MOODY, FAMIGLIETTI & ANDRONICO

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E-merging Issues & Trends

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If you would like to discuss the content of this E-merging Issues & Trends issue, please call:

William S. Andronico, CPA, MBA, MST
Partner

MFA - Moody, Famiglietti & Andronico, LLP
1 Highwood Drive. Tewksbury, MA 01876
Tel: (978) 557-5300 | wandronico@mfa-cpa.com

EITF Issues Affect 2009 Financial Reporting

As the world struggles to balance the dream of international accounting standards with the realities of national customs and laws, the Emerging Issue Task Force (EITF) of the Financial Accounting Standards Board (FASB) is stepping up to new issues with answers that might affect you.

In some respects, a rash of detailed accounting guidance may not be seen as good news. Indeed, proponents of principles-based accounting have pointed to the already-thick volumes of *EITF Abstracts* as a symbol of excessive rules-based guidance. But some detailed guidance is a necessity, and we support the EITF's efforts to try to help accountants find answers to the questions that arise in connection with today's complex and ever changing business practices.

In addition to the complexities of changing business and financial practices, the EITF is dealing with issues related to recent accounting standards. The fallout from recent pronouncements on fair values and business combinations has spread far and wide, raising questions about how to apply the standards. Will your company be affected? It may be, if it engages in certain types of business and financial practices, including the following:

Areas Affected

- Acquisition of "defensive" intangible assets.
- Investments that are accounted for using the equity method.
- Revenue arrangements that are contingent on achieving of milestones.
- Leases with maintenance deposits.
- Warrants or convertible debt.
- Use of third-party guarantees for debt.
- Securities with certain redemption features.

To help you sift through the potential effects on your company's financial reporting, this issue of *E-merging Issues and Trends* summarizes the topics addressed and consensuses reached by the EITF during 2008, and it provides our perspective on the need for interpretive guidance.

The Fallout from Recent Accounting Standards

As is often the case with new accounting standards, several recent FASB Statements have stirred up a beehive of unanswered questions, and practitioners are looking for guidance before they get stung by unwanted consequences, such as the second guessing of regulators. The standards that raised the most questions during 2008 address the accounting for business combinations (Statement 141R), non controlling interests (Statement 160), and fair value measurements (Statement 157).

Areas Affected

The questions raised by Statements 141R, 160 and 157 and discussed by the EITF during 2008 touch on a broad array of subjects ranging from equity method investments (Issue 08-6) and defensive intangible assets (Issue 08-7) to financial instruments (Issue 08-8) and redeemable securities (Topic D-98). Highlights of the resulting decisions (consensuses) and announcements are summarized below and described in more detail in Table 1.

• Equity method investments

The equity method of accounting for investments requires that the investor report its investment as an asset and adjust the value of the asset for its proportional share of the investee's net income. Statements 141R and 160 contain provisions that affect equity method accounting, and Issue 08-6 clarifies the way these provisions should be applied. Among other things, the consensus affects the way an investor in an equity method investee must account for the issuance of new shares by the investee. Currently, the investor may make a policy election to recognize the impact in either earnings or equity. Under Issue 08-6, the issuance is accounted for as though the equity method investor had sold a proportionate share of its investment with the related gain or loss recognized in earnings

• Defensive intangible assets

A defensive intangible asset is one that the entity does not intend to use itself but intends to hold as a way to prevent others from using it. A common example is a trade name. It can be acquired in a business combination or an asset acquisition. The application of FASB Statements 141R and 157 to these assets was unclear in some respects. Among other things, Issue 08-7 clarifies that: (a) a defensive asset should be considered a separate unit of accounting and should not be combined with an existing asset whose value it may enhance, and (b) it would be rare for a defensive intangible asset to have an indefinite life.

• Financial instruments

Currently, financial instruments issued by a company based on the equity of one of its consolidated subsidiaries are not considered indexed to the company's own stock, with the result that they are typically treated as derivatives and recognized at fair value each reporting period. In response to questions about an apparent inconsistency with Statement 160, Issue 08-8 reverses that determination and allows certain instruments previously accounted for as derivatives to be included in equity consistent with FASB Statement 160's treatment of noncontrolling interests (provided the instruments meet other requirements to be classified as equity, such as EITF Issue 00-19).

• Redeemable securities

When noncontrolling interests are deemed redeemable, they may need to be classified outside of permanent equity for SEC Reporting under Regulation S-X. EITF Topic D-98 was revised during 2008 to provide guidance on how to measure and classify these types of securities under Statement 160. Depending on the nature of the redemption feature, (e.g., whether it is issued or guaranteed by the parent company), the application of Topic D-98 could affect the parent company's earnings per share. These consensuses and announcements take effect for calendar year 2009.

The Results of Emerging Business Trends

As new business trends and ever more innovative financial practices continue to evolve, they often raise reporting questions or open up questions about new areas of accounting, even when they are not the subjects of new accounting pronouncements. The past year was no exception, as the EITF discussed a number of accounting questions raised by current trends and practices involving partnerships, leases, liabilities, and financial instruments.

Areas Affected

The EITF's answers to some of the questions raised by business trends and practices have a relatively broad impact; others have a narrower impact and may affect only certain types of entities. The topics with the broadest impact involve accounting for lease maintenance deposits (Issue 08-3) and liabilities with third-party credit enhancements (Issue 08-5). The narrower topics involve master limited partnerships (Issue 07-4) and financial instruments considered indexed to an entity's own stock (Issue 07-5). Highlights of the trends, questions raised and decisions reached are summarized below and described in more detail in Table 1.

• Lease maintenance deposits

Leases increasingly include maintenance deposits that can be refunded to the lessee if specified maintenance activities are performed. These types of lease agreements can raise accounting questions

when: (1) the lessee is responsible for maintaining the leased asset, and (2) the lessee makes payments to the lessor that will be reimbursed to the lessee upon completion of maintenance of the leased asset. Some lessees treated the payments as a deposit. Others treated them as contingent rent expense or maintenance expense when the initial payment was made. Issue 08-3 clarifies that the lessee should treat the payment as a deposit, and it may either expense or capitalize the cost of maintenance at the time the maintenance is performed, whichever is consistent with the lessee's accounting policy.

• Liabilities with credit enhancements

The use of third-party credit enhancements in connection with debt offered to investors can raise questions about the measurement of fair value when the instrument is carried or disclosed at fair value. For example, a company may issue debt with a contractual financial guarantee from a third party of the issuer's payment obligations. When measuring the fair value of that liability, accountants may be puzzled over how to reflect the third party's guarantee. Issue 08-5 clarifies that the unit of accounting for the debt does not include the third-party credit enhancement, and the issuer should not include the effect of the credit enhancement in the fair value measurement of the liability.

• Master limited partnerships

The capital structures and formulas by which stakeholders may participate in earnings have grown complex for master limited partnerships (MLPs). MLPs are common in the oil and gas industry. In some cases, questions have arisen about the calculations of earnings per share (EPS) for MLPs that distribute available cash to limited partners, general partners, and holders of incentive distribution rights (IDRs) and use the two-class method of allocating earnings. Issue 07-4 provides guidance on how to apply the two-class method when: (a) current period earnings exceed cash distributions, and (b) cash distributions exceed current period earnings.

• Financial instruments

A plethora of settlement provisions for financial instruments has emerged in recent years, and these provisions can complicate the determination of whether an instrument may be considered indexed to an entity's own stock for accounting purposes. This determination is important because it is one of several conditions that, when taken together, could provide relief from a burdensome accounting requirement that would otherwise apply, (i.e., the issuer would need to separate the instrument from the host contract and account for it as a derivative). Issue 07-5 provides guidance that establishes a systematic approach for making this determination.

The consensuses on all the foregoing Issues take effect for calendar year 2009.

On the Horizon

The EITF is currently discussing a number of other issues that have arisen as a result of recent accounting standards and contemporary business practices. One issue involves the application of Statement 160 to transfers of interests in subsidiaries (Issue 08-10,) and two issues involve the accounting for popular revenue arrangements (Issues 08-1 and 08-9), including those in which revenue is contingent on the achievement of certain milestones. Highlights of the discussions and decisions exposed for public comment (consensuses for exposure) are summarized in Table 1.

MFA Viewpoint

The activities of the EITF over the past year serve as a reminder of the need for balance as part of a rational and systematic approach to standard setting. More than ever before, accountants must strive to find the right balance between principles-based guidance and the timely availability of sufficient interpretive guidance.

• Why now?

The right balance is especially important now because the desire for one set of global accounting standards is ushering in an era of unprecedented change for US accountants. In the push to eliminate differences between US GAAP and IFRS, the drive toward international convergence is increasing the number of new or revised standards, speeding up the pace of standard-setting, and thereby subjecting financial reporting to more risks.

• What risks?

There is a risk of reaching a new kind of tipping point. Years ago, the tipping point was commonly believed to be the point where the output of standard-setters exceeded the capacity of preparers, auditors and users of financial statements to digest and implement changes in accounting principles. The popular term for such a tipping point was a state of "standards overload." Today, that risk continues, but it is increasingly accompanied by a risk of insufficient interpretive guidance as a byproduct of the rush to conform US GAAP and international standards. This added risk puts more pressure on the entire system.

• What pressure?

When coupled with too great a sense of urgency, convergence efforts can result in a lack of due process or lead to inadvertent oversights, either of which might manifest itself in uncertainties about how to apply the new standards and raise ques-

tions such as those found in the first section of this Advisory on "the fallout from recent accounting standards." The EITF is well-equipped to resolve such matters, but there are difficult tradeoffs with the kinds of issues described in the second section of this Advisory on "the results of emerging business trends." In effect, the EITF may find itself torn between the implementation issues and the questions about emerging trends. Too little interpretive guidance on implementation issues can result in unwanted diversity of practice. Too little interpretive guidance on emerging trends can result in opaque financial reporting. Either can seriously undermine the credibility of US financial reporting.

• How can confidence be maintained?

The key is to put a process in place to balance the convergence efforts with an attempt to identify emerging trends in the US and around the world that raise accounting questions and call for new solutions. Some of these will be global; others national. Accountants need to be prepared for both. We don't know yet what form the process might take, but we hope the EITF will be an intrinsic part of the process and will continue its important mission for many years to come.

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Table 1:

EITF Fact Sheet

Summaries of Issues Discussed

Issue No. 07-4, "Application of the Two-Class Method under FASB Statement No. 128, *Earnings* per Share, to Master Limited Partnerships."
This Issue addresses questions that arise when calculating earnings per share (EPS) for master limited partnerships (MLPs) using the two-class method. The questions arise when applying the EPS calculations to the increasingly complex ways that stakeholders in the partnerships can participate in earnings and distributions.

Key points about the calculations and participations are as follows:

- *EPS calculations*. The two class method is a formula for allocating earnings. Under this formula, EPS is determined for each class of common stock and participating security according to dividends declared (or accumulated) and participation rights in undistributed earnings.

- *Complex participations.* Today's publicly traded MLPs often issue multiple classes of securities that may participate in partnership distributions according to a formula specified in the partnership agreement. Typically, the capital structure for an MLP consists of publicly-traded units held by limited partners, a general partner interest, and incentive distribution rights (IDRs).

A key issue is how the current period earnings of a master limited partnership should be allocated to the general partner, limited partners, and, when applicable, holders of IDRs.

Consensus: At its March 2008 meeting, the Task Force reached the following consensus:

– Undistributed earnings should be allocated to the general partner, limited partners and any holders of IDRs using the contractual terms of the partnership agreement.

– When cash distributions are in excess of current-period earnings, net income (or loss) should be reduced (or increased) by distributions to the general partner, limited partners, and holders of IDRs. The resulting excess of distributions over earnings is allocated to the general partner and limited partners based on their respective sharing of losses (that is, the provisions for allocation of losses to the partners' capital accounts) specified in the partnership agreement.

Ratification: The FASB ratified the consensus on March 26, 2008. The effective date is for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those fiscal years. Earlier application is not permitted. The guidance in this Issue is to be applied retrospectively for all financial statements presented.

EITF Fact Sheet

Issue No. 07-5, "Determining Whether an Instrument (or Embedded Feature) is Indexed to an Entity's Own Stock."
This Issue addresses questions that can arise when determining whether an instrument (or an embedded feature) is indexed to an entity's own stock. This determination is important because it is one of several conditions that, when taken together, could result in a conclusion that an instrument or embedded feature is not a derivative. As compared to prior guidance, the consensus on Issue 07-5 will result in fewer instruments being classified as equity and more being classified as derivatives and as liabilities.

Consensus: In June 2008, the Task Force reached a consensus that the following instruments would not be considered indexed to the entity's own shares:

– Instruments with a strike price denominated in a currency other than the issuer's functional currency.

– Market-based employee option valuation instruments, such as ESOARS.

For other types of instruments, the Task Force reached a consensus that entities should apply a two-step approach for determining whether the instrument or embedded feature is indexed to an entity's own stock.

• *Step 1*. Evaluate the instrument's contingent exercise provisions, if any. When conducting this step, companies should look to the guidance in EITF Issue 01-6, "The Meaning of 'Indexed to a Company's Own Stock.'" This guidance provides conditions under which contingent exercise provisions preclude an instrument or embedded feature from being indexed to an entity's own stock. (For example, the contingent exercise provision cannot be based on an observable market or index other than one based on the market for the issuer's stock or measures of the issuer's own operations, such as sales, income or equity). If this step does not indicate any precluding factors, then the analysis would proceed to Step 2.

• *Step 2*. Evaluate the instrument's settlement provisions. When conducting this step, two tests should be considered:

a) Does the settlement amount equal the difference between the fair value of a fixed number of the entity's shares and a fixed amount of cash or other financial instruments? If so, then the instrument would be considered indexed to its own stock.

b) Is the strike price or the number of shares underlying the instrument fixed? If not, the instrument would still be considered indexed to the entity's own stock if the settlement amount is only affected by certain types of inputs, (i.e., inputs to the fair value of a "fixed-for-fixed" forward or option on equity shares).

Examples of such inputs include:

– The entity's stock price

– The instrument strike price

– The instrument term

– Expected dividends or other dilutive activities

– Stock borrow cost

– Interest rates

– Stock price volatility

– The entity's credit spread

– The ability to maintain a standard hedge position in the underlying shares.

If the instrument's settlement provisions incorporate other inputs or contain features such as leverage factors, then the instrument would not be considered indexed to the entity's own shares. For example, if an instrument has any of the following features that result in a settlement price reset, the instrument will fail the second test of Step 2 and will not be considered indexed to the company's own stock:

– Settlement price resets for a decline in the stock price not directly linked to a specific action by the company.

– Settlement price resets as a result of company sale of common stock at a lower price (that is equal to fair value at the time of sale).

– Settlement price resets as a result of company failure to meet a revenue milestone.

Ratification: The FASB ratified the consensus on June 25, 2008.

The consensus is effective for financial statements issued for fiscal years beginning after December 15, 2008 and interim periods within those years. Early adoption is not permitted. The guidance in this Issue should be applied to all instruments in its scope that are outstanding as of the effective date.

EITF Fact Sheet

Issue No. 08-1, "Revenue Recognition for a Single Unit of Accounting."

This Issue addresses questions that have arisen in practice when applying the FASB's current guidance for recognizing revenue to contemporary revenue arrangements that consist of multiple payment streams. For example, certain service contracts may require an up-front payment at inception and periodic payments as services are provided.

- *Current guidance.* Currently, the guidance for such transactions is provided in part by EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." But this guidance does not specifically address many issues encountered in practice today.
- *Contemporary arrangements.* A common set of issues regards the inability to separate deliverables and recognize revenue on items that have been delivered because there is no vendor-specific objective evidence (VSOE) or verifiable objective evidence (VOE) of the fair value of one or more undelivered items.

As one step in updating and expanding the guidance for revenue recognition, Issue 08-1 focuses on the fair value threshold of EITF Issue No. 00-21 and considers whether it needs to be revised.

Separately, the Task Force is also considering questions related to the "milestone method." (See Issue No. 08- 9, "The Milestone Method of Revenue Recognition," on page 12 of this report).

<u>Consensus for exposure:</u> In November 2008, the Task Force reached a consensus for exposure that covers arrangements that are currently subject to Issue No. 00-21 and amends that Issue to reflect the following changes and clarifications:

– In the absence of VSOE or VOE of selling price for the undelivered unit or units of accounting, a vendor should use its best estimate of the selling price for the undelivered items and allocate the arrangement consideration to the delivered unit or units using the residual method.

– The amount allocated to the delivered units cannot exceed the selling price of the delivered units of accounting based on VSOE or acceptable third-party evidence (TPE), if known.

– The vendor should disclose both qualitative and quantitative information on an aggregated basis that provides an understanding of the inputs and methodologies used to develop the estimated selling price. Separate disclosures should be made for individually significant arrangements.

The scope of Issue 08-1 excludes arrangements that are subject to SOP 97-2, "Software Revenue Recognition." During the discussions about the scope of Issue 08-1, the Task Force suggested and the FASB Chairman agreed that a separate project should be added to the EITF's agenda on arrangements that are subject to SOP 97-2.

The consensus for exposure was ratified by the FASB on November 24, 2008 and exposed for public comment as a draft abstract.

The draft abstract calls for application of Issue 08-1 prospectively to revenue arrangements entered into or materially modified in fiscal years beginning on or after December 15, 2009. Earlier application would be permitted as of the beginning of a vendor's fiscal year.

EITF Fact Sheet

Issue No. 08-3, "Accounting by Lessees for Maintenance Deposits Under Lease Arrangements."

This Issue addresses the accounting for certain lease arrangements that require the lessee to pay maintenance deposits to ensure that it properly maintains the leased asset. The maintenance deposits in the scope of this Issue are refunded to the lessee if the specified maintenance activities are performed.

Consensus: In June 2008, the Task Force reached a consensus that a maintenance payment in the scope of this Issue should be accounted for as a deposit asset. When the underlying maintenance is performed, the costs should be expensed or capitalized consistent with the lessee's maintenance accounting policy. Any amounts on deposit that are less than probable of being returned should be recognized as additional expense.

Ratification: The FASB ratified the consensus on June 25, 2008.

The consensus is effective for financial statements issued for years beginning after December 15, 2008 and interim periods within those years. Early adoption by an entity that had previously applied an alternative policy is not permitted.

Issue No. 08-4, "Transition Guidance for Conforming Changes to Issue No. 98-5."

The Task Force amended EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios" for changes made by EITF Issue No. 00-27, " Application of Issue No. 98-5 to Certain Convertible Instruments" and FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. While Issue 00- 27 and Statement 150 were issued several years ago, Issue 98-5 was never updated to reflect the effect of those two standards and some entities continued to apply the superseded guidance in Issue 98-5.

Consensus: In June 2008 the Task Force reached a consensus that the conforming changes made to Issue 98- 5 are effective for financial statements issued for fiscal years ending after December 15, 2008. Earlier application is permitted. The Task Force agreed not to finalize the tentative conclusions in Issue 00-27. The Task Force also decided not to codify Issues 98-5 and 00-27 into a single abstract

Ratification: The FASB ratified the consensus on June 25, 2008.

Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value With a Third-Party Credit Enhancement."

This Issue addresses questions about how to measure the fair value of debt instruments with inseparable third-party credit enhancements.

For example, a company may issue debt with a contractual guarantee by a third party to meet the payment obligations of the issuer, if the issuer defaults. These guarantees are typically purchased by the issuer who then combines them with the debt and issues the combined securities to investors.

At issue is whether the fair value of the instrument should take into account the third-party credit enhancement – or if it should consider only the issuer's risk of non-performance.

Consensus: In September 2008, the Task Force reached a consensus that:

- The unit of accounting for the debt does not include the third-party credit enhancement, and the issuer of a liability with an inseparable third-party credit enhancement should not include the effect of the third-party credit enhancement in the fair value measurement of the liability.
- An entity that has an outstanding liability within the scope of Issue 08-5 should disclose the existence of the credit enhancement.

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– This Issue does not apply to credit enhancements provided by the government or governmental agencies, (e.g., deposit insurance).

Ratification: The FASB ratified the consensus on September 24, 2008.

Issue 08-5 is effective on a prospective basis in the first reporting period on or after December 15, 2008.

In the period of adoption, an entity must disclose the valuation technique(s) used to measure the fair value of any liabilities that fall within the scope of this Issue, and it must discuss any changes in the valuation techniques used to measure these liabilities in prior periods.

Issue No. 08-6, "Equity Method Investment Accounting Considerations."

This Issue addresses questions about the accounting for equity method investments. The questions arose following the issuance in 2007 of FASB Statements No. 141R, *Business Combinations*, and No. 160, *Noncontrolling Interests in Consolidated Financial Statements—an amendment of ARB No. 51*.

Statements 141R and 160 do not directly address the accounting for equity method investments, but questions arose because the standards amended, (i.e., Statement 141 and ARB 51), contained certain provisions that were used in applying the equity method.

Consensus: In November 2008, the Task Force reached a consensus on the following clarifications:

– The initial carrying value of an equity method investment should be measured at cost in accordance with paragraphs D3-D7 of Statement 141R.

– Subsequent to the initial measurement, equity method investors are required to recognize their share of other-than-temporary impairments of equity method investments in accordance with APB Opinion 18. They are not required to do any separate impairment testing of the investee's underlying assets (including its underlying indefinite-lived intangible assets). But they must also consider the effect, if any, of the impairment on the investor's basis difference in the assets giving rise to the investee's impairment charge.

– If the equity method investee issues shares, the equity method investor should account for the issuance as if it had sold a proportionate share of its investment, with the resulting gain or loss recognized in earnings.

– If the equity method investor changes to the cost method, it should continue to apply the guidance in paragraph 19(1) of APB Opinion 18 that addresses such changes.

Ratification: The FASB ratified the consensus on November 24, 2008.

Issue 08-6 is effective in fiscal years beginning on or after December 15, 2008 and interim periods within those fiscal years. The consensus should be applied prospectively. Early application is not permitted by an entity that has previously adopted an alternative accounting policy.

EITF Fact Sheet

Issue No, 08-7, "Accounting for Defensive Intangible Assets."
This Issue addresses questions that have arisen in anticipation of the complexities involved in applying Statements 141R and 157, *Fair Value Measurements*, to certain types of intangible assets (known as defensive intangible assets) acquired in a business combination or asset acquisition.

- *Defensive intangible assets.* Defensive intangible assets are intangible assets that are not being actively used, but are held to prevent another entity from using them. An example might be a trade name of an acquired entity that the acquirer does not intend to use itself. An asset of this type is defensive because it is a "locked-up" asset. Such an asset is likely contributing to an increase in the value of other assets owned by the acquiring entity.

- *Fair value complexities.* Typically, in the past, when a company acquired an asset of this type, it allocated little or no value to the asset. However, this practice will change when Statements 141R and 157 become effective and intangible assets must be recognized at a value that reflects the asset's highest and best use based on market participant assumptions. The new standards have raised questions about how defensive assets should be accounted for subsequent to their acquisition.

Consensus: In November 2008, the Task Force reached a final consensus that:

– A defensive asset should be accounted for as a separate unit of accounting. It should not be included as part of the cost of the acquirer's existing intangible assets because the defensive asset is separately identifiable.

– The useful life of the defensive asset should reflect the period over which the entity consumes the expected benefits of the asset, (i.e., by estimating the period over which the defensive intangible asset will diminish in fair value).

– It would be rare for a defensive asset to have an indefinite life.

– A defensive intangible asset cannot be considered immediately abandoned.

– The scope of this Issue excludes all research and development intangible assets. These assets should be accounted for in accordance with paragraph 16 of Statement 142 as amended by Statement 141R.

Ratification: The FASB ratified the consensus on November 24, 2008.

Issue 08-7 is effective for intangible assets acquired on or after the first annual reporting period beginning on or after December 15, 2008. The guidance must be applied prospectively. Earlier application is not permitted.

Issue No. 08-8, "Accounting for an Instrument (or an Embedded Feature) with a Settlement Amount that is Based on the Stock of an Entity's Consolidated Subsidiary."
This Issue addresses questions that have arisen about the accounting for certain financial instruments following the issuance of Statement 160.

At issue are instruments (and embedded features) for which the payoff to the counterparty is based, in whole or in part, on the stock of a consolidated subsidiary. An example would be warrants to purchase shares of a consolidated subsidiary.

The questions relate to consistency with current guidance.

- *Current guidance.* Currently, EITF Issue No. 00-6, "Accounting for Freestanding Derivative Financial Instruments Indexed to, and Potentially Settled in, the Stock of a Consolidated Subsidiary," indicates that instruments issued by an entity based on the equity of one of the entity's consolidated subsidiaries are not equity instruments of the consolidated entity, with the result that they are typically treated as derivatives and recognized at fair value each reporting period.

- *Consistency issues.* Some accountants have questioned whether the guidance in Issue 00-6 is consistent with that provided in Statement 160. After the effective date of Statement 160, the noncontrolling interest in a subsidiary's stock will be classified in the equity of the consolidated entity.

EITF Fact Sheet

Therefore, instruments in the scope of Issue 08-8 will no longer be treated as derivatives, provided they are not required to be classified as liabilities, (e.g., under Statement 150 or Issue 00-19.)

Consensus: In November 2008, the Task Force reached a consensus that:

– Instruments based on the stock of a subsidiary are not precluded from being considered indexed to the company's own stock in the consolidated financial statements of the parent.

– An equity-classified instrument within the scope of Issue 08-8 generally would be presented as a component of noncontrolling interest in the consolidated financial statements, whether the instrument was entered into by the parent or the subsidiary.

– If an equity-classified instrument within the scope of Issue 08-8 is entered into by the parent and expires unexercised, the carrying amount of that instrument would be reclassified from the noncontrolling interest to the controlling interest.

As a result of this consensus, certain instruments linked to subsidiary stock that were previously accounted for as derivatives may be included in equity consistent with FASB Statement 160, if they meet other requirements to be classified as equity, such as EITF Issue 00-19, and if the subsidiary is substantive.

Ratification: The FASB ratified Issue 08-8 on November 24, 2008.

The consensus reached in Issue 08-8 is effective for fiscal years and interim periods within those years beginning on or after December 15, 2008.

Under the transition guidance, the fair value of an outstanding instrument that was previously classified as an asset or liability will become its net carrying amount at the date of initial application, and the net carrying amount will be reclassified to noncontrolling interest. Gains or losses recorded during the period that the instrument was classified as an asset or liability are not reversed.

Issue No. 08-9, "Milestone Method of Revenue Recognition."

This Issue provides guidance on a new "milestone" method of revenue recognition that previously has not been specifically authorized in the accounting standards.

The guidance responds to questions that continue to arise about the accounting for revenue arrangements involving multiple payment streams. Some of the most complex issues arise in the types of arrangements that provide for payments that are contingent upon the achievement of "milestones."

An example of a payment contingent on a milestone would be a payment that is due a biotechnology company upon the successful completion of clinical trials. Such payments can involve the allocation of revenue for a single unit of accounting across multiple accounting periods.

Currently, guidance for revenue recognition in such arrangements is provided in part by EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables." But this guidance does not specifically address many issues encountered in practice.

In the absence of any authoritative literature, some companies have adopted the so-called "milestone" method under which revenue is recognized as milestones are achieved.

EITF Fact Sheet

The growing use of this method raises questions about whether it is considered acceptable and, if so, whether it should be required in certain circumstances.

Tentative consensus: The Task Force discussed this Issue in September and November 2008 and tentatively agreed that:

- The milestone method may be acceptable when the milestone is substantive. But it is not necessarily the only acceptable method, even when an arrangement contains substantive milestones.
- The criteria for use of this method include the requirements that: (1) the consideration earned from the achievement of a milestone must relate solely to past performance, (2) the milestone must be substantive, and (3) there must have been substantial uncertainty about the achievement of the milestone at the date the arrangement was entered into.
- In general, the milestone method may be applied to all contractual revenue arrangements, (written, oral, or implied), under which a vendor satisfies its performance obligations to a customer over a period of time and when a portion or all of the arrangement consideration is contingent upon the achievement of a milestone, unless the unit of accounting that includes the milestone is accounted for under SOP 81-1 or SOP 97-2.

Further discussion is expected at a future meeting.

Issue No. 08-10, "Selected Statement 160 Implementation Questions."

This Issue responds to inquiries about potential conflicts in the accounting for gains and losses on certain transactions that trigger deconsolidation accounting under Statement 160 and other standards.

Key points about the potential conflicts and deconsolidation triggers:

- *Potential conflicts.* Statement 160 requires recognition of a gain or loss upon deconsolidation and loss of control. In contrast, the literature for certain types of transfers generally tends to preclude recognition of gains or losses.
- *Deconsolidation triggers.* The potential for conflicting guidance is evident in the accounting treatment for the following types of transfers that can result in deconsolidation of subsidiaries: (a) A transfer of an interest in a subsidiary that is in substance real estate, (b) A transfer of an interest in a subsidiary to an equity method investee, and (c) A transfer of an interest in a subsidiary in exchange for a joint venture interest.

Consensus for exposure: In November 2008, the Task Force reached a consensus for exposure that clarifies that FASB Statement No. 66, not Statement 160, would apply to a transfer that is in substance real estate. Statement 160 would apply to the other two types of transfers.

In addition, to avoid potential conflicts with other accounting standards, the consensus for exposure would amend ARB 51 to apply only when the subsidiary is a substantive entity. ARB 51 provides guidance on partial sales of interests in a subsidiary, including sales that result in deconsolidation of the subsidiary.

The FASB approved the consensus for exposure on November 24, 2008, and the draft abstract was released for public comment.

EITF Fact Sheet

Topic D-98, "Classification and Measurement of Redeemable Securities."

The SEC Observer made several announcements in 2008 to explain the interaction between the SEC staff's views on the classification and measurement of redeemable securities (codified as EITF Topic D-98) and the FASB's releases on noncontrolling interests (Statement 160) and certain convertible debt instruments (FSP APB 14-1).

(1) Noncontrolling Interests

In March 2008, the SEC Observer announced proposed amendments to Topic D-98 to conform with FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*. Statement 160 requires noncontrolling interests in consolidated subsidiaries to be classified and accounted for as equity in the consolidated financial statements. The SEC's revisions clarify that Topic D-98 applies to redeemable noncontrolling interests and requires them to be classified outside of permanent equity (temporary equity or mezzanine).

As revised, Topic D-98 provides guidance for situations where classification of an equity security in temporary equity is no longer required, (e.g., when the redemption feature expires or the terms of the security are modified). When this classification is no longer required, the equity security should be reclassified to permanent equity at its carrying amount on the date of reclassification. Reversals of previous adjustments to the carrying amount of the equity security would be inappropriate.

Additionally, the SEC staff revised Topic D-98 to provide guidance on measuring the gain or loss that is recorded when a parent deconsolidates a subsidiary. Previous adjustments to the carrying amount of noncontrolling interests should be eliminated by recording a credit to the parent's equity (because the previous adjustments to the carrying amount were recorded as debits to the parent's equity). This will have the effect of reducing the gain, or increasing the loss, upon deconsolidation. The SEC staff encourages disclosure of the amount credited to equity.

Finally, the SEC staff provided the following guidance for calculating the effect of redeemable noncontrolling interests on earnings per share:

- For noncontrolling interests in the form of preferred shares, if the redemption feature is issued or guaranteed by the parent, the entire adjustment to the carrying amount of the noncontrolling interest reduces (or increases) income available to common shareholders of the parent.
- For noncontrolling interests in the form of preferred shares, if the redemption feature is not issued or guaranteed by the parent, the adjustment to the carrying amount of the noncontrolling interest reduces (or increases) the subsidiary's income available to common shareholders, which then affects parent company earnings per share.
- For noncontrolling interests in the form of common shares redeemable at fair value, the carrying amount should be adjusted each period to the redemption amount, but the adjustments have no effect on earnings per share.
- For noncontrolling interests in the form of common shares redeemable at other than fair value, the adjustments to the carrying amount may adjust: a) net income attributable to the parent or b) income available to common shareholders of the parent.

The revised guidance should be applied for fiscal years beginning after December 15, 2008 (the effective date of Statement 160).

(2) Convertible Debt

In September 2008, the SEC Observer announced the SEC's views on the interaction between Topic D-98 and the FASB's recent guidance on certain convertible debt provided in FSP APB 14-1, "Accounting for Convertible Debt Instruments that may be settled in Cash upon Conversion (including Partial Cash Settlement)."

If the equity-classified component of the instruments covered by the FSP is considered redeemable, then a portion of it would be classified as temporary equity. That portion is calculated as the excess of: (1) the amount of cash or other assets that would be required to be paid to the holder upon redemption or conversion, over (2) the current carrying amount of the liability-classified component of the convertible debt instrument.

EITF Fact Sheet

Other Issues – EITF Agenda Decisions

Note that in mid-2008, the authority to set the EITF agenda passed from the Agenda Committee to the FASB Chairman. Since that change, the Agenda Committee has become an advisory body for the Chairman.

Accounting for Share-Based Payment Transactions with Nonemployees

In January, the Agenda Committee decided not to add this Issue to the EITF agenda.

Determining Whether a Money Market Mutual Fund is Designed to Create and Pass Along Interest Rate Risk for Purposes of Applying Interpretation 46(R)

In January, the Agenda Committee decided not to add this Issue to the EITF agenda. The Task Force chairman explained that the staff is researching this and other issues related to FASB Interpretation No. 46 (revised December 2003), *Consolidation of Variable Interest Entities*, to determine if these issues merit further standard setting consideration.

Lessor Revenue Recognition for Maintenance Services

The EITF considered Issue 08-2 to address questions about how revenue should be recognized for lease arrangements that require the lessor to perform certain maintenance services to the leased asset during the lease term. Sometimes the fees for the maintenance services are included in the periodic lease payments and other times the payments are made separately. In June 2008, the issue was removed from the EITF's agenda amid concerns that the guidance would create additional complexity and would not help users of financial statements.

Accounting for Purchases and Sales of Partial Interests in a Subsidiary That Is In Substance Real Estate

In July, based on the Agenda Committee's recommendations and input from the FASB members, the FASB Chairman decided not to add this Issue to the EITF agenda. But some aspects of the subject are considered under Issue 08-10.

Determining Whether Payments to Incentive Distribution Rights Holders in Master Limited Partnerships Represent Equity Distributions or Compensation Expense

In March, after considering a proposed project plan, the Agenda Committee reconsidered this Issue and recommended that it not be added to the EITF Agenda. The Issue had also been considered in November 2007.

Determining What Constitutes a Mine When Accounting for Stripping Costs Incurred during Production

In June, after discussion with the Agenda Committee, the FASB Chairman decided not to add this issue to the EITF agenda.

Accounting for Share Lending Arrangements in Contemplation of Convertible Debt Issuances and the Related Determination of Earnings per Share

In November, the FASB Chairman agreed to add this Issue to the EITF agenda.