

MINUTES



**To:** Board Members  
**From:** M. Bellantoni (ext. 445)  
**Subject:** Minutes of September 28, 2005 Board Meeting: Ratification of EITF Consensuses **Date:** October 4, 2005  
**cc:** Bielstein, Smith, Petrone, Golden, Geary, Moss, Oakley, Sarno, Beswick, Cospes, Belcher, Jacobs, Thuener, Mahoney, Gabriele, Polley, Swift, Bellantoni, Richter, Attmore, Bean, Leisenring, FASB Intranet

*The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. Official consensus positions of the EITF are presented in meeting minutes and in EITF Abstracts. Board ratification completes the overall due process of developing an EITF consensus as set forth in EITF Abstracts, Topic No. D-1, "Implications and Implementation of an EITF Consensus."*

Topic: Board ratification of consensuses reached on EITF Issues Nos. 04-13, 05-7, and 05-8; Board ratification of modifications to the existing consensuses in EITF Issues Nos. 96-19 and 05-6.

Basis for Discussion: Board Memorandum dated September 22, 2005

Length of Discussion: 10:00 am to 10:15 am

Attendance:

Board members present:	Batavick, Herz, Seidman, Trott, and Young
Board members absent:	Crooch and Schipper
Staff in charge of topic:	Geary
Other staff at Board table:	Bellantoni, Beswick, Golden, and L. Smith
Outside participants:	None

**Summary of Decisions Reached:**

The Board considered and ratified the consensuses on the following three Issues reached at the September 15, 2005 EITF meeting:

1. Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty"
2. Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues"
3. Issue No. 05-8, "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature."

The Board also considered and ratified modifications to the existing consensuses in the following Issues:

1. Issue No. 96-19, "Debtor's Accounting for a Modification or Exchange of Debt Instruments"
2. Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination."

**Objective of Meeting:**

The objective of the meeting was for the Board to (a) ratify the consensuses reached on three Issues and (b) ratify the modifications to existing consensuses on two Issues.

**Matters Discussed and Decisions Reached:**

***Ratification of Consensuses Reached***

1. Mr. Geary stated that the Task Force reached a consensus in Issue 04-13. The Task Force approved the draft abstract posted to the FASB website on July 7, 2005, with certain modifications to clarify some of the indicating factors and the inclusion of examples to illustrate the consensus. In addition, the Task Force reached a consensus that this Issue should be applied for new arrangements entered into, or modifications or renewals of existing arrangements, beginning in the first interim or annual reporting period beginning after March 15, 2006 .

2. Mr. Herz noted that five Board members were present at the meeting. Both of the absent members, Michael Crooch and Katherine Schipper, had provided him with voting instructions for each Issue.
3. Mr. Trott noted that Mr. Geary was working with the Task Force on multiple editorial clarifications on Issue 04-13 and asked Mr. Geary if those items had been resolved with the Task Force. Mr. Geary responded that the staff had been working with the Task Force on those items and that the staff is ready to move forward with the Issue. All Board members agreed to ratify the consensus in Issue 04-13.
4. Mr. Geary stated that the Task Force reached three consensuses in Issue 05-7. The first is that an entity should include, upon the modification of a convertible debt instrument, the change in fair value of the related embedded conversion option in the analysis to determine whether a debt instrument has been extinguished pursuant to Issue 96-19. The change in the fair value of an embedded conversion option should be calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification and it should be included in the Issue 96-19 analysis because there is a direct correlation between the value of an embedded conversion option and the yields demanded on a convertible debt instrument. Because the determination of whether an extinguishment or modification has occurred under Issue 96-19 focuses solely on a differential *cash flow* analysis, the Task Force also agreed to amend Issue 96-19 to include noncash changes to conversion terms under this consensus. The second consensus is that the modification of a convertible debt instrument should affect subsequent recognition of interest expense for the associated debt instrument for changes in the fair value of the embedded conversion option. The change in the fair value of an embedded conversion option should be calculated as the difference between the fair value of the embedded conversion option immediately before and after the modification. The third consensus is that the issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification of a convertible debt instrument. The Task Force also reached a consensus that this Issue should be applied to future modifications of debt instrument beginning in the first interim or annual reporting period beginning after December 15, 2005.

5. Ms. Seidman stated that the consensus is a practical solution to the current state of affairs in accounting. Mr. Herz thought that given the intersection of historical-based accounting, beneficial conversion accounting, and the economics, the Task Force came to a good set of resolutions overall on this Issue. All Board members agreed to ratify the consensus in Issue 05-7 including the amendment to Issue 96-19.
6. Mr. Beswick stated that the Task force reached three consensus on Issue 05-8. The first is that the issuance of convertible debt with a beneficial conversion feature results in a basis difference for purposes of applying Statement 109. The second consensus is that the basis difference that results from the issuance of convertible debt with a beneficial conversion feature is a temporary difference for purposes of applying Statement 109. The third consensus is that the recognition of deferred taxes for the temporary difference of the convertible debt with a beneficial conversion feature should be recorded as an adjustment to additional paid-in capital. The Task Force also reached a consensus that this Issue should be applied to financial statements beginning in the first interim or annual reporting period beginning after December 15, 2005. This Issue should be applied by retrospective application pursuant to Statement 154. Early application is permitted in periods for which financial statements have not been issued.
7. Mr. Beswick noted that, subsequent to the EITF meeting, a representative from an accounting firm expressed the following concern over the transition guidance provided in Issue 05-8. In order for an entity that has changed accounting firms to retrospectively apply the consensus reached in this Issue, the predecessor auditor will need to audit the retrospective application of this Issue in prior period financial statements. If that predecessor auditor is not currently independent and cannot cure its independent issues, then the entity will be forced to engage the successor auditor in a reaudit of the entire prior period financial statements. The representative indicated that the entities that are most likely to have issued convertible debt with a beneficial conversion feature would also be the entities that were most likely to have changed accounting firms from the Big 4 accounting firms to another accounting firm within the last two years as a result of the Sarbanes Oxley Act. The reaudit of the prior period financial statements could create undue financial hardship for the entity.

8. Mr. Beswick also noted that during the deliberations of Statement 154, this scenario was specifically addressed by the Board and considered in the comment letter analysis. At that time, the Board concluded that this scenario would be best addressed by the PCAOB in the auditing and reporting literature. The FASB staff is planning to address this issue specifically with the PCAOB prior to the effective date of Issue 05-8.
9. Mr. Trott noted that this issue has been brought to the PCAOB directly by a Board member. In addition, the issue has been presented to the AICPA. Therefore, this auditing issue is not a surprise to the Board.
10. Ms. Seidman asked Mr. Smith if he was aware of how many companies were applying conclusions different from what was being presented in Issue 05-8. Mr. Smith responded that, based on discussions that occurred prior to the EITF meeting, a number of organizations were not applying the conclusions presented in Issue 05-8.
11. Ms. Seidman questioned whether this issue was different from the guidelines pertaining to reauditing other deferred tax issues. Mr. Golden clarified that the independence rules are different in regard to whether the predecessor auditor consents to the reissuance of the report or needs to perform some additional auditing procedures.
12. Mr. Smith noted that he had informed Ms. Schipper of this auditing issue before the meeting and she had not changed her decision; she was still in favor of ratifying the consensus. Mr. Herz responded that a similar discussion was not held with Mr. Crooch. All of the Board members present agreed to ratify the consensus reached in Issue 05-8.

***Ratification of Consensus Modifications or Amendments***

13. Mr. Geary stated that the Task Force reached a consensus in Issue 05-6 at the June 15-16, 2005 EITF meeting. However, during its deliberations, the Task Force discussed whether the amortization period for an existing leasehold improvement should be reevaluated after the initial determination of the amortization period, but was not asked to reach a consensus. At the September 15, 2005 EITF meeting, the Task Force

agreed to modify the consensus by including the following paragraph in the Status section of the abstract:

At the September 15, 2005 EITF meeting, the Task Force agreed to clarify that the consensus in Issue 05-6 does not apply to preexisting leasehold improvements. Therefore, the consensus in Issue 05-6 should not be used to justify the reevaluation of the amortization period for preexisting leasehold improvements for additional renewal periods that are reasonably assured when new leasehold improvements are placed into service significantly after and are not contemplated at or near the beginning of the lease term.

14. Mr. Herz stated that he was voting in favor of the modification though he disagreed with the consensus because he did not think it provided the best reporting. All of the Board members agreed to ratify the consensus modification for Issue 05-6.

15. Discussion of the amendment to Issue 96-19 occurred during the discussion of the consensus on Issue 05-7 (see paragraphs 4–5, above). All of the Board members agreed to ratify the amendment to Issue 96-19.

**Follow-up Items:**

16. None

**General Announcements:**

17. None