

EITF Roundup

November 2003

[Issue No. 02-14](#)

[Issue No. 03-1](#)

[Issue No. 03-6](#)

[Issue No. 03-9](#)

[Issue No. 03-10](#)

[Issue No. 03-12](#)

[Issue No. 03-13](#)

[Issue No. 03-16](#)

[Issue No. 03-17](#)

[Administrative Matters](#)

[Issue No. 03-8](#)

[SEC Announcement
Transition](#)

[Other](#)

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.

Deloitte & Touche LLP is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte & Touche LLP shall not be responsible for any loss sustained by any person who relies on this publication.

This issue of *EITF Roundup* addresses matters discussed at the Emerging Issues Task Force meeting held on November 12-13, 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, along with the Deloitte 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>.

Topics discussed at the November 12-13, 2003 meeting included the following:

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

When an investor has the ability to exercise significant influence over an investee and it has economic interests other than common stock in the investee, should the investor apply the equity method of accounting for its investment? Previously, the Task Force evaluated an economic-interest model for investors to use in evaluating whether the equity method of accounting applies to their economic interests. This model divides an investor's economic interest into one of two categories, for which the equity method may apply, residual interest category or other economic interest category, for which the equity method would not be applicable.

The Task Force was requested to discontinue consideration and remove this Issue from the agenda because the expansion of the equity method to interests other than common stock is an amendment of APB Opinion No. APB 18, *The Equity Method of Accounting for Investments in Common Stock*; however, they were unable to reach a consensus on its removal, many of the Task Force members do not believe the Issue conflicts with higher-level GAAP. A new working group will be formed to address how the equity method of accounting should be applied to "residual interest" investments, other than common stock, and whether noncommon stock investments that meet the residual interest definition and also meet the definition of marketable equity securities under Statement of Financial Accounting Standards No. (SFAS) 115, *Accounting for Certain Investments in Debt and Equity Securities* should be accounted for under SFAS 115 or APB Opinion 18.

Further discussion of this Issue is expected.

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 18, SFAS 115, and SFAS 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 impairment* are not defined by current authoritative literature. Issue 03-1 addresses how to determine the meaning of other-than-temporary in accounting for impairments (i.e., the investment's fair value is less than the investment's cost) and how that concept should be applied to investments accounted for (1) under the cost method, (2) the equity method, (3) as either available-for-sale, or (4) held-to-maturity under SFAS 115 or in accordance with SFAS 124.

The Task Force has been discussing an other-than-temporary impairment model that uses the following three-step process, with some modifications for cost method investments and certain debt securities:

Step 1: Determine whether the investment is impaired.

Step 2: Determine whether the impairment is other-than-temporary.

Step 3: Recognize an other-than-temporary impairment loss equal to the difference between the investment's cost and its fair value at the balance-sheet date.

At the November 12-13, 2003 meeting, the Task Force discussed the model with respect to marketable equity securities and debt securities but was unable to reach a consensus. However, a consensus was reached on required disclosures for SFAS 115 and SFAS 124 securities.

For each category of SFAS 115 and SFAS 124 investments, investors should disclose, in addition to the disclosures already required by SFAS 115 and SFAS 124, the:

- (1) Aggregate amount of unrealized losses, and
- (2) Aggregate related fair value of investments with unrealized losses.

The above disclosures should be segregated into two categories:

- Securities that have been in an unrealized loss position for less than 12 months
- Securities that have been in an unrealized loss position for 12 months or more.

Additionally, certain qualitative disclosures should be made. These disclosures are intended to provide information to help the financial statement reader understand why an investment's fair value that is below cost is not an other-than-temporary impairment. These disclosures might include the nature of the investments, the severity of the unrealized losses, the duration of the impairments and any evidence, both positive and negative, the investor considered in reaching the conclusion that the impairments are temporary.

The EITF consensus, upon Board ratification, will be required to be applied to financial statements for fiscal years ending after December 15, 2003.

Further discussion of this Issue is expected.

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

SFAS 128 indicates that participating securities that are not convertible into a class of common stock should use the two-class method for computing earnings per share (EPS). [The two-class method is an earnings allocation formula that determines earnings per share for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings.] 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. Issues previously discussed and either tentative conclusions or agreements reached included:

- Issue 1—Whether the two-class method requires the presentation of basic and diluted EPS for all participating securities.

Tentative Conclusion—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. However, presentation for a participating security that is not common stock is not precluded.

- Issue 2—How to define a participating security that requires the application of the definition in SFAS 128, paragraph 61. (Paragraph 61 requires the use of either the "if-converted method" for those securities that are

convertible into common stock if the effect is dilutive or for securities that are not convertible into a class of common stock, the "two-class" method.)

Tentative Conclusion—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 stock, whether that participation is conditioned upon the occurrence of a specified event or not, regardless of the form of that participation.

- Issue 4—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.

Tentative Conclusion—(This tentative conclusion represents a slight modification to the one the Task Force reached at a previous meeting.) An entity would allocate losses to a participating security only if the security's contractual terms provide for the security to share in current losses with common stock.

At its November 12-13, 2003 meeting, the Task Force reached tentative conclusions on the following Issues:

- Issue 3—How undistributed earnings should be allocated to a participating security.

Tentative Conclusion—Undistributed earnings should be allocated to a participating security based upon the contractual participation rights of the security to share in those earnings. If the terms of a security do not specify objectively determinable, nondiscretionary participation rights, then undistributed earnings would not be allocated based on arbitrary assumptions. Also, if an entity could avoid distributions of undistributed earnings to participating holders, despite actually distributing all earnings, then no allocation of that period's earnings to the participating security would be made. Participation rights that are contingent on or subject to the discretion of the company should be fully disclosed as addressed in paragraph 4 of SFAS 129.

- Issue 2(b)(i)—Whether dividends or dividend equivalents paid to the holder of a convertible security in the form of a reduction to the conversion price or an increase in the conversion ratio of the security represent participation rights.

Tentative Conclusion—Dividend equivalents that either reduce the conversion price or increase the conversion ratio of a convertible security do not represent participation rights.

- Issue 2(b)(ii)—Whether an entity should recognize a dividend equivalent that is applied to reduce the conversion price or increase the conversion ratio of a convertible security in its financial statements, and if so, how those dividend equivalents should be recognized in the financial statements.

Tentative Conclusion—A dividend equivalent that is applied to either reduce the conversion price or increase the conversion ratio of a convertible security should be recognized in an entity's financial statements and the dividend should be treated as a contingent beneficial conversion feature under EITF Issues No. 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, and No. 00-27, *Application of EITF Issue No. 98-5, Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios, to Certain Convertible Instruments*.

- Issue 2(a) Whether all potential common shares, that is, securities or other contracts that may entitle their holders to obtain common stock (such as options, warrants, forwards, or other contracts to issue common stock) may be participating securities. The Task Force discussed but did not reach any conclusions on this Issue. The Task Force discussed whether this Issue should be removed from Issue 03-6 as it may be addressed in or have significant interaction with the Board's *Equity-Based Compensation* and *Liabilities and Equity* projects. The Task Force also decided that Topic D-95 should be revisited to determine the appropriateness of allowing the if-converted method for participating securities. The Task Force will conclude on whether to include or exclude Issue 2(a) from Issue 03-6 once Topic D-95 is revisited at a future meeting.

- Issue 5—Whether a convertible participating security should be excluded from the basic EPS computation when the entity has a net loss. The Task Force reached a tentative conclusion that a convertible participating security would be included in the computation of basic EPS if an entity has a net loss from continuing operations consistent with Issue 4 above (i.e., if contractually obligated due to the residual nature of the security).
- Issue 6—How a convertible participating security is included in the computation of diluted EPS. The Task Force discontinued discussion on this Issue. The FASB staff observed that SFAS 128 already provides appropriate guidance for the inclusion of convertible securities in the computation of diluted EPS.

Further discussion of this Issue is expected.

Issue No. 03-9, *Interaction of Paragraphs 11 and 12 of FASB Statement No. 142, Goodwill and Other Intangible Assets, Regarding Determination of Useful Life and Amortization of an Intangible Asset*

Paragraph 11 of SFAS 142 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) provides that one of the factors in estimating the useful life an intangible asset is:

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).

Questions have been raised regarding the evaluation of "substantial cost" and "material modifications" in determining whether an intangible asset has an indefinite useful life and, if not, what is the appropriate useful life. Previously, the Task Force tentatively agreed that costs of renewal or extension should include any net negative expected present value cash flows arising as a result of activities or undertakings necessary to affect and/or accomplish renewal. In connection with the tentative agreement, the Task Force asked the FASB staff to further consider the impact of the tentative agreement on the life and amortization period of an intangible asset. Further, the Task Force asked the FASB staff to consider the impact of the tentative agreement on whether, and if so, when, an intangible asset would have an indefinite life.

At the November 12-13, 2003 meeting, the Task Force was not asked to reach a consensus on this Issue. The Task Force discussed the "pattern-of-economic benefit" amortization method illustrated by the FASB staff. The Task Force expressed concern that the implication of this method is that the valuation approach would seem to dictate the amortization approach. As a result of those and other concerns, the Task Force requested that a working group be established to discuss the issues in determining whether an intangible asset has a finite or indefinite life and the appropriate method of amortization for a finite life intangible asset.

Further discussion of this Issue is expected.

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 the manufacturer or 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 on a gross-basis as revenue, when received from the manufacturers, which is the predominant current practice in accounting for manufacturer's coupons by resellers.

At the November 12-13, 2003 meeting, the Task Force reached a consensus 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 but instead should be shown as revenue. 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 resellers that accept manufacturer's incentives in partial (or full) payment of the price charged by the reseller,
- (2) For which the reseller receives a direct reimbursement from the vendor (or a clearinghouse authorized by the vendor) based on the face amount of the incentive,
- (3) For which the terms of reimbursement for a vendor's sales incentive must not be influenced by or negotiated in conjunction with any other arrangement with the vendor, but, rather, may only be determined by the terms of the incentive, and
- (4) The reseller is subject to an agency relationship with the vendor in a sales transaction between the vendor and the consumer.

For coupons not within the scope of 1-4, 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 provisions of this consensus would be applied to new arrangements, including modifications to existing arrangements, entered into (or, as the case may be, redeemed) in fiscal periods beginning after the date of FASB ratification of the final consensus. If determinable, pro forma disclosure of the impact of the consensus on prior periods presented is encouraged. Additionally, financial statements for prior periods presented, for comparative purposes, are *permitted* to be restated/reclassified to comply with the consensus, including any necessary restatement to the adoption of Issue 02-16. However, restatement/reclassification would only be permitted from the date that Issue 02-16 was adopted and forward (consistent with the original timing and method of transition undertaken by an entity to adopt the provisions of Issue 02-16). Restatement of the years presented prior to the adoption of the provisions of Issue 02-16 is not permitted.

No further discussion of this Issue is expected.

Issue No. 03-12, *Impact of FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, on EITF Issue No. 95-1, Revenue Recognition on Sales with a Guaranteed Minimum Resale Value*

Issue 95-1 provides guidance that when a manufacturer, in the sale of equipment, guarantees to the purchaser the future residual value of the equipment, the transaction should be accounted for as a lease, using the principles addressed in SFAS 13, *Accounting for Leases*. This consensus was partially nullified due to the issuance of FASB Interpretation (FIN) 45. The effect of the partial nullification required manufacturers to continue to apply SFAS 13 for transactions within the scope of Issue 95-1, but if the lease was determined to qualify as a sales-type lease, the manufacturer would be required to treat the residual value guarantee within the scope of paragraph 3(a) of FIN 45.

At the November 12-13, 2003 meeting, the Task Force reached a consensus that FIN 45 should not have affected the consensus previously reached in Issue 95-1 and the previous partial nullification should be reversed.

No further discussion of this Issue is expected.

Issue 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*

Paragraph 42 of SFAS 144 addresses reporting discontinued operations for a component unit of an entity when:

- (a) the operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and (b) the entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

In practice, the above requirements have been interpreted in a very restrictive fashion, which may not coincide with what the Board intended.

The Issues considered were:

Issue 1: Cash flows of the component that should be considered in the determination of whether cash flows have been or will be eliminated from the ongoing operations of the entity.

Issue 2: The types of continuing involvement that constitute significant continuing involvement in the operations of the disposal component.

Issue 3: What the reassessment period would be with respect to the criteria in paragraph 42 of SFAS 144.

The Task Force was not asked to reach a consensus on Issues 1 and 2. The Task Force expressed general agreement with the approach developed by the FASB staff and the working group. However, the Task Force requested that the FASB staff further develop the issue to more clearly articulate the principles and objectives of the assessment. The Task Force also requested that the staff consider what level or recharacterization of cash flows is acceptable in concluding that cash flows have been eliminated, and after that criteria has been developed, provide examples illustrating the views for characterizing the component unit as discontinued operations.

The Task Force reached a tentative conclusion on the reassessment period. The assessment should be made during the period that includes the point at which the component initially meets the criteria to be classified as held for sale and one year after the date the component is actually disposed of. It should be based on all facts and circumstances, including management's intent and ability to eliminate the cash flows of the disposal component from its operations and management's intent and ability not to have significant continuing involvement in the operations of the disposal component. If at any time the criteria are not expected to be met within one year after the disposal date, the component's operations should be reclassified from discontinued operations. If at any time the criteria are expected to be met within one year after the disposal date, the component's operations should be reclassified to discontinued operations.

Further discussion of this Issue is expected.

Issue No. 03-16, *Accounting for Investments in Limited Liability Companies*

There is no specific authoritative literature that addresses accounting for limited liability corporations (LLC). LLCs have characteristics of both corporations and partnerships, but are dissimilar from both in certain respects. The guidance of when to apply the equity method or cost method of accounting to a noncontrolling investment differs for investments in corporations and investments in partnerships. Under APB 18, an investor in common stock of a corporation is generally assumed to have significant influence and is required to use the equity method of accounting when the investment represents 20 percent or more of the investee's outstanding common stock. In addition, AICPA Statement of Position (SOP) No. 78-9, *Accounting for Investments in Real Estate Ventures*, and AICPA Accounting Interpretation No. 2, *Investments in Partnerships and Ventures*, of APB 18, have been used to support equity method accounting for certain investments in partnerships. That guidance requires the use of the equity method unless the investor's interest "is so minor that the limited partner may have virtually no influence over partnership operating and financial policies." The SEC staff acknowledged in EITF Topic D-46, *Accounting for Limited Partnership Investments*, that practice generally has viewed investments of more than 3 to 5 percent to be more than minor and, thus, subject to the equity method.

This Issue addresses whether an LLC should be treated as a corporation or a partnership for purposes of determining whether a noncontrolling investment in the LLC should be accounted for using the cost method or the equity method of accounting.

The Task Force reached a tentative conclusion that SOP 78-9 should be followed for LLCs that have separate ownership accounts for each investor. That consensus, if reached, would be applied for the first fiscal period beginning after FASB ratification, and presented upon adoption in a manner similar to a cumulative effect of a change in accounting principle as described in APB 20, *Accounting Changes*.

Further discussion of this Issue is expected.

Issue 03-17, *Subsequent Accounting for Executory Contracts Recorded on an Entity's Balance Sheet*

This Issue addresses the subsequent accounting for an asset arising from an executory contract that has already been recognized on the balance sheet. It does not, however, address initial recognition of assets and liabilities arising from executory contracts. The specific accounting issues to be addressed were:

Issue 1: The appropriate method of amortization of an asset arising from an executory contract.

Issue 2: The appropriate method of derecognition of a balance-sheet credit arising from an executory contract.

At the November 12-13, 2003 meeting, the Task Force discussed this Issue but was not asked to reach a consensus. The Task Force determined that the guidance in this Issue may be impacted by the consensus reached on Issue 03-9, discussed above and may be incorporated into Issue 03-9. However, the Task Force requested the FASB staff to develop examples for further consideration.

Further discussion of this Issue is expected.

Administrative Matters

Issue 03-8, *Accounting for Claims-Made Insurance and Retroactive Insurance Contracts by the Insured Entity*

The EITF discussed changes made to Issue 03-8 to clarify and reconcile the guidance contained in Issue No. 86-12, *Accounting by Insureds for Claims-Made Insurance Policies*, Issue No. 03-3, *Applicability of EITF Abstracts, Topic No. D-79 to Claims-Made Insurance Policies*, and Topic D-79, *Accounting for Retroactive Insurance Contracts Purchased by Entities Other Than Insurance Enterprises*. The FASB staff will make minor changes and submit the final codification to the Task Force for its final consensus.

SEC Announcement

The SEC Observer announced that Topic D-98, *Classification and Measurement of Redeemable Securities*, still applies for financial instruments that have been given a scope exception from SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*, through FASB Staff Position (FSP) 150-3, *Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150*. Topic D-98 will be updated to reflect this announcement.

Transition

EITF consensuses generally are effective for transactions or arrangements entered into after the next reporting period following the date of FASB ratification of the consensuses. This transition guidance generally applies unless otherwise noted by the Task Force.

Other

The following Issues were added to the EITF agenda:

- Whether Mining Rights are Tangible or Intangible Assets
- Mineral Assets—Impairments and Business Combinations
- Allocation of Goodwill to Reporting Units for a Mining Enterprise
- The Accounting for Certain Costs in the Mining Industry Including Deferred Stripping Costs

- Application of FASB Statement No. 142, *Goodwill and Other Intangible Assets*, to Certain Assets of Oil and Gas Companies Subject to FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*.

The following Issues were removed from the EITF agenda:

- Issue No. 01-J, *Accounting for the Deconsolidation of a Majority-Owner Subsidiary*
- Issue No. 00-N, *Measuring Fair Value of Equity Securities with Restrictions in a Nonmonetary Exchange*
- Issue No. 03-14, *Participants' Accounting for Emissions Allowances under a "Cap and Trade" Program*.

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, the SEC, and the IASB, 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>.