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May 30, 2003

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the May 15, 2003 meeting of the FASB Emerging Issues Task Force (a marked version of the May 20, 2003 draft is also being provided to EITF members only) and an inventory of open issues for the next EITF meeting. After your review, please discard the confidential marked version of the minutes. An updated statistical summary of EITF Issues will be made available on the FASB Website.

Issue 03-5
As you know, based on input from various Task Force members during the minutes process, the FASB staff concluded that the consensus reached by the Task Force needed further clarification and, therefore, the Board was not asked to ratify the consensus on this Issue. The FASB staff will prepare materials for Task Force consideration at the July meeting.

Meeting Time and Location
The next EITF meeting will be held on **Thursday, July 31, 2003** at the FASB offices in Norwalk, Connecticut. The meeting will start at **8:00 a.m.** and conclude no later than **4:00 p.m.** At this time, the FASB staff believes that a one day meeting will be sufficient to cover related discussion materials. However, a decision by the EITF Agenda Committee as to whether the meeting should be extended will be communicated to the Task Force as soon as possible.

EITF Agenda Committee Materials
Descriptions of proposed issues and any other items for EITF consideration should be submitted by no later than **Monday, June 9, 2003**, so that they may be considered by the EITF Agenda Committee and then distributed to Task Force members sufficiently in advance of the meeting.

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

Draft minutes available	**August 5, 2003**
Final minutes available	**August 14, 2003**

Please call me at extension 229 if you have any questions.

Sincerely,

Patrick G. Durbin
Practice Fellow

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MINUTES OF THE MAY 15, 2003 OPEN MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, May 15, 2003

Starting Time:	8:00 a.m.
Concluding Time:	3:30 p.m.

Task Force Members Present:
Lawrence W. Smith (Chairman)
Frank H. Brod
Jack T. Ciesielski
Mitchell A. Danaher
Leland E. Graul
Joseph F. Graziano
John M. Guinan
Stuart H. Harden
David L. Holman
James A. Johnson
David B. Kaplan
Louis W. Matusiak, Jr.
Richard H. Stock
Mark V. Sever (AcSEC Observer)
Scott A. Taub (SEC Observer)

Task Force Members Absent:
None

Others at Meeting Table:
G. Michael Crooch, FASB Board Member
Robert H. Herz, FASB Board Member
Gary S. Schieneman, FASB Board Member
Katherine A. Schipper, FASB Board Member
Edward W. Trott, FASB Board Member
John K. Wulff, FASB Board Member
Shelly C. Luisi, SEC Associate Chief Accountant
Eric J. Schuppenhauer, SEC Professional Accounting Fellow
Patrick G. Durbin, FASB Practice Fellow
James N. Parrott, FASB Practice Fellow
* Jules M. Cassel, FASB Senior Technical Advisor
* Jeffrey D. Cropsey, FASB Project Manager
* Brian F. Degano, FASB Practice Fellow
* Samuel O. Lynn, FASB Practice Fellow
* Gregory S. Martin, FASB Practice Fellow
* Lisa M. Munro, FASB Practice Fellow
* Michael W. Tovey, FASB Practice Fellow
* Theodore S. Baran, PricewaterhouseCoopers LLP[1]
* Robert Uhl, Deloitte & Touche LLP[1]

* For certain issues only.

[1] Member of the Working group for EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease."

ADMINISTRATIVE MATTERS

- The Task Force Chairman expressed gratitude for the advice and counsel of Jackson M. Day during his tenure as SEC Observer to the Task Force.

- The Task Force Chairman announced the finalization of the *EITF Operating Procedures*, noting that the voting procedures now stipulate that a consensus requires the objection of no more than three of the voting members present.

- The Task Force Chairman announced the finalization of an addendum to the March 23, 2003 EITF meeting minutes, which consists of the illustrative examples related to EITF Issue No. 02-9, "Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold," previously distributed to all Task Force members.

- The Task Force discussed the report on the EITF Agenda Committee meeting. The following decisions and recommendations were made by the Agenda Committee:

a. Evaluating Evidence to Support Renewal or Extension When Determining the Useful Life and Estimating the Fair Value of a Recognized Intangible Asset. The Agenda Committee decided to add this issue to the EITF agenda and suggested that the issue's scope should be refined to address the issues surrounding the costs that should be considered in determining whether "substantial cost" is involved and what modifications constitute "material modifications." The Agenda Committee also expressed a desire for the issue to be framed as broadly as possible so as not to restrict the application of that guidance to specific industry situations.

b. Evaluating the Elimination of Cash Flows from the Ongoing Operations of an Entity as a Result of a Disposal Transaction. The Agenda Committee decided not to add this issue to the EITF's agenda at this time but agreed that a number of issues have arisen in practice in applying the criteria in paragraph 42 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Therefore, the Agenda Committee recommended that the FASB staff solicit input from Task Force members on issues related to (1) which cash flows should be considered in determining whether "cash flows of the component have been eliminated" and (2) the threshold for determining "significant continuing involvement" in a disposal component. The Agenda Committee also agreed to reconsider this issue at a future meeting.

c. Applicability of AICPA Statement of Position 97-2, *Software Revenue Recognition*, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software. The Agenda Committee decided to add this Issue to the EITF agenda for discussion at the May 15, 2003 EITF meeting. Refer to discussion of EITF Issue No. 03-5, "Applicability of AICPA Statement of Position 97-2, *Software Revenue Recognition*, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software," elsewhere in these minutes.

d. 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 in EITF Issue No. 90-19, "Convertible Bonds with Issuer Option to Settle for Cash upon Conversion"). The Agenda Committee decided to add this issue to the EITF's agenda, but acknowledged that any guidance developed in this issue could be temporary pending the completion of Phase II of the FASB's Liabilities and Equity project, which is expected to address the issue of bifurcation of instruments containing both debt and equity features. The Agenda Committee acknowledged that an active market exists today for instruments similar to the instrument described in this issue and that it would be worthwhile to provide interim guidance until the Board completes Phase II.

e. EITF Issue No. 98-4, "Accounting by a Joint Venture for Businesses Received at its Formation." The Agenda Committee recommended that this Issue be removed from the EITF's agenda because the Board has addressed an identical issue in its Fresh Start (New Basis) project. The Task Force did not object to the Agenda Committee's recommendation.

- The following comment letters were reported as received (previously distributed to all Task Force members):

a. EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease" (3 comment letters).[1]

b. EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor" (7 comment letters). The Task Force Chairman stated that the FASB staff has considered the issues raised regarding the transition provisions of Issue 02-16, and has concluded that, for an enterprise that had previously adopted the guidance in that Issue on a prospective basis, it would be inappropriate for that enterprise to subsequently report the adoption of that guidance as a cumulative effect of a change in accounting principle.

c. EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments" (9 comment letters).[1]

d. EITF Issue No. 03-4, "Accounting for 'Cash Balance' Pension Plans" (1 comment letter).[1]

- The SEC Observer announced that the SEC staff was aware of the need to update the guidance in *EITF Abstracts*, Topic No. D-98, "Classification and Measurement of Redeemable Securities," as a result of the issuance of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. The SEC staff will work with the FASB staff to codify the appropriate revisions and advised registrants that in the interim, in the event that there is an apparent conflict, the guidance in Statement 150 should be followed.

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

REVISION TO *EITF ABSTRACTS*

Issue No. 00-21

Title: Revenue Arrangements with Multiple Deliverables

Scope Language Revisions

At the May 15, 2003 EITF meeting, the Task Force discussed and finalized certain revisions to the scope language in paragraph 4(a) of Issue 00-21. The purpose of those revisions is to clarify the application of Issue 00-21 to a multiple-deliverable arrangement (or a deliverable(s) in a multiple-deliverable arrangement) that is within the scope of higher-level authoritative literature. Specifically, the revisions clarify that the higher-level literature, to which one or more of the deliverables in an arrangement are subject, falls into one of the following three categories:

1. Higher-level literature that provides guidance regarding separation of the deliverables and allocation of arrangement consideration.
2. Higher-level literature that requires separation of the deliverables that are within the scope of higher-level literature from those that are not, but provides no guidance regarding allocation of the arrangement consideration to the deliverables that are within the scope of higher-level literature and to those that are not.
3. Higher-level literature that provides no guidance regarding the separation of deliverables that are within the scope of that higher-level literature from those that are not, or the allocation of arrangement consideration to the deliverables that are within the scope of the higher-level literature and to those that are not.

The Task Force believes that the following revised scope language adequately addresses the application of Issue 00-21 under each of the three circumstances described above. Accordingly, they agreed that the following language would replace the existing language in paragraph 4(a) currently in *EITF Abstracts*.[1]

> A multiple-deliverable arrangement or a deliverable(s) in a multiple-deliverable arrangement may be within the scope of higher-level authoritative literature.[1] That higher-level authoritative literature (including, but not limited to, Statements 13, 45, and 66; Interpretation 45; Technical Bulletin 90-1; and SOPs 81-1, 97-2, and 00-2) (referred to hereinafter as "higher-level literature") may provide guidance with respect to whether and/or how to allocate consideration of a multiple-deliverable arrangement. The following describes the three categories into which that higher-level literature falls and the application of this Issue or the higher-level literature in determining separate units of accounting and allocating arrangement consideration:

[1] For an enterprise that adopted the consensuses in this Issue prior to the May 15, 2003 meeting, the revised guidance in paragraph 4(a) should be treated as a new consensus subject to the transition and effective date provisions in *EITF Abstracts*, Topic No. D-1, "Implications and Implementation of an EITF Consensus," as revised at the May 15, 2003 meeting.

i. If higher-level literature provides guidance regarding the determination of separate units of accounting and how to allocate arrangement consideration to those separate units of accounting, the arrangement or the deliverable(s) in the arrangement that is within the scope of that higher-level literature should be accounted for in accordance with the relevant provisions of that literature rather than the guidance in this Issue.

ii. If higher-level literature provides guidance requiring separation of deliverables within the scope of higher-level literature from deliverables not within the scope of higher-level literature, but does not specify how to allocate arrangement consideration to each separate unit of accounting, such allocation should be performed on a relative fair value basis using the entity's best estimate of the fair value of the deliverable(s) within the scope of higher-level literature and the deliverable(s) not within the scope of higher-level literature.[2,3] Subsequent accounting (identification of separate units of accounting and allocation of value thereto) for the value allocated to the deliverable(s) not subject to higher-level literature would be governed by the provisions of this Issue.

iii. If higher-level literature provides no guidance regarding the separation of the deliverables within the scope of higher-level literature from those deliverables that are not or the allocation of arrangement consideration to deliverables within the scope of the higher-level literature and to those that are not, then the guidance in this Issue should be followed for purposes of such separation and allocation.[4] In such circumstances, it is possible that a deliverable subject to the guidance of higher-level literature does not meet the criteria in paragraph 9 of this Issue to be considered a separate unit of accounting. In that event, the arrangement consideration allocable to such deliverable should be combined with the amount allocable to the other applicable undelivered item(s) within the arrangement. The appropriate recognition of revenue should then be determined for those combined deliverables as a single unit of accounting.

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[1] Whether a deliverable(s) is within the scope of higher-level authoritative literature is determined by the scope provisions of that literature, without regard to the order of delivery of that item in the arrangement. The term *higher-level literature* refers to categories (a) and (b) of the generally accepted accounting principles (GAAP) hierarchy as defined in AICPA Statement on Auditing Standards No. 69, *The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report*. EITF consensuses represent category (c) of the hierarchy.

[2] Solely for purposes of the allocation between deliverables within the scope of higher-level literature and deliverables not within the scope of higher-level literature, an entity's best estimate of fair value is not limited to vendor-specific objective evidence of fair value or third-party evidence of fair value, as those concepts are discussed in paragraph 16 of this Issue.

[3] For example, leased assets are required to be accounted for separately under the guidance of Statement 13. Consider an arrangement that includes the lease of equipment under an operating lease, the maintenance of the leased equipment throughout the lease term (executory cost), and the sale of additional equipment unrelated to the leased equipment. The arrangement consideration should be allocated between the Statement 13 deliverables and the non-Statement 13 deliverables on a relative fair value basis using the entity's best estimate of fair value of the Statement 13 and non-Statement 13 deliverables. (Although Statement 13 does not provide guidance regarding the accounting for executory costs, it does provide guidance regarding the allocation of arrangement

consideration between the lease and the executory cost elements of an arrangement. Therefore, this example refers to the leased equipment and the related maintenance as Statement 13 deliverables.) The guidance in Statement 13 would then be applied to separate the maintenance from the leased equipment and to allocate the related arrangement consideration to those two deliverables. This Issue would be applied to further separate any non-Statement 13 deliverables and to allocate the related arrangement consideration.

[4] For example, SOP 81-1 provides separation and allocation guidance (segmentation provisions) for deliverables within its scope. However, SOP 81-1 does not provide separation and allocation guidance between SOP 81-1 deliverables and non-SOP 81-1 deliverables. Consider an arrangement that includes designing complex electronic equipment, manufacturing complex electronic equipment (both SOP 81-1 deliverables), and providing the service of running the equipment for a fixed period of time once the equipment is designed, manufactured, and placed in service (a non-SOP 81-1 deliverable). This Issue would be applied to identify separate units of accounting and to allocate arrangement consideration to those separate units of accounting. If applying the guidance in this Issue results in the separation of the design and manufacture of the equipment from the service of running the equipment, the segmentation provisions of SOP 81-1 would be used to determine if it is appropriate to further segment the design deliverables from the manufacture deliverables in accordance with its segmentation provisions. If this Issue prohibits separation of the SOP 81-1 deliverables from the non-SOP 81-1 deliverables, then the amounts otherwise allocable to the design and manufacture deliverables and to the service of running the equipment should be combined. The appropriate recognition of revenue should then be determined for those combined deliverables as a single unit of accounting.

Revision to Example 8 in Exhibit 00-21B

At the May 15, 2003 EITF meeting, the Task Force reached a consensus on EITF Issue No. 03-5, "Applicability of AICPA Statement of Position 97-2, *Software Revenue Recognition*, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software." That consensus requires that, in an arrangement that contains software that is more than incidental to the products or services as a whole, all software deliverables and all non-software deliverables in the arrangement that meet certain criteria are within the scope of SOP 97-2. Example 8 of Issue 00-21 involves the sale of a computer system that consists of a CPU, monitor, and keyboard. The Task Force agreed that the following revision should be made to the first paragraph of Example 8 to clarify that, in that example, the CPU does not include more-than- incidental software, and, therefore, is not subject to SOP 97-2 (additions are underscored):

Example 8—Sale of Computer System

Company B sells computer systems. On April 20, a customer purchases a computer system from Company B for $1,000. The system consists of a CPU, a monitor, and a keyboard. <u>Solely for purposes of simplifying this illustration of the application of the guidance in this Issue, it is assumed that the CPU does not include software that is more-than-incidental to the products in the arrangement; therefore, the provisions of SOP 97-2 do not apply.</u> On April 30, Company B delivers the CPU to the customer without the monitor or keyboard. Each of the items can be purchased separately at a cost of $700 for the CPU, $300 for the monitor, and $100 for the keyboard. The CPU could function with monitors or keyboards manufactured by others, who have them readily available. The customer is entitled to a refund equal to the separate price of any item composing the system that is not delivered. The arrangement does not include any general rights of return. Company B is evaluating whether delivery of the CPU represents a separate unit of accounting.

REVISION TO *EITF ABSTRACTS*

Topic No. D-1

Title: Implications and Implementation of an EITF Consensus

In connection with the recent finalization of the *EITF Operating Procedures*, the Task Force Chairman announced the following revisions to Topic D-1. For convenience, Topic D-1 is included below in its entirety (additions are underscored).

Topic No. D-1

Topic: Implications and Implementation of an EITF Consensus

Dates Discussed: September 25, 1984; February 14, 1985; December 3-4, 1986; March 10, 1988; November 21, 2002; January 23, 2003; May 15, 2003

Task Force members discussed the implications of a Task Force consensus on an accounting issue. The Task Force Chairman stated that the Task Force was not intended to be an accounting-standards-setting body. He summarized that the primary purpose of the Task Force was to identify emerging accounting issues and to advise the FASB staff on whether the issues require FASB action. He noted that the Task Force might reach a consensus that the accounting for a particular transaction or issue is clear or that a particular transaction or issue is analogous to a transaction or issue for which the accounting is already clear, such that a consistent accounting practice will evolve. Either consensus would obviate the need for FASB action. [Note: See Subsequent Developments section below.]

The SEC Observer stated that he believes a Task Force consensus will set the tone for future accounting and that he will question SEC registrants' accounting practices that differ from a Task Force consensus. He stated that he does not expect that a consensus of the Task Force will normally result in a challenge of the accounting followed in good faith in previously filed financial statements, but that such decisions will have to be made on a case-by-case basis. He noted that the staff of the SEC has always sought advice on accounting matters and that the EITF provides an opportunity to seek advice in a public forum.

In response to a request for information regarding the method of implementation of a Task Force consensus, the Task Force Chairman reported that the majority of Task Force members would permit a change in accounting method to adopt a Task Force consensus to be applied prospectively. The Task Force Chairman indicated that the FASB staff's analysis of this issue was that APB Opinion No. 20, *Accounting Changes*, would require a cumulative catch-up adjustment approach to implementing a Task Force consensus, and he asked for suggestions as to how this issue could be resolved. Task Force members suggested several approaches to the issue, and the Task Force Chairman indicated that the FASB staff would explore those alternatives.

The Task Force discussed the relationship of an EITF consensus and an FASB Technical Bulletin. Several Task Force members expressed concern that inclusion of an EITF consensus in an FASB Technical Bulletin might lead to the appearance that there are two classes of EITF consensuses—those that have been endorsed by the FASB in a Technical Bulletin and those that have not. Task Force members acknowledged that inclusion in a Technical Bulletin enhances the retrievability of an accounting position; however, they expressed a preference for incorporating the topical index for *EITF Abstracts* into the separate *Index to Original Pronouncements* and the topical indexes to *Current Text* and *Original Pronouncements* so users of those publications would be aware of other relevant material. The Task Force Chairman indicated that the FASB staff is exploring alternatives to integrate various indexes and to enhance the retrievability of EITF issues. He requested input from Task Force members regarding possible improvements.

Subsequent Developments

The topical index for *EITF Abstracts* was incorporated into the topical index for *Current Text* in the June 1, 1988 softbound edition. A combined index that includes *Original Pronouncements*, *Current Text*, *EITF Abstracts*, and the Q&A Special Reports was added to both the *Original Pronouncements* and *Current Text* in the June 1, 1989 softbound edition.

In January 1992, the AICPA issued Statement on Auditing Standards (SAS) No. 69, *The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report*, which revises the generally accepted accounting principles (GAAP) hierarchy. The application of EITF consensuses (category c of the hierarchy) effective after March 15, 1992 is mandatory under SAS 69. EITF consensuses issued before March 16, 1992 become effective in the hierarchy for initial application of an accounting principle after March 15, 1993.

In November 1992, the FASB issued FASB Statement No. 111, *Rescission of FASB Statement No. 32 and Technical Corrections*. Statement 111 amends FASB Interpretation No. 20, *Reporting Changes under AICPA Statements of Position*, which extends the provisions of paragraph 4 of Opinion 20, to include AICPA Statements of Position. Statement 111 further extends those provisions to EITF consensuses. Paragraph 5 of Interpretation 20 as amended states:

> For purposes of applying *APB Opinion No. 20*, an enterprise making a change in accounting principle to conform with the recommendations of an AICPA statement of position or practice bulletin, an FASB technical bulletin, or a consensus of the FASB

> Emerging Issues Task Force (EITF) shall report the change as specified in the pronouncement. If the pronouncement does not specify the manner of reporting a change in accounting principle to conform with its recommendations, an enterprise making a change in accounting principle to conform with the recommendations of the pronouncement shall report the change as specified by Opinion 20, except that EITF consensuses may be applied prospectively to future transactions unless otherwise stated.

Paragraph 27 of Statement 111 explains this amendment by stating that "unless a consensus specifies the manner of reporting a change in accounting principle, an enterprise making a change in accounting principle to conform with an EITF consensus may apply the consensus prospectively to future transactions or may apply the provisions of Opinion 20 to prior transactions."

In June 1995, the FASB Committee to Review the EITF published its 10-year review of the EITF. That report recommended that the EITF consensuses be cross-referenced in *Original Pronouncements* and *Current Text*. The Committee's intent is to better communicate the authority of EITF consensuses and to make them "easier to use in relation to pronouncements to which they relate." In response to that recommendation, the June 1, 1996 softbound edition of *Original Pronouncements* and *Current Text* includes cross-references to EITF Issues. In *Original Pronouncements*, the status pages of applicable pronouncements have been updated to reflect either the impact of a given pronouncement on an EITF Issue (for example, resolves, nullifies, or affects that Issue) or the relationship of an EITF Issue to a given pronouncement (for example, interpretive or related). In *Current Text*, a list of EITF Issues that provide supplemental guidance on a topic has been added to each applicable topic. Those EITF Issues may be either interpretive of or related by topic to the guidance in that section. For paragraphs where an EITF Issue(s) provides interpretive guidance, a note is added to alert the reader to that guidance.

At the November 21, 2002 meeting, the Task Force Chairman announced that beginning with the January 2003 EITF Agenda Committee meeting, two FASB Board members will become Agenda Committee members. In addition, beginning with the January 23, 2003 EITF meeting, all EITF consensuses will be subject to FASB Board ratification. That ratification will occur at a public Board meeting approximately two weeks following each EITF meeting.

At the January 23, 2003 meeting, the Task Force Chairman announced that in addition to the procedural changes announced at the November 21, 2002 meeting, the following changes to the EITF operating procedures were effective:

- A quorum is two-thirds of voting members or their approved substitutes.
- A consensus of the Task Force requires that no more than one-third of the voting members or approved substitutes present at the meeting object to a

proposed position on an Issue [see subsequent modification in the following paragraph].

At the May 15, 2003 meeting, the Task Force Chairman announced a further modification to the operating procedure revisions announced at the January 23, 2003 meeting: a consensus of the Task Force requires that no more than three voting members object to a proposed position on an Issue. Also at the May 15, 2003 meeting, the Task Force Chairman announced that, unless otherwise specified, the effective date for an EITF consensus shall be for transactions or arrangements entered into after the beginning of an entity's next reporting period beginning after the date of Board ratification of that consensus.[1,2] For purposes of determining any cumulative effect of adopting a consensus, that determination must be made as of the beginning of the fiscal year containing the fiscal period during which the consensus becomes effective.[3] The Task Force will consider any unique transition or effective date considerations relevant to a particular consensus on a case-by-case basis.

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[1] In the next technical corrections Statement issued by the FASB, the last sentence of paragraph 5 of Interpretation 20 will be modified to reflect that decision.

[2] For public entities that issue interim financial statements, that next reporting period will be the next interim period. For nonpublic entities, that next reporting period will be the next fiscal year.

[3] APB Opinion No. 28, *Interim Financial Reporting*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, provide guidance on reporting accounting changes in interim financial statements.

Topic D-107

SEC Staff Announcement

Topic: Lessor Consideration of Third-Party Residual 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) and 7(d) of Statement 13 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 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 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*.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 01-8

Title: Determining Whether an Arrangement Contains a Lease

Dates Discussed: January 23–24, 2002; June 19–20, 2002; September 11-12, 2002; January 23, 2003; March 20, 2003; May 15, 2003

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

FASB Statement No. 23, *Inception of the Lease*

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

FASB Statement No. 98, *Accounting for Leases*

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

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

FASB Statement No. 141, *Business Combinations*

FASB Interpretation No. 21, *Accounting for Leases in a Business Combination*

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

FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*

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

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

International Accounting Standards 17, *Leases*

International Financial Reporting Interpretations Committee Draft Interpretation, "Determining Whether an Agreement Contains a Lease"

Introduction

1. Prior to its rescission, EITF Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities,"[1] required that when the trading criteria in the consensus were met, energy contracts (including energy-related contracts such as capacity contracts, requirements contracts, and transportation contracts) were to be accounted for at fair value. Paragraph 5 of that Issue stated, however, that "in certain circumstances, transportation and other energy-related contracts may represent lease transactions that should be accounted for in accordance with Statement 13 and, therefore, are not within the scope of this Issue," and went on to state that "the determination of whether a transportation contract or some other type of energy-related contract is a lease is a judgmental decision based on the substance of each contract."

2. In connection with the discussion of EITF Issue No. 00-17, "Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10,"[2] the Task Force reiterated the observation that in certain circumstances, transportation and other energy-related contracts may represent lease transactions that should be accounted for in accordance with Statement 13. At the July 19–20, 2000 meeting, the Task Force agreed to add to the EITF agenda a separate issue to provide guidance for use in determining whether an energy-related contract should be considered a lease subject to the requirements of Statement 13. At the September 20, 2001 meeting, the Task Force agreed to form a working group to address this Issue and subsequently agreed to expand the Issue to address all arrangements, not just those involving energy trading contracts.

Issue

3. The issue is how to determine whether an arrangement contains a lease that is within the scope of Statement 13.

Prior EITF Discussion

4. At the January 23–24, 2002 meeting, the FASB staff reported on the November 5, 2001 and December 17, 2001 meetings of the Working Group. The Working Group agreed that the evaluation of whether an arrangement conveys the right to use property, plant, or equipment should be based on the substance of an arrangement and that the property that is the subject of a lease must be specified (explicitly or implicitly) either at inception of the arrangement or at the beginning of the lease term. The Working Group generally agreed that when property, plant, or equipment is explicitly identified and the benefits of the property, plant, or equipment are conveyed based on the passage of time, the arrangement is likely a lease. The difficulty in determining whether an arrangement is a lease arises when the property, plant, or equipment is

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[1] At its October 25, 2002 meeting, the Task Force reached a consensus on EITF Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," to rescind Issue 98-10 and the related interpretive guidance of EITF Issue No. 00-17, "Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10," and *EITF Abstracts*, Topic No. D-105, "Accounting in Consolidation for Energy Trading Contracts between Affiliated Entities When the Activities of One but Not Both Affiliates Are within the Scope of Issue No. 98-10." However, the scope of this Issue was expanded to include all arrangements, not just energy trading contracts, because of the diversity in practice in determining whether an arrangement contains a lease.

[2] Refer to footnote 1.

not explicitly identified and/or the benefits of property, plant, or equipment are conveyed based on the output of the property, plant, or equipment.

5. The Working Group discussed certain characteristics that must be present in an arrangement in order for the arrangement to be a lease but did not propose a recommendation to the Task Force. The FASB staff noted that the Working Group's discussions to date have focused on how to determine whether an arrangement conveys the right to control the use of specified property, plant, or equipment when the purchaser receives some or all of the output from the property, plant, or equipment. The Working Group expects to further consider that issue as well as the issue of how to determine whether property, plant, or equipment has been *implicitly* specified in an arrangement and whether a lease must convey some of the benefits and risks incident to ownership. The Task Force expressed support for the general direction of the Working Group's discussions to date.

6. At the June 19–20, 2002 meeting, the Task Force discussed the Working Group recommendations for this Issue. Based on those recommendations, the Task Force reached a tentative conclusion that was later revised at the January 23, 2003 meeting. (See paragraph 8.)

7. The Task Force discussed whether an undivided interest in property, plant, or equipment could be the subject of a lease. That is, whether an undivided interest holder would have the ability to control the use of a portion of specified property, plant, or equipment[3] (on either a pro rata or non–pro rata basis) and, if so, whether such a right can be conveyed (leased) by the undivided interest holder. The Task Force reached a tentative conclusion that an undivided interest in property, plant, or equipment may be the subject of a lease. However, at the September 11–12, 2002 meeting, the Task Force withdrew its prior tentative conclusion that an undivided interest in property, plant, or equipment may be the subject of a lease. Some Task Force members suggested that a portion of property, plant, or equipment (including an undivided interest) may be the subject of a lease only if that portion is a separate functional unit (for example, one floor of an office building). The Task Force requested that the Working Group prepare a draft abstract for approval by the Task Force at its next meeting that addresses the following points:

a. The meaning of "separate functional unit"
b. Whether the fact that any party, other than the purchaser of output, controls the use of the property, plant, or equipment should be determinative that the arrangement is not a lease within the scope of Statement 13
c. Issues raised in the comment letters received to date
d. Transition issues
e. Examples applying the consensus.

8. At the January 23, 2003 meeting, the Task Force discussed a revised Working Group recommendation that was based on the tentative conclusion reached at the June 19–20, 2002 meeting. The Task Force reached a tentative conclusion that the following model should be used in determining whether an arrangement contains a lease.

[3] The *specified property, plant, or equipment* may be the undivided interest in property, plant, or equipment.

The evaluation of whether an arrangement contains a lease within the scope of Statement 13 should be based on the substance of the arrangement. Paragraph 1 of Statement 13 defines a lease as:

> . . . an agreement conveying the *right to use* property, plant, or equipment (land and/or depreciable assets) usually *for a stated period of time*. It includes agreements that, although not nominally identified as leases, meet the above definition, such as a "heat supply contract" for nuclear fuel.[1] This definition does not include agreements that are contracts for services that do not transfer the right to use property, plant, or equipment from one contracting party to the other. On the other hand, agreements that do transfer the right to use property, plant, or equipment meet the definition of a lease for purposes of this Statement even though substantial services by the contractor (lessor) may be called for in connection with the operation or maintenance of such assets. [Emphasis added.]
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> [1]Heat supply (also called "burn-up") contracts usually provide for payments by the user-lessee based upon nuclear fuel utilization in the period plus a charge for the unrecovered cost base. The residual value usually accrues to the lessee, and the lessor furnishes no service other than the financing.[4]

Property, plant, or equipment

Property, plant, or equipment, as used in Statement 13, includes only land and/or depreciable assets. Therefore, inventory (including equipment parts inventory) and minerals, precious metals, or other natural resources cannot be the subject of a lease for accounting purposes because those assets are not depreciable. Additionally, intangibles (for example, motion picture film licensing rights or workforce) and rights to minerals, precious metals, or other natural resources are not depreciable assets (they are amortized or depleted) so they may not be the subject of a lease.[5]

Although specific property, plant, or equipment may be explicitly identified in an arrangement, it is not the subject of a lease if fulfillment of the arrangement is not dependent on the use of the specified property, plant, or equipment. For example, if the owner/seller is obligated to deliver a specified quantity of goods or services and has the right and ability to provide those goods or services using other property, plant, or equipment not specified in the arrangement,[6] then fulfillment of the arrangement is not dependent on the specified property, plant, or equipment and the arrangement does not contain a lease. The owner/seller's obligation and ability to substitute other property, plant, or equipment

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[4] Paragraph 64 of Statement 13 also notes that "the Board's conclusion that nuclear fuel leases meet the definition of a lease as expressed in paragraph 1 is based on the fact that under present generally accepted accounting principles a nuclear fuel installation constitutes a depreciable asset. Thus, a nuclear fuel lease conveys the right to use a depreciable asset. . . ."

[5] Paragraph 1 of Statement 13 states that "this Statement does not apply to lease agreements concerning the rights to explore for or to exploit natural resources such as oil, gas, minerals, and timber. Nor does it apply to licensing agreements for items such as motion picture films, plays, manuscripts, patents, and copyrights."

[6] Other property, plant, or equipment not specified in the arrangement may include property, plant, or equipment owned or controlled by the owner/seller, or it may include a third party's property, plant, or equipment (for example, when the owner/seller purchases goods or services in the spot market to fulfill its obligation under the arrangement).

pursuant to a warranty obligation[7] do not preclude lease treatment. In addition, an owner/seller's obligation (contingent or otherwise) or ability to substitute other property, plant, or equipment for any reason on or after a specified date does not preclude lease treatment prior to the date of substitution.

Property, plant, or equipment has been implicitly specified if, for example, the seller owns or leases only one asset with which to fulfill the obligation (and it is not economically feasible or practicable for the owner/seller to perform its obligation through the use of alternative property, plant, or equipment).

Right to use property, plant, or equipment

An arrangement conveys the *right to use* property, plant, or equipment if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying property, plant, or equipment. The right to control the use of the underlying property, plant, or equipment is conveyed if the purchaser has the ability or right to do any one of the following:

a. Operate the property, plant, or equipment or direct others to operate the property, plant, or equipment in a manner it determines while obtaining or controlling the output or other utility of the property, plant, or equipment, [8]
b. Control physical access to the underlying property, plant, or equipment, or
c. Take substantially all of the output or other utility expected to be produced or generated by the property, plant, or equipment for the term of the arrangement, unless both of the following conditions are met:
    i. The price that the purchaser will pay for the output is either fixed per unit of output or indexed to market prices of the output.
    ii. The arrangement requires the owner/seller to pay substantive damages, based on the then-current market prices, to the purchaser if it fails to deliver,[9] and the owner/seller is a substantive entity with the financial ability to fulfill its obligations under the arrangement.

[7] For example, in order to substitute the same or similar property, plant, or equipment when the specified property, plant, or equipment is not operating properly.

[8] The purchaser's ability to operate the property, plant, or equipment may be evidenced by (but is not limited to) the purchaser's ability to hire, fire, or replace the property's operator or the purchaser's ability to specify significant operating policies and procedures in the arrangement with the owner/seller having no ability to change such policies and procedures. A requirement to follow "prudent operating practices" (or other similar requirements) generally does not convey the right to control the underlying property, plant, or equipment. Similarly, a contractual requirement designed to enable the purchaser to monitor or ensure the seller's compliance with performance, safety, pollution control, or other general standards generally does not establish control over the underlying property, plant, or equipment.

[9] In other words, the owner/seller is obligated to pay market-based liquidating damages over the term of the arrangement to compensate the purchaser for actual losses incurred as a result of the buyer's having to locate an alternative supply of the item required to be delivered from the specified property, plant, or equipment.

Timing of assessment

The assessment of whether an arrangement contains a lease should be made at inception of the arrangement based on all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after inception of the arrangement should only be made if the arrangement is significantly modified.[10] Changes in circumstances (for example, changes in the productivity of the property, plant, or equipment when the purchaser's right to output is capped) do not modify the arrangement.

9. The Task Force instructed the Working Group to draft an abstract for approval by the Task Force at its March 20, 2003 meeting. The Task Force requested that the Working Group address the following points:

a. The interaction, if any, between Statement 13 and Statement 133 and what differentiates each Statement when applied to arrangements contemplated by this Issue
b. How the "substantially all" criterion of the proposed recommendation (in paragraph 8, above) is applied.

The Task Force also requested that the Working Group provide additional examples applying the proposed recommendation, propose guidance on transition, and provide a basis for its recommendations to be included in the abstract.

10. At the March 20, 2003 meeting, the FASB staff presented the Working Group's recommendations regarding transition, the timing of when an assessment is made, how the "substantially all" criterion is applied, and the interaction between Statement 13 and Statement 133 for arrangements that have attributes of both a lease and a derivative. The Task Force agreed to continue consideration of the general approach developed by the Working Group based on the previous tentative conclusion and certain subsequent Working Group recommendations. Several Task Force members expressed concern with the operationality of that approach and questioned whether the purchaser would have access to the information necessary to make the assessments required by that approach. Other Task Force members were still concerned with how the "substantially all" criterion (criterion (c) in the tentative conclusion) would be applied, while a few members suggested that that criterion should be eliminated altogether. The Task Force instructed the Working Group to:

a. Consider ways to improve the operationality of the tentative conclusion including whether the "substantially all" portion of the tentative conclusion should be based on estimated output or existing capacity
b. Consider whether the liquidating damages criterion (paragraph (c)(ii) in the tentative conclusion in paragraph 8 above) should be retained
c. Recommend guidance regarding how the lease portion of an arrangement should be separated from the entire arrangement.

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[10] A significant modification to an arrangement is one in which the determination that an arrangement contains a lease (or does not contain a lease) would change from the previous determination using the modified arrangement and the circumstances that existed at inception.

The Task Force Chairman requested that Task Force members provide the FASB staff with any other suggestions or comments for Working Group consideration in order to further refine and clarify the approach outlined in the tentative conclusion.

Current EITF Discussion

11. At the May 15, 2003 EITF meeting, the Task Force reached a consensus that the guidance in the attached abstract, included as Appendix 01-8A, should be used to determine whether an arrangement contains a lease that is within the scope of Statement 13.

12. The Task Force discussed how arrangement consideration should be allocated among separate units of accounting when the arrangement includes a lease and other non-lease elements. At issue is whether, in determining the minimum lease payments, *all* products and services provided by the lessor in a multiple element arrangement are considered *executory costs* as that term is used in Statement 13 and, therefore, should be deducted from total consideration that the lessee is obligated to make or can be required to make in connection with the leased property. The Task Force reached a consensus that substantial services (other than insurance, maintenance, and taxes) provided by the lessor (for example, significant operating services) are not executory costs within the scope of Statement 13. If an arrangement contains a lease and related executory costs, as well as other non-lease elements, the classification, recognition, measurement, and disclosure requirements of Statement 13 shall be applied by both the purchaser and the supplier to the lease element of the arrangement. Other elements of the arrangement not within the scope of Statement 13 should be accounted for in accordance with other applicable generally accepted accounting principles. For purposes of applying Statement 13, payments and other consideration called for by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into (a) those for the lease, including the related executory costs and profits thereon, and (b) those for other services on a relative fair value basis consistent with the guidance in paragraph 4(a) of EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables."

13. The consensus in this Issue should be applied to (a) arrangements agreed to or committed to,[11] if earlier, after the beginning of an entity's next reporting period beginning after May 28, 2003, (b) arrangements modified after the beginning of an entity's next reporting period beginning after May 28, 2003, and (c) arrangements acquired in business combinations initiated after the beginning of an entity's next reporting period beginning after May 28, 2003. Arrangements that are determined to be leases based on application of this Issue are not subject to EITF Issue No. 97-10, "The Effect of Lessee Involvement in Asset Construction," if the construction project was *committed to*[12] prior to May 28, 2003, provided that construction has commenced by December 31, 2004.

Status

14. No further EITF discussion is planned.

[11] Consistent with paragraph 5(b) of Statement 13, as amended.
[12] Consistent with the use of that phrase in Issue 97-10.

Appendix 01-8A

ABSTRACT FOR ISSUE NO. 01-8

Title: Determining Whether an Arrangement Contains a Lease

Dates Discussed: January 23–24, 2002; June 19–20, 2002; September 11–12, 2002; January 23, 2003; March 20, 2003; May 15, 2003

References: FASB Statement No. 13, *Accounting for Leases*
FASB Statement No. 23, *Inception of the Lease*
FASB Statement No. 66, *Accounting for Sales of Real Estate*
FASB Statement No. 98, *Accounting for Leases*
FASB Statement No. 109, *Accounting for Income Taxes*
FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*
FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*
FASB Statement No. 141, *Business Combinations*
FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*
FASB Interpretation No. 21, *Accounting for Leases in a Business Combination*
FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*
FASB Concepts Statement No. 6, *Elements of Financial Statements*
FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*
AICPA Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*
International Accounting Standard 17, *Leases*
International Accounting Standard 17, *Leases*
International Financial Reporting Interpretations Committee Draft Interpretation, "Determining Whether an Agreement Contains a Lease"

ISSUE

1. Prior to its rescission, Issue No. 98-10, "Accounting for Contracts Involved in Energy Trading and Risk Management Activities,"[1] required that when the trading criteria in the consensus are met, energy contracts (including energy-related contracts such as capacity contracts, requirements contracts, and transportation contracts) should be accounted for at fair value. Paragraph 5 of that Issue stated, however, that "in certain circumstances, transportation and other energy-related contracts may represent lease transactions that should be accounted for in accordance with Statement 13 and, therefore, are not within the scope of this Issue," and went on to state that "the determination of whether a transportation contract or some other type of energy-related contract is a lease is a judgmental decision based on the substance of each contract."

2. In connection with the discussion of Issue No. 00-17, "Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10,"[2] the Task Force reiterated the observation that in certain circumstances, transportation and other energy-related contracts may represent lease transactions that should be accounted for in accordance with Statement 13. At the July 19-20, 2000 meeting, the Task Force agreed to add Issue 01-8 to the EITF agenda as a separate issue to provide guidance for use in determining whether an energy-related contract should be considered a lease subject to the requirements of Statement 13. At the September 20, 2001 meeting, the Task Force agreed to form a working group to address this Issue and subsequently agreed to expand the Issue to address all arrangements, not just those involving energy trading contracts.

3. The issue is how to determine whether an arrangement contains a lease that is within the scope of Statement 13.

4. In applying this Issue, separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.

5. Leases that are within the scope of Statement 13 are not derivative instruments subject to Statement 133, although a derivative embedded in a lease may be subject to the requirements of Statement 133.

6. This Issue does not address whether an undivided interest or a pro rata portion of property, plant, or equipment could be the subject of a lease. That is, the issue of how to determine when a

[1] At its October 25, 2002 EITF meeting, the Task Force reached a consensus on Issue No. 02-3, "Issues Involved in Accounting for Derivative Contracts Held for Trading Purposes and Contracts Involved in Energy Trading and Risk Management Activities," to rescind Issue 98-10 and the related interpretive guidance of Issue No. 00-17, "Measuring the Fair Value of Energy-Related Contracts in Applying Issue 98-10," and Topic No. D-105, "Accounting in Consolidation for Energy Trading Contracts between Affiliated Entities When the Activities of One but Not Both Affiliates Are within the Scope of Issue No. 98-10." However, the scope of this Issue was expanded to include all arrangements, not just energy trading contracts, because of the diversity in practice in determining whether or not an arrangement contains a lease.

[2] Refer to footnote 1.

component part of property, plant, or equipment is itself property, plant, or equipment for purposes of applying Statement 13 is not the subject of this Issue. Nevertheless, arrangements that identify a physically distinguishable portion of property, plant, or equipment are within the scope of this Issue.

EITF DISCUSSION

7. The Task Force reached a consensus that the guidance beginning in paragraph 8 should be used to determine whether an arrangement contains a lease that is within the scope of Statement 13. Examples illustrating the application of the guidance in this Issue are included in Exhibit 01-8A. Exhibit 01-8B summarizes the considerations that the Task Force deemed significant in reaching the consensus. Paragraph 1 of Statement 13 defines a lease as:

> . . . an agreement conveying the *right to use* property, plant, or equipment (land and/or depreciable assets) usually *for a stated period of time*. It includes agreements that, although not nominally identified as leases, meet the above definition, such as a "heat supply contract" for nuclear fuel.[1] This definition does not include agreements that are contracts for services that do not transfer the right to use property, plant, or equipment from one contracting party to the other. On the other hand, agreements that do transfer the right to use property, plant, or equipment meet the definition of a lease for purposes of this Statement even though substantial services by the contractor (lessor) may be called for in connection with the operation or maintenance of such assets. [Emphasis added.]
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> [1]Heat supply (also called "burn up") contracts usually provide for payments by the user-lessee based upon nuclear fuel utilization in the period plus a charge for the unrecovered cost base. The residual value usually accrues to the lessee, and the lessor furnishes no service other than the financing.

Paragraph 64 of Statement 13 also indicates that "the Board's conclusion that nuclear fuel leases meet the definition of a lease as expressed in paragraph 1 is based on the fact that under present generally accepted accounting principles a nuclear fuel installation constitutes a depreciable asset. Thus, a nuclear fuel lease conveys the right to use a depreciable asset…."

Consensus Guidance

8. The evaluation of whether an arrangement contains a lease within the scope of Statement 13 should be based on the substance of the arrangement using the following guidance.

Property, plant, or equipment

9. Property, plant, or equipment, as used in Statement 13, includes only land and/or depreciable assets. Therefore, inventory (including equipment parts inventory) and minerals, precious metals, or other natural resources cannot be the subject of a lease for accounting purposes because those assets are not depreciable. Additionally, intangibles (for example, motion picture film licensing rights or workforce) and rights to explore for minerals, precious

metals, or other natural resources are not depreciable assets (they are amortized or depleted) so they may not be the subject of a lease.[3]

10. Although specific property, plant, or equipment may be explicitly identified in an arrangement, it is not the subject of a lease if fulfillment of the arrangement is not dependent on the use of the specified property, plant, or equipment. For example, if the owner/seller is obligated to deliver a specified quantity of goods or services and has the right and ability to provide those goods or services using other property, plant, or equipment not specified in the arrangement,[4] then fulfillment of the arrangement is not dependent on the specified property, plant, or equipment and the arrangement does not contain a lease. A warranty obligation that permits or requires the substitution of the same or similar property, plant, or equipment when the specified property, plant, or equipment is not operating properly does not preclude lease treatment. In addition, a contractual provision (contingent or otherwise) permitting or requiring the owner/seller to substitute other property, plant, or equipment for any reason on or after a specified date does not preclude lease treatment prior to the date of substitution.

11. Property, plant, or equipment has been implicitly specified if, for example, the seller owns or leases only one asset with which to fulfill the obligation and it is not economically feasible or practicable for the owner/seller to perform its obligation through the use of alternative property, plant, or equipment.

Right to use property, plant, or equipment

12. An arrangement conveys the *right to use* property, plant, or equipment if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying property, plant, or equipment. The right to control the use of the underlying property, plant, or equipment is conveyed if any one of the following conditions is met:

a. The purchaser has the ability or right to operate the property, plant, or equipment or direct others to operate the property, plant, or equipment in a manner it determines while obtaining or controlling more than a minor amount of the output or other utility of the property, plant, or equipment,[5]

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[3] Paragraph 1 of Statement 13 states that "this Statement does not apply to lease agreements concerning the rights to explore for or to exploit natural resources such as oil, gas, minerals, and timber. Nor does it apply to licensing agreements for items such as motion picture films, plays, manuscripts, patents, and copyrights."

[4] Other property, plant, or equipment not specified in the arrangement may include property, plant, or equipment owned or controlled by the owner/seller, or it may include a third party's property, plant, or equipment (for example, when the owner/seller purchases goods or services in the spot market to fulfill its obligation under the arrangement).

[5] The purchaser's ability to operate the property, plant, or equipment may be evidenced by (but is not limited to) the purchaser's ability to hire, fire, or replace the property's operator or the purchaser's ability to specify significant operating policies and procedures in the arrangement with the owner/seller having no ability to change such policies and procedures. A requirement to follow "prudent operating practices" (or other similar requirements) generally does not convey the right to control the underlying property, plant, or equipment. Similarly, a contractual requirement designed to enable the purchaser to monitor or ensure the seller's compliance with performance, safety, pollution control, or other general standards generally does not establish control over the underlying property, plant, or equipment.

b. The purchaser has the ability or right to control physical access to the underlying property, plant, or equipment while obtaining or controlling more than a minor amount of the output or other utility of the property, plant, or equipment or

c. Facts and circumstances indicate that it is remote[6] that one or more parties other than the purchaser will take more than a minor amount of the output or other utility that will be produced or generated by the property, plant, or equipment during the term of the arrangement,[7] and the price that the purchaser (lessee) will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

Reassessment of the Arrangement

13. The Task Force reached a consensus that the assessment of whether an arrangement contains a lease should be made at inception of the arrangement based on all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if (a) there is a change in the contractual terms, (b) a renewal option is exercised or an extension is agreed to by the parties to the arrangement, (c) there is a change in the determination as to whether or not fulfillment is dependent on specified property, plant, or equipment, or (d) there is a substantial physical change to the specified property, plant, or equipment. A reassessment of an arrangement should be based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (for example, the estimated amount of output to be delivered to the purchaser or other potential purchasers) would not trigger a reassessment. The following more fully describes the conclusions of the Task Force in that regard.

a. *Change in contractual terms.* The arrangement should be reassessed under the Application Guidance in this Issue if the contractual arrangement among the parties involved changes, unless the change only renews or extends the arrangement.

b. *Renewal or extension.* A renewal or extension of the arrangement that does not include modification of any of the terms in the original arrangement prior to the end of the term of the original arrangement should be evaluated under the Application Guidance in this Issue only with respect to the renewal or extension period. The accounting for the remaining term of the original arrangement should continue without modification. The exercise of a renewal option that was included in the *lease term*[8] at the inception of the arrangement would not be considered a renewal for the purpose of reevaluating the arrangement. For example, a lease with a base term of 10 years and a purchaser renewal option for a second 10-year period would have been classified as having a 20-year term if the lease imposed a

[6] As the term is used in Statement 5.
[7] All evidence should be considered when making the assessment as to the possibility that other parties will take more than a minor amount of the output, including evidence provided by the arrangement's pricing. For example, if an arrangement's pricing provides for a fixed capacity charge designed to recover the supplier's capital investment in the subject property, plant, or equipment, the pricing may be persuasive evidence that it is remote that parties other than the purchaser will take more than a minor amount of the output or other utility that will be produced or generated by the property, plant, or equipment.
[8] As defined by paragraph 5(f) of Statement 13, as amended.

penalty on the lessee in such an amount that, at inception of the lease, the renewal option was determined to be reasonably assured of being exercised. Accordingly, the exercise of the renewal option would not trigger a reassessment under the Application Guidance in this Issue.

c. *Dependency upon specific property, plant, or equipment.* A change in the determination as to whether or not fulfillment is dependent on specified property, plant, or equipment requires a reassessment of the arrangement under the Application Guidance in this Issue to determine whether the arrangement contains a lease on a prospective basis. For example, if an arrangement was initially determined to include a lease because, in part, fulfillment of the arrangement was initially dependent upon specific property, plant, or equipment and an event or events occurred subsequent to the inception of the arrangement such that fulfillment was no longer dependent upon the specific property, plant, or equipment (for example, an active market for the product develops subsequent to inception of the arrangement), the arrangement would be reassessed to determine if the arrangement contains a lease as of the date that the arrangement is no longer dependent upon specific property, plant, or equipment.

d. *Physical change to specific property, plant, or equipment.* A substantial physical change to the specified property, plant, or equipment requires a reassessment of the arrangement under the Application Guidance in this Issue to determine whether the arrangement contains a lease on a prospective basis. For purposes of determining if a physical change to the specified property, plant, or equipment gives rise to a reassessment, increases or decreases in productive capacity that result from adding or subtracting a physically distinct unit of property, plant, or equipment should be ignored if fulfillment of the arrangement is dependent upon a distinct unit of property, plant, or equipment that remains unchanged. For example, a machine generates 100 units of productive capacity at inception. If the seller increases capacity to 200 units by installing a second machine that is physically distinct from, and capable of being operated independently of, the original machine, the increase in capacity would not give rise to a reassessment if the original machine is specified in the arrangement and fulfillment of the arrangement is dependent on the specified machine. (However, if the seller is able to provide output from either machine, a reassessment under the guidance in subparagraph 13(c), above, may be warranted.) Conversely, if the original machine were replaced by a new machine that is capable of generating 200 units of productive capacity, reassessment would be appropriate.

14. The Task Force reached a consensus that when an arrangement (or a portion of an arrangement) ceases to be a lease or becomes a lease due to a modification to the arrangement or other change discussed above, the following guidance shall be applied to account for the revised categorization of the arrangement:

a. *Supply arrangement to operating lease for the Purchaser/Lessee.* Any recognized asset (such as a prepaid asset or a derivative) for the purchase contract is considered part of the minimum lease payments and is initially recognized as prepaid rent. Any recognized liability (such as a payable or a derivative) for the purchase contract is considered a reduction of the minimum lease payments and is initially recognized as a lease payable.

b. *Supply arrangement to operating lease for the Seller/Lessor*. Any recognized liability (such as a deferred revenue or derivative) for the sales contract is considered part of the minimum lease payments and is initially recognized as deferred rent. Any recognized asset (such as a receivable or derivative) for the sales contract is considered a reduction of the minimum lease payments and is initially recognized as a lease receivable provided the asset is recoverable from future receipts.

c. *Supply arrangement to capital lease for the Purchaser/Lessee.* Any recognized asset or liability (such as a prepaid asset, a payable, or a derivative) for the purchase contract is included in the basis of the leased asset or lease obligation.

d. *Supply arrangement to sales-type lease for the Seller/Lessor.* If the criteria for sale treatment in paragraph 8 of Statement 13 (or other applicable literature, such as Statement 66) are met, the property, plant, or equipment is derecognized and any recognized asset or liability for the supply arrangement is recognized in earnings as an adjustment of the minimum lease payments. If the criteria for sale treatment are not met, any recognized asset or liability for the supply arrangement is considered a reduction of (or part of) the minimum lease payments and Statement 13 should be followed with respect to recognition of the lease.

e. *Operating lease to supply arrangement for the Purchaser/Lessee.* Any recognized prepaid rent or rent payable is initially recognized as an asset or liability associated with the purchase contract.

f. *Operating lease to supply arrangement for the Seller/Lessor.* Any recognized deferred rent or rent receivable is initially recognized as a liability or an asset associated with the sales contract, subject to a recoverability test.

g. *Capital lease to supply arrangement for the Purchaser/Lessee*. If the leased asset is real estate, including integral equipment, derecognition of the property, plant, or equipment and related capital lease obligation is subject to Statement 66. If the leased asset is other than real estate, including integral equipment, the property, plant, or equipment and related lease obligation are derecognized. Prior to recognizing a sale, the asset subject to the capital lease should be assessed for impairment under Statement 144. That assessment should consider the terms of any revisions to the arrangement that caused the reassessment. Any difference between the capital lease asset and obligation (after reducing the asset for any impairment) is initially recognized as an asset or liability associated with the supply arrangement.

h. *Direct-financing or sales-type lease to supply arrangement for the Seller/Lessor.* The property, plant, or equipment should be recognized at the lower of (1) the original cost of the property, plant, or equipment, (2) the present fair value of the property, plant, or equipment, or (3) the present carrying amount of the lease receivable.

Multiple Element Arrangements that Contain a Lease

15. If an arrangement contains a lease and related executory costs, as well as other non-lease elements, the classification, recognition, measurement, and disclosure requirements of Statement 13 shall be applied by both the purchaser and the supplier to the lease element of the arrangement. Other elements of the arrangement not within the scope of Statement 13 shall be accounted for in accordance with other applicable generally accepted accounting principles. For purposes of applying Statement 13, payments and other consideration called for by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into (a) those for the lease, including the related executory costs and profits thereon, and (b) those for other services on a relative fair value basis, consistent with the guidance in paragraph 4(a) of EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables."

Transition

16. The consensus in this Issue should be applied to (a) arrangements agreed to or committed to,[9] if earlier, after the beginning of an entity's next reporting period beginning after May 28, 2003, (b) arrangements modified after the beginning of an entity's next reporting period beginning after May 28, 2003, and (c) arrangements acquired in business combinations initiated after the beginning of an entity's next reporting period beginning after May 28, 2003. Arrangements that are determined to be leases based on application of this Issue are not subject to EITF Issue No. 97-10, "The Effect of Lessee Involvement in Asset Construction," if the construction project was *committed to*[10] prior to May 28, 2003, provided that construction has commenced by December 31, 2004.

STATUS

17. No further EITF discussion is planned.

[9] Consistent with paragraph 5(b) of Statement 13, as amended.
[10] Consistent with the phrase used in Issue 97-10.

Exhibit 01-8A

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON ISSUE 01-8

Example 1

A production company (the purchaser) enters into an arrangement with a third party to supply a minimum quantity of a specialty gas needed in its production process for a specified period of time. The supplier designs and constructs a facility adjacent to the purchaser's plant to produce the needed gas and maintains ownership and control over all significant aspects of operating the facility. The agreement provides for the following:

- The facility is explicitly identified in the arrangement, and the supplier has the contractual right to supply gas from other sources. However, supplying gas from other sources is not economically feasible or practicable.
- The supplier has the right to provide gas to other customers and to remove and replace the facility's equipment and modify or expand the facility to enable the supplier to do so. However, at inception of the arrangement, the supplier has no plans to modify or expand the facility. The facility is designed to meet only the purchaser's needs.
- The supplier is responsible for repairs, maintenance, and capital expenditures.
- The supplier must stand ready to deliver a minimum quantity of gas each month.
- On a monthly basis, the purchaser will pay a fixed capacity charge and a variable charge based on actual production taken. The purchaser must pay the fixed capacity charge irrespective of whether it takes any of the facility's production. The variable charge includes the facility's actual energy costs, which comprise approximately 90 percent of the facility's total variable costs. The supplier is subject to increased costs resulting from the facility's inefficient operations.
- In the event that the facility does not produce the stated minimum quantity, the supplier must return all or a portion of the fixed capacity charge.

Evaluation:

The arrangement contains a lease within the scope of Statement 13. Property, plant, or equipment (the facility) is explicitly identified in the arrangement and fulfillment of the arrangement is dependent on the facility. While the supplier has the right to supply gas from other sources, its ability to do so is nonsubstantive. The purchaser has obtained the *right to use* the facility because, based on the facts presented—in particular, the fact that the facility is designed to meet only the purchaser's needs and the fact that the supplier has no plans to expand or modify the facility—it is remote that one or more parties other than the purchaser will take more than a minor amount of the facility's output and the price the purchaser will pay is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.

Example 2

A manufacturing company (the purchaser) enters into an arrangement with a third party to supply a specific component part of its manufactured product for a specified period of time. The supplier designs and constructs a plant adjacent to the purchaser's manufacturing facility to produce the component part. The designed capacity of the plant exceeds the purchaser's current needs and the supplier maintains ownership and control over all significant aspects of operating the plant. The arrangement provides for the following:

- The supplier's plant is explicitly identified in the arrangement, but the supplier has the right to fulfill the arrangement by shipping the component parts from another plant owned by the supplier. However, to do so for any extended period of time would be uneconomical.
- The supplier is responsible for repairs, maintenance, and capital expenditures of the plant.
- The supplier must stand ready to deliver a minimum quantity. The purchaser is required to pay a fixed price per unit for the actual quantity taken. Even if the purchaser's needs are such that they do not need the stated minimum quantity, they still only pay for the actual quantity taken.
- The supplier has the right to sell the component parts to other customers and has a history of doing so (by selling in the replacement parts market) such that it is expected that parties other than the purchaser will take more than a minor amount of the component parts produced at the supplier's plant.

Evaluation:

The arrangement is *not* within the scope of this Issue. Property, plant, or equipment (the plant) is explicitly identified in the arrangement and fulfillment of the arrangement is dependent on the facility. While the supplier has the right to supply component parts from other sources, the supplier would not have the ability to do so because it would be uneconomical. However, the purchaser has not obtained the *right to use* the plant because (a) the purchaser does not have the ability or right to operate or direct others to operate the plant or control physical access to the plant, and (b) the likelihood that parties other than the purchaser will take more than a minor amount of the component parts produced at the plant is more than remote, based on the facts presented.

Exhibit 01-8B

BACKGROUND INFORMATION AND BASIS FOR CONSENSUS

Introduction

B1. This exhibit summarizes considerations that Task Force members deemed significant in reaching the conclusions in this consensus. It includes reasons for accepting certain approaches and rejecting others. Individual Task Force members gave greater weight to some factors than to others.

Scope of Issue

B2. The Task Force originally raised the Issue during its deliberations on the accounting for energy trading activities. However, the issue of whether an arrangement contains a lease is not unique to energy-related contracts. The same issue may arise in outsourcing arrangements, such as the outsourcing of the data processing functions of an enterprise (it may be a significant element, particularly in those arrangements that require a substantial investment in computer hardware and terminals devoted solely to the use of a single customer); in the telecommunications industry where providers of network capacity (primarily in the form of conduit, fiber optic cables, and related equipment) often grant rights to capacity on the basis of an indefeasible right of use; and in some take-or-pay contracts. The Task Force agreed that the scope of this Issue should be expanded to address the broader question of how to determine whether any arrangement contains a lease within the scope of Statement 13.

Approach to Address Issue

B3. Based on the definition of a lease in paragraph 1 of Statement 13, determining whether an arrangement contains a lease requires the evaluation of whether the arrangement conveys the *right to use* the underlying property, plant, or equipment to a non-owner. The Task Force discussed whether that evaluation should be based on the explicit terms in the arrangement or whether it should be based on the substance of the arrangement. That is, whether the evaluation should depend on whether the arrangement explicitly provides for the use of specific property, plant, or equipment, or whether the substance of each arrangement should be evaluated in order to determine whether the right to use property, plant, or equipment is conveyed (perhaps implicitly).

B4. The Task Force agreed that the evaluation of whether an arrangement conveys the right to use the underlying property, plant, or equipment should be based on the substance of the arrangement. Prior to its rescission, paragraph 5 of Issue 98-10 stated that "the determination of whether a transportation contract or some other type of energy-related contract is a lease is a judgmental decision based on the *substance* of each contract" (emphasis added). The fact that a contract is labeled a "transportation contract" is not determinative that the contract is not a lease and the fact that a contract is labeled a "lease" is not determinative that the contract is a lease. Additionally, the fact that the definition of a lease in paragraph 1 of Statement 13 includes agreements that may not be nominally identified as leases implies that the evaluation should be based on the substance of the arrangement. The SEC, in addressing reporting by hotel management companies, has also indicated that "determining whether a contract is a service agreement or a lease is dependent on the facts and circumstances, and requires a rigorous analysis of the rights, obligations, risks and rewards of the management company and the property owner" (Division of Corporate Finance's *Current Accounting and Disclosure Issues –* March 2001).

Multiple Element Arrangements that Contain a Lease

B5. The Task Force agreed that Statement 13 provides for separate recognition of a lease that is embedded in a multiple element arrangement, based on the language in paragraph 1 and the definition of minimum lease payments in paragraph 5(j) (which excludes any portion of the payment attributable to executory costs, including amounts paid for maintenance, insurance, and taxes) used for purposes of determining lease classification. To clarify that this Issue addresses multiple element arrangements that include a lease (and not just whether an *entire* arrangement is a lease), the title of the Issue was changed to more appropriately reflect that point ("Determining Whether an Arrangement Contains a Lease").

B6. The Task Force discussed how arrangement consideration should be allocated among separate units of accounting when the arrangement contains a lease and other non-lease elements. At issue is whether *all* products and services provided by the lessor in a multiple element arrangement are considered *executory costs* as that term is used in Statement 13 and, therefore, should be deducted from total consideration that the lessee is obligated to pay or can be required to pay in connection with the leased property in arriving at the minimum lease payments. The Task Force reached a consensus that substantial services provided by the lessor (for example, significant operating services) are not executory costs within the scope of Statement 13. The Task Force agreed that for purposes of applying Statement 13, payments and other consideration called for by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into those for the lease, including the related executory costs and profits thereon, and those for other services on a relative fair value basis, consistent with the guidance in paragraph 4(a) of Issue 00-21.

Property, plant, or equipment

B7. The Task Force discussed the scope of *property, plant, or equipment* as that term is used in Statement 13. In practice, there appears to be differing views as to what constitutes "property, plant, or equipment." Paragraph 1 of Statement 13 parenthetically defines property, plant, or equipment as "land and/or depreciable assets." However, some constituents have argued that certain arrangements involving non-depreciable assets are within the scope of Statement 13. For example, "parts leasing" arrangements are being marketed to the aviation and computer parts industries. Under those arrangements, the parts manufacturer or supplier and the parts user agree on a list of parts that comprise the "leased asset." The user makes a periodic (or usage) payment to the supplier, and ownership of the parts (as evidenced by UCC filings) resides with the supplier. At the end of the arrangement's term, the user has the ability to purchase the parts at the then fair value or to return any unused parts. Another example of an arrangement in which non-depreciable assets are the subject of a "lease" involves precious metals. A supplier "leases" a quantity of precious metals to a manufacturer. The manufacturer uses the precious metals in its manufacturing process and salvages the same metals from used product. At the end of the arrangement, the manufacturer returns the same quantity of precious metals (either from salvage or by purchasing from others) to the supplier.[11]

B8. The Task Force agreed that property, plant, or equipment, as used in Statement 13, must be land and/or depreciable assets. Therefore, inventory (including equipment parts inventory) and minerals, precious metals, or other natural resources cannot be the subject of a lease because those assets are not depreciable.[12]

B9. The Task Force discussed whether specific property, plant, or equipment needs to be identified (either explicitly or implicitly) in the arrangement in order for the arrangement to contain a lease. The Task Force agreed that the subject of the lease must be specified no later than the beginning of the lease term. However, the identification of the property in the arrangement need not be explicit; it may be implicit. For example, in the case of a power purchase contract, if the seller of the power is an SPE that owns a single power plant, that power plant is implicitly specified in the contract because it is unlikely that the SPE could obtain replacement power to fulfill its obligations under the contract because an SPE generally has limited capital resources. Similarly, in the case of a throughput contract, the seller may have only a single pipeline and the prospect of obtaining access to a second pipeline may not be economically feasible. In that case, the seller's pipeline is implicitly specified in the contract. If, on the other hand, no property, plant, or equipment is explicitly specified in the contract and it is economically feasible for the seller to perform its obligation independent of the operation of a particular asset, there would be no implicit specification of the property, plant, or equipment and such a contract would not contain a lease.

Lease Term

B10. The Task Force discussed whether a period of time needs to be stated in order for an arrangement to contain a lease. The Task Force agreed that although a lease normally provides for the use of property, plant, or equipment for a specified period of time, an arrangement providing for a specified measure of use (for example, a number of units produced) would be within the scope of Statement 13. The arrangement must include a "lease term" as defined in paragraph 5(f) of Statement 13 (as amended by paragraph 22 of Statement 98). The "term of the lease" could be a period of time or measure of use. This does not preclude the measure of time from being specified as contingent on a future event. For example, a lease of school buses could expire "at the end of the 2004-2005 school year." The fact that the school district had not yet set the calendar for the last day of school in 2005 should not lead to a conclusion that the contract is a service arrangement.

[11] This arrangement likely contains an embedded derivative that would need to be analyzed pursuant to Statement 133 (for example, a gold loan is a loan host contract with an embedded forward contract).
[12] Additionally, Statement 13 explicitly excludes "lease agreements concerning the rights to explore for or to exploit natural resources such as oil, gas, minerals, and timber" and "licensing agreements for items such as motion picture films, plays, manuscripts, patents, and copyrights."

B11. The Task Force agreed that Statement 13, as amended, is sufficiently clear in defining the lease term so there is no need to provide additional guidance in this Issue.

Right to use

B12. When specific property, plant, or equipment is explicitly identified and the benefits of the property, plant, or equipment are conveyed based on time, application of paragraph 1 of Statement 13 is fairly simple (the arrangement likely contains a lease). The difficulty in determining whether an arrangement contains a lease arises when the *right to use* the underlying property, plant, or equipment is conveyed in some other manner (for example, based on the output of the property, plant, or equipment). With that, the Task Force focused on how to determine whether an arrangement conveys the *right to use* the specified property, plant, or equipment when the purchaser receives some or all of the output from the property, plant, or equipment. The Task Force agreed that an arrangement conveys the *right to use* property, plant, or equipment if the arrangement conveys to the purchaser (lessee) the right to physically control the use of the underlying property, plant, or equipment, either through operations or access, while obtaining or controlling more than a minor amount of the output of the property, plant, or equipment. Similarly, the purchaser (lessee) may obtain the right to use property, plant, or equipment through its contractual ability to exclude others' use of the property, plant, or equipment (for example, by obtaining or having the right to obtain all or substantially all of the output of the property, plant, or equipment).

B13. Task Force members generally agreed that the *right to use* property, plant, or equipment is conveyed in arrangements in which the purchaser has the right or ability to take all or substantially all of the output or other utility that will be produced or generated by the property, plant, or equipment (or, said another way, when other parties will not take more than a minor amount of the output) if the arrangement's pricing contains an element that is designed to recover some or all of the supplier's capital investment in such property, plant, or equipment irrespective of the quantity of output taken by the purchaser. In such arrangements, the purchaser's rights under the arrangement essentially restricts others' ability to use, or to obtain the benefits of, the property, plant, or equipment, even though the property, plant, or equipment may be physically in the possession of, or operated by, the supplier or a third party. The Task Force noted that some arrangements that provide that the purchaser (lessee) will take all or substantially all of the output from specific property, plant, or equipment may not convey the *right to use* the property, plant, or equipment if the purchaser is essentially paying for a product or service rather than paying for a *right to use* specific property, plant, or equipment. If the price that the purchaser will pay is contractually fixed per unit of output or at the current market price as of the time of delivery of the output, then the purchaser is paying for a product or service rather than paying for the *right to use* the property, plant, or equipment.

B14. Some Task Force members believe that the determination of whether the purchaser has obtained the *right to use* the property, plant, or equipment specified in the arrangement should include more of an assessment of the risks and rewards inherent in owning the property, plant, or equipment. For example, some members suggested that if the purchaser guarantees the future value of the asset or has a bargain purchase option on the asset, then the purchaser may have obtained the *right to use* the property, plant, or equipment. Others suggested that if an arrangement meets one of the four criteria in paragraph 7 of Statement 13 to be classified as a capital lease by the lessee, the arrangement should automatically be a lease within the scope of Statement 13 (that is, this Issue should affirmatively include those arrangements within its scope). However, the focus of this Issue is on identifying when an arrangement contains a lease. The fact that an arrangement conveys certain risks and rewards incident to ownership is not in and of itself determinative that the arrangement conveys the *right to use* the underlying property, plant, or equipment.[13] In reaching the consensus, the Task Force generally agreed that risks and rewards of ownership are characteristics relevant to lease classification not to whether or not a lease exists, and potential lease classification is not a basis for determining whether the arrangement contains a lease.

B15. The effect of clarifying *right to use* in the manner provided for by the consensus may result in many take-or-pay arrangements being recognized as leases. That is because the purchaser makes payments for the time that the property, plant, or equipment is made available for use rather than on the basis of actual use or output (resulting in the arrangement's pricing being neither fixed per unit of output nor indexed to market prices). In many take-or-pay arrangements, the purchaser is contractually committed to pay the supplier irrespective of whether the purchaser actually uses the property, plant, or equipment or obtains the output from the property, plant, or equipment. In such arrangements, the purchaser is paying for the *right to use* the property, plant, or equipment.

Undivided Interests (or a Pro Rata Portion of Property, Plant, or Equipment)

B16. The Task Force is divided on the issue of whether a pro rata portion of the output of an asset (for example, a pro rata undivided interest) can be the subject of a lease. Some Task Force members note the guidance in SOP 78-9 on accounting for an investment in real estate in which the investor has a direct undivided ownership interest and the guidance relating to partial sales of real estate in Statement 66. They also note the longstanding practice in project finance of leasing undivided interests in power or extractive facilities. Still other Task Force members argue that an undivided interest in property, plant, or equipment is different in character than a physical asset because the undivided interest represents an economic right with respect to the physical asset rather than the physical asset itself. They note that the Statement 13 definition of a lease is based on the right to use a physical asset (land and/or depreciable assets). They also look to Technical Bulletin No. 88-1, which indicates that the right to control the use of the leased asset is the equivalent of physical use, inferring that an undivided interest owner must be able to physically use the property, plant, or equipment.

B17. In the interest of making progress on this Issue, the Task Force agreed to be silent on the issue of whether a pro rata undivided interest can be the subject of a lease. However, the Task Force agreed that a non-pro rata portion of property, plant, or equipment could be the subject of a lease. That is, when a portion of an asset is physically distinguishable from the larger asset, that portion could be the subject of a lease (for example, one or more floors of an office building).

[13] However, an arrangement that conveys the right to use property, plant, or equipment will typically also convey certain risks and rewards of ownership. Therefore, the transfer of risks and rewards of ownership may be indicative that the arrangement conveys the right to use property, plant, or equipment.

Derivatives

B18. The Task Force discussed the scope of this Issue and the concern of some of its members that the scope may include contracts that may be derivatives pursuant to Statement 133. Issue No. 01-12, "The Impact of the Requirements of FASB Statement No. 133 on Residual Value Guarantees in Connection with a Lease," addressed a similar scope question by resolving the overlap between Statement 13 and Statement 133 with respect to residual value guarantees. In Issue 01-12, the Task Force reached a consensus that residual value guarantees that are subject to the requirements of the lease accounting literature (including Statement 13) are not subject to the requirements of Statement 133 due in part to the fact that Statement 133 did not amend Statement 13 (concluding that the Board did not intend to change the accounting for leases in relation to Issue 01-12). Consistent with the consensus in Issue 01-12, the Task Force believes the fact that the Board did not amend Statement 13 to exclude derivatives that are subject to Statement 133 from its scope suggests that the Board did not intend to change the scope of Statement 13. As such, this Issue explicitly states that leases within the scope of Statement 13 are not derivative instruments subject to Statement 133, although a derivative embedded in a lease is subject to Statement 133.

B19. Notwithstanding the discussion in paragraph B18, above, in most cases, a lease would never be a derivative and vice versa (that is, the two standards should not overlap). A derivative is a right to the changes in value of the asset related to the underlying whereas a lease is a *right to use* the asset (property, plant, or equipment). Additionally, paragraph 10(e)(2) of Statement 133 excludes from its scope contracts that are not traded on an exchange if the underlying is the price or value of a nonfinancial asset that is not readily convertible to cash. However, some Task Force members questioned whether the guidance in this Issue contradicts the guidance in paragraph 59(c) of Statement 133 regarding that statement's assessment of take-or-pay contracts. Paragraph 59(c) states:

> *Take-or-pay contracts*. Under a take-or-pay contract, an entity agrees to pay a specified price for a specified quantity of a product whether or not it takes delivery. Whether a take-or-pay contract is subject to this Statement depends on its terms. For example, if the product to be delivered is not readily convertible to cash and there is no net settlement option, the contract fails to meet the criterion in paragraph 6(c) and is not subject to the requirements of this Statement. *However, a contract that meets all of the following conditions is subject to the requirements of this Statement: (1) the product to be delivered is readily convertible to cash, (2) the contract does not qualify for the normal purchases and normal sales exception in paragraph 10(b), and (3) little or no initial net investment in the contract is required.* [Emphasis added.]

B20. The fact that a contract is labeled as "take-or-pay" is not determinative that the contract is not a lease. Whether a "take-or-pay" contract is subject to Statement 13, to Statement 133, or to neither depends on its terms. Statement 13 and the guidance in this Issue should be applied first to determine whether a take-or-pay contract is within the scope of Statement 13. Any portion of the arrangement that is not a lease may be subject to Statement 133 (or any other GAAP) and any lease portion of the arrangement may contain an embedded derivative that is subject to Statement

133. Nevertheless, a "take-or-pay" contract that meets all of the conditions in paragraph 59(c) of Statement 133 will, in most cases, not be a lease due to the requirement that the product to be delivered be readily convertible to cash. In order for an asset to be readily convertible to cash, it must have quoted market prices available in an active market.[14] Most arrangements that call for delivery of an asset that has quoted market prices available in an active market will generally not be dependent upon specific property, plant, or equipment to fulfill the arrangement. However, in the unlikely event that the arrangement is dependent upon specific property, plant, or equipment and the other criteria in this Issue are met, Statement 13 is applied to the lease portion of the arrangement.

[14] Footnote 5 to paragraph 9(c) of Statement 133.

Issue No. 03-1

Title: The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments

Dates Discussed: January 23, 2003; March 20, 2003; May 15, 2003

References: FASB Statement No. 7, *Accounting and Reporting by Development Stage Enterprises*

FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*

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

FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*

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

FASB Special Report, *A Guide to Implementation of Statement 115 on Accounting for Certain Investments in Debt and Equity Securities: Questions and Answers*

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

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

AICPA Practice Bulletin No. 6, *Amortization of Discounts on Certain Acquired Loans*

AICPA Statement on Auditing Standards No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

AICPA Auditing Guide, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*

AICPA Audit and Accounting Guide, *Banks and Savings Institutions*

AICPA Audit and Accounting Guide, *Health Care Organizations*

SEC Staff Accounting Bulletin No. 59, *Accounting for Noncurrent Marketable Equity Securities*

International Accounting Standard 28, *Accounting for Investments in Associates*

International Accounting Standard 36, *Impairment of Assets*

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

Standards Interpretations Committee 20, *Equity Accounting Method: Recognition of Losses*

Introduction

1. The impairment methodology for various types of investments accounted for in accordance with the provisions of Opinion 18 and Statement 115 is predicated on the notion of *other than temporary*. Some believe that the authoritative literature discussing the notion of other than temporary is ambiguous and has led to inconsistent application.

2. While investments accounted for in accordance with Opinion 18 and Statement 115 share certain similarities, they are also different in many respects. In spite of such differences, the FASB staff believes a common approach to evaluating other-than-temporary impairment to all such investments can be developed; a common approach would reduce ambiguity and inconsistent application.

Issue

3. The issue is to determine the meaning of other-than-temporary impairment and its application to investments accounted for under the cost method or the equity method, or investments classified as either available-for-sale or held-to-maturity under Statement 115 (including individual securities and mutual funds) and investments accounted for under Statement 124.

Prior EITF Discussion

4. EITF Issue No. 02-14, "Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means," is a scope issue related to Opinion 18. In responding to that Issue, the FASB staff developed a view that recommended that the Task Force define *other-than-temporary* impairment and provide additional guidance on how other-than-temporary impairment should be applied to certain investments accounted for by the cost method under Opinion 18. At the September 11–12, 2002 EITF meeting, the Task Force requested that the FASB staff develop views regarding the meaning of other-than-temporary impairment and its application to certain investments carried at cost.

5. At the November 21, 2002 EITF meeting, the Task Force discussed the meaning of other-than-temporary impairment and its application to certain investments carried at cost. The Task Force requested that the FASB staff consider other impairment models within U.S. GAAP when developing its views. The Task Force also requested that the scope of the impairment issue be expanded to include equity-method investments and investments subject to Statement 115 and that the issue be addressed by the Task Force separately from Issue 02-14.

6. At the January 23, 2003 EITF meeting, the Task Force noted that several complex issues surround the application of other-than-temporary impairment. In light of those complex issues, the Task Force requested that a working group be established to develop an approach for assessing other-than-temporary impairment that would be appropriate for different types of investments.

7. At the March 20, 2003 EITF meeting, the Task Force discussed proposed guidance for assessing other-than-temporary impairment that was recommended by the Working Group. That proposed guidance would apply to investments accounted for under the cost method or the equity method, investments classified as either available-for-sale or held-to-maturity under Statement 115 (including individual securities and mutual funds), and investments accounted for under Statement 124. It would not apply to investments within the scope of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets." The proposed guidance includes the following:

Step 1: Determine whether an investment is impaired
Step 2: Determine whether an impairment is other than temporary
Step 3: Recognize an impairment loss equal to the difference between the investment's carrying amount and its fair value (measured as of the date of the financial statements).

8. Step 1 of the proposed guidance generally states that an investment is considered impaired if its fair value is less than its amortized cost basis (hereinafter referred to as its carrying amount). Step 1 also provides that, for investments with no readily determinable fair value, the fair value of the investment should be measured when an impairment indicator is present.

9. Step 2 of the proposed guidance includes the following underlying principle for determining whether an impairment is other than temporary: an impairment shall be deemed other than temporary unless positive evidence indicating that an investment's carrying amount is recoverable within a reasonable period of time outweighs negative evidence to the contrary. Under the proposed guidance, if an investment has been impaired for one year, it would be unlikely that sufficient objective and verifiable positive evidence would be available to support the recoverability of the investment's carrying value to overcome the extent of the negative evidence, except for certain investments with noncontingent contractual future cash flows. That one-year period, however, is not intended to be a bright-line for purposes of determining whether an impairment is other than temporary.

10. The Task Force generally supported the proposed guidance with respect to its application to equity securities but asked that the Working Group further refine some of the specific guidance within each of the steps of the impairment model. The Task Force also requested that the Working Group further explore the application of Step 2 of the proposed guidance to certain debt securities, including the impact of an investor's ability and/or intent to hold an investment when it is not probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security that was not impaired at acquisition and the decline in its fair value is due only to interest rate fluctuations.

11. The Task Force also requested that the Working Group further consider the accounting for the investment after an impairment is recognized under Step 3 of the proposed model, specifically focusing on investments accounted for under the equity method.

Current EITF Discussion

12. At the May 15, 2003 EITF meeting, the Task Force discussed additional Working Group recommendations regarding the refinement of the proposed guidance for assessing other-than-temporary impairment. The Task Force expressed concern over the applicability and feasibility of a single impairment model for all types of investments. Consequently, the Task Force directed the FASB staff to consider whether the characteristics of different types of investments (for example, Statement 115 marketable equity securities, Statement 115 debt securities, and investments subject to Opinion 18) require different models for evaluating whether or when an impairment is considered other-than-temporary.

Status

13. Further EITF discussion is expected at a future meeting.

Issue No. 03-3

Title: Applicability of *EITF Abstracts*, Topic No. D-79, "Accounting for Retroactive Insurance Contracts Purchased by Entities Other Than Insurance Enterprises," to Claims-Made Insurance Policies

Date Discussed: May 15, 2003

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

FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*

FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*

AICPA Audit and Accounting Guide, *Health Care Organizations*

Introduction

1. Many entities use claims-made policies to satisfy their insurance needs for such coverage as product liability, directors and officers (D&O), and malpractice. However, in recent years entities have been purchasing coverage for a variety of other exposures using a claims-made format. Under a claims-made insurance policy, an entity is insured for any claims reported during the term of the policy, in many cases including those that occurred prior to the policy effective date, but after the specified retroactive date.

2. Generally, entities purchasing a claims-made policy will renew the policy each year. The amount of coverage purchased may increase over time to meet current needs (for example, changing risk within the entity) or to respond to the overall environment (for example, the expected settlement costs of the same claim today may cost more than in prior years). When operations cease, the entity generally purchases tail-coverage to insure itself against any previously unasserted claims. Presuming the entity can renew the claims-made policy each year and can obtain tail coverage when desired, such a strategy effectively converts the claims-made policy into an occurrence-based policy covering the entity for any claim made against it. Entities generally use claims-made coverage because it is the only form of insurance available for certain exposures, particularly, exposures for which the occurrence date may be difficult to determine or for which the occurrence may span a long period of time. Therefore, a claims-made policy mitigates potential coverage disputes because the occurrence date generally is not relevant to the determination of coverage. Also, there may be reduced insurance costs in the first several years of a claims-made policy as compared to an occurrence-based policy. Many entities that purchase claims-made insurance policies have no knowledge of unasserted outstanding claims or of liabilities that have not met the recognition criteria contained in Statement 5 or in other applicable U.S. GAAP, and, therefore, have no recognized liability for claims, including incurred but not reported (IBNR) claims.[1] In other situations, however, entities that purchase claims-made insurance policies are aware of potential claims based on a specific incident(s). In those

[1] Issue 1 of EITF Issue No. 86-12, "Accounting by Insureds for Claims-Made Insurance Policies," and paragraph 8.13 of the Health Care Organizations Guide provide further guidance on the recognition of a liability for claims incurred but not reported.

situations, unasserted claims can be either specifically excluded from or specifically included in the coverage.

Issue

3. The issue is whether the guidance in *EITF Abstracts*, Topic No. D-79, "Accounting for Retroactive Insurance Contracts Purchased by Entities Other Than Insurance Enterprises," applies to claims-made policies and thereby nullifies the consensuses reached on Issues 4, 5, and 6 of EITF Issue No. 86-12, "Accounting by Insureds for Claims-Made Insurance Policies." For purposes of this Issue, consistent with the conclusions in Statement 113, the "insured event" in a claims-made insurance policy is the reporting to the insurer of a claim for a loss covered by the policy, rather than the occurrence of the underlying event

Current EITF Discussion

4. At the May 15, 2003 EITF meeting, the Task Force reached a consensus that a claims-made insurance policy that provides coverage for specific, known claims that were reportable[2] prior to the policy period contains a retroactive provision. If a claims-made insurance policy contains a retroactive provision, the retroactive and prospective provisions of the policy should be accounted for separately, if practicable. If it is not practicable to separate the retroactive and prospective provisions, the claims-made insurance policy should be accounted for entirely as a retroactive contract. A claims-made insurance policy that contains no retroactive provisions should be accounted for on a prospective basis.

5. The Task Force observed that paragraph 95 of Statement 113 states that "in claims-made insurance, the insured event is the reporting to the insurer, within the period specified by the policy, of a claim for a loss covered by the insurance contract." Accordingly, a prospective claims-made insurance policy only covers claims for losses reported to the insurer during the policy term, regardless of the occurrence date of those incidents that give rise to those claims. A retroactive provision provides coverage for "insured events" that occurred or were reportable prior to the policy term, that is, the policy covers claims for specific, known claims that were ~~not~~ reportable.

6. In reaching its consensus, the Task Force also noted that all relevant facts and circumstances should be considered in evaluating whether a claims made policy contains a retroactive provision. The Task Force provided the following indicators that a claims-made insurance policy does not contain a retroactive provision (that is, it is not providing coverage for previously reportable claims) and, therefore, should be accounted for on a prospective basis:

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[2] The phrase *specific, known claims that were reportable* (by the insured entity to the insurance carrier) would encompass asserted claims, known unasserted claims, and any known previous event or circumstance that might result in a specific claim (whether asserted or unasserted), regardless of whether the insured has recognized a loss contingency for those claims, including those claims that were not reported, but would have been reportable had a claims made policy been in place in a prior period. A recognized liability for claims for losses related to events that the insured is not specifically aware of but expects to be reported (IBNR) (and, therefore, are not yet reportable), generally would not be determinative in concluding that the claims-made insurance policy contains a retroactive provision.

a. The insured consistently purchases claims-made insurance policies as part of its risk management program for the specific type of risk being insured, and tail coverage for both prior periods and prior policies is readily available and not excessively priced as compared to tail coverage offered to similar companies.

b. The claims-made insurance policy is responsive to unknown risks for a finite or limited period of time, as evidenced by the fact that (a) the type of risk being insured is inherently short-tailed, that is, the claims are incurred during the policy period and paid out in their entirety shortly after the end of the policy period, (b) the policy term is for a limited period of time (for example, one-year coverage), (c) claims-made coverage is the most readily available coverage for this type of insurance risk, and (d) the occurrence date of the type of risk covered by the policy is unclear (that is, the causal event that gives rise to an insured claim is difficult to determine.)[3]

c. The claims-made insurance policy contains an unambiguous trigger indicating that a claim is covered by the policy. That contract trigger should not be subject to interpretation, negotiation, or manipulation. An example of an unambiguous "trigger" that indicates that a claim is covered by a claims-made insurance policy would include the following provisions:

   (i) The insured notifies the insurance carrier during the policy term that a claim has been asserted, or that an incident has occurred, and
   (ii) The insured must represent that it was not aware of any such incident when the claims-made policy was purchased.

d. The premium charged for the claims-made insurance policy is not significantly in excess of the premium that would be charged for a claims-made insurance policy that could be purchased by a similar entity with similar insurance risks and that has no knowledge of any circumstances or events that would result in any claims, excluding any anticipated amounts for a typical number of claims for which the insured is not aware to have specifically occurred, but that it expects would be reported (IBNR).

e. The insurer may base the premium for the claims-made insurance policy on estimates and predictions that are based upon the past experience of the insured, but the premium is not based on settlement estimates of specific, known events that are expected to be recovered under the policy.

f. The premium charged for the policy in the current year is not significantly in excess of that charged in previous years, other than for increases in the amount or type of coverage. An anticipated increase in premiums that is expected to occur because the insured entity is advancing towards the "mature-stage" of premiums for claims-made insurance, would not be considered in making that determination.

[3] Such a lack of identification creates difficulty for an entity to self-insure its insurance risk (for example, a manufacturing entity may be completely unaware of the potential health hazards attributable to its core products, and may want to protect itself in case a by-product of its production process becomes the next "asbestos").

g. The claims-made insurance policy is primarily intended to cover insurance risk and is not a financing arrangement. Claims-made insurance policies that are intended to cover insurance risk typically include features such as (a) an absence of adjustment features based on experience and (b) coverage of the ultimate loss from the claim, once made, regardless of period of settlement.

h. If the claims-made insurance policy has a specified retroactive date prior to the inception of the claims-made relationship with the insurer, the period from that specified retroactive date to the inception of the claims-made relationship with that insurer is either short or covered by other insurance policies.

7. The Task Force further observed that, although the guidance in Topic D-79 applies in situations in which the insured entity uses a claims-made insurance policy to finance known losses, (that is, when the insurance contract was purchased in order to provide insurance coverage for specific, known events that occurred or were reportable prior to the inception of the contract), Topic D-79 did not intend to preclude prospective accounting for those claims-made insurance policies that contain only prospective provisions.

8. The Task Force also observed that an insured entity may, for various reasons, contemporaneously enter into multiple claims-made insurance policy contracts. In those circumstances, an entity should consider whether those insurance contracts should be combined in order to determine the appropriate accounting treatment. The guidance contained in paragraph 8 of Statement 113 is helpful in those instances.

9. Examples to illustrate the application of this consensus are included in Exhibit 03-3A.

Status

10. No further EITF discussion is planned. However, in order to achieve the Board's stated objective of simplification and codification, the Task Force directed the FASB staff to codify the consensuses reached in Issue 03-3, Issue 86-12, and Topic D-79 (and the examples discussed in each of those Issues) into one EITF Issue to be entitled, "Accounting for Claims-Made Insurance and Retroactive Insurance Contracts by the Insured Entity."

Exhibit 03-3A

EXAMPLES OF THE APPLICATION OF THE EITF CONSENSUS ON ISSUE 03-3

Example 1

Company ABC is a manufacturer that purchases D&O insurance under a claims-made insurance policy each year. Company ABC immediately reports any asserted claims or incidents that could result in an asserted claim to its insurance carrier. Company ABC currently has no knowledge of any unasserted claims against it. Further, Company ABC is unaware of any event that would result in any claims. Company ABC considers the use of a claims-made insurance policy to be the most efficient and least costly method available to manage its insurance risk related to suits against its directors and officers. Company ABC pays BrokerCo to handle its insurance needs. BrokerCo supplies Company ABC with binding quotes from several insurance carriers and a comparison to binding quotes for other similar companies. Company ABC believes that its premiums are comparable to those of other similar entities that have similar insurance risk profiles and no knowledge of any events or circumstances that might result in a claim. Company ABC has an option to purchase tail-coverage which would effectively convert its claims-made policies into occurrence based policies at any time. On January 1, 20X3, Company ABC pays its annual premium of $5 million for its policy. The policy has a retroactive date to January 1, 20X0, which is the year that Company ABC first started using the claims-made insurance approach with its insurance carrier. Company ABC is unable to bifurcate its policy premium into its retroactive and prospective provisions.

In June 20X3, there is a precipitous drop in the stock price of Company ABC, and a lawsuit is brought against the directors of Company ABC. Company ABC notifies its insurer about the asserted claim, and the insurer agrees that those claims are covered by its claims-made policy in effect for 20X3.

Evaluation: Company ABC determined in 20X0 that its claims-made insurance policy is a prospective contract that does not contain any retroactive provisions. Essentially, Company ABC was unaware of any known events or circumstances that might result in a claim and viewed the premiums paid for its D&O insurance as providing coverage against claims that might occur during the policy period. In making its determination that the claims-made insurance policy did not contain a retroactive provision, Company ABC also considered the following:

- Company ABC typically uses a claims-made policy to manage its insurance risk and plans to continue purchasing a claims-made insurance policy annually.
- Tail coverage is readily available.
- The premium charged for the claims-made policy is not significantly in excess of premiums charged for other similar entities with similar insurance profiles.
- The claims-made policy contains an unambiguous contract trigger to determine when claims are covered.
- Because Company ABC has no knowledge of any asserted claims or events that would result in a claim, the claims-made policy is primarily expected to cover insurance risk related to future claims.

Example 2
Same facts as above, except that the precipitous drop in the stock price of Company ABC occurred in 19X9, prior to the inception of Company ABC's claims-made insurance program with its insurance carrier. During the negotiation of the contract premium, Company ABC discussed its concerns with its insurance carrier and the two agreed that the retroactive date would include any claims related to the drop in the stock price. As a result, the premium was $50 million.

Evaluation: Company ABC determined in 20X0 that its claims-made insurance policy contains a retroactive provision. Company ABC knows that the $50 million premium charged represents the expected costs of settling any claims related to the drop in its stock price, an event that was fully known at the inception of the contract. Company ABC disclosed this fact to its insurer and the two agreed that it might result in a claim and negotiated a premium based upon that premise. In making its determination that its D&O policy contains a retroactive provision, Company ABC also considered the following:

- The claims-made policy was taken out in part in response to a known incident that was reported to the insurer.
- The premium charged by the insurer includes an estimate of the expected settlement costs for the unasserted claim.
- The policy premium charged primarily represents a financing of the unasserted claim.

Prior to accounting for the entire contract retroactively, Company ABC should, if practicable, bifurcate the contract into its retroactive and prospective provisions and account for each separately.

Example 3
On February 20, 20X2, Company XYZ determined that it needed to recognize a $100 million liability for environmental contamination as a result of an accident at one of its manufacturing plants. Company XYZ initially believed that it would manage the clean-up and any lawsuits arising from the accident through an internal self-insurance program. Subsequently, Company XYZ decided to purchase a claims-made insurance policy that would include all claims arising from the incident. Company XYZ decided that it should purchase the policy because (a) it would be more efficient to transfer the risk associated with the development and timing of claims to a third party and (b) representing that the risk associated with all claims had been transferred to a third party would reduce the risk profile of the Company to its shareholders and other potential investors. On April 1, 20X2, Company XYZ pays InsurerCo $60 million for a claims-made insurance policy. Company XYZ and InsurerCo expect the claims related to the incident to be settled over a 10-year period after the purchase of the policy.

Evaluation: Based upon an evaluation of the indicators, Company XYZ determines that its claims-made insurance policy contains a retroactive provision. In making that determination, Company XYZ specifically considered the following:

- The claims-made policy was purchased specifically to cover known claims for which a liability had been recognized.
- The claims-made policy effectively represented a financing of the liability previously recognized by Company XYZ.
- The premium charged was primarily based on expected payouts for an event that has already occurred.

Example 4

HealthCo is a health care provider that purchases medical malpractice insurance in order to manage its insurance risks. HealthCo purchases a claims-made insurance policy each year from its insurance carrier. HealthCo would be able to purchase tail-coverage from its insurance carrier if it chose to do so. Although HealthCo has no knowledge of any asserted or unasserted claims against it, HealthCo estimates and recognizes a liability for claims incurred but not reported of $25 million at December 31, 20X2, based on actuarial reviews of its historical claims reporting and payment patterns. HealthCo engages an insurance brokerage firm to ensure that its insurance premiums are consistent with those offered to similar companies with similar insurance risks. During 20X2, HealthCo paid out $95 million of malpractice claims that were fully covered by its insurance program. On January 1, 20X3, HealthCo pays its annual premium of $100 million for its claims-made policy. HealthCo expects that it will require a liability of $29 million on December 31, 20X3. The policy does not cover incidents occurring prior to the inception of the claims-made insurance program with that insurance carrier. In negotiating its policy with InsurerCo, HealthCo asserts to InsurerCo that it is unaware of any specific, current claims (asserted or unasserted) against it.

Evaluation: Based upon an evaluation of the indicators, HealthCo determines that its claims-made insurance policy is a prospective contract that does not contain any retroactive provisions. In making that determination, HealthCo specifically considered the following:

- There are no known asserted or unasserted claims that are expected to be covered by the policy. The liability recognized for IBNR claims would not preclude HealthCo from concluding that its claims-made insurance policy is prospective as the Company represented that it did not know of any asserted claims.
- Tail coverage is readily available.
- The premium charged for the claims-made policy is not significantly in excess of premiums charged for similar policies with no retroactive dates.
- There is a clear and unambiguous contract coverage trigger.

Issue No. 03-4

Title: Determining the Classification and Benefit Attribution Method for a "Cash Balance" Pension Plan

Dates Discussed: March 20, 2003; May 15, 2003

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

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

FASB Special Report, *A Guide to Implementation of Statement 87 on Employers' Accounting for Pensions: Questions and Answers*

FASB Special Report, *A Guide to Implementation of Statement 106 on Employers' Accounting for Postretirement Benefits Other Than Pensions: Questions and Answers*

Introduction

1. In recent years, so-called hybrid pension plans have become more popular among employers. Typically, those arrangements describe the pension benefit by reference to an account balance rather than a monthly annuity at retirement. Such plans are often referred to as "cash balance" pension plans (or cash balance plans). For purposes of this Issue, a cash balance plan communicates to employees a pension benefit in the form of a current account balance based on current and past principal credits, and interest credits over time based on those principal credits. Authoritative literature currently does not specifically address that type of plan.

2. For purposes of this Issue, the Task Force considered a plan (referred to hereinafter as "the cash balance plan") with the following characteristics:

- A defined principal-crediting rate as a percentage of salary
- A defined, non-contingent interest-crediting rate that entitles participants to future interest credits at a stated, fixed rate until retirement.

Issues

3. The issues are:

Issue 1—Whether, for the purposes of applying Statement 87, the cash balance plan should be considered a defined benefit plan or defined contribution plan

Issue 2—If that cash balance plan is determined to be a defined benefit plan, the nature of the benefit promise and the appropriate benefit attribution approach based on that promise.

Prior EITF Discussion

4. At the March 20, 2003 EITF meeting, the Task Force reached a tentative conclusion on Issue 1 that the cash balance plan should be considered a defined benefit plan for purposes of applying Statement 87. In light of the definitions of a defined contribution plan and a defined benefit plan in Statement 87, the Task Force based that conclusion on the following attributes of the cash balance plan:

- The cash balance plan communicates the pension benefit to be provided as a function of principal credits based on salary and future interest credits thereon at a stated rate.[1]
- The employer's financial obligation to the plan is not satisfied by the prescribed principal and interest credit contributions—as hypothetical additions to participants' accounts—for the period; rather, the employer must fund, over time, amounts that can accumulate to the benefits due at the time of distribution to each participant pursuant to the plan's terms.
- A defined contribution plan, under Statement 87, is a plan that provides an individual account for each participant and each participant's benefit is based solely on the assets invested and the return on those assets. In the cash balance plan, individual account balances are determined by reference to a hypothetical account rather than specific invested assets, and the benefit is dependent upon the employer's promised interest-crediting rate, not the actual return on any plan assets. The definition of a defined benefit plan under Statement 87 includes any plan that is not a defined contribution plan.
- The employer's contributions to a cash balance plan trust and the earnings on the invested plan assets may be unrelated to the principal and interest credits to participants' hypothetical accounts.

5. On Issue 2, the Task Force did not reach any conclusions but directed the FASB staff to consider the question of whether the cash balance plan was "pay-related" as that concept is defined in Statement 87 and the Special Report on employers' accounting for pensions. In considering that question, the Task Force asked the FASB staff to specifically consider whether Question 50 of the Special Report is applicable to the cash balance plan. The Task Force also asked the FASB staff to consider examples of various plan features that would indicate when it is appropriate and necessary to depart from a plan's benefit formula in determining the attribution of benefits for accounting purposes.

Current EITF Discussion

6. At the May 15, 2003 EITF meeting, the Task Force affirmed, as a consensus, its previous tentative conclusion on Issue 1 that the cash balance plan should be considered a defined benefit plan for purposes of applying Statement 87. The Task Force reached a consensus on Issue 2 that the benefit promise in the cash balance arrangement is not pay-related as contemplated by Statement 87 and its related interpretive guidance. Accordingly, use of a projected unit credit method is neither required nor appropriate for purposes of measuring the benefit obligation and annual cost of benefits earned under Statement 87. The appropriate cost attribution approach, therefore, is the traditional unit credit method.

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[1] Paragraph 11 of Statement 87 states, "For purposes of this Statement, a defined benefit pension plan is one that defines an amount of pension benefit to be provided, usually as a function of one or more factors such as age, years of service, or compensation."

7. The Task Force observed that the consensuses relate to the plan described in this Issue. The determination of whether a plan is pay-related and the appropriate benefit attribution approach for a "cash balance" plan with other characteristics or for other types of defined benefit pension plans depend on an evaluation of the specific features of those benefit arrangements.

Transition

8. If an enterprise had been accounting for the cash balance pension plan addressed in this Issue as a defined contribution plan, the effect of applying the consensuses (that is, the difference between the funded status as a defined benefit plan and any existing prepaid or accrued pension cost) should be reported as the effect of adopting a new accounting principle (in a manner similar to a cumulative effect type adjustment) as of the beginning of the year containing the next reporting period beginning after May 28, 2003.

9. If an enterprise had been accounting for a cash balance pension plan as a defined benefit plan, the effect of remeasuring the pension obligation using the guidance in this consensus should be calculated as of the plan's next measurement date after May 28, 2003. Any difference in the measurement of the obligation as a result of applying the consensus should be reported as a component of actuarial gains and losses under Statement 87. For an enterprise that has an accounting policy of immediate recognition of all gains and losses, or all gains and losses outside the 10-percent corridor described in paragraph 32 of Statement 87, the component of such gain or loss that can be attributed to the adoption of the guidance in this consensus, using a with and without calculation, should be reported as the effect of adopting the consensus (in a manner similar to a cumulative effect type adjustment) as of the measurement date.

Status

10. No further discussion is planned.

Issue No. 03-5

Title: Applicability of AICPA Statement of Position 97-2, *Software Revenue Recognition*, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software

Date Discussed: May 15, 2003

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

FASB Statement No. 86, *Accounting for the Costs of Computer Software to Be Sold, Leased, or Otherwise Marketed*

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

AICPA Statement of Position 98-9, *Modification of SOP 97-2, Software Revenue Recognition, With Respect to Certain Transactions*

Introduction

1. During the course of discussing the scope provisions of EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," Task Force members expressed concerns about apparent diversity in practice with respect to the application of the provisions of SOP 97-2 to arrangements containing software deliverables and non-software deliverables (for example, computer hardware). Similar concerns had previously been expressed and, as a result, an Issue was added to the EITF agenda in 2000, but was removed in November 2002 (along with eight other revenue recognition issues) in light of the Board's active project on revenue recognition. That Issue dealt with how to allocate an overall arrangement fee between more-than-incidental licensed software and (a) property, plant, or equipment sold or (b) property, plant, or equipment leased. At the time that Issue was added, the EITF Agenda Committee observed that the issue concerning the allocation of the overall arrangement fee between more-than-incidental software and the lease of property, plant, or equipment was outside the scope of SOP 97-2.

2. As a result of the most recent concerns of the Task Force, this Issue, rather than addressing revenue recognition directly, is intended to address the apparent diversity in practice with respect to the application of the scope provisions of SOP 97-2. Specifically, this Issue addresses the applicability of SOP 97-2 to non-software deliverables in an arrangement containing more-than-incidental software.

3. This Issue focuses solely on whether non-software deliverables included in arrangements that contain more-than-incidental software are included within the scope of SOP 97-2, and does not address the allocation of the overall arrangement fee to the software and the non-software elements of the arrangement. This Issue does not address the determination of whether the software is more than incidental but assumes that an arrangement includes software that is more than incidental[1] to the products or services as a whole.

[1] As indicated in footnote 2 to paragraph 2 of SOP 97-2, indicators of whether software is incidental to a product as a whole include (but are not limited to) (a) whether the software is a significant focus of marketing effort or is sold separately, (b) whether the vendor is providing post-contract customer support, and (c) whether the vendor incurs significant costs that are within the scope of Statement 86.

Issue

4. The issue is whether non-software deliverables included in an arrangement that contains software that is more than incidental to the products or services as a whole are included within the scope of SOP 97-2.

Current EITF Discussion

5. At the May 15, 2003 EITF Meeting, the Task Force reached the following consensus:

> In an arrangement that includes software that is more than incidental to the products or services as a whole, software and software-related elements are included within the scope of SOP 97-2. Software-related elements include software-products and services such as those listed in paragraph 9 of SOP 97-2[2] as well as any non-software deliverable(s) for which a software deliverable is essential to its functionality. For example, in an arrangement that includes software, computer hardware that will contain the software, and additional unrelated equipment, if the software is essential to the functionality of the hardware, the hardware would be considered software-related and, therefore, included within the scope of SOP 97-2. However, because the software is not essential to the functionality of the unrelated equipment, the equipment would not be considered software-related and would, therefore, be excluded from the scope of SOP 97-2.

6. In reaching that consensus, the Task Force asked the FASB staff to refine the consensus guidance by utilizing the separation criteria in EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables," to define *essential to the functionality*. During the process of drafting the minutes, it became apparent that Task Force members had differing views of the direction given to the FASB staff. As such, the FASB staff plans to solicit additional input from Task Force members prior to the July 31, 2003 EITF meeting and to distribute a draft abstract for this Issue for consideration at that meeting. As a result, the Board was not asked to ratify the consensus reached by the Task Force.

Status

7. Further discussion is planned at a future meeting.

[2] As indicated in paragraph 9 of SOP 97-2, examples of software deliverables include software products, upgrades/enhancements, postcontract customer support, and services.

Issue No. 03-6

Title: Participating Securities and the Two-Class Method under FASB Statement No. 128, *Earnings per Share*

Date Discussed: May 15, 2003

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

FASB Statement No. 128, *Earnings per Share*

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

Proposed FASB Statement, *Earnings per Share and Disclosure of Information about Capital Structure*, issued January 1996

APB Opinion No. 15, *Earnings per Share*

AICPA Accounting Interpretation 85, "EPS Treatment of Two-Class and Participating Securities," of APB 15

AICPA Accounting Interpretation 86, "Two-Class Method for Nonconvertible Securities," of APB 15

AICPA Accounting Interpretation 87, "Two-Class Method for Convertible Securities," of APB 15

Introduction

1. Statement 128 provides guidance on the calculation and disclosure of earnings per share (EPS). Statement 128 defines EPS as "the amount of earnings attributable to each share of common stock" and indicates that the objective of EPS is to measure the performance of an entity over the reporting period. In its deliberations of Statement 128, the Board decided to retain the two-class method of computing EPS for enterprises with participating securities.

2. Paragraph 60(a) of Statement 128 provides the following description of participating securities:

> Securities that may participate in dividends with common stocks according to a predetermined formula (for example, two for one) with, at times, an upper limit on the extent of participation (for example, up to, but not beyond, a specified amount per share)….

Paragraph 61 of Statement 128 further states:

> The if-converted method shall be used for those securities that are convertible into common stock if the effect is dilutive. For those securities that are not convertible into a class of common stock, the "two class" method of computing earnings per share shall be used.

Questions have arisen as to what constitutes a participating security and when participating securities require the application of the two-class method.

Issues

3. The issues are:

Issue 1—How to define a participating security for purposes of applying paragraphs 60 and 61 of Statement 128.

Issue 2(a)—Whether paragraph 61 of Statement 128 requires an entity to use the two-class method in computing EPS based on the presence of a non-convertible participating security, regardless of the characteristics of that participating security.

Issue 2(b)—If paragraph 61 of Statement 128 does not *require* an entity with a non-convertible participating security to use the two-class method in computing EPS, how an entity should determine whether the use of the two-class method is appropriate.

Current EITF Discussion

4. At the May 15, 2003 EITF meeting, the Task Force discussed Issue 1 but was not asked to reach a consensus. Members of the Task Force requested that the FASB staff organize an advisory group that would explore the issue further and create a revised issue summary for discussion at a future meeting. The Task Force requested that the advisory group consider the issues and specifically address conditions under which a participating security requires (a) the use of the two-class method, (b) an adjustment to earnings available to common shareholders, or (c) disclosure in accordance with Statement 129. The Task Force requested that the advisory group provide specific examples of securities for which participation may be ambiguous or for which participation rights are contingent (for example, a warrant with an exercise price that changes based on dividends).

Status

5. Further discussion is expected at a future meeting.

Status of Remaining Open Issues

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 staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
00-18	Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees	5-00	7-00, 7-01, 11-01, 1-02, 3-02	Not sched-uled	Munro Durbin	Pending further consideration by the FASB staff of the appropriate course of action with respect to Issue 3 in light of current developments.	June 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. The FASB staff continues to pursue different approaches to providing additional guidance around the meaning of "sufficient disincentive for nonperformance" for the purpose of establishing when a performance commitment exists as originally introduced in Issue 96-18. Additionally, the FASB staff is considering whether the right to receive the equity instruments upon grantee performance might be accounted for as a derivative in accordance with Statement 133 depending on whether the goods or services being provided are, for example, readily convertible to cash.						

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
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 sched-uled	Martin Richards	Pending further progress on Phase II of the Board's *Liabilities and Equity* project.	Late 2003 / Early 2004
01-11	Application of EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," to a Contemporaneous Forward Purchase Contract and Written Put Option	9-01	11-01	Not sched-uled	Martin Lynn	Resolved by the issuance of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. Expected to be removed from the agenda upon completion of the EITF impact analysis for Statement 150.	June Agenda Committee meeting.
01-J	Accounting for the Deconsolidation of a Majority-Owned Subsidiary	11-01	N/A	Not sched-uled	McIntosh Durbin	Pending further consideration by the FASB staff of the implications of Interpretation 46 on the fact pattern described in this Issue.	Issue Summary for July meeting.

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
02-14	Whether the Equity Method of Accounting Applies When an Investor Does Not Have an Investment in Voting Stock of an Investee but Exercises Significant Influence through Other Means	3-02	9-02, 11-02, 1-03	7-03	McIntosh Tovey	Consideration of model for recording equity method earnings and losses; FASB staff to explore applicability of variable interest concepts from Interpretation 46.	Issue Summary for July meeting
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 sched-uled	Martin Lynn	On hold, pending deliberations during Phase II of the Board's *Liabilities and Equity* project.	Late 2003/ Early 2004
02-J	Interpretation of an "Unconstrained Right to Pledge or Exchange" Transferred Assets in a Collateralized Bond Obligation	9-00 (AC) 11-02 (TF)	N/A	Not sched-uled	Martin/ Lusniak	FASB staff to prepare initial Issue Summary for discussion at an upcoming meeting.	Provision-ally planned for September 2003 meeting.

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
02-L	Reporting Gains and Losses on Derivative Instruments That Are Subject to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and Not Held for Trading Purposes	11-02 (de-rived from 02-3)	N/A	7-03	Martin Lynn	FASB staff to prepare initial Issue Summary for discussion at an upcoming meeting.	Provision-ally planned for July 2003 meeting.
03-1	The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments	1-03 (de-rived from 02-14)	3-03, 5-03	7-03	Munro Tovey	FASB staff and Working Group to develop separate models for different types of investments	Issue Summary for July Meeting
03-5	Applicability of AICPA Statement of Position 97-2, *Software Revenue Recognition*, to Non-Software Deliverables in an Arrangement Containing More-Than-Incidental Software	3-03	5-03	7-03	Munro TBD	Draft abstract to be developed by the FASB staff for Task Force consideration.	Issue Supplement for the July Meeting
03-6	Participating Securities and the Two-Class Method under FASB Statement No. 128, *Earnings per Share*	3-03	5-03	7-03	Degano Martin	FASB staff to convene special advisory group to consider examples of specific securities and application of alternative views	June meeting of Special Advisory Group.

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
03-F	Accounting Treatment of Emission Allowances Administered under the U.K. Emissions Trading Scheme	3-03	N/A	7-03	Durbin Martin	Evaluate IFRIC draft interpretation for possible leverage on this Issue; broaden Issue to consider all emissions trading programs, not just UK scheme.	Issue Summary for July meeting.
03-H	Evaluating Evidence to Support Renewal or Extension When Determining the Useful Life and Estimating the Fair Value of a Recognized Intangible Asset	5-03	N/A	7-03	Durbin Pinson	FASB staff to develop initial issue summary.	June Agenda Committee meeting.
03-I	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 in Issue 90-19)	5-03	N/A	Not sched-uled	Martin TBD	FASB staff to develop initial issue summary.	June Agenda Committee meeting.
03-J	Accounting for Claims-Made Insurance and Retroactive Insurance Contracts by the Insured Entity.	5-03	N/A	7-03	Degano TBD	Codification of Issue 86-12, Topic D-79, and Issue 03-3.	Draft codification to be presented with July meeting materials.

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**
00-N	Measuring Fair Value of Equity Securities with Restrictions in a Nonmonetary Exchange	5-00	N/A		Munro	FASB staff to evaluate implications of recent decisions in Board Project – *Measuring All Financial Assets and Liabilities at Fair Value.*	June Agenda Committee Meeting
	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		TBD	Pending consideration of an FASB project that may address the measurement of beneficial interests in securitized financial instruments.	

	Accounting for Investments in Limited Liability Companies	4-01	N/A		Degano McIntosh	Pending FASB staff consideration of issues relating to the accounting for investors' interests in unconsolidated real estate investments following suspension of AcSEC activities.	June Agenda Committee meeting.
	Evaluating the Elimination of Cash Flows from the Ongoing Operations of an Entity as a Result of a Disposal Transaction	5-03	N/A		TBD	Pending FASB staff consideration of other issues related to elimination of cash flows and determining "significant continuing involvement" under paragraph 42 of FAS 144.	June Agenda Committee meeting.