EITF 0913FN 2013 10 22

FINANCIAL ACCOUNTING STANDARDS BOARD
401 Merritt 7, P.O. Box 5116
Norwalk, Connecticut 06856-5116
Telephone: 203-847-0700 *Fax*: 203-849-9470
Internet address: eitf@fasb.org or dor@fasb.org

October 22, 2013

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the September 13, 2013 meeting of the FASB Emerging Issues Task Force and an inventory of open issues for future EITF meetings. Also included as exhibits are the proposed Accounting Standards Updates for Issues 13-D and 13-G.

Confidential marked versions of the minutes and the exhibits showing changes from the October 8, 2013 Final Drafts are being distributed under separate cover. After your review, please discard the confidential marked versions.

Board Ratification

As you know, on Wednesday, October 2, 2013, the Board ratified the consensuses-for-exposure reached by the Task Force on Issues 13-D and 13-G. The Board approved 60-day exposure periods for each of the proposed Updates. The proposed Updates are expected to be posted to the FASB website on October 23, 2013.

The next EITF meeting is scheduled for November 14, 2013. The extra EITF meeting date reserved for October 24, 2013, will not be utilized.

Please call me at 203.956.5212 if you have any questions.

Sincerely,

Daghan Or
Practice Fellow
dor@fasb.org

Emerging Issues Task Force
Meeting Minutes
September 13, 2013

MINUTES OF THE SEPTEMBER 13, 2013 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Friday, September 13, 2013
Starting Time: 8:30 a.m.
Concluding Time: 3:00 p.m.

Task Force Members Present:
Susan M. Cosper (Chairman)
John M. Althoff
Mark M. Bielstein
James G. Campbell
Terri Z. Campbell
Alexander M. Corl
Jackson Day
L. Charles Evans
Stuart H. Harden
Carl Kampel[1]
*Mark LaMonte[1]
Lawrence J. Salva
Matthew L. Schroeder
Ashwinpaul C. (Tony) Sondhi
Robert Uhl
Richard C. Paul (FinREC Observer)
*Diane Rubin (PCC Observer)[1]

Task Force Members Absent:
Paul A. Beswick (SEC Observer)

* For certain issues only.

[1] Participated by telephone.

Others at Meeting Table:
Russell G. Golden, FASB Board Member
Daryl E. Buck, FASB Board Member
James L. Kroeker, FASB Board Member
Thomas J. Linsmeier, FASB Board Member
R. Harold Schroeder, FASB Board Member
Marc A. Siegel, FASB Board Member
Larry W. Smith, FASB Board Member
Shelly C. Luisi, SEC Senior Associate Chief Accountant
Daghan Or, FASB Practice Fellow
* Meredith A. Brown, FASB Practice Fellow
* Lee Klumpp, FASB Practice Fellow
* Nicholas K. Milone, FASB Practice Fellow
* Lauren Mottley, FASB Associate Practice Fellow
* Brian J. Schilb, FASB Practice Fellow

* For certain issues only.

ADMINISTRATIVE MATTERS

- An FASB staff member announced that at its July 17, 2013 meeting the FASB Board made the following EITF agenda decisions regarding issues discussed at the July 9, 2013 EITF Agenda Committee meeting:

    - Issue added to the EITF agenda:
        - Determining Whether the Host Contract in a Hybrid Financial Instrument Is More Akin to Debt or Equity (see EITF Issue No. 13-G)
    - Issue not added to the EITF agenda:
        - Deferred Tax Accounting for an Asset Retirement Obligation When There Is a Limitation on the Deductibility of Asset Retirement Expenditures.

- An FASB staff member announced that any consensuses-for-exposure reached at this meeting and any consensuses-for-exposure reached at prior meetings that are affirmed as consensuses at this meeting will be considered by the Board for ratification and exposure for public comment or ratification and issuance as a final Accounting Standards Update, respectively, at the October 2, 2013 Board meeting.

- The EITF chairman announced the addition of a Private Company Council (PCC) Observer to the EITF and welcomed Ms. Diane Rubin, Novogradac & Company LLP, to that role.

- The EITF chairman welcomed Mr. James L. Kroeker, FASB Board Vice Chairman, to his first EITF meeting as a Board member. Mr. Kroeker had attended prior EITF meetings as the SEC Observer and as an FASB Practice Fellow.

- The EITF chairman welcomed the following FASB Fellows whose terms began recently: Jennifer Hillenmeyer – E&Y, Scot A. Muir – KPMG, Andrew J. Winters – D&T, Nicholas K. Milone – PwC, Adam M. Smith – PwC (valuation), Sean R. May – INTEL (industry).

- An FASB staff member announced that the comment letter deadline for Issue No. 12-G, "Measuring the Financial Liabilities of a Consolidated Collateralized Financing Entity," had been revised. The comment letter period has been extended to October 17, 2013.

- An FASB staff member announced that the next regularly scheduled EITF meeting will be held on Thursday, November 14, 2013. The EITF Agenda Committee meeting to be held in conjunction with the November EITF meeting has been canceled. The Extra EITF meeting date reserved for October 24, 2013, will not be utilized.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 13-B

Title: Accounting for Investments in Qualified Affordable Housing Projects

Dates Discussed: March 14, 2013; September 13, 2013

Introduction

1. The objective of this Issue is to provide guidance on accounting for investments in affordable housing projects that qualify for the low income housing tax credit.

2. The low income housing tax credit program is designed to encourage investment of private capital for use in the construction and rehabilitation of low income housing. This program is an indirect tax subsidy that allows investors in a flow-through limited liability entity, such as a limited partnership or limited liability company that manages or invests in a qualified affordable housing project, to receive the benefits of the tax credits allocated to the entity that owns the qualified affordable housing project. The Revenue Reconciliation Act of 1993, enacted in August 1993, retroactively extended and made permanent the low income housing tax credit. Investors in entities operating qualified affordable housing projects receive tax benefits in the form of tax credits and tax deductions from operating losses. The tax credits are generated and earned over a 10-year period as a result of renting a sufficient number of units to qualifying tenants and are subject to restrictions on gross rentals paid by those tenants. Those credits are subject to recapture by the Internal Revenue Service over a 15-year period starting with the first year tax credits are earned.

3. Investments in qualified affordable housing projects through flow-through limited liability entities have different risks and rewards than traditional equity investments. Generally, investors in qualified affordable housing project investments seek a majority of their return through the receipt of tax credits and other tax benefits (such as operating losses). Accordingly, the principal risk associated with qualified affordable housing investments is potential noncompliance with the tax code requirements resulting in unavailability or recapture of the tax credits (for example, failure to rent property to qualified tenants may result in loss of low income housing tax credits) and other tax benefits.

4. Currently, under U.S. generally accepted accounting principles (U.S. GAAP), a reporting entity that invests in a qualified affordable housing project may elect to account for that investment using the effective yield method if all the conditions in paragraph 323-740-25-1 are met. For those investments that are not accounted for using the effective yield method, paragraph 323-740-25-2 requires that those investments be accounted for in accordance with Subtopic 970-323, Real Estate—General—Investments—Equity Method and Joint Ventures, which results in the investments being accounted for under either the equity method or the cost method. Some stakeholders have said that the conditions requiring the availability of tax credits to be guaranteed by a creditworthy entity and projected yield based solely on the cash flows from guaranteed tax credits to be positive in order to use the effective yield method are overly restrictive and therefore should be reconsidered. To these stakeholders, those conditions prevent

many investments from qualifying for the use of the effective yield method, which they believe provides users with a better understanding of the returns from such investments than the equity or cost methods.

Issue

5. The issue is how an entity should account for its limited liability entity investment in a qualified affordable housing project.

Scope

6. The Issue applies to all reporting entities that invest in a qualified affordable housing project through a limited liability entity that is a flow-through entity for tax purposes.

Prior EITF Discussion

7. At the March 14, 2013 EITF meeting, the Task Force reached a consensus-for-exposure that an entity may elect to account for its Low Income Housing Tax Credit (LIHTC) investment using the effective yield method if all of the following conditions are met:

a. It is probable that the tax credits allocable to the investor will be available.
b. The investor retains no operational influence over the LIHTC investment other than protective rights, and substantially all of the projected benefits are from tax credits and other tax benefits (for example, tax benefits generated from the operating losses of the investment).
c. The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.
d. The investor is a limited liability investor in the affordable housing project for both legal and tax purposes, and the investor's liability is limited to its capital investment.

8. Under the effective yield method, the tax credit allocated and any other tax benefits, net of the amortization of the investment in the limited liability entity, are recognized in the income statement as a component of income taxes attributable to continuing operations. The Task Force agreed that for those LIHTC investments that do not qualify for the effective yield method, the LIHTC investment would continue to be accounted for as an equity or cost method investment in accordance with Subtopic 970-323.

9. The Task Force's expectation is that the revised conditions would result in more LIHTC investments qualifying for the effective yield method than under current U.S. GAAP as a result of (a) removing the requirement for a guarantee by a creditworthy entity and (b) modifying the requirement for a positive yield to be based not only on the cash flows from the tax credits but rather on both cash flows from the tax credits and other tax benefits. One Task Force member disagreed with the application of the "effective yield" measurement approach if the requirement for a guarantee by a creditworthy entity was removed and if the requirement for a positive yield included other tax benefits. That Task Force member noted that the effective yield method of accounting would be appropriate for LIHTC investments with characteristics similar to those of debt instruments. That is, the effective yield method of measurement is appropriate for LIHTC investments with fixed cash inflows or cash inflows that vary based on financial terms (for example, interest rates). The Task Force member stated that current or future investments in

qualified affordable housing projects that qualify for the effective yield measurement approach could have significant cash flow variability that is not based on financial terms. The Task Force member further noted that a more appropriate measurement method for LIHTC investments meeting the conditions specified would be to amortize the LIHTC investment on a systematic basis based on the realization of the tax benefits. The Task Force agreed to include a question for constituents about the method of accounting that should be used to account for investments in qualified affordable housing projects.

10. Some Task Force members expressed concern about limiting the scope of the proposed Update to only investments in qualified affordable housing projects because it might result in treating investments made under other tax credit programs that meet the specified conditions in the proposed Update differently. As a result of those concerns, the Task Force agreed to include a question for constituents about the applicability of the guidance in this proposed Update to investments made under other tax credit programs.

Current EITF Discussion

11. At the September 13, 2013 EITF meeting, the Task Force considered the feedback received from the comment letters on the proposed Update for this Issue, which was posted to the FASB website on April 17, 2013, with a comment period that ended on June 17, 2013. Seventy-three comment letters were received on the proposed Update. A summary of those responses was provided to the Task Force in advance.

Conditions and Other Transactions

12. Based on the comment letter responses, the Task Force revised the condition in paragraph 323-740-25-1(aa) of the proposed Update as follows (added text is <u>underscored</u> and deleted text is ~~struck through~~):

> The investor <u>does not have the ability to exercise</u> ~~retains no operational~~ <u>significant</u> influence over the ~~LIHTC investment other than protective rights~~ <u>operating and financial policies of the limited liability entity</u>, and substantially all of the projected benefits are from tax credits and other tax benefits (for example, tax benefits generated from the operating losses of the investment).

In reaching that decision, the Task Force agreed with a majority of the comment letter respondents who indicated that the condition to have "no operational influence" was overly restrictive. The Task Force noted that the intent of the condition is to identify those investments that are made for the primary purpose of receiving tax credits and other tax benefits. Therefore, the Task Force decided that an investor who has the ability to influence the operating and financial policies of the limited liability entity should not be precluded from applying the guidance in the proposed Update as long as that investor does not have the ability to exercise significant influence. The Task Force determined that the existence of significant influence should be assessed in accordance with Topic 323 considering the indicators of significant influence in paragraphs 323-10-15-6 and 15-7. The Task Force acknowledged that the guidance in those paragraphs was intended for application to investments in common stock and not to investments in limited liability partnership interests. Therefore, the subsequent paragraphs (paragraphs 323-10-15-8 through 15-11) that address voting stock ownership levels (for example, the significant influence presumption at a 20 percent or more voting stock ownership) would not be applicable in the determination of whether a limited liability investor has significant influence in a LIHTC investment. However, if a reporting entity either does not qualify for or elects not to apply the guidance in the proposed Update, it should continue to apply the existing guidance for real estate investments in paragraph 970-323-25-6, as interpreted for SEC registrants in paragraph 323-30-S99-1, in evaluating whether the limited liability entity would be accounted for as an equity method or a cost method investment. That is, when an entity does not qualify for or elects not to apply the guidance in the proposed Update, the equity method should be used unless the investor's interest "is so minor that the limited partner may have virtually no influence over partnership operating and financial policies." The Task Force also considered the use of an alternative condition of "no substantive participating rights." The Task Force noted that the term "participating rights" currently used in the consolidation guidance of Topic 810 is designed for determining whether a presumption of control by a general partner can be overcome and therefore may not be appropriate in the context of determining the level of influence an individual limited partner investor can exercise on its investment. The Task Force decided that the use of existing equity method accounting concepts and principles would be more appropriate and more operable for purposes of assessing this criterion.

13. Based on concerns raised by comment letter respondents, the Task Force also discussed and decided that other transactions, such as bank loans, between the investor and the limited liability entity should not preclude an investor from applying the guidance in the proposed Update as long as the investments are made for the primary purpose of receiving tax credits and other tax benefits. To maintain that objective, the Task Force decided that other transactions between the reporting entity and the limited liability entity should not be considered in determining whether the conditions in the proposed Update are met, provided that (a) the reporting entity is in the business of entering into those transactions, (b) those transactions are entered into at market rates commensurate to rates offered to other counterparties with similar credit quality, and (c) the transactions do not give the reporting entity the ability to exercise significant influence over the operating and financial policies of the limited liability entity.

14. The Task Force also tentatively decided that a reporting entity should evaluate its eligibility to use the guidance in the proposed Update (a) based on facts and conditions that exist at the time of the initial investment or (b) upon a change in the nature of the investment or in the relationship with the limited liability entity that could result in the reporting entity no longer meeting the conditions to be able to use the guidance in the proposed Update.

Amortization Method and Balance Sheet Classification

15. Many respondents to the proposed Update indicated that the effective yield method of amortizing the investment was overly complex. Some respondents indicated that a proportional amortization method would better reflect the pattern of economic benefits received from LIHTC investments. In response to such feedback, the Task Force discussed and decided to change the method of accounting from the effective yield method to the proportional amortization method on the basis that it would provide a reasonable reflection of the economics of such investments in a less complex manner. Under the proportional amortization method, the cost of the investment is amortized each reporting period in proportion to the tax credits and other tax benefits received. The resulting amortization would be recognized as a component of income taxes attributable to

continuing operations consistent with the proposed Update. The Task Force clarified that a reporting entity electing the proportional amortization method should not record deferred taxes on the book and tax bases differences in the investment because (a) the investment has similarities with the purchase of future tax benefits, as illustrated in paragraphs 740-10-55-199 through 55-201, and (b) it would not be appropriate to record deferred taxes on a temporary difference resulting from an amortization that is already being recorded within the income tax provision. Additionally, to be consistent with its determination that these investments are tax credit investments that are economically different from other real estate entity investments, the Task Force tentatively decided that the LIHTC investment should be classified as a deferred tax asset on a reporting entity's balance sheet and not as an investment. The Task Force requested that the staff perform additional analysis of its tentative decision to present the investment as a deferred tax asset on the balance sheet.

Impairment

16. The Task Force also discussed whether a reporting entity should test the LIHTC investment for impairment using a trigger-based recoverability test similar to the model under Topic 360 on property, plant and equipment, or using a valuation-allowance model similar to the method under Topic 740 on income taxes. The Task Force decided that a reporting entity should test a LIHTC investment for impairment when it is more likely than not that the investment will not be realized through the receipt of tax credits and other tax benefits (similar to a valuation-allowance model). The Task Force reached that decision on the basis that (a) the nature of the investment is similar to the purchase of future tax benefits, and (b) the carrying amount of the investment is classified as a deferred tax asset.

Applicability to Other Tax Credit Investments

17. The Task Force also discussed whether the guidance in the proposed Update should be extended to tax credit investments other than LIHTC investments. Based on comment letter responses, other common tax credit investments include, but may not be limited to, investments in historic tax credits, alternative energy tax credits, and new markets tax credits. Some Task Force members argued that the proportional amortization method should be applied to all tax credit investments that meet the revised conditions because that method would be suitable for all tax credit investments that are made for the primary purpose of receiving tax credits and other tax benefits regardless of the type of investment. Those Task Force members favored extending the guidance to other tax credit investments or allowing the use of analogy to this guidance. Other Task Force members expressed concern that there may be unintended consequences if the guidance in the proposed Update were applied to other types of tax credit investments. Those concerns were expressed especially for situations in which there are other transactions between the investor and the limited liability entity that have not been contemplated in the development of the proposed guidance. Those Task Force members stated that there is not enough information at this time to be able to determine whether the scope should be expanded.

18. The Task Force requested that the FASB staff perform further outreach and research to determine whether other types of tax credit investments would meet the revised conditions in the proposed Update. The Task Force also requested that the staff analyze other transactions between an investor and a limited liability entity that may be common in other types of tax credit investments.

Recurring Disclosures

19. The Task Force affirmed its consensus-for-exposure that the guidance would include disclosure objectives that would enable users of financial statements to understand the nature of the investments in qualified affordable housing tax projects, the financial statement effect of those investments, and the related tax credits. The Task Force decided to add a separate disclosure showing the amount of deferred tax assets arising from such investments. The Task Force also decided to remove the example disclosure about ongoing regulatory reviews and the status of such reviews, because several respondents were concerned about the cost and effort necessary to provide that disclosure.

Transition and Transition Disclosures

20. The Task Force affirmed its consensus-for-exposure that an entity should apply the proposed amendments retrospectively, with early adoption permitted as of the beginning of the fiscal year of adoption for financial statements not yet issued. The Task Force also decided that a reporting entity that uses the effective yield method to account for its LIHTC investments prior to the date of adoption of the proposed amendments would be permitted to continue to apply the effective yield method for those LIHTC investments. In reaching that decision, the Task Force considered the possibility that the costs may outweigh the benefits of changing from the effective yield method to a proportional amortization method for some reporting entities.

Status

21. Further discussion on this Issue will be held at a future meeting.

Issue No. 13-D

Title: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

Dates Discussed: June 11, 2013; September 13, 2013

Introduction

1. Entities commonly issue share-based payment awards that require a specific performance target to be achieved for employees to benefit from the awards. Examples of performance targets include an entity attaining a specified profitability metric or selling shares in an initial public offering. Generally, an award with a performance target also requires an employee to render service until the performance target is achieved. In some cases, however, the terms of an award may provide that the performance target could be achieved after an employee completes the requisite service period. That is, the employee would be entitled to benefit from the award regardless of whether the employee is rendering service on the date the performance target is achieved.

2. U.S. GAAP does not contain explicit guidance on how to account for such share-based payments. Many reporting entities account for performance targets that could be achieved after the requisite service period as performance conditions that affect the vesting of the award and, therefore, do not reflect the performance target in the estimate of the grant-date fair value. Other reporting entities treat those performance targets as nonvesting conditions that affect the grant-date fair value of the award. The proposed Update is intended to resolve the diverse accounting treatment of those awards in practice.

Issue

3. The issue is whether a performance target that can be achieved after the requisite service is a performance condition that affects vesting or a condition that affects the grant-date fair value of the awards.

Scope

4. This Issue would apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that the performance target could be achieved after the requisite service period. That would be the case when an employee is eligible to retire or is otherwise eligible to terminate employment before the end of the period in which a performance target (for example, an initial public offering or change in control event) could be achieved and still be entitled to benefit from the award if and when the performance target is achieved.

Prior EITF Discussion

5. At the June 11, 2013 EITF meeting, the Task Force discussed and acknowledged the merits of all alternative views, focusing on the performance condition approach and the non-vesting condition approach. The Task Force also observed that the view that would treat the performance target as a non-vesting condition would be more consistent with recent tentative decisions reached under International Financial Reporting Standards (IFRS). The Task Force noted the

opportunity for substantial convergence but also observed that this approach may add additional measurement uncertainty to the grant-date fair value of the awards, which would add complexity to the measurement of the awards.

6. A majority of the Task Force members expressed initial support for treatment of the performance target as a performance condition because the measurement of the grant-date fair value of the awards is less complex when applying this approach, when compared with applying the non-vesting condition approach. However, some Task Force members and some Board members raised concern that this approach would weaken the main recognition principle of Topic 718, Compensation—Stock Compensation, that compensation cost should be recognized when the employee services are received, and would result in a different approach than under IFRS. The Task Force directed the FASB staff to perform additional analysis on this Issue to assist the Task Force in making a decision on this Issue. This analysis shall include:

a. Comparison of the performance condition approach and the non-vesting condition approach to IFRS 2, *Share-based Payments* (including the proposed amendments to IFRS 2 in the IASB's 2012 annual improvements project)
b. Consideration of other types of performance targets that may be relevant to awards that are in the scope of this Issue
c. Analysis of the measurement complexities under both approaches
d. Obtain and report on feedback from users as to their preferred approach
e. Analyze how both approaches would affect awards issued to retirement-eligible employees and other employees.

Current EITF Discussion

7. At the September 13, 2013 EITF meeting, the Task Force discussed the results of additional outreach and staff analyses on this Issue as requested at the previous meeting.

Performance Condition Treatment

8. The Task Force decided that a performance target that could be achieved after the requisite service period should be treated as a performance condition that affects the vesting of the awards.

9. For awards within the scope of the proposed Update, the Task Force decided that a reporting entity would apply existing guidance in Topic 718 as it relates to share-based payments with performance conditions that affect vesting. Consistent with that guidance, performance conditions that affect vesting would not be reflected in estimating the fair value of an award at the grant date. Compensation cost would be recognized if it is probable that the performance condition will be achieved. The total amount of compensation cost recognized during and after the requisite service period would reflect the number of awards that are expected to vest and would be adjusted to reflect those awards that ultimately vest.

10. The Task Force observed that the definition of a performance condition requires (a) an employee to render service for a specified period of time and (b) achieving a specified performance target that is defined solely by reference to an employer's own operations. When an employee is eligible to retire at the grant date, the existing guidance in paragraphs 718-10-55-86 through 55-88 indicates that there is, effectively, a one-day requisite service period, being the

day of the grant. The Task Force therefore noted that both (a) and (b) from the definition are present in awards within the scope of the proposed Update. Accordingly, the Task Force decided that treating those performance targets as performance conditions would be consistent with the definition of a performance condition.

11. Some Task Force members also emphasized that the treatment of awards within the scope of the proposed Update as performance conditions is consistent with the Board's original basis for conclusions when it developed FASB Statement No. 123 (revised 2004), *Share-Based Payment*. The Board concluded at that time that reflecting a performance condition in the grant-date fair value of an award was generally not considered to be measurable with sufficient reliability for financial reporting purposes. Developing probability distributions that reflect the likelihood of achieving the performance target was, in most cases, not considered reliable because of the limited data on which to base that information. Accordingly, the Board concluded at that time that vesting conditions should be ignored when calculating the grant-date fair value of the awards. Instead, the Board decided that the outcome of vesting conditions should reflect the amount of compensation cost that is ultimately recognized on the basis of the number of awards that vest to the recipient. The Task Force noted that performance targets that could be achieved after a requisite service period are no less difficult to measure with sufficient reliability than other awards that contain performance conditions. The outcome of performance targets, such as a future initial public offering, is also no less difficult to predict today than it was at the time the Board issued Statement 123(R). Therefore, the Task Force decided that there was no compelling reason to require awards within the scope of the proposed Update to be treated differently from other awards with performance conditions that affect vesting.

12. The Task Force acknowledged the potential anomaly that, in some cases, the accounting for the performance target as a performance condition would result in no compensation cost being recognized during the period in which the employee services are received. That is the case, for example, when the performance target becomes probable of being achieved after the requisite service period. Alternatively, compensation cost might never be recognized because the performance condition might not become probable of being achieved. This may be the case, for example, when there is a highly uncertain performance target such as an initial public offering or a change in control event. The Task Force noted that the lack of compensation cost in such circumstances is not unique to the awards within the scope of the proposed Update; other types of performance conditions also would produce the same accounting result of no compensation cost because compensation cost cannot be recognized until a performance condition is considered probable of being achieved. The Task Force decided that it was preferable to recognize compensation cost after the requisite service period in some cases, such as in the initial public offering case, rather than to recognize a highly subjective compensation cost over the requisite service period. The Task Force also preferred accounting for the performance target as a performance condition because that treatment adjusts the compensation cost for the actual number of awards that vest.

13. In supporting its decision, the Task Force also observed another advantage of the performance condition treatment over the nonvesting condition treatment. The alternative approach would have required entities to assess at the grant date whether certain employees are retirement eligible or will become retirement eligible during the period. Entities would have had

to undertake at least two different valuations for the same performance-based award and utilize two different measurement and recognition patterns for those awards, for example, one for retirement-eligible employees and another for all other employees. While entities already have to track different awards separately today (for example, awards with service conditions separately from awards with performance conditions), the Task Force noted that the alternative approach would have introduced incremental complexity.

14. The Task Force acknowledged that if the IFRS Interpretations Committee's proposed definition of a performance condition under IFRS 2, *Share-based Payment,* is finalized, the amendments in the proposed Update would diverge from IFRS. Performance targets that could be achieved after the requisite service period would not be accounted for as performance conditions under the proposed changes to IFRS 2. The Task Force noted that potential difference but ultimately decided that the improvement to U.S. GAAP as a result of the amendments in the proposed Update would take priority over convergence in this aspect of the share-based payments guidance.

Disclosures

15. The Task Force reached a consensus-for-exposure not to add incremental disclosure requirements to those already required by Topic 718. The disclosures required by Topic 718 are intended to enable users of the financial statements to understand the nature and terms of the share-based payment arrangements that existed during the period and the potential effects of those arrangements on shareholders. The Task Force noted that those objectives and related disclosures also are appropriate and sufficient for awards within the scope of the proposed Update.

Effective Date and Transition

16. The Task Force decided that the amendments in the proposed Update should be applied prospectively to share-based payment awards granted or modified on or after the effective date. Earlier adoption would be permitted. The Task Force considered allowing retrospective adoption but rejected it on the basis that it would require significant hindsight estimates about the probability of achieving the performance target. The Task Force also decided that the transition disclosures in Subtopic 250-10 on accounting changes would apply in the period of adoption. The effective date will be determined by the Task Force after considering stakeholder feedback on the proposed Update.

Board Ratification

17. At its October 2, 2013 meeting, the Board ratified the consensus-for-exposure reached by the Task Force on this Issue and approved the issuance of a proposed Update for a 60-day public comment period.

Status

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

Issue No. 13-G

Title: Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity

Date Discussed: September 13, 2013

Introduction

1. Entities commonly raise capital by issuing different classes of shares, including preferred stock, that entitle the holders to certain preferences and rights over the other shareholders. The specific terms of those shares may include conversion rights, redemption rights, voting powers, and liquidation and dividend payment preferences, among other features. One or more of those embedded features may meet the definition of a derivative under U.S. GAAP. Shares that include such embedded derivative features are referred to as hybrid financial instruments.

2. An entity that issues or invests in a hybrid financial instrument issued in the form of a share is required to separate an embedded derivative feature from the host contract (that is, the underlying share) and account for the feature as a derivative according to Subtopic 815-10 if certain criteria under U.S. GAAP are met. One such criterion for separation is that the economic characteristics and risks of the embedded derivative feature are not clearly and closely related to the economic characteristics and risks of the host contract.

3. In the case of derivatives embedded in a hybrid financial instrument that is issued in the form of a share, that criterion requires evaluating whether the nature of the host contract is more akin to debt or to equity and whether the economic characteristics and risks of the embedded derivative feature are clearly and closely related to the host contract. If the host contract is akin to equity, then equity-like features (for example, a conversion option) are considered clearly and closely related to the host contract and thus, would not be separated from the host. If the host contract is akin to debt, then equity-like features are not considered clearly and closely related to the host. In the latter case, an entity may be required to separate the equity-like embedded derivative feature from the debt host contract and account for the feature as a derivative pursuant to Subtopic 815-10 if certain other criteria under U.S. GAAP are met.

4. There are predominantly two methods used in current practice by an issuer or investor in evaluating whether the nature of the host contract within a hybrid financial instrument issued in the form of a share is more akin to debt or to equity. One of the methods considers all terms and features in a hybrid financial instrument including the embedded derivative feature that is being evaluated for separate accounting. The other method considers all terms and features in the hybrid financial instrument except for the embedded derivative feature that is being evaluated for separate accounting. The use of different methods can result in different accounting outcomes for economically similar hybrid financial instruments. Additionally, there is diversity in practice with respect to the consideration of redemption features in relation to other features when determining whether the nature of the host contract is more akin to debt or to equity. For example, some consider the existence of a fixed-price, noncontingent redemption option held by the investor in a convertible preferred stock to be determinative in concluding that the host contract is akin to debt. Others believe that the existence of that redemption option would not, in

and of itself, determine whether the host contract is akin to debt or equity. The objective of this Issue is to eliminate the use of different methods in practice and thereby reduce existing diversity surrounding the accounting for hybrid financial instruments issued in the form of a share under U.S. GAAP.

Issues

5. There are two issues that this Issue looks to address:

> **Issue A**: Whether to (a) consider all of an instrument's terms and embedded derivative features (that is, use a whole-instrument approach), (b) exclude the embedded derivative feature being evaluated (that is, use a chameleon approach), or (c) exclude all embedded derivative features (that is, use a pure-host approach) when determining the nature of the host contract.
>
> **Issue B**: How an entity should determine the nature of the host contract when an investor in a convertible preferred equity instrument holds a non-contingent, fixed-price redemption option.

Scope

6. This Issue would apply to all reporting entities that are issuers of, or investors in, hybrid financial instruments that are issued in the form of a share. The Task Force decided that limiting the scope to hybrid financial instruments issued in the form of a share is appropriate on the basis of feedback indicating that diversity in practice is observed most commonly in the treatment of hybrid financial instruments issued in the form of a share (for example, convertible preferred stock).

Current EITF Discussion

7. At the September 13, 2013 EITF meeting, the Task Force considered and discussed the three alternative views in determining whether the host contract in a hybrid financial instrument is more akin to debt or to equity. The Task Force further discussed how an entity should determine the nature of the host contract when an investor in a convertible preferred equity instrument holds a non-contingent, fixed-price redemption option.

Method for Evaluating the Nature of the Host Contract

8. For a hybrid financial instrument issued in the form of a share, the Task Force reached a consensus-for-exposure that an entity would determine the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid financial instrument, weighing each term and feature on the basis of relevant facts and circumstances. That is, the determination of the nature of the host contract would be based on a consideration of economic characteristics and risks of the entire hybrid financial instrument, including the embedded derivative feature that is being evaluated for separate accounting from the host contract.

9. In supporting that decision, the Task Force noted that it is not appropriate to disregard any term or feature in the analysis of the economic characteristics and risks of the host contract because the instrument's cash flows ultimately depend on the interaction of all contractual

provisions within the instrument and the way in which an investor or issuer may exercise options within the contract.

10. The Task Force also noted that its proposed approach is the most commonly used approach in current practice and is consistent with the guidance included in SEC Staff Announcement: Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under Topic 815 (formerly EITF Topic No. D-109 under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and currently codified in paragraph 815-10-S99-3), which states that "the consideration of the economic characteristics and risks of the host contract should be based on all of the stated or implied substantive terms and features of the hybrid financial instrument."

11. The Task Force acknowledged that the proposed approach could result in situations in which an embedded derivative feature is, in effect, found to be clearly and closely related to itself. However, the Task Force decided that the alternative approach (of considering all terms and features except the embedded derivative feature that is being evaluated for separate accounting) would have been less desirable because it would have required a separate determination of the nature of the host contract for each embedded derivative feature being evaluated for separate accounting and it would have had the potential to result in (a) the host contract changing its nature depending on the embedded derivative feature being evaluated, and/or (b) separating a compound derivative that includes both equity-like and debt-like features, which may be difficult for preparers to value and investors to understand. The Task Force believes that it is not appropriate for a host contract within a single hybrid financial instrument to change its nature for purposes of this evaluation when the economics of the instrument remain unchanged.

12. The Task Force also considered but rejected an alternative that would have disregarded all embedded derivative features in the analysis of the economic characteristics and risks of the host contract. The Task Force rejected that approach because it believes that the approach could have resulted in an over-reliance on the legal form of the instrument in determining the nature of the host, as opposed to consideration of all relevant terms, features, facts, and circumstances.

13. One Task Force member expressed a preference for the alternative approach currently applied in practice for hybrid financial instruments issued in the form of a share. That is, in determining the nature of the host contract, an entity would evaluate all terms and features in a hybrid financial instrument except for the embedded derivative feature being evaluated for separate accounting. That Task Force member believes that this alternative approach is consistent with the overall objective of the embedded derivative analysis (that is, to compare the economic characteristics and risks associated with the embedded derivative feature and related timing and amount of cash flows with that of the instrument as if the embedded derivative feature had not been added to the instrument). In addition, that Task Force member noted that the alternative approach avoids the potential for situations in which an entity may conclude that an embedded derivative feature is clearly and closely related to the host contract primarily because of the embedded derivative feature itself.

Consideration of Redemption Features

14. In evaluating all relevant stated and implied substantive terms and features of a hybrid

financial instrument issued in the form of a share, the Task Force noted that there was diversity in practice with respect to how entities were considering a fixed-price, noncontingent redemption option held by the investor when determining the nature of the host contract. The Task Force reached a consensus-for-exposure that in evaluating the terms and features of a hybrid financial instrument, the existence or omission of any single term or feature, including a fixed-price, noncontingent redemption feature held by the investor, would not necessarily determine the economic characteristics and risks of the host contract. Although the consideration of an individual term or feature may be weighted more heavily in the evaluation on the basis of facts and circumstances, judgment would be required based on an evaluation of all of the relevant terms and features. For example, the presence of a fixed-price, noncontingent redemption option held by the investor in a convertible preferred stock contract is not, in and of itself, determinative in the evaluation of whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument. Rather, the nature of the host contract would depend on the economic characteristics and risks of the entire hybrid financial instrument.

15. Some believe that more determinative guidance in U.S. GAAP, such as a rebuttable presumption approach, may help reduce complexity and diversity in practice. In addition, the Task Force observed the view held by some that the redemption option provides downside protection for the holder and thus, suggests a host contract that is more akin to debt. However, the Task Force noted that it is not possible to reasonably establish that as a likely economic outcome. For example, if the issuer does not have sufficient capital, the issuer would be unable to redeem the security even if the investor exercised the redemption option. That would be the case under various state laws and corporate charters under which a preferred share cannot be redeemed if it would cause the issuer to become insolvent. Accordingly, even with a redemption option, an investor may be exposed to the residual risks (that is, negative movements) of an equity investment

16. The Task Force also observed that for private issuers of preferred shares, in many cases, the issuer would either perform well and have a liquidity event (in which case the conversion option would be exercised) or the issuer would perform poorly (in which case the preferred shareholders would effectively become the residual interest holders). Therefore, the Task Force noted that, in many circumstances, the redemption option would not be exercised.

Effective Date and Transition

17. The Task Force reached a consensus-for-exposure that the effects of initially adopting the amendments resulting from this Issue would be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a share as of the beginning of the annual reporting period for which the proposed amendments are effective. This transition method is consistent with other clarifying guidance issued by the Board on accounting for embedded derivative features, as well as the transition framework established by the Derivatives Implementation Group (DIG) in Statement 133 Implementation Issue K5, "Transition Provisions for Applying the Guidance in Statement 133 Implementation Issues." Retrospective application would be permitted to all relevant prior periods. Early adoption would be permitted. The effective date will be determined by the Task Force after considering stakeholder feedback on the proposed Update.

Board Ratification

18. At its October 2, 2013 meeting, the Board ratified the consensus-for-exposure reached by the Task Force on this Issue and approved the issuance of a proposed Update for a 60-day public comment period.

Status

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

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues that will be added to the proposed agenda for the November 14, 2013 meeting will be considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
12-F	Recognition of New Accounting Basis (Pushdown) in Certain Circumstances	5/12	1/13; 3/13	11/13	Evans	Gupta/ Or	The staff had prepared an Issue Supplement for the September 13, 2013 EITF meeting	November 14, 2013 EITF meeting
12-G	Measuring the Financial Liabilities of a Consolidated Collateralized Financing Entity	7/12	9/12; 3/13; 6/13	11/13	Day	Hillenmeyer/ McKinney	The FASB staff will prepare an Issue Supplement addressing comments received on the proposed Update	Comment deadline extended to October 17, 2013; November 14, 2013 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
12-H	Accounting for Service Concession Arrangements	9/12	1/13; 3/13; 6/13	11/13	Althoff	Gagnon/ Mottley	The FASB staff will prepare an Issue Supplement addressing comments received on the proposed Update	Comment deadline September 16, 2013; November 14, 2013 EITF meeting
13-B	Accounting for Investments in Qualified Affordable Housing Projects	11/12	3/13; 9/13	11/13	Day	Brown/ Klumpp	The FASB staff will prepare another Issue Supplement addressing concerns that arose at the September 13, 2013 EITF meeting	November 14, 2013 EITF meeting
13-D	Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period	5/13	6/13; 9/13	3/14	Evans	Motley/ Schilb	The FASB staff will prepare an Issue Supplement addressing comments received on the proposed Update	Comment deadline December 23, 2013; March 13, 2014 EITF meeting
13-E	Reclassification of Collateralized Mortgage Loans upon a Troubled Debt Restructuring	5/13	6/13	11/13	Althoff	May/ Sangiuolo	The FASB staff will prepare an Issue Supplement addressing comments received on the proposed Update	Comment deadline September 16, 2013; November 14, 2013 EITF meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
13-F	Accounting for the Effect of a Federal Housing Administration Guarantee	5/13	N/A	11/13	Althoff	May/ Sangiulo	The FASB staff will prepare an Issue Summary	November 14, 2013 EITF meeting
13-G	Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity	7/13	9/13	3/14	Bielstein	Milone/ Or	The FASB staff will prepare an Issue Supplement addressing comments received on the proposed Update	Comment deadline December 23, 2013; March 13, 2014 EITF meeting

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	**Description**	**Date Added**	**Date(s) Discussed**	**Next Meeting**	**FASB Staff**	**Immediate Plans**	**Due Date - Next Deliverable**
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	11/02	N/A	Not scheduled	TBD	Statement 166 addressed this Issue and, therefore, the FASB staff will request that the Issue be removed from the EITF's technical agenda at a future meeting.	Future Agenda Committee or EITF Meeting
06-12	Accounting for Physical Commodity Inventories for Entities within the Scope of the AICPA Audit and Accounting Guide, Brokers and Dealers in Securities	8/06	11/06	Not scheduled	TBD	No immediate plans to address this Issue.	Future EITF Meeting
09-D	Application of the AICPA Audit and Accounting Guide, Investment Companies, by Real Estate Investment Companies	2/09	N/A	Not scheduled	TBD	Pending the outcome of the Board's projects on consolidation, investment companies, and investment properties.	Future EITF Meeting
10-B	Accounting for Multiple Foreign Exchange Rates	3/10	7/10, 9/10	Not scheduled	TBD	No immediate plans to address this Issue.	N/A

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