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The purpose of this publication is to briefly describe matters discussed at the most recent meeting of the Emerging Issues Task Force (EITF or the "Task Force"). This summary was prepared by Deloitte & Touche LLP representatives. Although this summary of the discussions and conclusions reached is believed to be accurate, no representation can be made that it is complete or without error. Official meeting minutes are prepared by the Financial Accounting Standards Board staff and are available approximately two weeks after each meeting. The official meeting minutes sometimes contain additional information and comments; therefore, this meeting summary is not a substitute for reading the official minutes. In addition, tentative conclusions may be changed or modified at future meetings.

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This issue of *EITF Roundup* addresses matters discussed at the open Emerging Issues Task Force meeting held on July 31, 2003. EITF consensuses are subject to ratification by the Financial Accounting Standards Board (FASB) at a regular weekly FASB meeting and are not final until ratified. Official EITF minutes are published after ratification by the FASB and can be obtained from the FASB. Official EITF minutes, along with the Deloitte & Touche observer's meeting summary, are posted to the Deloitte Accounting Research Tool (DART) website. To subscribe to DART, visit <http://www.deloitte.com/us/dart>.

EITF consensuses generally are effective for transactions or arrangements entered into after the beginning of an entity's next reporting period beginning after the date of FASB ratification of that consensus. This transition guidance generally applies unless otherwise noted by the Task Force.

Topics discussed at the July 31, 2003 meeting included the following.

### ***Issue No. 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments***

Recognizing impairment for various types of investments accounted for under the provisions of APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, Statement of Financial Accounting Standards (SFAS) No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and SFAS No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, is predicated on the notion of *other-than-temporary*. The terms *other-than-temporary* and *other-than-temporary impairments* are not defined by current authoritative literature. Issue 03-1 addresses how to determine the meaning of other-than-temporary for impairments and how that concept should be applied to investments accounted for under the cost method, the equity method, as either available-for-sale or held-to-maturity under SFAS 115 or in accordance with SFAS 124.

At its previous meeting, after considering the merits of adopting a single model for all investment types, the EITF directed the FASB staff to consider whether the characteristics of the different types of investments should require different models for evaluating whether an impairment is considered other-than-temporary. Separate impairment models were prepared for the following types of investments:

1. SFAS 115 and SFAS 124 equity securities
2. SFAS 115 and SFAS 124 debt securities
3. Cost method investments accounted for under APB 18 Opinion No. 18, *The Equity Method of Accounting For Common Stock*
4. Equity method investments accounted for under APB 18.

These four models predominantly use the same three-step process:

- Step 1: Determine whether the investment is impaired. An investment is considered impaired if the fair value of the investment is less than its amortized cost basis (carrying amount).

- Step 2: Determine whether the impairment is other-than-temporary. An impairment is deemed other-than-temporary unless positive evidence indicating that the investment's carrying amount is recoverable within a reasonable period of time outweighs any evidence to the contrary. Evidence that is objective and verifiable should be given greater weight than evidence that is not.
- Step 3: Recognize an other-than-temporary impairment loss equal to the difference between the investment's carrying amount and its fair value. An other-than-temporary impairment loss should be recognized in current period earnings and the fair value of that investment becomes its new basis (adjusted carrying amount). The new basis should not be adjusted for subsequent recoveries in fair value.

At the July 31, 2003 meeting, the Task Force discussed the four models proposed by the FASB staff. In its discussion about the models for SFAS 115 and SFAS 124 equity and debt securities, the Task Force asked the FASB staff to revise the models as follows and to circulate revised models prior to the next EITF meeting:

- Remove any specific ("bright-line") guidance establishing a stated time period after which securities that are "under water" would be deemed to be other-than-temporarily impaired. The model should emphasize that as time passes, more evidence is required to overcome negative evidence that an impairment is other-than-temporary.
- Clarify what is meant by *objective and verifiable* evidence to support recoverability of the carrying value of an investment.
- Require disclosure of an aging of investments with unrealized losses deemed temporary and explain the rationale for not recognizing impairment.
- Clarify that the impairment should be assessed at the balance-sheet date.

In its discussion of the model for cost method investments, the Task Force agreed that the test in step 1 of the three-step process should be based on a model similar to the impairment test for goodwill in SFAS No. 142, *Goodwill and Other Intangible Assets*, which requires that an impairment test be performed annually, or more frequently when certain negative indicators are present. The Task Force directed the FASB staff to conform the model to the other models discussed and to remove any "bright-line" time period guidance from the model.

For investments accounted for under the equity method, the Task Force agreed to suspend further discussions regarding an impairment model for equity method investments until the models for the other three categories of investments can be developed.

Further discussion of this Issue is expected at a future meeting.

## **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**

This Issue addresses whether non-software deliverables included in arrangements that contain more-than-incidental software are included within the scope of AICPA Statement of Position (SOP) 97-2.

At the May 15, 2003 meeting, the Task Force reached a consensus that in an arrangement that contains software that is more-than-incidental to the products or services as a whole, only software and software-related elements are included within the scope of SOP 97-2. However, software-related elements include software-related products and services such as those listed in paragraph 9 of SOP 97-2 (i.e., upgrades/enhancements, postcontract customer support, or services) as well as other software-related products for which the software is *essential to the functionality of the non-software deliverable*. In reaching this consensus, the Task Force directed the FASB staff, during the minutes preparation process, to refine the consensus by utilizing the separation criteria of EITF Issue No. 00-21, *Revenue Arrangements with Multiple Deliverables*, to define *essential to the functionality*.

However, because the Task Force members had differing views on the directions given to the FASB staff, the Board was not asked to ratify the consensus reached at the May 15, 2003 meeting. To help clarify the May 15, 2003 consensus, the FASB staff created four alternatives for consideration by the Task Force. At the July 31, 2003 meeting, the Task Force reached a consensus that software-related elements include software-related products and services as well as any non-software deliverable(s) for which a software deliverable is essential to its functionality. This consensus is applicable to transactions entered into during the first period beginning after ratification by the Board, which is expected to occur at the August 13, 2003 FASB meeting.

Further discussion of this Issue is not expected.

## **Issue No. 03-6, *Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share***

SFAS 128 indicates that entities with participating securities that are *not* convertible into a class of common stock should use the two-class method of computing earnings per share (EPS). However, questions have been raised concerning the definition of a participating security and when that participating security requires the application of the two-class method for calculating EPS. The issues considered and tentative conclusions reached by the Task Force at the July 31, 2003 meeting were:

- Whether the two-class method requires the presentation of basic and diluted EPS for all participating securities. The EITF reached a tentative conclusion that basic and diluted EPS do not need to be presented for all participating securities. The presentation of basic and diluted EPS is only required for common stock.
- How to define a participating security that requires application of paragraph 61 of SFAS 128. The EITF reached a tentative conclusion that, for purposes of applying paragraphs 60 and 61 of SFAS 128 (calculation of EPS for participating securities), a participating security is a security that may participate in undistributed earnings with common stocks, whether that participation is conditioned upon the occurrence of a specified event or not, regardless of the form of that participation.
- Whether all potential common shares (i.e., securities or other contracts that may entitle their holders to obtain common stock) may be participating securities. The Task Force generally agreed that potential common shares are participating securities if they have the right, in their current form, to participate in undistributed earnings. However, the Task Force asked the FASB staff to explore how these securities affect EPS, to provide examples of calculating EPS under the treasury stock method, and to compare those results to results obtained under the two-class method.
- How undistributed earnings should be allocated to a participating security. The Task Force tentatively agreed that undistributed earnings should be allocated to a participating security based upon the contractual participation rights of the security to share in those earnings, but asked the FASB staff to further explore the implications of this conclusion.
- Whether an entity that allocated undistributed earnings to a nonconvertible participating security would continue to do so in a period of net loss if the effect is antidilutive. The Task Force reached a tentative conclusion that an entity would continue to allocate undistributed earnings/losses to the nonconvertible participating security in periods of net income as well as net loss.

Further discussion of this Issue is expected at a future meeting.

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

Instrument C within EITF Issue No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash upon Conversion*, requires the issuer, upon conversion, to satisfy the accreted value of the obligation (the amount accrued to the benefit of the holder exclusive of the conversion spread) in cash but allows the issuer to satisfy the conversion spread (the excess conversion value over the accreted value) in either cash or stock. Issue 03-7 addresses how an issuer should account for the partial cash-based and partial stock-based settlement of a debt instrument that is structured in the form of Instrument C.

At the July 31, 2003 meeting, the Task Force reached a consensus that upon settlement of the debt (recognized liability) by payment of the principal in cash and settlement of the conversion spread (unrecognized equity instrument) with stock, only the cash payment should be included in the computation of gain or loss on extinguishment of the recorded liability. This consensus will be effective for transactions or arrangements entered into after the beginning of an entity's next reporting period beginning after the date the Board ratifies this consensus, which is anticipated to occur at the August 13, 2003 FASB meeting.

Further discussion of this Issue is not expected.

## **Issue No. 03-9, *Evaluating the Criteria in Sub-Paragraph 11(d) of FASB Statement No. 142, Goodwill and Other Intangible Assets, Regarding Renewal or Extension When Determining the Useful Life of an Intangible Asset***

Paragraph 11 of SFAS No. 142, *Goodwill and Other Intangible Assets*, discusses the determination of the estimated useful life of intangible assets and the factors that should be considered when determining the appropriate useful life. Paragraph 11(d) includes "any legal, regulatory, or contractual provisions that enable renewal or extension of the asset's legal or contractual life without substantial cost (provided there is evidence to support renewal or extension, and renewal or extension can be accomplished without material modifications of the existing terms and conditions)." This guidance should be considered in the determination of the useful life of intangible assets.

Questions have been raised regarding the evaluation of "substantial cost" and "material modifications" in determining whether an intangible asset has an indefinite useful life or the appropriate useful life if it is determined not to have an indefinite useful life. The Task Force was asked to determine (1) what costs should be considered in assessing whether a renewal or extension requires "substantial cost" and (2) what existing terms and conditions upon renewal or extension are subject to the "material modifications" consideration of paragraph 11(d) of SFAS 142.

At the July 31, 2003 meeting, the Task Force tentatively agreed that costs of renewal or extension include any net negative expected present value cash flows arising as a result of the activities or undertakings necessary to effect and/or accomplish renewal. The Task Force asked the FASB staff to develop this conclusion further for discussion at a future meeting. The Task Force did not discuss what existing terms and conditions are subject to the "material modifications" consideration of paragraph 11(d).

Further discussion of this Issue is expected at a future meeting.

## **Issue No. 03-10, *Application of EITF Issue No. 02-16, 'Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor,' by Resellers to Sales Incentives Offered to Consumers by Manufacturers***

In an effort to increase demand for their products, manufacturers (or "vendors") often offer coupons directly to consumers, who use the coupon at a reseller to obtain a discount on the product. After the coupons are presented to the reseller, the reseller submits the coupon to a clearinghouse to obtain a reimbursement from the manufacturer for the discount given to the consumer. Because the reseller has obtained a reimbursement for the discount given to the consumer, the transaction has not affected the reseller's gross margin. The Task Force was asked to determine if these reimbursements should be offset against cost of sales in accordance with Issue No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, or be recorded as revenue when received from the manufacturers, which is the predominant current practice in accounting for manufacturer's coupons by resellers.

At the July 31, 2003 meeting, the Task Force reached a tentative conclusion that consideration received by a reseller from the vendor in exchange for vendor sales incentives tendered by consumers (manufacturer's coupons) should not be reported as a reduction of the cost of the reseller's purchases from the vendor. The Task Force emphasized that the vendor sales incentives subject to this tentative conclusion are limited to vendor incentives (1) that can be tendered by a consumer at any reseller in partial payment of the price charged by the reseller, (2) for which the reseller receives a direct reimbursement from the vendor



based on the face amount of the incentive, and (3) that are not part of any broader vendor-reseller incentive program or cooperative promotional program. Additionally, for coupons not within the scope of (1) through (3), the guidance in Issue 02-16 should be applied to determine the appropriate treatment of the consideration paid by the vendor to the reseller.

The Task Force also reached a tentative conclusion that this consensus will be effective for coupons redeemed in fiscal years beginning after December 15, 2003, with no early application or restatement of prior periods permitted.

Because of the potential effect of this Issue, this tentative conclusion will be posted on the FASB website for public comment, and the Task Force expects to reach a consensus on this Issue at its next meeting after reviewing any public comments received.

## **Issue No. 03-11, *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" as Defined in EITF Issue No. 02-3, "Issues Related to Accounting for Contracts Involved in Energy Trading and Risk Management Activities"***

In Issue 02-3, the Task Force reached a consensus that gains and losses (realized or unrealized) on all derivative instruments within the scope of SFAS 133 should be presented net in the income statement, whether or not settled physically, if the derivative instruments are held for trading purposes. However, the Task Force did not address the issue of whether gains or losses (realized or unrealized) should be presented gross or net in the income statement for derivative instruments that are not held for trading purposes. In addition, SFAS 133 does not provide guidance on whether aggregate net or gross presentation is the appropriate level of summarization in the income statement for a derivative's gains and losses; thus, current practice looks to EITF Issue No. 99-19, *Reporting Revenue Gross as a Principal versus Net as an Agent*, to determine how to summarize gains or losses realized upon physical settlement of derivative instruments not held for trading purposes. However, that guidance may not be reasonable for all derivative instruments. The Task Force was asked to determine whether realized gains and losses from derivative instruments not held for trading purposes should be shown gross or net in the income statement.

At the July 31, 2003 meeting, the Task Force reached a consensus that determining whether realized gains and losses on derivative contracts not held for trading purposes should be reported on a net or gross basis is a matter of judgment that depends on the relevant facts and circumstances. Accordingly, entities should continue to consider the indicators set forth in Issue 99-19. Additionally, entities should disclose where the gains and losses are recorded in the income statement and whether they are presented on a net or gross basis. This consensus is effective for transactions or arrangements entered into after the beginning of the next reporting period beginning after the date of Board ratification of this consensus, which is anticipated to occur at the August 13, 2003 FASB meeting.

Further discussion of this Issue is not expected.

## **Administrative Matters**

### **Issue No. 03-8, *Accounting for Claims-Made Insurance and Retroactive Insurance Contracts by the Insured Entity***

The Task Force approved Issue 03-8, which codifies the following EITF issues:

- Issue No. 86-12, *Accounting by Insureds for Claims-Made Insurance Policies*
- Issue No. 03-3, *Applicability of Topic No. D-79 to Claims-Made Insurance Policies*
- Topic No. D-79, *Accounting for Retroactive Insurance Contracts Purchased by Entities Other Than Insurance Enterprises*.

These issues were codified because of the recent consensus on Issue 03-3 and its effect on Issue 86-12 and Topic D-79. In this codification, some of the original items discussed in Issue 86-12 and Topic D-79 have been modified to comply with recent accounting guidance.

### **Issue No. 02-9, *Accounting for Changes That Result in a Transferor Regaining Control of Financial Assets Sold***

The Task Force approved modifications to the journal entry descriptions contained in Scenario A and Scenario C in Example 1 for Issue 1 of Exhibit 02-9A.

## **Clarification of EITF Abstracts, Topic No. D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock"**

The SEC observer clarified that for purposes of calculating the excess of (1) fair value of the consideration transferred to the holders of the preferred stock over (2) the carrying amount of the preferred stock in the registrant's balance sheet, the carrying amount of the preferred stock should be reduced by the issuance costs of the preferred stock, regardless of where in the stockholders' equity section those costs were initially classified when the preferred stock was issued. The SEC observer noted that this clarification was made to specifically address where these costs should be recognized, as there have been some differences in practice. Any changes in the calculation of EPS caused by the clarification of Topic D-42 should be reflected retroactively in the first fiscal period ending after September 15, 2003 by restating the financial statements of prior periods in accordance with the provisions of paragraphs 27-30 of APB Opinion No. 20, *Accounting Changes*. Earlier application is encouraged.

### **Other**

The following Issues were added to the EITF agenda:

- Applying the Conditions in Paragraph 42 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, in Determining Whether to Report Discontinued Operations
- Subsequent Accounting for Energy Contracts Acquired in a Business Combination Initially Recorded at Fair Value.

The following Issue was removed from the EITF agenda:

- Issue No. 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*.

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