FINANCIAL ACCOUNTING STANDARDS BOARD
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October 18, 2004

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the September 29–30, 2004 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 October 13 draft. After your review, please discard the confidential marked version of the minutes.

November Meeting Time and Location
The next EITF meeting will be held on **November 17–18, 2004,** at the FASB offices in Norwalk, Connecticut. The meeting will begin on Wednesday, November 17, at 1:00 p.m. and end no later than 5:30 p.m. On Wednesday evening, a dinner will be held at a location to be announced later. On Thursday, November 18, the meeting will begin at 8:00 a.m. and end no later than 4:00 p.m. Coffee will be available and lunch will be provided.

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

Draft minutes available	**November 23, 2004**
Final minutes available	**December 9, 2004**

Agenda Committee Meeting
The next Agenda Committee meeting is scheduled for November 2, 2004. Materials for any potential new issues should be provided by October 25, 2004.

Please call me at extension x212 if you have any questions.

Sincerely,

Landon B. Westerlund
Practice Fellow

0904FN

MINUTES OF THE SEPTEMBER 29–30, 2004 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Wednesday, September 29, 2004

Starting Time:	10:30 a.m.
Concluding Time:	5:30 p.m.

Thursday, September 30, 2004

Starting Time:	8:00 a.m.
Concluding Time:	4:00 p.m.

Task Force Members Present:

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

Task Force Members Absent:

None

*For certain issues only.

Others at Meeting Table:
Robert H. Herz, FASB Board Member
George J. Batavick, FASB Board Member
G. Michael Crooch, FASB Board Member
Gary S. Schieneman, FASB Board Member
Katherine Schipper, FASB Board Member
Leslie F. Seidman, FASB Board Member
Edward W. Trott, FASB Board Member
Russell G. Golden, FASB Senior Technical Advisor
Landon B. Westerlund, FASB Practice Fellow
Shelly C. Luisi, SEC Senior Associate Chief Accountant
Marilyn Thaemert, SEC Assistant Chief Accountant
* Richard Graff, Mining Industry Working Group Representative[1]
*Steven P. Belcher, FASB Practice Fellow
* Christopher J. Larson, FASB Practice Fellow
* Paul G. Laurenzano, FASB Practice Fellow
* Kevin T. McBride, FASB Industry Fellow
* Lisa M. Munro, FASB Practice Fellow
* Gerard M. O'Callaghan, FASB Practice Fellow
* Matthew H. Pinson, FASB Industry Fellow
* Eric M. Smith, FASB Industry Fellow
* Randall S. Sogoloff, FASB Practice Fellow

* For certain issues only.

[1] Invited to discuss with the Task Force issues relating to EITF Issue No. 04-6, "Accounting for Stripping Costs Incurred during Production in the Mining Industry."

ADMINISTRATIVE MATTERS

- Prior Meeting Minutes. An FASB staff member solicited objections to the final minutes of the June 30–July 1, 2004 meeting. No objections were noted.

- The Task Force discussed the report on the EITF Agenda Committee meeting held on August 20, 2004. The following decisions were made by the Agenda Committee:

a. *Accounting in a Business Combination for Deferred Postcontract Customer Support Revenue of a Software Vendor*. The Agenda Committee decided to add this Issue to the EITF's agenda.

b. *The Carrying Amount of an Intangible Asset That Previously Was Combined with Other Indefinite-Lived Intangible Assets for Impairment Testing Purposes*. The Agenda Committee decided not to add this issue to the EITF's agenda.

c. *Accounting for Suspended Well Costs.* The Agenda Committee agreed to add this Issue to the EITF's Agenda. An Agenda Committee member requested that the FASB staff develop additional criteria for evaluating whether exploratory well costs should be capitalized beyond one year. Refer to the discussion of EITF Issue No. 04-9, "Accounting for Suspended Well Costs," elsewhere in these minutes.

- Addition to the EITF's agenda of an Issue that will address whether instruments that are issued as stock-based compensation are participating securities. The Task Force agreed to add an Issue to the EITF's agenda that will address whether instruments that are issued as stock-based compensation subject to the provisions of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and FASB Statement No. 123, *Accounting for Stock-Based Compensation*, including options and unvested restricted stock, and that receive dividends declared on common stock are participating securities. The Task Force also agreed that EITF Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, *Earnings per Share*," provides no guidance about whether unvested instruments that are issued as stock-based compensation are participating securities.

- Removal of EITF Issue No. 04-E, "The Meaning of Similar Economic Characteristics," from the EITF's Agenda. The FASB staff asked the Task Force to remove Issue 04-E from its agenda because the staff is considering providing guidance on this issue. The Task Force agreed to remove Issue 04-E from the EITF's agenda. A related Issue about segment reporting was addressed by the Task Force at the September 29–30, 2004 meeting in EITF Issue No. 04-10, "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds."

Comment letters on the following Issues were reported as received:

a. EITF Issue No. 02-14, "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock" (1 comment letter)

b. EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (37 comment letters)[1]

c. EITF Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, *Earnings per Share"* (1 comment letter)

d. EITF Issue No. 03-11, "Reporting Realized Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and Not 'Held for Trading Purposes' as Defined in EITF Issue No. 02-3, 'Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities'" (1 comment letter)

e. EITF Issue No. 04-7, "Determining Whether an Interest Is a Variable Interest in a Potential Variable Interest Entity" (1 comment letter)[2]

f. EITF Issue No. 04-8, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share" (36 comment letters)[2]

g. EITF Issue No. 04-9, "Accounting for Suspended Well Costs" (1 comment letter).[2]

- November 2004 Meeting: The FASB staff asked Task Force members to anticipate a day-and-a-half meeting for the November 17–18, 2004 EITF meeting.

- The Task Force Chairman introduced Mr. Lawrence E. Weinstock, Mana Products, Inc., as a member of the Task Force representing the private company preparer constituency. Mr. Weinstock's appointment expands the Task Force to 14 members.

- 2005 EITF Meeting Dates. The FASB staff formally confirmed the following EITF meeting dates for 2005:

  March 16–17, 2005
  June 15–16, 2005
  September 14–15, 2005
  November 9–10, 2005.

[1] The FASB staff provided the Task Force with an update on the proposed FSPs EITF Issue 03-1-a, "Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1," and EITF Issue 03-1-b, "Effective Date of Paragraph 16 of EITF Issue No. 03-1."
[2] Discussion of comment letter(s) occurred during the discussion of the related Issue.

OTHER TECHNICAL MATTERS

SEC STAFF ANNOUNCEMENT

Topic: Use of the Residual Method to Value Acquired Assets Other Than Goodwill

Date Discussed: September 29–30, 2004

FASB Statement No. 141, *Business Combinations*, states, in paragraph 39, that "an intangible asset shall be recognized as an asset apart from goodwill if it arises from contractual or other legal rights...." The SEC staff is aware of instances in which registrants have asserted that certain intangible assets that arise from legal or contractual rights cannot be separately and directly valued (hereinafter referred to as a "direct value method") because the nature of the particular asset makes it fundamentally indistinguishable from goodwill in a business combination (for example, cellular/spectrum licenses, cable franchise agreements, and so forth). Accordingly, some have applied a policy of assigning purchase price to all other identifiable assets and liabilities as provided in Statement 141, with the remaining residual amount being allocated to the "indistinguishable" intangible asset. In those instances, there is either no goodwill recognized or the amount of goodwill recognized uses a technique other than the one specified in paragraph 43 of Statement 141. These methods have been referred to as "the residual method" of valuing intangible assets and have been used in the telecommunications, broadcasting, and cable industries. Similar methods were used to allocate purchase price in acquisitions under APB Opinion No. 16, *Business Combinations*.

Some have asserted that the residual method provides an acceptable approach for determining the fair value of the intangible asset to which the residual is assigned, either because it approximates the value that would be attained from a direct value method or because they believe that other methods of valuation are not practicable under the circumstances. Others have indicated that the residual method should be used as a proxy for fair value of the intangible asset in these situations, since the fair value of the intangible asset in question is not determinable. When it is or has been used in assigning purchase price, the residual method is also often used in impairment tests.

The SEC staff believes that the residual method does not comply with the requirements of Statement 141. Paragraph 37(e) of Statement 141 requires intangible assets that meet the recognition criteria to be recorded at fair value. Paragraph 43 of Statement 141 states that "the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed shall be recognized as an asset referred to as goodwill." The SEC staff notes that a fundamental distinction between other recognized intangible assets and goodwill is that goodwill is both defined and measured as an excess or residual asset, while other recognized intangible assets are required to be measured at fair value. The SEC staff does not believe that the application of the residual method to the valuation of intangible assets can be assumed to produce amounts representing the fair values of those assets. The SEC staff also notes that valuation difficulty does not provide relief from the requirements in paragraphs 37(e) and 39 of Statement 141 to separately recognize intangible assets at fair value apart from goodwill. Furthermore, the SEC staff notes that the same types of assets being valued using the residual method by some entities are being valued using a direct value method by other entities. Accordingly the SEC staff believes the residual method should no longer be used to value intangible assets other than goodwill. Rather, a direct value method should be used to determine the fair value of all intangible assets required to be recognized under Statement 141. Impairment testing of intangible assets similarly should not rely on a residual method and should, instead, comply with the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets*.

Transition

Registrants should apply a direct value method to such assets acquired in business combinations completed after September 29, 2004. Further, registrants who have applied the residual method to the valuation of intangible assets for purposes of impairment testing shall perform an impairment test using a direct value method on all intangible assets that were previously valued using the residual method by no later than the beginning of their first fiscal year beginning after December 15, 2004. Impairments of intangible assets recognized upon application of a direct value method by entities previously applying the residual method should be reported as a cumulative effect of a change in accounting principle. Related deferred tax effects should also be reported as part of the cumulative effect of a change in accounting principle. Reclassification of recorded balances between goodwill and intangible assets immediately prior to adoption of this SEC staff announcement is prohibited. Early adoption of a direct value method is encouraged.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 03-9

Title: Determination of the Useful Life of Renewable Intangible Assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets*

Dates Discussed: July 31, 2003; November 12–13, 2003; March 17–18, 2004; June 30–July 1, 2004; September 29–30, 2004

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

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

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

Introduction

1. This Issue addresses how the pertinent factors in subparagraph 11(d) of Statement 142 should be evaluated in determining the useful life of an intangible asset for which a marketplace participant anticipates renewal (hereinafter referred to as a "renewable intangible asset").

2. Paragraph B174 of Statement 141 states that judgment is required in determining the period over which future cash flows should be expected for purposes of determining the fair value of an intangible asset. Those estimates of future cash flows should incorporate assumptions that marketplace participants would use in making estimates of fair value, such as assumptions about future contract renewals *and* other benefits such as those that might result from acquisition-related synergies. In cases in which contractual or legal rights are routinely renewed, estimates of future cash flows should extend beyond the remaining contractual or legal term.

3. Statement 142 provides guidance that could define the useful life of a renewable intangible asset different from the useful life that would be derived solely from the guidance in Statement 141. Paragraph 11 of Statement 142 requires an entity to assess whether certain "pertinent factors" limit a useful life of an intangible asset to the reporting entity (that is, whether the pertinent factors limit the period over which an asset is expected to contribute directly or indirectly to future cash flows). In particular, paragraph 11(d) of Statement 142 states that an entity should consider "any legal, regulatory, or contractual provisions that enable renewal or extension of the asset's legal or contractual life without *substantial cost* (provided there is evidence to support renewal or extension and renewal or extension can be accomplished without *material modifications* of the existing terms and conditions)" (emphasis added).

Issue

4. The issues are:

Issue 1— When considering whether renewal of a contractual or legal right giving rise to an intangible asset requires "substantial cost" pursuant to paragraph 11(d) of Statement

142, the expenditures that should be considered to be a "cost" of the renewal or extension

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

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

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

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

Prior EITF Discussion

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

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

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

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

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

9. The Task Force was not asked to reach a consensus on the FASB staff's proposed model noting that the proposed approach would result in most intangible assets subject to amortization being amortized using the "pattern-of-economic-benefit" method rather than the straight-line method. The Task Force also noted that the implication of that approach is that, in many cases, the guidance in paragraph 11 of Statement 142 is obviated by the decisions that are required in determining the fair value of intangible assets pursuant to Statement 141.

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

11. At the March 17–18, 2004 EITF meeting, the FASB staff presented the practice issue identified by the Working Group: determining the useful life of intangible assets that have contractual provisions that enable renewal or extension. The Working Group also identified three possible approaches to addressing that issue: (a) set the useful life of the intangible asset for amortization purposes equal to the period over which the entity projects that the intangible asset will contribute to its cash flows, (b) refine the definition of the intangible asset that is recognized apart from goodwill under Statement 141, and (c) restrict the useful life of the intangible asset for amortization purposes to a period shorter than the period over which the entity projects that the intangible asset will contribute to its cash flows based on the probability of renewal or extension.

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

13. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed how substantial costs and material modifications should be evaluated for determining whether a renewable intangible asset is in substance a single asset. The Task Force generally agreed that a renewable intangible asset is in substance a single asset if renewal is reasonably assured. Further, the Task Force generally agreed that an entity should evaluate substantial costs and material modifications when evaluating whether renewal is reasonably assured.

14. The Task Force discussed the meaning of *substantial costs* and generally agreed that the costs that an entity should evaluate are those expected renewal costs that the entity would not otherwise incur if the contract was not subject to renewal. The Task Force discussed whether the timing of the cash flows should be a factor in the determination of whether the renewal costs are significant. Further, the Task Force noted that paragraph B60 of Statement 142 requires an entity to evaluate significance by comparing those expected renewal costs to the fair value of the renewable intangible asset. The Task Force also discussed the meaning of *material modification*.

15. The Task Force was not asked to reach a consensus but directed the FASB staff to further develop the meaning of substantial costs and material modification for the Task Force's consideration.

Current EITF Discussion

16. At the September 29–30, 2004 EITF meeting, the Task Force decided to remove this Issue from the EITF agenda. The Task Force discussed the meaning of both *renewal cost* and *modification* and discussed the implication that those factors have on the useful life of a renewable intangible asset. The Task Force generally agreed that limiting the useful life of a renewable intangible asset to a period that is shorter than the period over which the renewable intangible asset is expected to contribute future cash flows is inconsistent with the definition of *useful lif*e under Statement 142 and the market participant approach for determining fair value in Statement 141. Accordingly, the Task Force asked the Board to consider that issue. The Board agreed to consider whether to provide guidance on how the factors in subparagraph 11(d) of Statement 142 should be evaluated in determining the useful life of an intangible asset.

Status

17. No further EITF discussion is planned.

Issue No. 03-13

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

Dates Discussed: November 12–13, 2003; March 17–18, 2004; June 30–July 1, 2004; September 29–30, 2004

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

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

Introduction

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

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

3. The Working Group noted that the cash flows of the component include gross cash flows (cash inflows and cash outflows) that are directly associated with revenue-producing and cost-generating activities of the component, that is, cash flows directly associated with the operations of the component. Situations in which the seller engages in activities with the component after its disposal often result in continuing cash flows to the seller. The Working Group noted that the

activities that generate continuing cash flows may or may not have similar characteristics as compared with the activities that generated the cash flows prior to the disposal of the component.

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

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

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

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

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

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

    (1) Significance of the contract or agreement to the overall operations of the disposed component,
    (2) The rights conveyed by the contract to each party, and

(3) Whether the contract was carried out on an arm's-length basis.

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

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

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

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

Issue

9. The issues are:

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

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

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

Prior EITF Discussion

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

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

12. With respect to the appropriate assessment period (Issue 3), the Task Force reached a tentative conclusion that the appropriate assessment period should include the point at which the component initially meets the criteria to be classified as held for sale and one year after the date the component is actually disposed of. The assessment should be based on all facts and circumstances, including management's intent and ability to eliminate the cash flows of the disposed component from its operations and management's intent and ability not to have significant continuing involvement in the operations of the disposed component. If the criteria in paragraph 42 are not expected to be met within one year after the disposal date, the component's operations should be reclassified from discontinued operations. If the criteria in paragraph 42 are met or are expected to be met within one year after the disposal date, the component's operations should be classified as discontinued operations. The Task Force observed that events or circumstances beyond an entity's control may extend the period over which cash flows of the disposed component continue or over which significant continuing involvement in the disposed component remains. Therefore, the Task Force also agreed that an exception to the one-year period should apply in situations described in paragraph 31 of Statement 144.

13. At the March 17–18, 2004 EITF meeting, the Task Force discussed the Working Group's proposed approach for assessing whether cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity, which focuses on whether continuing cash flows are direct or indirect cash flows. Cash flows of the component would not be eliminated if the continuing cash flows are considered direct cash flows. The determination as to whether the continuing cash flows are direct or indirect is based on an evaluation of a set of indicators. That set of indicators focuses on the characteristics of the cash inflows to and cash outflows from the entity following the disposal. The indicators specifically address (a) the customers who purchase products or services of the entity that are similar to products or services of the disposed component, (b) the costs associated with the similar products or services sold, and (c) the nature of the products or services sold to or purchased from the disposed component. The relative strength of each indicator is considered in relation to the other indicators to determine whether the cash flows are direct or indirect cash flows of the disposed component.

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

15. The Task Force discussed and expressed general support for the direction of the Working Group's proposed approach. The Task Force asked the FASB staff to further refine and articulate the principles set forth in the proposed approach and provide more guidance on the application of the proposed approach to the specific examples. Additionally, the Task Force

requested that the FASB staff develop additional examples for specific fact patterns raised by some Task Force members.

16. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed the Working Group's revised proposed approach for assessing whether the criteria in paragraph 42 of Statement 144 have been met for purposes of classifying the results of operations of a component of an entity that either has been disposed of or is classified as held for sale as discontinued operations.

17. The proposed approach for assessing whether cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity focuses on whether continuing cash flows are direct or indirect cash flows. Cash flows of the component would not be eliminated if the continuing cash flows to the entity are considered direct cash flows. The determination of whether cash flows are *direct* or *indirect* depends on the nature and significance of the cash flows and requires judgment. Direct cash flows include gross cash flows (cash inflows and cash outflows) that are directly associated with the revenue-producing and cost-generating activities of an entity. The revenue-generating activities (cash inflows) of a component have been continued and, therefore, are considered direct cash flows if (a) significant cash inflows are expected to be recognized by the remaining entity as a result of a migration of revenues from the disposed component after the disposal transaction or (b) significant cash inflows are expected to be received by the remaining entity as a result of the continuation of activities between the remaining entity and the disposed component after the disposal transaction. The cost-generating activities (cash outflows) of the component have been continued and, therefore, are considered direct cash flows if (c) significant cash outflows are expected to be recognized by the remaining entity as a result of a migration of costs from the disposed component after the disposal transaction or (d) significant cash outflows are expected to be recognized by the remaining entity as a result of the continuation of activities between the remaining entity and the disposed component after the disposal transaction.

18. The proposed approach for assessing whether the remaining entity will have any significant continuing involvement in the operations of the component after the disposal transaction focuses on whether the entity has (a) the ability to influence the operating and/or financial policies of the disposed component, (b) retained risk associated with the operations of the disposed component, or (c) the ability to obtain benefits associated with the ongoing operations of the disposed component. The determination as to whether the remaining entity has significant continuing involvement is based on a quantitative and qualitative assessment from the perspective of the disposed component and should take into consideration all types of continuing involvement, individually and in the aggregate. The proposed approach provides two categories of relationships that should be considered in determining whether an entity has significant continuing involvement in the operations of the component: (a) the entity retains an interest in the disposed component sufficient to enable it to exert significant influence over the component's operating and financial policies and (b) the entity and the buyer (or disposed component) are parties to a contract or agreement that, based on a consideration of several factors, constitutes significant continuing involvement.

19. The Task Force discussed and expressed general support for the scope and direction of the Working Group's proposed approach; however, the Task Force did not support specifying a

threshold (that is, a specific percentage) to be used in evaluating whether continuing cash flows are significant. The Task Force asked the FASB staff to further refine and articulate how an entity should evaluate the nature of the cash flows to determine whether the cash flows need to be evaluated for significance in the proposed approach. Additionally, the Task Force asked the FASB staff to further articulate the basis for the conclusions that were reached in the examples in the Issue Summary for this Issue and to apply the proposed approach to the examples in Statement 144. The FASB staff also will propose disclosures for disposed components that are presented as discontinued operations for the Task Force's consideration.

Current EITF Discussion

20. At the September 29–30, 2004 EITF meeting, the Task Force reached a tentative conclusion on an approach for evaluating whether the criteria in paragraph 42 of Statement 144 have been met for purposes of classifying the results of operations of a component of an entity that either has been disposed of or is classified as held for sale as discontinued operations. Additionally, the Task Force requested that the FASB staff incorporate the following tentative conclusions into that approach. The revised approach, which incorporates these tentative conclusions, is included in the attached draft abstract as Appendix 03-13A.

a. Include an assessment period for determining when the criteria in paragraph 42 of Statement 144 have been met. The assessment period should include the point at which the component initially meets the criteria to be classified as held for sale through one year after the date the component is actually disposed of. The assessment should be based on all facts and circumstances, including management's intent and ability (a) to eliminate the cash flows of the disposed component from its operations and (b) to not have significant continuing involvement in the operations of the disposed component. For one year after a component has been disposed of, an entity is required to reassess whether the criteria in paragraph 42 are expected to be met when significant events or circumstances occur that could change its current assessment.
b. Include a presumption that the continued sale of a commodity in an active market is a "migration." That presumption can be overcome based on facts and circumstances, such as the lack of similarity of the commodity and whether the sale of the commodity after the disposal transaction occurs in a different geographic region as compared to the sale of the commodity before the disposal transaction. For purposes of this Issue, the term *commodity* is defined as products whose units are interchangeable and immediately marketable at quoted prices.
c. Retain the requirement to evaluate only gross cash inflows and gross cash outflows (as opposed to other operating measures) in determining whether continuing cash flows are significant.
d. Modify the definition of *continuing involvement* such that it does not explicitly include (1) the retention of risk associated with the ongoing operations of the disposed component or (2) the ability to obtain benefits associated with the ongoing operations of the disposed component. Incorporate these concepts into the determination as to whether the ongoing entity has the ability to influence the operating and (or) financial policies of the disposed component.
e. Require disclosure of the methodology for determining the amounts presented in discontinued operations in situations where the ongoing entity will engage in a "continuation

of activities" with the disposed component after its disposal. If such amounts presented in discontinued operations include intercompany revenues and expenses, those amounts should be disclosed for all periods presented.

f. Clarify that a "migration" occurs when there is an expectation that the ongoing entity would continue to generate revenues and costs from the sale of similar products or services to specific customers of the disposed component.

21. The Task Force also reached a tentative conclusion that the consensus would be applied to a component of an enterprise that is either disposed of or classified as held for sale in fiscal periods beginning after December 15, 2004. Previously reported operating results related to disposal transactions initiated within an enterprise's fiscal year that includes the date that this consensus is ratified may be reclassified to reflect the consensus.

22. The Task Force asked the FASB staff to post the draft abstract to the FASB website for public comment. Comments received will be considered by the Task Force at the November 17–18, 2004 EITF meeting.

Status

23. The draft abstract was posted to the FASB's website on October 15, 2004 for a 15-day comment period. Further discussion is expected at a future meeting.

APPENDIX 03-13A

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

Issue No: 03-13

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

Dates Discussed: November 12–13, 2003; March 17–18, 2004; June 30–July 1, 2004; September 29–30, 2004; November 17–18, 2004

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

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

ISSUE

1. Paragraph 42 of Statement 144 states that:

> The results of operations of a component of an entity that either has been disposed of or is classified as held for sale shall be reported in discontinued operations in accordance with paragraph 43 if both of the following conditions are met: (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

2. Consideration of the guidance in paragraph 42 of Statement 144 has generated questions about how to apply the criterion that the operations and cash flows be *eliminated* from the ongoing operations of the reporting entity (the "ongoing entity"). Specifically, which cash flows of the disposed component have to be eliminated from the ongoing operations of the entity? Additionally, questions have been raised about the types of continuing involvement that constitute significant continuing involvement. A working group was formed to address those issues.

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

3. The issues are:

Issue 1— How an ongoing entity should evaluate whether the operations and cash flows of a disposed component have been or will be eliminated from the ongoing operations of the entity.

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

EITF DISCUSSION

4. The Task Force reached a consensus on Issue 1 that the evaluation of whether the operations and cash flows of a disposed component have been or will be eliminated from the ongoing operations of the entity depends on whether continuing cash flows have been or are expected to be generated and, if so, whether those continuing cash flows are *direct* or *indirect*. Continuing cash flows are cash inflows or outflows that are generated by the ongoing entity and are associated with activities involving a disposed component. If continuing cash flows are generated, the determination as to whether those continuing cash flows are direct or indirect should be based on their *nature* and *significance*. If any continuing cash flows are *direct*, the cash flows have not been eliminated and the operations of the component should not be presented as a discontinued operation. Conversely, if all continuing cash flows are *indirect*, the cash flows are considered to be eliminated and the disposed component meets the paragraph 42(a) criterion to be considered a discontinued operation. The assessment as to whether continuing cash flows are direct cash flows should be based on management's expectations using the best information available.

5. Cash flows[2] of a component include gross cash flows (cash inflows and cash outflows) that are associated with the revenue-producing and cost-generating activities of that component (that is, "direct" cash flows). The intention of the criterion in paragraph 42(a) is to determine whether, in substance, the ongoing entity continues either the revenue-producing activities (cash inflows)

[2] The cash flows that are associated with the revenue-producing and cost-generating activities are the same cash flows utilized in the Statement 144 impairment analysis under the "held and used" model.

or the cost-generating activities (cash outflows) of the disposed component after the disposal transaction.

6. The revenue-producing activities (cash inflows) of the component have been continued and therefore are considered direct cash flows if:

a. Significant cash inflows are expected to be recognized by the ongoing entity as a result of a migration[3] of revenues from the disposed component after the disposal transaction; or
b. Significant cash inflows are expected to be received by the ongoing entity as a result of the continuation of activities[4] between the ongoing entity and the disposed component after the disposal transaction.

The cost-generating activities (cash outflows) of the component have been continued and therefore are considered direct cash flows if:

c. Significant cash outflows are expected to be recognized by the ongoing entity as a result of a migration[5] of costs from the disposed component after the disposal transaction; or

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[3] The term *migration* means the ongoing entity expects to continue to generate revenues and (or) incur expenses from the sale of similar products or services to specific customers of the disposed component. An entity is not required to perform a quantitative assessment to conclude that a migration has occurred (for example, an entity that closes several smaller retail stores and opens a superstore in the immediate area would likely conclude based on a qualitative assessment that a migration of specific retail customers is expected, even if the entity has not tracked the identity of all its individual customers). There is a presumption that if the ongoing entity continues to sell a similar commodity on an active market after the disposal transaction, the revenues and (or) costs would be considered a "migration." This presumption may be overcome based on facts and circumstances, such as the lack of similarity of the commodities and whether the sale of the commodity after the disposal transaction occurs in a different geographic region as compared to the sale of the commodity before the disposal transaction. For purposes of this Issue, the term *commodity* means products whose units are interchangeable and have an immediate marketability at quoted prices.

[4] The term *continuation of activities* means the continuation of any revenue-producing or cost-generating activity through active involvement with the disposed component. For example, the ongoing entity sold or purchased products or services to (from) the disposed component before its disposal (recognized as intercompany sales or cost of sales) and it continues to sell or purchase similar products or services to (from) the disposed component or a related party to the disposed component after its disposal (recognized as sales or cost of sales). After the disposal transaction, the former intercompany sales or cost of sales are no longer eliminated in consolidation, which will result in continuing cash inflows or outflows to the ongoing entity.

[5] Refer to footnote 3.

d. Significant cash outflows are expected to be recognized by the ongoing entity as a result of the continuation of activities[6] between the ongoing entity and the disposed component after the disposal transaction.

The Task Force reached a consensus that the guidance below should be used to evaluate whether continuing cash flows are direct cash flows:

Nature of Activities That Generate Continuing Cash Flows

7. In evaluating whether continuing cash flows are direct cash flows, the ongoing entity should first consider the nature of the activities that generate those continuing cash flows. A disposal transaction may result in the ongoing entity (a) recognizing revenues or costs that likely would have been generated by the disposed component absent the disposal transaction (a "migration") or (b) continuing any of the revenue-producing or cost-generating activities through active involvement with the disposed component (a "continuation of activities"). In situations in which continuing cash flows are being generated by the ongoing entity from either a migration or a continuation of activities, the ongoing entity should then determine whether the cash flows are significant. If continuing cash flows are not generated from either a migration or a continuation of activities, the ongoing entity would not need to determine whether the cash flows are significant but should perform an evaluation to assess whether it has significant continuing involvement in the operations of the disposed component. Examples of continuing cash flows that would likely result from activities other than a migration or continuation of activities include, but are not limited to, (a) interest income recognized from seller-provided financing, (b) contingent consideration in a business combination, (c) dividends on an investment, and (d) a passive royalty interest in the disposed component's operations.

Significance of Continuing Cash Flows

8. If expected continuing cash inflows or outflows are the result of a migration of revenues or costs to the ongoing entity or a continuation of activities between the disposed component and

[6] Refer to footnote 4.

the ongoing entity, the ongoing entity should consider whether the continuing cash flows will be significant. The evaluation as to whether continuing cash flows would be significant is a matter of judgment and should be based on a comparison between the expected continuing cash flows to be generated by the ongoing entity after the disposal transaction and the cash flows that would have been expected to be generated by the disposed component absent the disposal transaction. The cash flows that would have been expected to be generated by the disposed component should include cash flows from both third-party and intercompany transactions (the amount of cash flows attributed to intercompany transactions should be determined based on a consideration of the transactions as if they had been between unrelated third parties). Continuing cash inflows should be evaluated separately from continuing cash outflows in evaluating significance, regardless of whether financial statement presentation is on a gross or net basis. If a determination is made that continuing cash inflows represent direct cash flows, an evaluation of cash outflows is not necessary. If a determination is made that continuing cash flows are indirect (cash inflows and cash outflows), the ongoing entity should perform an evaluation under the criterion in paragraph 42(b) to assess whether it has significant continuing involvement in the operations of the disposed component.

Significant Continuing Involvement

9. If the operations and cash flows of a disposed component have been (or will be) eliminated from the ongoing operations of an entity as a result of a disposal transaction (see Issue 1 for guidance on making that determination), an entity should evaluate whether the ongoing entity will have significant continuing involvement in the operations of the component after the disposal transaction. The Task Force reached a consensus on Issue 2 that continuing involvement in the operations of the disposed component provides the ongoing entity with the ability to influence the operating and (or) financial policies of the disposed component. The retention of risk or the ability to obtain benefits should be considered in the overall evaluation of whether the ongoing entity has the ability to influence the operating and (or) financial policies of the disposed component. However, the retention of risk or the ability to obtain benefits associated with the ongoing operations of the disposed component does not indicate by itself that the ongoing entity has the ability to influence the operating and (or) financial policies of the

disposed component resulting in continuing involvement. An interest in the disposed component or the existence of a contractual arrangement or other type of arrangement with the disposed component should be evaluated to determine whether the ongoing entity has continuing involvement with the disposed component.

10. The determination as to whether the continuing involvement is significant should be based on quantitative and qualitative assessments from the perspective of the disposed component. The assessment should consider all types of continuing involvement, individually and in the aggregate.

11. The following factors, among others, should be considered in evaluating whether continuing involvement constitutes significant continuing involvement:[7]

a. The ongoing entity retains an interest[8] in the disposed component sufficient to enable the ongoing entity to exert significant influence over the disposed component's operating and financial policies. An interest that provides the ongoing entity with significant influence may or may not be accounted for under the equity method of accounting, since an entity would only consider those interests that are common stock or in-substance common stock in evaluating whether the equity method of accounting is appropriate. However, interests other than common stock or in-substance common stock may provide the ongoing entity with significant influence over the disposed component's operating and financial policies. A cost method investment in common stock or in-substance common stock alone would not be considered significant continuing involvement.

b. The ongoing entity and the buyer (or the disposed component) are parties to a contract or otherwise parties to an arrangement that in substance enables the ongoing entity to exert significant influence over the disposed component's operating and financial policies.

[7] The guidance in this paragraph should be used only to evaluate the criterion in paragraph 42(b) of Statement 144 and should not be used to evaluate the criterion in paragraph 42(a) of Statement 144 or whether an entity meets the criteria for sale accounting or gain recognition set forth in other applicable accounting literature.

[8] An entity holding a call option to acquire an interest in the disposed component may be a form of continuing involvement. If the call option represents a form of continuing involvement, the determination of whether that continuing involvement is significant depends on a number of factors, including whether the call option is at fair value, when the call option becomes exercisable, and the percentage ownership underlying the call option.

Judgment is required in evaluating whether a contract or an arrangement constitutes significant continuing involvement, and all available information should be considered in performing the related analysis. The following factors should be considered in that regard; however, no one factor should be considered presumptive or determinative:

i. Significance of the contract or arrangement to the overall operations of the disposed component
ii. The extent to which the ongoing entity is involved in the operations of the disposed component
iii. The rights conveyed by the contract to each party
iv. The pricing terms of the contract or arrangement.

12. The circumstances discussed in paragraph 44 of Statement 144 would not constitute continuing cash flows or continuing involvement. Examples include the following:

a. The resolution of contingencies that arise pursuant to the terms of the disposal transaction, such as the resolution of purchase price adjustments and indemnification issues with the purchaser
b. The resolution of contingencies that arise from and that are directly related to the operations of the component prior to its disposal, such as environmental and product warranty obligations retained by the seller
c. The settlement of employee benefit plan obligations (pension, postemployment benefits other than pensions, and other postemployment benefits), provided that the settlement is directly related to the disposal transaction.

Assessment Period

13. The Task Force reached a consensus that the appropriate assessment period should include the point at which the component initially meets the criteria to be classified as held for sale through one year after the date the component is actually disposed of. The assessment should be based on all facts and circumstances, including management's intent and ability to (a) eliminate the cash flows of the disposed component from its operations and (b) not have significant

continuing involvement in the operations of the disposed component. For one year after a component has been disposed of, an entity is required to reassess whether the criteria in paragraph 42 are expected to be met when only significant events or circumstances occur that may change its current assessment. If the occurrence of a significant event or circumstance at any time during the assessment period results in an expectation that the criteria in paragraph 42 will not be met by the end of the assessment period, the component's operations should not be presented as discontinued operations. If the occurrence of a significant event or circumstance at any time during the assessment period results in an expectation that the criteria in paragraph 42 will be met by the end of the assessment period, the component's operations should be presented as discontinued operations. Reclassification into and out of discontinued operations for all periods presented may be required during the assessment period.

14. Refer to the flowchart in Exhibit 03-13A for an illustration of the above guidance. Examples illustrating the application of the above guidance are included in Exhibit 03-13B.

Disclosures

15. The following information should be disclosed in the notes to the financial statements for each discontinued operation that generates continuing cash flows: (a) the nature of the activities that give rise to continuing cash flows, (b) the period of time continuing cash flows are expected to be generated, and (c) the principal factors used to conclude that the expected continuing cash flows are not direct cash flows of the disposed component. Additionally, in situations in which the ongoing entity will engage in a "continuation of activities" with the disposed component after its disposal and the amounts presented in continuing operations after the disposal transaction include a continuation of revenues and expenses that were intercompany transactions (eliminated in consolidated financial statements) before the disposal transaction, those amounts should be disclosed for all periods presented for comparability purposes. The types of continuing involvement, if any, that the entity will have after the disposal transaction should be disclosed. That information should be disclosed in the period in which operations are initially classified as discontinued.

Transition

16. The consensus should be applied to a component of an enterprise that is either disposed of or classified as held for sale in fiscal periods beginning after December 15, 2004. Previously reported operating results related to disposal transactions initiated within an enterprise's fiscal year that includes the date that this consensus is ratified may be reclassified to reflect the consensus.

Board Ratification

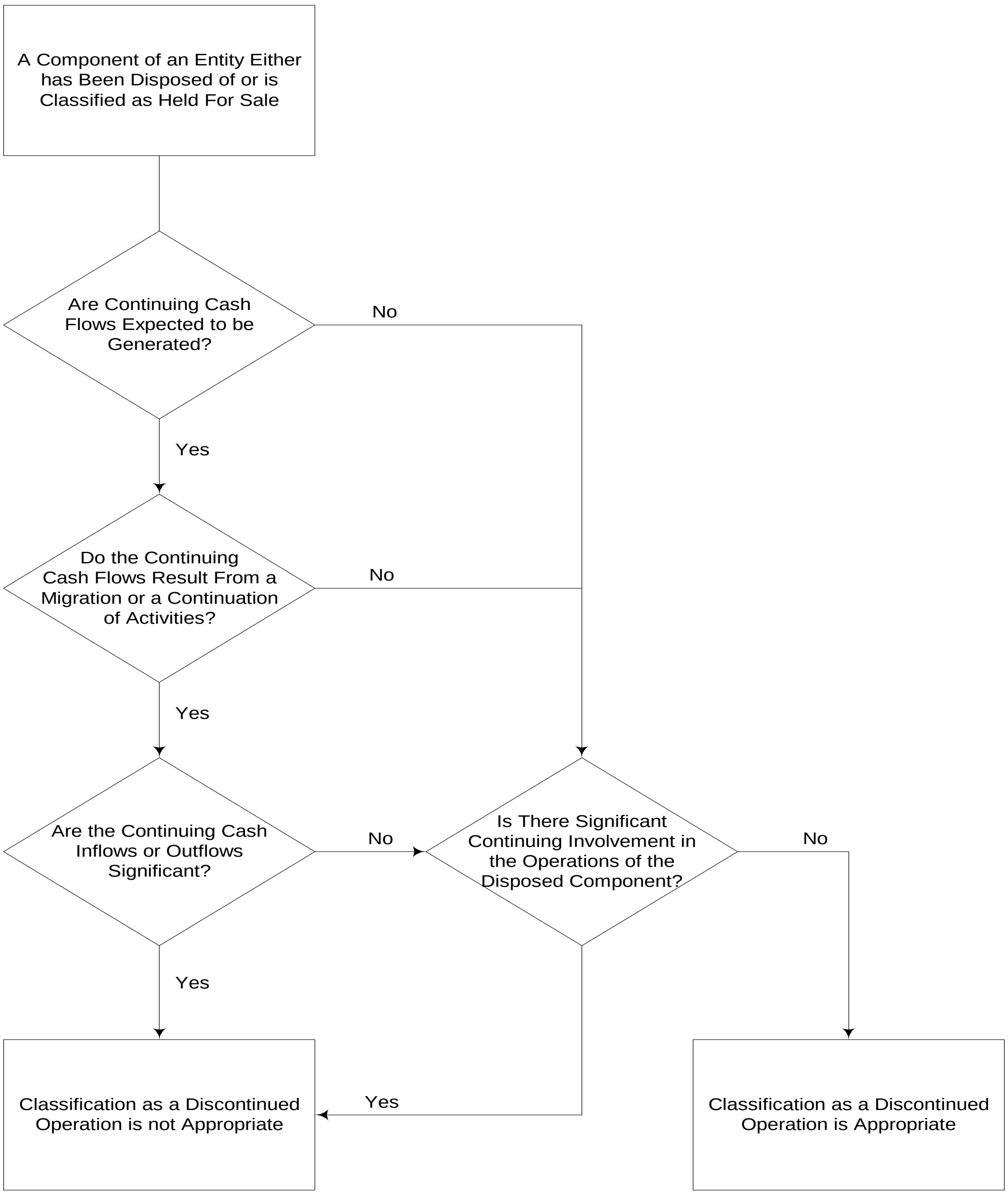
17. At its November 30, 2004 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

STATUS

18. No further EITF discussion is planned.

Exhibit 03-13A

DETERMINING WHEN A COMPONENT SHOULD BE CLASSIFIED AS A DISCONTINUED OPERATION[9]



[9] This diagram represents an overview of the provisions of this Issue with respect to determining when a component should be classified as a discontinued operation. The diagram is a visual supplement to the written consensus. It should be neither interpreted to alter any requirements of the consensus nor considered a substitute for its requirements.

Exhibit 03-13B

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON ISSUE 03-13

Example 1

An entity owns and operates retail stores that sell household goods. For that entity, each store is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each store is a component of the entity.

To expand its retail store operations in one region, the entity decides to close 2 of its retail stores and open a new "superstore" within 10 miles of the retail stores to be closed. The new superstore will continue to sell the household goods previously sold through the two retail stores along with other types of goods. The ongoing entity purchased and will continue to purchase the household goods from an unrelated wholesale distributor. The ongoing entity estimates that a migration of customers from the closed retail stores after the disposal transaction will result in the ongoing entity recognizing $400 thousand of sales ($200 thousand from each store). The ongoing entity estimates that each of the disposed components would have generated $250 thousand of sales absent the disposal transaction.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated by the ongoing entity from transactions with customers of the disposed component.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a migration, since customers are migrating from the closed retail stores to the superstore, which sells products similar to those sold in the closed retail stores. Therefore, an evaluation of the significance of the continuing cash flows must be performed.

Step 3: Are the continuing cash flows significant? Yes. The ongoing entity estimates that the continuing cash inflows will approximate 80 percent of the cash inflows that would have been generated by each of the components absent the disposal transaction. The ongoing entity believes that 80 percent is significant.

Conclusion: The continuing cash flows should be considered direct cash flows of the disposed components due to the significant cash inflows that are expected to be generated by the ongoing entity as a result of a migration of customers from the closed retail stores to the superstore. An evaluation of cash outflows is not necessary. Since the continuing cash flows are considered direct cash flows, classification as a discontinued operation would not be appropriate. An evaluation of continuing involvement is not necessary.

Example 2

An entity owns and operates retail stores and has Internet operations (website), all of which sell household goods. For that entity, each store is a component of the entity and the Internet operation is a component of the entity.

The entity closes a retail store, which is expected to result in a migration of customers to the website operations. The website sells the household goods previously sold through the closed retail store in addition to other products. The ongoing entity purchased and will continue to purchase the household goods from an unrelated wholesale distributor. The ongoing entity estimates that a migration of customers from the closed retail store to the website after the disposal transaction will result in the ongoing entity recognizing $50 thousand of sales related to such migration. The ongoing entity estimates that the component would have generated $250 thousand of sales absent the disposal transaction.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated by the ongoing entity from transactions with customers of the disposed component.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a migration, since customers are migrating from the closed retail store to the website, which sells products similar to those sold in the closed retail store. Therefore, an evaluation of the significance of the continuing cash flows must be performed.

Step 3: Are the continuing cash flows significant? Yes. The ongoing entity estimates that the continuing cash inflows will approximate 20 percent of the cash inflows that would have been incurred absent the disposal transaction. The ongoing entity believes that 20 percent is significant.

Conclusion: The continuing cash flows should be considered direct cash flows of the disposed component due to significant cash inflows that are expected to be generated by the ongoing entity as a result of a migration of customers from the closed retail store to the website. An evaluation of cash outflows is not necessary. Since the continuing cash flows are considered direct cash flows, classification as a discontinued operation would not be appropriate. An evaluation of continuing involvement is not necessary.

Example 3

An entity owns a commercial building that is being leased to third-party lessees. For that entity, the building is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, the building is a component of the entity. The entity commits to a plan to sell the building. The building is classified as held for sale at that date. The ongoing entity will enter into a long-term management agreement with the buyer under which the ongoing entity will continue to manage the day-to-day operations of the building in exchange for a management fee at market rates.

The ongoing entity estimates that continuing cash inflows as a result of a continuation of activities (providing management services) will result in the ongoing entity recognizing $250 thousand of revenue. The ongoing entity estimates that the disposed component would have generated $5 million of rental revenue absent the disposal transaction. The ongoing entity estimates that after the disposal transaction, continuing cash outflows as a result of a continuation of activities (providing management services) between the ongoing entity and the disposed component will result in the ongoing entity recognizing $200 thousand of cash outflows. The ongoing entity estimates that the disposed component would have generated $1 million of cash outflows associated with owning and managing the building absent the disposal transaction.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated by the ongoing entity resulting from the management agreement.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a continuation of activities, since the ongoing entity provided management services, along with other services such as providing rental space, before the disposal transaction and will continue to provide management services to the disposed component after the disposal transaction. Therefore, an evaluation of the significance of the continuing cash flows must be performed.

Step 3: Are the continuing cash flows significant? Yes. The ongoing entity estimates that the continuing cash inflows will approximate 5 percent of the cash inflows that would have been generated by the disposed component. The ongoing entity does not believe this is significant. However, the continuing cash outflows will approximate 20 percent of the cash outflows that would have been generated by the disposed component. The ongoing entity believes that this is significant.

Conclusion: The continuing cash flows should be considered direct cash flows of the disposed component due to significant cash outflows that are expected to be generated by the ongoing entity as a result of a continuation of management activities between the ongoing entity and the disposed component after disposal. Since the continuing cash flows are considered direct cash flows, classification as a discontinued operation would not be appropriate. An evaluation of continuing involvement is not necessary.

Example 4

An entity owns an oil field that produces crude oil that is sold in an active market. For that entity, a field is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, the field is a component of the entity. The entity commits to a plan to sell the oil field to a third-party buyer. The oil field is classified as held for sale at that date. The entity will bring another oil field online shortly after the sale in the same geographic region and expects to sell the same amount and type of crude oil extracted from this new field as it did from the sold oil field to the same market. The ongoing entity will not have any involvement in the operations of the sold oil field after its disposal.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are expected to be generated from the sale of oil, since the ongoing entity will continue to sell a similar type of oil to the same market.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a migration, since there is a presumption that the ongoing entity continuing to sell a similar commodity in an active market after the disposal transaction would be considered a migration. This presumption may be overcome based on facts and circumstances. The new oil field is located in the same geographic region as the sold oil field and will be selling a similar type of crude oil to the same market. Therefore, the presumption that a migration has occurred cannot be overcome, and an evaluation of the significance of the continuing cash flows must be performed.

Step 3: Are the continuing cash flows significant? Yes. The ongoing entity will be selling the same amount of crude oil from the new oil field and therefore estimates that the continuing cash inflows will approximate 100 percent of the cash inflows that would have been generated absent the disposal transaction. The ongoing entity believes that 100 percent is significant.

Conclusion: The continuing cash flows should be considered direct cash flows of the disposed component due to the significant cash inflows that are expected to be generated by the ongoing entity as a result of a migration of customers from the sold oil field to the new oil field. An evaluation of cash outflows is not necessary. Since the continuing cash flows are considered direct cash flows, classification as a discontinued operation would not be appropriate. An evaluation of continuing involvement is not necessary.

Example 5

An entity owns several commercial buildings that are being leased to third-party lessees. The buildings are of the same type and are located in the same geographic region. For that entity, the building is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each building is a component of the entity. The entity commits to a plan to sell one of the buildings. The building is classified as held for sale at that date.

The ongoing entity will purchase another commercial building in the same geographic region as the sold building. The ongoing entity does not anticipate that any lessees from the sold building will terminate their leases and migrate to the new building; however, the ongoing entity believes that certain lessees from the sold building will also be lessees in the new building. The seller provides the buyer financing in the form of a 5-year recourse loan equal to 20 percent of the purchase price. The loan bears a market rate of interest, the rights conveyed are customary for these types of loan agreements, and the buyer is considered to have high credit quality. The ongoing entity will not otherwise be involved in the operations of the disposed component.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Cash flows associated with the disposed component are being generated by the ongoing entity resulting from (1) leasing space in the new building to some of the same lessees of the old building and (2) interest income from the seller-provided financing.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? No. The continuing cash flows do not result in a migration nor do they provide for a continuation of activities. Although the ongoing entity will lease space to some of the same lessees as the old building, the new building will not generate revenues or incur costs from specific customers who have migrated from the disposed component, since the lessees of the disposed component are not expected to terminate their leases and migrate to the new building. Additionally, there will not be any continuation of activities between the ongoing entity and the sold building. That is, the interest income recognized is from an activity that is different in nature from the activities of leasing and managing space in a building. Accordingly, an evaluation of the significance of the continuing cash flows is not necessary. An evaluation of continuing involvement should be performed.

Step 3: Does the ongoing entity have significant continuing involvement in the operations of the disposed component? No. The seller-provided financing likely will not result in the ongoing entity having the ability to significantly influence the operating and (or) financial policies of the disposed component after it is sold, based on the following:

a. The agreement is not significant to the overall operations of the disposed component, since the loan amount is equal to 20 percent of the purchase price, the loan is recourse, and the buyer is considered to have high-credit quality.
b. The extent to which the ongoing entity is involved in the operations of the disposed component is limited to the loan agreement.
c. The rights conveyed by the loan agreement do not enable the ongoing entity to exert significant influence over the disposed component.

Conclusion: Since the continuing cash flows are considered indirect cash flows and the ongoing entity will not have significant continuing involvement in the operations of the disposed component, classification as a discontinued operation would be appropriate.

Example 6

An entity that manufactures sporting goods has a bicycle division that designs, manufactures, markets, and distributes bicycles to its company-owned retail stores as well as third-party retailers. For that entity, the bicycle manufacturing operation is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, the manufacturing of the bicycles is a component of the entity.

The entity has experienced losses in its bicycle division resulting from an increase in manufacturing costs (principally, labor costs). The entity decides to remain in the bicycle business but will outsource the manufacturing operations and commits to a plan to sell the related manufacturing facility. The facility is classified as held for sale at that date. The entity will sell the manufacturing facility along with the third-party customer contracts and will enter into an outsourcing agreement with the buyer of that facility. The agreement will allow the ongoing entity to purchase 5 percent of the output from the facility at market for a period of 10 years, which will be sold through the company-owned store locations. The outsourcing agreement includes customary terms and does not permit the ongoing entity to be otherwise involved in the operations of the disposed component. The revenues generated from sales to company-owned store locations approximated 5 percent of the total revenues generated by the disposed component. The outsourcing agreement does not meet the definition of a lease based on an evaluation of the guidance in EITF Issue No. 01-8, "Determining Whether an Arrangement is a Lease."

There are no continuing cash inflows as a result of the continuation of activities, since no revenue will be generated by the ongoing entity as a direct result of the disposal transaction. The ongoing entity estimates that the continuing cash outflows as a result of a continuation of activities (the outsourcing arrangement) will result in the ongoing entity recognizing $50 thousand in costs to provide product for the company-owned retail stores. The ongoing entity estimates that the disposed component would have generated $1 million of costs to manufacture product for the third-party customers and the company-owned retail stores.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated by the ongoing entity resulting from the purchasing of manufactured product from the disposed component.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a continuation of activities between the ongoing entity and the disposed component, since the ongoing entity will purchase manufactured product from the disposed component. Therefore, an evaluation of the significance of the continuing cash flows should be performed.

Step 3: Are the continuing cash flows significant? No. The ongoing entity estimates that the continuing cash outflows will approximate 5 percent of the cash outflows that would have been generated by the disposed component. The ongoing entity believes that 5 percent is not significant.

Step 4: Does the ongoing entity have significant continuing involvement in the operations of the disposed component? No. The outsourcing agreement likely will not result in the ongoing entity having the ability to significantly influence the operating and (or) financial policies of the disposed component after it is sold based on the following:

a. The agreement is not significant to the overall operations of the disposed component, since the ongoing entity will be purchasing only 5 percent of the output from the facility.
b. The extent to which the ongoing entity is involved in the operations of the disposed component is limited to its ability to purchase bicycles for a period of 10 years.
c. The rights conveyed by the agreement do not enable the ongoing entity to exert significant influence over the disposed component.
d. The outsourcing agreement is at market.

Conclusion: Since the continuing cash flows are considered indirect cash flows and the ongoing entity will not have significant continuing involvement in the operations of the disposed component, classification as a discontinued operation would be appropriate.

Example 7

An entity manufactures and sells furniture through its company-owned and dealer-owned retail stores. These company-owned and dealer-owned stores also purchase furniture from third-parties. For that entity, each of the company-owned retail stores is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each retail store is a component of the entity.

The entity has experienced losses in its company-owned store division resulting from an increase in costs associated with operating its retail stores (principally, labor and rental costs). The entity decides to remain in the furniture manufacturing business but will sell its retail operations to its dealers and commits to a plan to sell those retail stores. The retail stores are classified as held for sale at that date. The entity will sell the retail stores and will enter into a supply arrangement to supply furniture to the dealer-owned stores, which include the stores that were previously company-owned stores.

The entity estimates that continuing cash inflows as a result of a continuation of activities (selling furniture) will result in the ongoing entity recognizing $10 million of revenue from the sale of furniture to the dealers that have acquired the company-owned stores. The entity estimates that the disposed component would have generated $11 million from the sale of furniture through the company-owned retail stores.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated by the ongoing entity resulting from the sale of product to the disposed component.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a continuation of activities between the ongoing entity and the disposed component, since the ongoing entity will sell manufactured product to the disposed component. Therefore, an evaluation of the significance of the continuing cash flows should be performed.

Step 3: Are the continuing cash flows significant? Yes. The entity estimates that the continuing cash inflows will approximate 91 percent of the cash inflows that would have been generated by the component absent the disposal transaction. The entity believes that 91 percent is significant.

Conclusion: The continuing cash flows should be considered direct cash flows of the disposed component due to the significant cash inflows that are expected to be generated by the ongoing entity as a result of the sale of manufactured product to the disposed component. An evaluation of cash outflows is not necessary. Since the continuing cash flows are considered direct cash flows, classification as a discontinued operation would not be appropriate. An evaluation of continuing involvement is not necessary.

Example 8

An entity mines, refines, and smelts aluminum that is sold to third-party customers and used in the entity's fabrication business. For that entity, the manufacturing (which includes the mining, refining, and smelting operations) and fabrication businesses are the lowest levels at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, the manufacturing and fabrication businesses each represent components of the entity.

The entity has experienced losses in its fabrication operation resulting from an increase in costs (principally, labor costs). The entity decides to remain in the aluminum manufacturing business but will sell its fabrication operation. The fabrication operation is classified as held for sale at that date. The entity will sell the fabrication business and will enter into a 5-year supply arrangement with the buyer to supply approximately 10 percent of the aluminum requirements to the disposed component at market rates. The terms of the supply agreement are customary, and the agreement does not provide the ongoing entity with the ability to otherwise be involved in the operations of the disposed component.

The entity estimates that continuing cash inflows as a result of a continuation of activities (selling aluminum) will result in the ongoing entity recognizing $300 thousand of revenue from the sale of aluminum to the disposed component. The entity estimates that the disposed component would have generated $10 million of revenue from the sale of fabricated aluminum to third-party customers absent the disposal transaction.

The entity estimates that continuing cash outflows as a result of a continuation of activities (selling aluminum) will result in the ongoing entity recognizing $250 thousand of costs associated with the production of the aluminum to be sold to the disposed component. The entity estimates that the disposed component would have generated $12 million of costs associated with the fabrication of aluminum to be sold to third-party customers absent the disposal transaction.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated by the ongoing entity resulting from the sale of product to the disposed component.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a continuation of activities between the ongoing entity and the disposed component, since the ongoing entity will sell raw materials to the disposed component. Therefore, an evaluation of the significance of the continuing cash flows should be performed.

Step 3: Are the continuing cash flows significant? No. The entity estimates that the continuing cash inflows will approximate 3 percent of the cash inflows and 2 percent of the cash outflows that would have been generated by the disposed component absent the disposal transaction. The entity believes that 3 percent and 2 percent are not significant.

Step 4: Does the ongoing entity have significant continuing involvement in the operations of the disposed component? The supply agreement likely will not result in the ongoing entity having the ability to significantly influence the operating and (or) financial policies of the disposed component after it is sold, based on the following:

a. The agreement is not significant to the overall operations of the disposed component, since the ongoing entity will be selling 10 percent of the disposed component's aluminum requirements.
b. The extent to which the ongoing entity is involved in the operations of the disposed component is limited to the ability to sell aluminum for a period of five years.
c. The rights conveyed by the agreement do not enable the ongoing entity to exert significant influence over the disposed component.
d. The agreement is at market.

Conclusion: Since the continuing cash flows are considered indirect cash flows and the ongoing entity will not have significant continuing involvement in the operations of the disposed component, classification as a discontinued operation would be appropriate.

Example 9

An entity is a manufacturer and distributor of medical devices. For that entity, the medical device operation is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, the medical device operation is a component of the entity.

The entity sells the medical device operations to a third-party buyer. In conjunction with the sale, the ongoing entity and the buyer enter into a 5-year royalty agreement that provides the ongoing entity with the right to receive a royalty fee from the buyer equal to 10 percent of revenues generated from the sale of medical devices that were sold previously by the entity. The terms of the royalty agreement do not provide the ongoing entity with the ability to be otherwise involved in the operations of the disposed component.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated resulting from the royalty arrangement.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? No. The royalty agreement does not provide for a migration nor does it provide for a continuation of activities. The revenue-producing activities and cost-generating activities of the component before the disposal transaction were the manufacturing and sale of medical devices. The ongoing entity will not continue any of those activities after the disposal transaction; therefore, the cash flows associated with the royalty fee are indirect cash flows. Accordingly, an evaluation of the significance of the continuing cash flows is not necessary. An evaluation of continuing involvement should be performed.

Step 3: Does the ongoing entity have significant continuing involvement in the operations of the disposed component? The royalty arrangement would likely not provide the ongoing entity with the ability to significantly influence the operating and (or) financial policies of the disposed component based on the following:

a. The royalty agreement is not significant to the overall operations of the disposed component.
b. The extent to which the ongoing entity is involved in the operations of the disposed component is limited to the ability to receive a royalty for a period of 5 years.
c. The rights conveyed by the agreement do not enable the ongoing entity to exert significant influence over the disposed component.

Conclusion: Since the continuing cash flows are considered indirect cash flows and the ongoing entity will not have significant continuing involvement in the operations of the disposed component, classification as a discontinued operation would be appropriate.

Example 10

An entity that is a franchisor in the quick-service restaurant business also operates company-owned restaurants. For that entity, an individual company-owned restaurant is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each company-owned restaurant is a component of the entity.

Based on its evaluation of the ownership mix of its system-wide restaurants in certain markets, the entity commits to a plan to sell its company-owned restaurants in one region to an existing franchisee. The restaurants are classified as held for sale at that date. The ongoing entity will enter into a franchise agreement that will provide it with the right to sell product to the restaurants in addition to receiving franchise fees determined, in part, based on the future revenues of the restaurants. The entity estimates that the continuing cash inflows from the sale of product will approximate 20 percent of the cash inflows, while the franchise fee will approximate 5 percent of the cash inflows that would have been generated by the disposed component absent the disposal transaction.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows would be generated by the ongoing entity from the sale of product and the franchise fee.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a continuation of activities between the ongoing entity and the disposed component, since the ongoing entity will sell product to the disposed component and will provide franchise services to the disposed component. The ongoing entity sold product prior to the disposal transaction and performed services similar to franchise services on its own behalf prior to the disposal transaction. Therefore, an evaluation of the significance of the continuing cash flows should be performed.

Step 3: Are the continuing cash flows significant? Yes. The entity estimates that the continuing cash inflows will approximate 25 percent of the cash inflows that would have been generated by the disposed component absent the disposal transaction. The entity believes that 25 percent is significant.

Conclusion: The continuing cash flows should be considered direct cash flows of the disposed component due to the significant cash inflows that are expected to be generated by the ongoing entity as a result of the sale of product to the disposed component and the franchise fee. An evaluation of cash outflows is not necessary. Since the continuing cash flows are considered direct cash flows, classification as a discontinued operation would not be appropriate. An evaluation of continuing involvement is not necessary.

Example 11

An entity that is a franchisor in the quick-service restaurant business also operates company-owned restaurants. For that entity, an individual company-owned restaurant is the lowest level at which the operations and cash flows can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. Therefore, each company-owned restaurant is a component of the entity.

Based on its evaluation of the ownership mix of its system-wide restaurants in certain markets, the entity commits to a plan to sell its company-owned restaurants in one region to an existing franchisee. The restaurants are classified as held for sale at that date. The ongoing entity will enter into a franchise agreement that will provide them with the right to receive franchise fees determined, in part, based on the future revenues of the restaurants. The entity estimates that the continuing cash inflows from the franchise fee will approximate 5 percent of the cash inflows that would have been generated by the disposed component absent the disposal transaction.

Evaluation:

Step 1: Are continuing cash flows expected to be generated by the ongoing entity? Yes. Continuing cash flows are being generated by the ongoing entity from the franchise agreement.

Step 2: Do the continuing cash flows result from a migration or continuation of activities? Yes. The continuing cash flows are the result of a continuation of activities between the ongoing entity and the disposed component, since the ongoing entity will provide franchise services to the disposed component. The ongoing entity performed services similar to the franchise services on its own behalf prior to the disposal transaction. Therefore, an evaluation of the significance of the continuing cash flows should be performed.

Step 3: Are the continuing cash flows significant? No. The entity estimates that the continuing cash inflows will approximate 5 percent of the cash inflows that would have been generated by the disposed component absent the disposal transaction. The entity believes that 5 percent is insignificant.

Step 4: Does the ongoing entity have significant continuing involvement in the operations of the disposed component? The franchise arrangement would likely constitute significant continuing involvement. Although the franchise agreement is only 5 percent of net sales, the ongoing entity is actively involved in the operations of the disposed component through the franchise agreement and, therefore, would have the ability to significantly influence the operating and (or) financial policies of the disposed component.

Conclusion: Although the continuing cash flows generated by the franchise agreement are indirect cash flows because they are not significant, the franchise agreement provides the ongoing entity with significant continuing involvement in the ongoing operations of the disposed component. Therefore, classification as a discontinued operation would not be appropriate.

Issue No. 04-1

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

Dates Discussed: March 17–18, 2004; June 30–July 1, 2004; September 29–30, 2004

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

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

FASB Statement No. 141, *Business Combinations*

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

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

AICPA Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*

Introduction

1. This Issue addresses the accounting for preexisting relationships between the parties to a business combination.

Issues

2. The issues are:

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

Issue 2— How the effective settlement of an executory contract in a business combination should be measured

Issue 3— Whether the acquisition of a right that the acquirer had previously granted to the acquired entity to use the acquirer's recognized or unrecognized intangible assets should be included in the measurement of the settlement amount or included as part of the business combination

Issue 4— Whether the acquirer should recognize, apart from goodwill, an acquired entity's intangible asset(s) that, before the business combination, arose solely from the acquired entity's contractual right to use the acquirer's recognized or unrecognized intangible asset(s)

Issue 5— Whether it is appropriate for an acquirer to recognize a settlement gain in conjunction with the effective settlement of a lawsuit or an executory contract in a business combination.

Prior EITF Discussion

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

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

5. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed the following model that was proposed by the FASB staff to address the measurement and recognition of the settlement of a preexisting relationship. The model reflects two general principles: (a) the measurement and recognition of the identifiable assets and liabilities of the acquired entity should be based on fair value (a marketplace participant view) and (b) the accounting for the settlement of the preexisting relationship generally should be the same whether within a business combination or absent a business combination.

Step 1: Allocate the cost of the acquired entity to the identifiable assets acquired and liabilities assumed (including any identifiable assets and liabilities related to the preexisting relationship) based on their fair values at the date of the acquisition with any residual recognized as goodwill in accordance with Statement 141.

Step 2: Segregate the identifiable assets and liabilities related to the preexisting relationship.

Step 3: For each asset (liability) identified in Step 2, determine how the amount allocated to each asset (liability) in Step 1 would be recognized had that amount been paid (incurred) absent the business combination.

6. The Task Force discussed the model and directed the FASB staff to further explore alternative views for the measurement and recognition of the settlement of a preexisting relationship in a business combination.

Current EITF Discussion

7. At the September 29–30, 2004 EITF meeting, the Task Force reached a consensus on Issue 1 that consummation of a business combination between parties with a preexisting relationship should be evaluated to determine if a settlement of a preexisting relationship exists. The Task Force determined that a business combination between two parties that have a preexisting relationship is a multiple-element transaction with one element being the business combination and the other element being the settlement of the preexisting relationship.

8. The Task Force reached a consensus on Issue 2 that the effective settlement of an executory contract in a business combination as a result of a preexisting relationship should be measured at

the lesser of (a) the amount by which the contract is favorable or unfavorable from the perspective of the acquirer when compared to pricing for current market transactions for the same or similar items or (b) any stated settlement provisions in the contract available to the counterparty to which the contract is unfavorable. To the extent that a stated settlement amount is less than the off-market component of the contract, the difference should be included as part of the business combination. An unfavorable contract is not necessarily a loss contract for the acquirer. The Task Force observed that the amount recognized as a settlement gain or loss in the acquirer's consolidated statement of operations may differ from the amount measured in cases in which the acquirer had previously recognized an amount in its financial statements related to the preexisting relationship. For example, if an entity acquires a supplier for which it previously had recognized an $8 liability on the supply contract (as a result of a previous business combination) and the measured loss on that contract is $10 based on this consensus, the entity would recognize a $2 loss (the $10 measured loss on the contract less the $8 loss previously recognized) in its statement of income.

9. The Task Force reached a consensus on Issue 3 that the acquisition of a right that the acquirer had previously granted to the acquired entity to use the acquirer's recognized or unrecognized intangible assets (for example, rights to the acquirer's trade name under a franchise agreement or rights to the acquirer's technology under a technology licensing agreement, hereinafter referred to as a "reacquired right") should be included as part of the business combination. The Task Force observed that if the contract giving rise to the reacquired right includes terms that are favorable or unfavorable when compared to pricing (for example, royalty rates) for current market transactions for the same or similar items, an entity should measure a settlement gain or loss as the lesser of (a) the amount by which the contract is favorable or unfavorable to market terms from the perspective of the acquirer or (b) the stated settlement provisions of the contract available to the counterparty to which the contract is unfavorable. Refer to the consensus in Issue 2 for additional guidance on the measurement of the settlement amount for the favorable or unfavorable terms or the settlement provisions of the contract.

10. The Task Force reached a consensus on Issue 4 that a reacquired right (which would exclude the amount recognized as a settlement gain or loss as a result of the application of the consensus in Issue 3) should be recognized as an intangible asset apart from goodwill. The Task Force observed that Statement 142 requires that the fair value of all identifiable intangibles, including trade name and technology assets, be separately valued when determining implied goodwill. For example, if an entity reacquires the right to its trade name in a certain geographic location, the entity should recognize the value of the reacquired trade name as either a separate intangible asset or a part of its recognized trade name. The entity is not required to allocate the cash flows associated with its trade name to separate assets that represent other geographic locations in Step 2 of the goodwill impairment test.

11. The Task Force reached a consensus on Issue 5 that a settlement loss or gain should be recognized in conjunction with the effective settlement of a lawsuit (including threatened litigation) or executory contract in a business combination, unless otherwise specified in existing authoritative literature. The Task Force observed that the amount recognized as a settlement gain or loss in the acquirer's consolidated statement of operations may differ from the amount measured in cases in which the acquirer had previously recognized an amount in its financial

statements related to the preexisting relationship. The Task Force also observed that the effective settlement of a lawsuit in a business combination should be measured at fair value.

12. The Task Force also reached a consensus that the following disclosures should be required for business combinations between parties with a preexisting relationship:

a. The nature of the preexisting relationship
b. The measurement of the settlement amount of the preexisting relationship, if any, and the valuation method used to determine the settlement amount
c. The amount of any settlement gain or loss recognized and its classification in the statement of operations.

Transition

13. The consensuses in this Issue should be applied to business combinations consummated and goodwill impairment tests performed in reporting periods beginning after Board ratification of the consensuses. Amounts previously recognized as goodwill should not be reclassified as an identifiable intangible asset, however, previously recognized goodwill should be tested for impairment by applying these consensuses in Step 2 of a goodwill impairment test. Any effect on a goodwill impairment charge as a result of the application of these consensuses should be reported in operating income. Early application of the consensuses is permitted in periods for which financial statements have not been issued.

Board Ratification

14. At its October 13, 2004 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

Status

15. No further EITF discussion is planned.

Issue No. 04-5

Title: Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights

Dates Discussed: June 30–July 1, 2004; September 29–30, 2004

References: FASB Statement No. 57, *Related Party Disclosures*

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

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*

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

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

APB Opinion No. 20, *Accounting Changes*

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

Introduction

1. For many years, financial statement preparers and auditors have debated how to evaluate whether a partnership should be consolidated by one of its partners. Recent guidance provided in Interpretation 46(R)[1] regarding kick-out rights in the context of evaluating variable interests and consolidation of variable interest entities has renewed the debate over what considerations are relevant in making that evaluation, particularly with regard to whether the general partner should consolidate a limited partnership. In practice today, the question of whether a partnership should be consolidated by one of its partners is typically addressed by analogizing to the guidance in SOP 78-9, which specifically provides guidance on the accounting for investments in real estate ventures, including investments in corporate joint ventures, general partnerships, limited partnerships, and undivided interests. Very little authoritative guidance exists for purposes of assessing whether a limited partner's rights are *important rights* that, under SOP 78-9, might preclude a general partner from consolidating a limited partnership. As a result, differing views in practice about what rights constitute important rights have evolved over time.

Issue

2. The issue is when a sole general partner should consolidate a limited partnership.

Prior EITF Discussion

3. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed the general direction and approach for addressing which rights held by a limited partner(s) would preclude consolidation of a limited partnership by the sole general partner. The Task Force agreed that the framework developed by the Working Group for EITF Issue No. 98-6, "Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General

[1] Refer to paragraph B20 of Interpretation 46(R).

Partner and the Limited Partners Have Certain Approval or Veto Rights," is an appropriate starting point for this Issue, including the presumption that a sole general partner should consolidate a limited partnership absent certain rights held by the limited partner(s). A Task Force member noted that the scope of this Issue should be limited to those limited partnerships with a single general partner or limited partnerships with multiple general partners only if all the general partners are related parties. The Task Force provided the FASB staff with a general direction for developing this Issue.

Current EITF Discussion

4. At the September 29–30, 2004 EITF meeting, the Task Force discussed a proposed framework for addressing when a sole general partner should consolidate a limited partnership but did not reach a consensus. The proposed framework presumes that a sole general partner in a limited partnership controls the limited partnership and, therefore, should include the limited partnership in its consolidated financial statements. The presumption of control can be overcome if the limited partners have (a) the substantive ability to remove the sole general partner or otherwise dissolve the limited partnership or (b) substantive participating rights.

5. The Task Force generally agreed with the presumption of control by the sole general partner and that the presumption could be overcome if the limited partners have the ability to remove the sole general partner or otherwise dissolve the limited partnership. The Task Force also generally agreed that the evaluation of whether the rights to dissolve the partnership or remove the general partner are substantive should be consistent with the guidance in paragraph B20 of Interpretation 46(R).

6. The Task Force also discussed the evaluation of whether participating rights held by the limited partners would overcome the presumption of control by the sole general partner. The Task Force observed that there is an inconsistency between the important rights concept in SOP 78-9 and substantive participating rights in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor Has a Majority of the Voting Interest but the Minority Shareholders Have Certain Approval or Veto Rights." The Task Force directed the FASB staff to develop an approach to reconcile this inconsistency and to consider the protective rights concept in Issue 96-16. The Task Force acknowledged that such an approach may require a reconsideration of certain aspects of Issue 96-16 and SOP 78-9. The Task Force also directed the FASB staff to consider whether the nature of a limited partnership should be considered when evaluating whether a sole general partner should consolidate that entity. The Task Force also asked the FASB staff to consider whether there are substantive differences between corporations and partnerships that warrant different consolidation treatment by a general partner or majority owner with respect to the rights of limited partners or minority owners.

Status

7. Further discussion is expected at a future meeting.

Issue No. 04-6

Title: Accounting for Stripping Costs Incurred during Production in the Mining Industry

Dates Discussed: June 30–July 1, 2004; September 29–30, 2004

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

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

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

AICPA Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins,* Chapter 4, "Inventory Pricing"

AICPA Accounting Research Bulletin No. 45, *Long-Term Construction-Type Contracts*

APB Opinion No. 20, *Accounting Changes*

AICPA Statement of Position 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*

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

International Accounting Standards Exposure Draft 6, *Exploration and Evaluation of Mineral Resources*

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

Introduction

1. In the mining industry, companies may be required to remove overburden and other mine waste materials to access mineral deposits. The costs of removing overburden and waste materials are referred to as "stripping costs." During the development of a mine (before production begins), it is generally accepted in practice that stripping costs are capitalized as part of the depreciable cost of building, developing, and constructing the mine. Those capitalized costs are typically amortized over the productive life of the mine using the units of production method. A mining company may continue to remove overburden and waste materials, and therefore incur stripping costs, during the production phase of the mine. Questions have been raised about the appropriate accounting for stripping costs incurred during the production phase, and diversity in practice exists.

Scope

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

Definition of the Production Phase

3. This Issue applies to the accounting for stripping costs incurred in the production phase of a mining operation. For purposes of defining the scope of this Issue, the definition of the production phase of a mine is as follows:

> The production phase of a mine is deemed to have begun when operations have commenced and revenue is realized from the sale of minerals, irrespective of the level of production.

Issue

4. The issue is how stripping costs incurred during production in the mining industry should be accounted for.

Prior EITF Discussion

5. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed the accounting for stripping costs incurred during production but did not reach a consensus. The Task Force asked the FASB staff to further explore and develop with the Mining Industry Working Group the following alternatives for accounting for stripping costs: (a) expense as incurred, (b) defer as an asset (no liability recognition) and recognize in earnings using a proportional performance ratio, and (c) include in inventory as a variable production cost. The Task Force also requested the FASB staff to solicit a recommendation from the Working Group.

Current EITF Discussion

6. At the September 29–30, 2004 EITF meeting, the Task Force discussed the accounting for stripping costs incurred during production but did not reach a consensus. The Task Force considered the recommendation of the Working Group that stripping costs incurred during production are a mine development cost that should be capitalized as an investment in the mine and attributed to the proven and probable reserves benefited in a systematic and rational manner. A majority of the Task Force members expressed support for the Working Group recommendation; however, the Task Force directed the FASB staff to develop additional guidance about what constitutes a systematic and rational manner of attributing the capitalized costs to proven and probable reserves benefited. Additionally, the Task Force generally agreed that the attribution of stripping costs incurred in the pre-production phase of the mine should be the same as those incurred during the production phase.

Status

7. Further discussion is expected at a future meeting.

Issue No. 04-7

Title: Determining Whether an Interest Is a Variable Interest in a Potential Variable Interest Entity

Dates Discussed: June 30–July 1, 2004; September 29–30, 2004

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

FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*

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

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

Introduction

1. Interpretation 46(R) provides guidance on how to apply the controlling financial interest criteria in ARB 51 to variable interest entities (VIEs). VIEs are evaluated for consolidation based on all contractual, ownership, or other interests that expose their holders to the expected losses or the expected residual returns of the entity. Those interests are termed variable interests. An integral part of applying Interpretation 46(R) is determining which pecuniary interests are variable interests.

2. Paragraph 2(c) of Interpretation 46(R) defines variable interests as "…contractual, ownership, or other pecuniary interests in an entity that change with changes in the fair value of the entity's net assets exclusive of variable interests." Paragraph B4 of Interpretation 46(R) describes what should be considered when determining whether an interest is a variable interest as follows:

> The identification of variable interests involves determining which assets, liabilities, or contracts create the entity's variability and which assets, liabilities, equity, and other contracts absorb or receive that variability. The latter are the entity's variable interests. The labeling of an item as an asset, liability, equity, or as a contractual arrangement does not determine whether that item is a variable interest. It is the role of the item—to absorb or receive the entity's variability—that distinguishes a variable interest. That role, in turn, often depends on the design of the entity.

3. An entity's variability is the sum of the absolute values of the expected losses and expected residual returns. Expected losses and expected residual returns are derived from expected cash flows of the entity. However, expected losses and expected residual returns refer to amounts discounted and adjusted for market factors and assumptions rather than to undiscounted cash flow estimates.

4. Constituents have raised concerns that Interpretation 46(R) is unclear as to how a reporting enterprise should determine whether a contract absorbs variability of an entity's net assets exclusive of variable interests; that is, whether the contract should be considered a variable interest. Different approaches for making that determination have been developed and used, which has resulted in inconsistent identification of certain interests as variable interests. Those inconsistencies can have a significant impact on the determination as to what the expected losses of the entity are, whether the entity is a VIE, and, ultimately, which party, if any, should consolidate the VIE.

5. There is diversity in practice regarding the methods used to determine whether an interest absorbs variability of an entity's net assets exclusive of variable interests. The following are four potential approaches for determining whether an interest is a variable interest:

a. *Fair value approach*—the determination is based on whether the interest absorbs variability in the fair value of the entity's net assets (exclusive of variable interests).
b. *Cash flow approach*—the determination is based on whether the interest absorbs variability in the cash flows of the entity's net assets (exclusive of variable interests).
c. *Combination approach*—the determination is based on whether the interest absorbs variability in either the cash flows or the fair value of the entity's net assets (exclusive of variable interests).
d. *By design approach*—the determination is based on the role of the interest; that is, whether it is used to absorb variability of the entity's net assets (exclusive of variable interests). In making this determination, many factors are considered, such as the role of each interest holder, the design of the VIE, the expectations of the interest holders, and the manner in which the VIE was marketed to the interest holders.

6. The FASB staff observed that in determining whether an interest creates or absorbs variability of the VIE's net assets exclusive of variable interests, issues have arisen regarding the difference between (a) assets that are physically held/owned by the VIE and (b) positions that are created by derivative and nonderivative forward contracts (referred to as "forward contracts") and that have economic profiles that are similar to owning the assets. When analyzing forward contracts pursuant to the guidance provided by paragraphs B12 and B13 of Interpretation 46(R), different conclusions can be reached as to whether a forward contract is a variable interest if one considers synthetically created positions to be assets similar to the assets created by cash transactions. A contract that creates a similar economic profile to the actual ownership of an asset is commonly referred to as a synthetic asset. A long position in an asset has the economic profile of owning the asset and is created by either purchasing the asset through a cash transaction or synthetically creating the asset through the use of a derivative instrument (for example, a forward to purchase the asset). A conclusion that a contract that synthetically creates a long position in an asset is similar to owning an asset would lead to the conclusion that the synthetic asset creates risks that are similar to owning an asset and therefore would likely not be a variable interest before consideration of the counterparty's credit and performance risk. That issue should be addressed when determining whether an interest is a variable interest and it should be addressed separately from the issue of what variability should be considered when making that determination.

Issues

7. The issues are:

Issue 1— What aspects or components of the variability in an entity's net assets (exclusive of variable interests) should be considered when determining whether an interest is a variable interest

Issue 2— When determining whether an interest is a variable interest, whether long positions of a VIE that are synthetically created by derivative transactions should be considered in the same manner as long positions created by cash transactions.

Prior EITF Discussion

8. At the June 30–July 1, 2004 EITF meeting, the Task Force discussed the four potential approaches described in paragraph 5, above, and some of the attributes inherent in those approaches. During the discussion, a fifth approach that incorporates the attributes of the combination approach and the by-design approach was introduced. The Task Force was not asked to reach a consensus on Issue 1. The Task Force asked the FASB staff and the Working Group to further develop the fifth approach and to include examples for each of the five potential approaches for discussion at a future meeting.

Current EITF Discussion

9. At the September 29–30, 2004 EITF meeting, FASB staff presented an approach developed by the FASB staff and the Working Group that would first require the determination of the type of variability that needs to be considered: (a) the fair value variability, (b) the cash flow variability, or (c) both the fair value and cash flow variability. The FASB staff observed that although an interest may be absorbing the variability of a variable interest entity using any of the three approaches, many enterprises do not consider such interests to be variable interests because the interest was not designed to absorb the variability of the variable interest entity or the interest creates an amount of variability that offsets the amount of variability absorbed. The FASB staff and the Working Group had identified that issue as an issue that should be addressed when determining whether an interest is a variable interest. As a result, the FASB staff re-characterized the Issues to be addressed as follows:

Issue 1(a)— The variability that should be considered when determining whether an interest is a variable interest

Issue 1(b)— The interests that absorb variability of the variable interest entity that should be considered variable interests of the variable interest entity.

10. The Task Force discussed the appropriate variability to be considered in Issue 1(a). Task Force members acknowledged that fair value variability and cash flow variability can both be important when determining whether an interest is a variable interest, but raised conceptual and operational concerns regarding the use of a combined approach. The Task Force introduced a new approach to address Issue 1(a) that would require the identification of the predominant variability of the entity in determining whether either fair value variability or cash flow

variability should be used to determine whether interests are variable interests in the entity. When evaluating the predominant variability of the entity, the Task Force observed that an investor should consider, among other factors, the variability that the entity was designed to be exposed to. The Task Force directed the FASB staff to further develop this new approach and to include examples illustrating the application of this approach, as well as the fair value and cash flow approaches.

11. The Task Force did not specifically discuss Issue 1(b).

Status

12. Further discussion is expected at a future meeting.

Issue No. 04-8

Title: The Effect of Contingently Convertible Instruments on Diluted Earnings per Share

Dates Discussed: June 30–July 1, 2004; September 29–30, 2004

References: FASB Statement No. 128, *Earnings per Share*

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

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

FASB Staff Position No. FAS 129-1, "Disclosure Requirements under FASB Statement No. 129, *Disclosure of Information about Capital Structure*, Relating to Contingently Convertible Securities"

Proposed FASB Statement, *Earnings per Share (a revision of Statement 128) (December 2004)*

Introduction

1. Contingently convertible debt instruments, commonly referred to as Co-Cos, are financial instruments that add a contingent feature to a convertible debt instrument. Co-Cos are generally convertible into common shares of the issuer after the common stock price has exceeded a predetermined threshold for a specified time period (market price trigger). Currently, most issuers of Co-Cos exclude the potential dilutive effect of the conversion feature from diluted EPS until the market price contingency is met. Co-Cos generally carry a lower interest rate than conventional, nonconvertible debt and, in some structures, permit the issuer to recognize little or no interest costs.

2. While the terms of Co-Cos can vary based on an issuer's specific facts and circumstances, a typical Co-Co includes a contingent market price trigger that exceeds a specified conversion price of the issuer's underlying stock price by a certain percentage (usually 10 percent, 20 percent, or 30 percent) on the date of issuance. Some Co-Cos have floating market price triggers under which conversion is dependent upon the market price of the stock exceeding the conversion price by a certain percentage(s) at specified times during the life of the debt. Other Co-Cos require the market price trigger to be sustained for a specified period, for example, 20 percent above the conversion strike price for a 30-day period. In addition, Co-Cos may have many additional features such as parity features, issuer call options, and investor put options.

3. A Co-Co usually has a conversion price that exceeds the market price of the underlying stock at its issuance date and a market price trigger that exceeds the conversion price. For example, assume a Co-Co is issued for $1,000 and is convertible into 10 shares of common stock. A typical relationship of the relevant prices is as follows:

- Common stock price at Co-Co's issuance date—$80
- Implied conversion price—$100 ($1,000/10 shares into which the debt converts)
- *Market price trigger* permitting conversion—$120.

The market price trigger is higher than the conversion price and, accordingly, the instrument is less likely to be converted than a conventional convertible debt instrument without the market price trigger. Most issuers do not include the dilutive effect of the instrument in diluted EPS unless the market price trigger had been achieved—that is, the market price of the common stock exceeded $120 for the specified period. In contrast, if the instrument did not include the market price trigger, the dilutive effect of the instrument would have been included in diluted EPS on an if-converted basis from the date that the instrument was issued (even though the stock price may not have exceeded the implied conversion price). As illustrated in this example, a Co-Co is likely to be less dilutive in the EPS computation than a noncontingent convertible debt instrument.

Issue

4. The issue is when the dilutive effect of contingently convertible instruments should be included in diluted earnings per share.

Prior EITF Discussion

5. At the June 30–July 1, 2004 EITF meeting, the Task Force reached a tentative conclusion that Co-Cos should be included in diluted earnings per share computations (if dilutive) regardless of whether the market price trigger (or other contingent feature) has been met. That is, Co-Cos are not contingently issuable shares (paragraphs 30–35 of Statement 128) or contingently issuable potential common shares (paragraph 35 of Statement 128) because the Co-Cos have already been issued and are outstanding. Accordingly, Co-Cos should be accounted for as convertible debt pursuant to paragraphs 26–28 of Statement 128 for purposes of calculating diluted EPS.

6. The Task Force agreed that the tentative conclusion would be applied by restating previously reported diluted earnings per share, but deferred concluding on the effective date until a final consensus is reached.

7. The Task Force agreed that a draft abstract should be posted to the FASB's website. The draft abstract was posted to the FASB's website on July 19, 2004, for a 45-day comment period.

Current EITF Discussion

8. At the September 29–30, 2004 EITF meeting, the Task Force considered comments received on the draft abstract and addressed the following three issues: (i) whether to reaffirm the tentative conclusion for Co-Cos, (ii) whether the scope of the tentative conclusion should be expanded beyond Co-Cos, and (iii) transition and effective date.

9. The Task Force reached a consensus on Issues (i) and (ii) that all instruments that have embedded conversion features (for example, contingently convertible debt, contingently convertible preferred stock, and Instrument C in EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion," with a market-based contingency) that are contingent on market conditions indexed to an issuer's share price should be included in diluted earnings per share computations (if dilutive) regardless of whether the market conditions have been met. The consensus includes instruments that have more than one contingency if one of the contingencies is based on market conditions indexed to the issuer's share price and that

instrument can be converted to shares based on achieving a market condition—that is, the conversion is not dependent on a substantive non-market-based contingency. This consensus is reflected in the draft abstract attached as Appendix 04-8A.

10. The Task Force directed the FASB staff to present for the EITF Agenda Committee's consideration issues that would address the effect on EPS of non-market based contingencies for issued instruments and market-based contingencies for freestanding instruments.

Transition

11. The effective date of the consensus in this Issue will coincide with the effective date of the proposed Statement that revises Statement 128. The consensus should be applied to reporting periods ending after the effective date, which is expected to be December 15, 2004.

12. The consensus reached by the Task Force should be applied retroactively to instruments outstanding at the date of adoption of this consensus.[1] Diluted earnings per share of all prior periods presented for comparative purposes should be restated to conform to the consensus guidance. For instruments within the scope of this Issue whose terms have been modified prior to the date of adoption of this consensus, the consensus would apply to terms of the instrument in place at the date of adoption, and diluted earnings per share of all prior periods would be restated based upon the modified terms. For instruments within the scope of this Issue that have been cash settled before the date of adoption, restatement of diluted earnings per share is not required; however, for instruments that have been converted or stock settled before the date of adoption, restatement of diluted earnings per share for all prior periods presented is required to conform to the consensus guidance.

Board ratification

13. At its October 13, 2004 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

Status

14. The EITF Agenda Committee will consider whether the Task Force should address (a) the effect on EPS of non-market-based contingencies for issued instruments and (b) market-based contingencies for freestanding instruments.

15. No further EITF discussion is planned on this Issue.

[1] The date of adoption of this consensus is the end of the first reporting period after its effective date.

Appendix 04-8A

EITF ABSTRACTS (DRAFT[2])

Issue No. 04-8

Title: The Effect of Contingently Convertible Instruments on Diluted Earnings per Share

Date Discussed: June 30–July 1, 2004; September 29–30, 2004

References: FASB Statement No. 128, *Earnings per Share*
FASB Statement No. 129, *Disclosure of Information about Capital Structure*
FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*
FASB Staff Position No. FAS 129-1, "Disclosure Requirements under FASB Statement No. 129, *Disclosure of Information about Capital Structure*, Relating to Contingently Convertible Securities"
Proposed FASB Statement, *Earnings per Share (a revision of Statement 128) (December 2004)*

ISSUE

1. This Issue addresses when contingently convertible instruments should be included in diluted earnings per share. For purposes of this Issue, contingently convertible instruments are instruments that have embedded conversion features that are contingently convertible or exercisable based on (a) a market price trigger or (b) multiple contingencies if one of the contingencies is a market price trigger and the instrument can be converted or share settled based on meeting the specified market condition. A market price trigger is a market condition that is based at least in part on the issuer's own share price. Examples of contingently convertible instruments subject to this Issue include contingently convertible debt, contingently convertible preferred stock, and Instrument C in EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion," all with embedded market price triggers.

2. While the terms of contingently convertible instruments vary, a typical instrument includes a market price trigger that exceeds a specified conversion price of the issuer's underlying stock price on the date of issuance by a specified percentage (for example, 10 percent, 20 percent, or

[2] 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.

30 percent). Some contingently convertible instruments have floating market price triggers for which conversion is dependent upon the market price of the issuer's stock exceeding the conversion price by a specified percentage(s) at specified times during the term of the debt. Other contingently convertible instruments require that the market price of the issuer's stock exceed a specified level for a specified period (for example, 20 percent above the conversion price for a 30-day period). In addition, contingently convertible instruments may have additional features such as parity features, issuer call options, and investor put options.

3. The issue is when the dilutive effect of contingently convertible instruments should be included in diluted earnings per share computations.

EITF DISCUSSION

4. The Task Force reached a consensus that contingently convertible instruments should be included in diluted earnings per share (if dilutive) regardless of whether the market price trigger has been met. The Task Force observed that there is no substantive economic difference between contingently convertible instruments and conventional convertible instruments with a market price conversion premium. Accordingly, the Task Force concluded that the treatment for diluted EPS should not differ because of a contingent market price trigger.

5. The Task Force also agreed that the consensus should be applied to instruments that have multiple contingencies if one of the contingencies is a market price trigger and the instrument is convertible or settleable in shares based on meeting a market condition—that is, the conversion is not dependent (or no longer dependent) on a substantive non-market-based contingency. For example, if an instrument is convertible upon meeting a market price trigger or a substantive non-market-based contingency (for example, a change in control), the issuer should apply the consensus in this Issue. Alternatively, if the instrument is convertible upon achieving both a market price trigger and a substantive non-market-based contingency, the instrument is not within the scope of this Issue until the non-market-based contingency has been met.

Transition

6. The consensus in this Issue is effective as of the effective date of the proposed Statement that revises Statement 128. The consensus should be applied to reporting periods ending after the effective date.

7. For contingently convertible instruments outstanding at the date of adoption of this consensus[1] and whose terms have not been modified since the date of issuance, prior-period diluted earnings per share should be restated to conform to the guidance in this consensus for comparative purposes.

8. For contingently convertible instruments outstanding at the date of adoption of this consensus and whose terms have been modified, prior-period diluted earnings per share should be restated to conform to the guidance in this consensus for comparative purposes based on the modified terms of the instrument at the date of adoption of this Issue.

9. For contingently convertible instruments that have been stock settled (stock settled would include conversion) prior to the date of adoption of this consensus, all prior-period diluted earnings per share should be restated to conform to the guidance in this consensus for comparative purposes.

10. Contingently convertible instruments that have been cash settled prior to the date of adoption of this consensus are not subject to the guidance in this consensus, and prior-period diluted earnings per share should not be restated.

Board Ratification

11. At its October 13, 2004 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

[1] The date of adoption of this consensus is the end of the first reporting period after its effective date.

STATUS

12. The EITF Agenda Committee will consider whether the Task Force should address (a) the effect on EPS of non-market-based contingencies for issued instruments and (b) market-based contingencies for freestanding instruments.

13. No further EITF discussion is planned on this Issue.

Exhibit 04-8A

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS IN ISSUE 04-8

The following illustrates diluted earnings per share computations for two examples of contingently convertible instruments.

Example 1—Contingently convertible debt with a market price trigger

The holder of the debt may convert the debt into shares of common stock when the share price exceeds the market price trigger; otherwise, the holder is only entitled to the par value of the debt.

Assumptions:

1. Principal amount of the convertible debt—$1,000
2. Conversion ratio—20
3. Conversion price per share of common stock—$50[3]
4. Share price of common stock at issuance—$40
5. Market price trigger—average share price for the year must exceed $65 (130% of conversion price)
6. Interest rate—4%
7. Effective tax rate—35%
8. Shares of common stock outstanding—2,000.

The contingently convertible debt is issued on January 1, 200X, income available to common shareholders for the year ended December 31, 200X, is $10,000, and the average share price for the year is $55. The issuer of the contingently convertible debt should apply the consensus in this Issue, which requires the issuer to include the dilutive effect of the convertible debt in diluted earnings per share even though the market price trigger of $65 has not been met. In this

[3] Conversion price = (Convertible bond's principal amount) ÷ (Conversion ratio) = $1,000 ÷ 20 = $50.

example, basic EPS is $5.00,[4] and applying the if-converted method to the debt instrument dilutes earnings per share to $4.96.[5]

Example 2—Instrument C in Issue 90-19 with a market price trigger

In Example 2, the assumptions are the same as Example 1 except that the issuer of the contingently convertible debt must settle the principal amount of the debt in cash and it may settle any conversion premium in either cash or stock. The holder of the instrument is only entitled to the conversion premium if the share price exceeds the market price trigger. The contingently convertible instrument is issued on January 1, 200X, income available to common shareholders for the year ended December 31, 200X is $10,000, and the average share price for the year is $64. In this example, basic EPS is $5.00, and applying the method required by Issue 90-19 for this instrument results in diluted earnings per share of $4.99.[6]

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[4] Basic EPS = [Income available to common shareholders (IACS)] ÷ [Shares outstanding (SO)] = $10,000 ÷ 2,000 shares = $5.00 per share.

[5] Diluted EPS computed using the if-converted method = [IACS + Interest (1-tax rate)] ÷ (SO + Potential common shares) = ($10,000 + $26) ÷ (2,000 + 20) shares = $4.96 per share.

[6] Potential common shares = (Conversion spread value) ÷ (Average share price) = $14 × 20 shares ÷ $64 = 4.38 shares.

Diluted EPS (computed in accordance with Issue 90-19) = IACS ÷ (SO + Potential common shares) = ($10,000) ÷ (2,000 + 4.38) shares = $4.99 per share.

Issue No. 04-9

Title: Accounting for Suspended Well Costs

Date Discussed: September 29–30, 2004

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

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

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

Introduction

1. Paragraph 19 of Statement 19 requires costs of drilling exploratory wells to be capitalized pending determination of whether the well has found proved reserves. If the well has proved reserves, the capitalized costs become part of the entity's wells, equipment, and facilities; if, however, the well has not found proved reserves, the capitalized costs of drilling the well are expensed, net of any salvage value. Questions have arisen in practice about the application of this guidance as a result of changes in oil- and gas-exploration processes and lifecycles.

2. In certain circumstances, an exploratory well can find reserves but classification of those reserves as proved cannot be made when drilling is completed. To meet the classification of proved reserves, the geological and engineering data must support with reasonable certainty that the quantities of reserves are recoverable under *existing economic and operating conditions* (typically, prices and costs at the date that the estimate is made). For example, after reserves are found, an entity may be required to obtain additional geological information, government approvals, sales contracts through negotiations, and project financing before the entity can classify the reserves as proved.

3. Statement 19 acknowledges that an exploratory well may find reserves, but classification of those reserves as proved cannot be made when drilling is completed. Paragraphs 31-34 of Statement 19 provide guidance on whether exploratory well costs can continue to be capitalized in those situations.

4. If classification of proved reserves cannot be made at the completion of the drilling in an area requiring a major capital expenditure, paragraph 31(a) requires that the cost continue to be carried as an asset provided that (a) there have been sufficient reserves found to justify completion as a producing well if the required capital expenditure is made and (b) drilling of the additional exploratory well is under way or firmly planned for the near future. If either of those two criteria is not met, the entity must expense the exploratory well costs.

5. For all other exploratory wells not addressed in paragraph 31(a), paragraph 31(b) requires the capitalized costs to be charged to expense if the reserves cannot be classified as proved after a year following the completion of drilling.

6. Application of paragraph 31 of Statement 19 to the facts and circumstances commonly faced by oil- and gas-producing companies in the current exploration environment has become a concern. There are diverse views on how an entity should evaluate the paragraph 31 criteria in this changed environment—specifically, the one-year deferral period.

Issue

7. The issue is whether there are circumstances that would permit the continued capitalization of exploratory well costs beyond one year other than when additional exploration wells are necessary to justify major capital expenditures and those wells are under way or firmly planned for the near future.

Current EITF Discussion

8. At the September 29–30, 2004 EITF meeting, the Task Force agreed to remove this Issue from the EITF agenda and requested that the Board consider an amendment to Statement 19 to address the issue. Further, the Task Force recommended that the Board amend Statement 19 to permit the continued capitalization of exploratory well costs beyond one year if (a) the well has found a sufficient quantity of reserves to justify its completion as a producing well and (b) the entity is making sufficient progress assessing the reserves and the economic and operating viability of the project. The Task Force also recommended that the Board permit the continued capitalization of exploratory well costs if the determination of proved reserves is dependent solely on the pending availability of capacity of an existing pipeline and similar situations.

9. The Task Force also recommended that the Board consider the following guidance for evaluating whether an entity is making sufficient progress.

a. All relevant facts and circumstances should be evaluated when determining whether an entity is making sufficient progress on assessing the reserves and the economic and operating viability of the project. The following are some indicators, among others, that an entity is making sufficient progress:

   - Commitment of personnel to the project who are at the appropriate levels and who have the appropriate skills
   - Costs are being incurred to assess the reserves and their potential development
   - An assessment process covering the economic, legal, political, and environmental aspects of the potential development is in progress
   - Existence (or active negotiations) of sales contracts with customers for the oil and gas
   - Existence (or active negotiations) of agreements with governments, lenders, and venture partners
   - Outstanding requests for proposals for development of the required facilities
   - Existence of firm plans, established timetables, or contractual commitments.
   - Progress is being made on contractual arrangements that will permit future development

b. While these are indicators that an entity is making progress toward assessing the reserves and the project, long delays in the assessment or development plan (whether anticipated or unexpected) raise doubts about whether the entity is making sufficient progress to continue the capitalization of exploratory well costs after one year following the completion of drilling. The Task Force observed that the longer the assessment process for the reserves and the project, the more difficult it is to conclude that the entity is making sufficient progress to continue the capitalization of those exploratory well costs.

c. If an entity has not engaged in substantial activities, or activities have been suspended, to assess the reserves or the development of the project one year after the drilling of the exploratory well is completed, any capitalized costs associated with that well should be expensed, net of any salvage value. The planning of activities for the near future (other than additional exploration wells under paragraph 31(a) of Statement 19 and other geological testing methods) in the absence of other actual activities is not sufficient to continue the capitalization of exploratory well costs beyond one year after the completion of drilling.

d. An entity should expense any capitalized exploratory well costs when it no longer plans to continue the assessment of the reserves and the economic and operating viability of the project. However, brief interruptions in the activities required to assess the reserves or the project should not require capitalized costs to be expensed.

e. An entity should not continue to capitalize exploratory well costs on the chance that (a) some event will occur that is totally outside the entity's control or (b) technology will be developed to make the development of the well economically and operationally viable.

10. The FASB staff will provide the recommendations of the EITF to the Board at a future Board meeting.

Status

11. No further EITF discussion is planned.

Issue No: 04-10

Title: Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds

Date Discussed: September 29–30, 2004

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

Introduction

1. Statement 131 requires that a public business enterprise report financial and descriptive information about its reportable operating segments. Operating segments are components of an enterprise about which separate financial information is available that is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. Generally, financial information is required to be reported on the basis that it is used internally for evaluating segment performance and deciding how to allocate resources to segments.

2. Paragraph 16 of Statement 131 requires that an enterprise report separate information about each operating segment that (a) has been identified in accordance with paragraphs 10-15 of that Statement or that results from aggregating two or more of those segments in accordance with paragraph 17 of that Statement and (b) exceeds the quantitative thresholds in paragraph 18 of that Statement. Operating segments (and aggregated operating segments) that are required to be reported separately are deemed "reportable segments." If an operating segment does not meet one of the quantitative thresholds in paragraph 18, paragraph 19 permits an entity to combine information about that segment with other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the operating segments share a majority of the aggregation criteria listed in paragraph 17.

3. Paragraph 17 of Statement 131 permits two or more operating segments to be aggregated into a single operating segment if aggregation is consistent with the objective and basic principles of Statement 131, if the segments have similar economic characteristics, and if the segments are similar in each of the following areas:

a. The nature of the products and services
b. The nature of the production processes
c. The type or class of customer for their products and services
d. The methods used to distribute their products or provide their services
e. If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

4. Questions have arisen regarding how an enterprise should consider the aggregation criteria listed in paragraph 17 in applying the guidance in paragraph 19 to operating segments that do not meet the quantitative thresholds. Specifically, whether operating segments must always have similar economic characteristics *and* meet a majority of the remaining five aggregation criteria,

items (a)-(e), listed in paragraph 17 or whether operating segments must meet a majority of all six aggregation criteria (that is, the five aggregation criteria, items (a)-(e), and similar economic characteristics).

Issue

5. The issue is how an enterprise should evaluate the aggregation criteria in paragraph 17 of Statement 131 when determining whether operating segments that do not meet the quantitative thresholds may be aggregated in accordance with paragraph 19 of Statement 131.

Current EITF Discussion

6. At the September 29–30, 2004 EITF meeting, the Task Force reached a consensus that operating segments that do not meet the quantitative thresholds can be aggregated only if aggregation is consistent with the objective and basic principles of Statement 131, the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria listed in (a)-(e) of paragraph 17 of Statement 131.

7. The consensus in this Issue should be applied for fiscal years ending after October 13, 2004. The corresponding information for earlier periods, including interim periods, should be restated unless it is impractical to do so.

Board Ratification

8. At its October 13, 2004 meeting, the Board ratified the consensus reached by the Task Force on this Issue.

Status

9. No further EITF discussion is planned.

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues on the proposed agenda for the November 17–18, 2004 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	FASB Staff	Immediate Plans	Due Date - Next Deliverable
03-13	Applying the Conditions in Paragraph 42 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, in Determining Whether to Report Discontinued Operations	5/03	11/03, 3/04, 6/04, 9/04	11/04	Sogoloff Larson	FASB staff posted a draft abstract to the FASB website for public comment on October 15, 2004 for a 15-day comment period. The Task Force will consider the comments received at the November meeting.	November meeting materials.
04-5	Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights	5/04	6/04, 9/04	11/04	Larson O'Callaghan	FASB staff to prepare an Issue Summary based on input received from the Task Force at the September meeting.	November meeting materials

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
04-6	Accounting for Stripping Costs Incurred during Production in the Mining Industry	11/03	6/04, 9/04	11/04	Westerlund Larson	FASB staff to prepare an Issue Summary that develops additional guidance on the attribution of capitalized stripping costs.	November meeting materials
04-7	Determining Whether an Interest Is a Variable Interest in a Potential Variable Interest Entity	5/04	6/04, 9/04	11/04	Laurenzano Sogoloff Belcher	FASB staff to prepare an Issue Summary with assistance from the Working Group.	November meeting materials
04-F	Accounting in a Business Combination for Deferred Postcontract Customer Support Revenue of a Software Vendor	8/04	N/A	11/04	Moss Thuener	The FASB staff will prepare an Issue Summary for the November 2004 meeting.	November meeting materials
04-H	Whether instruments that are issued as stock-based compensation are participating securities under FASB Statement No. 128, *Earning per Share* (added at the September 29-30, 2004 EITF meeting)	9/04	N/A	11/04	Oakley Larson	The FASB staff will prepare an Issue Summary for the November 2004 meeting.	November meeting materials

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
00-18	Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees	5/00	7/00, 7/01, 11/01, 1/02, 3/02	Not scheduled	Munro	Pending further progress in the Board's project on share-based payments (Phase II), which is expected to include recognition and measurement for share-based transactions with non-employees.	N/A
	The remaining issue in Issue 00-18 is Issue 3: For transactions that include a grantee performance commitment, how the grantee should account for the contingent right to receive, upon performing as specified in the arrangement, grantor equity instruments that are the consideration for the grantee's future performance. The Task Force asked the FASB staff to focus on improving the guidance (originally from Issue 96-18) used to determine the date at which a commitment for counterparty performance to earn the equity instruments is reached. The measurement date issues, as well as several of the other issues and subissues of Issue 00-18 (also related to Issues 96-18 and 00-8), will be under consideration in the Board's share-based payment project.						
00-27	Application of EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," to Certain Convertible Instruments	5/00	11/00, 1/01	Not scheduled	Laurenzano Richards	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
02-D	The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a)(1) of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*	3/02	N/A	Not scheduled	Laurenzano Sogoloff	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	9/00 (AC) 11/02 (TF)	N/A	Not scheduled	Laurenzano Lusniak	Pending developments in the Board's project on QSPE's and reconsideration by the FASB staff as to the extent of the issue.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
03-17	Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet	5/03	11/03	Not scheduled	McBride O'Callaghan	Issue addresses the amortization of a recognized executory contract that has periods of both positive and negative cash flows. This issue is pending the Board's consideration of how the factors in paragraph 11(d) of Statement 142 should be evaluated in determining the useful life of an intangible asset (formerly EITF Issue 03-9)	N/A

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	Laurenzano	Pending consideration of an FASB project that may address the measurement of beneficial interests in securitized financial instruments.	Pending develop-ments in a Board project