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ACCOUNTING STANDARDS UPDATE

No. 2010-04
January 2010

Accounting for Various Topics

Technical Corrections to SEC Paragraphs

An Amendment of the *FASB Accounting Standards Codification*™

Financial Accounting Standards Board
of the Financial Accounting Foundation

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Securities and Exchange Commission (SEC) Content

Accounting for Various Topics

Technical Corrections to SEC Paragraphs

This Accounting Standards Update represents technical corrections to SEC paragraphs.

1. Due to the release of SFAS 141R, supersede paragraph 323-10-S99-3, with no link to a transition paragraph, as follows:

~~**> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings**~~

~~**> > > SEC Staff Announcement: Accounting for Subsequent Investments in an Investee After Suspension of Equity Method Loss Recognition when an Investor Increases Its Ownership Interest from Significant Influence to Control Through a Market Purchase of Voting Securities**~~

323-10-S99-3 <u>Paragraph superseded by Accounting Standards Update 2010-04</u>. ~~The following is the text of SEC Staff Announcement: Accounting for Subsequent Investments in an Investee after Suspension of Equity Method Loss Recognition when an Investor Increases Its Ownership Interest from Significant Influence to Control Through a Market Purchase of Voting Securities.~~

~~Date Discussed: January 19-20, 2000~~

~~At the November 17-18, 1999 meeting, the Task Force agreed with the EITF Agenda Committee's recommendation that the proposed issue, "Accounting for Subsequent Investments in an Investee After Suspension of Equity Method Loss Recognition," not be added to the EITF agenda at this time. The proposed issue will be reconsidered at a future meeting pending further input from the EITF AcSEC Observer on the status of AcSEC's project on the reconsideration of AICPA Statement of Position 78-9, Accounting for Investments in Real Estate Ventures. (The issue was subsequently added to the EITF's agenda at the January 19-20, 2000 meeting.) Pending EITF or AcSEC resolution of the issues identified in the proposed issue, the SEC staff will expect public companies to follow the guidance for the fact pattern described below.~~

~~The SEC staff has recently addressed a fact pattern in which a subsequent investment was made in an equity method investee after suspension of equity method loss recognition in accordance with APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock.~~

~~Opinion 18, paragraph 19(i), states:~~

> ~~An investor's share of losses of an investee may equal or exceed the carrying amount of an investment accounted for by the equity method plus advances made by the investor. The investor ordinarily should discontinue applying the equity method when the investment (and net advances) is reduced to zero and should not provide for additional losses unless the investor has guaranteed obligations of the investee or is otherwise committed to provide further financial support for the investee. [Footnote reference omitted.]~~

~~Assuming that an investor has appropriately applied the above guidance, the issue arises as to how an investor should account for a subsequent investment in an investee after the suspension of equity method losses has occurred.~~

~~The following generic fact pattern illustrates the issue:~~

> ~~Investor A has held a 25 percent equity method investment in Investee B since 19X2. Through the end of 19X5, Investor A recognized Investee B losses sufficient to reduce its investment to $0. Investor A had no other investments in Investee B, had not guaranteed any obligations of Investee B, and had no obligations or commitments to provide further financial support. As a result, Investor A recognized no additional equity method losses after 19X5, although Investee B continued to incur net losses through May 31, 19X9. The additional equity method losses not recognized by Investor A total $25 through May 31, 19X9. On June 1, 19X9, Investor A makes an additional acquisition of 50 percent of Investee B common stock in the market for $100. At the time of the additional investment, Investee B has $200 in assets and $300 in liabilities.~~
>
> ~~Investor A now has an investment of $100 in Investee B, representing the carrying value of the original 25 percent ($0) and the cost of the additional 50 percent ($100). Investee B has a net deficit in shareholders' equity of $100.~~

> ~~When Investor A makes its additional 50 percent investment, the question arises as to how it should treat the "unrecognized" or "suspended" losses from Investee B during the 19X6-19X9 time frame.~~

~~The SEC staff believes that in the circumstances in which an investor increases its ownership interest from one of significant influence to one of control through a purchase of additional voting securities in the market, and where no commitment or obligation to provide financial support existed prior to obtaining control, the acquisition should follow step acquisition accounting. Recognition of a "loss on purchase" or a restatement of prior-period financial statements is not appropriate.~~

~~In the above fact pattern, Investor A would make the following journal entry in the consolidation of Investee B:~~

~~Investee B assets~~	~~$ 200~~	
~~Goodwill~~	~~200~~	
~~Investee B liabilities~~		~~$ 300~~
~~Investment in B~~		~~100~~

~~The caption "goodwill" has been used for illustration purposes. In reality, Investor A would need to allocate the excess basis to all identifiable tangible and intangible assets of Investee B, using normal step acquisition accounting in accordance with APB Opinion No. 16, Business Combinations.~~

~~In this instance, the goodwill balance of $200 may be viewed to comprise three parts:~~

> ~~1. $25, representing the excess basis between the $0 carrying amount of the original 25 percent investment and the proportionate shareholders' equity deficit in Investee B of $25.~~
>
> ~~2. $150, representing the excess basis between the $100 cost of the additional 50 percent investment and the proportionate shareholders' equity deficit in Investee B of $50.~~
>
> ~~3. $25, representing 25 percent of the shareholders' equity deficit attributable to outside ownership. Absent an expressed obligation of the minority interest to fund this deficit, it is not appropriate to record an asset for a debit minority interest. As a result, this balance is included in goodwill.~~

2. Due to the amendments in paragraph 323-10-S99-3 above, supersede paragraph 323-10-S55-1, with no link to a transition paragraph, as follows:

~~> Accounting for Subsequent Investments in an Investee After Suspension of Equity Method Loss Recognition when an Investor Increases Its Ownership Interest from Significant Influence to Control Through a Market Purchase of Voting Securities~~

323-10-S55-1 Paragraph superseded by Accounting Standards Update 2010-04. ~~See paragraph 323-10-S99-3, SEC Staff Announcement: Accounting for Subsequent Investments in an Investee After Suspension of Equity Method Loss Recognition when an Investor Increases Its Ownership Interest from Significant Influence to Control through a Market Purchase of Voting Securities, for SEC Staff views on accounting for subsequent investments in an investee after suspension of equity method loss recognition when an investor increases its ownership interest from significant influence to control through a market purchase of voting securities.~~

3. Supersede paragraph 815-10-S99-2, with no link to a transition paragraph, as follows:

~~> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings~~

~~> > > SEC Staff Announcement: Classification of Gains and Losses from the Termination of an Interest Rate Swap Designated to Commercial Paper~~

815-10-S99-2 Paragraph superseded by Accounting Standards Update 2010-04. ~~The following is the text of SEC Staff Announcement: Classification of Gains and Losses from the Termination of an Interest Rate Swap Designated to Commercial Paper.~~

> ~~The SEC Observer made the following announcement of the SEC staff's position on the appropriate income statement classification of a gain or loss resulting from the termination of an interest rate swap designated to a commercial paper program that subsequently is canceled.~~
>
> ~~A company enters into a commercial paper program in which it issues three-month commercial paper that is expected to continuously "roll over" at each maturity date for a period of five years. In conjunction with its commercial paper program, the company enters into a five-year interest rate swap to receive a floating rate and pay a fixed rate ("the swap"). The purpose of the swap essentially is to lock in the interest payments on its commercial paper. The swap is designated to the future expected interest payments on the~~

~~commercial paper program. After two years, the commercial paper program is terminated and not replaced with new debt and, at the same time, the swap is terminated at a gain or loss. The issue is how the realized gain or loss on the swap should be classified in the income statement.~~

~~Consistent with Issue No. 84-7, "Termination of Interest Rate Swaps," the SEC staff believes that the accounting for realized gains and losses from the termination of an interest rate swap accounted for like a hedge is closely analogous to the accounting for a terminated futures contract described in FASB Statement No. 80, Accounting for Futures Contracts. Statement 80 addresses the accounting for both futures that qualify as hedges of existing assets and liabilities and those that qualify as hedges of anticipated transactions. Statement 80 states that gains and losses on a futures contract that qualifies as a hedge of an anticipated transaction should be deferred and recognized in income when the effects of the related hedged item are recognized. Statement 80 also states that deferred gains or losses on a futures contract that does not qualify as a hedge (for example, because the anticipated transaction is no longer considered to be a transaction probable of occurring) should be recognized immediately in income.~~

~~Because an interest rate swap designated to a commercial paper program is a hedge of a series of anticipated transactions (comprising interest payments on the future rollovers of the commercial paper), the SEC staff believes that any gain or loss on a terminated swap should be deferred and amortized in a manner consistent with the accounting for the remaining expected future interest payments to which the terminated swap was designated. In particular, if the commercial paper program is terminated along with the swap and the program is not replaced with new debt, the SEC staff believes that the gain or loss associated with the terminated swap should be recognized as an ordinary gain or loss because the gain or loss relates to the future anticipated interest payments associated with the rollover of the commercial paper, which are no longer going to occur.~~

~~Subsequent Developments~~

~~FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, was issued in June 1998 and was amended by FASB Statements No. 137, Accounting for Derivative Instruments and Hedging Activities-Deferral of the Effective Date of FASB Statement No. 133, and No. 138, Accounting for Certain Derivative Instruments and Certain Hedging Activities. The effective date for Statement 133, as amended, is for all fiscal quarters of all fiscal years beginning after June 15, 2000.~~

~~The hedging activity described in this announcement would likely be a cash flow hedge of the variability of the proceeds from the forecasted issuance of fixed-rate debt under Statement 133, assuming the commercial paper was issued on a discounted basis. (The hedging activity described in this announcement could be a cash flow hedge of the variability of the interest payments if the entity decided that the proceeds from its future borrowing under the commercial paper program would also be fixed and the effect of changes in interest rates would be reflected in the amount to be repaid at maturity. The analysis below is based on the assumption that the par amount of the commercial paper issued on a discounted basis was fixed, not variable.) Under Statement 133, the termination of the commercial paper program does not necessarily result in immediate recognition of derivative gains or losses in earnings. Accounting for the terminated cash flow hedge varies as follows depending on whether it is probable that the hedged forecasted issuance of debt will not occur:~~

> ~~1. If the swap is terminated and it is probable the forecasted transaction (variable proceeds from future issuance of debt) will not occur since the commercial paper program is being terminated without any replacement borrowing, the gains and losses accumulated in other comprehensive income (OCI) shall be recognized immediately in earnings, pursuant to paragraph 33 of Statement 133.~~
>
> ~~2. If the swap is terminated, but it continues to be probable that the forecasted transaction (variable proceeds from future issuance of debt) will occur since the commercial paper program is replaced by other short-term borrowings issued on a discounted basis, the gain or loss remains in OCI and is reclassified to earnings in the same period during which the hedged forecasted transaction affects earnings, pursuant to paragraph 32 of Statement 133. (These facts are not assumed in this Topic.)~~
>
> ~~3. If the swap is terminated but the commercial paper program remains in place, and it continues to be probable that the forecasted transaction (variable proceeds from future issuance of debt) will occur, the gain or loss remains in OCI and is reclassified to earnings in the same period during which the hedged forecasted transaction affects earnings, pursuant to paragraph 32 of Statement 133. (These facts are not assumed in this Topic.)~~

~~Statement 133 does not address the income statement classification (ordinary or extraordinary) of gains and losses reclassified out of OCI because it is probable that the hedged forecasted issuance of debt will not~~

~~occur. The guidance in Topic D-50, as affected by the guidance in Issue No. 00-9, "Classification of a Gain or Loss from a Hedge of Debt That Is Extinguished," should continue to be followed. (In Issue 00-9, the Task Force reached a consensus that if the reclassification to earnings of the amount in accumulated OCI resulting from a cash flow hedge of debt is required under Statement 133 when the debt is extinguished, the reclassified amount should not be classified as extraordinary.)~~

4. Due to the amendments made in paragraph 815-10-S99-2 above, supersede paragraph 815-10-S45-1, with no link to a transition paragraph, as follows:

~~**>** Classification of Gains and Losses from the Termination of an Interest Swap Designated to Commercial Paper~~

815-10-S45-1 <u>Paragraph superseded by Accounting Standards Update 2010-04.</u> ~~See paragraph 815-10-S99-2, SEC Staff Announcement: Classification of Gains and Losses from the Termination of an Interest Rate Swap Designation to Commercial Paper, for SEC Staff views on classification of gains and losses from the termination of an interest swap designated to commercial paper.~~

5. Due to the amendments made in paragraph 815-10-S99-2 above, supersede paragraph 815-30-S45-1, with no link to a transition paragraph, as follows:

~~**> Classification of Gains and Losses from the Termination of an Interest Swap Designated to Commercial Paper**~~

815-30-S45-1 <u>Paragraph superseded by Accounting Standards Update 2010-04.</u> ~~See paragraph 815-10-S99-2, SEC Staff Announcement: Classification of Gains and Losses from the Termination of an Interest Rate Swap Designation to Commercial Paper, for SEC Staff views on this issue.~~

6. Amend paragraph 855-10-S99-2, with no link to a transition paragraph, as follows:

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Issuance of Financial Statements

855-10-S99-2 The following is the text of SEC Staff Announcement: **Issuance of Financial Statements**.

~~Date Discussed: January 19-20, 2000; September 7, 2006~~

~~The SEC staff has received a number of inquiries regarding when financial statements are considered to have been issued.~~ In considering when financial statements have been issued ~~this issue~~, the SEC staff observed that Rules 10b-5 and 12b-20 under the Securities Exchange Act of 1934 and General Instruction C(3) to Form 10-K specify that financial statements must not be misleading as of the date they are filed with the Commission. For example, assume that a registrant widely distributes its financial statements but, before filing them with the Commission, the registrant or its auditor becomes aware of an event or transaction that existed at the date of the financial statements that causes those financial statements to be materially misleading. If a registrant does not amend those financial statements so that they are free of material misstatement or omissions when they are filed with the Commission, the registrant will be knowingly filing a false and misleading document. In addition, registrants are reminded of their responsibility to, at a minimum, disclose subsequent events, FN1 while independent auditors are reminded of their responsibility to assess subsequent events FN2 and evaluate the impact of the events or transactions on their audit report. FN3

> FN1 See ~~AICPA Codification of Statements on Auditing Standards,~~ AU Section 560, Subsequent Events, paragraphs 5 and 8 and Section 855-10-50.
>
> FN2 See AU 560 and AU Section 561, Subsequent Discovery of Facts Existing at Date of the Auditor's Report.
>
> FN3 See AU Section 530, Dating of the Independent Auditor's Report, and AU 560, paragraph 9.

A registrant and its independent auditor have responsibilities with regard to post-balance-sheet-date subsequent events, as well as the application of authoritative literature applicable to such events. ~~Referring to AICPA Statement on Auditing Standards No. 1~~ See Topic 855 and AU 560, Subsequent Events ~~(SAS 1 or AU 560)~~, paragraph 3.~~3 states:~~

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

Generally, the staff believes that financial statements are "issued" as of the date they are distributed for general use and reliance in a form and format that complies with generally accepted accounting principles (GAAP) and, in the case of annual financial statements, that contain an audit report that indicates that the auditors have complied with generally accepted auditing standards (GAAS) in completing their audit. Issuance of financial statements then would generally be the earlier of when the annual or quarterly financial statements are widely distributed to all shareholders and other financial statement users FN4 or filed with the Commission. Furthermore, the issuance of an earnings release does not constitute issuance of financial statements because the earnings release would not be in a form and format that complies with GAAP and GAAS.

> FN4 Posting financial statements to a registrant's web site would ~~not~~ be considered wide distribution to all shareholders and other financial statement users <u>if the registrant uses its web site to disclose information to the public in a manner consistent with the requirements of Regulation FD. See the Commission's interpretive guidance in Exchange Act Release No. 58288 (Aug. 7, 2008).</u> ~~as not all such parties necessarily have the ability to access a registrant's web site or be aware that such a posting had occurred~~.

7. Amend paragraph 805-50-S99-2, with no link to a transition paragraph, as follows:

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Push-Down Accounting

805-50-S99-2 The following is the text of SEC Staff Announcement: Push Down Accounting.

~~Date Discussed: April 18-19, 2001~~

The SEC staff has received a number of inquiries regarding the facts and circumstances under which push-down accounting is required to be applied by SEC registrants. In Staff Accounting Bulletin ~~No. 54,~~ <u>Topic No. 5.J, Push Down Basis of Accounting Required in Certain Limited Circumstances [805-50-S99-1]</u>~~Application of "Pushdown" Basis of Accounting in Financial Statements of Subsidiaries Acquired by Purchase~~, the SEC staff indicated that it believes push-down accounting is required in "purchase transactions that result in an entity becoming substantially wholly owned."

The SEC staff believes that the views in SAB ~~54~~ Topic 5.J [805-50-S99-1] also should be followed in the context of a company that becomes substantially wholly owned as a result of a series of related and anticipated transactions. In determining whether a company has become substantially wholly owned, the SEC staff has stated that push-down accounting would be required if 95 percent or more of the company has been acquired (unless the company has outstanding public debt or preferred stock that may impact the acquirer's ability to control the form of ownership of the company), permitted if 80 percent to 95 percent has been acquired, and prohibited if less than 80 percent of the company is acquired.

For example, if a parent company purchases all the outstanding ~~minority~~ noncontrolling interest of a majority-owned subsidiary (which has no public debt outstanding) in a single transaction or a series of related and anticipated transactions which includes the subsequent issuance of subsidiary shares to new investors, the SEC staff believes that push-down accounting would be required to be applied in the subsidiary's financial statements, regardless of the size of the ~~minority~~ noncontrolling interest sold to new investors. The SEC staff believes that push-down accounting would be required even though the subsidiary became wholly owned for only a short time and there was a plan for the subsidiary to issue shares subsequent to becoming wholly owned.

In applying SAB ~~54~~ Topic 5.J [805-50-S99-1] to specific facts and circumstances, a registrant must distinguish between transactions resulting in only a significant change in (recapitalization of) a company's ownership (for example, as the result of an initial public offering for which push-down accounting is not required) and purchase transactions in which the company becomes substantially wholly owned and for which push-down accounting is required.

For purposes of determining whether a company has become "substantially wholly owned" as the result of a single transaction or a series of related and anticipated transactions in which investors acquire ownership interests, the SEC staff believes that it is appropriate to aggregate the holdings of those investors who both "mutually promote" the acquisition and "collaborate" on the subsequent control of the investee company (the collaborative group). ~~FN1~~ That is, the SEC staff believes that push-down accounting is required if a company becomes substantially wholly owned by a group of investors who act together as effectively one investor and are able to control the form of ownership of the investee.

~~FN1 Topic No. D-97 Footnote 1—A collaborative group is not necessarily the same as a control group as defined in SEC Staff~~

~~Announcement: Issue No. 88-16, "Basis in Leveraged Buyout Transactions."~~

The SEC staff believes that under a "mutual promotion and subsequent collaboration" model, a member of a collaborative group would be any investor FN~~2~~ 1 that helps to consummate the acquisition and works or cooperates with the subsequent control of the acquired company. For purposes of assessing whether an investor is part of a collaborative group, the SEC staff believes that a rebuttable presumption exists that any investor investing at the same time as or in reasonable proximity to the time others invest in the investee is part of the collaborative group with the other investor(s). Determination of whether such a presumption is rebutted necessarily will involve the consideration of all pertinent facts and circumstances. Among the factors considered by the SEC staff FN~~3~~ 2 that would be indicative of an investor not being part of a collaborative group include:

FN~~2~~ 1 ~~Topic No. D-97 Footnote 2—~~Preexisting, or rollover, investors should be evaluated for inclusion in the collaborative group on the same basis as new investors.

FN~~3~~ 2 ~~Topic No. D-97 Footnote 3—~~In an assessment of whether the presumption is overcome, any single factor should not be considered in isolation.

I. Independence

The investor is substantive. For example, the investor is an entity with substantial capital (that is, comparable to that expected for a substantive business with similar risks and rewards) and other operations. In contrast, an investor that is a special-purpose entity whose only substantive assets or operations are its investment in the investee generally would not be considered substantive.

The investor is independent of and unaffiliated with all other investors.

The investor's investment in the investee is not contingent upon any other investor making investments in the investee.

The investor does not have other relationships with any other investor that are material to either investor.

II. Risk of Ownership

The investor is investing at fair value.

The investor invests funds from its own resources.

The investor fully shares with all other investors in the risks and rewards of ownership in the investee in proportion to its class and amount of investment. That is, the investor's downside risk or upside reward are not limited, and the investor does not receive any other direct or indirect benefits from any other investor as a result of investing in the investee. FN~~4~~ 3

FN~~4~~ 3 ~~Topic No. D-97 Footnote 4—~~Put options, call options, tag-along rights, and drag-along rights should be carefully evaluated. They may act to limit an investor's risk and rewards of ownership, effective voting rights, or ability to sell its investee shares. A tag-along right grants a shareholder the option to participate in a sale of shares by the controlling shareholder or collaborative group, generally under the same terms and in the same proportion. A drag-along right grants the controlling shareholder or collaborative group the option to compel shareholders subject to the drag-along provision to sell their shares in a transaction in which the controlling shareholder or collaborative group transfers control of the company, generally under the same terms and in the same proportion.

The funds invested by the investor are not directly or indirectly provided or guaranteed by any other investor.

The investor is at risk only for its own investment in the investee and not another's investment in the investee. That is, the investor is not providing or guaranteeing any part of another investor's investment in the investee. FN~~5~~ 4

FN~~5~~ 4 ~~Topic No. D-97 Footnote 5—~~See footnote ~~4~~ 3.

III. Promotion

The investor did not solicit other parties to invest in the investee.

IV. Subsequent Collaboration

The investor is free to exercise its voting rights in any and all shareholder votes.

The investor does not have disproportionate or special rights that other investors do not have, such as a guaranteed seat(s) on the investee's board, required supermajority voting rights for major or significant corporate decisions, guaranteed consent rights over corporate actions, guaranteed or specified returns, and so forth.

The investor's ability to sell its investee shares is not restricted, except as provided by the securities laws or by what is reasonable and customary in individually negotiated investment transactions for closely held companies (for example, a right of first refusal held by the investee on the investor's shares in the event of a bona fide offer from a third party).

The SEC staff has considered the applicability of push-down accounting in transactions in which financial investors, acting together effectively as one investor (that is, as a collaborative group), acquire ownership interests in a company. The investee company experiences a significant change in ownership, but no single financial investor obtains substantially all of the ownership interest in the company. Consider the following example:

Investor C formulates a plan to acquire and consolidate companies in a highly fragmented industry in order to achieve economies of scale. Investor C approaches Investors A and B with the plan, and they agree to invest with Investor C in the acquisition and consolidation plan. Investors A, B, and C (the Investors) are each substantive entities, with no overlap of employees but with a number of prior joint investments and other business relationships that are individually material to the Investors. Furthermore, upon completion of the current plan, the resulting entity is expected to be material to each individual investor.

Shortly thereafter, Company D is identified as an acquisition candidate in the industry. The Investors negotiate a legally binding agreement with Company D to acquire 100 percent of the outstanding common stock of Company D (to be held 40 percent, 40 percent, and 20 percent by Investors A, B, and C, respectively) for cash. In connection with the change in ownership, Company D's bylaws are amended to provide that the Investors each have the right to elect an equal number of members of Company D's board of directors. Company D's board of directors also is to include Company D's chief executive officer and two independent directors. In addition, the bylaws are amended to provide that no action requiring board of directors' approval may be approved without consent of a majority of the board as well as a majority of the Investor A directors, the Investor B directors, and the Investor C directors, each voting as a separate class. Effectively, any significant corporate action by Company D would require the approval of each investor.

Stock held by the Investors is to be restricted as to transfer for five years, after which each of the Investors has a right of first refusal and tag-along rights if some part of the group of Investors decides to sell its interests.

The funds invested by each investor come from the respective investor's resources; however, Investors A and B provide Investor C certain limited first-loss guarantees of its investment.

In the context of this example, the SEC staff concluded that Investors A, B, and C did not overcome the presumption that they were members of a collaborative group of investors. Furthermore, since the collaborative group of Investors acquired 100 percent of the outstanding common stock of Company D, the SEC staff concluded that push-down accounting was required to be applied in Company D's financial statements. The factors the SEC staff considered in reaching its conclusion that the presumption was not rebutted included, among others, the following:

Investors A, B, and C acted in concert to negotiate their concurrent investments in Company D, which were made pursuant to the same contract.

The investments by Investors A, B, and C were being made in connection with a broader strategic initiative the three investors were pursuing together.

There were a number of prior business relationships between the Investors that were material to the Investors.

Investor C does not share fully in the risks and rewards of ownership due to the limited first-loss guarantees provided by Investors A and B.

No single Investor controlled the board of directors, and due to the amendments to the bylaws regarding board representation and voting, any of the three Investors could unilaterally block any board action. In other words, Investors A, B, and C were compelled to collaborate on the subsequent control of Company D.

There are restrictions on each Investor's ability to transfer its shares.

~~The guidance in this announcement should be applied prospectively to transactions initiated after April 19, 2001.~~

8. Amend paragraph 805-20-S99-3, with no link to a transition paragraph, as follows:

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Use of Residual Method to Value Acquired Assets Other than Goodwill

805-20-S99-3 The following is the text of SEC Staff Announcement: Use of Residual Method to Value Acquired Assets Other than Goodwill.

~~Date Discussed: September 29–30, 2004~~

~~FASB Statement No. 141, Business Combinations, states, in paragraph~~ Paragraph 805-20-25-10 discusses the recognition of identifiable intangible assets acquired in a business combination. ~~an intangible asset shall be recognized as an asset apart from goodwill if it arises from contractual or other legal rights~~. The SEC staff is aware of instances in which registrants have asserted that certain intangible assets that arise from legal or contractual rights cannot be separately and directly valued (hereinafter referred to as a "direct value method") because the nature of the particular asset makes it fundamentally indistinguishable from goodwill in a business combination (for example, cellular/spectrum licenses, cable franchise agreements, and so forth). Accordingly, some have applied a policy of assigning purchase price to all other identifiable assets and liabilities as provided in ~~Statement 141~~ Topic 805, with the remaining residual amount being allocated to the "indistinguishable" intangible asset. In those instances, there is either no goodwill recognized or the amount of goodwill recognized uses a technique other than the one specified in paragraph 805-30-30-1 ~~43 of Statement 141~~. These methods have been referred to as "the residual method" of valuing intangible assets and have been used in the telecommunications, broadcasting, and cable industries. ~~Similar methods were used to allocate purchase price in acquisitions under APB Opinion No. 16, Business Combinations.~~

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

The SEC staff believes that the residual method does not comply with the requirements of ~~Statement 141~~ Topic 805. Except for certain exceptions noted in ~~Paragraph~~ paragraphs 805-20-30-10 through 30-12, ~~37 (e) of Statement 141 requires~~ identifiable intangible assets that meet the recognition criteria ~~to~~ shall be recorded at fair value. Paragraph 805-30-30-1 discusses the initial measurement of goodwill. ~~43 of Statement 141 states that, "the excess of the cost of an acquired entity over the net of the amounts assigned to assets acquired and liabilities assumed shall be recognized as an asset referred to as goodwill." The SEC staff notes that a fundamental distinction between other recognized intangible assets and goodwill is that goodwill is both defined and measured as an excess or residual asset, while other recognized intangible assets are required to be measured at fair value. The SEC staff does not believe that the application of the residual method to the valuation of intangible assets can be assumed to produce amounts representing the fair values of those assets. The SEC staff also notes that valuation difficulty does not provide relief from the requirements in paragraphs 37(e) and 39 of Statement 141 to separately recognize intangible assets at fair value apart from goodwill. Furthermore, the SEC staff notes that the same types of assets being valued using the residual method by some entities are being valued using a direct value method by other entities. Accordingly, the SEC staff believes the residual method should no longer be used to value intangible assets other than goodwill. Rather, a direct value method should be used to determine the fair value of all intangible assets required to be recognized under Statement 141.~~

The SEC staff notes that a fundamental distinction between other recognized intangible assets and goodwill is that goodwill is both defined and measured as an excess or residual asset, while other recognized intangible assets are required to be measured at fair value. The SEC staff does not believe that the application of the residual method to the valuation of intangible assets can be assumed to produce amounts representing the fair values of those assets. The SEC staff also notes that valuation difficulty does not provide relief from the requirements in paragraphs 805-20-25-1 and 805-20-30-1 to separately recognize intangible assets at fair value apart from goodwill. Furthermore, the SEC staff notes that the same types of assets being valued using the residual method by some entities are being valued using a direct value method by other entities. Accordingly, the SEC staff believes the residual method should no longer be used to value intangible assets other than goodwill. Rather, a direct value method should be used to determine the fair value of all intangible assets required to be recognized at fair value under Topic 805.

Impairment testing of intangible assets similarly should not rely on a residual method and should, instead, comply with the provisions of Topic 350 ~~FASB Statement No. 142, Goodwill and Other Intangible Assets~~.

~~Transition~~

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

9. Amend paragraph 320-10-S99-2, with no link to a transition paragraph, as follows:

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of Subtopic 320-10 ~~FASB Statement No. 115~~

320-10-S99-2 The following is the text of SEC Staff Announcement: Adjustments in Assets and Liabilities for Holding Gains and Losses as Related to the Implementation of Subtopic 320-10 ~~FASB Statement No. 115~~.

~~Date Discussed: January 20, 1994~~

~~The SEC Observer made the following announcement of the SEC staff's position on the implementation of FASB Statement No. 115, Accounting for Certain Investments in Debt and Equity Securities.~~

~~Registrants currently are evaluating the effects on their financial statements of adopting Statement 115.~~ The SEC staff has been asked whether certain assets and liabilities, such as ~~minority~~ noncontrolling interests, certain life insurance policyholder liabilities, deferred acquisition costs, and intangible assets arising from insurance contracts acquired in business combinations ~~the present value of future profits~~, should be adjusted with a corresponding adjustment to other comprehensive income ~~shareholders' equity~~ at the same time unrealized holding gains and losses from securities classified as available-for-sale are recognized in other comprehensive income ~~shareholders' equity~~. That is, should the carrying value of these assets and liabilities be adjusted to the amount that would have been reported had unrealized gains and losses been realized?

~~This issue is not addressed specifically in the literature. However, paragraph~~ Paragraph ~~36(b) of FASB Statement No. 109, Accounting for Income Taxes,~~ 740-20-45-11(b) addresses specifically the classification of the deferred tax effects of unrealized holding gains and losses reported in other comprehensive income ~~a separate component of shareholders' equity~~. Paragraph 740-20-45-11(b) ~~36(b) of FAS 109~~ requires that the tax effects of those gains and losses be reported as charges or credits directly to other comprehensive income ~~the related component of shareholders' equity~~. That is, the recognition of unrealized holding gains and losses in ~~shareholders'~~ equity may create temporary differences for which deferred taxes would be recognized, the effect of which would be reported in accumulated other comprehensive income ~~a separate component of shareholders' equity~~ along with the related unrealized holding gains and losses. Therefore, ~~Statement 109 requires that~~ deferred tax assets and liabilities are required to be recognized for the temporary differences relating to unrealized holding gains and losses as though those gains and losses actually had been realized, except the corresponding charges or credits are reported in other comprehensive income ~~a separate component of shareholders' equity~~ rather than as charges or credits to income in the statement of income.

By analogy to paragraph 740-20-45-11(b) ~~to the requirements of Statement 109~~, the SEC staff believes that, in addition to adjusting deferred tax assets and liabilities, registrants should adjust other assets and liabilities that would have been adjusted if the unrealized holding gains and losses from securities classified as available-for-sale actually had been realized. That is, to the extent that unrealized holding gains or losses from securities classified as available-for-sale would result in adjustments of ~~minority~~ noncontrolling interest, policyholder liabilities, deferred acquisition costs that are amortized using the gross-profits method, or intangible assets arising from insurance contracts acquired in business combinations ~~amounts representing the present value of future profits~~ that are amortized using the gross-profits method had those gains or losses actually been realized, the SEC staff believes that those balance sheet amounts should be adjusted with corresponding credits or charges reported directly to other comprehensive income. ~~shareholders' equity. [Note: See Subsequent Developments section below.]~~ As a practical matter, the staff, at this time, would not extend those adjustments to other accounts such as liabilities for compensation to employees. The adjustments to asset accounts should be accomplished by way of valuation allowances that would be adjusted at subsequent balance sheet dates.

For example, ~~registrants should adjust minority interest for a portion of the unrealized holding gains and losses from securities classified as available-for-sale if those gains and losses relate to securities that are owned by a less-than-wholly-owned subsidiary whose financial statements are consolidated. Certain~~ certain policyholder liabilities ~~also~~ should be adjusted to the extent that liabilities exist for insurance policies that, by contract, credit or charge the policyholders for either a portion or all of the realized gains or losses of specific securities classified as available-for-sale. Further, ~~certain~~ asset amounts that are amortized using the gross-profits method, such as deferred acquisition costs accounted for under paragraph 944-30-35-4 ~~FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments,~~ ~~and the present value of future profits recognized as a result of acquisitions of life insurance enterprises accounted for as purchase business combinations~~ and certain intangible assets arising from insurance contracts acquired in business combinations, should be adjusted to reflect the effects that would have been recognized had the unrealized holding gains and losses actually been realized. Further, capitalized acquisition costs associated with insurance contracts covered by ~~Statement No. 60, Accounting and Reporting by Insurance Enterprises,~~ paragraph 944-30-35-4 should not be adjusted for an unrealized holding gain or loss unless a "premium deficiency" would have resulted had the gain or loss actually been realized.

This announcement should not affect reported net income. It addresses only the adjustment of certain assets and liabilities and the reporting of unrealized holding gains and losses from securities classified as available for sale.

~~The staff would expect registrants to comply with the guidance in this announcement when registrants adopt Statement 115. In addition, the staff~~

~~would expect mutual life insurance enterprises to comply with the guidance in this announcement when those enterprises adopt Statement 115 and FASB Interpretation No. 40, Applicability of Generally Accepted Accounting Principles to Mutual Life Insurance and Other Enterprises.~~

~~Subsequent Developments~~

~~In January 1995, the FASB issued FASB Statement No. 120, Accounting and Reporting by Mutual Life Insurance Enterprises and by Insurance Enterprises for Certain Long-Duration Participating Contracts. Statement 120 extends the requirements of Statements 60 and 97 and FASB Statement No. 113, Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts, to mutual life insurance enterprises, assessment enterprises, and fraternal benefit societies. In addition, Statement 120 defers the effective date of the general provisions of Interpretation 40 to fiscal years beginning after December 15, 1995.~~

~~In June 1997, the FASB issued Statement 130, which amends Statement 115 to requires that unrealized gains and losses on available-for-sale securities be reported in other comprehensive income. The accumulated balance of those changes in value continues to be reported in a separate component of shareholders' equity until realized.~~

10. Based on the amendments made to paragraph 320-10-S99-2 above, amend paragraph 944-20-S99-2, with no link to a transition paragraph, as follows:

> > > SEC Observer Comment: Accounting for Intangible Assets Arising from Insurance Contracts Acquired in a Business Combination ~~the Present Value of Future Profits Resulting from the Acquisition of a Life Insurance Company~~

944-20-S99-2 The following is the text of SEC Observer Comment: Accounting for Intangible Assets Arising from Insurance Contracts Acquired in a Business Combination ~~the Present Value of Future Profits Resulting from the Acquisition of a Life Insurance Company~~.

The SEC staff will require registrants to provide the following disclosures about intangible assets arising from insurance contracts acquired in a business combination ~~PVP assets~~ in filings with the Commission:

1. A description of the registrant's accounting policy

2. An analysis of the intangible assets arising from insurance contracts acquired in a business combination ~~PVP asset~~ account for each year for which an income statement is presented—that analysis should include the intangible assets arising from insurance contracts acquired in a business combination ~~present value of future profits (PVP)~~ balance at the beginning of the year, the amount of ~~PVP~~ additions during the year arising from acquisitions of insurance companies, ~~the amount of interest accrued on the unamortized PVP balance during the year, the interest accrual rate,~~ the amount of amortization during the year, the amount of any write-offs during the year due to impairment and how those write-offs were determined, and the ~~PVP~~ balance at the end of the year

3. The estimated amount or percentage of the end-of-the-year ~~PVP~~ balance of intangible assets arising from insurance contracts acquired in a business combination to be amortized during each of the next five years.

11. Amend paragraph 505-50-S99-1, with no link to a transition paragraph, as follows:

> SEC Staff Guidance

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Grantor Balance Sheet Presentation of Unvested, Forfeitable Equity Instruments Granted to a Nonemployee

505-50-S99-1 The following is the text of SEC Staff Announcement: Grantor Balance Sheet Presentation of Unvested, Forfeitable Equity Instruments Granted to a Nonemployee.

~~Date Discussed: July 19-20, 2000~~

The SEC staff has received inquiries on the appropriate balance sheet presentation of arrangements where unvested, forfeitable equity instruments are issued to an unrelated nonemployee (the counterparty) as consideration for future services. The arrangements addressed by the staff entitle the grantor to recover the specific consideration paid, plus a substantial mandatory penalty, as a minimum measure of damages for counterparty nonperformance. Consequently, pursuant to paragraph 505-50-30-12, ~~Issue~~

~~No. 96-18, "Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services,"~~ sufficiently large disincentives for counterparty nonperformance exist such that a performance commitment and measurement date have been achieved as of the date of issuance. The fair value of these arrangements is measured in accordance with <u>paragraph 505-50-30-6</u> ~~FASB Statement No. 123, Accounting for Stock-Based Compensation~~. Practice appears mixed as to whether such transactions are recorded at the measurement date. Some registrants make no entries until performance occurs, while others record the fair value of the equity instruments as equity at the measurement date and record the offset either as an asset or as a reduction of stockholders' equity (contra-equity). This announcement sets forth the SEC staff's position on the appropriate accounting at the measurement date.

In evaluating the appropriate balance sheet classification for the above arrangements, the staff considered the following guidance:

• <u>Paragraph 505-50-25-4</u> ~~Issue 96-18~~, which states that the <u>guidance</u> ~~Task Force~~ ~~did~~ <u>does</u> not address the period(s) or the manner (that is, capitalize versus expense) in which an enterprise should recognize the fair value of equity instruments that were issued, other than to reach a consensus that an asset or expense should be recognized in the same period(s) and in the same manner (capitalize or expense) as if the enterprise had paid cash for the goods or services instead of issuing equity instruments.

~~• Statement 123, paragraphs 92-96, which provides further insight into the question of when equity has been issued for accounting purposes. Statement 123, paragraph 96 states:~~

~~An equity instrument may be conditionally transferred to another party under an agreement that allows that party to choose at a later date whether to deliver the agreed consideration for it, which may be goods or services rather than cash or financial instruments, or to forfeit the right to the instrument conditionally transferred, with no further obligation. In that situation, the equity instrument is not issued for accounting purposes until the issuing entity has received consideration for it and the condition is thus satisfied.~~

The SEC staff believes that if the issuer receives a right to receive future services in exchange for unvested, forfeitable equity instruments, those equity instruments should be treated as unissued for accounting purposes until the future services are received (that is, the instruments are not considered issued until they vest). Consequently, there would be no recognition at the measurement date and no entry should be recorded. ~~The SEC staff will not enforce compliance with this guidance for arrangements entered into before July 20, 2000.~~

~~This announcement does not apply to similar arrangements in which the issuer exchanges fully vested, nonforfeitable equity instruments as those types of arrangements are being addressed separately by the EITF in Issue No. 00-18, "Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees."~~

~~Subsequent Developments~~

~~FASB Statement No. 123 (revised 2004), Share-Based Payment, was issued in December 2004. Statement 123(R) amends the application of Statement 123 for certain issues. Statement 123(R) does not affect the accounting in this announcement for grantor balance sheet presentation of unvested, forfeitable, equity instruments granted to a nonemployee~~.

12. Amend paragraph 840-30-S99-1, with no link to a transition paragraph, as follows:

> SEC Staff Guidance

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Lessor Consideration of Third-Party Value Guarantees

840-30-S99-1 The following is the text of SEC Staff Announcement: Lessor Consideration of Third-Party Value Guarantees.

~~Date Discussed: May 15, 2003~~

~~The SEC Observer made the following announcement of the SEC staff's position on lessors' application of paragraphs 5(j) and 7(d) of FASB Statement No. 13, Accounting for Leases, to arrangements involving third-party guarantees of the expected residual value of leased property.~~

The SEC staff has been asked to provide its views on a lessor's application of paragraphs ~~5(j)~~ <u>840-10-25-1(d)</u> and ~~7(d) of Statement 13~~ <u>840-10-25-5</u> for certain lease arrangements that involve a guarantee of the expected residual value of leased property by an unrelated third party. These arrangements are common in the equipment leasing industry. For example, an automobile leasing company may obtain a guarantee for the full or partial recovery of the expected residual value of an automobile at the expiration of the lease term from an unrelated third party.

The SEC staff has been asked to consider whether a lessor, when applying paragraph 840-10-25-1(d) ~~7(d) of Statement 13~~ at lease inception, should include, in minimum lease payments, residual value guarantees for a portfolio of leased assets for which settlement is not solely based upon the residual value of the individual leased assets. In such cases, the lessor is economically assured of receiving a minimum residual value for a portfolio of assets that are subject to separate leases but not for each individual asset. Accordingly, when an asset has a residual value in excess of the "guaranteed" amount, such excess is offset against shortfalls in residual value that exist in other assets in the portfolio. The SEC staff believes that residual value guarantees of a portfolio of leased assets preclude a lessor from determining the amount of the guaranteed residual value of any individual leased asset within the portfolio at lease inception and, accordingly, no such amounts should be included in minimum lease payments.

~~If, for leases outstanding as of the balance sheet date, an accounting change is required in order to comply with the requirements of this announcement (for example, to reflect leases as operating leases rather than sales-type or direct financing leases), registrants should restate all prior period financial statements, in a manner akin to that described in paragraph 36 of APB Opinion No. 20, Accounting Changes, not later than the beginning of the first fiscal quarter beginning after December 15, 2003 (January 1, 2004, for a calendar-year company).~~

~~The SEC staff understands that some registrants may wish to modify their third-party residual value guarantees that are the subject of this announcement in order to meet the criteria for sales-type or direct financing lease accounting. If, for leases outstanding as of the date of modification and prior to the adoption of the provisions of this announcement, a lessor modifies its third-party residual value guarantee arrangements, the lessor should apply the guidance in paragraphs 9, 17, and 18 of Statement 13 when evaluating the change. In these cases, if the modified residual value guarantees appropriately result in sales-type or direct financing lease accounting, the SEC staff would not object if the registrant did not restate prior period financial statements for the accounting for such leases. The SEC staff believes that it would be inappropriate to extend this transition method to analogous situations that differ from the arrangement described in the third paragraph of this announcement.~~

The SEC staff also has been asked for its views on situations in which a lessor had not obtained a residual value guarantee at inception, yet had assumed such a guarantee existed when determining the minimum lease payments. The staff would view that situation as an error, which would require restatement as described in ~~paragraph~~ paragraphs 250-10-45-23 and 250-10-50-7~~36 of Opinion 20~~, regardless of whether a residual value guarantee is subsequently obtained.

~~Any financial statements filed with the SEC before adoption of the provisions of this announcement should include disclosures similar to those described in Question 3, "The Impact on an Auditor's Report of an FASB Statement Prior to the Statement's Effective Date," of AICPA AU Section 9410, Adherence to Generally Accepted Accounting Principles: Auditing Interpretations of Section 410, and SEC Staff Accounting Bulletin Topic 11-M, Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of a Registrant When Adopted in a Future Period.~~

13. Amend paragraph 715-20-S99-1, with no link to a transition paragraph, as follows:

> SEC Staff Guidance

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Selection of Discount Rate Used for Measuring Defined Benefit Pension Obligation and Obligations of Postretirement Plans Other than Pensions

715-20-S99-1 The following is the text of SEC Staff Announcement: Selection of Discount Rate Used for Measuring Defined Benefit Pension Obligation and Obligations of Postretirement Plans Other than Pensions.

~~Dates Discussed: September 23, 1993; November 16, 2006~~

The SEC Observer made the following announcement of the SEC staff's position on the selection of discount rates used for purposes of measuring defined benefit pension obligations under paragraph 715-30-35-44 ~~FASB Statement No. 87, Employers' Accounting for Pensions,~~ and obligations of postretirement benefit plans other than pensions under paragraph 715-60-35-80~~FASB Statement No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions~~. Those paragraphs provide guidance for selecting discount rates to measure obligations for pension benefits [EITF D-

36, seq# 3.1] and postretirement benefits other than pensions.[EITF D-36, seq# 3.3]

~~The SEC staff recently questioned a registrant about that registrant's selection of discount rates for purposes of measuring its defined benefit pension obligation under Statement 87. Paragraph 44A of Statement 87 (as amended by FASB Statement No 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans), provides guidance for selecting discount rates to measure defined benefit pension obligations. FN 1~~

~~That paragraph states:~~

~~Pursuant to paragraph 44, an employer may look to rates of return on high-quality fixed-income investments in determining assumed discount rates. The objective of selecting assumed discount rates is to measure the single amount that, if invested at the measurement date in a portfolio of high-quality debt instruments, would provide the necessary future cash flows to pay the pension benefits when due. Notionally, that single amount, the projected benefit obligation, would equal the current market value of a portfolio of high-quality zero coupon bonds whose maturity dates and amounts would be the same as the timing and amount of the expected future benefit payments. Because cash inflows would equal cash outflows in timing and amount, there would be no reinvestment risk in the yields to maturity of the portfolio. However, in other than a zero coupon portfolio, such as a portfolio of long-term debt instruments that pay semiannual interest payments or whose maturities do not extend far enough into the future to meet expected benefit payments, the assumed discount rates (the yield to maturity) need to incorporate expected reinvestment rates available in the future. Those rates shall be extrapolated from the existing yield curve at the measurement date. The determination of the assumed discount rate is separate from the determination of the expected rate of return on plan assets whenever the actual portfolio differs from the hypothetical portfolio above. Assumed discount rates shall be reevaluated at each measurement date. If the general level of interest rates rises or declines, the assumed discount rates shall change in a similar manner.~~

~~Interest rates have been declining and are at their lowest levels in more than a decade.~~ At each measurement date, the SEC staff expects registrants to use discount rates to measure obligations for pension benefits and postretirement benefits other than pensions that reflect the then current level of interest rates. The staff suggests that fixed-income debt securities that receive one of the two highest ratings given by a recognized ratings agency be considered high quality (for example, a fixed-income security that receives a rating of Aa or higher from Moody's Investors Service, Inc.).

14. Amend paragraph 605-20-S99-1, with no link to a transition paragraph, as follows:

> SEC Staff Guidance

> > Announcements Made by SEC Staff at Emerging Issues Task Force (EITF) Meetings

> > > SEC Staff Announcement: Accounting for Management Fees Based on a Formula

605-20-S99-1 The following is the text of SEC Staff Announcement: Accounting for Management Fees Based on a Formula.

~~Date Discussed: April 18-19, 2001~~

The SEC staff has been asked to provide its views on revenue recognition under arrangements (other than those covered by Subtopic 605-35 ~~AICPA Statement of Position 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts~~) that contain a performance-based incentive fee that is not finalized until the end of a period of time specified in the contract. These arrangements are common in the investment advisory and real estate management businesses. For example, an investment advisor may receive a base fee for managing a fund plus a variable incentive fee based on the extent by which the fund's investment performance exceeds a benchmark index, such as the return on the S&P 500. Similarly, a hotel management company may receive a bonus of a portion of any operating income generated above a specified level. ~~FN1~~

~~FN1 Topic No. D-96 Footnote 1—The SEC staff understands that in certain entities within the scope of AICPA Statement of Position No. 78-9, Accounting for Investments in Real Estate Ventures, the manager is the general partner in a partnership and receives fees in the form of partnership allocations. If the general partner manager has been accounting for such arrangements on the equity method in accordance with that SOP, the manager may continue to apply that method.~~

The SEC staff has been asked to consider the accounting for the incentive fee at interim dates before the end of the measurement period specified in the arrangement. The issue arises because of the possibility that fees earned by exceeding performance targets early in the measurement period may be reversed due to missing performance targets later in the measurement period. Consequently, if, for example, a property manager performing services under an arrangement with a one year measurement period records revenue in the first three quarters of the year based on the property exceeding a level of operating profit, it may have to reverse all or a portion of that revenue before year-end if there is an operating loss.

To illustrate, assume the following example:

> Investment Advisor A manages Fund B and is paid a flat fee per month ("base fee"). In addition, Advisor A also will receive 20 percent of Fund B's returns in excess of the return on the S&P 500 for the year. The contract is terminable by either party with reasonable notice at the end of each quarter. In the event of a termination, the amount due for the incentive fee will be calculated at the termination date based on the fund and S&P 500 returns to date. Assume that Fund B's returns exceed the returns of the S&P 500 by $200,000 in the first quarter, $100,000 in the second quarter, and $50,000 in the fourth quarter, and that the return on the fund is $75,000 less than the S&P 500 return in the third quarter. Thus, the total return of Fund B for the year exceeds the comparable S&P 500 return by $275,000. Advisor A's share of the $275,000 is $55,000.

Based on informal surveys received, the SEC staff understands that a majority of property managers and investment advisors apply an accounting policy in which the manager does not record any incentive fee income until the end of the contract year (Method 1). The result of that method in the example is that Advisor A would record $55,000 in incentive fee revenue in the fourth quarter. Other companies record as revenue the amount that would be due under the formula at any point in time as if the contract was terminated at that date (Method 2). Accordingly, Advisor A would record $40,000 of incentive fee revenue in the first quarter and $20,000 in the second quarter. In the third quarter, however, $15,000 of the previously recognized revenue would be reversed in revenue. Finally, $10,000 of incentive fee revenue would be recognized in the fourth quarter.

The SEC staff would not object to either Method 1 or Method 2 as described above; however, the SEC staff considers Method 1 to be the preferable accounting policy. The SEC staff believes that Method 1 is more consistent with the analysis presented in ~~Question 8 of~~ Staff Accounting Bulletin Topic 13.A ~~No. 101, Revenue Recognition in Financial Statements~~, which states that "the staff does not believe that it is appropriate to recognize revenue based upon the probability of a factor being achieved." Furthermore, Method 1 eliminates the potential that revenue will be recognized in one quarter and reversed in a future quarter.

The SEC staff also would not object to Method 2. The calculated revenue may be viewed as realizable at an interim date due to the termination provisions in the arrangement. Furthermore, this approach results in revenue recognition that reflects the performance of the manager-revenue is higher in periods in which the manager's performance has exceeded the specified performance target(s), while revenue is lower in periods in which the manager's performance has not exceeded the specified performance target(s). This method also does not involve a consideration of future performance, as it relies only on the calculated fee at the interim measurement date.

However, some companies apply a variation on Method 2 that the SEC staff would object to. This variation reduces the amount of revenue that would be recognized under Method 2 to the extent management believes it is likely that a portion of the calculated amount will be lost due to future performance. The SEC staff would object to this method because it explicitly considers future performance in determining how much revenue to recognize, which is inconsistent with both the requirement that the fee must be fixed or determinable before revenue is recognized and ~~Question 8~~ ~~of~~ SAB Topic 13.A ~~101~~.

Disclosure

Disclosure of the accounting policy used with regard to these arrangements should be made in accordance with Section 235-10-50 ~~APB Opinion No. 22, Disclosure of Accounting Policies,~~ and SAB Topic 13 ~~101~~. Registrants should disclose whether the company has recorded any revenue that is at risk due to future performance contingencies, the nature of the contracts giving rise to the contingencies, and, if material, the amount of any such revenue recorded.

Variations

The SEC staff has been asked about its views on several variations to the basic fact pattern described in the above example. Although it is not possible to address every situation, the SEC staff is providing the following additional guidance:

Amounts that would be receivable upon termination pursuant to penalty or liquidated damage provisions (that is, amounts in addition to the amount that would be payable under the specified measurement formula) are not an appropriate basis on which to recognize revenue, unless a termination has occurred.

If the customer could avoid all or part of a payment by terminating the contract at will, revenue may only be recorded at an interim date up to the amount that the customer would be required to pay in the event of termination.

If the incentive fee is a fixed amount, rather than a variable amount (for example, a flat fee for exceeding the S&P 500), those applying Method 2 should only recognize revenue in an interim period when the target has been exceeded and should limit the amount of revenue to be recognized to a ratable portion of the fixed incentive payment.

The SEC staff's views would not change if the manager or advisor did not have termination rights during the term of the contract.

The SEC staff would encourage registrants with questions about contracts that are similar to, but vary from, the above example to submit those questions to the SEC staff for pre-clearance.

~~Transition~~

~~The SEC staff would expect all registrants to discuss their accounting policy for revenue recognition in accordance with Opinion 22. The provisions of this announcement should be adopted no later than the beginning of the first fiscal quarter of the fiscal year beginning after December 15, 2001 (January 1, 2002, for a calendar-year company). If an accounting change is required to conform the accounting to the requirements of this announcement, that change should be calculated as of the beginning of the quarter of adoption and presented as a cumulative effect of a change in accounting principle, as described in paragraph 20 of APB Opinion No. 20, Accounting Changes. Early adoption of the provisions of this announcement is permitted. If early adoption occurs in any quarter other than the first quarter of the fiscal year, the registrant should restate prior quarters within the same fiscal year as described in paragraph 10 of FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements. Any financial statements filed with~~

~~the SEC before adoption of the provisions of this announcement should include disclosures similar to those described in Question 3, "The Impact on an Auditor's Report of an FASB Statement Prior to the Statement's Effective Date," of AICPA AU Section 9410, "Adherence to Generally Accepted Accounting Principles: Auditing Interpretations of Section 410," and SEC Staff Accounting Bulletin Topic 11-M, Disclosure of the Impact That Recently Issued Accounting Standards Will Have on the Financial Statements of a Registrant When Adopted in a Future Period.~~

15. Amend paragraph 815-10-S99-3 and its related heading, with no link to a transition paragraph, as follows:

> > > SEC Staff Announcement: Determining the Nature of a Host Contract Related to a Hybrid Instrument Issued in the Form of a Share Under Topic 815~~FASB Statement No. 133~~

815-10-S99-3 The following is the text of SEC Staff Announcement: Determining the Nature of a Host Contract Related to a Hybrid Instrument Issued in the Form of a Share under Topic 815 ~~FASB Statement No. 133~~.

~~Dates Discussed: March 15, 2007~~

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

Consistent with Section 815-15-25 ~~paragraphs 12 and 60 of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities~~, the SEC staff believes that the determination of the nature of the host contract for a hybrid financial instrument issued in the form of a share (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument) should be based on a consideration of economic characteristics and risks. The SEC staff also believes that in performing an evaluation of an embedded derivative feature under paragraph 815-15-25-1(a) ~~12(a) of Statement 133~~, the consideration of the economic characteristics and risks of the host contract should be based on all of the stated or implied substantive terms and features of the hybrid financial instrument. FN 1 In evaluating the stated and implied substantive terms and features, the existence or omission of any single term or feature is not necessarily determinative of the economic characteristics and risks of the host contract (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument). Although the consideration of an individual term or feature may be weighted more heavily in the evaluation, judgment is required based upon an evaluation of all the relevant terms and features. For example, the SEC staff believes that the fact that a preferred stock contract without a mandatory redemption feature would be classified as temporary equity under paragraph 480-10-S99-3A ~~Section Topic D-98~~ is not in and of itself determinative of the nature of the host contract (that is, whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument). Rather, the SEC staff believes that the nature of the host contract depends upon the economic characteristics and risks of the preferred stock contract. FN 2

> FN 1 ~~Topic No. D-109 Footnote 1—~~The "hybrid financial instrument" includes the terms and features pertaining to other embedded derivatives that are separately evaluated under paragraph 815-15-25-1 ~~12 of Statement 133~~. However, the SEC staff understands that as an accounting policy some registrants exclude the terms and features pertaining to the individual embedded derivative being evaluated under paragraph 815-15-25-1 ~~12 of Statement 133~~ in determining the nature of the host contract for that particular embedded derivative.

> FN 2 ~~Topic No. D-109 Footnote 2—~~The SEC staff does not believe the guidance pertaining to the paragraph 815-10-15-74(a) ~~11(a)~~ scope exception in paragraph 815-10-15-76 ~~Statement 133 Implementation Issue No. C2,"Application of the Exception to Contracts Classified in Temporary Equity,"~~ is applicable, by analogy, to the determination of the nature of the host contract under paragraph 815-15-25-1(a) ~~12(a) of Statement 133~~.

This staff announcement is limited to the SEC staff's position regarding the determination of whether a host contract related to a hybrid financial instrument issued in the form of a share is considered to be a debt instrument or an equity instrument for purposes of the evaluation of an embedded derivative (or multiple embedded derivatives) under paragraph 815-15-25-1(a) ~~12(a) of Statement 133~~. It is not intended to address when an embedded derivative (or multiple embedded derivatives) should be separated from the host contract under Topic 815 ~~Statement 133~~ or the accounting under Topic 815 ~~Statement 133~~ when such separation is required. Topic 815 ~~Statement 133 and the related interpretative guidance in the Statement 133 Implementation Issues provide~~ provides the relevant guidance for these matters. For example, paragraphs 815-15-25-24 through 25-25 ~~Statement 133 Implementation Issue No. B19,"Identifying the Characteristics of a Debt Host Contract," provides~~ provide guidance on how an entity determines the characteristics of a debt host contract once a conclusion has been reached that the host contract is a debt instrument.

~~Transition~~

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

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

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

16. Amend paragraph 323-30-S99-1, with no link to a transition paragraph, as follows:

323-30-S99-1 The following is the text of SEC Staff Announcement: Accounting for Limited Partnership Investments.

~~Date Discussed: May 18-19, 1995~~

~~The Task Force discussed a letter received from the SEC Observer that discusses the SEC staff's position on the application of the equity method to investments in limited partnerships. The SEC staff previously had not objected to the use of the cost method for limited partnership investments of up to 20 percent, assuming the investor concluded that it did not have"significant influence" over the investee, as defined in APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock.~~

The SEC staff's ~~revised~~ position on the application of the equity method to investments in limited partnerships is that investments in all limited partnerships should be accounted for pursuant to paragraph 970-323-25-6 ~~paragraph 8 of AICPA Statement of Position 78-9, Accounting for Investments in Real Estate Ventures~~. That guidance requires the use of the equity method unless the investor's interest is so minor that the limited partner may have virtually no influence over partnership operating and financial policies." The SEC staff understands that practice generally has viewed investments of more than 3 to 5 percent to be more than minor. ~~The SEC staff would expect the guidance in SOP 78-9 to be applied to all limited partnership investments made after May 18, 1995.~~

17. Amend paragraph 320-10-S00-1 as follows:

320-10-S00-1 ~~No updates have been made to this subtopic~~<u>The following table identifies the changes made to this Subtopic.</u>

Paragraph Number	Action	Accounting Standards Update	Date
320-10-S99-2	Amended	2010-04	01/15/2010

18. Amend paragraph 323-10-S00-1, by adding the following items to the table, as follows:

323-10-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
323-10-S55-1	Superseded	2010-04	01/15/2010
323-10-S99-3	Superseded	2010-04	01/15/2010

19. Add paragraph 323-30-S00-1 as follows:

<u>**323-30-S00-1** The following table identifies the changes made to this Subtopic.</u>

Paragraph Number	Action	Accounting Standards Update	Date
323-30-S99-1	Amended	2010-04	01/15/2010

20. Amend paragraph 505-50-S00-1, by adding the following items to the table, as follows:

505-50-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
505-50-S99-1	Amended	2010-04	01/15/2010

21. Add paragraph 605-20-S00-1 as follows:

605-20-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
605-20-S99-1	Amended	2010-04	01/15/2010

22. Add paragraph 715-20-S00-1 as follows:

715-20-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
715-20-S99-1	Amended	2010-04	01/15/2010

23. Amend paragraph 805-20-S00-1 as follows:

805-20-S00-1 ~~No updates have been made to this subtopic~~The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
805-20-S99-3	Amended	2010-04	01/15/2010

24. Amend paragraph 805-50-S00-1 as follows:

805-50-S00-1 ~~No updates have been made to this subtopic~~The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
805-50-S99-2	Amended	2010-04	01/15/2010

25. Amend paragraph 815-10-S00-1 as follows:

815-10-S00-1 ~~No updates have been made to this subtopic~~The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
815-10-S45-1	Superseded	2010-04	01/15/2010
815-10-S99-2	Superseded	2010-04	01/15/2010
815-10-S99-3	Amended	2010-04	01/15/2010

26. Add paragraph 815-30-S00-1 as follows:

815-30-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
815-30-S45-1	Superseded	2010-04	01/15/2010

27. Amend paragraph 840-30-S00-1, by adding the following items to the table, as follows:

840-30-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
840-30-S99-1	Amended	2010-04	01/15/2010

28. Add paragraph 855-10-S00-1 as follows:

855-10-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
855-10-S99-2	Amended	2010-04	01/15/2010

29. Add paragraph 944-20-S00-1 as follows:

944-20-S00-1 The following table identifies the changes made to this Subtopic.

Paragraph Number	Action	Accounting Standards Update	Date
944-20-S99-2	Amended	2010-04	01/15/2010