 that revenue related to maintenance services should be recognized into income as those services are performed utilizing a proportional performance method that is determined to be the most appropriate method under the circumstances. Task Force members observed that the tentative conclusion reached on Issue 2 may be reconsidered pending the outcome of future discussion on Issue 1.

Current EITF Discussion

9. At the June 12, 2008 EITF meeting, the Task Force discussed whether additional standard setting related to maintenance services provided in connection with a lease would result in improved financial reporting. Certain Task Force members and an EITF Observer who represent the user constituency observed that such standard setting could create additional complexity and would not provide users with better information. Based on that discussion, the Task Force decided to recommend to the FASB Chairman that this project be removed from the EITF's agenda. At the June 25, 2008 FASB Board meeting, the FASB Chairman announced that Issue 08-2 would be removed from the EITF's agenda.

Status

10. No further EITF discussion is planned.

Issue No. 08-3

Title: Accounting by Lessees for Maintenance Deposits

Dates Discussed: March 12, 2008; June 12, 2008

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

FASB Statement No. 13, *Accounting for Leases*

FASB Statement No. 29, *Determining Contingent Rentals*

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

FASB Interpretation No. 19, *Lessee Guarantee of the Residual Value of Leased Property*

FASB Staff Position, AUG AIR-1, *Accounting for Planned Major Maintenance Activities*

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

AICPA Industry Audit Guide, *Audits of Airlines*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition*

International Accounting Standard 17, *Leases*

EITF Issue No. 86-33, "Tax Indemnifications in Lease Agreements"

EITF Issue No. 96-21, "Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities"

EITF Issue No. 98-9, "Accounting for Contingent Rent"

EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities"

EITF Issue No. 08-2, "Lessor Revenue Recognition for Maintenance Services"

Introduction

1. Under certain equipment lease agreements, a lessee is legally and contractually responsible for repair and maintenance of the leased asset throughout the lease term. Additionally, certain lease agreements include provisions requiring the lessee to make deposits[1] to the lessor in order to financially protect the lessor in the event the lessee does not properly maintain the leased asset.

[1] Lease agreements often refer to these deposits as "maintenance reserves" or "supplemental rent." However, the lessor is required to reimburse the deposits to the lessee upon the completion of maintenance activities that the lessee is contractually required to perform under the lease agreement.

2. Under a typical arrangement, those deposits are calculated based on a performance measure, such as hours of use of the leased asset, and are contractually required under the terms of the lease agreement to be used to reimburse the lessee for required maintenance of the leased asset upon the completion of that maintenance. The lessor is contractually required to reimburse the lessee for the maintenance costs paid by the lessee, to the extent of the amounts on deposit.

3. The maintenance deposits made under the lease agreement do not transfer to the lessor either the obligation to maintain the asset or the cost or quality risk associated with the maintenance activities. Whether or not there are available reimbursable deposits, the lessee remains legally responsible for maintaining the leased asset throughout the lease term pursuant to the applicable provisions of the lease.

4. There may be cases in which the total cost of cumulative maintenance events over the term of the lease is less than the cumulative deposits, resulting in excess amounts on deposit at the expiration of the lease. In those cases, some lease agreements provide that the lessor is entitled to retain such excess amounts; whereas other agreements specifically provide that, at the expiration of the lease agreement, such excess amounts are returned to the lessee (refundable maintenance deposit).

5. Diversity in practice exists with respect to the accounting for maintenance deposits that may not be refunded (if the lessee does not perform the specified maintenance activities). Some lessees account for the payments as a deposit. When the underlying maintenance is performed, the deposit is expensed or capitalized in accordance with the lessee's maintenance accounting policy. Once it is determined that an amount is not probable of being used to fund future maintenance expense, it is recognized as additional expense at the time such determination is made. Others account for the payments as contingent rent expense or maintenance expense when the initial payment is made. When the underlying maintenance is performed, maintenance expense is recorded and any reimbursement is credited to rent expense (or maintenance expense).

Issue

6. The issue is whether lessees should account for maintenance deposits that may not be refunded (if the lessee does not perform the specified maintenance activities) as a deposit or as contingent rental expense.

Scope

7. This Issue applies to the lessee's accounting for maintenance deposits paid by a lessee under an arrangement accounted for as a lease and refunded only if the lessee performs specified maintenance activities. Payments to a lessor that are not substantively and contractually related to maintenance of the leased asset are not within the scope of this Issue.

Prior EITF Discussion

8. At the March 12, 2008 EITF meeting, the Task Force reached a consensus-for-exposure that all maintenance deposits within the scope of this Issue should be accounted for as a deposit. When the underlying maintenance is performed, the deposit is expensed or capitalized in accordance with the lessee's maintenance accounting policy. Once it is determined that an

amount on deposit is not probable of being used to fund future maintenance activities, it is recognized as additional expense at the time such determination is made.

Current EITF Discussion

9. At the June 12, 2008 EITF meeting, the Task Force discussed the comment letters received on the draft abstract and affirmed as a consensus the consensus-for-exposure reached at the March 12, 2008 EITF meeting with certain amendments discussed below.

10. The Task Force decided to revise the draft abstract based on the comment letters received. Paragraph 5 was added to include a reference to a lessee's potential obligation to return the leased asset to the lessor in a certain condition. Paragraph 7 was edited to clarify that payments made that are less than probable of being refunded by the lessor at inception of the lease are not considered maintenance deposits within the scope of this Issue. Paragraph 9 was edited to clarify that when a lessee subsequently determines that the deposit is less than probable of being returned because the lessee no longer expects to incur the underlying maintenance cost, it shall be recognized as additional expense. In addition, the Task Force decided to clarify that the use of the term "probable" in this Issue is intended to be consistent with the definition in paragraph 25 of Concepts Statement 6.

11. The Task Force discussed whether this Issue should provide additional guidance related to changes in estimate and agreed not to provide such guidance.

12. The Task Force discussed whether this Issue should provide revenue recognition guidance (related to maintenance deposits) for the lessor. The Task Force agreed that this Issue should not provide revenue recognition guidance for the lessor. However, the Task Force instructed the staff to perform additional research for the Task Force's consideration of whether a new issue should be added to its agenda..

13. Appendix 08-3A reflects changes made to the draft abstract as a result of the above decisions (added text is underlined and deleted text is ~~struck out~~).

Effective Date and Transition

14. The Task Force reached a consensus that this Issue should be effective for financial statements issued for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

15. The Task Force reached a consensus that entities should recognize the effect of the change as a change in accounting principle as of the beginning of the fiscal year in which this consensus is initially applied for all arrangements existing at the effective date. The cumulative effect of the change in accounting principle shall be recognized as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately. The transition disclosures in paragraphs 17 and 18 of Statement 154 should be provided.

Board Ratification

16. At its June 25, 2008 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

17. No further EITF discussion is planned.

Appendix 08-3A

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

Issue No. 08-3

Title: Accounting by Lessees for ~~Nonrefundable~~ Maintenance Deposits

Dates Discussed: March 12, 2008; ~~[~~June ~~11~~–12, 2008~~]~~

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

FASB Statement No. 13, *Accounting for Leases*

FASB Statement No. 29, *Determining Contingent Rentals*

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

FASB Interpretation No. 19, *Lessee Guarantee of the Residual Value of Leased Property*

FASB Staff Position, AUG AIR-1, *Accounting for Planned Major Maintenance Activities*

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

AICPA Industry Audit Guide, *Audits of Airlines*

AICPA Statement of Position 81-1, *Accounting for Performance of Construction-Type and Certain Production-Type Contracts*

SEC Staff Accounting Bulletin No. 104, Topic 13, *Revenue Recognition*

International Accounting Standard 17, *Leases*

EITF Issue No. 86-33, "Tax Indemnifications in Lease Agreements"

EITF Issue No. 96-21, "Implementation Issues in Accounting for Leasing Transactions involving Special-Purpose Entities"

EITF Issue No. 98-9, "Accounting for Contingent Rent"

EITF Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities"

[*] **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.~~This draft abstract is being exposed for a public comment period that will end on May 5, 2008.~~**

Objective

1. **The objective of this Issue is to clarify how a lessee shall account for a ~~nonrefundable~~ maintenance deposit under an arrangement accounted for as a lease.**

All paragraphs in this Issue have equal authority. **Paragraphs in bold set out the main principles.**

Background

2. Under certain equipment lease agreements, a lessee is legally or contractually responsible for repair and maintenance of the leased asset throughout the lease term. Additionally, certain lease agreements include provisions requiring the lessee to make deposits[1] to the lessor in order to financially protect the lessor in the event the lessee does not properly maintain the leased asset.

3. Under a typical arrangement, those deposits are calculated based on a performance measure, such as hours of use of the leased asset, and are contractually required under the terms of the lease agreement to be used to reimburse the lessee for required maintenance of the leased asset upon the completion of that maintenance. The lessor is contractually required to reimburse the lessee for the maintenance costs paid by the lessee, to the extent of the amounts on deposit.

4. In some cases, the total cost of cumulative maintenance events over the term of the lease is less than the cumulative deposits, resulting in excess amounts on deposit at the expiration of the lease. In those cases, some lease agreements provide that the lessor is entitled to retain such excess amounts ~~(nonrefundable maintenance deposit)~~; whereas other agreements specifically provide that, at the expiration of the lease agreement, such excess amounts are returned to the lessee (refundable maintenance deposit). Refundable maintenance deposits are accounted for as a deposit but diversity has developed on the accounting for ~~nonrefundable~~ maintenance deposits that may not be refunded (if the lessee does not perform the specified maintenance activities).

5. If a lessee is required to return an asset to the lessor in a certain condition at the end of the lease term, the lessee will need to evaluate other GAAP for when (and if) to record a liability related to the return condition requirement.

Scope

6~~5~~. T~~he scope of t~~his Issue ~~is limited to nonrefundable~~ applies to the lessee's accounting for maintenance deposits paid by a lessee under an arrangement accounted for as a lease that are refunded only if the lessee performs specified maintenance activities.

7~~6~~. Payments to a lessor~~Deposits~~ that are not substantively and contractually related to

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[1] Lease agreements often refer to these deposits as "maintenance reserves" or "supplemental rent." However, the lessor is required to reimburse the deposits to the lessee upon the completion of maintenance activities that the lessee is contractually required to perform under the lease agreement.

maintenance of the leased asset are not within the scope of this Issue. If at lease inception a lessee determines that it is less than probable[2] that the total amount of payments will be returned to the lessee as a reimbursement for maintenance activities, the lessee shall consider that when determining the portion of each payment that is not within the scope of this Issue.

Recognition

8~~7~~. ~~Nonrefundable m~~Maintenance deposits within the scope of this Issue shall be accounted for as a deposit asset.

9~~8~~. Lessees shall continue to evaluate whether it is probable that an amount on deposit will be returned to reimburse the costs of the maintenance activities incurred by the lessee. When an amount on deposit is less than probable of being returned, it shall be recognized as additional expense. When the underlying maintenance is performed, the ~~deposit~~ maintenance costs shall be expensed or capitalized in accordance with the lessee's maintenance accounting policy. ~~Once it is determined that an amount on deposit is not probable of being used to fund future maintenance expense, it shall be recognized as additional expense at the time such determination is made.~~

Transition

10~~9~~. This Issue is effective for financial statements issued for fiscal years beginning after December 15, 2008, including interim periods within those fiscal years. Earlier application by an entity that has previously adopted an alternative accounting policy is not permitted.

11~~10~~. Entities shall recognize the effect of the change as a change in accounting principle as of the beginning of the fiscal year in which this consensus is initially applied for all arrangements existing at the effective date. The cumulative effect of the change in accounting principle shall be recognized as an adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that fiscal year, presented separately. The cumulative ~~-~~effect adjustment is the difference between the amounts recognized in the statement of financial position before initial application of this Issue and the amounts recognized in the statement of financial position at initial application of this Issue.

12~~11~~. The transition disclosures in paragraphs 17 and 18 of Statement 154 shall be provided~~impact of applying this Issue shall comply with the disclosure requirements of Statement 154 for changes in accounting principles~~.

The provisions of this Issue need not be applied to immaterial items.

[2] The use of the term "probable" in this Issue is intended to be consistent with the definition in paragraph 25 of Concepts Statement 6.

Issue No. 08-4

Title: Transition Guidance for Conforming Changes to EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios"

Dates Discussed: March 12, 2008; June 12, 2008

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

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

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

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

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

Introduction

1. Certain consensuses in Issue 00-27 nullified portions of the guidance in Issue 98-5. A general status update that included transition guidance was added to Issue 98-5 to acknowledge the issuance of Issue 00-27. However, the portions of Issue 98-5 that were nullified by Issue 00-27 were not specifically identified in Issue 98-5, nor were the illustrative examples in Issue 98-5 updated for the effects of Issue 00-27.

2. In addition, Statement 150 was issued in May 2003. Instruments within the scope of Statement 150 are accounted for pursuant to the guidance in that Statement, not the guidance in Issues 98-5 or 00-27. A status update was added to Issue 00-27 clarifying that instruments within the scope of Statement 150 are no longer within the scope of Issue 00-27. However, a status update was not included in Issue 98-5.

Prior EITF Discussion

3. The issues brought to the Task Force at the March 12, 2008 EITF meeting were as follows:

Issue 1— Whether transition guidance should be provided for conforming changes to Issue 98-5

Issue 1(a)— What the appropriate effective date and transition guidance for the conforming changes to Issue 98-5 should be

Issue 2— Whether convertible instruments that have terms that provide for settlement through the issuance of (a) a variable number of shares with a fixed monetary amount if settlement occurs when the share price is less than a certain amount or (b) a fixed number of shares if settlement occurs when the share price is equal to or greater than a certain amount, should be evaluated as having (1) a single compound embedded feature (that is, one embedded feature with the characteristics of a share-settled "put warrant") or (2) two separate embedded features (that is, an embedded put option and an embedded conversion feature).

4. At the March 12, 2008 EITF meeting, the Task Force decided to provide transition guidance for the conforming changes to Issue 98-5 relating to Issue 00-27 and Statement 150.

5. The Task Force reached a consensus-for-exposure that the conforming changes to Issue 98-5 shall be effective for financial statements issued for fiscal years ending after December 15, 2008, with earlier application permitted. The effect, if any, of applying the conforming changes shall be presented retrospectively with the cumulative-effect of the change being reported in retained earnings in the statement of financial position as of the beginning of the first period presented (retrospective application). Additionally, any transition impact of applying these conforming changes shall comply with the disclosure requirements of Statement 154 for changes in accounting principles.

6. The Task Force discussed Issue 2, but decided not to include any additional guidance because that issue has broader implications and seems to be beyond the scope of providing conforming changes to Issue 98-5. After further consideration, it became clear that the guidance on determining what constitutes a "conversion option" for financial instruments that have terms that provide for settlement through the issuance of (a) a variable number of shares with a fixed monetary amount if settlement occurs when the share price is less than a certain amount or (b) a fixed number of shares if settlement occurs when the share price is equal to or greater than a certain amount, may have a significant impact on other transactions that are within the scope of Statement 133 that have not been contemplated. Therefore, the Task Force decided not to address Issue 2.

7. As a result of its decision to not address Issue 2, the Task Force agreed that Case 1(d) in Exhibit 98-5A shall be nullified as part of the conforming changes because it illustrates the accounting for a financial instrument with terms that provide for settlement through the issuance of (a) a variable number of shares with a fixed monetary amount if settlement occurs when the share price is less than a certain amount or (b) a fixed number of shares if settlement occurs when the share price is equal to or greater than a certain amount. The illustration in Case 1(d) requires interpretations of other accounting literature that was issued subsequent to Issue 98-5 and was not reflected in that example. As a result, Case 1(d) will be nullified as part of the conforming changes.

Current EITF Discussion

8. At the June 12, 2008 EITF meeting, the Task Force discussed the comment letter received on the draft abstract and affirmed as a consensus the consensus-for-exposure reached at the March 12, 2008 EITF meeting.

9. Appendix 08-4A presents the abstract for Issue 08-4. Furthermore, Exhibit 08-4A of the abstract illustrates all of the conforming changes to Issue 98-5 (added text is underlined and deleted text is ~~struck out~~).

Board Ratification

10. At its June 25, 2008 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

11. No further EITF discussion is planned.

Appendix 08-4A

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

Issue No. 08-4

Title: Transition Guidance for Conforming Changes to Issue No. 98-5

Dates Discussed: March 12, 2008; ~~[~~June ~~11~~–12, 2008~~]~~

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

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

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

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

Objective

1. **The objective of this Issue is to provide transition guidance for conforming changes made to Issue 98-5 that resulted from Issue 00-27 and Statement 150.**

All paragraphs in this Issue have equal authority. **Paragraphs in bold set out the main principles.**

[*] **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.~~This draft abstract is being exposed for a public comment period that will end on May 5, 2008.~~**

Background

2. Certain consensuses in Issue 00-27 nullified portions of the guidance in Issue 98-5. A general status update that included transition guidance was added to Issue 98-5 to acknowledge the issuance of Issue 00-27. However, the portions of Issue 98-5 that were nullified by Issue 00-27 were not specifically identified in Issue 98-5, nor were the illustrative examples in Issue 98-5 updated for the effects of Issue 00-27.

3. In addition, Statement 150 was issued in May 2003. Instruments within the scope of Statement 150 are accounted for pursuant to the guidance in that Statement, not the guidance in Issues 98-5 and 00-27. A status update was added to Issue 00-27 clarifying that instruments within the scope of Statement 150 are no longer within the scope of Issue 00-27. However, a status update for Statement 150 was not included in Issue 98-5.

Scope

4. **This issue applies to the conforming changes (included in Exhibit 08-4A) made to Issue 98-5 that resulted from Issue 00-27 and Statement 150.**

Transition

5. **Conforming changes made to Issue 98-5 that resulted from Issue 00-27 and Statement 150 shall be effective for financial statements issued for fiscal years ending after December 15, 2008. Earlie~~y~~ application is permitted. The ~~impact~~effect, if any, of applying the conforming changes~~, if any,~~ shall be presented retrospectively with the cumulative-effect of the change being reported in retained earnings in the statement of financial position as of the beginning of the first period presented.**

6. If as a result of applying the conforming changes in this Issue an entity has a change to its accounting, it shall comply with the disclosure requirements of Statement 154 for changes in accounting principles. Exhibit 08-4A includes the conforming changes made to Issue 98-5 relating to Issue 00-27 and Statement 150. [Added text is underlined and deleted text is ~~struck out~~.]

The provisions of this Issue need not be applied to immaterial items.

Exhibit 08-4A

EITF ABSTRACTS

Issue No. 98-5

Title: Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios

Dates Discussed: May 21, 1998; July 23, 1998; September 23–24, 1998; November 18–19, 1998; January 21, 1999; March 24–25, 1999; May 19–20, 1999; March 12, 2008; June 12, 2008

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

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

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

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

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

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

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

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

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

APB Opinion No. 20, *Accounting Changes*

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

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

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*

AICPA Accounting Interpretation, *Interest on Receivables and Payables*, of APB Opinion No. 21

SEC Staff Accounting Bulletin No. 68, *Increasing Rate Preferred Stock*

EITF Issue No. 85-17, "Accrued Interest upon Conversion of Convertible Debt"

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

EITF Issue No. 08-4, "Transition Guidance for Conforming Changes to Issue No. 98-5"

ISSUE

1. Entities may issue convertible debt securities and convertible preferred stock with a nondetachable conversion feature that is in-the-money at the commitment date[1] (a "beneficial conversion feature"). Those securities may be convertible into common stock at the lower of a conversion rate fixed at the commitment date or a fixed discount to the market price of the common stock at the date of conversion. Opinion 14 addresses an issuer's accounting for convertible debt with a nondetachable (embedded) conversion feature, the terms of which provide for (a) an initial conversion price that is greater than market value at the date of issuance and (b) a conversion price that does not decrease, except under antidilution protection. Opinion 14 does not explicitly address situations in which the embedded conversion feature is in-the-money at issuance, nor does it explicitly address convertible preferred stock.

2. Certain convertible securities may have a conversion price that is variable based on future events such as a subsequent round of financing at a price lower than the convertible securities' original conversion price, a liquidation or a change in control of the company, or an initial public offering at a share price lower than an agreed-upon amount. Opinion 14 also does not explicitly address situations in which the conversion terms are contingently adjustable.

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[1] ~~The commitment date is the date when an agreement as to terms has been reached and the investor is committed to purchase the convertible securities based on those terms (that is, performance by the investor is probable because of sufficiently large disincentives for nonperformance). In certain cases, the securities may be purchased by a number of investors, such as a group of lenders participating in a syndicate. In those situations, the latest commitment date for the group or issuance date for each individual security, whichever comes first, should be considered the commitment date.~~ The commitment date is defined as the date when an agreement has been reached with an unrelated party, binding on both parties and usually legally enforceable, with the following characteristics:

a. The agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction. The fixed price may be expressed as a specified amount of an entity's functional currency or of a foreign currency. It may also be expressed as a specified interest rate or specified effective yield.

b. The agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable. In the legal jurisdiction that governs the agreement, the existence of statutory rights to pursue remedies for default equivalent to the damages suffered by the nondefaulting party, in and of itself, represents a sufficiently large disincentive for nonperformance to make performance probable for purposes of applying the definition of a firm commitment.

The Task Force observed that if an agreement includes subjective provisions that permit either party to rescind its commitment to consummate the transaction (for example, a provision that allows an investor to rescind its commitment to purchase a convertible instrument in the event of a material adverse change in the issuer's operations or financial condition or a provision that makes the commitment subject to customary due diligence or shareholder approval), a commitment date should not occur until the provisions expire or the convertible instrument is issued, whichever is earlier. [Note: This consensus has been modified by Issue 4 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

3. This Issue applies to convertible securities with beneficial conversion features that must be settled in stock and to those that give the issuer a choice of settling the obligation in either stock or cash. This Issue also applies to instruments with beneficial conversion features that are convertible into multiple instruments, for example, a convertible preferred stock that is convertible into common stock and detachable warrants. In addition, this Issue applies to instruments with conversion features that are not beneficial at the commitment date but that become beneficial upon the occurrence of a future event, such as an initial public offering.

4. The issues are:

Issue 1—Whether embedded beneficial conversion features present in convertible securities should be valued separately at the commitment date

Issue 2—If the answer to Issue 1 is to value beneficial conversion features separately, then how an embedded conversion feature should be recognized and measured

Issue 3—How the issuance of convertible securities with beneficial conversion ratios that adjust (or arise) based on the occurrence of specified future events should be accounted for.

EITF DISCUSSION

5. The Task Force reached a consensus that embedded beneficial conversion features present in convertible securities should be valued separately at issuance. [Note: This consensus has been partially nullified by Statement 133 and Statement 150. See STATUS section.] The embedded beneficial conversion feature should be recognized and measured by allocating a portion of the proceeds equal to the intrinsic value of that feature to additional paid-in capital. That amount should be calculated at the commitment date[2] as the difference between the conversion price and the fair value[3] of the common stock or other securities into which the security is convertible, multiplied by the number of shares into which the security is convertible (intrinsic value).[4]

6. The Task Force observed that in certain circumstances, the intrinsic value of the beneficial conversion feature may be greater than the proceeds allocated to the convertible instrument. In those situations, the Task Force reached a consensus that the amount of the discount assigned to the beneficial conversion feature is limited to the amount of the proceeds allocated to the

[2]Refer to footnote 1.

[3]The fair value is the amount at which the common stock and/or other securities could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and should be used as the basis for the measurement, if available. That quoted price should not be adjusted to reflect transferability restrictions, large block factors, avoided underwriter's fees, or time value discounts. If a quoted market price is not available, the estimate of fair value should be based on the best information available in the circumstances.

[4]In circumstances in which convertible securities are issued with detachable warrants, the Task Force noted that in order to determine the amount to be allocated to the beneficial conversion feature, the issuer must first allocate the proceeds between the convertible instrument and the detachable warrants using the relative fair value method of Opinion 14. A similar methodology would be used in circumstances in which convertible securities are issued along with another security, such as common stock.

convertible instrument. [Note: This consensus has been partially nullified by Statement 133. See STATUS section.] ~~Except as provided in paragraph 10 below, the discount assigned to the convertible instrument, if any, should be amortized over the period to the security's earliest conversion date.~~ For convertible instruments that have a stated redemption date, a discount resulting from recording a beneficial conversion option shall be required to be amortized from the date of issuance to the stated redemption date of the convertible instrument, regardless of when the earliest conversion date occurs. For convertible instruments that do **not** have a stated redemption date, such as perpetual preferred stock, a discount resulting from the accounting for a beneficial conversion option shall be amortized from the date of issuance to the earliest conversion date. [Note: This consensus has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

7. The Task Force noted that, in accordance with Statement 129, the issuer should disclose in the footnotes to its financial statements the terms of the transaction, including the excess of the aggregate fair value of the instruments that the holder would receive at conversion over the proceeds received and the period over which the discount is amortized.

8. For convertible preferred securities, any recorded discount resulting from allocation of proceeds to the beneficial conversion feature is analogous to a dividend and should be recognized as a return to the preferred shareholders ~~over the minimum period from the date of issuance to the date at which the preferred shareholders can realize that return (that is, through the date of earliest conversion)~~[5] using the effective yield method. [Note: This consensus has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

9. For convertible debt securities, any recorded discount resulting from allocation of proceeds to the beneficial conversion feature should be recognized as interest expense ~~over the minimum period from the date of issuance to the date at which the debtholder can realize that return (that is, through the date of earliest conversion[6])~~ using the effective yield method. [Note: This consensus has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

10. In situations in which the instrument incorporates a multiple-step discount (for example, an instrument that provides for a 15 percent discount to the market price after 3 months, a 25 percent discount after 6 months, a 35 percent discount after 9 months, and a 40 percent discount after 1 year), the basic accounting model described above is modified. For those types of convertible securities, the Task Force reached a consensus that the computation of the intrinsic value should be made using the conversion terms that are most beneficial to the investor. If the convertible instrument has a stated redemption date, the resultant discount should be amortized from the date of issuance to the stated redemption date of the convertible instrument, regardless

[5] ~~For those preferred securities that are convertible at the date of issuance, the Task Force observed that the discount would be fully amortized through retained earnings at the date of issuance.~~

[6] ~~For those debt securities that are convertible at the date of issuance, the Task Force observed that the discount would be fully amortized through interest expense at the date of issuance.~~

of when the earliest conversion date occurs (in the example noted above, the discount would be 40 percent and the amortization period would be from issuance to the stated redemption date). [Note: This consensus has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

10A. ~~The resultant discount should be~~For convertible instruments that do **not** have a stated redemption date, the resultant discount should be amortized over the minimum period in which the investor can recognize that return (in the example noted above, the discount would be 40 percent and the amortization period would be 1 year). [Note: This consensus has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.] However, amortization recognized may require adjustment to ensure that the discount amortized at any point in time is not less than the amount the holder of the instrument could obtain if conversion occurred at that date. That is, at the end of 3 months, at least the 15 percent discount should have been recognized. This method can be expressed as requiring cumulative amortization equal to the *greater of* (a) the amount derived using the effective yield method based on the conversion terms most beneficial to the investor or (b) the amount of discount which the investor can realize at that interim date.

11. In circumstances in which the instrument is converted prior to amortization of the full amount of the discount, the remaining unamortized discount at the date of conversion should be ~~included in the carrying value of the convertible security that is transferred to equity at the date of conversion.~~ immediately recognized as interest expense or as a dividend, as appropriate.[6a] If the amount of unamortized discount is recognized as an expense (because the convertible instrument was in debt form), the expense should not be classified as extraordinary. [Note: This consensus has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.] If, however, the amount of discount amortized exceeds the amount the holder realized because conversion occurred at an earlier date, the Task Force agreed that no adjustment should be made to amounts previously amortized.

12. The Task Force also considered situations in which a debt instrument containing the embedded beneficial conversion feature is extinguished prior to conversion. The Task Force recognized that a portion of the reacquisition price includes a repurchase of the beneficial conversion feature. The Task Force reached a consensus that the amount of the reacquisition price to be allocated to the beneficial conversion feature should be measured using the intrinsic value of that conversion feature at the extinguishment date. The residual amount, if any, would be allocated to the convertible security. The Task Force indicated that the issuer would record a gain or loss on extinguishment of the convertible debt security. The Task Force observed that the gain or loss from the extinguishment of debt should be classified in accordance with the guidance in Statement 4. [Note: See STATUS section.] If the convertible instrument is a preferred security, guidance is provided in Topics No. D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock," and 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."

[6a] For convertible debt that does not include a beneficial conversion option, Accounting Interpretation 1 of Opinion 26 and Issue 85-17 continue to apply. Those pronouncements state that the net carrying amount of the convertible debt, including any unamortized premium or discount, is credited to equity upon conversion.

13. The Task Force also discussed the accounting for (a) a security that becomes convertible only upon the occurrence of a future event outside the control of the holder and (b) a security that is convertible from inception but contains conversion terms that change upon the occurrence of a future event. The Task Force reached a consensus that any contingent beneficial conversion feature should be measured ~~at~~ using the commitment date stock price but not recognized in earnings until the contingency is resolved.

14. The consensuses reached are applicable to instruments issued after May 20, 1999. Examples of the application of the above consensuses are in Exhibit 98-5A. [Note: See paragraph 18B of the STATUS section.]

14A. Conforming changes made to Issue 98-5 relating to Issue 00-27 and Statement 150 shall be effective for financial statements issued for fiscal years ending after December 15, 2008, with earlier application permitted.[6b] The impact, if any, of applying the conforming changes should be presented retrospectively with the cumulative-effect of the change being reported in retained earnings in the statement of financial position as of the beginning of the first period presented. [Note: See paragraphs 17A–18C and 19A–19C of the STATUS section.]

STATUS

15. Statement 133 was issued in June 1998 and has been subsequently amended. The effective date for Statement 133, as amended, is for all fiscal quarters of all fiscal years beginning after June 15, 2000.

16. The terms of the entire embedded conversion feature should be analyzed to determine whether it meets the criteria under paragraph 12 of Statement 133 to be separated from the host contract and accounted for as a derivative under that Statement. Paragraph 12(c) indicates that one criterion for separate accounting essentially is that the embedded derivative, as a freestanding instrument, would meet the definition of a derivative and be subject to Statement 133. Under paragraph 11(a) of Statement 133, contracts issued by the reporting entity that are both (1) indexed only to its own stock and (2) classified in stockholders' equity in its statement of financial position are not considered derivatives by that entity under Statement 133. However, the scope exception in paragraph 11(a) does not apply to the holder of a security convertible into the common stock of the issuer. Furthermore, the holder generally will conclude that the embedded conversion feature is not clearly and closely related to the host contract (refer to the criterion in paragraph 12(a)). Statement 155, which was issued in February 2006, amends Statement 133. Statement 155 provides a fair value measurement election for certain hybrid financial instruments with embedded derivatives that otherwise would require bifurcation. A hybrid financial instrument that is elected to be accounted for in its entirety at fair value cannot be used as a hedging instrument in a Statement 133 hedging relationship.

[6b] Conforming changes were made to the following portions of Issue 98-5: footnote 1 to paragraph 1; paragraph 6; paragraph 8 and its related footnote 5; paragraph 9 and its related footnote 6; paragraphs 10, 10A, 11, 13, 17A, 18, 18B, 18C, 19A, 19B, and 19C; Cases 1(a), 1(b), ~~1(c), 1(d),~~ 2, 3, 4, ~~5,~~ and 6. Cases 1(c), 1(d), and 5 have been deleted.

17. During the discussion of this Issue, it was mentioned that the issuer of those securities will generally be unable to reliably measure the fair value of the embedded beneficial conversion feature. The observation may be equally applicable to the holder of such securities. Paragraph 16 of Statement 133 states, "If an entity cannot reliably identify and measure the embedded derivative instrument that paragraph 12 requires be separated from the host contract, the entire contract shall be measured at fair value with gain or loss recognized in earnings, but it may not be designated as a hedging instrument pursuant to this Statement." However, paragraph 301 of Statement 133 clarifies that it should be unusual that an entity would conclude that it cannot reliably separate an embedded derivative from its host contract.

17A. Issue 00-27 addresses a number of practice issues raised about the application of the Issue 98-5 model. The Task Force reached consensuses on portions of Issue 00-27 at the November 15–16, 2000 meeting.

18. The original consensuses reached in Issue 98-5 are applicable to instruments issued after May 20, 1999 and prior to November 16, 2000 (unless a commitment date, as defined under Issue 98-5, occurred before November 16, 2000, in which case Issue 98-5 applies to those instruments). For instruments issued after November 16, 2000, for which a commitment date, as originally defined in Issue 98-5, has not occurred prior to November 16, 2000, the consensuses in Issue ~~No.~~ 00-27~~, "Application of Issue No. 98-5 to Certain Convertible Instruments,"~~ should be applied. Issue 98-5 originally defined a commitment date as the date when an agreement as to terms has been reached and the investor is committed to purchase the convertible securities based on those terms (that is, performance by the investor is probable because of sufficiently large disincentives for nonperformance). In certain cases, the securities may be purchased by a number of investors, such as a group of lenders participating in a syndicate. In those cases, the latest commitment date for the group or issuance date for each individual security, whichever comes first, should be considered as the commitment date.

18A. During the discussions of Issue 00-27, the SEC Observer stated that the consensus on Issue 1 of Part II of Issue 00-27 must be applied to all transactions subject to Issue 98-5, including those transactions for which a commitment date occurred before November 16, 2000. The effect, if any, of initial application of the consensus on Issue 1 of Part II to all prior transactions (including existing, terminated, and converted) subject to Issue 98-5 should be reported as of the beginning of a registrant's quarter that includes the date of the Issue 00-27 consensus (November 16, 2000) in a manner similar to the cumulative effect of a change in accounting principle in accordance with Opinion 20.

18B. Cases 1(a), 1(b), 2, 3, 4, and 6 in Exhibit 98-5A have been amended to reflect the guidance provided in Issue 00-27.

18C. Refer to Exhibit 00-27B of Issue 00-27 for an illustration of the amendments to Issue 98-5 by Issue 00-27.

19. 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.

19A. Statement 150 was issued in May 2003 and 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, 2004, except for mandatorily redeemable financial instruments of a nonpublic entity. Statement 150 establishes standards for issuer's classification and measurement of certain financial instruments with characteristics of both liabilities and equity, and requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances).

19B. Cases 1(c) and 5 in Exhibit 98-5A have been nullified as the instruments described in those examples are within the scope of Statement 150.

19C. At the March 12, 2008 meeting, the Task Force decided that Case 1(d) should be nullified as the instruments described in that example require an assessment of accounting literature that was issued subsequent to this Issue.

20. No further EITF discussion is planned.

Exhibit 98-5A

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUSES ON ISSUE 98-5

Case 1(a)—Instrument Is Convertible at Inception, Fixed Dollar Conversion Terms (Base Case)

Assumptions:

1. $1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance.
2. Convertible at date of issuance.
3. Convertible at $40 per share.
4. Fair value (FV) of common at commitment date equals $50 per share.

Calculation:

FV at commitment date	$50
Conversion price (stated and will not change)	$40
Intrinsic value of beneficial conversion feature	$250,000[7]
Amount to record at date of issuance	**$250,000**

The beneficial conversion feature is calculated at its intrinsic value (that is, the difference between the conversion price and the fair value of the common stock into which the debt is convertible, multiplied by the number of shares into which the debt is convertible) at the commitment date. A portion of the proceeds from issuance of the convertible debt, equal to the intrinsic value, is then allocated to additional paid-in capital (APIC). Because the debt ~~is convertible at the date of issuance, the debt discount is charged to interest expense at the date of issuance~~ has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five-year period from the date of issuance to the stated redemption date.

Entry at date of issuance:

Cash	$1,000,000	
Debt discount~~Interest expense~~	250,000	
Debt		$1,000,000
APIC		250,000

[Note: The facts in this example have been amended to include a stated redemption date. The analysis in ~~T~~this example has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

[7] Convertible into 25,000 shares (1,000,000 ÷ 40) with an intrinsic value of $10 (50 – 40) or overall: (1,000,000 ÷ 40) × (50 – 40).

Case 1(b)—Instrument Is *Not* Convertible at Inception, Fixed Dollar Conversion Terms (Base Case)

Assumptions:

1. $1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance.
2. Convertible in one year.
3. Convertible at $40 per share.
4. FV of common at commitment date equals $50 per share.

Calculation:

FV at commitment date	$50
Conversion price (stated and will not change)	$40
Intrinsic value of beneficial conversion feature	$250,000[8]
Amount to record over period to stated redemption~~convert~~	**$250,000**

The beneficial conversion feature is calculated at its intrinsic value at the commitment date (that is, the difference between the conversion price and the fair value of the common stock into which the debt is convertible, multiplied by the number of shares into which the debt is convertible). A portion of the proceeds from issuance of the convertible debt, equal to the intrinsic value, is then allocated to additional paid-in capital. Because the debt~~ is convertible in one year, the debt discount is amortized to interest expense over one year using the interest method.~~ has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five-year period from the date of issuance to the stated redemption date.

Entry at date of issuance:

Cash	$1,000,000	
Debt discount	250,000	
Debt		$1,000,000
APIC		250,000

[Note: The facts in this example have been amended to include a stated redemption date. The analysis in ~~T~~this example has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

[8] (1,000,000 ÷ 40) × (50 – 40)

~~Case 1(c)—Instrument Is Convertible at Inception, Fixed Percentage Conversion Terms (Base Case)~~

~~Assumptions:~~

1. ~~$1,000,000 of convertible debt.~~
2. ~~Convertible at date of issuance.~~
3. ~~Convertible at 80 percent of fair market value when converted.~~
4. ~~FV of common at commitment date equals $50 per share.~~

~~Calculation~~:

~~FV at commitment date~~	~~$50~~
~~Conversion price~~	~~$40~~[9]
~~Intrinsic value of beneficial conversion feature~~	~~$250,000~~[10]

~~Amount to record at issuance~~	**~~$250,000~~**

~~In this case, the terms of the security change upon the occurrence of a future event (that is, the conversion price changes depending on the fair value of the common stock at the date of conversion). In this example, because the conversion percentage is fixed, the amount the investor will receive is *always* $250,000. However, because the beneficial conversion feature is to be settled by issuing equity, the amount attributed to the beneficial conversion feature is recorded as a component of equity. Because the debt is convertible at the date of issuance, the debt discount is charged to interest expense at the date of issuance.~~

~~Entry at date of issuance:~~

~~Cash~~	~~$1,000,000~~	
~~Interest expense~~	~~250,000~~	
~~Debt~~		~~$1,000,000~~
~~APIC~~		~~250,000~~

[9] ~~50 × 80%~~

[10] ~~(1,000,000 ÷ 40) × (50 – 40)~~

~~**Case 1(d)—Instrument Is Convertible at Inception, Conversion Terms Are Not Fixed**~~

~~**Assumptions:**~~

1. ~~$1,000,000 of convertible debt.~~
2. ~~Convertible at date of issuance.~~
3. ~~Convertible at the lower of 80 percent of fair market value when converted or $40.~~
4. ~~FV of common at commitment date equals $50 per share.~~

~~**Calculation:**~~

~~FV at conversion date~~	~~**$40**~~	~~**$50**~~	~~**$60**~~	~~**$70**~~
~~80% of stock price at conversion date~~	~~$32~~	~~$40~~	~~$48~~	~~$56~~
~~Conversion price~~	~~$32~~	~~$40~~	~~$40~~	~~$40~~
~~Intrinsic value of beneficial conversion feature at commitment date~~	~~$250,000~~[11]	~~$250,000~~[12]	~~$250,000~~[13]	~~$250,000~~[14]

~~The beneficial conversion feature is calculated at its intrinsic value at the commitment date (that is, the difference between the conversion price and the fair value of the common stock into which the debt is convertible, multiplied by the number of shares into which the debt is convertible). A portion of the proceeds from issuance of the convertible debt, equal to the intrinsic value of $250,000, is then allocated to additional paid-in capital. Because the debt is convertible at issuance, the debt discount is recorded as a charge to interest expense immediately. No additional amount would be recognized at the conversion date in recognition of an increase in the fair value of the stock conversion.~~

~~Entry at date of issuance:~~

~~Cash~~	~~$1,000,000~~	
~~Interest expense~~	~~250,000~~	
~~Debt~~		~~$1,000,000~~
~~APIC~~		~~250,000~~

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[11] ~~(1,000,000 ÷ 40) × (50 – 40)~~

[12] ~~(1,000,000 ÷ 40) × (50 – 40)~~

[13] ~~(1,000,000 ÷ 40) × (50 – 40)~~

[14] ~~(1,000,000 ÷ 40) × (50 – 40)~~

Case 2—Instrument Containing a Fixed Percentage Conversion Feature Dependent on a Future Event

Assumptions:

1. $1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance.
2. Convertible upon an initial public offering (IPO).
3. Convertible at 80 percent of stock price at commitment date (that is, $40).
4. FV of common at commitment date equals $50 per share.

Calculation:

IPO price	**$50**	**$60**	**$70**
Stock price at commitment date	$50	$50	$50
80% of stock price at commitment date	$40	$40	$40
Intrinsic value of beneficial conversion feature at commitment date	$250,000[15]	$250,000[16]	$250,000[17]

The instrument is not convertible at the commitment date; however, it will become convertible and that conversion feature will be beneficial if an IPO is completed. The intrinsic value of the beneficial conversion feature is calculated at the commitment date using the stock price as of that date, that is, $250,000. However, that amount would only be recorded at the date an IPO is completed. If the IPO were completed on the third anniversary of the debt issuance, the discount amount would be recorded at that date and amortized over a two-year period ending on the stated redemption date of the debt.

Entry at issuance:

Cash	$1,000,000	
Debt		$1,000,000

Entry at IPO:

Debt discount ~~Interest expense~~	$250,000	
APIC		$250,000

[Note: The facts in this example have been amended to include a stated redemption date. The analysis in ~~T~~this example has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

[15](1,000,000 ÷ 40) × (50 – 40)

[16](1,000,000 ÷ 40) × (50 – 40)

[17](1,000,000 ÷ 40) × (50 – 40)

Case 3—Convertible Instrument Containing Fixed Terms That Change Based on a Future Event

Assumptions:

1. $1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance.
2. Convertible at date of issuance.
3. Convertible at 80 percent of stock price at commitment date (that is, $40).
4. FV of common at commitment date equals $50 per share.
5. If there is an IPO, the conversion feature adjusts to the lesser of $30 or 80 percent of the IPO price.

Calculation:

FV at commitment date	$50
Conversion price at commitment date	$40
Intrinsic value of basic beneficial conversion feature at commitment date	$250,000[18]
Conversion price at contingency resolution	unknown
~~Most beneficial conversion price at commitment date~~	~~$30~~
Intrinsic value of contingent beneficial conversion feature at commitment date	unknown~~$666,667~~[19]
~~Amount recorded at issuance date~~	~~250,000~~
~~Additional intrinsic value of contingent beneficial conversion feature at commitment date~~	~~$416,667~~

This instrument includes a "basic" beneficial conversion feature that is not contingent upon the occurrence of a future event and a contingent beneficial conversion feature. Accordingly, the intrinsic value of the basic beneficial conversion feature of $250,000 is calculated at the commitment date and recorded at the issuance date. Because the debt~~ is convertible at the date of issuance, the debt discount is charged to interest expense at the date of issuance~~ has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five-year period from the date of issuance to the stated redemption date.

~~The amount of the contingent beneficial conversion feature also is calculated at the commitment date using the terms most advantageous to the investor, based on the facts available at that date. In this instance, the most beneficial conversion price at the commitment date is $30 per share. Accordingly, the beneficial conversion feature is calculated using the $30 per-share conversion price resulting in a contingent beneficial conversion amount of $666,667. However, the amount in excess of the $250,000 previously recognized would not be recorded until the IPO occurs.~~

[18] (1,000,000 ÷ 40) × (50 – 40)

[19] ~~(1,000,000 ÷ 30) × (50 – 30)~~

Entry at date of issuance:

Cash	$1,000,000	
Debt discount ~~Interest expense~~	250,000	
Debt		$1,000,000
APIC		250,000

~~Subsequent entry (assuming IPO occurs):~~

~~Interest expense~~	~~$416,667~~	
~~APIC~~		~~$416,667~~

The terms of the convertible debt instrument do not permit the number of shares that would be received upon conversion if an IPO occurs to be calculated at the commitment date. Refer to Issues 3 and 7 of Issue 00-27 for guidance on recognition and measurement of the contingent beneficial conversion feature.

[Note: The facts in this example have been amended to include a stated redemption date. The analysis in ~~T~~this example has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

Case 4—Conversion Dependent on a Future Event and Terms Are Variable

Assumptions:

1. $1,000,000 of convertible debt with a redemption date on the fifth anniversary of issuance.
2. Convertible at date of issuance.
3. Convertible at 80 percent of stock price at commitment date (that is, $40).
4. FV of common at commitment date equals $50 per share.
5. If the stock price increases at least 15 percent one year after an IPO, the conversion feature adjusts to 65 percent of the fair value of the common stock one year after the IPO.

Calculation:

FV at commitment date	$50
Conversion price at commitment date	$40
Conversion price at contingency resolution	unknown~~$37.38~~~~[20]~~
Intrinsic value of basic beneficial conversion feature at commitment date	$250,000[21]
Intrinsic value of contingent beneficial conversion feature at commitment date	unknown~~$538,256~~~~[22]~~

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[20] ~~(50 × 115%) × 65%~~

[21] (1,000,000 ÷ 40) × (50 – 40)

[22] ~~(1,000,000 ÷ 37.38) × (57.50 – 37.38)~~

The amount of the beneficial conversion feature is measured using the terms of the beneficial conversion feature that are operative at issuance, that is, the 20 percent discount. The intrinsic value of that beneficial conversion feature ($250,000) is calculated at the commitment date and recorded at the issuance date. Because the debt ~~is convertible at the date of issuance, the debt discount is charged to interest expense at the date of issuance~~ has a stated redemption on the fifth anniversary of issuance, the debt discount should be amortized over a five-year period from the date of issuance to the stated redemption date.

~~Because this instrument also contains a contingent beneficial conversion feature, that amount also should be calculated at the commitment date assuming that an IPO will occur in the future and the company's stock appreciates by the requisite percentage using facts available at the commitment date. Accordingly, the conversion price is calculated assuming that (a) the IPO price is the stock price at the commitment date and (b) the targeted stock appreciation is achieved. However, an additional amount, representing the intrinsic value of the "contingent" beneficial conversion feature ($288,256),[23] would only be recorded once the IPO has been completed and the targeted stock price has been achieved 1 year later.~~

Entry at date of issuance:

Cash	$1,000,000	
Debt discount ~~Interest expense~~	250,000	
Debt		$1,000,000
APIC		250,000

~~Subsequent entry (assuming IPO occurs and targeted stock price is achieved):~~

~~Interest expense~~	~~$288,256~~	
~~APIC~~		~~$288,256~~

The terms of the convertible debt instrument do not permit the number of shares that would be received upon conversion if an IPO occurs to be calculated at the commitment date. Refer to Issues 3 and 7 of Issue 00-27 for guidance on recognition and measurement of the contingent beneficial conversion feature.

[Note: The facts in this example have been amended to include a stated redemption date. The analysis in ~~T~~this example has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

~~Case 5—Fixed Percentage Conversion Price Based on a Range of Stock Prices in the Future~~

~~Assumptions:~~

[23] ~~$538,256 – $250,000~~

1. ~~$1,000,000 of convertible debt.~~
2. ~~Convertible at date of issuance.~~
3. ~~Convertible at 80 percent of the average stock price for the 30 days preceding the date of conversion.~~
4. ~~FVof common at commitment date equals $50 per share.~~
5. ~~Average price per share for the 30 days preceding the commitment date equals $45 per share.~~

~~**Calculation:**~~

~~FV at commitment date~~	~~$50~~
~~80% of range preceding date of issuance~~	~~$36~~
~~Intrinsic value of beneficial conversion feature at commitment date~~	~~$388,889~~[24]

~~The intrinsic value of the beneficial conversion feature is measured at the commitment date using facts available at that date. In this instance, the average stock price for the 30-day period preceding the commitment date is used in calculating the beneficial conversion feature. Because the security is immediately convertible, the intrinsic value of the beneficial conversion feature ($388,889) would be charged to interest expense at issuance.~~

~~Entry at date of issuance:~~

~~Cash~~	~~$1,000,000~~	
~~Interest expense~~	~~388,889~~	
~~Debt~~		~~$1,000,000~~
~~APIC~~		~~388,889~~

Case 6—Extinguishment of Convertible Debt That Includes a Beneficial Conversion Feature

At the commitment date:

Proceeds from issuance of zero coupon convertible debt	$100
Intrinsic value of beneficial conversion feature	$90

At the commitment date, the issuer records $90 as discount on the debt with the offsetting entry to additional paid-in capital. The remainder ($10) is recorded as debt and is accreted to its full face value of $100 over the period from the issuance date until the stated redemption date of the

[24] ~~(1,000,000 ÷ 36) × (50 – 36)~~

instrument (3 years)~~earliest conversion date~~. The debt is subsequently extinguished one year after issuance.

At the extinguishment date:

Reacquisition price	$150
Intrinsic value of beneficial conversion feature at extinguishment date	$80
Carrying value of debt	$22[25]~~100~~

At the date of extinguishment, the extinguishment proceeds should first be allocated to the beneficial conversion feature ($80 as noted above). The remainder ($70) is allocated to the extinguishment of the convertible security.

Entry to record the extinguishment:

Debt	$22~~100~~	
Equity (paid-in capital)	80	
Loss on extinguishment	48	
~~Gain on extinguishment~~		~~$30~~
Cash		150

[Note: The facts in this example have been amended to include a stated redemption date. The analysis in this example has been amended by Issue 6 of Issue 00-27. See paragraphs 17A–18C of the STATUS section.]

[25] The net carrying value of the debt one year after issuance is calculated using the effective interest method to amortize the debt discount over three years.

Issue No. 08-5

Title: Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement

Date discussed: June 12, 2008

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

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

FASB Statement No. 157, *Fair Value Measurements*

FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*

Statement 133 Implementation Issue No. B3, "Investor's Accounting for a Put or Call Option Attached to a Debt Instrument Contemporaneously with or Subsequent to Its Issuance"

Statement 133 Implementation Issue No. K3, "Determination of Whether Combinations of Options with the Same Terms Must Be Viewed as Separate Option Contracts or as a Single Forward Contract"

Introduction

1. Debt securities are often issued with a third-party credit enhancement. For example, a financial guarantee from an unrelated third party that guarantees the issuer's payment obligations. That guarantee is generally purchased by the issuer who then combines it with the debt and issues the combined security to an investor. By issuing debt combined with the guarantee, the issuer is able to obtain a lower interest rate and/or receive higher proceeds.

2. The guarantee provides the investor with additional assurance that the obligation will be paid (either by the guarantor or the issuer). In most cases involving guaranteed debt, when the issuer defaults, it is not released from its obligation. The issuer is required to reimburse the guarantor. Therefore, from the issuer's perspective, upon default to the investor the issuer's obligation still exists, the only change is the identity of the creditor.

3. Statement 159, which was effective for fiscal years beginning after November 15, 2007, allows an entity to measure its financial assets and liabilities at fair value subject to certain requirements. An entity may elect the fair value option for a liability considered by this Issue. As a result, questions have arisen regarding whether the issuer would consider the effect of the third-party guarantee when measuring the liability under Statement 157.

Issue

4. The issue is whether an issuer of debt with a third-party credit enhancement that is inseparable from the debt instrument should treat the debt and the credit enhancement as one unit

of accounting or two units of accounting when the measurement attribute for that debt is fair value. This Issue does not address the unit of valuation under Statement 157, which may not be the same as the unit of accounting.

Scope

5. This Issue applies to an issuer's accounting for debt issued with an inseparable third-party credit enhancement that is measured or disclosed at fair value. This Issue does not apply to the investor's accounting for the debt instrument. Also, this Issue does not apply to guarantees provided by a government or government agencies (for example, deposit insurance).

Current EITF Discussion

6. At the June 12, 2008 EITF meeting, the Task Force reached a consensus-for-exposure that the scope of this Issue should apply to an issuer's accounting for all third-party credit enhancements that are issued with and are inseparable from a debt instrument that is measured at fair value. The Task Force clarified that this Issue should be considered when an issuer is required to disclose the fair value of a debt instrument (such as by Statement 107) even if it is measured on a different basis in the financial statements.

7. The Task Force also reached a consensus-for-exposure that the issuer should not include the effect of the third-party credit enhancement in the fair value measurement of the liability. Thus, the fair value measurement is determined considering the issuer's credit standing (without regard to the third-party guarantor's credit standing). The Task Force concluded that the unit of accounting for the debt does not include the guarantee (or other third-party credit enhancement), and that the guarantee does not represent an asset of the issuer. That guarantee is obtained for the benefit of the investor.

8. The Task Force reached a consensus-for-exposure that an entity that has outstanding debt within the scope of this Issue should disclose the existence of the credit enhancement. At the Task Force's request, the FASB staff confirmed that such a disclosure is not already required by other accounting pronouncements (such as Statements 107, 157, and 159). The Task Force also decided to require certain transitional disclosures, which are discussed below.

Effective Date and Transition

9. The Task Force reached a consensus-for-exposure that this Issue should be effective on a prospective basis in the first reporting period beginning after [the date of the Board ratification of the consensuses], including interim periods. The effect of initially applying the guidance in this Issue shall be included in the change in fair value in the period of adoption. Earlier application is not permitted.

10. The Task Force reached a consensus-for-exposure that in the period of adoption an entity should disclose the valuation techniques used to measure liabilities within the scope of this Issue and include a discussion of changes, if any, from the valuation techniques used to measure those liabilities in prior periods.

Board Ratification

11. At the June 25, 2008 meeting, the Board ratified the consensus-for-exposure reached by the Task Force in this Issue and approved the issuance of a draft abstract for a public comment period.

Status

12. The draft abstract will be posted to the FASB website after July 1, 2008. Comments on the draft abstract are due by August 4, 2008. Further discussion is expected at a future meeting.

Appendix 08-5A

EITF ABSTRACTS (DRAFT)[1]

Issue No. 08-5

Title: Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement

Dates Discussed: June 12, 2008; [September 10, 2008]

References: FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
FASB Statement No. 157, *Fair Value Measurements*
FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*

Objective

1. **The objective of this Issue is to determine an issuer's unit of accounting for debt issued with an inseparable third-party credit enhancement that is measured or disclosed at fair value.**

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

Background

2. Debt securities are often issued with credit enhancements obtained from an unrelated third-party. For example, debt may be issued with a financial guarantee from an unrelated third party that guarantees the issuer's payment obligations. That guarantee is generally purchased by the issuer who then combines it with the debt and issues the combined security to an investor. By issuing debt combined with the guarantee, the issuer is able to obtain a lower interest rate and/or receive higher initial proceeds.

[1] **This draft abstract is being exposed for a public comment period that will end on August 4, 2008.**

3. Statement 159, which is effective for fiscal years beginning after November 15, 2007, allows an entity to measure its financial assets and liabilities at fair value subject to certain requirements. An entity has the option of electing the fair value option for the liability considered by this Issue. Furthermore, Statement 107 requires disclosure of the fair value of all financial instruments, with certain exceptions. Statement 157 states that the fair value of a liability shall reflect the nonperformance risk (that is, the risk that the obligation will not be fulfilled) relating to that liability. As a result, questions have arisen regarding whether the issuer would consider the effect of the third-party credit enhancement when measuring the liability at fair value under Statement 157.

Scope

4. **This Issue applies to debt issued with an inseparable third-party credit enhancement (for example, debt that is issued with a contractual third-party guarantee) measured or disclosed at fair value.**

5. This Issue does not apply to guarantees provided by a government or government agencies; for example, deposit insurance.

Measurement

6. **The issuer of debt with a third-party credit enhancement that is inseparable from the debt instrument shall not include the effect of the credit enhancement in the fair value measurement of the liability.**

7. The unit of accounting for the debt does not include the third-party credit enhancement. That credit enhancement is obtained for the benefit of the investor and does not represent an asset of the issuer.

Disclosure

8. **An issuer shall disclose the existence of a third-party credit enhancement on its issued debt.**

Transition

9. This Issue shall be effective on a prospective basis in the first reporting period beginning after [the date of Board ratification of the consensuses]. The effect of initially applying the guidance in this Issue shall be included in the change in fair value in the year of adoption. Earlier application is not permitted.

10. The Task Force reached a consensus that in the period of adoption an entity shall disclose the valuation technique(s) used to measure the fair value of liabilities in the scope of this Issue and include a discussion of changes, if any, in the valuation techniques used to measure those liabilities in prior periods.

The provisions of this Issue need not be applied to immaterial items.

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 September 10, 2008 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
08-1	Revenue Recognition for a Single Unit of Accounting	1/08	3/08, 6/08	9/08	Uhl	Maples/ Elsbree/ Bement	The FASB staff will work with the Working Group to prepare an Issue Supplement for a future meeting	September 10, 2008 EITF meeting
08-5	Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement	5/08	6/08	9/08	M.Schroeder	Switter/ Maples	The FASB staff will prepare an Issue Supplement for a future meeting	Draft Abstract comment period closes August 4, 2008. September 10, 2008 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
08-E	Accounting for Defensive Intangible Assets	6/08	N/A	9/08	TBD	Maples/ TBD	The issue was transferred from the FASB agenda. The FASB staff will prepare an Issue Summary for a future meeting	September 10, 2008 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**
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	11/02	N/A	Not scheduled	TBD	The Board's project on QSPE's is not expected to address this Issue and, therefore, the FASB staff will bring this Issue to the Agenda Committee at a future meeting to determine whether to begin discussions on this Issue or to request that the Task Force remove this Issue from the agenda.	Future Agenda Committee or EITF Meeting

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**
06-12	Accounting for Physical Commodity Inventories for Entities within the Scope of the AICPA Audit and Accounting Guide, *Brokers and Dealers in Securities*	8/06	11/06	Not scheduled	TBD	Pending the outcome of the Board's project to amend ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*.	Future EITF Meeting

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