FINANCIAL ACCOUNTING STANDARDS BOARD
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April 14, 2014

TO: MEMBERS OF THE FASB EMERGING ISSUES TASK FORCE

Included are the final minutes of the March 13, 2014 meeting of the FASB Emerging Issues Task Force and an inventory of open issues for future EITF meetings. Also included as separate exhibits are the Accounting Standards Update for Issue 13-D and the proposed Accounting Standards Update for Issue 12-F.

Confidential marked versions of the exhibits and marked versions of the minutes (for Issues 13-F and 13-G) showing changes from the April 2, 2014 Fatal Flaw Drafts are being distributed under separate cover. After your review, please discard the confidential marked versions.

Board Ratification

As you know, on Wednesday, March 26, 2014, the Board ratified the consensus reached by the Task Force on Issue 13-D. The Accounting Standards Update for that Issue is expected to be posted to the FASB website on or about April 30, 2014. The Board also ratified the consensus-for-exposure reached by the Task Force on Issue 12-F. The Board approved a 90-day exposure period for the proposed Update. The proposed Update is expected to be posted to the FASB website on or about April 30, 2014.

The next regularly scheduled EITF meeting is scheduled for June 12, 2014. The extra EITF meeting date reserved for May 15, 2014, will be utilized for an education session on Issues 12-G and 13-G.

Please call me at 203.956.5212 if you have any questions.

Sincerely,

Daghan Or
Practice Fellow
dor@fasb.org

Emerging Issues Task Force
Meeting Minutes
March 13, 2014

MINUTES OF THE NOVEMBER 14, 2013 MEETING OF THE FASB EMERGING ISSUES TASK FORCE

Location: FASB Offices
401 Merritt 7
Norwalk, Connecticut

Thursday, March 13, 2014
Starting Time: 8:30 a.m.
Concluding Time: 2:25 p.m.

Task Force Members Present:
Susan M. Cosper (Chairman)
John M. Althoff
Mark M. Bielstein
James G. Campbell[1]
Terri Z. Campbell
Alexander M. Corl
Jackson Day
L. Charles Evans
Stuart H. Harden
Carl Kampel
Mark LaMonte
Lawrence J. Salva
Ashwinpaul C. (Tony) Sondhi
Robert Uhl
Daniel Murdock (SEC Observer)
* Richard C. Paul (FinREC Observer)[1]
* Diane Rubin (PCC Observer)[1]

Task Force Members Absent:
None

* For certain issues only.

[1] Participated by telephone.

Others at Meeting Table:
Russell G. Golden, FASB Board Member
Daryl E. Buck, FASB Board Member
James L. Kroeker, FASB Board Member
Thomas J. Linsmeier, FASB Board Member
R. Harold Schroeder, FASB Board Member
Marc A. Siegel, FASB Board Member
Larry W. Smith, FASB Board Member
Shelly C. Luisi, SEC Senior Associate Chief Accountant
Daghan Or, FASB Practice Fellow
* Rahul Gupta, FASB Project Manager
* Jennifer Hillenmeyer, FASB Practice Fellow
* Stephen C. McKinney, FASB Practice Fellow
* Lauren Mottley, FASB Associate Practice Fellow
* Brian J. Schilb, FASB Practice Fellow
* Andrew J. Winters, FASB Practice Fellow
* Nicholas K. Milone, FASB Practice Fellow

* For certain issues only.

ADMINISTRATIVE MATTERS

- An FASB staff member announced that any consensuses-for-exposure reached at this meeting and any consensuses-for-exposure reached at prior meetings that are affirmed as consensuses at this meeting will be considered by the Board for ratification and exposure for public comment or ratification and issuance as a final Accounting Standards Update, respectively, at the March 26, 2014 Board meeting.

- The EITF chairman reported on the January 29, 2014 FASB Board meeting to discuss agenda prioritization. At that meeting, the Board decided to remove the following Issues from the EITF agenda:

  a. Issue No. 03-15, "Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure"
  b. Issue No. 06-12, "Accounting for Physical Commodity Inventories for Entities within the Scope of the AICPA Audit and Accounting Guide, Brokers and Dealers in Securities"
  c. Issue No. 09-D, "Application of the AICPA Audit and Accounting Guide, Investment Companies, by Real Estate Investment Companies"
  d. Issue No. 10-B, "Accounting for Multiple Foreign Exchange Rates."

  The Board also decided to remove the following potential new issue that was pending further EITF Agenda Committee consideration:

  "Application of EITF Issue No. 99-20, 'Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets,' When a Special-Purpose Entity Holds Equity Securities and Whether an Investment That Is Redeemable at the Option of the Investor Should Be Considered an Equity Security or Debt Security"

- The next EITF meeting is scheduled for June 12, 2014. The extra EITF meeting date reserved for May 15, 2014, will be utilized for an education session on Issues 12-G and 13-G.

DISCUSSION OF AGENDA TECHNICAL ISSUES

Issue No. 12-F

Title: Pushdown Accounting

Dates Discussed: January 17, 2013, March 14, 2013, November 14, 2013; March 13, 2014

Introduction

1. Current U.S. GAAP offers limited guidance for determining when, if ever, the cost of acquiring an entity should be used to establish a new accounting and reporting basis (pushdown) in the acquired entity's separate financial statements. SEC Staff Accounting Bulletin Topic No. 5.J, *New Basis of Accounting Required in Certain Circumstances*, EITF Topic No. D-97, "Push-Down Accounting," and other comments made by the SEC Observer at EITF meetings (which are codified in paragraphs 805-50-S99-1 through S99-4), provide guidance for SEC registrants on pushdown accounting. Additionally, certain financial institutions are required by their regulators to apply pushdown accounting in certain circumstances. The SEC staff's guidance indicates that if a purchase transaction results in an entity becoming substantially wholly owned, its standalone financial statements should be adjusted to reflect the basis of accounting of the acquirer. The SEC staff's guidance further states that pushdown accounting is (a) required when 95 percent or more of an entity's ownership is acquired, (b) permitted when 80 to 95 percent is acquired, and (c) prohibited when less than 80 percent is acquired. The existence of other interests, such as public debt, preferred stock, or a significant noncontrolling interest, however, may affect the acquired entity's ability to apply pushdown accounting. The SEC staff's guidance also indicates that holdings of investors who both mutually promote the acquisition and collaborate on the subsequent control of the acquired entity (collaborative groups) should be aggregated for the purpose of determining whether the acquired entity has become substantially wholly owned.

2. In the past, the EITF has considered several Issues that address pushdown accounting but has only reached a consensus on a few of them, including the application of pushdown accounting to non-SEC registrants (EITF Issue No. 86-9, "IRC Section 338 and Push-Down Accounting") and the change in accounting basis in master limited partnership transactions (EITF Issue No. 87-21, "Change of Accounting Basis in Master Limited Partnership Transactions"). In Issue 86-9, the Task Force concluded that pushdown accounting is not required for entities that are not SEC registrants even if an acquisition meets all of the following three conditions: (a) the acquired entity is neither an SEC registrant nor a party to the transaction effecting a change in ownership, (b) a step-up in tax basis is elected by the acquired entity, and (c) there are no compelling reasons for the acquired entity to retain the old basis. Similarly, in Issue 87-21, the Task Force concluded that pushdown accounting is not appropriate for any of the following transactions that create a master limited partnership: (a) rollup, (b) dropdown, (c) rollout, and (d) reorganization. Both Issues are codified in Subtopic 805-50, Business Combinations—Related Issues.

3. Since the SEC staff's guidance is only mandatory for SEC registrants, diversity in practice exists in the application of pushdown accounting by entities that are not SEC registrants. In

addition, comparability issues have arisen due to the option in the SEC guidance to apply pushdown accounting when between 80 and 95 percent of an entity has been acquired. The FASB staff also notes that practice issues related to the application of pushdown accounting continue to arise as a result of the limited guidance, including the absence of a basis for conclusions and a principle for when pushdown accounting should be applied.

Issue

4. The issue is whether a reporting entity should establish a new accounting basis in its standalone financial statements (that is, apply pushdown accounting) as a result of a transaction or other event in which an acquirer obtains control of the reporting entity, and, if so, the resulting level of controlling ownership at which the new accounting basis should be required.

Working Group Recommendation – Scope

5. The working group on this Issue met on July 26, 2012, to discuss the scope of this Issue. Working group members represented accounting firms, users, and preparers. The SEC staff observed the meeting. The working group explored several scope alternatives during the meeting ranging from the narrowest—addressing pushdown accounting issues in a purchase transaction—to the broadest—developing overarching principles for all possible new basis issues. The working group recommended that the Task Force should pursue a scope that includes an approach that would be applied by a reporting entity in its separate financial statements as a result of a transaction or other event in which an acquirer obtains controlling financial interest in the entity.

Scope

6. The Issue addresses whether a new basis of accounting (pushdown) should be established in the separate financial statements of an entity when there is a change-in-control event in which an acquirer obtains control of the entity.

Prior EITF Discussion

7. At its January 17, 2013 meeting, the Task Force discussed the following three alternative views regarding the application of pushdown accounting:

a. A new accounting basis should be established when an acquirer obtains *substantially all* (defined in the Master Glossary in the context of the concepts underlying the leases classification criteria of Topic 840 as 90 percent) of the controlling financial interest in a reporting entity and thereby obtains control over the form of ownership of the reporting entity
b. A new accounting basis should be established when an acquirer obtains control of the reporting entity
c. A new accounting basis should not be established in an acquired entity's separate financial statements.

8. The Task Force expressed a preference for expanding the use of pushdown accounting to change-in-control events and directed the FASB staff to perform user outreach to understand the relevance of pushdown accounting in standalone financial statements of an acquired entity. The

Task Force asked the staff to solicit feedback from private company preparers and users as well as from the Private Company Council (PCC) members.

9. At the March 14, 2013 EITF meeting, the Task Force discussed the feedback received from users of both public and nonpublic entity financial statements and the PCC that indicated mixed views on whether the new basis in the standalone financial statements of an acquired entity provides beneficial information for investment decision making. Some Task Force members indicated that the threshold for requiring pushdown accounting should remain high and should only be applied when there is a transaction, and, therefore, supported View A. Other Task Force members preferred a change-in-control threshold to apply pushdown accounting. Those Task Force members preferred a lower threshold because they believe that it would be operationally beneficial for both the acquiring entity and the subsidiary to not have to maintain two different sets of books. Additionally, one Task Force member noted that in determining the parent's accounting, a change in control is considered a significant event accounted for at fair value and pushdown accounting would align the accounting between the parent and subsidiary. Some Task Force members also commented that application of pushdown accounting to standalone financial statements of the acquired entity (subsidiary) would help users analyze its financial statements in the context of the financial statements of the acquirer (parent).

10. The Task Force directed the FASB staff to develop a model under which pushdown accounting could be optionally applied when an acquirer obtains control of a reporting entity.

Threshold of Applying Pushdown Accounting

11. At the November 14, 2013 EITF meeting, the Task Force discussed the threshold of applying pushdown accounting and tentatively decided that pushdown accounting would be required for a public business entity if the change-in-control event causes the entity to become substantially wholly owned by the acquirer. The Task Force also tentatively decided that all entities (that is, both public business entities and non-public entities) would have the option to apply pushdown accounting in their separate financial statements upon occurrence of a change-in-control event in which an acquirer obtains control of the entity. One Task Force member objected to the application of pushdown accounting upon change-in-control events on the basis that there has not been demonstrated user support on the use of pushdown accounting.

12. In addition, the Task Force directed the staff to reconvene the working group on this Issue and research the following issues regarding the application of pushdown accounting:

a. Definition of "substantially wholly-owned," including the related issue of collaborative groups whereby ownership is obtained by multiple parties
b. Application of pushdown accounting when an entity becomes substantially wholly-owned as a result of a series of transactions over time (step acquisitions)
c. Potential exceptions for the application of pushdown accounting at the substantially wholly owned level, such as when there is public debt or other significant interest holders in the acquired entity.
d. Other events or circumstances in which pushdown accounting should be required or precluded.

Application of Change-In-Control-Based Pushdown Accounting Model

13. The Task Force discussed a series of other issues pertaining to the change-in-control-based pushdown accounting model and made the following tentative decisions:

a. Consistent with business combinations accounting, a change in control event for purposes of pushdown accounting would include events in which control is obtained by the acquirer without transfer of consideration. The acquired entity would follow the recognition, measurement, and disclosure guidance in Topic 805, Business Combinations, for its assets, liabilities, and equity instruments, as applicable.
b. Acquisition-related debt incurred by the acquirer would not be recognized in the acquired entity's separate financial statements unless the acquired entity is required to recognize a liability for the debt in accordance with other applicable U.S. GAAP. The Task Force directed the staff to develop application guidance to clarify when such debt would be recognized as a liability of the acquired entity.
c. An acquired entity would recognize goodwill that arises from the change in control event. However, bargain purchase gains, if any, would not be recognized in the acquired entity's income statement.

Current EITF Discussion

Threshold for Application of Pushdown Accounting

14. The Task Force considered both change in control and substantially wholly owned as potential thresholds for pushdown accounting and reached a consensus-for-exposure that the threshold should be change in control. The Task Force concluded that the change-in-control threshold is the best trigger for pushdown accounting because it is already established in Topic 810 and Topic 805 as a threshold for consolidation and business combinations. The Task Force determined that the gain or loss of control of a business or nonprofit activity is considered to be a significant economic event for which remeasurement of an entity’s net assets may be a more faithful depiction of the transaction in certain circumstances. The Task Force highlighted that the Board already has determined business combinations to be a significant event that requires new basis accounting for the net assets acquired and, in the absence of another distinct threshold that is conceptually grounded in U.S. GAAP, change-in-control events also could serve as the basis for establishing a new basis in an acquired entity’s separate financial statements. The Task Force also decided that a change-in-control threshold for pushdown accounting would eliminate the need to develop a virtual acquirer concept (collaborative groups), under which a group of investors is viewed as a single acquirer. The Task Force agreed that developing the concept of a virtual acquirer would make the guidance on pushdown accounting overly complicated.

15. The Task Force decided that a super-control concept, such as substantially-wholly-owned, is not appropriate because it would not only be inconsistent with the current threshold for consolidations and business combinations, but also would be challenging to define as a conceptually sound, effective, and operable principle. The Task Force acknowledged that the current SEC staff guidance is based on a substantially-wholly-owned threshold and could serve as a starting point for a new principle, but it expressed skepticism about developing a cost-effective principle to the existing concept in the SEC staff guidance. The Task Force considered the feedback provided by the working group from its January 31, 2014 meeting that the current SEC staff guidance is deemed by many to be overly complex. The Task Force discussed whether

it could make that guidance less complex and concluded that retaining a substantially-wholly-owned threshold but simplifying the SEC staff guidance could make the thresholdit less effective by increasing structuring opportunities to avoid or achieve pushdown accounting.

Option to Apply Pushdown Accounting

16. The Task Force reached a consensus-for-exposure to provide entities with an option to apply pushdown accounting. In reaching the consensus-for-exposure, the Task Force considered that a mandatory application of pushdown accounting would result in a substantial increase in the number of entities applying pushdown accounting and also an increase in the frequency of pushdown accounting being applied by the same entity. The Task Force believes that those results may not be beneficial to many users of financial statements and may be a costly exercise for many preparers. The Task Force also considered the user feedback that indicated mixed views about the relevance and benefits of pushdown accounting and noted that some users would prefer not to distort historical trends by establishing a new basis of accounting for each change-in-control event, while other users would prefer a new basis and consider an acquired entity's financial information in the context of its parent.

17. The Task Force observed that an optional model may reduce comparability among entities whose control is obtained by an acquirer. However, the Task Force decided that it is more important to satisfy different user needs by allowing entities to apply judgment on the basis of their unique set of facts and circumstances than to achieve comparability in this area. Furthermore, the Task Force noted that there is already a lack of comparability today among entities because of the optional nature of pushdown accounting among nonpublic entities and the optionality allowed for in the current model applicable to SEC registrants when between 80 percent and 95 percent of an entity is acquired.

18. The Task Force also reached a consensus-for-exposure that an acquired entity should evaluate separately the option to apply pushdown accounting at each change-in-control event and that the guidance should not be treated as a one-time accounting policy election. The Task Force believes that every change-in-control event is a distinct event and, therefore, an entity should make its pushdown accounting election on the basis of the facts and circumstances and the needs of its users for each distinct change-in-control event.

Recognition and Measurement

19. The Task Force reached a consensus-for exposure that an acquired entity that elects the option to apply pushdown accounting should reflect in its separate financial statements the new basis of accounting established by the acquirer for the individual assets and liabilities of the acquired entity by applying Topic 805 on business combinations. If the acquirer did not establish a new basis of accounting for the individual assets and liabilities of the acquired entity because it was not required to apply the guidance in Topic 805, the acquired entity should reflect in its separate financial statements the new basis of accounting that would have been established by the acquirer had the acquirer applied Topic 805. The acquired entity should recognize goodwill that arises due to the application of Topic 805 in its separate financial statements. However, if the application of Topic 805 results in a bargain purchase gain, the acquired entity should not recognize the gain in its income statement because that gain more appropriately would be reflected in the financial statements of the acquirer. For subsequent measurement, the acquired

entity should follow the guidance in Topic 805 and other applicable Topics to account for its assets (including goodwill), liabilities, and equity instruments.

20. The Task Force also reached a consensus-for-exposure that any acquisition-related debt incurred by the acquirer should be recognized in the acquired entity's separate financial statements only if the acquired entity is required to recognize a liability for that debt in accordance with other applicable U.S. GAAP (for example, Subtopic 405-40 on obligations resulting from joint and several liability arrangements). The Task Force referred to the definition of a liability in FASB Concepts Statement No. 6, Elements of Financial Statements, which states that "liabilities are probable future sacrifices of economic benefits arising from present obligations of a particular entity to transfer assets or provide services to other entities in the future as a result of past transactions or events," and concluded that an acquired entity would recognize a liability for the debt incurred by the acquirer only if that debt is the acquired entity's liability as defined in Concepts Statement No. 6.

Disclosure

21. The Task Force reached a consensus-for-exposure that an acquired entity that elects the option to apply pushdown accounting should disclose information that enables users of financial statements to evaluate the nature and effect of the pushdown accounting on its financial statements. To meet the disclosure objective, the acquired entity should provide the disclosures required in Topic 805, as applicable.

22. The Task Force also discussed whether disclosures should be required if an acquired entity does not elect to apply pushdown accounting when a change-in-control event occurs whereby an acquirer obtained control of an the acquired entity. The Task Force reached a consensus-for-exposure that if the acquired entity does not elect the option to apply pushdown accounting, it should disclose that it has (a) undergone a change-in-control event whereby an acquirer has obtained control of the entity during the reporting period and (b) decided elected to continue to prepare its financial statements using its historical basis that existed before the acquirer obtained control of the entity. The Task Force noted that such disclosure would require an entity to assess at each reporting period whether an acquirer has obtained its control, even though it may elect not to apply pushdown accounting for such an event.

Transition Method

23. The Task Force reached a consensus-for-exposure that an acquired entity should apply the pushdown accounting guidance prospectively to all events in which an acquirer obtains control of the entity and that occur after the effective date of the final Accounting Standards Update. The Task Force believes that applying the guidance in the period of the change-in-control event is important, and therefore the Task Force decided against allowing a retrospective transition which would have allowed for election of pushdown accounting for change-in-control events whereby an acquirer obtained control of an acquired entity in the past and would have required the use of hindsight for significant fair value estimates.

Effective Date and Early Application

24. The effective date will be determined after the Task Force considers stakeholder feedback on the proposed Update.

Board Ratification

25. At its March 26, 2014 meeting, the Board ratified the consensus-for-exposure reached by the Task Force on this Issue and approved the issuance of a proposed Update for a 90-day public comment period.

Status

26. Further discussion on this Issue will be held at a future meeting.

Issue No. 12-G

Title: Measuring the Financial Assets and Financial Liabilities of a Consolidated Collateralized Financing Entity

Dates Discussed: September 11, 2012, March 14, 2013, June 13, 2013, November 14, 2013; March 13, 2014

Introduction

1. A reporting entity is required to consolidate in its financial statements a collateralized financing entity (CFE), such as a collateralized debt obligation (CDO) or collateralized loan obligation (CLO) entities, when the reporting entity determines that it is the primary beneficiary of the CFE in accordance with the guidance in Topic 810 on consolidation. A reporting entity may be the primary beneficiary when it holds some of the beneficial interests issued by the CFE. In some instances, a reporting entity may be the primary beneficiary if it only holds beneficial interests that represent compensation for services (such as management fees or servicing fees).

2. Many reporting entities currently elect the fair value option to account for the financial assets and the financial liabilities of a consolidated CFE. The fair value, as determined under U.S. GAAP, of a CFE's financial assets may differ from the fair value of its financial liabilities even when the financial liabilities have recourse only to the financial assets. The differences between the fair value of the assets and the fair value of the liabilities could result from any one of the following:

a. Liquidity discounts that were inherent in the exit price for the CFE's liabilities and not in the CFE's assets
b. Differences between the duration of the CFE's assets and the duration of the CFE's liabilities
c. Principal markets for the assets and the liabilities that were not identical.

3. The Task Force received input indicating that diversity in practice has developed in the accounting for this measurement difference in both the initial consolidation and the subsequent measurement of the financial assets and the financial liabilities of a CFE. For example, some reporting entities record the difference in the consolidated statement of comprehensive income as a gain or loss and allocate the amount between controlling and noncontrolling beneficial interest holders in arriving at net income (loss) attributable to common shareholders. Those amounts are then reclassified to retained earnings and appropriated retained earnings, as applicable, in the statement of changes in equity. Other reporting entities record the entire difference as a direct adjustment to appropriated retained earnings in the statement of changes in equity. Some other reporting entities measure both the financial assets and the financial liabilities on the basis of the more observable of the fair value of the financial assets and the fair value of the financial liabilities to eliminate any differences other than those related beneficial interests retained by the reporting entity.

4. The objective of this Issue is to address this measurement difference that may exist today between a collateralized financing entity’s financial assets and financial liabilities in consolidation when those financial assets and financial liabilities are both measured at fair value.

Issue

5. The Issue is how a reporting entity should initially and subsequently account for the difference between the fair value of the financial assets and the fair value of the financial liabilities of a consolidated CFE.

Prior EITF Discussion

6. At the November 14, 2013 EITF meeting, the Task Force reached a consensus that a reporting entity applying this guidance should measure both the financial assets and the financial liabilities of the CFE using the more observable of the fair value of the financial assets and the fair value of the financial liabilities of the CFE. This represents a change from the measurement methodology in the revised proposed Update dated July 19, 2013, for this Issue that would have required the financial liabilities to be measured on the basis of the fair value of the financial assets. The new measurement methodology was developed in response to feedback from comment letters that indicated that the fair value of the financial liabilities is often more observable than the fair value of the financial assets.

7. If the fair value of the financial assets of the CFE is more observable, those financial assets would be measured at fair value and the financial liabilities would be measured in consolidation as (a) the sum of the fair value of the financial assets and the carrying value of any nonfinancial assets held temporarily, less (b) the sum of the fair value of any beneficial interests retained by the reporting entity (other than those that represent compensation for services) and the reporting entity’s carrying value of any beneficial interests that represent compensation for services. The resulting amount would be allocated to the individual financial liabilities (other than the beneficial interests retained by the reporting entity) using a reasonable and consistent methodology.

8. If the fair value of the financial liabilities of the CFE is more observable, those financial liabilities would be measured at fair value and the financial assets would be measured in consolidation as (a) the sum of the fair value of the financial liabilities (other than the beneficial interests retained by the reporting entity), the fair value of any beneficial interests retained by the reporting entity (other than those that represent compensation for services), and the reporting entity’s carrying value of any beneficial interests that represent compensation for services, less (b) the carrying value of any nonfinancial assets held temporarily. The resulting amount would be allocated to the individual financial assets using a reasonable and consistent methodology.

9. The Task Force also clarified that a reporting entity's consolidated statement of income (loss) should, when this guidance is elected, reflect the reporting entity's own economic interests in the CFE, including (a) changes in the fair value of the beneficial interests retained by the reporting entity and (b) beneficial interests that represent compensation for services.

10. The Task Force agreed that a reporting entity that consolidates a CFE should be required to apply the guidance resulting from this Issue to measure the financial assets and the financial

liabilities of the CFE upon its initial consolidation. A reporting entity should subsequently elect to either (a) apply the guidance resulting from this Issue or (b) apply other guidance in other relevant Topics for the subsequent measurement of the financial assets and the financial liabilities of a consolidated CFE. However, a reporting entity within the scope of this Issue would not be able to measure the financial assets or the financial liabilities of a consolidated CFE using the fair value option guidance in Topic 825 on financial instruments even if the reporting entity elects or does not elect to apply the subsequent measurement guidance resulting from this Issue.

11. The Task Force also decided that a reporting entity's decision to apply the guidance resulting from this Issue or other relevant Topics for the subsequent measurement of the financial assets and the financial liabilities of a CFE should be an accounting policy election that should be applied consistently to all CFEs consolidated by the reporting entity. While structures may vary by CFE, the Task Force decided that the difference in structures is being considered by allowing an entity to use the more observable of the fair value of the financial assets and the fair value of the financial liabilities.

12. The Task Force selected an effective date for public business entities of annual periods, and interim periods within those annual periods, beginning after December 15, 2014. For entities other than public business entities, the Task Force selected an effective date of annual periods beginning after December 15, 2015, and interim periods within annual periods beginning after December 15, 2016. Early adoption would be permitted.

13. Lastly, the Task Force decided that a reporting entity could apply the amendments resulting from this Issue using a modified retrospective approach by recording a cumulative-effect adjustment to equity as of the beginning of the annual period of adoption or could apply the amendments retrospectively to all relevant prior periods beginning with the fiscal year in which the amendments in Accounting Standards Update No. 2009-17, *Consolidations (Topic 810): Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*, were initially adopted.

14. During the final review of the Update resulting from this Issue, the FASB staff observed that there were multiple interpretations of which financial assets should be considered the financial assets of a consolidated CFE (thus within the scope of this Issue) and which financial assets should be considered the financial assets of the reporting entity (thus outside the scope of this Issue). This distinction is relevant when a reporting entity parent transfers financial assets to a consolidated CFE. The staff determined that it was necessary to perform additional outreach with stakeholders and further discuss the scope of this Issue with the Task Force at its March 13, 2014 meeting; therefore, the Board did not issue the Update.

Current EITF Discussion

15. At the March 13, 2014 meeting, the Task Force discussed the following four scope alternatives for this Issue:

View A: A CFE's financial assets should comprise all financial assets to which a CFE's beneficial interest holders have recourse (that is, all of the financial assets legally held by the CFE).

View A': A CFE's financial assets should include all financial assets to which a CFE's beneficial interest holders have recourse except financial assets legally transferred to the CFE by the reporting entity parent that were not measured at fair value prior to transfer.

View B: A CFE's financial assets should comprise all financial assets except those transferred to a CFE by the reporting entity parent that would have failed sale accounting if the CFE were not consolidated.

View C: A CFE's financial assets should comprise only financial assets that were not transferred from the reporting entity parent (that is, only financial assets acquired or generated separately should be measured under this guidance).

16. Some Task Force members raised concerns that View A could lead to the recognition of a gain or loss by a reporting entity on the transfer of assets to a consolidated CFE, even when the reporting entity has not surrendered control of those assets. Those Task Force members noted that the recognition of a gain or loss upon the transfer of financial assets to a consolidated entity would conflict with the requirements in Topics 810 and 860. However, other Task Force members supported View A, noting that the other scope alternatives may make it very difficult and complex to appropriately define which CFEs are in the scope of this Issue.

17. Some Task Force members favored View C because it eliminates the issues related to the transfer of financial assets from the reporting entity parent to a CFE. Some Task Force members highlighted that the reporting entities that would be in the scope of View C were the ones that truly have the potential for an uneconomic mismatch related to their consolidated CFEs, and were the CFEs that drove the need to address this Issue originally.

18. Many Task Force members indicated that View A' or variations of View A’ might be reasonable because it would eliminate the potential for significant gains and losses for transferred financial assets that were not being measured at fair value and also resolve the measurement difference when both the financial assets and financial liabilities of a CFE are measured at fair value. However, several questions were raised about how View A' would work and whether it would be more or less restrictive than current fair value option guidance. For example, the Task Force discussed a scenario in which securities transferred to a consolidated CFE from the reporting entity parent were measured at fair value under the fair value option prior to transfer. If the reporting entity did elect to use the measurement guidance resulting from this Issue, the reporting entity would no longer be able to use the fair value option for those assets. The Task Force noted that reporting entities that were using the fair value option could potentially structure transactions to stop the otherwise irrevocable fair value option previously made for those assets. The Task Force considered but did not agree on inserting anti-abuse language that would address such operational concerns with View A'. Task Force members noted that there also could be other scenarios that could raise various operational concerns.

19. Some Task Force members emphasized that the original goal of this Issue was to resolve the measurement difference between the financial assets and the financial liabilities in a consolidated

CFE when both are measured at fair value. According to those Task Force members, the goal was not to permit an accounting recharacterization of financial assets transferred into a consolidated CFE that would allow an entity to switch to or from fair value or change the presentation of its financial assets.

20. One Board member noted that a potential solution could be to provide this guidance as an exception to the measurement guidance in Statement of FASB Statement No. 157, *Fair Value Measurements* (contained in Topic 820). That way, the guidance would allow entities that wish not to apply the requirement to separately measure the financial assets and financial liabilities of a CFE. That is, the guidance would not provide the opportunity for entities to recharacterize their CFE's financial assets and financial liabilities from amortized cost to fair value, or vice versa. Rather, the guidance would provide a practical expedient for the measurement of CFEs by entities that under other Topics already measure at fair value both the CFE's financial assets and its financial liabilities.

21. While the Task Force acknowledged that considering this guidance as a practical expedient for the measurement of CFEs would resolve many of the concerns and complexities resulting from the potential recharacterization of financial assets, the Task Force raised some questions about this new alternative, including:

a. Whether financial assets that were measured at fair value through other comprehensive income prior to transfer by the reporting entity should also be in the scope of the practical expedient
b. How the initial difference between the fair value of the financial assets and the fair value of the financial liabilities, and related subsequent changes, should be presented when the practical expedient is not elected
c. Whether the practical expedient should be an accounting policy election applied consistently to all CFEs within the scope of this Issue or whether it should be a decision made on a CFE-by-CFE basis.

22. The Task Force decided that it would be beneficial for the FASB staff to further develop the practical-expedient alternative because of the complexity of this Issue and the diverse views expressed by Task Force members. The Task Force asked the staff to present its analysis as part of an education session tentatively scheduled for May 15, 2014, to help facilitate a more productive discussion of this Issue at the June 12, 2014 EITF meeting. The Task Force hopes to reach a conclusion at the June 12, 2014 EITF meeting but will have to determine based on the analysis presented by the staff whether it will be necessary to expose that conclusion for public comment.

Status

23. Further discussion is expected at a future meeting.

Issue No. 13-D

Title: Accounting for Share-Based Payments When the Terms of an Award Provide That a Performance Target Could Be Achieved after the Requisite Service Period

Dates Discussed: June 11, 2013; September 13, 2013; March 13, 2014

Introduction

1. Entities commonly issue share-based payment awards that require a specific performance target to be achieved for employees to benefit from the awards. Examples of performance targets include an entity attaining a specified profitability metric or selling shares in an initial public offering. Generally, an award with a performance target also requires an employee to render service until the performance target is achieved. In some cases, however, the terms of an award may provide that the performance target could be achieved after an employee completes the requisite service period. That is, the employee would be entitled to benefit from the award regardless of whether the employee is rendering service on the date the performance target is achieved.

2. U.S. GAAP does not contain explicit guidance on how to account for such share-based payments. Many reporting entities account for performance targets that could be achieved after the requisite service period as performance conditions that affect the vesting of the award and, therefore, do not reflect the performance target in the estimate of the grant-date fair value. Other reporting entities treat those performance targets as nonvesting conditions that affect the grant-date fair value of the award. The proposed Update is intended to resolve the diverse accounting treatment of those awards in practice.

Issue

3. The issue is whether a performance target that can be achieved after the requisite service is a performance condition that affects vesting or a condition that affects the grant-date fair value of the awards.

Scope

4. This Issue would apply to all reporting entities that grant their employees share-based payments in which the terms of the award provide that the performance target could be achieved after the requisite service period. That would be the case when an employee is eligible to retire or is otherwise eligible to terminate employment before the end of the period in which a performance target (for example, an initial public offering or change in control event) could be achieved and still be entitled to benefit from the award if and when the performance target is achieved.

Prior EITF Discussion

5. At the September 13, 2013 EITF meeting, the Task Force discussed the results of additional outreach and staff analyses on this Issue as requested at the previous meeting.

6. The Task Force decided that a performance target that could be achieved after the requisite service period should be treated as a performance condition that affects the vesting of the awards.

7. For awards within the scope of the proposed Update, the Task Force decided that a reporting entity would apply existing guidance in Topic 718 as it relates to share-based payments with performance conditions that affect vesting. Consistent with that guidance, performance conditions that affect vesting would not be reflected in estimating the fair value of an award at the grant date. Compensation cost would be recognized if it is probable that the performance condition will be achieved. The total amount of compensation cost recognized during and after the requisite service period would reflect the number of awards that are expected to vest and would be adjusted to reflect those awards that ultimately vest.

8. The Task Force observed that the definition of a performance condition requires (a) an employee to render service for a specified period of time and (b) achieving a specified performance target that is defined solely by reference to an employer's own operations. When an employee is eligible to retire at the grant date, the existing guidance in paragraphs 718-10-55-86 through 55-88 indicates that there is, effectively, a one-day requisite service period, being the day of the grant. The Task Force therefore noted that both (a) and (b) from the definition are present in awards within the scope of the proposed Update. Accordingly, the Task Force decided that treating those performance targets as performance conditions would be consistent with the definition of a performance condition.

9. Some Task Force members also emphasized that the treatment of awards within the scope of the proposed Update as performance conditions is consistent with the Board's original basis for conclusions when it developed FASB Statement No. 123 (revised 2004), *Share-Based Payment*. The Board concluded at that time that reflecting a performance condition in the grant-date fair value of an award was generally not considered to be measurable with sufficient reliability for financial reporting purposes. Developing probability distributions that reflect the likelihood of achieving the performance target was, in most cases, not considered reliable because of the limited data on which to base that information. Accordingly, the Board concluded at that time that vesting conditions should be ignored when calculating the grant-date fair value of the awards. Instead, the Board decided that the outcome of vesting conditions should reflect the amount of compensation cost that is ultimately recognized on the basis of the number of awards that vest to the recipient. The Task Force noted that performance targets that could be achieved after a requisite service period are no less difficult to measure with sufficient reliability than other awards that contain performance conditions. The outcome of performance targets, such as a future initial public offering, is also no less difficult to predict today than it was at the time the Board issued Statement 123(R). Therefore, the Task Force decided that there was no compelling reason to require awards within the scope of the proposed Update to be treated differently from other awards with performance conditions that affect vesting.

10. The Task Force acknowledged the potential anomaly that, in some cases, the accounting for the performance target as a performance condition would result in no compensation cost being recognized during the period in which the employee services are received. That is the case, for example, when the performance target becomes probable of being achieved after the requisite service period. Alternatively, compensation cost might never be recognized because the performance condition might not become probable of being achieved. This may be the case, for example, when there is a highly uncertain performance target such as an initial public offering or

a change in control event. The Task Force noted that the lack of compensation cost in such circumstances is not unique to the awards within the scope of the proposed Update; other types of performance conditions also would produce the same accounting result of no compensation cost because compensation cost cannot be recognized until a performance condition is considered probable of being achieved. The Task Force decided that it was preferable to recognize compensation cost after the requisite service period in some cases, such as in the initial public offering case, rather than to recognize a highly subjective compensation cost over the requisite service period. The Task Force also preferred accounting for the performance target as a performance condition because that treatment adjusts the compensation cost for the actual number of awards that vest.

11. In supporting its decision, the Task Force also observed another advantage of the performance condition treatment over the nonvesting condition treatment. The alternative approach would have required entities to assess at the grant date whether certain employees are retirement eligible or will become retirement eligible during the period. Entities would have had to undertake at least two different valuations for the same performance-based award and utilize two different measurement and recognition patterns for those awards, for example, one for retirement-eligible employees and another for all other employees. While entities already have to track different awards separately today (for example, awards with service conditions separately from awards with performance conditions), the Task Force noted that the alternative approach would have introduced incremental complexity.

12. The Task Force acknowledged that if the IFRS Interpretations Committee's proposed definition of a performance condition under IFRS 2, *Share-based Payment*, is finalized, the amendments in the proposed Update would diverge from IFRS. Performance targets that could be achieved after the requisite service period would not be accounted for as performance conditions under the proposed changes to IFRS 2. The Task Force noted that potential difference but ultimately decided that the improvement to U.S. GAAP as a result of the amendments in the proposed Update would take priority over convergence in this aspect of the share-based payments guidance.

Current EITF Discussion

13. At the March 13, 2014 EITF meeting, the Task Force discussed the constituent feedback and reached a consensus on this Issue.

Performance Condition Treatment

14. The definition of a performance condition in U.S. GAAP does not require specifically that an employee be rendering service at the time the performance target is achieved. Therefore, it is not clear from the definition whether a performance target that could be achieved after the requisite service period should be treated as a performance condition or as a nonvesting condition that affects the grant-date fair value of the awards. The Task Force decided that a performance target that affects vesting and that could be achieved after the requisite service period should be treated as a performance condition. Almost all respondents agreed with the Task Force's consensus-for-exposure on the performance condition treatment.

15. For awards within the scope of the Update, the Task Force decided that a reporting entity should apply existing guidance in Topic 718 as it relates to share-based payments with performance conditions that affect vesting. Consistent with that guidance, performance conditions that affect vesting should not be reflected in estimating the fair value of an award at the grant date. Compensation cost should be recognized when it is probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest.

16. The Task Force observed that the definition of performance condition requires (a) an employee to render service for a specified period of time and (b) achieving a specified performance target that is defined solely by reference to an employer's own operations. When an employee is eligible to retire at the grant date, the existing guidance in paragraphs 718-10-55-86 through 55-88 indicates that the service condition is nonsubstantive, meaning that there is, effectively, a one-day requisite service period, being the day of the grant. The Task Force therefore noted that both (a) and (b) above are present in awards within the scope of the Update. Accordingly, the Task Force decided that treating those performance targets as performance conditions is consistent with the definition of a performance condition.

17. Some Task Force members also emphasized that the treatment of awards within the scope of the Update as performance conditions is consistent with the Board's original basis for conclusions when it developed FASB Statement No. 123 (revised 2004), Share-Based Payment. The Board concluded at that time that reflecting a performance condition in the grant-date fair value of an award generally was not considered to be measurable with sufficient reliability for financial reporting purposes. Developing probability distributions that reflect the likelihood of achieving the performance target was, in most cases, not considered reliable because of the limited data on which to base that information. Accordingly, the Board concluded at that time that vesting conditions should be ignored when calculating the grant-date fair value of the awards. Instead, the Board decided that the outcome of vesting conditions should reflect the amount of compensation cost that is ultimately recognized on the basis of the number of awards that vest to the recipient. The Task Force noted that performance targets that could be achieved after a requisite service period are no less difficult to measure with sufficient reliability than other awards that contain performance conditions. The outcome of performance targets, such as a future initial public offering, is no less difficult to predict today than it was at the time the Board issued Statement 123(R). Therefore, the Task Force decided that there was no compelling reason to require awards within the scope of the Update to be treated differently from other awards with performance conditions that affect vesting.

18. In supporting its decision, the Task Force also observed that the nonvesting condition approach would have required entities to assess at the grant date whether certain employees are retirement eligible or will become retirement eligible during the performance period for purposes of valuing the awards. Entities would have had to undertake at least two different valuations for

the same performance-based award, for example, one for retirement-eligible employees and another for all other employees. While entities already have to track different awards separately today, the Task Force noted that the nonvesting condition approach would have introduced incremental complexity.

Attribution Period of the Compensation Cost

19. The Task Force acknowledged that, in some cases, the accounting for the performance target as a performance condition would result in no compensation cost being recognized during the period in which the employee services are received. That is the case when the performance target becomes probable of being achieved after the requisite service period, for example, when there is a highly uncertain performance target such as an initial public offering. In this instance, there may be no compensation cost attributed to the reporting periods in which the employee's service is rendered, and the entire compensation cost would be recognized in the period in which the initial public offering becomes probable. Alternatively, compensation cost might not be recognized because the performance target might never become probable.

20. Furthermore, an employee may be immediately eligible to retire and is granted awards that include a performance target based on the company's profitability in three years' time. The terms of the award provide that the employee could retire before the outcome of the profit target is known and be entitled to receive the same awards that would have vested to the employee as if that employee had remained in service. In this case, the requisite service already has been rendered. If the entity initially determines that the performance target is probable, then the entire compensation cost would be recognized on the grant date. If the entity determines that the performance target is probable in a subsequent reporting period, then the entire compensation cost would be recognized in that subsequent period. Alternatively, compensation cost might not be recognized at all because the performance condition might never become probable of being achieved.

21. The Task Force noted that the lack of compensation cost during the service period in these circumstances is not unique to the awards within the scope of the Update; other types of performance conditions also would produce the same accounting result of no compensation cost being recognized during the service period because compensation cost cannot be recognized until a performance condition is considered probable of being achieved. The Task Force decided that it was preferable to recognize compensation cost after the requisite service period in some cases, such as in the initial public offering case, rather than to recognize a highly subjective compensation cost over the requisite service period. The Task Force also preferred accounting for the performance target as a performance condition because that treatment adjusts the compensation cost for the actual number of awards that vest.

Requisite Service Period and Vesting Period

22. Several respondents commented that existing guidance in Topic 718 illustrates that the requisite service period is often considered to be the same duration as the vesting period. The Task Force observed that, for awards within the scope of the Update, the requisite service period is the period during which an employee is required to provide service in exchange for an award and would end at the time the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. As indicated in the definition of vest, the stated

vesting period (which includes the period in which the performance target could be achieved) may differ from the requisite service period for awards within the scope of the Update.

Comparison with International Financial Reporting Standards

23. In December 2013, the IASB issued an amendment to IFRS 2 to define the term performance condition. Under the new definition, the performance target period cannot extend beyond the end of the service period. That is, performance targets that could be achieved after the requisite service period would not be accounted for as performance conditions. Rather, those targets would be accounted for as nonvesting conditions that are reflected in the grant-date fair value of the award.

24. In reaching its consensus on the amendments in the Update, the Task Force considered, at length, the IASB's amendments to IFRS 2. The Task Force acknowledged that the amendments in the Update would diverge from IFRS but ultimately decided that its consensus was more consistent with the Board's original basis for conclusions on share-based payments and more consistent with the predominant interpretation of U.S. GAAP under current practice.

Strike-out Amendment to the Illustrative Guidance

25. The Task Force observed that the example in paragraph 718-10-55-88, which illustrates how to estimate the requisite service period for retirement-eligible employees, would inadvertently conflict with its consensus on this Issue. The Task Force concluded that that paragraph was not meant to provide guidance on awards within the scope of the Update; rather, it was meant to illustrate how the requisite service period is estimated. During deliberations, the Task Force initially decided to recommend that the conflicting language within this paragraph be amended in the Board's Technical Corrections project. However, several respondents to the Exposure Draft suggested that the Task Force include this amendment as part of the Update. The Task Force agreed with that suggestion and decided to modify paragraph 718-10-55-88 as part of this guidance and to remove the conflicting language. The Task Force concluded that this modification does not change the substance of or the conclusions in that illustration.

Disclosures

26. The Task Force decided not to add incremental disclosure requirements to those already required by Topic 718. The disclosures required by Topic 718 are intended to enable users of the financial statements to understand the nature and terms of the share-based payment arrangements that existed during the period and the potential effects of those arrangements on shareholders. The Task Force noted that those objectives and related disclosures also are appropriate and sufficient for awards within the scope of the Update. Respondents generally agreed with the Task Force's conclusion not to add incremental disclosures.

Transition Method

27. The Task Force decided that the amendments in the Update should be applied prospectively to share-based payment awards granted or modified on or after the effective date. Earlier adoption is permitted. A number of respondents recommended that the Task Force allow transition alternatives and permit entities to adopt the amendments in the Update on a retrospective basis if they wanted to enhance comparability. The Task Force agreed with that suggestion and decided to permit retrospective adoption for all awards with performance targets that are outstanding on or after the beginning of the first annual period presented in the financial

statements at the date of adoption. The Task Force also decided that the use of hindsight should be allowed to provide relief in those cases when retrospective transition would otherwise require significant judgment in determining the exact prior period in which the outcome of the performance target may have become probable (for example, a profitability-based performance target for which it may be unclear on the transition date when the target became probable of being achieved).

28. The Task Force decided that the transition disclosures in Subtopic 250-10 on accounting changes should apply in the period of adoption. Respondents did not express any opposing views to these requirements.

Effective Date

29. Respondents were asked about the time and effort needed to implement the amendments in the Update and whether there should be a difference in the requirements between public business entities and all other entities. Most respondents who answered those questions commented that significant effort would not be needed and that there should not be a difference between public business entities and all other entities. The Task Force considered that feedback together with the FASB's Private Company Decision-Making Framework. While the framework generally recommends that private companies (a) should be given an additional year to adopt new guidance and (b) should not be required to adopt amendments during an interim period within the initial fiscal year of adoption, the Task Force decided that those guidelines were not necessary for the amendments in the Update because the amendments are largely providing clarifying guidance and can be applied on a prospective basis. Task Force members also noted that private companies would have adequate time before the effective date to go through their learning cycle.

Board Ratification

30. At its March 26, 2014 meeting, the Board ratified the consensus reached by the Task Force on this Issue.

Status

31. No further EITF discussion is planned.

Issue No. 13-G

Title: Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity

Dates Discussed: September 13, 2013; March 13, 2014

Introduction

1. Entities commonly raise capital by issuing different classes of shares, including preferred stock, that entitle the holders to certain preferences and rights over the other shareholders. The specific terms of those shares may include conversion rights, redemption rights, voting powers, and liquidation and dividend payment preferences, among other features. One or more of those embedded features may meet the definition of a derivative under Topic 815. Shares that include such embedded derivative features are referred to as hybrid financial instruments.

2. An entity that issues or invests in a hybrid financial instrument issued in the form of a share is required to separate an embedded derivative feature from the host contract (that is, the underlying share) and account for the feature as a derivative according to Subtopic 815-10 if certain criteria under paragraph 815-15-25-1 are met. One such criterion for separation is that the economic characteristics and risks of the embedded derivative feature are not clearly and closely related to the economic characteristics and risks of the host contract.

3. In the case of derivatives embedded in a hybrid financial instrument that is issued in the form of a share, that criterion requires evaluating whether the nature of the host contract is more akin to debt or to equity and whether the economic characteristics and risks of the embedded derivative feature are clearly and closely related to the host contract. If the host contract is akin to equity, then equity-like features (for example, a conversion option) are considered clearly and closely related to the host contract and, thus, would not be separated from the host. If the host contract is akin to debt, then equity-like features are not considered clearly and closely related to the host. In the latter case, an entity may be required to separate the equity-like embedded derivative feature from the debt host contract and account for the feature as a derivative pursuant to Subtopic 815-10 if certain other criteria under paragraph 815-15-25-1 are met.

4. There are predominantly two methods used in current practice by an issuer or investor in evaluating whether the nature of the host contract within a hybrid financial instrument issued in the form of a share is more akin to debt or to equity. One of the methods considers all terms and features in a hybrid financial instrument including the embedded derivative feature that is being evaluated for separate accounting. The other method considers all terms and features in the hybrid financial instrument except for the embedded derivative feature that is being evaluated for separate accounting. The use of different methods can result in different accounting outcomes for economically similar hybrid financial instruments. Additionally, there is diversity in practice with respect to the consideration of individual features, in particular redemption features, in relation to all other features when determining whether the nature of the host contract is more akin to debt or to equity. For example, some consider the existence of a fixed-price, noncontingent redemption option held by the investor in a convertible preferred stock to be determinative in concluding that the host contract is akin to debt. Others believe that the

existence of that redemption option would not, in and of itself, determine whether the host contract is akin to debt or equity. The objective of this Issue is to eliminate the use of different methods in practice and thereby reduce existing diversity surrounding the accounting for hybrid financial instruments issued in the form of a share under Topic 815.

Issues

5. There are two issues that this Issue looks to address:

> **Issue A**: Whether to (a) consider all of an instrument's terms and embedded derivative features (that is, use a whole-instrument approach), (b) exclude the embedded derivative feature being evaluated (that is, use a chameleon approach), or (c) exclude all embedded derivative features (that is, use a pure-host approach) when determining the nature of the host contract
>
> **Issue B**: How an entity should determine the nature of the host contract when an investor in a convertible preferred equity instrument holds a non-contingent, fixed-price redemption option.

Scope

6. This Issue would apply to all reporting entities that are issuers of, or investors in, hybrid financial instruments that are issued in the form of a share. The Task Force decided that limiting the scope to hybrid financial instruments issued in the form of a share is appropriate on the basis of feedback indicating that diversity in practice is observed most commonly in the treatment of hybrid financial instruments issued in the form of a share (for example, convertible preferred stock).

Prior EITF Discussion

7. At the September 13, 2013 EITF meeting, the Task Force considered and discussed the three alternative views in determining whether the host contract in a hybrid financial instrument is more akin to debt or to equity. The Task Force further discussed how an entity should determine the nature of the host contract when an investor in a convertible preferred equity instrument holds a noncontingent, fixed-price redemption option.

Method for Evaluating the Nature of the Host Contract

8. For a hybrid financial instrument issued in the form of a share, the Task Force reached a consensus-for-exposure that an entity would determine the nature of the host contract by considering all stated and implied substantive terms and features of the hybrid financial instrument, weighing each term and feature on the basis of relevant facts and circumstances. That is, the determination of the nature of the host contract would be based on a consideration of economic characteristics and risks of the entire hybrid financial instrument, including the embedded derivative feature that is being evaluated for separate accounting from the host contract.

9. In supporting that decision, the Task Force noted that it is not appropriate to disregard any term or feature in the analysis of the economic characteristics and risks of the host contract because the instrument's cash flows ultimately depend on the interaction of all contractual

provisions within the instrument and the way in which an investor or issuer may exercise options within the contract.

10. The Task Force also noted that its proposed approach is the most commonly used approach in current practice and is consistent with the guidance included in SEC Staff Announcement: Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under Topic 815 (formerly EITF Topic No. D-109, "Determining the Nature of a Host Contract Related to a Hybrid Financial Instrument Issued in the Form of a Share under FASB Statement No. 133 [*Accounting for Derivative Instruments and Hedging Activities*], and currently contained in paragraph 815-10-S99-3), which states that "the consideration of the economic characteristics and risks of the host contract should be based on all of the stated or implied substantive terms and features of the hybrid financial instrument."

11. The Task Force acknowledged that the proposed approach could result in situations in which an embedded derivative feature is, in effect, found to be clearly and closely related to itself. However, the Task Force decided that the alternative approach (of considering all terms and features except the embedded derivative feature that is being evaluated for separate accounting) would have been less desirable because it would have required a separate determination of the nature of the host contract for each embedded derivative feature being evaluated for separate accounting and it would have had the potential to result in (a) the host contract changing its nature depending on the embedded derivative feature being evaluated, and/or (b) separating a compound derivative that includes both debt-like and equity-like features, which may be difficult for preparers to value and investors to understand. The Task Force believes that it is not appropriate for a host contract within a single hybrid financial instrument to change its nature for purposes of this evaluation when the economics of the instrument remain unchanged.

12. The Task Force also considered but rejected an alternative that would have disregarded all embedded derivative features in the analysis of the economic characteristics and risks of the host contract. The Task Force rejected that approach because it believes that the approach could have resulted in an over-reliance on the legal form of the instrument in determining the nature of the host, as opposed to consideration of all relevant terms, features, facts, and circumstances.

13. One Task Force member expressed a preference for the alternative approach currently applied in practice for hybrid financial instruments issued in the form of a share. That is, in determining the nature of the host contract, an entity would evaluate all terms and features in a hybrid financial instrument except for the embedded derivative feature being evaluated for separate accounting. That Task Force member believes that this alternative approach is consistent with the overall objective of the embedded derivative analysis (that is, to compare the economic characteristics and risks associated with the embedded derivative feature and related timing and amount of cash flows with that of the instrument as if the embedded derivative feature had not been added to the instrument). In addition, that Task Force member noted that the alternative approach avoids the potential for situations in which an entity may conclude that an embedded derivative feature is clearly and closely related to the host contract primarily because of the embedded derivative feature itself.

Consideration of Redemption Features

14. In evaluating all relevant stated and implied substantive terms and features of a hybrid financial instrument issued in the form of a share, the Task Force noted that there was diversity in practice with respect to how entities were considering a fixed-price, noncontingent redemption option held by the investor when determining the nature of the host contract. The Task Force reached a consensus-for-exposure that in evaluating the terms and features of a hybrid financial instrument, the existence or omission of any single term or feature, including a fixed-price, noncontingent redemption feature held by the investor, would not necessarily determine the economic characteristics and risks of the host contract. Although the consideration of an individual term or feature may be weighted more heavily in the evaluation on the basis of facts and circumstances, judgment would be required based on an evaluation of all of the relevant terms and features. For example, the presence of a fixed-price, noncontingent redemption option held by the investor in a convertible preferred stock contract is not, in and of itself, determinative in the evaluation of whether the nature of the host contract is more akin to a debt instrument or more akin to an equity instrument. Rather, the nature of the host contract would depend on the economic characteristics and risks of the entire hybrid financial instrument.

15. Some believe that introducing more determinative guidance in U.S. GAAP, such as a rebuttable presumption approach, may help reduce complexity and diversity in practice. In addition, the Task Force observed the view held by some that the redemption option provides downside protection for the holder and, thus, suggests a host contract that is more akin to debt. However, the Task Force noted that the level of downside protection will vary depending on the specific facts and circumstances. For example, if the issuer does not have sufficient capital, the issuer would be unable to redeem the security even if the investor exercised the redemption option. That would be the case under various state laws and corporate charters under which a preferred share cannot be redeemed if it would cause the issuer to become insolvent. Accordingly, even with a redemption option, an investor may be exposed to the residual risks (that is, negative movements) of an equity investment.

16. The Task Force also observed that for private issuers of preferred shares, in many cases, the issuer would either perform well and have a liquidity event (in which case the conversion option would be exercised) or the issuer would perform poorly (in which case the preferred shareholders would effectively become the residual interest holders). Therefore, the Task Force noted that, in many circumstances, the redemption option would not be exercised.

Effective Date and Transition

17. The Task Force reached a consensus-for-exposure that the effects of initially adopting the amendments resulting from this Issue would be applied on a modified retrospective basis to existing hybrid financial instruments issued in the form of a share as of the beginning of the annual reporting period for which the proposed amendments are effective. This transition method is consistent with other clarifying guidance issued by the Board on accounting for embedded derivative features, as well as the transition framework established by the Derivatives Implementation Group (DIG) in Statement 133 Implementation Issue K5, "Transition Provisions for Applying the Guidance in Statement 133 Implementation Issues." Retrospective application would be permitted for all relevant prior periods. Early adoption would be permitted. The effective date will be determined by the Task Force after considering stakeholder feedback on

the proposed Update.

Current EITF Discussion

18. At the March 13, 2014 EITF meeting, the Task Force considered the feedback from nine comment letters received on the proposed Update for this Issue, which was issued on October 23, 2013, with a comment period that ended on December 23, 2013. A summary of the comment-letter responses was provided to the Task Force in the issue summary supplement.

Scope

19. One Task Force member asked whether there could be situations in which the issuer and the holder of a hybrid instrument (for example, a redeemable preferred stock) could reach different conclusions about bifurcation of the same embedded derivative feature (the redemption feature). That Task Force member suggested introducing guidance that would either minimize such potentially inconsistent treatment between the issuer and the holder or limit the scope of this Issue to issuers of hybrid instruments in the form of shares (which is where the Task Force member believes the current diversity in practice exists), but, ultimately, the Task Force reaffirmed its consensus-for-exposure that the scope of this Issue would apply to both issuers and holders of hybrid financial instruments issued in the form of a share.

Method for Evaluating the Nature of the Host Contract

20. The Task Force reaffirmed its consensus-for-exposure that for a hybrid financial instrument issued in the form of a share, an entity should consider all terms and features—including the embedded derivative feature being evaluated for bifurcation—when determining whether the nature of the host contract is more akin to debt or to equity (that is, the whole-instrument approach).

21. Some Task Force members expressed concern regarding the lack of guidance in the proposed Update with respect to how an entity would weigh and consider specific terms and features under the whole-instrument approach. Without providing such guidance, those Task Force members argued that diversity in practice cannot be effectively reduced. In addition, those Task Force members argued that it is inappropriate to ask entities to make a judgment without providing a basis on which the judgment should be made.

22. Other Task Force members noted that diversity would be reduced by requiring all entities to use the whole-instrument approach, and that guidance on how to consider features would not be more effective in reducing diversity. That is because the whole instrument approach would still require the use of judgment and a careful analysis of each set of unique facts and circumstances. In addition, those Task Force members questioned whether it would even be possible to create guidance that would be relevant to all hybrid financial instruments issued in the form of a share given the complexity and constantly evolving nature of these instruments, and the wide range of facts and circumstances surrounding individual issuances. Accordingly, those Task Force members did not favor establishing any additional guidance, because they believe doing so would be inconsistent with the principles of the whole-instrument approach.

23. Based on the discussion, several Board members indicated that they would prefer that the staff further explore the possibility of introducing implementation guidance to assist in

evaluating the specific terms and features of a hybrid financial instrument under the whole-instrument approach. Consequently, the Task Force has directed the staff to research the issue further and present its findings in a future education session, which is tentatively scheduled for May 15, 2014.

Status

24. Further discussion is expected at a future EITF meeting.

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues that will be added to the proposed agenda for the June 12, 2014 meeting will be considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
12-F	Pushdown Accounting	5/12	1/13; 3/13; 11/13; 3/14	9/18	Evans	Gupta/ Winters	The staff will prepare an Issue Supplement addressing comments received on the proposed Update	September 19, 2014 EITF meeting
12-G	Measuring the Financial Assets and Financial Liabilities of a Consolidated Collateralized Financing Entity	7/12	9/12; 3/13; 6/13; 11/13; 3/14	6/12	Day	Hillenmeyer/ McKinney	An education session will be held on May 15, 2014. The FASB staff will prepare an Issue Supplement addressing concerns raised at the March meeting.	June 12, 2014 EITF Meeting

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
13-F	Accounting for the Effect of a Federal Housing Administration Guarantee	5/13	11/13	6/12	Althoff	May/ Sangiulo	The FASB staff will prepare an Issue Supplement addressing comments received on the proposed Update	Comment deadline April 30, 2014; June 12, 2014 EITF meeting
13-G	Determining Whether the Host Contract in a Hybrid Financial Instrument Issued in the Form of a Share Is More Akin to Debt or to Equity	7/13	9/13; 3/14	6/12	Bielstein	Milone/ Or	An education session will be held on May 15, 2014. The FASB staff will prepare an Issue Supplement addressing concerns raised at the March meeting	June 12, 2014 EITF meeting