



# EITF Snapshot

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Audit and Enterprise Risk Services

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## March 2008

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This *EITF Snapshot* summarizes the March 12, 2008, meeting of the Emerging Issues Task Force.

Initial Task Force consensuses (“consensuses-for-exposure”) are exposed for a comment period upon ratification by the Financial Accounting Standards Board. At its first scheduled meeting after the comment period, the Task Force considers comments received and, as warranted, affirms its consensuses-for-exposure as consensuses. Consensuses are provided to the Board for ratification.

After the March 26, 2008, FASB meeting, 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.

### Issue 07-4     *Application of the Two-Class Method Under FASB Statement No. 128, Earnings per Share, to Master Limited Partnerships*

**STATUS:** Consensus reached.

**AFFECTS:** Publicly traded master limited partnerships (MLPs) with incentive distribution rights (IDRs) whose incentive distributions are accounted for as equity distributions. The consensus (1) does not address whether incentive distributions are equity distributions or compensation expense and (2) applies regardless of whether the IDR is a freestanding limited partner interest or embedded in the general partner (GP) interest.

The MLP ownership structure is common in industries such as petroleum and natural gas extraction and transportation.

**BACKGROUND:** In a typical publicly traded MLP, cash is distributed to common units held by limited partners (LPs), a GP interest, and IDRs, in accordance with the terms specified in the partnership agreement.

Generally, the partnership agreement obligates the GP to distribute all of the partnership’s available cash<sup>1</sup> after the end of each quarter to the LPs and GP, and when certain thresholds are met, to the IDR holder. A complicating factor in computing earnings per unit is that available cash, as determined under the partnership agreement, often differs from earnings (loss). Consequently, distributions may be greater than (or less than) earnings (loss) for any given period.

At issue is how, when applying the two-class method under Statement 128,<sup>2</sup> current-period earnings of an MLP should be allocated to the GP, to the LPs, and when applicable, to the IDR holder.

An additional application issue is whether the MLP becomes obligated to make distributions (and such distributions should be included in earnings per unit) as of the end of the period or once available cash has been determined by the GP. This issue arises because the partnership agreement usually allows the GP 30 to 60 days after the end of the reporting period to determine the amount of available cash.

<sup>1</sup> “Available cash” is typically defined in the partnership agreement as all cash on hand at the end of each quarter less cash retained by the partnership as capital to (1) operate the business (e.g., future capital expenditures); (2) comply with applicable law, debt, and other agreements; and (3) provide funds for distribution to the LP common unit, GP, and IDR holders for any one or more future quarters.

<sup>2</sup> FASB Statement No. 128, *Earnings per Share*.

**SUMMARY:** The Task Force reached the following consensus:

**Earnings in Excess of Cash Distributions** — Current-period earnings should be reduced by the amount of distributions to the GP, LPs, and IDR holder determined in accordance with the contractual terms of the partnership agreement. The remaining undistributed earnings should be allocated to the GP, LPs, and IDR holder by using the distribution waterfall for available cash (i.e., a schedule that prescribes distributions to the various interest holders at each threshold) specified in the partnership agreement. If an analysis of the contractual terms of the partnership agreement reveals that available cash represents a “specified threshold” for the reporting period presented, as described in Example F in paragraph 16 of Issue 03-6,<sup>3</sup> no undistributed earnings should be allocated to the IDR holder. Conversely, if the partnership agreement does not address this issue or does not explicitly limit distributions to the IDR holder to the holder’s share of available cash determined in the reporting period presented, then a specified threshold would not exist and the MLP would effectively allocate all current-period earnings (including undistributed earnings) to the GP, LPs, and IDR holder by using the distribution waterfall for available cash specified in the partnership agreement. Thus, current-period earnings are effectively treated as though they are available cash distributions.

**Cash Distributions in Excess of Earnings** — Any excess of distributions over current-period earnings (loss) should be allocated to the GP and LPs on the basis of their respective sharing of losses specified in the partnership agreement (i.e., the provisions for allocation of losses to the partners’ capital accounts for the reporting period presented). If the IDR holder is not contractually obligated to share in current-period losses, the excess of distributions over current-period earnings (loss) amount is not allocated to the IDR holder. However, if the IDR holders have a contractual obligation to share in the losses of the MLP on a basis that is objectively determinable (as described in paragraphs 17 and 18 of Issue 03-6), the excess of distributions over earnings (loss) should be allocated to the GP, LPs, and IDR holders on the basis of their respective sharing of losses specified in the partnership agreement for the reporting period presented.

The Task Force concluded that for the MLP to report current-period earnings per unit, the GP must use current-period information to determine the amount of available cash (i.e., the MLP becomes obligated to make distributions of available cash at the end of the current reporting period, which may be before available cash is determined).

**TRANSITION:** If ratified by the FASB, this consensus is effective for fiscal years beginning after December 15, 2008, and interim periods within those fiscal years, applied retrospectively for all financial statements presented. Early application would not be permitted.

**NEXT STEPS:** FASB ratification is expected at the Board’s March 26, 2008, meeting.

## **Issue 07-5      Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity’s Own Stock**

**STATUS:** Consensus-for-exposure.

**AFFECTS:** Entities with (1) options or warrants on their own shares (not within the scope of Statement 150<sup>4</sup>), including market-based employee stock option valuation instruments;<sup>5</sup> (2) forward contracts on their own shares, including forward contracts entered into as part of an accelerated share repurchase program; and (3) convertible debt instruments and convertible preferred stock. Also affected are entities that issue equity-linked financial instruments (or financial instruments that contain embedded equity-linked features) with a strike price that is denominated in a foreign currency.

**BACKGROUND:** The instruments described above may contain contract terms that call into question whether the instrument or embedded feature is indexed to the entity’s own stock. A derivative instrument or embedded derivative feature that is deemed indexed to an entity’s own stock **may** be exempt from the requirements of Statement 133<sup>6</sup> for derivatives. In addition, a freestanding instrument that is indexed to a company’s own stock remains eligible for equity classification under Issue 00-19.<sup>7</sup>

At issue are the following:

- How an entity should evaluate whether an instrument (or embedded feature) is indexed to its own stock.

<sup>3</sup> EITF Issue No. 03-6, “Participating Securities and the Two-Class Method Under FASB Statement No. 128.”

<sup>4</sup> FASB Statement No. 150, *Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity*.

<sup>5</sup> For example, employee stock option appreciation rights securities (ESOARS). See additional discussion about ESOARS in Deloitte’s [October 24, 2007, Heads Up](#).

<sup>6</sup> FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

<sup>7</sup> EITF Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock.”

- How the term “standard antidilution provisions” should be defined and whether there should be a conforming amendment to the definition of standard antidilution in Issue 05-2.<sup>8</sup>
- How the currency in which the strike price of an equity-linked financial instrument (or embedded equity-linked feature) is denominated affects the determination of whether the instrument is indexed to an entity’s own stock.
- How an issuer should account for market-based employee stock option valuation instruments.

**SUMMARY: How an entity should evaluate whether an instrument (or embedded feature) is indexed to its own stock** — The Task Force reached a consensus-for-exposure that an entity should use the following two-step approach to evaluate whether an equity-linked financial instrument (or embedded feature) is indexed to its own stock:

**Step 1:** *Evaluate the instrument’s contingent exercise provisions*, if any, on the basis of the existing consensus on contingent exercise provisions in Issue 01-6.<sup>9</sup> That is, instruments whose exercisability is affected by one or more variables other than the entity’s stock price are considered indexed to an entity’s own stock provided that the exercise-contingency is not based on (1) an observable market, other than the market for the entity’s stock, or (2) an observable index, other than one that is solely referenced to the entity’s own operations.<sup>10</sup> If the evaluation in step 1 would not preclude an instrument from being considered indexed to the entity’s own stock, the analysis would proceed to step 2.

**Step 2:** *Evaluate the instrument’s settlement provisions*. An instrument would be considered indexed to an entity’s own stock if its settlement amount will equal the difference between the fair value of a fixed number of the entity’s equity shares and a fixed amount of cash or another financial asset (also known as “fixed-for-fixed”). An instrument would also be considered indexed to an entity’s own stock even when the strike price or the number of shares used to calculate the settlement amount is **not** fixed, as long as the only variables that could affect the settlement amount would be inputs to the determination of the fair value of a fixed-for-fixed forward or option on equity shares. In performing this step, all possible settlement alternatives should be considered. That is, entities must presume the occurrence of a contingent event or other condition that would adjust the settlement terms of that instrument or embedded feature when evaluating whether an instrument or embedded feature is indexed to its own stock.

Under the consensus-for-exposure, fair value inputs of a fixed-for-fixed forward or option on equity shares may include the entity’s stock price, time, dividends or other dilutive activities, stock borrow cost, interest rates, stock price volatility, the entity’s credit spread, and the ability to maintain a standard hedge position in the underlying shares. An instrument would not be considered indexed to the entity’s own stock if its settlement amount is affected by variables that are leveraged or are extraneous to the pricing of a fixed-for-fixed option or forward contract on equity shares.

**How the term “standard antidilution provisions” should be defined and whether a conforming amendment should be made to Issue 05-2 to change the definition of standard antidilution provisions in that Issue** — The Task Force decided not to address these issues. Thus, entities would evaluate all provisions by using the two-step approach noted above (e.g., evaluate whether settlement adjustments for the effects of dilutive events such as equity restructurings and dividends are inputs to the determination of the fair value of a fixed-for-fixed forward or option). In addition, no changes will be made to Issue 05-2.

**How the currency in which the strike price of an equity-linked financial instrument (or embedded feature) is denominated affects the determination of whether the instrument is indexed to an entity’s own stock** — The Task Force reached a consensus-for-exposure that an equity-linked financial instrument (or embedded equity-linked feature) would **not** be considered indexed to the entity’s own stock if the strike price is denominated in a currency other than the issuer’s functional currency (including a conversion option embedded in a convertible debt instrument that is denominated in a currency other than the issuer’s functional currency). The

<sup>8</sup> EITF Issue No. 05-2, “The Meaning of ‘Conventional Convertible Debt Instrument’ in Issue No. 00-19.”

<sup>9</sup> EITF Issue No. 01-6, “The Meaning of ‘Indexed to a Company’s Own Stock.’”

<sup>10</sup> For example, the entity’s sales revenue; earnings before interest, taxes, depreciation, and amortization; net income; or total equity.

determination of whether an equity-linked financial instrument is indexed to an entity's own stock is **not** affected by the currency used in the market(s) in which the underlying shares trade. This consensus-for-exposure is consistent with the FASB's proposed Implementation Issue C21.<sup>11</sup>

**How an issuer should account for market-based employee stock option valuation instruments**

— The Task Force also reached a consensus-for-exposure that market-based employee stock option valuation instruments are not considered indexed to an entity's own stock. The settlement amount of these instruments is affected by employee behavior, which is not an input in the determination of the fair value of a fixed-for-fixed option or forward. Consequently, such instruments would generally be accounted for as derivatives under Statement 133.

**TRANSITION:** A consensus would be effective for fiscal years beginning after December 15, 2008, including interim periods within those fiscal years. It would be applied to outstanding instruments as of the beginning of the fiscal year in which this Issue is initially applied as a cumulative-effect adjustment to the opening balance of retained earnings. Early application would not be permitted.

**NEXT STEPS:** FASB ratification is expected at the Board's March 26, 2008, meeting, after which the consensus-for-exposure will be exposed for comment.

## Issue 08-1 Revenue Recognition for a Single Unit of Accounting

**STATUS:** No decision reached.

**AFFECTS:** Entities that enter into revenue arrangements that provide for multiple payment streams for a single deliverable or a single unit of accounting. For example, a service provider may receive an up-front payment upon inception of a service contract with a customer and then receive additional payments as services are provided to that customer. Other examples can be more complex, such as in biotechnology and pharmaceutical research and development arrangements involving multiple deliverables treated as a single unit of accounting, up-front payments, payments for specific services, and payments upon achievement of certain clinical milestones. This Issue is not limited to a particular industry.

**BACKGROUND:** Before evaluating how to recognize revenue for transactions with multiple payment streams, entities should identify all the deliverables in an arrangement. Some arrangements may contain only one deliverable. If there are multiple deliverables, each deliverable must be evaluated to determine whether it should be treated separately or in combination with other deliverables (i.e., single unit of accounting) in accordance with Issue 00-21<sup>12</sup> or other applicable guidance. Thus, under Issue 00-21, an entity may be required to combine multiple deliverables into a single unit of accounting. **However, Issue 00-21 does not address how to recognize revenue.** Some interpret Issue 00-21 as requiring that entities use a **single attribution model** for revenue recognition for a single unit of accounting. Others interpret Issue 00-21 as permitting a **multiple attribution model** for revenue recognition for a single unit of accounting under certain facts and circumstances.

Under a single attribution model, a single method is used to recognize all arrangement consideration (e.g., arrangement consideration is recognized either systematically over the term of the arrangement or on a per-unit basis, but **not both**). Under a multiple attribution model, multiple methods may be used to recognize arrangement consideration (e.g., **both** a systematic basis and a per-unit basis may be used for the single unit of accounting). For example, an up-front payment may be recognized on a straight-line basis over the term of the arrangement, while a price paid per unit may be recognized as units are delivered.

At issue is whether, and under what circumstances, it is acceptable to use a multiple attribution model to account for a single unit of accounting consisting of (1) a single deliverable or (2) multiple deliverables.

**SUMMARY:** The Task Force did not reach a consensus-for-exposure. The Task Force asked the FASB staff to perform additional research to identify examples of potential practice issues related to revenue arrangements involving a single unit of account with a single deliverable or multiple deliverables.

**NEXT STEPS:** Further deliberations by the Task Force are expected at the Task Force's June 2008 meeting.

<sup>11</sup> Proposed Statement 133 Implementation Issue No. C21, "Whether Options (Including Embedded Conversion Options) Are Indexed to Both an Entity's Own Stock and Currency Exchange Rates."

<sup>12</sup> EITF Issue No. 00-21, "Revenue Arrangements With Multiple Deliverables."

## Issue 08-2 Lessor Revenue Recognition for Maintenance Services

**STATUS:** Tentative consensus reached.

**AFFECTS:** Lessor entities, including, but not limited to, those in the airline, utility, and real estate industries that are obligated under a lease arrangement to maintain a leased asset during the lease term. This includes arrangements that convey the right to use property, plant, or equipment and that are accounted for as leases under Issue 01-8<sup>13</sup> (e.g., certain power purchase agreements, airline capacity purchase arrangements, and take-or-pay contracts). However, this Issue does not apply to maintenance services within the scope of Technical Bulletin 90-1<sup>14</sup> (i.e., maintenance services that are under a separate, nonlease arrangement).

**BACKGROUND:** Maintenance services are not defined in U.S. GAAP. However, examples of maintenance services might include janitorial services in an office space lease or planned major maintenance in an aircraft lease. Lessors bill for maintenance services in various ways. For example, in a lease of an aircraft, the lessor might bill for maintenance services on the basis of flight hours. In an office space lease, maintenance might be included in the base rent billed to the lessee. Alternatively, it might be billed separately as a common-area maintenance charge. While billings may occur evenly throughout the lease term, the lessor may incur the maintenance expense unevenly.

**Example** — Entity A (a regional airline) enters into a lease arrangement with Entity B (a major airline). Under the lease arrangement, Entity A leases its regional jets to the major airline and agrees to perform certain planned major maintenance. Entity B makes payments to Entity A for the use of the leased regional jets, including a payment designed to compensate Entity A for planned major maintenance. The planned major maintenance payments are billed evenly throughout the lease term; however, the planned major maintenance is typically only performed every two or three years.

Statement 13<sup>15</sup> indicates that “executory costs such as **maintenance**, insurance, and taxes, together with any profit thereon, shall be excluded from minimum lease payments.” However, the Statement does not provide guidance on accounting (e.g., revenue recognition for the lessor) for executory costs.

At issue is whether the scope of this Issue should include **all** payments for maintenance services in an arrangement accounted for as a lease or only those considered executory costs under Statement 13. Also at issue is how a lessor should recognize revenue related to maintenance services that are included within the scope of this Issue.

**SUMMARY:** The Task Force did not reach a consensus-for-exposure. The Task Force asked the FASB staff to analyze the Issue’s scope in more detail, including whether certain major maintenance activities are separate services provided to the lessee or embedded in the right to use the asset. The Task Force also asked the FASB staff to analyze how this Issue would apply to (1) lessor entities whose policy is to capitalize maintenance (e.g., those that use the built-in-overhaul method), (2) lessor entities that contract with a third party to perform the required maintenance services, and (3) situations in which the benefit of planned major maintenance services extend beyond the lease term.

However, the Task Force did tentatively conclude that “revenue related to maintenance services should be recognized into income as those services are performed utilizing a proportional performance method that is determined to be the most appropriate method under the circumstances.” For example (and if appropriate in the circumstances), an entity might recognize revenue related to maintenance services over the lease term in proportion to the costs expected to be incurred in performing maintenance services under the contract. An entity would not be permitted to default to recognizing revenue on a straight-line basis.

**NEXT STEPS:** Further deliberations by the Task Force are expected at the Task Force’s June 2008 meeting.

## Issue 08-3 Accounting by Lessees for Maintenance Deposits Under Lease Agreements

**STATUS:** Consensus-for-exposure.

**AFFECTS:** Lessees that make **nonrefundable** maintenance deposits.

**BACKGROUND:** Certain lease agreements require the lessee to make maintenance deposits to the lessor. During the lease term, the lessee is required to maintain the leased asset. Typically, the lessee is entitled to a reimbursement of the maintenance cost to be paid by the lessor from the maintenance deposit

<sup>13</sup> EITF Issue No. 01-8, “Determining Whether an Arrangement Contains a Lease.”

<sup>14</sup> FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*.

<sup>15</sup> FASB Statement No. 13, *Accounting for Leases*.

upon completion of the required maintenance. Some lease agreements provide that if, at the end of the lease term, excess amounts are on deposit with the lessor (i.e., the total cost of cumulative maintenance events over the term of the lease is less than the cumulative deposits), the lessor is entitled to retain the excess amounts (nonrefundable maintenance deposit).

When the deposits are nonrefundable, some account for the payments as a **deposit** (i.e., the lessee records a deposit asset upon payment to the lessor). Then the deposit is expensed or capitalized (depending on the lessee's maintenance accounting policy) when the underlying maintenance is performed. However, if it is determined that it is not probable that a portion of the deposit will be used to fund future maintenance expense, that amount is recognized as additional rent expense in the period in which this determination is made. Others account for the deposit payments as **contingent rent expense** or maintenance expense at the time the payment is made.

At issue is whether lessees should account for nonrefundable maintenance deposits as a deposit or as contingent rental expense.

**SUMMARY:** The Task Force reached a consensus-for-exposure that all nonrefundable maintenance deposits that are contractually and substantively related to maintenance should be accounted for as a deposit. Accordingly, the maintenance deposit made to the lessor initially capitalized as a deposit should be expensed or capitalized as part of a fixed asset (depending on the lessee's maintenance accounting policy) when the underlying maintenance is performed. If it is determined that it is not probable that a portion of the deposit will be used to fund future maintenance expense, it is recognized as additional rent expense at the time this determination is made.

**TRANSITION:** The Task Force reached a consensus-for-exposure that this Issue should be effective for fiscal years beginning after December 15, 2008, applied by recognizing the cumulative effect of the change in accounting principle in the opening balance of retained earnings as of the beginning of the fiscal year in which this consensus is initially applied. Earlier application would not be permitted.

**NEXT STEPS:** FASB ratification is expected at the Board's March 26, 2008, meeting, after which the consensus-for-exposure will be exposed for a comment period.

## Administrative Matters

**Topic D-98**<sup>16</sup> — The SEC observer announced revisions to Topic D-98. The revisions primarily address the SEC staff's views regarding the interaction between Topic D-98 and Statement 160.<sup>17</sup> The revisions also reflect other clarifications to Topic D-98 that are unrelated to Statement 160. The revised Topic D-98 will indicate that the classification, measurement, and earnings-per-share guidance applies to noncontrolling interests (e.g., when the noncontrolling interest is redeemable at a fixed price by the holder or upon the occurrence of an event that is not solely within the control of the issuer). This includes noncontrolling interests redeemable at fair value. The revisions to Topic D-98 that are specific to accounting for noncontrolling interests should be applied no later than the effective date of Statement 160. Statement 160 is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008.

**Issue 00-27**<sup>18</sup> — Issue 00-27 currently includes 10 final consensuses and nine tentative conclusions (including subissues) on application issues related to Issue 98-5.<sup>19</sup> The Task Force voted to discontinue discussion of the remaining nine tentative conclusions and remove those issues from the EITF's agenda.

In a separate decision, the Task Force **voted not to codify** Issues 98-5 and 00-27 into a single EITF abstract. The FASB staff noted that the **final** consensuses in Issues 98-5 and 00-27 will be codified as part of the Codification project.

**Issue 98-5** — The FASB staff discussed certain proposed updates to Issue 98-5. The staff indicated that the reason these updates are necessary is that a constituent indicated that some entities have continued to apply certain guidance in Issue 98-5 after such guidance was nullified by the final consensuses in Issue 00-27 or Statement 150. Application of Issue 98-5 without the consideration of subsequent nullifications could be considered an error; however, some believe that transition guidance for related transactions is necessary since Issue 98-5 was not updated to reflect the changes resulting from the issuance of Issue 00-27 and Statement 150. The Task Force reached a consensus-for-exposure that transition guidance for all conforming changes made to Issue 98-5 should be provided. The conforming changes would be effective for financial statements issued for fiscal years ending after December 15, 2008, applied retrospectively.

<sup>16</sup> EITF Topic No. D-98, "Classification and Measurement of Redeemable Securities."

<sup>17</sup> FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*.

<sup>18</sup> EITF Issue 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."

<sup>19</sup> EITF Issue No. 98-5, "Accounting for Convertible Securities With Beneficial Conversion Features or Contingently Adjustable Conversion Ratios."

The Task Force also decided not to provide guidance on whether convertible instruments that have terms that provide for settlement through the issuance of (1) a variable number of shares with a fixed monetary amount if settlement occurs when the share price is less than a certain amount or (2) a fixed number of shares if settlement occurs when the share price is equal to or greater than a certain amount, should be evaluated as having (1) a single compound embedded feature (i.e., one embedded feature with the characteristics of a share-settled “put warrant”) or (2) two separate embedded features (i.e., an embedded put option and an embedded conversion feature).

**Proposed EITF Project Plan** — The Task Force discussed the FASB staff’s proposed project plan for a potential EITF Issue that would address whether payments to incentive distribution rights holders in master limited partnerships represent equity distributions or compensation expense. The Task Force voted not to add this issue to the EITF’s agenda.



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The purpose of this publication is to briefly describe matters discussed at the most recent meeting of the Emerging Issues Task Force. This summary was prepared by Deloitte's National Office Accounting Standards and Communications Group. 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 three 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.

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