

Accounting Roundup

April 1, 2003

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The purpose of this publication is to briefly describe key regulatory and professional developments that have recently occurred in the field of accounting and to provide links to locations where additional information can be found on each topic. Readers seeking additional information about a topic should review the information referred to in the hyperlinks and not rely solely on the descriptions included in this communication.

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March 20, 2003 EITF Meeting

The EITF addressed the following six issues and administrative items at its March 20, 2003 meeting. All consensuses reached by the EITF are subject to ratification by the FASB and will be presented at a regular weekly FASB meeting. Consensuses will not be effective until ratified.

The entire text of the Deloitte & Touche-prepared EITF minutes, including details of the consensuses reached and other viewpoints, is available at <http://www.deloitte.com/us/EITF>.

Issue No. 01-08, *Determining Whether an Arrangement Contains a Lease*

The EITF continued to discuss how to determine whether an arrangement contains a lease that is within the scope of SFAS No. 13, *Accounting for Leases*. At previous meetings, the EITF reached a tentative conclusion in favor of a model proposed by the working group that could be used to determine whether an arrangement meets the SFAS 13 definition of 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."

At its March meeting, the EITF reached a tentative conclusion in favor of the working group's proposed model (as further revised) but instructed the working group to further consider (1) whether the revised model is operational in practice and (2) the necessity of the model incorporating a liquidating damages requirement (refer to the Deloitte & Touche-prepared meeting summary at www.deloitte.com/us/eitf for a detailed discussion of how this criterion fits into the model). Further discussion of this issue at a future meeting is expected.

Issue No. 02-2, *When Certain Separate Contracts That Meet the Definition of Financial Instruments Should Be Combined for Accounting Purposes*

Companies may, for various reasons, contemporaneously enter into multiple contracts that individually meet the definition of a financial instrument in paragraph 540 of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*. The financial reporting impact of recording those contracts separately may be different from the impact of recording those contracts on a combined basis. The issue is how to determine when separate contracts that meet the definition of financial instruments should be combined for accounting purposes.

After discussion of three alternative approaches to this issue, the EITF selected alternative B, which is to request that the FASB undertake development of a comprehensive combining model for all types of transactions, including those involving nonfinancial instruments. The SEC Observer also indicated support for alternative B and stated that the SEC will continue to challenge the accounting for all transactions (both transactions that involve financial instruments and those that do not) when it appears that multiple transactions have been used to circumvent generally accepted accounting principles (GAAP). Further discussion of this issue is not expected.

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

Paragraph 55 of SFAS No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, requires a transferor to recognize in its financial statements assets previously accounted for as having been sold when one or more of the conditions in paragraph 9 (regarding control of the assets) are no longer met. The transferor recognizes those assets together with liabilities to the former transferee(s) or beneficial interest holder(s) and initially measures the assets and liabilities at fair value on the date of the change, as if the transferor purchased them on that date. The issue is how to apply the accounting requirements of paragraph 55 with respect to beneficial interests held by the transferor and loans that do not meet the definition of security, including whether the transferor should recognize a gain or loss when the provisions of paragraph 55 are applied.

At this meeting, the FASB staff presented a revised view of subissue 2 as to the appropriate method by which assets should be re-recognized by a transferor when the entire special-purpose entity becomes nonqualifying under the provisions of paragraph 55 of SFAS 140. The EITF reached a consensus on this revised view. The EITF also reached a final consensus on the remaining open subissue 5, relating to the repurchase of assets from a special-purpose entity that is no longer qualifying under SFAS 140. The EITF reaffirmed the consensuses reached on the other subissues at previous meetings. The EITF asked the FASB staff to prepare journal entries that will be included in the final issue summary to better explain the guidance. Further discussion of this issue is not expected.

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

Companies sometimes acquire the right to significantly influence the operations of another entity and/or share in a substantial portion of the economic risks and rewards of another entity without owning a voting interest in that entity. Often, under such arrangements, an entity may have some risk of ownership with respect to another entity without holding a voting ownership interest. The issue is when, if ever, a company should apply the equity method of accounting if it does not have an investment in the common stock of another entity yet is able to exercise significant influence over the operating activities of that entity.

The EITF reached a tentative conclusion based on a three-step model. The EITF asked the FASB to consider transition issues related to this issue and APB Opinion No. 18, The Equity Method of Accounting for Investments in Common Stock. Further discussion of this issue at a future meeting is expected.

Issue 03-1, The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments

Following up on its discussion at the November 21, 2002 EITF meeting of Issue 02-14, the EITF discussed the meaning of other-than-temporary impairment and its application to certain investments carried at cost. The EITF requested that the FASB staff consider other impairment models within U.S. GAAP when developing its views. The EITF also requested that the scope of the impairment issue be expanded to include equity investments and investments subject to SFAS No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, and that the issue be addressed by the EITF as a separate issue.

The EITF discussed a model that includes securities without a readily determinable fair value as proposed by the working group. A consensus was not reached at this meeting; therefore, further discussion of this issue at a future meeting is expected.

Issue 03-4, Accounting for "Cash Balance" Pension Plans

Cash balance pension plans are similar to defined contribution plans; however, most are hybrid arrangements with features of both defined contribution plans and defined benefit plans. The defined contribution features include the provision for lump sum distributions in the future based on stipulated contributions and interest credits. The defined benefit features include the provision of a life annuity, interest credits in excess of what may be obtainable in the market, joint and survivor options, and grandfathered or transitional defined benefit formulas. In addition, contributions and trust earnings are unrelated to contribution and interest credits. The presence of the defined benefit features, in general, makes it impractical to account for such arrangements as defined contribution plans, because there is no way to segregate assets into defined contribution and defined benefit components and there are prior service costs and deferred gains or losses related to the defined benefit arrangement. In addition, most employers have chosen to classify plans as defined benefit or defined contribution based on the strict Internal Revenue Service definition that a defined contribution plan requires specific individual account balances, a condition that is not present in many cash balance arrangements. The issues concern whether a cash balance plan should be accounted for as a defined benefit plan or a defined contribution plan and, if the former, what the appropriate pattern of benefit accruals is for a cash balance plan.

The EITF reached a tentative conclusion that cash balance pension plans should be accounted for as defined benefit plans under SFAS No. 87, Employer's Accounting for Pensions. The EITF instructed the FASB staff to develop a list of indicators that could be used in determining what actuarial method is most appropriate for a specific plan. The FASB staff will also develop examples of the application of these criteria to specific plans. Further, the FASB staff will consider possible revisions to Q&A 50 of the FASB Staff Implementation Guide to Statement 87 as it relates to this issue. Further discussion of this issue is expected at a future meeting.

EITF Administrative Discussions

- The Task Force reached a consensus at its November 21, 2002 meeting on Issue 02-3, *Recognition and Reporting of Gains and Losses on Energy Trading Contracts under EITF Issues No. 98-10, Accounting for Contracts Involved in Energy Trading and Risk Management Activities, and No. 00-17, Measuring the Fair Value of Energy-Related Contracts in Applying Issue No. 98-10*. At the March 20, 2003 meeting the FASB staff clarified that the guidance in this issue is not meant to preclude a derivative that was designated as trading from being designated as a hedging instrument under SFAS 133, provided all hedge accounting criteria are met. The issue summary will be revised to reflect this conclusion.
- The EITF reached a consensus at its November 21, 2002 meeting on Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables*. At the March 20, 2003 meeting, the EITF discussed a scope issue for transactions in which one deliverable in a revenue arrangement with multiple deliverables falls under guidance at a higher level of GAAP than an EITF Issue (e.g., an SFAS or an SOP). The issue is how to apply Issue 00-21 to those situations. EITF members raised significant concerns, and an informal working group was formed to address those concerns. Further discussion at a future meeting is expected.
- The EITF reached a consensus at its November 21, 2002 meeting on Issue No. 02-16, *Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor*, and revisions to specific transition provisions were announced at the January 23, 2003 EITF meeting. At the March 20, 2003 meeting, the transition provisions were discussed further. At this meeting, the EITF reached a consensus in favor of allowing subissue 1 of Issue 02-16 to be

adopted either (1) prospectively, as the previous consensus would have required, or (2) as a cumulative effect of a change in accounting principle. Entities must disclose whether they have elected to adopt prospectively or as a cumulative effect change. The EITF also reached a consensus that, to the extent that reclassification of prior-period income statements for comparative purposes would not result in a change to the net income of those periods, companies are permitted but not required to reclassify prior periods upon adoption of Issue 02-16. The SEC observer stated that, to the extent the adoption of Issue 02-16 affects income statement trends, registrants should provide adequate disclosure in MD&A.

Recent FASB Meetings

March 26, 2003 Meeting:

The FASB discussed the following topics:

- Business combinations—purchase method procedures
- Principles-based standards
- Permitted activities of qualifying special-purpose entities
- Financial instruments: derivatives implementation.

The handouts distributed at this meeting are available on the FASB's website at http://www.fasb.org/board_handouts/03-26-03.pdf.

March 17, 2003 Meeting:

The FASB discussed the following topics:

- Business combinations—purchase method procedures
- Combinations of not-for-profit organizations
- Combinations between mutual enterprises.

The handouts distributed at this meeting are available on the FASB's website at http://www.fasb.org/board_handouts/03-17-03.pdf.

Final conclusions were not reached at either of these meetings, and further discussion relating to these projects is expected at future meetings. Project summaries maintained by the FASB staff are available on the FASB's website at <http://www.fasb.org/project>.

Note: Conclusions of the FASB are subject to change at future Board meetings and generally do not affect current accounting requirements until an official position (Statement or Interpretation) is issued. Official positions of the FASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue a Statement or Interpretation.

SEC Proposes Amendments Regarding CEO and CFO Certifications

On March 21, 2003 the SEC proposed amendments to its rules and forms that would require companies to provide the corporate officer certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002 as exhibits to the periodic

reports to which they relate. The SEC also is publishing interim guidance regarding the filing procedures for the certifications required by Section 906, pending the adoption of final rules.

The proposed amendments are expected to make it easier for investors to access the certifications more efficiently. They would also enable the SEC staff and, with regard to Section 906 certifications, the Department of Justice to search periodic reports more expeditiously to verify that the required certifications have been included in the reports and to review the certifications.

Section 302 of the Sarbanes-Oxley Act requires the principal executive and financial officers of a company filing periodic reports to certify in each quarterly and annual report, among other things, that the report does not (1) contain any untrue statement of a material fact or (2) omit to state a material fact necessary in order to make the statements made, in light of the circumstances under which such statements were made, not misleading, and the financial statements, and other financial information included in the report, fairly present in all material respects the financial condition and results of operations of the company.

Section 906 of the Sarbanes-Oxley Act adds a provision to the U.S. criminal laws that contains a separate certification requirement. This provision expressly creates new criminal penalties for a knowingly or willfully false certification. The amendments proposed by the SEC affect rules and forms under the Securities Exchange Act of 1934 and the Investment Company Act of 1940.

The proposed rule is available on the SEC's website at <http://www.sec.gov/rules/proposed/33-8212.htm>.

Acting Chief Accountant to Leave SEC

On March 27, 2003, the SEC announced that Jackson M. Day, the SEC's Acting Chief Accountant, will be returning to the private sector. The SEC's press release noted that Mr. Day will remain with the Commission for a short period of time to assist in the selection a new Chief Accountant and the subsequent transition. The SEC will conduct a nationwide search for a new Chief Accountant. The SEC's press release can be read in its entirety at <http://www.sec.gov/news/press/2003-42.htm>.

AICPA Proposes SOP for Life Insurance Companies

On March 14, 2003, the AICPA's Accounting Standards Executive Committee issued an exposure draft of a proposed SOP, *Accounting by Insurance Enterprises for Deferred Acquisition Costs on Internal Replacements Other Than Those Specifically Described in FASB Statement No. 97*.

The proposed SOP specifies how life insurance companies should account for deferred acquisition costs related to insurance contracts that are replaced by other contracts. The applicable accounting would largely depend on whether a replacement contract is considered to be a new contract or the continuation of an existing contract, based on specified criteria.

The exposure draft and a related announcement can be obtained on the AICPA's website at http://www.aicpa.org/members/div/acctstd/edo/acctg_for_DAC_2003_03.asp. Comments should be received by the AICPA by May 14, 2003.

Further information about AcSEC is available on the AICPA's website at <http://www.aicpa.org/members/div/acctstd/index.htm>.

March 19-20, 2003 IASB Meeting

At its March 19-20, 2003 meeting in London, the IASB took the following actions:

- Discussed various issues and reached certain tentative decisions in its projects on
 - Business Combinations (phase two)
 - Convergence Topics
 - First-Time Application of IFRS (The Board has now completed its deliberations on this project, with a final IFRS expected to be issued in the second quarter of 2003)
 - Insurance Contracts (phase one)
- Considered issues raised by participants at its March 10-14, 2003 public hearings on proposed amendments to IAS No. 32, *Financial Instruments: Disclosure and Presentation*, and IAS No. 39, *Financial Instruments: Recognition and Measurement*
- Reviewed portions of a preliminary draft of a discussion document on measurement objectives, prepared by the Canadian Accounting Standards Board, as the basis for a possible IASB project on this topic.

The next IASB meeting is scheduled for April 24-25, 2003 in London. Additionally, the IASB will meet with the chairs of national accounting standards-setting bodies from April 30 to May 2.

Further information about the IASB can be obtained on the IASB's website at <http://www.iasb.org.uk> and on Deloitte & Touche's IAS Plus website at <http://www.iasplus.com/index.htm>.

Note: Conclusions of the IASB are subject to change at future Board meetings and generally do not affect current accounting requirements for entities that apply IASB standards until an official position (IFRS or Interpretation) is issued. Official positions of the IASB are determined only after extensive deliberation and due process, including a formal vote by written ballot to issue an IFRS or Interpretation.

PCAOB Proposal on Annual Support Fees from Issuers

The Sarbanes-Oxley Act of 2002, which created the PCAOB, also authorizes it to assess issuers, as defined, an annual support fee to fund its operations. At its March 13, 2003 meeting in Washington, D.C., the PCAOB approved the issuance of proposed rules regarding that assessment. The proposed rules would do the following:

- Limit the assessment to two classes of issuers: (1) public companies with average market capitalizations greater than \$25 million and (2) investment companies with average net asset values greater than \$250 million
- Address the assessment of a separate annual support fee to fund the operations of the standards-setting body designated by the SEC to establish accounting principles, as provided for under the Sarbanes-Oxley Act
- Permit the PCAOB to report to the SEC an issuer's nonpayment of fees, for possible sanctions
- Prohibit any public accounting firm registered with the PCAOB from signing an unqualified opinion or issuing a consent on the financial statements of an issuer that is delinquent in its fees.

The proposed rules are available on the PCAOB's website at <http://www.pcaobus.org/pcaob1/rulelistings.asp>. Comments should be received by the PCAOB by April 4, 2003.

An archived webcast of the PCAOB meeting can be accessed at <http://www.connectlive.com/events/pcaob/>.

Abbreviations Frequently Used in Accounting Roundup

AcSEC	Accounting Standards Executive Committee	IASB	International Accounting Standards Board
AICPA	American Institute of Certified Public Accountants	IFAC	International Federation of Accountants
EITF	Emerging Issues Task Force	IFRS	International Financial Reporting Standard
FASB	Financial Accounting Standards Board	PCAOB	Public Company Accounting Oversight Board
FIN	FASB Interpretation	SEC	Securities and Exchange Commission
FSP	FASB Staff Position	SFAS	Statement of Financial Accounting Standards
GASB	Governmental Accounting Standards Board	SOP	Statement of Position
IAS	International Accounting Standard	TPA	Technical Practice Aid

Deloitte Accounting Research Tool Available

Deloitte & Touche is making available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called the Deloitte Accounting Research Tool (DART), the library includes material from the FASB, the EITF, the AICPA, and the SEC, in addition to Deloitte & Touche's own accounting manual and other interpretative accounting guidance.

Updated every business day, DART has an intuitive design and navigation system, which, together with its powerful search features, enable users to quickly locate information anytime, from any computer. Additionally, DART subscribers receive periodic e-mails highlighting recent additions to the DART library.

For more information, including subscription details and an online DART demonstration, visit <http://www.deloitte.com/us/dart>.

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