FINANCIAL ACCOUNTING STANDARDS BOARD
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July 6, 2006

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the June 15, 2006 meeting of the FASB Emerging Issues Task Force and an inventory of open issues for the next EITF meeting. Also included is a confidential version of the minutes that has been marked for changes from the June 29 draft. After your review, please discard the confidential marked version of the minutes.

September Meeting Time and Location
The next EITF meeting will be held on **September 6–7, 2006,** at the FASB offices in Norwalk, Connecticut. (However, if no additional issues are added to the EITF agenda, the EITF Chairman may elect to only hold a one-day meeting on Thursday, September 7, 2006.) Based on our preliminary thoughts, the meeting will begin on Wednesday, September 6, at 1:00 p.m. and conclude no later than 5:00 p.m. On Wednesday, the FASB will host a dinner at a location to be announced later. On Thursday, September 7, 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	**September 12, 2006**
Final minutes available	**September 26, 2006**

Agenda Committee Meeting
The next Agenda Committee meeting will be held some time in late July. Materials for any potential new issues should be submitted as soon as possible. Once a meeting date has been set, a deadline for the agenda items will be communicated.

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

Sincerely,

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

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MINUTES OF THE JUNE 15, 2006 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, June 15, 2006

Starting Time:	8:30 a.m.
Concluding Time:	3:45 p.m.

Task Force Members Present:

Lawrence W. Smith (Chairman)
Mark M. Bielstein
Frank H. Brod
Jack T. Ciesielski
Mitchell A. Danaher
Leland E. Graul
Joseph F. Graziano
Stuart H. Harden
Jan R. Hauser
David L. Holman
James A. Johnson
Carl Kampel[1]
Matthew L. Schroeder
Ashwinpaul C. (Tony) Sondhi
Lawrence E. Weinstock
Scott A. Taub (SEC Observer)

Task Force Members Absent:

None

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

Others at Meeting Table:
Robert H. Herz, FASB Board Member
George J. Batavick, FASB Board Member
G. Michael Crooch, FASB Board Member
Katherine Schipper, FASB Board Member
Leslie F. Seidman, FASB Board Member
Edward W. Trott, FASB Board Member
Donald M. Young, FASB Board Member
Russell G. Golden, FASB Senior Technical Advisor
James W. Geary, FASB Practice Fellow
Susan M. Cosper, FASB Practice Fellow
Shelly C. Luisi, SEC Senior Associate Chief Accountant
* Paul A. Beswick, FASB Practice Fellow
* Jason L. Jacobs, FASB Practice Fellow
* Stuart J. Moss, FASB Practice Fellow
* Reginald D. Oakley, FASB Practice Fellow
* Mark E. Trench, FASB Project Manager

* For certain issues only.

ADMINISTRATIVE MATTERS

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

- The Task Force discussed the report on the EITF Agenda Committee meeting held on May 5, 2006. The following decisions were made by the Agenda Committee:

a. *Accounting for a Previously-Bifurcated Conversion Option in Convertible Debt That No Longer Meets the Bifurcation Criteria in Paragraph 12 of FASB Statement No. 133,* Accounting for Derivative Instruments and Hedging Activities. The Agenda Committee decided to add this Issue to the EITF agenda.

b. *Application of EITF Issue No. 05-7,* "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues," *to the Reduction or Elimination of an Embedded Conversion Option.* The Agenda Committee decided to add this Issue to the EITF agenda. Refer to the discussion of EITF Issue No. 06-6, "Application of EITF Issue No. 05-7, 'Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues,' to the Reduction or Elimination of an Embedded Conversion Option," elsewhere in these minutes.

c. *Application of AICPA Audit and Accounting Guide,* Brokers and Dealers in Securities, *to Entities That Engage in Energy Trading Activities.* The Agenda Committee agreed to defer making a decision on this potential new issue pending the FASB staff's additional research to identify possible scope alternatives as well as the types of inventory that may be accounted for at fair value. At a future Agenda Committee meeting, the Agenda Committee will decide whether to add this issue to the EITF agenda.

d. *Accounting for Joint Development, Manufacturing, and Marketing Arrangements in the Biotechnology and Pharmaceutical Industries.* The Agenda Committee agreed to defer making a decision on this potential new issue pending the FASB staff's additional research on the structures of these arrangements for determining the scope of this issue. Some Agenda Committee members also commented that there might be additional accounting considerations in addition to questions raised about income statement presentation. Those considerations could include, for example, whether the value of the expected net sharing arrangements should be recognized by a research and development entity in advance of receiving the proceeds from its partner. The FASB staff will also consider these issues as part of the additional material that will be presented to the Agenda Committee. An FASB staff member requested that Task Force members provide the FASB staff with information on the types of structures and industries that could be affected by this potential issue by July 11, 2006, so that the FASB staff has sufficient time to prepare the potential issue for consideration at the next Agenda Committee meeting. At a future Agenda Committee meeting, the Agenda Committee will decide whether to add this issue to the EITF agenda.

- The Task Force Chairman announced that to improve convergence efforts between U.S. practices with international practices, the position of IASB International Financial Reporting Interpretations Committee (IFRIC) Observer to the EITF had been created. Mr. James J. Leisenring, IASB Board Member (and liaison to the FASB), Mr. Robert P. Garnett, IFRIC Chairman, or a representative of the IASB or its staff will be observing all future EITF meetings. Likewise, the Chairman indicated that he or a representative of the FASB staff will be observing all future IFRIC meetings as well.

- An FASB staff member announced that at its May 31, 2006 meeting, the Board decided to remove the Useful Life and Amortization of Intangible Assets project from the FASB agenda. That project was originally added to the FASB agenda after the EITF was unable to reach a consensus on EITF Issue No. 03-9, "Determination of the Useful Life of Renewable Intangible Assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets*." The Board exposed proposed FASB Staff Position (FSP) FAS 142-d, "Amortization and Impairment of Acquired Renewable Intangible Assets," for comment, but a final FSP was not issued. Enterprises should continue to follow the guidance in Statement 142 for determining the useful life of an intangible asset.

EITF Issue No. 03-17, "Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet," addresses the amortization of a recognized executory contract that has periods of both positive and negative cash flows. The EITF has classified Issue 03-17 as inactive pending developments on the Useful Life and Amortization of Intangible Assets project. With the Board's decision to remove the project from the FASB agenda, the FASB staff intends to submit a request to the EITF Agenda Committee to determine whether this Issue should be reactivated.

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

a. EITF Issue No. 05-1, "Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option," Draft Abstract (Comment Letters Nos. 1 & 2)[1]

b. EITF Issue No. 06-2, "Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, *Accounting for Compensated Absences*," Draft Abstract (Comment Letters Nos. 1 & 2)[1]

c. EITF Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)," Draft Abstract (Comment Letters Nos. 1 – 8)[1]

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

d. EITF Issue No. 06-1, "Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive Service from the Service Provider" (Comment Letter No. 1)[2]

e. EITF Issue No. 06-4, "Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" (Comment Letters Nos. 2A & 3A)[2]

f. EITF Issue No. 06-5, "Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*" (Comment Letters Nos. 1 & 2).[2]

- 2007 EITF Meeting Dates. An FASB staff member formally confirmed the following EITF meeting dates for 2007:

January 18, 2007
March 14–15, 2007
June 13–14, 2007
November 28–29, 2007.

The FASB staff member also indicated that a September 2007 meeting date would be confirmed at a later time.

- September 2006 EITF Meeting: An FASB staff member asked Task Force members to anticipate a day-and-a-half EITF meeting to be held on September 6–7, 2006.

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

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 05-1

Title: Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option

Dates Discussed: March 17, 2005; June 15–16, 2005; September 15, 2005; March 16, 2006; June 15, 2006

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

FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*

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

FASB Statement No. 128, *Earnings per Share*

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

FASB Technical Bulletin No. 80-1, *Early Extinguishment of Debt through Exchange for Common or Preferred Stock*

Proposed FASB Statement, *Earnings per Share,* issued September 30, 2005

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

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

AICPA Accounting Interpretation No. 1, *Debt Tendered to Exercise Warrants,* of APB Opinion No. 26

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

EITF Issue No. 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"

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

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

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

Introduction

1. At the September 29–30, 2004 EITF meeting, a consensus was reached on Issue 04-8. Subsequently, the question was raised as to whether the contingently convertible instruments (CoCos) addressed in Issue 04-8 also may contain an embedded issuer call option that, upon exercise, permits conversion of an instrument by the holder even when the instrument's market price trigger has not been met. Although this Issue was raised in the context of CoCos with market price triggers, it also extends beyond market price triggers to any situation in which a call option permits conversion of an instrument by the holder that is not otherwise currently convertible. These call options provide the issuer with the ability to call the debt at any time (excluding lock-out periods). Upon exercise of the call option, the holder has the ability to receive cash for the call price or a defined number of equity shares or, in some cases, a combination of cash and shares. However, the holder typically will choose to receive equity if the value of the equity exceeds the cash call price of the debt.

2. To illustrate the underlying issue, consider the following example:

> An entity issues a CoCo on January 1, 2006, with a market price trigger, a $1,000 par amount, and a maturity date of December 31, 2020. The debt instrument is convertible at the option of the holder if the share price of the issuer exceeds a specified amount. The issuer can call the debt at any time between 2009 and the maturity date of the debt. If the issuer calls the debt, the holder has the option to receive cash for the call amount or a fixed number of shares as specified in the terms of the instrument upon issuance, regardless of whether the market price trigger has been met. In 2010, the issuer calls the debt prior to the market price trigger being met and the holder elects to receive a fixed number of shares (as specified in the terms of the instrument).

Issue

3. The issue is how the conversion of an instrument that became convertible upon the issuer's exercise of a call option should be accounted for.

Scope

4. This Issue applies to the issuance of equity securities to settle a debt instrument that was not otherwise currently convertible but became convertible upon the issuer's exercise of a call option when the issuance of equity securities is pursuant to the instrument's original conversion terms. Statement 84 provides guidance about conversions pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance to induce conversion, and Issue 05-7 provides guidance about modifications to embedded conversion options.

Prior EITF Discussion

5. At the March 17, 2005 EITF meeting, the Task Force reached a tentative conclusion that no gain or loss should be recognized upon the conversion of an instrument that became convertible as a result of an issuer's exercise of a call option pursuant to the original terms of the instrument. The Task Force based its tentative conclusion on the fact that Opinion 26 does not apply to debt that is converted to equity of the issuer based on conversion privileges that were included in the terms of the instrument.

6. The Task Force asked the FASB staff to consider the earnings per share treatment for these instruments before the exercise of the call option and provide examples to compare that treatment with the earnings per share treatment for instruments with similar terms. The examples also illustrate the application of Opinion 26 to these similar instruments. The FASB staff provided the Task Force with these examples for the June 15–16, 2005 EITF meeting.

7. At the June 15–16, 2005 EITF meeting, the Task Force discussed the previous tentative conclusion but was not asked to reach a consensus. Certain Task Force members proposed alternatives that would result in either debt conversion accounting or debt extinguishment accounting depending on whether the shares underlying the conversion were included in diluted earnings per share before the issuer exercised its call. Other Task Force members proposed alternatives based on whether the instruments could be converted due to factors that were not within the control of the issuer. The Task Force asked the FASB staff to research these alternatives for consideration at a future EITF meeting.

8. At the September 15, 2005 EITF meeting, the Task Force discussed accounting for the conversion of an instrument that became convertible upon the issuer's exercise of a call option but was unable to reach a consensus. Task Force members were divided between treating all such conversions as extinguishments and treating only conversions of instruments that did not otherwise contain a substantive conversion feature as extinguishments. Consequently, the Task Force no longer supported its previous tentative conclusion and asked the FASB staff to research the operationality of an alternative view that would result in either debt conversion accounting or debt extinguishment accounting depending on whether the instrument, at issuance, contains a substantive conversion feature that is outside the control of the issuer.

9. At the March 16, 2006 EITF meeting, the Task Force reached a tentative conclusion that the issuance of equity securities to settle a debt instrument (pursuant to the instrument's original conversion terms) that became convertible upon the issuer's exercise of a call option should be accounted for as a conversion if the debt instrument contained a substantive conversion feature as of its issuance date. That is, no gain or loss should be recognized related to the equity securities issued to settle the instrument. The issuance of equity securities to settle a debt instrument that became convertible upon the issuer's exercise of a call option should be accounted for as a debt extinguishment if the debt instrument did not contain a substantive conversion feature as of its issuance date. That is, the fair value of the equity securities issued should be considered a component of the reacquisition price of the debt.

10. The Task Force agreed that, for purposes of applying its tentative conclusion:

a. A substantive conversion feature is a conversion feature that is at least reasonably possible (the term *reasonably possible* has the same meaning that it has in Statement 5) of being exercised in the future absent the issuer's exercise of a call option
b. The issuance date of an instrument is the instrument's commitment date, as defined in Issue 4 of Issue 00-27

c. The assessment of whether the conversion feature is substantive may be performed after the issuance date but should be based only on assumptions, considerations, and/or marketplace information available as of the issuance date.

11. The Task Force also agreed that the illustrative examples that were provided to facilitate its discussion of this Issue should not be included in the draft abstract. Rather, certain methods of evaluating the substance of a conversion feature that were implicit in the examples should be described in the draft abstract. Additionally, the Task Force agreed that the draft abstract should clarify that the consensus in this Issue does not address the treatment of an instrument for purposes of applying Statement 128 and related interpretive guidance, including Issue 04-8.

12. The Task Force also discussed the interaction of the scope of this Issue and the guidance in Issue 03-7. The Task Force reached a tentative conclusion that Issue 03-7 should be amended to clarify that it does not apply to settlements accounted for as extinguishments under Issue 05-1 and that such an amendment should be exposed, along with the draft abstract reflecting the tentative conclusion in this Issue, for a 30-day public comment period.

13. Draft abstracts reflecting the tentative conclusions were posted to the FASB website on April 4, 2006, for 30-day comment periods.

Current EITF Discussion

14. At the June 15, 2006 EITF meeting, the Task Force discussed the comment letters received on the draft abstract and considered whether the scope of this Issue should be revised to exclude the settlement of an instrument with an embedded conversion feature that will become exercisable solely due to the passage of time. The Task Force reached a consensus that the scope should not be revised to exclude the settlement of an instrument with an embedded conversion feature that will become exercisable solely due to the passage of time.

15. The Task Force affirmed the tentative conclusions reached at the March 16, 2006 EITF meeting as a consensus.

Transition

16. The Task Force reached a consensus that this Issue should apply to all conversions within the scope of this Issue that result from the exercise of call options that occur in interim or annual reporting periods beginning after June 28, 2006 (the date the Board ratifies the consensus), irrespective of whether the instrument was entered into prior or subsequent to ratification of this Issue. For instruments issued prior to the effective date of this consensus, the assessment as to whether a substantive conversion feature existed at issuance should be based only on assumptions, considerations, and/or marketplace information available as of the issuance date.

17. Appendixes 05-1A and 05-1B reflect the consensuses reached by the Task Force on this Issue. (Changes to the draft abstracts are shown in their respective appendixes; additions are underscored and deletions are ~~struck through~~.)

Board Ratification

18. At its June 28, 2006 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

Status

19. No further EITF discussion is planned.

Appendix 05-1A

EITF ABSTRACTS (DRAFT)

Issue No. 05-1

Title: Accounting for the Conversion of an Instrument That Became Convertible upon the Issuer's Exercise of a Call Option

Dates Discussed: March 17, 2005; June 15–16, 2005; September 15, 2005; March 16, 2006; ~~[~~June ~~14~~–15, 2006~~]~~

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

FASB Statement No. 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*

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

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

FASB Statement No. 128, *Earnings per Share*

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

FASB Technical Bulletin No. 80-1, *Early Extinguishment of Debt through Exchange for Common or Preferred Stock*

Proposed FASB Statement, *Earnings per Share,* issued September 30, 2005

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

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

AICPA Accounting Interpretation 1, *Debt Tendered to Exercise Warrants,* of APB Opinion No. 26

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

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

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

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

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

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

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

ISSUE

1. At the September 29–30, 2004 EITF meeting, a consensus was reached on Issue ~~No.~~ 04-8~~, "The Effect of Contingently Convertible Instruments on Diluted Earnings per Share~~.~~"~~ The contingently convertible instruments (CoCos) addressed in Issue 04-8 also may contain an embedded issuer call option that, upon exercise, permits conversion of an instrument by the holder even when the instrument's market price trigger has not been met. Although this Issue was raised in the context of CoCos with market price triggers, it also extends beyond market price triggers to any situation in which a call option permits conversion of an instrument by the holder that is not otherwise currently convertible. These call options provide the issuer with the ability to call the debt at any time (excluding lock-out periods). Upon exercise of the call option, the holder has the ability to receive cash for the call price or a defined number of equity shares or, in some cases, a combination of cash and shares. However, the holder typically will choose to receive equity if the value of the equity exceeds the cash call price of the debt.

2. To illustrate the underlying issue, consider the following example:

> An entity issues a CoCo on January 1, 2006, with a market price trigger, a $1,000 par amount, and a maturity date of December 31, 2020. The debt instrument is convertible at the option of the holder if the share price of the issuer exceeds a specified amount. The issuer can call the debt at any time between 2009 and the maturity date of the debt. If the issuer calls the debt, the holder has the option to receive cash for the call amount or a fixed number of shares as specified in the terms of the instrument upon issuance, regardless of whether the market price trigger has been met. In 2010, the issuer calls the debt prior to the market price trigger being met and the holder elects to receive a fixed number of shares (as specified in the terms of the instrument).

3. The issue is how the conversion of an instrument that became convertible upon the issuer's exercise of a call option should be accounted for.

Scope

4. This Issue applies to the issuance of equity securities to settle a debt instrument that was not otherwise currently convertible but became convertible upon the issuer's exercise of a call option when the issuance of equity securities is pursuant to the instrument's original conversion terms. Statement 84 provides guidance about conversions pursuant to terms that reflect changes made by the debtor to the conversion privileges provided in the terms of the debt at issuance to induce conversion and Issue ~~No.~~ 05-7~~, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues,"~~ provides guidance about modifications to embedded conversion options.

EITF DISCUSSION

5. The Task Force reached a ~~[~~consensus~~]~~ that the issuance of equity securities to settle a debt instrument (pursuant to the instrument's original conversion terms) that became convertible upon the issuer's exercise of a call option should be accounted for as a conversion if the debt instrument contained a substantive conversion feature as of its issuance date, as defined herein. That is, no gain or loss should be recognized related to the equity securities issued to settle the instrument. The issuance of equity securities to settle a debt instrument that became convertible upon the issuer's exercise of a call option should be accounted for as a debt extinguishment if the debt instrument did not contain a substantive conversion feature as of its issuance date. That is, the fair value of the equity securities issued should be considered a component of the reacquisition price of the debt.

6. For purposes of this Issue, the issuance date of an instrument is that~~e~~ instrument's commitment date, as defined in Issue 4 of Issue ~~No.~~ 00-27~~, "Application of Issue No. 98-5 to Certain Convertible Instruments~~.~~"~~ The assessment of whether the conversion feature is substantive may be performed after the issuance date but should be based only on assumptions, considerations, and/or marketplace information available as of the issuance date.

7. For purposes of applying this ~~[~~consensus~~]~~, a substantive conversion feature is a conversion feature that is at least reasonably possible of ~~becoming~~ being exercisable in the future absent the issuer's exercise of a call option. (The term *reasonably possible* has the same meaning that it has in Statement 5.) The Task Force agreed that for purposes of determining whether a conversion feature is reasonably possible of being exercised, the assessment of the holder's intent is not necessary.

8. For purposes of this Issue, the Task Force observed that if the conversion price of an instrument at issuance is extremely high so that conversion of the instrument is not deemed at least reasonably possible as of its issuance date, then the conversion feature would not be considered substantive. The Task Force referred to footnote 15 of paragraph A9 of Statement 150 in making that determination. Therefore, even if such an instrument included a conversion feature that provided for conversion due solely to the passage of time (for example, the instrument will become convertible at a date prior to its maturity date), it would be inappropriate to conclude that the conversion feature is substantive~~ at issuance was at least reasonably possible of becoming exercisable~~. The Task Force also observed that an instrument that~~ can only become~~ became convertible only upon the issuer's exercise of its call option does not possess a substantive conversion feature.

9. The Task Force observed that the following methods may be helpful in assessing whether a conversion feature is substantive (that is, a conversion feature is at least reasonably possible of being exercised in the future~~ becoming exercisable~~). This list is not intended to be all-inclusive.

a. **The fair value of the conversion feature relative to the fair value of the debt instrument.** Comparing the fair value of a conversion feature to the fair value of the debt instrument (that is, the complete instrument as issued) may provide evidence that the conversion feature is substantive.

b. **The effective annual interest rate per the terms of the debt instrument relative to the estimated effective annual rate of a nonconvertible debt instrument with an equivalent expected term and credit risk.** Comparing the effective annual interest rate ~~per the terms~~ of the debt instrument to the effective annual rate the issuer estimates it could obtain on a similar non-convertible instrument may provide evidence that a conversion feature is substantive.

c. **The fair value of the debt instrument relative to an ~~identical~~ instrument that is identical except for which the conversion option is not contingent.** Comparing the fair value of the debt instrument to the fair value of an identical instrument for which conversion is not contingent isolates the impact of the contingencies and may provide evidence about the substance of a conversion feature. If the fair value of the debt instrument is similar to the fair value of an identical convertible debt instrument for which conversion is not contingent, then it may indicate that the conversion feature is substantive. However, this approach may not be appropriate unless it is clear that the conversion feature, not considering the contingencies, is substantive.

d. **Qualitative evaluation of the conversion provisions.** The nature of the conditions under which the instrument may become convertible may provide evidence that the conversion feature is substantive. For example, if an instrument may become convertible upon the occurrence of a specified contingent event, the likelihood that the contingent event will occur prior to the instrument's maturity date may indicate that the conversion feature is substantive. However, this approach may not be appropriate unless it is clear that the conversion feature, not considering the contingencies, is substantive.

10. When extinguishment accounting is required under this Issue ~~U~~upon the settlement of ~~an~~ a debt instrument ~~that is within the scope of this Issue~~ with the characteristics of Instrument C in Issue ~~No.~~ 90-19~~, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion,"~~ the reacquisition price of the debt would include the cash payment for the accreted value of the debt and fair value of the equity instruments issued to settle the conversion spread. Pursuant to the guidance in Issue 03-7, for the settlement of a debt instrument with the characteristics of Instrument C as described in Issue 90-19 that is accounted for as a conversion under this Issue, the reacquisition price of the debt would not consider any shares transferred to settle the embedded equity instrument (the excess conversion spread in Issue 90-19)~~ by payment of the accreted value of the obligation in cash and settlement of the conversion spread with stock, the cash payment should be considered in the computation of gain or loss on extinguishment of the recognized liability. The treatment of the shares transferred should be determined by reference to the guidance in this Issue.~~

11. The Task Force also observed that this Issue does not ~~affect~~ address the treatment of an instrument for purposes of applying Statement 128 and related interpretive guidance, including Issue 04-8.

Transition

12. This Issue applies to all conversions within the scope of this Issue that result from the exercise of call options and is effective in interim or annual reporting periods beginning after

June 28, 2006 (the Board ratification date of the ~~[~~consensus~~]~~), irrespective of whether the instrument was entered into prior or subsequent to Board ratification of this Issue. For instruments issued prior to the effective date of this ~~[~~consensus~~]~~, the assessment as to whether a substantive conversion feature exists at issuance should be based only on assumptions, considerations, and/or marketplace information available as of the issuance date.

13. Early application of this Issue is permitted in periods for which financial statements have not yet been issued. Retrospective application to previously issued financial statements is not permitted.

Board Ratification

14. At its ~~[~~June 28, 2006~~]~~ meeting, the Board ratified the ~~[~~consensus~~es]~~ reached by the Task Force in this Issue.

STATUS

15. No further EITF discussion is planned.

Appendix 05-1B

EITF ABSTRACTS (DRAFT)

Issue No. 03-7

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

Dates Discussed: July 31, 2003; March 16, 2006; ~~[~~June ~~14~~ 15, 2006~~]~~

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

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

FASB Statement No. 138, *Accounting for Certain Derivative Instruments and Certain Hedging Activities*

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

FASB Statement No. 149, *Amendment of Statement 133 on Derivative Instruments and Hedging Activities*

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

FASB Technical Bulletin No. 80-1, *Early Extinguishment of Debt through Exchange for Common or Preferred Stock*

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

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

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

AICPA Accounting Interpretation 1, "Early Extinguishment of Debt," of APB Opinion No. 26

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

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

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

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

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

ISSUE

1. Issue ~~No.~~ 90-19~~, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion,"~~ addresses the accounting for all convertible bonds with characteristics of Instruments A, B, or C as described in that Issue.[1] Specifically, the issues addressed in Issue 90-19 are:

Issue 1— Whether the initial balance sheet treatment by the issuer should provide for separate or combined accounting for the conversion feature and debt obligation

Issue 2— How the issuer should account for the excess conversion spread over the accreted value

Issue 3— How each instrument should be treated in earnings-per-share computations.

2. The Task Force reached a consensus on Issue 1 that combined accounting for the conversion feature and debt obligation is appropriate for Instrument C. On Issue 2, the Task Force reached a consensus that Instrument C "should be accounted for *similarly to indexed debt obligations*" (emphasis added). That is, the issuer should adjust the carrying amount of the instrument in each reporting period to the higher of the current stock price or the accreted value of the instrument. The Task Force reconsidered that consensus guidance for Instrument C at the January 23–24, 2002 meeting to reflect the effect of the consensus guidance in Issue ~~No.~~ 00-19~~, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."~~ Issue 00-19 addresses how freestanding derivative financial instruments that are indexed to, and potentially settled in, a company's own stock should be classified and measured by the company.

3. At the January 23–24, 2002, meeting the Task Force revised the prior consensuses on Issues 1 and 2 of Issue 90-19 that Instrument C should be accounted for like convertible debt if the conversion spread meets the requirements of Issue 00-19 for classification within permanent equity. Paragraph 4 of Issue 00-19 discusses the Task Force consensus:

> . . . for purposes of evaluating under Statement 133 whether an embedded derivative indexed to a company's own stock would be classified in stockholders'

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[1] Instrument A: Upon conversion, the issuer must satisfy the obligation entirely in cash based on the fixed number of shares multiplied by the stock price on the date of conversion (the conversion value).
Instrument B: Upon conversion, the issuer may satisfy the entire obligation in either stock or cash equivalent to the conversion value.
Instrument C: Upon conversion, the issuer must satisfy the accreted value of the obligation (the amount accrued to the benefit of the holder exclusive of the conversion spread) in cash and may satisfy the conversion spread (the excess conversion value over the accreted value) in either cash or stock.

> equity if freestanding, the requirements of paragraphs 12–32 of [Issue 00-19] do not apply if the hybrid contract is a conventional convertible debt instrument in which the holder may only realize the value of the conversion option by exercising the option and receiving the entire proceeds in a fixed number of shares or the equivalent amount of cash (at the discretion of the issuer).

4. The Task Force also observed that the requirements of paragraphs 12–32 of Issue 00-19 apply when an issuer is evaluating whether any other embedded derivative instrument is an equity instrument and thereby excluded from the scope of Statement 133. The January 23–24, 2002 meeting minutes for Issue 90-19 explain that because the features of Instrument C are sufficiently different from *conventional* convertible debt, paragraphs 12–32 of Issue 00-19 should be applied in determining whether the conversion feature meets the criteria for classification as permanent equity. If the conversion feature does not meet those criteria, Instrument C should be bifurcated by the issuer and the bifurcated derivative (that is, the conversion feature) should be marked to market under the provisions of Statement 133.

5. While the Issue 90-19 consensus, as revised, provides guidance for the accounting for Instrument C at issuance, Issue 90-19 does not address the accounting at settlement for Instrument C, and questions have arisen in practice about the accounting for the excess of the conversion spread over the accreted value of the obligation at settlement. With the exception of Issue ~~No.~~ 05-1~~, "Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option,"~~ current accounting guidance for convertible debt (for example, Opinion 14, Opinion 26, Statement 84, and Issues ~~No.~~ 98-5, ~~"Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios,"~~ and ~~No.~~ 00-27~~, "Application of Issue No. 98-5 to Certain Convertible Instruments"~~) also does not specifically address the settlement accounting for Instrument C of Issue 90-19. Therefore, for settlement transactions other than those <u>accounted for as debt extinguishments in their entirety in accordance </u>with~~in~~ ~~the scope of~~ Issue 05-1, this Issue addresses how the issuer should account at settlement for Instrument C in Issue 90-19 if the issuer settles the conversion spread in stock. If settled in cash, the issuer would record a gain or loss based on the total cash consideration compared with the carrying amount of the debt. This Issue assumes that the embedded conversion feature meets the criteria in paragraphs 12–32 of Issue 00-19 for classification within permanent equity. If it did not meet those criteria, this Issue would not arise because the embedded conversion feature would be bifurcated from the debt host as a separate liability and accounted for as a derivative.

6. The issue is how the issuer should account for the partial cash-based and partial stock-based settlement of a debt instrument structured in the form of Instrument C as described in Issue 90-19.

EITF DISCUSSION

7. The Task Force reached a consensus that upon settlement of a security (other than ~~those instruments~~ <u>settlements accounted for as debt extinguishments in accordance with</u> ~~within the scope of~~ Issue 05-1) with the characteristics of Instrument C in Issue 90-19 by payment of the accreted value of the obligation (recognized liability) in cash and settlement of the conversion spread (unrecognized equity instrument) with stock, only the cash payment should be considered

in the computation of gain or loss on extinguishment of the recognized liability. That is, any shares transferred to settle the embedded equity instrument (referred to as the excess conversion spread in Issue 90-19) would not be considered in the settlement of the debt component.

Transition

8. This consensus is effective for settlement transactions entered into on or after the beginning of an entity's next reporting period beginning after August 13, 2003.

Board Ratification

9. At its August 13, 2003 meeting, the Board ratified the consensus reached by the Task Force in this Issue.

STATUS

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

10~~1~~. Issue 05-1 was ratified by the Board on ~~[~~June 28, 2006~~]~~, and ~~amends this Issue to clarify that the issuance of equity securities to settle a debt instrument that became convertible upon the issuer's exercise of a call option is not within the scope of this Issue. Issue 05-1~~ requires that the issuance of equity securities to settle a debt instrument that became convertible upon the issuer's exercise of a call option ~~such conversion~~ be accounted for as a debt conversion or a debt extinguishment based on whether the instrument contained a substantive conversion feature as of its issuance date. The guidance in this Issue does not apply when extinguishment accounting is required under Issue 05-1. When extinguishment accounting is required upon settlement of a debt instrument with the characteristics of Instrument C in Issue 90-19, the reacquisition price of the debt would include the cash payment for the accreted value of the debt and the fair value of the equity instruments issued to settle the conversion spread.

11. No further EITF discussion is planned.

Issue No. 06-1

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

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

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

Introduction

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

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

Prior Task Force Discussion

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

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

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

5. Task Force members also discussed how the consensus in Issue 01-9 might be applied and whether the model in Issue 01-9 was appropriate for the arrangements discussed in this Issue,

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

Issues

6. The issues are:

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

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

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

Current EITF Discussion

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

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

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

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

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

Transition and Disclosure

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

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

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

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

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change on revenue, cost of sales, income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for any prior periods retrospectively adjusted.
c. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented
d. A description of the nature of these programs including the amounts recognized in the statement of operations and their related classification for each period presented, where significant
e. If retrospective application to all prior periods is impracticable, disclosure of the reasons therefor, and a description of the method used to report the change should be made.

Board Ratification

14. At its June 28, 2006 meeting, the Board ratified the tentative conclusions reached by the Task Force in this Issue and approved the issuance of a draft abstract for a 30-day public comment period. A draft abstract is included as Appendix 06-1A.

Status

15. The draft abstract will be posted to the FASB website after July 6, 2006. Comments on the draft abstract are due by August 4, 2006. Further discussion is expected at a future meeting.

Appendix 06-1A

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

Issue No. 06-1

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

Dates Discussed: March 16, 2006; June 15, 2006; [September 6–7, 2006]

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

ISSUE

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

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

3. The issues are:

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

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

[1] **This draft abstract is being exposed for a 30-day public comment period.**

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

EITF DISCUSSION

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

Transition

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

a. The cumulative effect of the change to the new accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented

b. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position

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

6. If the cumulative effect of applying the change in accounting principle to all prior periods can be determined but it is impracticable to determine the period-specific effects of that change on all prior periods presented, the cumulative effect of the change to the new accounting principle shall be applied to the carrying amounts of assets and liabilities as of the beginning of the earliest period to which the new accounting principle can be applied. An offsetting

adjustment, if any, shall be made to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) for that period.

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

a. A description of the prior-period information that has been retrospectively adjusted

b. The effect of the change on revenue, cost of sales, income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for any prior periods retrospectively adjusted

c. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented

d. A description of the nature of these programs including the amounts recognized in the statement of operations and their related classification for each period presented, where significant

e. If retrospective application to all prior periods is impracticable, disclosure of the reasons therefor, and a description of the method used to report the change should be made.

Board Ratification

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

Status

9. No further EITF discussion is planned.

Exhibit 06-1A

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

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

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

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

Evaluation: The service provider should characterize the incentive as "cash consideration" for purposes of applying Issue 01-9 because the service provider has directed through a contractual arrangement that the benefit received by the service provider's customer must be in the form of cash (through a mail-in rebate).

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

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

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

Issue No. 06-2

Title: Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43, *Accounting for Compensated Absences*

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

References: FASB Statement No. 43, *Accounting for Compensated Absences*

FASB Statement No. 87, *Employers' Accounting for Pensions*

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

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

FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*

FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*

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

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

International Accounting Standard 19, *Employee Benefits*

Introduction

1. An entity may provide its employees with a benefit in the form of a compensated absence known as a sabbatical leave (sabbatical) whereby the employee is entitled to paid time off after working for an entity for a specified period of time. During the sabbatical, the individual continues to be a compensated employee and is not required to perform any duties for the entity.

2. In determining whether and, if so, when the cost of a sabbatical or other similar benefit arrangement should be accrued, entities have historically applied the guidance in paragraph 6 of Statement 43. Paragraph 6 of Statement 43 states, in part, that "an employer shall accrue a liability for employees' compensation for future absences if… (b) the obligation relates to rights that vest or accumulate" (footnote references omitted). In practice, questions have been raised with respect to the interpretation of paragraph 6(b) of Statement 43 as to whether, in the absence of a vesting condition, a sabbatical **accumulates**.

Issues

3. The issue is whether an employee's right to a compensated absence under a sabbatical or other similar benefit arrangement (a) that requires the completion of a minimum service period and (b) in which the benefit does not increase with additional years of service, accumulates pursuant to paragraph 6(b) of Statement 43.

Scope

4. The scope of this Issue is limited to those arrangements under which the sabbatical or other similar benefit arrangement is unrestricted (that is, the employee is not required to perform any direct or indirect services for or on behalf of the entity during the absence). Arrangements in which employees are required to engage in research or public service to enhance the reputation of or otherwise benefit the employer are not within the scope of this Issue.

Prior EITF Discussion

5. At the March 16, 2006 EITF meeting, the Task Force reached a tentative conclusion that an employee's right to a compensated absence under a sabbatical or other similar benefit arrangement (a) that requires the completion of a minimum service period and (b) in which the benefit does not increase with additional years of service accumulates pursuant to paragraph 6(b) of Statement 43 for arrangements in which the individual continues to be a compensated employee and is not required to perform duties for the entity during the absence. Therefore, assuming all of the other conditions of paragraph 6 of Statement 43 are met, the compensation cost associated with a sabbatical or other similar benefit arrangement should be accrued over the requisite service period.

6. The Task Force asked the FASB staff to prepare a draft abstract reflecting the tentative conclusions that were reached by the Task Force at the March 16, 2006 EITF meeting and to post that draft abstract to the FASB website for public comment. The draft abstract was posted to the FASB website on April 4, 2006, for a 30-day comment period.

Current EITF Discussion

7. At the June 15, 2006 EITF meeting, the Task Force considered the comment letters on the draft abstract and approved as a consensus the tentative conclusions reached at the March 16, 2006 EITF meeting.

Transition and Disclosure

8. At the June 15, 2006 EITF meeting, the Task Force reached a consensus that this Issue should be effective for fiscal years beginning after December 15, 2006. An entity should apply the consensus reached in this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position at the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods. Earlier adoption is permitted as of the beginning of an entity's fiscal year, provided that the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year.

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

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

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

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

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

12. Appendix 06-2A reflects changes made to the draft abstract as a result of the above decisions on transition, the effective date, and disclosure (additions are underscored and deletions are ~~struck through~~).

Board Ratification

13. At its June 28, 2006 meeting, the Board ratified the consensuses reached by the Task Force on this Issue.

Status

14. No further EITF discussion is planned.

Appendix 06-2A

EITF ABSTRACTS (DRAFT)

Issue No. 06-2

Title: Accounting for Sabbatical Leave and Other Similar Benefits Pursuant to FASB Statement No. 43

Dates Discussed: March 16, 2006; ~~[~~June ~~14~~ 15, 2006~~]~~

References: FASB Statement No. 43, *Accounting for Compensated Absences*

FASB Statement No. 87, *Employers' Accounting for Pensions*

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

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

FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*

FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*

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

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

International Accounting Standard ~~No.~~ 19, *Employee Benefits*

ISSUE

1. An entity may provide its employees with a benefit in the form of a compensated absence known as a sabbatical leave (sabbatical) whereby the employee is entitled to paid time off after working for an entity for a specified period of time. During the sabbatical, the individual continues to be a compensated employee and is not required to perform any duties for the entity.

2. In determining whether and, if so, when the cost of a sabbatical or other similar benefit arrangement should be accrued, entities have historically applied the guidance in paragraph 6 of Statement 43. Paragraph 6 of Statement 43 states in part that "an employer shall accrue a liability for employees' compensation for future absences if…(b) the obligation relates to rights that vest or accumulate" (footnote references omitted). In practice, questions have been raised with respect to the interpretation of paragraph 6(b) of Statement 43 as to whether, in the absence of a vesting condition, a sabbatical **accumulates**.

3. The issue is whether an employee's right to a compensated absence under a sabbatical or other similar benefit arrangement (a) that requires the completion of a minimum service period and (b) in which the benefit does not increase with additional years of service accumulates pursuant to paragraph 6(b) of Statement 43.

Scope

4. The scope of this Issue is limited to those arrangements under which the sabbatical or other similar benefit arrangement is unrestricted (that is, the employee is not required to perform any direct or indirect services for or on behalf of the entity during the absence). Arrangements in which employees are required to engage in research or public service to enhance the reputation of or otherwise benefit the employer are not within the scope of this Issue.

EITF DISCUSSION

5~~4~~. The Task Force reached a ~~[~~consensus~~]~~ that an employee's right to a compensated absence under a sabbatical or other similar benefit arrangement (a) that requires the completion of a minimum service period and (b) in which the benefit does not increase with additional years of service accumulates pursuant to paragraph 6(b) of Statement 43 for arrangements in which the individual continues to be a compensated employee and is not required to perform duties for the entity during the absence. Therefore, assuming all of the other conditions of paragraph 6 of Statement 43 are met, the compensation cost associated with a sabbatical or other similar benefit arrangement should be accrued over the requisite service period.

Transition

6~~5~~. The Task Force reached a ~~[~~consensus~~]~~ that this Issue should be effective ~~applied in financial reports~~ for fiscal years beginning after December 15, 2006~~the date the [consensus] is ratified by the Board~~. An entity should apply the consensus reached in this Issue through either (a) ~~Entities should recognize the effects of applying the [consensus] in this Issue as~~ a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position at the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods ~~unless it is impracticable to do so~~. Earlier adoption of this guidance is permitted as of the beginning of an entity's fiscal year provided that the entity has not yet issued financial statements, including interim financial statements, for any period of that fiscal year. ~~This should include the recognition of:~~

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

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

a. The cumulative effect of the change to the new accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented

b. The cumulative effect of the change on ~~An offsetting adjustment, if any, made to the opening balance of~~ retained earnings ~~(~~or on other ~~appropriate~~ components of equity or net assets in the statement of financial position~~) for that period~~

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

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

9~~7~~. If an entity chooses to apply the consensus reached in this Issue as a change in accounting principle through retrospective application to all prior periods ~~Upon application of this Issue~~, the following should be disclosed:

a. A description of the prior-period information that has been retrospectively adjusted~~, if any~~

b. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts ~~for the current period and~~ for any prior periods retrospectively adjusted

c. The cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

Board Ratification

10~~8~~. At its ~~[~~June 28, 2006~~]~~ meeting, the Board ratified the ~~[~~consensuses~~]~~ reached by the Task Force in this Issue.

STATUS

11~~9~~. No further EITF discussion is planned.

Issue No. 06-3

Title: How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)

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

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

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

APB Opinion No. 22, *Disclosure of Accounting Policies*

SEC Regulation S-X, Rule 5-03

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

EITF Issue No. 00-10, "Accounting for Shipping and Handling Fees and Costs"

EITF Issue No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred"

Introduction

1. Taxes are assessed by various governmental authorities on many different types of transactions. These taxes range from sales taxes that are applied to a broad class of transactions involving a wide range of goods and services to excise taxes that are applied only to specific types of transactions or items. The characteristics of how these different types of taxes are calculated, remitted to the governmental authority, and administered are numerous and varied and, therefore, it is difficult to summarize them into simple discernible models. Questions have arisen as to the income statement presentation for these types of taxes.

Issue

2. The issues are:

Issue 1— Whether the scope of this Issue should include (a) all nondiscretionary amounts assessed by governmental authorities, (b) all nondiscretionary amounts assessed by governmental authorities in connection with a transaction with a customer, or (c) only sales, use, and value added taxes

Issue 2— How taxes assessed by a governmental authority within the scope of this Issue (as determined under Issue 1) should be presented in the income statement (that is, gross versus net presentation).

Previous EITF Discussion

3. At the March 16, 2006 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that the scope of this Issue includes any tax assessed by a governmental authority that is

directly imposed on a revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes.

4. The Task Force reached a tentative conclusion on Issue 2 that the presentation of taxes within the scope of Issue 1 on either a gross basis (included in revenues and costs) or a net basis (excluded from revenues) is an accounting policy decision that should be disclosed pursuant to Opinion 22. In addition, for any such taxes that are reported on a gross basis, a company should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The disclosure of those taxes can be done on an aggregate basis.

5. The tentative conclusions reached in this Issue are not intended to readdress the consensuses in Issues 99-19, 00-10, and 01-14.

6. The Task Force observed that because the tentative conclusion in this Issue requires only the presentation of additional disclosures, an entity would not be required to reevaluate its existing policies related to taxes assessed by a governmental authority that are directly imposed on a revenue-producing transaction between a seller and a customer. However, a company that chooses to reevaluate its existing policies and elects to change the presentation of taxes within the scope of this Issue must follow the requirements of Statement 154, which provide that an entity may voluntarily change its accounting principles only to adopt a preferable accounting principle.

7. The Task Force also reached a tentative conclusion that this Issue should be applied to financial reports for interim and annual reporting periods beginning after December 15, 2006. Earlier application is permitted.

8. At its March 28, 2006 meeting, the Board ratified the tentative conclusions reached by the Task Force in this Issue and approved the issuance of a draft abstract for a 30-day public comment period. The draft abstract was posted to the FASB website on April 4, 2006.

Current EITF Discussion

9. The Task Force discussed the FASB staff's analysis of the comment letters received on the draft abstract and reached a consensus to clarify the scope of this Issue to ensure that its application is consistent with the tentative conclusions reached at the March 16, 2006 EITF meeting (additions are underscored and deletions are ~~struck through~~):

> The Task Force reached a consensus on Issue 1 that the scope of this Issue includes any tax assessed by a governmental authority that is ~~directly~~ both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer and may include, but is not limited to, sales, use, value added, and some excise taxes. The scope of this Issue excludes tax schemes that are based on gross receipts and taxes that are imposed during the inventory procurement process.

10. As a result of the comment letters received, the Task Force also considered whether the scope of this Issue should be revised and expanded to include any tax assessed by a governmental authority that is incurred as a result of a revenue transaction, either as a percentage of revenue or as a fixed dollar amount on each revenue transaction.

11. The Task Force reaffirmed that the scope of this Issue should continue to apply only to a tax assessed by a governmental authority that is both–imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer.

12. The Task Force affirmed the tentative conclusions reached at the March 16, 2006 EITF meeting as a consensus including the transition and effective dates.

13. Appendix 06-3A reflects changes made to the draft abstract as a result of the above decisions (additions are <u>underscored</u> and deletions are ~~struck through~~).

Board Ratification

14. At its June 28, 2006 meeting, the Board ratified the consensuses reached by the Task Force in this Issue.

Status

15. No further EITF discussion is planned.

Appendix 06-3A

***EITF ABSTRACTS* (DRAFT)**

Issue No. 06-3

Title: How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross versus Net Presentation)

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

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

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

APB Opinion No. 22, *Disclosure of Accounting Policies*

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

EITF Issue No. 00-10, "Accounting for Shipping and Handling Fees and Costs"

EITF Issue No. 01-14, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred"

ISSUE

1. Taxes are assessed by various governmental authorities on many different types of transactions. These taxes range from sales taxes that are applied to a broad class of transactions involving a wide range of goods and services to excise taxes that are applied only to specific types of transactions or items. The characteristics of how these different types of taxes are calculated, remitted to the governmental authority, and administered are numerous and varied and, therefore, it is ~~very~~ difficult to summarize them into simple discernible models. Questions have arisen as to the income statement presentation of these types of taxes.

2. The issues are:

Issue 1— Whether the scope of this Issue should include (a) all nondiscretionary amounts assessed by governmental authorities, (b) all nondiscretionary amounts assessed by governmental authorities in connection with a transaction with a customer, ~~or~~ (c) only sales, use, and value added taxes, or (d) any tax assessed by a governmental authority that is incurred as a result of a revenue transaction, either as a percentage of revenue or as a fixed dollar amount on each revenue transaction

Issue 2— How taxes assessed by a governmental authority within the scope of this~~e~~ Issue (as determined under Issue 1) should be presented in the income statement (that is, gross versus net presentation).

EITF DISCUSSION

3. The Task Force reached a ~~[~~consensus~~]~~ on Issue 1 that the scope of this Issue includes any tax assessed by a governmental authority that is ~~directly~~ both imposed on and concurrent with a specific revenue-producing transaction between a seller and a customer, and may include, but ~~are~~ is not limited to, sales, use, value added, and some excise taxes. The scope of this Issue excludes tax schemes that are based on gross receipts and taxes that are imposed during the inventory procurement process.

4. The Task Force reached a ~~[~~consensus~~]~~ on Issue 2 that the presentation of taxes within the scope of Issue 1 on either a gross basis (included in revenues and costs) or a net basis (excluded from revenues) ~~basis~~ is an accounting policy decision that should be disclosed pursuant to Opinion 22. An entity is not required to reevaluate its existing policies related to taxes assessed by a governmental authority as a result of this consensus. In addition, for any such taxes that are reported on a gross basis, ~~a company~~ an entity should disclose the amounts of those taxes in interim and annual financial statements for each period for which an income statement is presented if those amounts are significant. The disclosure of those taxes can be done on an aggregate basis.

5. The ~~[~~consensuses~~]~~ reached in this Issue are not intended to readdress the consensuses in Issues ~~No.~~ 99-19, ~~"Reporting Revenue Gross as a Principal versus Net as an Agent," No.~~ 00-10, ~~"Accounting for Shipping and Handling Fees and Costs,"~~ and ~~No.~~ 01-14~~, "Income Statement Characterization of Reimbursements Received for 'Out-of-Pocket' Expenses Incurred~~.~~"~~

Transition

6. The Task Force reached a consensus that the disclosures required under this Issue should be applied retrospectively to interim and annual financial statements for all periods presented, if those amounts are significant. The disclosure of those taxes described under the consensus can be made on an aggregate basis. The Task Force observed that ~~because~~ since ~~the [consensus] in~~ this Issue requires only the presentation of additional disclosures, at the date of adoption an entity would not be required to reevaluate its existing policies related to taxes assessed by a governmental authority that are ~~directly~~ imposed concurrently on a specific revenue-producing transaction between a seller and a customer. ~~However, a company~~ An entity that chooses to reevaluate its existing policies and elects to change the presentation of taxes within the scope of this Issue must follow the requirements of Statement 154, which provide that an entity may voluntarily change its accounting principles only to adopt a preferable accounting principle.

Effective Date

7. The ~~[~~consensuses~~]~~ in this Issue should be applied to financial reports for interim and annual reporting periods beginning after December 15, 2006. Earlier application is permitted.

Board Ratification

8. At its ~~[~~June 28, 2006~~]~~ meeting, the Board ratified the ~~[~~consensuses~~]~~ reached by the Task Force in this Issue.

STATUS

9. No further EITF discussion is planned.

Issue No. 06-4

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

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

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

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

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

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

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

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

International Accounting Standard 19, *Employee Benefits*

Introduction

1. Companies purchase life insurance for various reasons that may include protecting against the loss of "key" employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. One form of this insurance is split-dollar life insurance. The structure of split-dollar life insurance arrangements can be complex and varied.

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

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

designated portion of the death benefits and the employer receives the remainder of the death benefits. Depending on how the policy is structured, the beneficiary's proceeds are received directly either from the insurance company or from the employer (who remits the beneficiary's proportionate share once payment is received from the insurance company).

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

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

Issue

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

Scope

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

Prior EITF Discussion

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

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

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

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

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

Current EITF Discussion

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

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

Transition

10. The Task Force reached a tentative conclusion that this Issue should be effective for fiscal years beginning after December 15, 2006. Entities should recognize the effects of applying this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

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

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

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

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

a. A description of the prior-period information that has been retrospectively adjusted

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

Board Ratification

14. At its June 28, 2006 meeting, the Board ratified the tentative conclusions reached by the Task Force in this Issue and approved the issuance of a draft abstract for a 30-day public comment period. A draft abstract is included as Appendix 06-4A.

Status

15. The draft abstract will be posted to the FASB website after July 6, 2006. Comments on the draft abstract are due by August 4, 2006. Further discussion is expected at a future meeting.

Appendix 06-4A

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

Issue No. 06-4

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

Dates Discussed: March 16, 2006; June 15, 2006; [September 6–7, 2006]

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

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

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

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

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

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

International Accounting Standard 19, *Employee Benefits*

ISSUE

1. Companies purchase life insurance for various reasons that may include protecting against the loss of "key" employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. One form of this insurance is split-dollar life insurance. The structure of split-dollar life insurance arrangements can be complex and varied.

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

> An employer purchases a life insurance policy to insure the life of an employee and pays a single premium at inception of the policy. Based on the insurance carrier's experience (for example, mortality) it can either charge or credit the policyholder for the negative or positive experience, respectively. The additional premium or credit is typically effectuated

[1] This draft abstract is being exposed for a 30-day public comment period.

through an adjustment to the cash surrender value of the policy. The employer enters into a separate agreement that splits the policy benefits between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the insurance arrangement (and, in turn, the policy benefits promised to the employee). To effect the split-dollar arrangement, the employer endorses a portion of the death benefits to the employee (the employee designates a beneficiary for this portion of the death benefits). Upon the death of the employee, the employee's beneficiary receives the designated portion of the death benefits and the employer receives the remainder of the death benefits. Depending on how the policy is structured, the beneficiary's proceeds are received directly either from the insurance company or from the employer (who remits the beneficiary's proportionate share once payment is received from the insurance company).

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

a. Amounts that exceed the gross premiums paid by the employer

b. Amounts that exceed the sum of the gross premiums paid by the employer and an additional fixed or variable investment return on those premiums

c. The net insurance at the date of death (that is, the face amount of the death benefit under the policy, less the cash surrender value)

d. Amounts equal to a multiple of the employee's base salary at retirement or death (for example, twice the employee's base salary).

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

Scope

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

EITF DISCUSSION

5. The Task Force reached a [consensus] that for a split-dollar life insurance arrangement within the scope of this Issue, an employer should recognize a liability for future benefits in accordance with Statement 106 or Opinion 12 (depending upon whether a substantive plan is deemed to exist) based on the substantive agreement with the employee. The Task Force believed that a liability for the benefit obligation under Statement 106 or Opinion 12 has not been settled through the purchase of an endorsement type policy. The Task Force believed that the purchase of an endorsement type policy does not constitute a settlement since the policy does not qualify as non-participating because the policyholders are subject to the favorable and unfavorable experience of the insurance company.

Transition

6. The Task Force reached a [consensus] that this Issue should be effective for fiscal years beginning after December 15, 2006. Entities should recognize the effects of applying the [consensus] in this Issue through either (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

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

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

a. The cumulative effect of the change to the new accounting principle on periods prior to those presented reflected in the carrying amounts of assets and liabilities as of the beginning of the first period presented

b. The cumulative effect of the change on retained earnings or on other components of equity or net assets in the statement of financial position

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

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

a. A description of the prior-period information that has been retrospectively adjusted

b. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for any prior periods retrospectively adjusted

c. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

Board Ratification

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

STATUS

11. No further EITF discussion is planned.

Issue No. 06-5

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

Date Discussed: June 15, 2006

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

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

Introduction

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

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

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

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

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

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

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

Issues

5. The issues are:

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

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

Current EITF Discussion

6. At the June 15, 2006 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that a policyholder should consider any additional amounts included in the contractual terms of

the policy in determining the *amount that could be realized under the insurance contract*. The Task Force agreed that contractual limitations should be considered when determining the realizable amounts. Those amounts that are recoverable by the policyholder at the discretion of the insurance company should be excluded from the amount that could be realized. The Task Force also agreed that fixed amounts that are recoverable by the policyholder in future periods in excess of one year from the surrender of the policy should be recognized at their present value.

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

Transition

8. The Task Force reached a tentative conclusion that this Issue should be applied through either (a) a change in accounting principle through a cumulative effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

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

10. If a policyholder chooses to apply this Issue as a change in accounting principle through retrospective application to all periods, a policyholder should include the recognition of:

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

11. If a policyholder chooses to apply this Issue as a change in accounting principle through retrospective application to all prior periods, the following should be disclosed:

a. A description of the prior-period information that has been retrospectively adjusted
b. The effect of the change on income from continuing operations, net income (or other appropriate captions of changes in the applicable net assets or performance indicator), any other affected financial statement line item, and any affected per-share amounts for any prior periods retrospectively adjusted

c. The cumulative effect of the change on retained earnings or other components of equity or net assets in the statement of financial position as of the beginning of the earliest period presented.

Effective Date

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

Board Ratification

13. At its June 28, 2006 meeting, the Board ratified the tentative conclusions reached by the Task Force in this Issue and approved the issuance of a draft abstract for a 30-day public comment period. A draft abstract is included as Appendix 06-5A.

Status

14. The draft abstract will be posted to the FASB website after July 6, 2006. Comments on the draft abstract are due by August 4, 2006. Further discussion is expected at a future meeting.

Appendix 06-5A

EITF ABSTRACTS (DRAFT[1])

Issue No. 06-5

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

Dates Discussed: June 15, 2006; [September 6–7, 2006]

References: FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*
AICPA Audit and Accounting Guide, *Life and Health Insurance Entities*

ISSUE

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

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

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

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

[1] **This draft abstract is being exposed for a 30-day public comment period.**

policy that will waive the surrender charges on each individual policy if all of the policies are surrendered at the same time. The cost of the rider will vary depending on the individual facts and circumstances.

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

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

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

5. The issues are:

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

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

EITF DISCUSSION

6. The Task Force reached a [consensus] on Issue 1 that a policyholder should consider any additional amounts included in the contractual terms of the policy in determining the *amount that could be realized under the insurance contract*. The Task Force agreed that contractual limitations should be considered when determining the realizable amounts. Those amounts that are recoverable by the policyholder at the discretion of the insurance company should be excluded from the amount that could be realized. The Task Force also agreed that fixed amounts that are recoverable by the policyholder in future periods in excess of one year from the surrender of the policy should be recognized at their present value.

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

8. Exhibit 06-5A illustrates the above [consensuses].

Transition

9. The Task Force reached a [consensus] that this Issue should be effective through either (a) a change in accounting principle through a cumulative effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

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

11. If a policyholder chooses to apply the [consensus] reached in this Issue as a change in accounting principle through retrospective application to all periods, a policyholder should include the recognition of:

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

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

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

Effective Date

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

Board Ratification

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

STATUS

15. No further EITF discussion is planned.

Exhibit 06-5A

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

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

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

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

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

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

Evaluation:

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

Exhibit 06-5B

DEFINITIONS OF KEY TERMS

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

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

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

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

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

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

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

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

Issue No. 06-6

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

Date Discussed: June 15, 2006

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

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

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

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

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

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

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

Introduction

1. At the June 15, 2006 EITF meeting, the Task Force was asked to consider the redeliberation of Issue 2 and Issue 3 of Issue 05-7 due to a concern about the accounting for modifications that decrease the value of or that eliminated an embedded conversion option.

Background

2. At the September 15, 2005 EITF meeting, the Task Force reached the following consensus on Issue 05-7:

> Issue 1—An entity should include, upon the modification of a convertible debt instrument, the change in fair value of the related embedded conversion option in the analysis to determine whether a debt instrument has been extinguished pursuant to Issue 96-19. The change in the fair value of an embedded conversion option should be calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification and it should be included in the Issue 96-19 analysis.
>
> Issue 2—The modification of a convertible debt instrument should affect subsequent recognition of interest expense for the associated debt instrument by the recognition of the change in the fair value of the conversion option and the recognition of any consideration paid or received as part of that modification. The change in the fair value of an embedded conversion option should be calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification.

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

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

Issues

4. The issues are:

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

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

Current EITF Discussion

5. At the June 15, 2006 EITF meeting, the Task Force discussed this Issue but was not asked to reach any conclusions. Some Task Force members reaffirmed their support for the original consensus on Issue 05-7, while others acknowledged their concern that the current application of Issue 2 of Issue 05-7 allows entities to reduce the value of (or eliminate) a conversion option by providing the debt holder with equal consideration with no subsequent impact on interest expense (since the change in the value of a conversion option negates the impact of the consideration given).

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

7. The Task Force discussed alternative methods for determining whether a substantial modification had occurred including (a) assessing each change individually, (b) assessing the

changes in the equity and non-equity components separately, or (c) assessing the combined total change in value.

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

Status

9. Further discussion is expected at a future meeting.

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues on the proposed agenda for the September 6–7, 2006 meeting are considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
06-1	Accounting for Consideration Given by a Service Provider to Manufacturers or Resellers of Equipment Necessary for an End-Customer to Receive a Service from the Service Provider	10/05	3/06, 6/06	9/06	Hauser	Cosper/ Beswick	The FASB staff will prepare an Issue Summary Supplement for the next meeting.	September 2006 EITF meeting
06-4	Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements	11/05	3/06, 6/06	9/06	Holman	Trench/ Beswick	The FASB staff will prepare an Issue Summary Supplement for the next meeting.	September 2006 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
06-5	Accounting for Purchases of Life Insurance—Determining the Amount That Could Be Realized in Accordance with FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*	2/06	6/06	9/06	Schroeder	Beswick/ Trench	The FASB staff will prepare an Issue Summary Supplement for the next meeting.	September 2006 EITF meeting
06-6	Application of EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"	6/06 and 5/06	6/06	9/06	Holman	Stevens/ Jacobs	The FASB staff will prepare an Issue Summary Supplement for a future meeting.	September 2006 EITF meeting
06-E	Accounting for a Previously-Bifurcated Conversion Option in Convertible Debt That No Longer Meets the Bifurcation Criteria in Paragraph 12 of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*	5/06	N/A	9/06	Johnson	Roberge/ Stevens	The FASB staff will prepare an Issue Summary for a future meeting.	September 2006 EITF meeting

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

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
02-D	The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a)(1) of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*	3/02	N/A	Not scheduled	Jacobs	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	11/02	N/A	Not scheduled	Lusniak	The Board's project on QSPE's is not expected to address this Issue and, therefore, the FASB staff will bring this Issue to the Agenda Committee at a future meeting to determine whether to begin discussions on this Issue or to request that the Task Force remove this Issue from the agenda.	Future Agenda Committee Meeting

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
03-17	Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet	5/03	11/03	9/06	Moss	Issue addresses the amortization of a recognized executory contract that has periods of both positive and negative cash flows. This issue was 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). The Board has dropped this project from the FASB agenda.	Future Agenda Committee Meeting
05-4	The Effect of a Liquidated Damages Clause on a Financial Instrument Subject to EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"	2/05	6/05, 9/05	N/A	Thuener/ Jacobs/ Richards	Pending further progress on a DIG Issue for determining whether a registration rights agreement is a derivative	N/A

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