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EITF Snapshot

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This *EITF Snapshot* summarizes the March 13, 2014, 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 or "Board"). 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 final ratification.

The FASB plans to consider the EITF's March 2014 consensuses for ratification on March 26, 2014. After that date, the official EITF minutes, including the results of the FASB's ratification process, will be posted to Deloitte's Technical Library and to the FASB's Web site. EITF Issue Summaries (released before the meeting and used to frame the discussion) are also available on those sites. In addition, see the EITF's official minutes and ratified consensuses, since they may differ from this publication.

Issue 12-F Recognition of New Accounting Basis (Pushdown) in Certain Circumstances

Status: Consensus-for-exposure.

Affects: Acquired entities that issue stand-alone financial statements.

Background: Currently, there is limited U.S. GAAP guidance on determining whether an acquired entity can establish a new accounting and reporting basis in its stand-alone financial statements (commonly referred to as "pushdown" accounting). ASC 805-50-S99-1 through S99-4[1] contain pushdown accounting requirements for SEC registrants. Under this guidance, pushdown accounting is (1) **prohibited** when 80 percent or less of an entity's ownership is acquired, (2) **permitted** when between 80 percent and 95 percent is acquired, and (3) **required** when 95 percent or more is acquired.

This Issue addresses (1) whether an acquired reporting entity should establish a new accounting basis in its stand-alone financial statements as a result of a change in its ownership from a transaction or other event; (2) whether to permit or require pushdown accounting in such circumstances; and (3) if required, the level of change in ownership at which the new accounting basis should be required (e.g., upon obtaining control[2] of an acquired entity or upon obtaining substantially all of the controlling financial interest in an acquired entity).

Summary: At this meeting, the Task Force reached a consensus-for-exposure to (1) permit, but not require, an acquired entity to apply pushdown accounting upon a change-in-control event and (2) require acquired entities that have elected to apply pushdown accounting to provide disclosures that "enable users of financial statements of the acquired entity to evaluate the nature and effect of the pushdown accounting on [the entity's] financial statements."[3] In a reversal of a previous tentative decision, the Task Force decided not to require an acquired entity to apply pushdown accounting upon a change-in-control event that causes the acquired entity to become substantially wholly owned by the acquirer. The Task Force was concerned that such a requirement would involve unnecessary complexity.

At a previous meeting, the Task Force concluded that when applying pushdown accounting, an acquired entity would be:

- Prohibited from recognizing acquisition-related debt incurred by the acquirer unless the acquired entity is required to do so in accordance with applicable U.S. GAAP (e.g., because the acquired entity is legally obligated).

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 The Codification Master Glossary defines control as the "possession, direct or indirect, of the power to direct or cause the direction of the management and policies of an entity through ownership, by contract, or otherwise."

3 Entities would achieve that disclosure objective by providing the relevant disclosures required by ASC 805.

- Required to recognize the acquirer's goodwill.
- Prohibited from recognizing bargain purchase gains that resulted from the change-in-control transaction or event.

Effective Date and Transition: The Task Force tentatively decided that the Issue would apply "prospectively to all change-in-control events that occur after the effective date of the final Update resulting from this Issue." An entity would have the option of applying the Issue on a transaction-by-transaction basis. The Task Force did not discuss the Issue's effective date at this meeting.

Next Steps: FASB ratification is expected at the Board's March 26, 2014, meeting, after which a proposed ASU will be issued.

Issue 12-G Measuring the Financial Assets and Financial Liabilities of a Consolidated Collateralized Financing Entity

Status: Ongoing redeliberations.

Affects: Entities that consolidate a collateralized financing entity (CFE).[4]

Background: Under U.S. GAAP, reporting entities may be required to consolidate certain CFEs with which they are involved, such as collateralized debt obligation and collateralized loan obligation entities. Upon consolidation, those reporting entities initially measure the CFE's financial assets and financial liabilities (i.e., beneficial interests) at fair value. In certain instances, the aggregate fair value of the CFE's financial assets exceeds its financial liabilities[5] (or vice versa) even though the CFE's liabilities generally have recourse only to the assets of the CFE. Some have interpreted U.S. GAAP as requiring that this measurement difference be included in the reporting entity's earnings despite concerns by others that, economically, this difference is attributable to the holders of the CFE's liabilities. Such concerns have led to diversity in practice related to reporting entities' accounting for this difference.

In November 2013, the Task Force reached a consensus that would have eliminated any such measurement differences by requiring a reporting entity that consolidates a CFE to "use the more observable of the fair value of the financial assets or the financial liabilities to measure both the financial assets and the financial liabilities of a [CFE]" when the CFE is initially consolidated. In addition, a reporting entity would be permitted to elect to apply this measurement approach for the CFE's financial assets and financial liabilities for subsequent periods. However, after reaching the consensus, the Task Force realized that several different interpretations of the Issue's scope (pertaining to when a reporting entity transfers financial assets to a consolidated CFE) exist. To resolve the confusion, the Task Force decided to revisit the scope of the Issue at its March 2014 meeting.

Summary: At this meeting, the Task Force discussed various approaches for clarifying the scope of the CFE measurement guidance. While the Task Force ultimately did not reach a consensus on the scope of the Issue, it did discuss an alternative approach under which reporting entities would treat the CFE measurement guidance as an *optional* practicability exception to applying the fair value measurement guidance in ASC 820 when all of the financial assets and financial liabilities of a consolidated CFE are being accounted for at fair value under other U.S. GAAP (e.g., when the entity had elected the fair value option for all of the CFE's financial assets and financial liabilities). The Task Force plans to discuss this approach at its next meeting on June 12, 2014. At that meeting, the Task Force plans to also discuss (1) how entities that choose not to apply the CFE measurement guidance (i.e., the practicability exception for determining fair value) would account for any initial measurement difference between the fair value of the CFE's financial assets and the fair value of its financial liabilities (i.e., whether that difference should be reflected in earnings) and (2) whether the CFE measurement guidance could be elected on a CFE-by-CFE basis or must be applied as an entity-wide policy election.

Effective Date and Transition: The Task Force did not discuss the effective date or transition alternatives for this Issue at the meeting. It is expected that the effective date and transition will be discussed at the EITF's June 12, 2014, meeting.

Next Steps: The Task Force will continue deliberating this Issue at its June 12, 2014, meeting.

[4] A CFE is a "variable interest entity that holds financial assets, issues beneficial interest in those financial assets, and has no more than nominal equity. The beneficial interests have recourse to the related financial assets of the [CFE] and are classified as financial liabilities. A CFE may hold nonfinancial assets temporarily as a result of default by the debtor on the underlying debt instruments held as assets by the [CFE] or in an effort to restructure the debt instruments held as assets by the [CFE]."

[5] The FASB staff's August 27, 2012, Issue Summary notes that differences could result from "(a) liquidity discounts that were inherent in the exit price for the CFE's liabilities and not in the CFE's assets, (b) differences in the duration of the CFE's assets and the duration of the CFE's liabilities, or (c) principal markets for the assets and the liabilities that were not identical."

Issue 13-D Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved After the Requisite Service Period

Status: Final consensus.

Affects: Entities that issue stock compensation awards that include a performance target that can be met after an employee provides the requisite service.

Background: Stock compensation awards sometimes include a performance target that can be met after an employee provides the requisite service.

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

1. The performance target is treated as a performance condition that affects vesting. Under this approach, an entity does 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. The target is treated 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 achievement of the performance target.
3. The award is treated as a liability that is subsequently measured at 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 topic.

Summary: At this meeting, the Task Force discussed the exposure draft on this topic as well as the comment letters received on it. The Task Force reached a final consensus that entities should treat performance targets that can be met after the requisite service period as performance conditions that affect vesting. Therefore, under this consensus, an entity would not record compensation expense (measured as of the grant date without consideration of the effect 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. The Task Force also confirmed that no new disclosures will be required under this Issue.

Effective Date and Transition: This Issue will be effective for all entities for reporting periods (including interim periods) beginning after December 15, 2015. Early adoption is permitted. In addition, all entities will have the option of applying the Issue either prospectively (i.e., only to awards granted or modified on or after the effective date of the Issue) or retrospectively. Retrospective application would only apply to awards with performance targets outstanding at or after the beginning of the first annual period presented (i.e., the earliest presented comparative period).

Next Steps: FASB ratification is expected at the Board's March 26, 2014, meeting, after which a final ASU will be issued.

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

Status: Ongoing redeliberations.

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

Background: When performing an embedded derivative analysis, entities generally look to the SEC staff's guidance in ASC 815-10-S99-3 in evaluating whether the host contract of a financial instrument that contains embedded features is more akin to debt or to equity.[6] This guidance has led to two generally accepted 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 and accounted for as a derivative if certain other criteria are met.[9] Because an entity may choose, as an accounting policy election, which approach it will use, and given that there are different interpretations under the whole-instrument approach, diversity in practice exists. This Issue was added to the EITF's agenda to address that diversity in practice.

Summary: At this meeting, the Task Force discussed the exposure draft on this topic as well as the comment letters received on it. The Task Force reconfirmed that the Issue would apply to both issuers of, and investors in, a hybrid financial instrument issued in the form of a share. The Task Force also reconfirmed that entities with instruments within the scope of the Issue would be required 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. That is, the chameleon approach would no longer be permitted.

The Task Force did not, however, reach a consensus on how entities would consider the relevant terms and features of the hybrid instrument and weigh such features in determining whether the nature of the host contract is more akin to debt or equity. Specifically, some Task Force and FASB board members were concerned that the proposed ASU contained insufficient guidance on applying the whole-instrument approach to such instruments. The Task Force therefore decided to further research whether it could develop implementation guidance or a framework that entities could use in applying the whole-instrument approach.

Effective Date and Transition: The Task Force did not discuss the effective date or transition alternatives for this Issue at the meeting. It is expected that the effective date and transition will be discussed at the EITF's June 12, 2014, meeting.

Next Steps: The Task Force will continue deliberating this Issue at their June 12, 2014, meeting.

Administrative Matters

The next EITF meeting is scheduled for June 12, 2014. Comments on the following EITF Issue, discussed at a previous meeting and for which a consensus-for-exposure was reached, are due by April 30, 2014.

- Issue 13-F, "Classification of Certain Government-Insured Residential Mortgage Loans Upon Foreclosure by a Creditor."

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 Under ASC 815-15-25-1, an embedded feature is bifurcated and accounted for as a derivative if it does not qualify for any of the 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.

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