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EITF Snapshot.

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This *EITF Snapshot* summarizes the September 13, 2013, meeting of the Emerging Issues Task Force (EITF or "Task Force").

Initial Task Force consensuses ("consensuses-for-exposure") are exposed for a comment period upon ratification by the Financial Accounting Standards Board (FASB). After the comment period, the Task Force considers comments received and redeliberates the issues at a scheduled meeting in order to reach a final consensus. Those final consensuses are then provided to the Board for ratification.

After the October 2, 2013, FASB meeting, the official EITF minutes, including the results of the FASB's ratification process, will be posted to Technical Library: The Deloitte Accounting Research Tool and to the FASB's Web site. EITF Issue summaries also can be found on those sites. Also see the EITF's official minutes and ratified consensuses, since they may differ from this publication.

Issue 13-B Accounting for Investments in Tax Credits

Status: No consensus reached (tentative decisions made).

Affects: Entities that invest in limited liability entities that pass through income tax credits to their investors.

Background: Under U.S. GAAP, entities account for investments in limited partnerships that operate affordable housing projects by using the cost method, the equity method of accounting, or the effective yield method. ASC 323-740-35-2[1] states that under the effective yield method, "the investor recognizes [related Low Income Housing Tax Credits (LIHTC)] and amortizes the initial cost of the investment to provide a constant effective yield over the period that tax credits are allocated to the investor." In addition, entities present the amortization of their investments net within their provision for income taxes along with tax credits and other tax benefits. To apply the effective yield method, an entity must first assess whether the investment meets certain conditions outlined in EITF Issue 94-1,[2] codified in ASC 323-740, and make an accounting policy election to use the effective yield method to account for qualifying LIHTC investments.

An entity often cannot apply the accounting policy election in ASC 323-740 to use the effective yield method to account for its LIHTC investments, because many such investments do not meet the required conditions. Specifically, many such investments do not include a guarantee that the tax credits allocable to the investor will be available. In addition, many LIHTC investments do not provide a positive yield on the basis of the tax credits alone.

In March 2013, the EITF reached a consensus-for-exposure that would make it easier for investments to qualify for the effective yield method by eliminating the requirement that the availability of related tax credits be guaranteed and by permitting entities to consider both tax credits and other tax benefits when determining whether an LIHTC investment provides a positive yield. During its September 13 meeting, the EITF made a number of tentative decisions in response to feedback that the FASB received on the EITF's consensus-for-exposure.

Summary: The Task Force tentatively decided that entities would be permitted to elect to apply a proportionate amortization method[3] to LIHTC investments and other tax credit investments by analogy to the guidance in this Issue, if certain conditions are met.

Conditions that must be met for both LIHTC and other tax credit investments for an investor to apply the proportionate amortization method include the following (as stated in the Issue Summary):

> a. It is probable[4] that the tax credits allocable to the investor will be available.
>
> b. The investor retains no [significant ability to influence the operating and financial policies of the limited liability entity] and substantially all of the projected benefits are from tax credits and other tax benefits . . . .

1 For titles of *FASB Accounting Standards Codification* (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the *FASB Accounting Standards Codification*."

2 EITF Issue No. 94-1, "Accounting for Tax Benefits Resulting From Investments in Affordable Housing Projects."

3 Under the proportionate amortization method, "the cost of the investment is amortized each reporting period in proportion to the tax credits [and other tax benefits] received." Under the tentative decision, entities would no longer be permitted to apply the effective yield method.

4 The FASB staff clarified that the term "probable," as used in this context, is consistent with ASC 450-20, which defines "probable" as "[t]he future event or events are likely to occur."

c. The investor's projected yield based solely on the cash flows from the tax credits and other tax benefits is positive.

d. The investor is a limited liability investor in the limited liability entity for both legal and tax purposes, and the investor's liability is limited to its capital investment.

The Task Force also tentatively decided that an entity that enters into other transactions with the limited liability entity (e.g., makes a loan in addition to its investment) may not apply the proportionate amortization method to equity investments in that entity even if they are made to receive tax credits and other tax benefits, unless it is an LIHTC investment and meets the following conditions (as stated in the Issue Summary):

- "The reporting entity is in the business of entering into such other transactions."
- "Such other transactions are entered into at market rates commensurate with rates offered to other counterparties with similar credit quality."
- "The reporting entity does not acquire [a significant ability to influence the operating and financial policies of the limited liability entity] as a result of such other transactions."

The Task Force also tentatively decided that an entity should:

- Combine qualifying tax credit investments accounted for under the proportionate amortization method with other deferred tax assets in the statement of financial position.
- Disclose, in the footnotes to its financial statements, the amount of such investments included in the deferred tax asset line and that they relate to tax credits that have not been realized as of the balance sheet date.
- Assess whether it should record a valuation allowance for its tax credit investment along with other deferred tax assets in accordance with ASC 740.
- Assess whether an investment qualifies for the proportionate amortization method, provided that the entity has made the accounting policy election to apply this method, at initial recognition and when an event or changes in circumstances arise indicating that the investment may no longer meet the qualifying conditions.
- Disclose the impact of its tax credit investment on its financial statements.[5]

Finally, the Task Force requested that the FASB staff perform additional outreach to determine whether there are unforeseen consequences that may result from permitting entities to apply the guidance in this Issue to tax credit investments other than LIHTC investments and to consider whether the qualifying criteria should be further modified to address conditions that are unique to these other tax credit investments.

Effective Date and Transition: The Task Force tentatively decided that the guidance in this Issue should be applied retrospectively to all prior periods presented. Entities that previously applied the effective yield method would be permitted to continue applying the effective yield method only to those investments previously accounted for under this method. The Task Force will discuss the effective date at a future meeting.

Next Steps: The Task Force will discuss this Issue again at a future meeting.

Issue 13-D Determination of Whether a Performance Target That Can Be Met After the Requisite Service Period Is a Performance Condition or a Condition That Affects the Grant-Date Fair Value of the Awards

Status: Consensus-for-exposure.

Affects: Entities that issue stock compensation awards for which issuance or award amounts are contingent on the employer's achieving a specified performance target that could be achieved after the employee has provided the requisite service.

Background: Stock compensation awards commonly include a performance target that may affect the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award and that can be met after an employee provides the requisite service.

[5] The EITF's consensus-for-exposure reached in March 2013 included the suggestion that an entity provide disclosures to satisfy this objective. However, the EITF tentatively decided to remove a suggested disclosure related to regulatory reviews of the affordable housing project.

On the basis of discussions among members of the FAS 123(R) Resource Group during its September 13, 2005, meeting, an entity could account for a performance target (e.g., an entity that executes an initial public offering or achieves specified levels of earnings before income tax, depreciation, and amortization) that may be met after an employee provides the requisite service in one of the following three ways:

1. By treating the performance target as a performance condition that affects vesting. Under this approach, an entity would not record compensation cost until it is probable that the performance target will be achieved. Compensation cost is measured as of the grant date without consideration of the performance target.
2. By treating the performance target as a postvesting restriction that should be factored into the grant-date fair value of the award to be recognized as compensation expense over the requisite service period, without subsequent adjustment for changes in the likelihood of the performance target being achieved.
3. By treating the award as a liability and subsequently measuring the award liability at its fair value in each reporting period.

The FAS 123(R) Resource Group did not reach a unanimous conclusion on which of the three possible approaches an entity should use. Therefore, there is no explicit U.S. GAAP guidance on accounting for performance targets that can be met after the requisite service is provided.

This Issue was added to the EITF's agenda to address the lack of explicit guidance on this matter.

Summary: At this meeting, the Task Force reached a consensus-for-exposure that entities should treat performance targets that can be met after the requisite service period as performance conditions that affect vesting. Under this consensus, an entity would not record compensation expense (measured as of the grant date without consideration of the performance target) related to an award for which transfer to the employee is contingent on the entity's satisfaction of a performance target until it becomes probable that the performance target will be met.

Because the FAS 123(R) Resource Group first discussed this question in the context of retirement-eligible employees, the Task Force also discussed how an entity should account for awards to employees that are retirement-eligible on the grant date or that may become eligible during the service period. Although this topic is not an explicit part of the Task Force's consensus-for-exposure, the consensus reached would require that entities account for performance targets that can be met after the employee's estimated service period as a performance condition that affects vesting. That is, there would be no difference in the treatment of performance targets that can be met after the service period for retirement-eligible employees or employees that would not become retirement-eligible during the award's standard service period, except that the retirement-eligible employee's service period may be shorter.

No incremental recurring disclosures would be required under this Issue.

Effective Date and Transition: The Task Force reached a consensus-for-exposure that this Issue would be applied prospectively to awards that are granted or modified on or after the effective date of a final ASU related to this Issue. The Task Force will discuss the effective date at a future meeting.

Next Steps: FASB ratification is expected at the Board's October 2, 2013, meeting, after which the proposed ASU will be exposed for public comment.

Issue 13-G Determining Whether the Host Contract in a Hybrid Financial Instrument Is More Akin to Debt or to Equity

Status: Consensus-for-exposure.

Affects: Entities that issue or hold hybrid financial instruments issued in the form of a share.

Background: When evaluating whether a host contract within a financial instrument that contains embedded features is more akin to debt or to equity, entities have considered the SEC staff's guidance in ASC 815-10-S99-3.[6] This guidance has led to two acceptable methods for determining the nature of a host contract: the whole-instrument[7] approach and the chameleon[8] approach. Whether an entity uses the whole-instrument or the chameleon approach may affect whether an embedded feature is considered clearly and closely related to the host contract. If it is determined that an embedded feature is not clearly and closely related to the host contract, the embedded feature may be bifurcated if certain other criteria are met,[9] provided that no ASC 815 scope exceptions apply. Entities account for embedded derivatives that are bifurcated by measuring them at fair value and recording changes in fair value in net income.

The following example demonstrates how the chameleon and whole-instrument approaches are applied:

Example

Assume that an entity is using the chameleon approach to evaluate a conversion option embedded in a convertible preferred share instrument with a fixed-price redemption feature for bifurcation. In this case, the entity would exclude the conversion feature and only consider the remaining features. Because the redemption feature protects the holder from downside movement in the value of the entity's common or preferred stock and such protection is considered a significant indicator that the host, in the absence of the conversion option, is debt-like, an entity will typically conclude that the host is debt-like. As a result, the embedded conversion feature could be bifurcated under this approach (typically a conversion option that is an equity-like feature is not considered clearly and closely related to a debt host).

However, in practice, there are different interpretations of the (1) SEC staff's guidance in ASC 815-10-S99-3 and (2) application of the whole-instrument approach to a convertible preferred share with noncontingent fixed-price redemption features. Entities place varying degrees of weight on the various embedded features. In line with the example above, some place significant weight on the fixed-price redemption feature and conclude that the host is debt-like. These entities believe that the downside protection (i.e., protection from decreases in the equity value) provided by a noncontingent fixed-price redemption feature causes the nature of the host contract to be more akin to debt even when the hybrid instrument includes equity-like features such as dividend-participation rights, voting rights, or a conversion option. They believe that the existence of a noncontingent fixed-price redemption feature is a determinative factor in the conclusion that the host contract is debt-like. As a result, the embedded conversion feature could be bifurcated under this approach.

Others believe that all relevant terms and features must be weighted under the whole-instrument approach. Considering the same example, some have taken the view that an entity should also take into account equity-like features (including the conversion option, dividend-participation rights, and voting rights) in evaluating whether the conversion option is clearly and closely related to the host contract under the whole-instrument approach. They believe that ignoring any equity-like features and treating the presence of a fixed-price redemption feature as determinative of a debt-host would be contradictory to the SEC staff's guidance in ASC 815-10-S99-3. Under this approach, some might conclude that the conversion option is clearly and closely related to the host contract (by placing more emphasis on the equity-like features, including the conversion feature, dividend-participation rights, and voting rights) and that the embedded conversion feature would therefore not be bifurcated.

6 In ASC 815-10-S99-3, the SEC staff expressed its position that an entity must consider all "stated and implied substantive terms and features" of a hybrid instrument issued in the form of a share when determining whether a host contract is more akin to equity or to debt. However, the SEC staff also acknowledged that some registrants have an accounting policy in which the terms and features pertaining to the individual embedded derivative being evaluated are excluded from the determination of the nature of the host contract for that embedded derivative.

7 Under the whole-instrument approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, including the embedded feature being analyzed for bifurcation. When the whole-instrument approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract should not change as each embedded feature is analyzed separately.

8 Under the chameleon approach, an entity determines the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid instrument, except for the particular embedded feature being analyzed for bifurcation. When the chameleon approach is used to analyze a hybrid instrument with multiple embedded features, the nature of the host contract may change as each embedded feature is analyzed separately.

9 An embedded feature will be bifurcated and accounted for as a derivative if it does not qualify for scope exceptions in ASC 815 and (1) the embedded derivative is not clearly and closely related to the host contract, (2) the hybrid instrument is not accounted for at fair value with changes in fair value recognized in net income, and (3) a separate instrument with the same terms as the embedded derivative would meet the definition of a derivative instrument.

This Issue was added to the EITF's agenda to address the diversity in practice discussed above.

Summary: The Task Force reached a consensus-for-exposure that would require entities to apply the whole-instrument approach when determining the nature of the host contract in a hybrid financial instrument issued in the form of a share. The chameleon approach would not be permitted.

The Task Force also reached a consensus-for-exposure that would require entities to determine the nature of the host contract in a convertible preferred equity instrument with a fixed-price redemption feature by considering all relevant terms and features of the instrument and weighing each feature on the basis of the relevant facts. There would not be a rebuttable presumption that a convertible preferred equity instrument with a fixed-price redemption feature is debt-like because of the redemption feature.

Effective Date and Transition: The Task Force will discuss the effective date at a future meeting; however, the EITF tentatively decided that the guidance in this Issue would be adopted by reporting a cumulative-effect adjustment directly to retained earnings as of the beginning of the year of adoption.

Next Steps: FASB ratification is expected at the Board's October 2, 2013, meeting, after which the proposed ASU will be exposed for public comment.

Administrative Matters

EITF Issue No. 12-F, "Recognition of New Accounting Basis (Pushdown) in Certain Circumstances," was included in the EITF's September 13 meeting agenda but was not discussed. The EITF will discuss this Issue at its next meeting, scheduled for November 14, 2013.

Comments on the following EITF Issues, discussed at a previous meeting and for which a consensus-for-exposure was reached, are due by September 17, 2013:

- Issue 12-H, "Service Concession Arrangements."
- Issue 13-E, "Reclassification of Collateralized Mortgage Loans Upon a Troubled Debt Restructuring."

Comments on EITF Issue No. 12-G, "Measuring the Financial Liabilities of a Consolidated Collateralized Financing Entity," are due by October 17, 2013.

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