US Reporting Newsletter for Non-US Based Companies

Global Offerings Services

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Deloitte periodically publishes Accounting Roundups and Heads Ups. Click here to access the published ones.

GAAP Matters

Recent Emerging Issues Task Force (EITF) Meeting

The EITF met on September 29 – 30, 2004 and reached consensus on the following issues:

- Issue No. 04-1, *Accounting for Preexisting Relationships between the Parties to a Business Combination*
- Issue No. 04-8, *The Effects of Contingently Convertible Instruments on Diluted Earnings per Share*
- Issue No. 04-10, *Aggregating Operating Segments That Do Not Meet the Quantitative Thresholds*

All three EITF consensuses were ratified by the Financial Accounting Standards Board (FASB) at its October 13, 2004 meeting.

The Task Force also discussed the following issues without reaching a consensus:

- Issue No. 03-13, *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*
- Issue No. 04-5, *Investor's Accounting for an Investment in a Limited Partnership When the Investor Is the Sole General Partner and the Limited Partners Have Certain Rights*
- Issue No. 04-6, *Accounting for Post-Production Stripping Costs in the Mining Industry*
- Issue No. 04-7, *Determining Whether an Interest Is a Variable Interest in a Variable Interest Entity*

The Task Force removed from the agenda Issue No. 03-9, *Determination of the Useful Life of Renewable Intangible Assets under FASB Statement No. 142, Goodwill and Other Intangible Assets*, and recommended the FASB address this issue because it relates to inconsistencies between Statement 141 and Statement 142 that only the FASB can resolve. In addition, the Task Force removed from the agenda Issue 04-9, *Accounting for Suspended Well Costs*, and recommended that the FASB issue a Board-directed FSP to amend FASB Statement No. 19.

Click here for the full text of the September EITF roundup and click here for the full text of the minutes of the EITF meeting.

Consensus on EITF Issue No. 04-1*, Accounting for Preexisting Relationships between the Parties to a Business Combination*

This Issue addresses the accounting for a preexisting relationship when the parties to the relationship subsequently enter into a business combination. Specifically, the Issue is whether the business combination should be viewed as a single transaction or as one with multiple elements (i.e., a business combination and a *de facto* settlement of the previous relationship(s)). The Issue also addresses the recognition and measurement of a settlement of a preexisting relationship and whether certain reacquired rights should be recognized as intangible assets, apart from goodwill. At the September meeting, the Task Force reached a consensus (reaffirming a previous conclusion) that consummation of a business combination between two parties that have a preexisting relationship(s), are multiple element transactions. The Task Force also developed a model to address the accounting for the settlement of the preexisting relationship. Read more on the model below.

Issue No. 04-8, the Effects of Contingently Convertible Instruments on Diluted Earnings per Share

Contingently convertible debt instruments, commonly referred to as Co-Cos, add a contingent feature to convertible debt. Co-Cos generally are convertible into common shares of the issuer after the market price of the issuer's common stock exceeds a predetermined threshold for a specified period of time (market price trigger). For example, a typical Co-Co might be issued for $1,000 and convertible into ten shares of common stock (implying a conversion price of $100). However, the investor does not have the right to convert unless the market price of the issuer's stock exceeds $120 for five consecutive days. Frequently, a Co-Co includes other complex features (e.g., parity provisions and contingent call or investor put rights).

Co-Cos have found broad acceptance in the capital markets. One likely reason for their popularity is a potential for advantageous earnings per share (EPS) treatment afforded to Co-Cos when compared to conventional convertible debt instruments. Unless the effect is anti-dilutive, a conventional debt instrument usually is included in the computation of diluted EPS (even when the current stock price indicates that it is uneconomical to convert). In contrast, Co-Cos were (in practice) excluded from diluted EPS until the market price trigger was met based on the discussion in FASB Statement No. 128, *Earnings per Share*, on contingently issuable shares. Read more on the Co-Cos below.

EITF Issue No. 04-10, *Determining whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds*

This Issue is one of two that was added to the EITF agenda that deal with the aggregation of segments. Issue 04-10 addresses the aggregation of segments that do not meet the quantitative thresholds under paragraph 18 of FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*. If an operating segment does not meet one of the quantitative thresholds in paragraph 18, paragraph 19 permits an entity to combine information about that segment with other operating segments that do not meet the quantitative thresholds to produce a reportable segment only if the combined segments share a majority of the aggregation criteria listed in paragraph 17.

Two diverse views exist regarding which paragraph 17 criteria should be included in a majority test.

View A Must have similar:	**View B** Be similar in a majority of:
• **Economic characteristics AND** Be similar in a majority of: • Products and services • Production processes • Type of customer • Distribution methods • Regulatory environment	• **Economic characteristics** • Products and services • Production processes • Type of customer • Distribution methods • Regulatory environment

At the September meeting, the Task Force reached a View A consensus. Operating segments that do not meet the quantitative thresholds can be aggregated to produce a reportable segment if:

1. Aggregation is consistent with the objective and basic principles of Statement 131,
2. The segments have similar economic characteristics, and
3. The segments share a majority of the other aggregation criteria listed in View A above.

This consensus may put significant pressure on the determination of whether operating segments have similar economic characteristics, which is discussed in the "Agenda Committee Report and Other Items" section below. This consensus may potentially be applicable to a broad range of companies.

This consensus is effective no later than fiscal years ending after October 13, 2004, the day of FASB Board ratification. The corresponding information for earlier periods, including interim periods, shall be restated unless it is impractical to do so.

No further discussion is expected.

FASB Issues FSP *EITF Issue 03-1-1*, *Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"*

On September 30, 2004, the FASB issued FASB Staff Position (FSP) EITF Issue 03-1-1, which delayed the effective date of paragraphs 10-20 of EITF Issue No. 03-1. Paragraphs 10-20 of EITF Issue No. 03-1 give guidance on how to evaluate and recognize an impairment loss that is other than temporary (i.e., steps 2 and 3 of the impairment model). Application of those paragraphs is deferred pending issuance of proposed FSP EITF Issue 03-1-a. The guidance in paragraphs 6 through 9 of EITF Issue No. 03-1 (i.e., step 1 of the impairment model), as well as the disclosure requirements in paragraphs 21 and 22, have not been deferred and should be applied based on the transition provisions in EITF Issue No. 03-1. Click here to access the FSP.

FASB Issues Proposed FSP EITF Issue 03-1-a, *Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1,* "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

EITF Issue No. 03-1 provides guidance on the meaning of the phrase other-than-temporary impairment and its application to several types of investments including debt securities classified as held-to-maturity and available-for-sale under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*. Paragraph 16 of EITF Issue No. 03-1 provides separate guidance for evaluating whether an impairment is other-than-temporary for debt securities that cannot be contractually prepaid or otherwise settled in such a way that the investor would not recover substantially all of its cost.

On September 15, 2004, the FASB issued proposed FSP EITF Issue 03-1-a to address the application of EITF Issue No. 03-1 to debt securities that are impaired solely because of interest rate and/or

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sector-spread increases and that are analyzed for impairment under paragraph 16 of EITF Issue No. 03-1. Read more on the proposed FSP below.

FASB delays the Effective Date of the Share-Based Payment Standard

The FASB has decided to delay by six months the proposed effective date of the new standard on share-based compensation which will require companies to measure at fair value the cost of share-based compensation. On October 13, 2004, the FASB discussed effective dates for public companies (not including small business issuers). By a majority decision (five in favor and two opposed) the Board tentatively agreed the proposed standard should be effective for awards that are granted, modified, or settled in cash in **interim or annual** periods beginning after June 15, 2005, instead of January 1, 2005 as originally proposed, for example, awards granted in the third quarter for calendar year-end companies.

Additionally, as of the beginning of the period in which the final Statement is first applied, compensation cost would be recognized for the portion of awards outstanding for which the requisite service has not been rendered as of that date; measurement and attribution of compensation cost for those awards would be based on the same estimate of the grant-date fair value and the same attribution method used previously for either (a) recognition or (b) pro forma disclosures under the original provisions of Statement 123. Any cumulative-effect adjustment required under the final Statement (for example, for a change in the method of estimating forfeitures) would be recognized as of the beginning of the period in which the final Statement is first applied. Early adoption would be encouraged provided that financial statements for periods prior to the effective date have not been issued. Click here for the full text of the FASB meeting.

Note: The conclusion reported, herein, is tentative and may be changed at a future Board meeting. Tentative decisions only become final after a final standard has been issued.

AICPA Issues Technical Questions and Answers to Address Financial Accounting and Reporting Issues Related to SOP 03-1

On September 17, 2004, the American Institute of Certified Public Accountants (AICPA) issued the following Technical Questions and Answers to address financial accounting and reporting issues related to SOP 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*:

- TPA 6300.05, *Definition of an Insurance Benefit Feature*
- TPA 6300.06, *Definition of an Assessment*
- TPA 6300.07, *Level of Aggregation of Additional Liabilities Determined under SOP 03-1*
- TPA 6300.08, *Losses Followed by Losses*
- TPA 6300.09, *Reinsurance*
- TPA 6300.10, *Accounting for Contracts that Provide Annuitization Benefits.*

Click here to access the **Technical Questions and Answers.** These Technical Questions and Answers, like all technical questions and answers, have not been approved, disapproved, or otherwise acted upon by any senior technical committee of the AICPA. Although they may provide useful guidance, they are nonauthoritative and do not establish new U.S. GAAP.

SEC and Other Regulatory Matters

SEC Issues Staff Accounting Bulletin No. 106 Regarding the Application of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, by Oil and Gas producing Companies Following the Full Cost Accounting Method

On September 28, 2004, the SEC released SAB 106 which expresses the staff's views on the application of SFAS 143 by oil and gas producing companies following the full cost accounting method. SAB 106 provides interpretive responses related to the following:

- Computing the full cost ceiling to avoid double-counting the expected future cash outflows associated with asset retirement obligations,
- Required disclosures relating to the interaction of SFAS 143 and the full cost rules,
- The impact of SFAS 143 on the calculation of depreciation, depletion, and amortization. **SAB 106** is effective prospectively as of the beginning of the first fiscal quarter beginning after September 28, 2004.

Click here for the full text of SAB 106.

SEC Staff Announcement on the Use of the Residual Method to Value Acquired Assets Other Than Goodwill

On September 29, 2004, the SEC staff provided, through an announcement at the EITF meeting, guidance on the use of the residual method to value acquired assets other than goodwill. The residual method has been used by the telecommunications, broadcasting, and cable industries. Under the residual method, purchase price in a business combination is assigned to all other identifiable assets and liabilities as provided in FASB Statement No. 141, *Business Combinations*, with the remaining amount being allocated to an intangible asset. In these instances, there is either no goodwill recognized, or the amount of goodwill recognized uses a technique other than that specified in paragraph 43 of SFAS 141.

The SEC staff announcement indicates the belief of the SEC staff that the residual method does not comply with the requirements of SFAS 141, and, accordingly, should no longer be used. Instead, a direct value method should be used to determine the fair value of all intangible assets required to be recognized under SFAS 141. Impairment testing of intangible assets, similarly, should not rely on a residual method, and should instead comply with the provisions of FASB Statement No. 142, *Goodwill and Other Intangible Assets*. The SEC staff announcement provides that registrants should no longer apply the residual method to assets (other than goodwill) acquired in business combinations completed after September 29, 2004. Further, companies that have applied the residual method to the valuation of intangible assets for purposes of impairment testing will be required to perform an impairment test no later than the beginning of their first fiscal year beginning after December 15, 2004, using a direct method. Reclassification of recorded balances between goodwill and intangible assets immediately prior to adoption of the staff announcement is prohibited. Click here for the full text of the SEC staff announcement.

SEC Proposes Rule to Establish Voluntary Program for Reporting Financial Information on EDGAR Using XBRL

On September 27, 2004, the SEC proposed rule amendments to enable registrants to voluntarily submit supplemental tagged financial information using the Extensible Business Reporting Language (XBRL) format as exhibits to certain EDGAR (the Electronic Data Gathering,

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Analysis, and Retrieval system) filings. Registrants who choose to participate in the program, which is expected to begin with the 2004 calendar year-end reporting season, would continue to file their financial information in HTML or ASCII format as currently required. The voluntary program, in general, is intended to help the SEC evaluate the usefulness of data tagging and XBRL, in particular, to registrants, investors, the Commission, and the marketplace.

The SEC also issued a concept release which provides additional information on tagged data and solicits comment on the benefits and implications of data tagging as well as the adequacy and efficacy of XBRL as a format for reporting financial information.

Click here for the full text of the **proposed rule** and click here for the full text of the **concept release.** The comment period for the proposed rule ends November 1, 2004. Comments on the concept release should be submitted by November 15, 2004.

PCAOB Developments

Board Adopts *Conforming Amendments to PCAOB Interim Standards Resulting from the Adoption of PCAOB Auditing Standard No. 2, "An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements"*

On September 15, 2004, the Public Company Accounting Oversight Board (PCAOB) adopted amendments to its interim standards that conform the text of the interim standards to the requirements of PCAOB Auditing Standard No. 2, *An Audit of Internal Control over Financial Reporting Performed in Conjunction with an Audit of Financial Statements*. The amendments that affect integrated audits would be effective at the same time Auditing Standard No. 2 becomes effective. Amendments that affect audits of financial statements would be effective only for audits of financial statement periods ending on or after July 15, 2005. The conforming amendments will be submitted to the SEC for final approval, as required by the Sarbanes-Oxley Act of 2002.

Click here for the full text of the amendments.

Both SEC and PCAOB Update their Frequently Asked Questions on Section 404

As discussed in our June 2004 issue, both SEC and PCAOB issued frequently asked questions providing specific implementation guidance on certain topics associated with Auditing Standards No.2. On October 6, 2004 both the SEC and the PCAOB issued additional guidance. The SEC Staff FAQ comes in a form of a "revised" FAQ and adds questions and answers on: (1) the evaluation of (including the inability to evaluate) service organizations, (2) use of the term "material weakness," (3) consents for auditor's reports on internal control over financial reporting, (4) management's report on internal control over financial reporting in annual reports to shareholders, and (5) internal controls and supplementary information such as financial statement schedules required by Regulation S-X. Click here for the full text of the SEC FAQ.
The PCAOB issued a 10-page FAQ, which covers three additional topics – (1) internal control and compliance with laws and regulations; (2) evaluating deficiencies at service organizations, and (3) auditing internal controls at a service organization. Click here for the full text of the PCAOB FAQ.

Miscellaneous

Deloitte issues U.S. Generally Accepted Accounting Principles Compliance Checklist for External Distribution

Deloitte offers a U.S. Generally Accepted Accounting Principles (GAAP) Compliance Checklist that is appropriate for external distribution, including the audit clients. This checklist summarizes the accounting and disclosure requirements set forth in applicable authoritative literature, including AICPA Accounting Research Bulletins, Accounting Principles Board Opinions, FASB Statements of Financial Accounting Standards, FASB Interpretations, FASB Technical Bulletins, EITF Issues, and AICPA Accounting Interpretations. This checklist may be used to assist in considering an entity's compliance with such pronouncements. It is not, however, a substitute for the user's understanding of such pronouncements and the exercise of judgment in determining the appropriate application to an entity's financial statements. In addition, it is presumed that the user has a thorough understanding of the pronouncements, and the user is instructed to refer to the text of the pronouncements, as necessary, in considering particular items in the checklist.

The items in the U.S. GAAP Compliance Checklist are referenced to the applicable sections of Accounting Standards, Current Text, 2003/2004 edition, published by the FASB. Items in the checklist are also referenced to the original pronouncements listed in the first paragraph.

The information in the checklist reflects pronouncements issued prior to December 1, 2003 and EITF Issues through the EITF meeting of November 12 and 13, 2003. Users of the checklist should therefore also consider pronouncements issued after December 1, 2003, and issues discussed and consensuses reached by the EITF after November 12 and 13, 2003, as well as other professional literature, such as AICPA Statements of Position and Audit and Accounting Guides. Click here to access the checklist or contact your Deloitte professional.

Webcasts

Addressing Corporate Section 404 Readiness

On September 22, 2004, Deloitte & Touche LLP and the Financial Executives Research Foundation (FERF) co-hosted a web conference entitled "*Sarbanes-Oxley Section 404: Where Are We Now?*" designed to help financial executives. The purpose of these discussions was to provide financial executives with the opportunity to hear from thought-leaders on timely topics. The following topics were discussed: evaluating and remediating deficiencies; internal control over financial reporting; documentation and testing procedures; and available resources, including internal audit-related questions. Click here to access the playback of the conference.

Recent Deloitte Publications

Below is a list of Deloitte publications about the most recent rule proposals and legislative actions.

- Accounting Roundup, October 4, 2004
- Accounting Roundup: September 10, 2004

As used in this document, the term "Deloitte" includes Deloitte & Touche LLP, Deloitte Consulting LLP, and subsidiaries.

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Accounting Roundup: Third Quarter in Review

The New Landscape: SAS 70 in the Sarbanes-Oxley Era

This publication explains how the current environment has placed focus on Statement of Auditing Standards No. 70 (SAS 70) reports and what steps are needed to assess the effectiveness of internal control over financial reporting. Companies receiving third-party services that directly impact financial reporting controls or internal control environment activities are required to provide evidence that controls are in place both within the third-party provider and between the two organizations.

Avoiding Stumbles on the Path to Sarbanes-Oxley Section 404 Compliance

Deloitte & Touche LLP has identified ten challenges that you should highlight on your compliance trail map as you keep your section 404 projects on track. When engaged in an ambitious effort such as Sarbanes-Oxley Section 404 compliance projects, many people have a tendency to quicken their pace once the long-sought goal finally comes into view. But this urge to accelerate on the final approach, while understandable, should be resisted, as explained in this publication.

Antifraud Programs and Controls Whitepaper

This publication provides questions, examples, and steps for management to consider when creating and implementing antifraud programs and controls. Antifraud activities represent an important component of Sarbanes-Oxley compliance and an essential element of a COSO-based system of internal control. This document may be a useful tool as your company works to meet the requirements of the law.

Quality Assessment Services. Achieving Greater Enterprise Value and Better Corporate Governance Through Better Effective Internal Audit Performance

An independent quality assessment by companies of their Internal Audit department is required by the Institute of Internal Auditors' (IIA) International Standards for the Professional Practice of Internal Auditing (Standards) at least once every five years. Companies should obtain a more broad strategic assessment review, which can provide a level of comfort and understanding to boards and audit committees about their Internal Audit function's efficiency and effectiveness for assessing management's actions related to managing and mitigating enterprise risk. To obtain this publication – please contact your Deloitte professional.

Audit Committee Brief: August 2004

A review of key regulatory, technical and professional developments in corporate governance and accounting in this Deloitte's quarterly newsletter, *Audit Committee Brief*.

Strategies for Going Public

Deloitte's U.S. Offerings Services released an external publication, *Strategies for Going Public*, which will help companies through the initial public offering process by providing practical, working knowledge of the complex procedures involved. Helpful tools include a timetable for going public, a sample due diligence checklist, and a discussion of the new Sarbanes-Oxley requirements. The guidebook will also assist companies in optimizing teamwork by outlining the role of company and its professional advisors in the IPO process. To obtain this publication – please contact your Deloitte professional.

Accounting Roundup: August 20, 2004

Heads Up: Vol. 11, Issue 6. FASB to Tackle Two Tough Tax Topics

Taking Control. A Guide to Compliance with Section 404 of the Sarbanes-Oxley Act of 2002

Heads Up: Vol. 11, Issue 5. Consistency — A Fair-ly Good Idea! FASB Proposes to Make Fair Value Measurement Guidance Consistent

Heads Up: Vol. 11, Issue 4. Who Said Retirement Is Easy? FASB Proposes to Interpret Asset Retirement Accounting

IAS Plus Website -

The International Accounting Standards Board recently revised several pronouncements, such as IAS 1, 2, 3, 8, 10, 16, 17, 24, 28, 32, 33, 39 and 40. Deloitte's IAS Plus website discusses these revisions as well as other current and future developments in the International Financial Reporting Standards (IFRS) environment.

E-learning training materials for International Financial Reporting Standards

Deloitte is pleased to make available e-learning training materials for IFRS free of charge. Click here to Access Deloitte's IFRS e-Learning Material. Content on the following standards is now available: IAS 1, IAS 2, IAS 7, IAS 8, IAS 10, IAS 11, IAS 14, IAS 16, IAS 17, IAS 18, IAS 21, IAS 27, IAS 28, IAS 31, IAS 34, IAS 37, IAS 40, IAS 41, and the Framework for the Preparation and Presentation of Financial Statements. Modules on the remaining standards are currently being developed and will be released in phases throughout 2004.

Other useful publications can be obtained on Deloitte's website – Click here

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As used in this document, the term "Deloitte" includes Deloitte & Touche LLP, Deloitte Consulting LLP, and subsidiaries.

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GAAP Matters

Consensus on EITF Issue No. 04-1*, Accounting for Preexisting Relationships between the Parties to a Business Combination*

The Task Force developed a model to address the accounting for the settlement of the preexisting relationship when the parties to the relationship subsequently enter into a business combination:

Step 1: Allocate the cost of the acquired entity to the identifiable assets acquired and liabilities assumed (including any identifiable assets and liabilities related to the preexisting relationship) based on their estimated fair values at the date of the acquisition with any residual recognized as goodwill in accordance with Statement 141.

Step 2: Segregate the identifiable asset(s) and liability(ies) related to the preexisting relationship(s).

Step 3: For each asset (liability) identified in Step 2, determine how the amount allocated to each asset (liability) in Step 1 would be recognized had that amount been paid (incurred) absent the business combination. (See executory contract in Example 1 below for a departure from the pure fair value principal in Step 2.)

The Task Force determined that this consensus should be applied to the following categories of transactions as follows:

Executory contracts: The settlement amount should be measured at the lesser of (a) the amount by which the contract is favorable or unfavorable to market, or (b) any stated settlement provisions in the contract held by the counterparty to which the contract is unfavorable.

Example 1
Company X purchases supplies from Company Y at fixed rates. The contract has unfavorable pricing to X (favorable to Y or a marketplace participant buying Y out of the contract) that a marketplace participant would value at $3. A marketplace participant also would place a value of $1 on the selling effort and other relationships of having the contract in place. With three years remaining under the supply agreement, X pays $50 (net of liabilities assumed) to acquire Y.

Company X should recognize a loss on settlement of the supply contract of $3 related to the unfavorable pricing terms compared to market. The remaining $47 of purchase price, including the $1 related to the preexisting contract's value representing selling effort and other relationships should be accounted for as part of the business combination.

Lawsuits: The settlement amount would be equal to the difference between the fair value of the lawsuit and any preexisting recorded liability. The Task Force concluded that an acquirer should recognize the hypothetical settlement gain, or loss, as a result of this multiple element transaction.

Example 2
Company X is currently suing Company Y. Company X purchases Y for $300. The estimated fair value of the lawsuit at the business combination date was $50.

Company X should recognize a gain on settlement of $50 and adjust the purchase price of Company Y to $350.

Reacquired rights: The settlement amount should be measured in a manner consistent with that of an executory contract.
The remaining value, related to the reacquired right, should be included as part of the business combination.

Example 3
Company X acquired the business of its operating franchisee, Franchise A. Company X pays $100 (net of liabilities assumed) to acquire A. Assume the total fair value of A includes an intangible asset with a fair value of $40 related to the exclusive rights granted to A by X in a specified territory. Assume the terms of the agreement are at market rates.

Company X should not recognize any settlement because the pricing is at market terms. Company X should include the entire $40 related to the exclusive rights in the purchase price of Franchise A.

The Task Force also reached a consensus that a reacquired right should be recognized as an intangible asset apart from goodwill because it meets the separability criteria of Statement 141. That is, there is evidence of an exchange transaction for the asset as the acquirer had sold the right previously.

The final consensus requires the following disclosures:

- The nature of the preexisting relationship,
- The fair value of the acquired entity's assets and liabilities that were settled, including how fair value was determined, and
- The amount of settlement gain or loss recognized.

This consensus, ratified by the Board at its October 13, 2004 meeting, must be applied prospectively to business combinations and goodwill impairment tests completed in reporting periods beginning after Board ratification. Early application is permitted for business combinations completed in periods for which financial statements have not been issued. Entities are prohibited from reclassifying amounts recognized in prior periods.

No further discussion of this Issue is expected.

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Issue No. 04-8, The Effects of Contingently Convertible Instruments on Diluted Earnings per Share

At the June/July 2004 meeting, the Task Force reached a tentative conclusion that Co-Cos should be included in diluted EPS in **all** periods (except when inclusion is anti-dilutive) regardless of whether the contingency is met or whether the market price contingency is "substantive." Due to the broad potential impact, the tentative conclusion was posted for public comment.

At the September meeting, the Task Force considered this Issue, and comment letters received. After considering the alternative views, the Task Force affirmed its tentative consensus as it relates to **market price** contingencies. That is, a market price contingency should be ignored in calculating diluted EPS. The Task Force did not believe the economics of a Co-Co warranted different EPS treatment from conventional convertibles.

If ratified, this consensus would apply to convertible securities with a market price contingency, including:

- Contingently convertible debt,
- Contingently convertible preferred stock,
- Instrument C as described in EITF Issue No. 90-19, *Convertible Bonds with Issuer Option to Settle for Cash Upon Conversion*, if "conversion" is predicated on a market price contingency similar to a Co-Co.

Example 1
On June 30, 2003, a Co-Co is issued for $1,000 and convertible into ten shares of common stock (implying a conversion price of $100). However, the investor does not have the right to convert unless the market price of the issuer's stock exceeds $120 for five consecutive

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days. During the quarter ended December 31, 2004, the average stock price of the underlying common stock was $95 per share.

The issuer should include the security in diluted EPS under the if-converted method (unless the result is anti-dilutive). Under the consensus, the fact that the market price contingency is not met is ignored for purposes of applying the if-converted method.

Example 2
Same facts as Example 1 except the principal must be settled in cash and the conversion spread is settled in stock.

The EPS guidance in Issue 90-19 should be followed. The issuer should NOT include the security in diluted EPS as of December 31, 2004, because the security is accounted for under the treasury stock method (that is, it is instrument C as described above). Since the conversion price is greater than the average market price during the period, there are no incremental shares that would be issued.

Example 3
Same facts as Example 2. During the quarter ended March 31, 2005, the average stock price of the underlying common stock was $105 per share.

The issuer would include the security in diluted EPS as of March 31, 2005, under the treasury stock method because the average market price of the security was in the money.

The consensus will be effective at the same time as the FASB's yet to be finalized international convergence standard, FASB Statement No. 128(R), *Earnings per Share* (expected to be effective for periods ending after December 15, 2004). Retroactive restatement of earnings per share is required unless:

- The entire agreement is settled in cash before the end of the effective reporting period in which the consensus is first applied,

Or

- The agreement is amended such that the entire contract must be settled in cash.

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FASB Issues Proposed FSP EITF Issue 03-1-a, *Implementation Guidance for the Application of Paragraph 16 of EITF Issue No. 03-1,* "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments"

The proposed FSP addresses the application of EITF Issue No. 03-1 to debt securities that are impaired solely because of interest rate and/or sector-spread increases and that are analyzed for impairment under paragraph 16 of EITF Issue No. 03-1 and states the following:

- An investor should assert its ability and intent to hold an investment until a forecasted recovery at the individual security level.
- Minor impairments caused by interest-rate and/or sector-spread increases can be considered temporary and would not create the need for an assertion about the ability and intent to hold an investment until a forecasted recovery.
- An impairment is considered other-than-temporary when the investor's assertion to hold an investment until a forecasted recovery changes.
- There are circumstances in which a sale of an interest-rate impaired or sector-spread impaired security, for which an investor previously had asserted its ability and intent to hold until a forecasted recovery, may not necessarily call into question the investor's ability or intent to hold other securities to recovery. Such circumstances include the exceptions discussed in paragraphs 8 and 11 of SFAS 115, and the following:
    - Unexpected and significant changes in liquidity needs,
    - Unexpected and significant increases in interest rate and/or sector spreads that significantly extend the period that a security would need to be held by the investor, and
    - A *de minimus* volume of sales of securities.

The proposed FSP would be effective for other-than-temporary impairment evaluations of interest-rate impaired and sector-spread impaired debt securities that are analyzed under paragraph 16 of EITF Issue No. 03-1 on the last reporting date for reporting periods ending after the final FSP is posted to the FASB Web site.

Click here to access the **proposed FSP**. The comment period ends October 29, 2004.

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