

EITF Flash

Audit and Enterprise Risk Services

September 2005

by Gordon McDonald

This inaugural issue of *EITF Flash* reports on the September 15, 2005, meeting of the Emerging Issues Task Force within a day of the meeting, and enables readers to spot relevant topics and to understand quickly the meeting's outcome. Deloitte & Touche LLP's *EITF Roundup*, published within a week of the EITF meeting, will provide more in-depth information on each of the issues.

EITF consensuses are not final until ratified by the Financial Accounting Standards Board (FASB). Official EITF minutes and EITF Issue Summaries, distributed to the Task Force prior to the meeting, are posted to the Deloitte Accounting Research Tool Web site and the FASB Web site.

Issue 04-13 **Accounting for Purchases and Sales of Inventory With the Same Counterparty**

STATUS: Final Consensus Reached

AFFECTS: Entities that buy and sell (or exchange) inventories with the same counterparty.

SUMMARY: Approved the draft abstract posted on the FASB Web site (with some minor modifications). Entities that enter into inventory purchase and sales transactions with the same counterparty, **in contemplation of one another**, should combine the transactions and treat them as nonmonetary exchanges involving inventory.

Record nonmonetary exchanges of finished goods for raw material and finished goods for work-in-process in the same line of business at fair value. All other inventory-for-inventory exchange transactions do not culminate the earnings process (recognized at carrying value).

EFFECTIVE: The consensus should be applied to new arrangements entered into in reporting periods beginning after March 15, 2006.

NEXT STEPS: FASB ratification expected in September.

Issue 05-1 **Accounting for the Conversion of an Instrument That Becomes Convertible Only Upon the Issuer's Exercise of a Call Option**

STATUS: No Decision Reached

AFFECTS: Issuers of contingently convertible debt instruments and certain other instruments that are not currently convertible but become convertible upon the exercise of a call option.

SUMMARY: The Task Force was unable to reach a consensus and views were divided between the following: Account for the equity securities issued akin to a conversion, rather than a debt extinguishment; provided that the debt instrument may otherwise absent exercise of the call option, become

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convertible upon the passage of time or the occurrence of a substantive contingency outside the control of the issuer (EITF Issue Summary: View (B)); or

Account for equity securities issued to settle the debt instrument at their fair value. That is, the difference between the fair value of the equity securities issued and the carrying amount of the debt instrument settled should be recorded as a debt extinguishment gain or loss (EITF Issue Summary: View (D)).

- EFFECTIVE:** Not yet discussed.
- NEXT STEPS:** The Task Force will explore, at the next meeting, a variation of View B.

Issue 05-7 **Accounting for Modifications to Conversion Options Embedded In Debt Securities and Related Issues**

- STATUS:** Final Consensus Reached
- AFFECTS:** Entities modifying the conversion terms of convertible debt securities.
- SUMMARY:** Debt issuers are required to include the change in the fair value of a conversion option that is modified as a cash flow in their EITF Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments," analysis to determine whether the modification resulted in an extinguishment of the debt and the issuance of **new** debt (EITF Issue Summary: Issue 1 View (A)). When modifications result in an extinguishment of the debt, the **new** debt initially should be recorded at fair value and that amount should be used to determine the debt extinguishment gain or loss.
- If the modification does not result in an extinguishment of the debt, the change in the fair value of the conversion option should be recorded as a discount (or premium) associated with the debt with a corresponding offset to equity (EITF Issue Summary: Issue 2, View (A)). Debt issuers should not recognize a new beneficial conversion feature or reassess an existing beneficial conversion feature (EITF Issue Summary Issue 3, View (B)).
- EFFECTIVE:** The consensus should be applied prospectively to future modifications of debt instruments in reporting periods beginning after December 15, 2005. However, public companies should consider the remarks of the SEC staff, at the December 2004 AICPA Conference on Current SEC and PCAOB Developments, stating that it is the staff's belief that public companies should include the change in fair value of a modified conversion option in their Issue 96-19 analysis.
- NEXT STEPS:** FASB ratification expected in September.

Issue 05-8 **Income Tax Consequences of Issuing Convertible Debt With a Beneficial Conversion Feature**

- STATUS:** Final Consensus Reached
- AFFECTS:** Entities issuing convertible debt with a beneficial conversion feature accounted for under EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," and EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments."
- SUMMARY:** The EITF reached a consensus that the issuance of convertible debt with a beneficial conversion feature results in a basis difference that should be accounted for as a temporary difference for purposes of applying FASB Statement No. 109, *Accounting for Income Taxes*, (EITF Issue Summary: Issue 1, View (A) and Issue 2 View (A)).
- The recognition of deferred tax for the temporary difference should be recorded as an adjustment to additional paid-in capital (EITF Issue Summary: Issue 3 View (A)).
- EFFECTIVE:** The consensus is effective for reporting periods beginning after December 15, 2005, and should be applied retrospectively to all instruments with a beneficial conversion feature accounted for under Issues 98-5 and 00-27.
- NEXT STEPS:** FASB ratification expected in September.

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On September 20 at 2:00 PM EDT, we will host a 90-minute webcast on the highlights of the September EITF Meeting. [Register](#) for this webcast today.

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