



EITF Snapshot

Audit and Enterprise Risk Services

June 2008

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This *EITF Snapshot* summarizes the June 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 then provided to the Board for ratification.

After the June 25, 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 07-5 **Determining Whether an Instrument (or an Embedded Feature) Is Indexed to an Entity’s Own Stock**

STATUS: Consensus reached.

AFFECTS: Entities with (1) options or warrants on their own shares (not within the scope of Statement 150¹), including market-based employee stock option valuation instruments;² (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 133³ for derivatives. In addition, a freestanding instrument that is indexed to a company’s own stock remains eligible for equity classification under Issue 00-19.⁴

At issue are the following:

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

¹ FASB Statement No. 150, *Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity*.

² For example, employee stock option appreciation rights securities (ESOARS). See additional discussion about ESOARS in Deloitte’s [October 24, 2007, Heads Up](#).

³ FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

⁴ EITF Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock.”

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 01-6.⁵ 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.⁶ 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.** If the settlement amount will equal the difference between the fair value of a fixed number of the entity's equity shares and (1) a fixed monetary amount or (2) a fixed amount of another financial asset (such as a fixed stated principal of convertible debt) issued by the entity (also known as "fixed-for-fixed" settlement), then the instrument's settlement provisions would be considered indexed to the entity's own stock. The settlement provisions would also be considered indexed to the 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. When performing this step, an entity should consider all possible settlement alternatives. That is, an entity must presume the occurrence of a contingent event or another condition that would adjust the settlement terms of an instrument or embedded feature when evaluating whether that instrument or embedded feature is indexed to the entity's own stock.

The fair value inputs of a fixed-for-fixed forward or option on equity shares may include inputs such as the entity's stock price; time, dividends, or other dilutive activities such as a stock split; 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. However, the instrument's settlement provisions would not be considered indexed to the entity's own stock when the settlement amount is affected by inputs (variables) that are leveraged or that are extraneous to the pricing of a fixed-for-fixed option or forward contract on equity shares.

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 — The Task Force reached a consensus that an equity-linked financial instrument (or embedded equity-linked feature)⁷ 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. The Task Force decided that the 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 is consistent with the FASB's proposed Implementation Issue C21.⁸

How an issuer should account for market-based employee stock option valuation instruments — The Task Force also reached a consensus that market-based employee stock option valuation instruments are not considered indexed to an entity's own stock, as defined in step 2 (see above). 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 forward or option on equity shares. Consequently, such instruments would generally be accounted for as derivatives under Statement 133.

**EFFECTIVE DATE
AND TRANSITION:**

If ratified by the FASB, the consensus will be effective for fiscal years beginning after December 15, 2008, including interim periods within those fiscal years. The consensus must be applied to outstanding instruments as of the beginning of the fiscal year in which the Issue is adopted as a cumulative-effect adjustment to the opening balance of retained earnings for that fiscal year. Early application is not permitted.

NEXT STEPS:

FASB ratification is expected at the Board's June 25, 2008, meeting.

⁵ EITF Issue No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock.'"

⁶ For example, the entity's sales revenue; earnings before interest, taxes, depreciation, and amortization; net income; or total equity.

⁷ For example, conversion options embedded in a convertible debt instrument that is denominated in a currency other than the issuer's functional currency.

⁸ 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."

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 00-21⁹ 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 FASB staff and the Issue 08-1 Working Group will conduct additional research on various alternatives for addressing Issue 08-1.

NEXT STEPS: Further deliberations by the Task Force are expected at its September 2008 meeting.

Issue 08-2 Lessor Revenue Recognition for Maintenance Services

STATUS: Recommended for removal from the Task Force's agenda.

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, including those accounted for as leases under Issue 01-8¹⁰ (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 90-1¹¹ (i.e., maintenance services that are under a separate, nonlease arrangement) or that are not related to a leased asset.

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.

⁹ EITF Issue No. 00-21, "Revenue Arrangements With Multiple Deliverables."

¹⁰ EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease."

¹¹ FASB Technical Bulletin No. 90-1, *Accounting for Separately Priced Extended Warranty and Product Maintenance Contracts*.

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 13¹² 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 for executory costs (e.g., revenue recognition for the lessor).

At issue are the following:

Scope — For maintenance services that are executory costs under Statement 13, whether the Issue’s scope should include (1) **all** payments for maintenance services, (2) **only** payments for maintenance services that are **“planned major maintenance,”** or (3) only payments for maintenance services provided by a lessor to a lessee and **not** payments related to the **right to use** the leased asset.

Revenue recognition — How a lessor should recognize revenue related to maintenance services that are included within the scope of this Issue.

SUMMARY: The Task Force voted to remove this Issue from its agenda because it does not believe the benefits to financial statement users outweigh the costs that would most likely be associated with the increased complexity of additional revenue recognition guidance.

NEXT STEPS: No further discussion is expected.

Issue 08-3 **Accounting by Lessees for Maintenance Deposits Under Lease Arrangements**

STATUS: Consensus reached.

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 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 or it is determined that a portion of the deposit will not be returned. 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. Also at issue is whether the Task Force should provide revenue recognition accounting guidance for the lessor, either as part of Issue 08-3 or in a separate Issue.

SUMMARY: The Task Force reached a consensus that all nonrefundable maintenance deposits that are contractually and substantively related to maintenance of the leased asset are accounted for as deposit assets. The lessee’s deposit asset is expensed or capitalized as part of a fixed asset (depending on the lessee’s maintenance accounting policy) when the underlying maintenance is performed. When the lessee determines that it is less than probable that an amount on deposit will be returned to the lessee (and thus no longer meets the definition of an asset), the lessee must recognize an additional expense for that amount.

The Task Force decided not to include any revenue recognition guidance for lessors in Issue 08-3. The FASB staff indicated that it will perform further research on whether a separate agenda request related to the lessor’s accounting for maintenance deposits made by lessees is necessary.

¹² FASB Statement No. 13, *Accounting for Leases*.

EFFECTIVE DATE**AND TRANSITION:**

If ratified by the FASB, the consensus will be effective for fiscal years beginning after December 15, 2008, and must be 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 is not permitted.

NEXT STEPS:

FASB ratification is expected at the Board's June 25, 2008, meeting.

Issue 08-4**Transition Guidance for Conforming Changes to Issue No. 98-5****STATUS:**

Consensus reached.

AFFECTS:

Entities that have issued convertible debt with beneficial conversion features and that continue to follow certain guidance in Issue 98-5¹³ that was nullified by Issue 00-27¹⁴ or Statement 150. Beneficial conversion features are "in-the-money" conversion options as of the commitment date for the issuance of convertible debt.

BACKGROUND:

Much of the guidance in Issue 98-5 was nullified by certain consensuses in Issue 00-27. Transition guidance was added to Issue 98-5 to acknowledge the issuance of Issue 00-27 through a status update. However, the general status update in Issue 98-5 did not specifically identify the portions of Issue 98-5 (including illustrative examples) that were nullified by Issue 00-27. The issuance of Statement 150 in May 2003 also affected Issue 98-5, and while a status update was added to Issue 00-27 clarifying that instruments within the scope of Statement 150 are no longer within the scope of Issue 00-27, a status update for Statement 150 was not included in Issue 98-5.

At issue is whether the Task Force should provide transition guidance for the conforming changes to Issue 98-5 (to be included in Exhibit 08-4A of Issue 08-4) that are a result of Issue 00-27 and Statement 150.

SUMMARY:

The Task Force reached a consensus that transition guidance for all conforming changes made to Issue 98-5 should be provided.

EFFECTIVE DATE**AND TRANSITION:**

If ratified by the FASB, the consensus will be effective for financial statements issued for fiscal years **ending** after December 15, 2008, with early application permitted. The impact of applying the conforming changes, if any, must be presented retrospectively for all periods presented, with a cumulative-effect adjustment to retained earnings as of the beginning of the first period presented.

NEXT STEPS:

FASB ratification is expected at the June 25, 2008, Board meeting.

Issue 08-5**Issuer's Accounting for Liabilities Measured at Fair Value With a Third-Party Guarantee****STATUS:**

Consensus-for-exposure.

AFFECTS:

Entities that incur liabilities (e.g., by issuing debt securities) that have inseparable third-party guarantees (or other third-party credit enhancements) when such a liability is measured at fair value or a fair value measurement is disclosed.

BACKGROUND:

Certain entities issue debt that has been guaranteed by an unrelated third party (the "guarantor"). The issuer pays the guarantor for the guarantee that is attached to the issued debt. The guarantor guarantees the issuer's payment obligations to the investor under the debt arrangement. Generally, the guarantee is incorporated into the terms of the debt security and will transfer with the debt security (e.g., if the investor sells the debt to another party, the guarantee would remain attached to the debt). By issuing debt with a third-party guarantee, the issuer can lower its overall cost of borrowing. That is, the proceeds from issuing debt that has been guaranteed by a third party, less the cost of the third-party guarantee, may be greater than the proceeds received from issuing debt without a third-party guarantee.

Currently, authoritative accounting literature does not address whether the issuer should account for the guaranteed debt as one unit of accounting (the guaranteed liability) or two units of accounting (the unguaranteed liability and a third-party guarantee). This determination can result in a significant difference in how changes in an issuer's credit standing affect the fair value of the guaranteed

¹³ EITF Issue No. 98-5, "Accounting for Convertible Securities With Beneficial Conversion Features or Contingently Adjustable Conversion Ratios."

¹⁴ EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments."

debt. Paragraph 15 of Statement 157¹⁵ requires that the fair value of a liability incorporate the obligor's nonperformance risk, including its own credit risk. Under a one-unit-of-accounting approach, the fair value measurement of the liability would include the effect of the third-party guarantee. In this circumstance, changes in the issuer's credit standing would not necessarily affect the fair value measurement of its debt. That is because under this approach, the fair value of the debt **incorporates the credit standing of the guarantor**. Under a two-units-of-accounting approach, the fair value measurement of the liability would not include the effect of the third-party guarantee. In this circumstance, **changes in the issuer's credit standing** would affect the fair value measurement of its debt.

There is only a difference in accounting between the two approaches (i.e., one or two units of accounting) when the liability is measured at fair value (e.g., when changes in the issuer's credit standing are included in the subsequent measurement). There is no difference in accounting between the two approaches for liabilities measured at amortized (accrued) cost.

At issue is whether an issuer of debt with a third-party guarantee (or other third-party credit enhancement) that is inseparable from the debt instrument should treat the debt and the guarantee as (1) one unit of accounting or (2) two units of accounting, when the measurement attribute for that debt is fair value.

SUMMARY:

The Task Force reached a consensus-for-exposure that an issuer of debt with a third-party guarantee (or other third-party credit enhancement) that is inseparable from the debt instrument must treat the debt and the guarantee as two units of accounting. Under the consensus-for-exposure, the fair value measurement of the debt does not include the effect of the third-party guarantee; therefore, changes in the issuer's credit standing affect the fair value measurement of the issuer's debt.

EFFECTIVE DATE

AND TRANSITION:

A consensus would be effective beginning in the first reporting period after issuance. Entities would apply this Issue prospectively. The effect of initial application would be included in the change in fair value of the debt security in the period of adoption. Entities would be required to disclose any change in fair value measurement method that occurs as a result of the initial application of this Issue. Early adoption would not be permitted.

NEXT STEPS:

FASB ratification is expected at the Board's June 25, 2008, meeting, after which the consensus-for-exposure will be exposed for a comment period.

¹⁵ FASB Statement No. 157, *Fair Value Measurements*.

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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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