Assurance and Advisory
Business Services

December 2000

Financial Reporting Developments

Financial Reporting and Accounting Update 2000

Ernst & Young

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Letter to Clients and Friends

This Financial Reporting Developments booklet highlights significant developments in financial accounting and reporting that occurred during the period from December 15, 1999 to December 15, 2000. The booklet also includes summaries of proposals presently under consideration by the Financial Accounting Standards Board, the Securities and Exchange Commission, the American Institute of Certified Public Accountants, and the Governmental Accounting Standards Board. A summary of the issues considered by the FASB's Emerging Issues Task Force through its November 2000 meeting also is included. In addition, the booklet summarizes certain Auditing Standards Board pronouncements issued and proposals under consideration. Where applicable, the summaries refer to related Ernst & Young publications, copies of which can be obtained from any Ernst & Young partner.

If you have any questions about these items or other accounting and financial reporting developments, please contact any partner in the Ernst & Young office nearest you. We will continue to keep you informed about important developments as they occur.

Ernst & Young LLP

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Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—A Replacement of FASB Statement 125
(FASB Statement 140—September 2000)

Summary:

Statement 140 replaces Statement 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. Statement 140 changes certain provisions of Statement 125 and could have a significant impact not only on financial services companies, but also on commercial companies that engage in securitization transactions.

The new rules:

- Revise the Statement 125 rules to be followed when determining whether a special purpose entity (SPE) is a qualifying SPE (QSPE)—a key to determining whether the transfer qualifies as a sale. In a change from current practice, the Statement requires that a QSPE have at least 10% of its beneficial interests held by parties unrelated to the transferor. The Statement also limits the amount and type of derivative instruments that a QSPE can hold.
- Require that for a transfer to a QSPE to be accounted for as a sale, the transferor must **not** retain effective control over the transferred assets through a removal-of-accounts provision that allows the transferor to unilaterally reclaim specific transferred assets. This is significantly more restrictive than existing guidance and primarily will impact revolving period securitizations.
- Require extensive disclosures about securitizations entered into during the period and retained interests in securitized financial assets at the balance sheet date, accounting policies, sensitivity information relating to retained interests, and cash flows distributed to the transferor.

The FASB is preparing an updated Special Report, *A Guide to Implementation of Statement 140 on Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities: Questions and Answers*.

Effective Date:

Statement 140 is effective for transfers occurring after March 31, 2001. However, the expanded disclosures about securitizations and collateral are effective for fiscal years ending after December 15, 2000. They are not required, however, for prior periods (e.g., 1998 and 1999).

Other E&Y Sources:

- Accounting Release, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—A Replacement of FASB Statement 125* (No. BB4156).

Rescission of FASB Statement 53 (FASB Statement 139—June 2000)

Summary:

Statement 139 rescinds Statement 53, *Financial Reporting by Producers and Distributors of Motion Picture Films*. Statement 53 is no longer needed because the AICPA issued SOP 00-2, *Accounting by Producers or Distributors of Films* (see a discussion of that SOP in the AICPA section of this booklet). An entity that previously was subject to the requirements of Statement 53 now is required to follow the guidance in SOP 00-2. Statement 139 also amends Statement 63*, Financial Reporting by Broadcasters*, to indicate that a broadcaster is required to apply the guidance in SOP 00-2 if it owns the film (program material) that is shown on its cable, network, or local television outlets.

Effective Date:

Statement 139 is effective for fiscal years beginning after December 15, 2000, with earlier application encouraged.

Accounting for Certain Derivative Instruments and Certain Hedging Activities—An Amendment of FASB Statement 133 (FASB Statement 138—June 2000)

Summary:

Statement 138 amends Statement 133*, Accounting for Derivative Instruments and Hedging Activities*, to address a limited number of Statement 133 implementation issues using the following criteria: (a) implementation difficulties would be eased for a significant number of entities, (b) there would be no conflict with or modifications to the basic Statement 133 model, and (c) there would be no delay in Statement 133's effective date. Statement 138 amends Statement 133 such that:

- The normal purchases and normal sales exceptions are expanded.
- The specific risks that can be identified as the hedged risk are redefined so that in a hedge of interest rate risk, the risk of changes in a benchmark interest rate would be the hedged risk.
- Recognized foreign-currency-denominated assets and liabilities may be the hedged item in fair value hedges or cash flow hedges.
- Intercompany derivatives may be designated as the hedging instruments in cash flow hedges of foreign currency risk in the consolidated financial statements even if those intercompany derivatives are offset by unrelated third-party contracts on a net basis.

Certain FASB decisions based on the recommendations of the FASB's Derivatives Implementation Group also have been incorporated into the amendment.

The FASB staff released a new publication titled, *Accounting for Derivative Instruments and Hedging Activities,* that presents Statement 133 as amended by Statements 137 and 138. Also, it includes the results of the Derivatives Implementation Group (DIG), as cleared by the FASB through September 25, 2000, with cross-references between the issues and the paragraphs of the Statement.

Effective Date:

Statement 138 is effective for fiscal years beginning after June 15, 2000 (July 1, 2000 for a June 30 year-end company) — the same effective date as Statement 133, as amended by Statement 137).

Other E&Y Sources:

- Financial Reporting Developments booklet, *An Executive Overview of FASB Statement No. 133, as Amended by Statements 137 and 138* (No. BB0877).

Accounting for Certain Transactions Involving Stock Compensation (FASB Interpretation 44—March 2000)

Summary:

FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, provides guidance on 20 practice issues regarding the application of APB Opinion No. 25, *Accounting for Stock Issued to Employees*. Because the FASB focused on interpreting rather than completely overhauling APB 25, the issues were resolved within APB 25's intrinsic value framework. Many of the conclusions reached in the Interpretation will change practice significantly. Some of the more significant provisions of the Interpretation include:

- The common law definition of an employee should be used to determine whether an individual qualifies as an employee for purposes of applying APB 25. Options granted to individuals who do *not* meet that definition would be accounted for at fair value (for example, options granted to independent contractors). If the recipient of an option changes status (such as from an employee to a non-employee, or vice versa), the accounting for the option must be changed to reflect the recipient's status. For example, if an employee becomes a non-employee and does not forfeit his or her options, the accounting for the options must change from intrinsic to fair value. The accounting for the change in status also depends on the requirements of the original grant. If the original grant provides that the employee is allowed to keep the options when he or she becomes a non-employee, compensation expense is recognized only for the portion of the options attributable to remaining vesting. If the original plan would have required forfeiture, the options are considered to be newly granted, and their entire fair value would be recognized.
- Options granted by a parent company to employees of a consolidated subsidiary are accounted for under APB 25 in the financial statements of the subsidiary. APB 25, however, does not apply in the separate financial statements of a subsidiary for equity awards that the subsidiary grants to employees of the parent. Options granted to employees of unconsolidated subsidiaries and joint ventures also must be accounted for at fair value.
- Reducing the exercise price of an option directly or indirectly (often referred to as "a synthetic repricing") results in variable accounting for the award from the date of modification to the date the award is exercised, forfeited, or expires unexercised. If options are canceled, any options issued at a lower price either six months before the cancellation or six months after the cancellation would be considered repriced, thereby giving rise to variable accounting.

- If a plan is modified to provide for acceleration of vesting contingent upon a future event (such as involuntary termination), compensation expense is measured as of the modification date using intrinsic value. However, that compensation is ultimately recognized only if the future event actually occurs and the options are accelerated.
- In a purchase business combination, the fair value of *vested* options are included in the purchase price. The fair value of partially vested options are included in the purchase price to the extent vested, while the intrinsic value of the unvested portion is allocated to unearned compensation and recognized as compensation expense over the remaining vesting period.

Effective Date:

The Interpretation is effective July 1, 2000, and is to be applied prospectively to all new awards, modifications to outstanding awards, and changes in employee status after that date, with the following exceptions:

- The requirements related to the definition of an employee apply to new awards granted after December 15, 1998.
- The requirements of repricings apply to modifications made after December 15, 1998 that either directly or indirectly reduce the exercise price of an award.
- The new rules relating to reloads apply to modifications to add a reload feature after January 12, 2000 (i.e., adding a reload feature to an option makes the option variable from that point forward). A reload stock option provides for an automatic grant of a new option at the then current market price in exchange for each previously owned share tendered by an employee in a stock for stock exercise.

Because the FASB decided that the Interpretation should be applied prospectively from July 1, 2000 (except for certain events described above), no adjustments would be made to financial statements for periods prior to July 1, 2000, upon the initial application of the Interpretation, nor would the financial statements be restated or otherwise affected.

Other E&Y Sources:

- Financial Reporting Developments booklet, *Summary of FASB Interpretation No. 44* (No. BB0865).

Using Cash Flow Information and Present Value in Accounting Measurements (Statement of Financial Accounting Concepts 7—February 2000)

Summary:

Concepts Statement 7 provides general principles governing the use of present value, especially when the amount of future cash flows, their timing, or both are uncertain, and establishes that an expected cash flow technique (based on probability-weighted cash flows) be used to determine present value. It also provides a common understanding of the objectives of present value in accounting measurements. The FASB rejected the use of entity-specific measurements, concluding that the objective of discounting is always to determine fair value. The fair value approach would be required even when companies are performing the retirement activities themselves, rather than hiring a third party. Additionally, the measurement of a liability would always give consideration to an entity's credit standing.

Concepts Statements (seven exist today) do not establish accounting standards and do not require changes in existing generally accepted accounting principles, but given the pervasiveness of discounting in accounting measurements, the effect of Concepts Statement 7 could be significant. The FASB does not intend to revisit existing accounting standards solely as a result of issuing this Concepts Statement. Instead, it will use this Concepts Statement in developing future accounting standards as issues arise and are added to the FASB's technical agenda. For example, in its current project on accounting for asset retirement obligations (ARO), the FASB tentatively has decided that an entity would be required to use an expected cash flow approach to estimate the fair value of the ARO liability, and the Exposure Draft on impairment would require that the undiscounted cash flows used to determine whether an impairment exists be estimated using an expected cash flow approach.

Proposals Under Consideration—Exposure Drafts

Liabilities and Equity Instruments (Exposure Draft—October 2000)

Comment Period:

Ends March 31, 2001.

Summary:

The proposed Statement would establish standards for accounting for financial instruments with characteristics of liabilities, equity, or both. It would require that an issuer classify liability components and equity components of a financial instrument separately. There would no longer be a mezzanine section on the balance sheet and redeemable preferred stock would be classified as a liability. The Exposure Draft (ED) also provides guidance on separating convertible debt into a debt component and an equity component.

The proposed Statement also would establish standards related to the accounting for the noncontrolling interest in a consolidated subsidiary. In what is likely to be controversial, the FASB proposed that minority interests would be included as a separate component of stockholders' equity and that net income attributable to minority interests would not be recognized as a deduction in arriving at net income.

Concurrent with the issuance of this ED, the FASB also issued an ED that would amend FASB Concepts Statement 6, *Elements of Financial Statements*. During the deliberations that led to the ED on liabilities and equity, the FASB decided that certain financial instrument components embodying obligations that require (or permit at the issuer's discretion) settlement by issuance of equity shares should be classified as liabilities. Those components would not have been classified as liabilities under the original definition of liabilities in Concepts Statement 6. This proposed amendment addresses that inconsistency between the decisions reached in the liabilities and equity ED and the distinction between liabilities and equity in Concepts Statement 6.

Effective Date:

The effective date for the final Statement will be for fiscal years beginning after June 15, 2002. In the initial year of adoption, an entity would be required to restate all financial statements for earlier years presented for the effects of financial instruments within the scope of the ED that were outstanding at any time during the initial year of adoption. An entity whose consolidated financial statements include one or more less-than-wholly-owned subsidiaries at any time during the initial year of adoption would be required to restate all financial statements presented for earlier years that include those subsidiaries to classify the noncontrolling interest as equity.

Impairment of Long-Lived Assets (Exposure Draft—June 2000)

Comment Period:

Ended October 13, 2000.

Summary:

The FASB added a project to its agenda to address various impairment issues arising from the implementation of FASB Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of,* and to consider amending APB No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions,* to apply the Statement 121 model to discontinued operations. The FASB issued an Exposure Draft (ED) that is likely to result in several significant changes in practice.

The ED provides guidance on differentiating between assets held and used and assets to be disposed of. The distinction is important because assets to be disposed of must be stated at the lower of the assets' carrying amount or fair value less cost to sell, and depreciation is no longer recognized. Assets to be disposed of would be classified as held for sale (and depreciation would cease) when management, having the authority to approve the action, commits to a plan to sell the asset(s) meeting all required criteria. If the plan of sale criteria are met after the balance sheet date but before issuance of the financial statements, the related asset would continue to be classified as held and used at the balance sheet date.

Liabilities for costs associated with a plan to dispose of an asset or to exit a business activity would be recognized in the period(s) in which they are incurred and an entity's *commitment* to a plan would not, in and of itself, result in the recognition of a liability. For example, if the employee termination benefit arrangement requires employees to render service until they are involuntarily terminated to receive the benefits, a liability for the benefits should be recognized ratably as employees render service following the entity's communication of the benefit arrangement. This would be a major change from the current EITF 94-3 requirements for severance pay.

The FASB also reached some tentative decisions that would amend APB 30 to:

- Apply a Statement 121 model to assets to be disposed of in connection with a discontinued operation.

- Retain the income statement display provisions in APB 30, but require expected losses from the discontinued business to be recognized in discontinued operations in the period(s) in which they occur, rather than at the measurement date as under APB 30.
- Significantly expand the criteria to qualify for discontinued operations presentation.

Effective Date:

The proposal would be effective prospectively for fiscal years beginning in 2002.

Other E&Y Sources:

- Accounting Release, *Proposed Statement of Financial Accounting Standards on Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities* (No. BB4153).
- Comment Letter on the Exposure Draft (No. BB0896).

Accounting for Obligations Associated with the Retirement of Long-Lived Assets (Exposure Draft—February 2000)

Comment Period:

Ended May 18, 2000.

Summary:

The proposal addresses the accounting for obligations arising from the retirement of all tangible long-lived assets and expands the scope of the February 1996 proposal to include obligations that are identifiable by the entity upon acquisition and construction and during the operating life of a long-lived asset.

Consistent with the FASB's new Concepts Statement on present value measurements, asset retirement obligations initially would be measured at fair value and would be recognized at the time the obligation was incurred. This would apply even in situations where asset retirement obligations (ARO) cannot be settled in current transactions with third parties and companies will perform the retirement activities themselves. A corresponding amount would be capitalized as part of the asset's carrying amount and depreciated over the asset's useful life using a systematic and rational allocation method, generally a straight-line method. Changes in the obligation due to revised estimates of the amount or timing of cash flows to settle the future liability would be recognized by increasing or decreasing the carrying amount of the ARO liability and the carrying amount of the related long-lived asset. Changes merely due to the passage of time (accretion of the discounted liability), would be recognized as an increase in the carrying amount of the liability and as a corresponding charge to interest expense. The FASB plans to issue a final Statement in the second or third quarter of 2001.

Effective Date:

If adopted, the new rules would be effective for financial statements for fiscal years beginning after June 15, 2001. Earlier application would be encouraged. An accounting change to adopt the standard would be made by recording a cumulative catch-up adjustment as of the beginning of the company's fiscal year in which the standard is first applied.

Other E&Y Sources:

- Accounting Release, *Proposed Statement of Financial Accounting Standards on Asset Retirement Obligations* (No. BB4147).
- Comment Letter on the Exposure Draft (No. BB0868).

Fair Value of Financial Instruments (Preliminary Views—December 1999)

Comment Period:

Ended May 31, 2000.

Summary:

The Preliminary Views was issued for public comment as a first step to developing an Exposure Draft of a proposed standard. In what would be a major change in practice, the FASB tentatively has concluded that all financial instruments, without exception, should be measured at fair value and the related adjustments should be reflected in net income each period. However, the FASB might first propose requiring a separate set of fair value financial statements as supplemental information or to enhance the Statement 107 disclosures as a first step. The project's scope comprises all financial assets and liabilities, and closely related nonfinancial items such as "core deposit" and insurance intangibles, and servicing assets. It would apply to all companies—commercial as well as financial institutions, nonpublic as well as public companies, including not-for-profit organizations.

The FASB next will consider the draft standard currently being prepared by a Joint Working Group of standard setters. The paper would then be issued to constituents as an Invitation to Comment. In addition, the FASB will reconsider the issues discussed in the Preliminary Views document based on the comments of the respondents as well as discuss other issues related to the use of fair value in the financial statements.

Other E&Y Sources:

- Accounting Release, *Summary of the FASB's Preliminary Views, Reporting Financial Instruments and Certain Related Assets and Liabilities at Fair Value* (No. BB4145).
- Comment Letter on the Exposure Draft (No. BB0867).

Business Combinations and Intangible Assets (Exposure Draft—September 1999)

Comment Period:

Ended December 7, 1999.

Summary:

The FASB's proposal would eliminate the pooling-of-interests method and change the accounting for goodwill and other purchased intangibles. Public hearings on the proposal were held in February 2000. The FASB concluded in the ED that the use of two methods (purchase and pooling) makes it difficult for users to compare the financial statements of companies engaged in business combinations, and that only the purchase method should be used. With regard to the amortization period for goodwill, the FASB proposed that all goodwill should be amortized over a period not to exceed 20 years. Goodwill amortization would be shown separately, net of tax, as the last line item in continuing operations. Companies would have the option to show a per-share amount on the face of the income statement for goodwill amortization and a per-share amount for income before goodwill amortization.

Recently, the FASB reached a tentative decision to modify certain provisions of ED to require use of a nonamortization approach to account for purchased goodwill. Under that approach, goodwill would not be amortized to earnings over a period of up to 20 years. Instead, goodwill would be reviewed for impairment only in the periods in which the recorded value of goodwill is greater than its fair value. Under this approach, amortization of goodwill would be precluded.

With regard to other purchased intangibles, the FASB has tentatively concluded in recent deliberations that:

- Other purchased intangible assets should be recognized separately as assets if they are reliably measurable. To be reliably measurable, control over the future economic benefits of the assets is obtained through contractual or other legal rights, or the intangibles must be "separable" (i.e., capable of being sold, transferred or exchanged).
- Regarding amortization of intangible assets with finite lives, the FASB tentatively agreed to remove the 20-year useful life presumption in the ED and require intangibles to be amortized over their useful economic lives.
- Intangible assets that have economic lives that are indefinite would not be subject to amortization until there is evidence that their lives no longer are indefinite. The FASB dropped the "observable market" criteria proposed in the ED for nonamortization.

Initially, prior to issuing the ED, the FASB tentatively concluded purchased in-process research & development (IPR&D) should be capitalized. However, the FASB ultimately concluded that it was not possible to address purchased IPR&D costs separately from other R&D costs. As a result, the FASB decided to postpone a reconsideration of the accounting treatment for purchased IPR&D until a future date when R&D costs can be considered in a comprehensive manner. Therefore, companies will continue to follow FASB Interpretation No. 4, *Applicability of FASB Statement 2 to Business Combinations Accounted for by the Purchase Method*, which requires companies to write off purchased IPR&D immediately in an acquisition.

The FASB approved most of the proposed extensive disclosure requirements in the ED related to the purchase method of accounting for business combinations except that it eliminated the required disclosure of the book values of the net assets acquired (as proposed in the ED), but retained disclosure of the fair values of the net assets acquired. The FASB also decided that the presentation of pro forma information required under APB 16 would continue to be required. The FASB currently is deliberating issues with regard to the impairment of goodwill. After the goodwill issue is resolved, the FASB will redeliberate its decisions to eliminate poolings.

Effective Date:

If adopted, the new rules would apply to business combinations and to intangible assets acquired in transactions initiated immediately after the date of issuance of the final standard (expected to be no earlier than the March 2001). Business combinations initiated prior to issuance of the final standard would be grandfathered under APB 16.

Other E&Y Sources:

- Accounting Release, *Business Combinations and Intangible Assets—Summary of the Proposed Statement* (No. BB4137).
- Comment Letter on the Exposure Draft (No. BB0830).

Consolidated Financial Statements: Purpose and Policy (Exposure Draft—February 1999)

Comment Period:

Ended May 24, 1999.

Summary:

The revised Exposure Draft (ED), *Consolidated Financial Statements: Purpose and Policy*, attempts to address concerns that many constituents raised with the earlier ED, *Consolidated Financial Statements: Policy and Procedures*, which was issued in October 1995. In the revised ED, the FASB decided to focus only on completing the consolidation policy portion of the project, including revising the definition of control and providing additional implementation guidance. The proposed Statement does not consider issues about consolidation procedures that were addressed in the initial ED.

The revised ED essentially retains the concept of control encompassed in the earlier ED and, as a result, would require more entities to be consolidated than presently occurs in practice. The proposed Statement would require a controlling entity (parent) to consolidate all entities that it controls (subsidiaries). Control of another entity is defined as the ability to direct the policies and management that guide the ongoing activities of another entity so as to increase the benefits and limit losses from those activities. The proposal would establish the following presumptions of control if an entity:

- Has a majority voting interest in or a right to appoint a majority of an entity's governing body.
- Has a large minority voting interest and no other party or organized group of parties has a significant voting interest.
- Has a unilateral ability to (1) obtain a majority voting interest in, or (2) obtain a right to appoint a majority of the corporation's governing body through the present ownership of convertible securities or other rights that are currently exercisable at the option of the holder and the expected benefit from converting those securities or exercising that right exceeds its expected cost.

- Is the only general partner in a limited partnership and no other partner or organized group of partners has the current ability to dissolve the limited partnership or otherwise remove the general partner.

The FASB also has been discussing an alternative consolidation approach for assessing relationships involving an interest in an entity (e.g., a special purpose entity) that has activities and decision-making powers that are significantly limited.

The FASB decided to proceed with the issuance of a final Statement on consolidation policy that would **exclude** issues related to the consolidation of SPEs and other entities with significantly limited powers and activities. Although no specific timetable for issuance was established, the FASB indicated that it hopes to issue a final Statement early in 2001. The FASB also plans to issue an ED in early 2001 that will address issues related to consolidation of SPEs and other entities with significantly limited activities and powers and expects to issue a final Statement by the end of 2001.

Effective Date:

The final Statement on consolidation policy excluding issues related to the consolidation of SPEs and other entities with significantly limited powers and activities will be effective for financial statements for annual periods beginning after December 15, 2001 (2002 fiscal years). If finalized, the new rules on consolidation of SPEs would be effective for financial statements for annual periods beginning after June 15, 2002.

Other E&Y Sources:

- Accounting Release, *Consolidated Financial Statements: Purpose and Policy* (No. BB4139).
- Comment Letter on the Exposure Draft (No. BB0791).

Other Projects

New Basis Issues

Summary:

The FASB recently began its deliberations on new basis issues—the second phase of its business combinations project. The FASB agreed first to discuss which transactions and events would result in the recognition of a new basis of accounting in the separate, external, general purpose financial statements of an entity, and then turn focus on the related issues of how and when to recognize that new basis of accounting. The FASB has tentatively concluded that a change in control would trigger new basis accounting at the acquired company level in its separate financial statements. The FASB has not indicated when it plans to issue an Exposure Draft.

Combinations of Not-for-Profit Organizations

Summary:

The FASB originally decided at the inception of its business combinations project (August 1996) that not-for-profit (NFP) organizations should be included in its scope. However, the FASB readdressed the scope of Part I of its business combinations project in March 1999 and decided that it would be preferable to consider issues associated with combinations of NFP organizations in a separate project. The FASB indicated that this project will be conducted using an approach referred to as differences-based approach. It would presume that APB 16, as amended by the FASB's final rules on business combinations, would apply to NFP combinations unless a unique circumstance is identified that would justify a difference in accounting. The FASB began to discuss the project during the spring of 2000.

The FASB tentatively agreed that the merger of two NFP organizations in which neither cash nor other assets are exchanged as consideration would be accounted for like a contribution in accordance with FASB Statement No. 116, *Accounting for Contributions Received and Contributions Made*, provided that the donor and donee can be identified. The donee would use the "net-assets" method whereby the donee would recognize, at their fair values: (1) all identifiable assets acquired (including intangible assets) and (2) all liabilities assumed. The FASB also agreed that an acquired net deficit (excess of recorded liabilities assumed over recorded value of assets required) should be recorded as an unidentifiable intangible asset.

The FASB also tentatively concluded that the acquisition of a for-profit business enterprise by a not-for-profit organization (NFP) falls within the purview of APB 16, unless there is a way to prove that the transaction was in part a contribution to the NFP by the for-profit entity. If so, the contribution received would then be measured by the NFP as the excess of the fair value of the acquired business over the cost of acquiring that business. The FASB plans to issue an Exposure Draft addressing combinations of NFP organizations early in 2001.

Business Reporting Model

Summary:

In 1998, the FASB initiated a research project on business reporting. An important portion of the work is being done by the FASB's constituents organized into working groups. The project is managed by a Steering Committee that is comprised of FASB members and constituent groups.

The project will: (a) identify present practices in selected industries for disclosure of various types of information outside the financial statements and MD&A, such as operating data, performance information, and forward-looking information; (b) consider ways to coordinate GAAP and SEC disclosure requirements to avoid redundancies; and (c) study present systems for the electronic delivery of information and consider the implications for business reporting. Although the disclosures will not be mandated, the FASB anticipates that eventually market forces, particularly user requests, will broaden the number of companies that voluntarily provide such disclosures. In January 2000, the Steering Committee published the first section of its broad study—a report on the electronic distribution of business reporting information—and plans to issue a final report around year-end.

Securities and Exchange Commission

Final Pronouncements

Final Rules Regarding Auditor Independence (November 2000)

Summary:

On November 15, the SEC adopted final independence rules that update and clarify the requirements in three areas: (1) nonaudit services that auditors may provide to audit clients; (2) financial relationships between auditors and audit clients; and, (3) employment relationships between spouses and other relatives of auditors and audit clients. The final rules reflect major changes from the proposals which were issued for comment during the summer of 2000.

With respect to nonaudit services, the SEC codified existing restrictions—consistent with our long-standing policies—on the following seven services: management functions; bookkeeping; certain appraisal and valuation services; certain actuarial services for insurance companies; executive recruitment; broker-dealer services; and legal services (limited foreign legal services will continue to be permitted).

The restriction on appraisal and valuation services does not apply to services related to items that are not material to the financial statements, actuarial valuations of pension, other post-employment benefit or similar liabilities, valuations performed in the context of planning and implementing a tax planning strategy or for tax compliance purposes, or valuations for nonfinancial purposes. The rules, when effective, would expand existing restrictions by limiting valuations for purchase price allocations for book purposes in purchase business combinations.

The rules also address two additional services as follows.

The SEC placed some conditions on the provision of services related to financial information systems design and implementation, or "IT" (which excludes services related to the assessment, design, and implementation of internal accounting and risk management controls on which there are no restrictions). The most significant condition is that, unlike any other individual nonaudit service, the company would have to disclose the fees paid to the auditor for IT services.

While we will still be able to provide substantial internal audit services under the new rules, there will be limits on total outsourcing for companies with over $200 million in total assets.

The rules call for proxy disclosure of: (1) aggregate audit and nonaudit fees for the most recent fiscal year similar to that required in the U.K. (As indicated above, companies that engage their auditors for IT services would separately disclose fees paid for such services); and (2) whether the audit committee has considered whether the nonaudit services are compatible with maintaining auditor independence. This latter disclosure is consistent with the communications specified under Independence Standards Board Standard No. 1 (“ISB No. 1”) and could be made in connection with the new proxy disclosures resulting from the Blue Ribbon Committee on Audit Committees recommendation as to the committee’s receipt of the ISB No. 1 letter and discussion thereof.

The new rules codify existing AICPA and SEC rules regarding business relationships, contingent fees, professionals employed by clients, etc., consistent with Ernst & Young’s policies.

The modernization of the personal independence rules regarding employment of spouses and other relatives by clients (including participation in stock option and employee benefit plans), and brokerage accounts (which now allow such accounts to the extent covered by the Securities Investor Protection Corporation), are particularly noteworthy and long overdue.

Effective Date:

The new restrictions on nonaudit services do not apply until 18 months after the effective date of the rules. The proxy disclosure requirement would first apply for statements filed with the SEC on or after February 5, 2001.

Frequently Asked Questions on Staff Accounting Bulletin No. 101 on Revenue Recognition (October 2000)

Summary:

The long-awaited frequently asked questions (FAQ) document on SAB 101 was issued by the SEC in October 2000. The SEC worked with accounting firms and preparers to identify the recurring questions and answers to inquiries about how the guidance in accounting standards and SAB 101 would apply to particular transactions. The FAQ document formalizes the positions the SEC staff has taken in numerous meetings, comment letters, and correspondence with industry groups and others, including key topics such as:

When revenue can be recognized if a form of title has been retained in certain countries.

1) Overcoming the presumptions in SAB 101 that customer acceptance provisions and remaining obligations require the deferral of revenue including guidance on analyzing the different types of customer acceptance provisions and determining whether remaining obligations can be considered inconsequential or perfunctory.
2) What factors should be considered in determining whether an obligation to install equipment precludes revenue recognition until the installation is completed.
3) Revenue recognition for nonrefundable payments, including specific guidance for telecommunications companies and R&D arrangements.
4) Accounting for certain costs of revenues.
5) Revenue recognition for refundable payments such as membership fees and certain types of service commissions.
6) Applying certain provisions of FASB Statement No. 48 on rights of return.

Effective Date:

SAB 101 is effective no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999.

Other E&Y Sources:

- Accounting Release on SAB 101- Updated for the FAQ (No. BB4154).

Regulation FD ("Fair Disclosure")(August 2000)

Summary:

Regulation FD requires an issuer that discloses material, nonpublic information, to make public disclosure of that same information:

1) simultaneously for intentional disclosures, or
2) "promptly" for non-intentional disclosures. "Promptly" is defined as the later of 24 hours or the start of the next trading day.

The new rule provides that an issuer may make the required disclosure by filing the information on a Form 8-K, or by another method intended to reach the public on a broad, non-exclusionary basis, such as a press release. While the SEC encourages issuers who maintain a website to post such information on its website, the new rules would not consider a website posting by itself to be a sufficient means of public disclosure.

The regulation applies only to communications with market professionals and security holders. The rules specifically exclude communications with the press, rating agencies, and ordinary-course-of-business communications with customers and suppliers. In addition, the regulation excludes communications made in connection with most registered securities offerings and does not apply to foreign issuers.

The new rules apply to communications by the issuer's senior management, its investor relations professionals, and others who regularly communicate with market professionals and security holders. The regulation requires public disclosure where the person making the selective disclosure knows or is reckless in not knowing that the information disclosed was both material and nonpublic.

The regulation is a disclosure rule and does not create liability for fraud (i.e. failure to make a disclosure required solely by Regulation FD will not result in a violation of Rule 10b-5). Where the regulation is violated, the SEC could bring an administrative proceeding seeking a cease and desist order, or a civil action seeking an injunction and/or civil penalties.

In addition, rules related to insider trading were approved. Pursuant to the new rules, a trader is liable for insider trading while he or she is aware of material nonpublic information. The approved exception to this rule is when a trader can demonstrate that, before becoming aware of the information, the trader entered into a contract, plan, or instruction to buy or sell the securities in the amount, at the price, and on the date which the purchase or sale was executed.

Effective Date:

October 23, 2000.

Other E&Y Sources:

- SEC Release on Selective Disclosure (No. CC0116).

Financial Statements and Periodic Reports for Related Issuers and Guarantors (August 2000)

Summary:

The final rules clarify the financial reporting rules for issuers and guarantors of guaranteed securities. These rules codify the positions the staff had developed through SAB 53 (which is now rescinded), later interpretations, and the registration statement review process, and eliminate substantially the need for requests for SEC staff "no-action" letters in this area.

The final rules (i) liberalize requirements for recently acquired guarantors, (ii) eliminate the option of presenting summarized financial information presentation for certain guarantee structures, (iii) provide an explicit exemption from periodic reporting under the Securities Exchange Act of 1934 if the registrant meets certain criteria, and (iv) require specific disclosures about guarantors and changes in financial information about guarantors.

Previously, presentation of summarized financial information was permitted in certain circumstances where the subsidiary was the issuer and the parent was the guarantor. This option is now eliminated. Condensed consolidating financial information is the only form of presentation acceptable where information about guarantors is required and full financial statements are not provided. Condensed consolidated financial information is prepared as a consolidation with the following columns:

Parent	Combined Guarantors that are joint and several	Column for each Guarantor that is not joint and several	Combined Non-Guarantors (if not minor)	Consolidating Adjustments	Total Consolidated Amounts

If the subsidiaries are not 100% owned or the guarantees are not full and unconditional, then full financial statements and periodic reporting is required under the Exchange Act.

No additional information (neither financial statements nor condensed consolidating financial information) is required if any of the following three situations exists:

1) the subsidiary issuer is a finance subsidiary and the parent company is the only guarantor of the securities;
2) if:
   - the parent company of the subsidiary has no independent assets or operations,
   - the parent guarantees the securities,
   - no subsidiary of the parent guarantees the securities, and
   - any subsidiary of the parent other than the issuer are "minor"
3) if:
   - the parent company issuer has no independent assets or operations, and
   - all of the parent company's subsidiaries, other than "minor" subsidiaries, guarantee the securities.

A subsidiary is “minor” if each of its total assets, stockholders’ equity, revenues, income from continuing operations before income taxes and cash flows from operating activities is less than 3% of the parent’s consolidated amounts (individually and in the aggregate).

Effective Date:

Registrants must apply the new rules in registration statements and post-effective amendments first filed after September 25, 2000, and in all subsequent Exchange Act periodic reports. Registrants that have existing Exchange Act reporting obligations must apply the new rules beginning with their annual report for their first fiscal year ending after September 25, 2000.

EDGAR Developments (August 2000)

Summary:

Effective November 27, 2000, the EDGAR system will no longer accept electronic filings using the DOS-based “legacy” EDGARLink software or nine-track tapes. Filers may continue to submit their official filings in either ASCII or HTML format. As of that date, filers using EDGARLink software will have to use EDGARLink Version 7.0 (or higher) to submit filings to EDGAR via the Internet, direct transmission or on magnetic tape cartridge. The software can be downloaded from the EDGAR filing web site at https://www.edgarfiling.sec.gov/. Earlier in 2000, the SEC adopted rules eliminating the Financial Data Schedule filing requirements and implemented various other aspects of modernization to the EDGAR system.

Proposals Under Consideration

Supplementary Financial Information (Release 33-7793—January 2000)

Comment Period:

Ended April 17, 2000.

Summary:

Citing perceived earnings management abuses and concerns from the financial statement analyst community, the SEC has proposed new rules that would expand certain schedule information currently required under Article 12 of Regulation S-X, by increasing the types of accounts reported and requiring a description of the nature of any additions and deductions, and changes in assumptions used in estimating the required account balance. The SEC also is proposing to reinstate the supplemental presentation of information for long-lived assets that was deleted by the Commission only a few years ago. The proposed supplemental information would be a new disclosure requirement under Regulation S-K, repositioned from the supplemental financial statement schedules. This information is not required to be audited and would be required in the Form 10-K.

Schedule II, Valuation and Qualifying Accounts, in Article 12 of Regulation S-X currently requires a reconciliation of the beginning and ending balances of certain valuation and qualifying accounts-generally certain asset contra accounts like accounts receivable. Under the proposed rule, registrants would provide details of the changes in nearly all material loss accruals. In addition to retaining the current information, items covered by the proposed rules would include: unamortized premiums and discounts, deferred tax valuation allowances, restructuring accruals under EITFs 94-3 and 95-3, accruals for costs of discontinued operations, environmental remediation costs, contingent income and franchise tax liabilities, product warranty liabilities, and litigation accruals. As part of the proposed rules, Schedule II would be rescinded and the information currently required by the schedule would be repositioned to a new Item 302(c) of Regulation S-K. Unlike Schedule II, the expanded supplementary financial information would not be required to be audited.

As part of its disclosure simplification initiative, the SEC rescinded the schedule requirement for plant, property and equipment in 1995. Since that action, the SEC received numerous complaints from financial statements analysts about the lack of such information. Those analysts indicated that the loss of such information diminished the predictability of financial results. In response to those concerns, the SEC proposes to reinstate the requirement to provide information about depreciation and amortization methods, useful lives, and salvage values of long-lived assets. While the previous disclosures were limited to plant property and equipment, the proposed rules also would apply to major intangible assets like goodwill, brand names, customer lists, non-compete agreements, and other similar intangible assets. Under the proposed rules, such information would be disaggregated for assets with significantly different asset characteristics.

We expect the proposed rules will increase the volume of disclosures that registrants currently provide to the SEC, and allow users to scrutinize the changes in valuation accounts and loss accruals. The rules proposal does not specify where the new disclosures must be provided. The SEC has requested comments on whether to require the information in quarterly reports on Form 10-Q, and in the MD&A portion of the Annual Report to Shareholders.

Based on comment letters received by the SEC, an overwhelming number of commenters are against the detailed disclosures regarding loss contingencies, particularly related to litigation and tax accruals, as such disclosures may place registrants at a competitive disadvantage. In addition, many commenters believe that the cost of providing the information required by the proposed rules would not be worth the benefit. We expect the SEC to adopt the rules but that consideration will be given to commenters concerns regarding sensitive loss contingencies and tax accruals. We also expect the final rules to allow for some level of aggregation in the disclosures.

Other E&Y Sources:

- Comment Letter (No. BB0860).

International Accounting Standards (Concept Releases 33-7801; 34-42430—February 2000)

Comment Period:

Ended April 30, 2000.

Summary:

For more than a decade, the SEC has been working with the International Organization of Securities Commissions (IOSCO) to advance the cause of transparent and efficient global capital markets. The focus of efforts to address accounting differences as a possible first step to create a common underpinning for financial reporting has been the International Accounting Standards Committee (IASC). At the end of 1999, the IASC recently completed the last major component of its "core standards" project and announced plans for a major reorganization.

The Release solicits comments from both domestic and foreign entities regarding the quality of the "core" accounting standards developed by the International Accounting Standards Committee (IASC) and raises broader questions regarding what supporting infrastructure is necessary in increasingly globalized capital markets. The Release seeks to identify the important concerns that would result from the acceptance of international accounting standards (IAS) and requests specific comment on whether the SEC should modify its current requirement for all financial statements of foreign registrants to be reconciled to US GAAP. The Release requests comments based on first-hand experiences that (1) issuers have had in applying IAS when preparing financial statements; (2) public accountants have had with auditing the application of IAS; and (c) investors have had with using financial statements prepared in accordance with IAS.

Registration of Securities on Form S-8 (Release 33-7647—February 1999)

Comment Period:

Ended May 7, 1999.

Summary:

In an effort to make Form S-8 less susceptible to abuse, without burdening companies operating legitimate employee benefit plans, this proposal would amend the instructions to Form S-8 to impose new qualification requirements for companies using Form S-8. The proposal would require, before filing a registration statement on Form S-8, that any company be timely in its Exchange Act reports during the 12 calendar months before the Form S-8 is filed. In addition, a company formed by merger of a nonpublic company into an Exchange Act reporting company with only nominal assets at the time of the merger would have to wait until it has filed an annual report on Form 10-K containing audited financial statements reflecting the merger before it can use Form S-8.

Regulation of Securities Offerings (Release 33-7606A—November 1998)

Comment Period:

Ended June 30, 1999.

Summary:

On November 13, 1998, the SEC proposed a broad package of regulatory reforms to the securities registration process to modernize the regulation of capital formation. Dubbed the "Aircraft Carrier proposal" by the SEC staff, the proposal builds on the SEC's 1996 concepts release and a related task force report on a proposed "Company Registration" system but its scope is much broader.

The Aircraft Carrier proposal has been delayed since it came under heavy fire from Wall Street firms and others who believed it would hinder U.S. capital markets and that it did not improve the current system. The SEC staff has indicated that it hopes to address and resolve the issues presented by the Aircraft Carrier in the next 12 to 24 months. The SEC staff has noted that these issues may get resolved in a series of smaller rule-making proposals which received broad acceptance.

The proposed rules would:

- Eliminate five existing registration forms, replacing them with a new three-tiered “ABC” system.
- Eliminate many of the current “quiet period” restrictions on issuer communications around the time of securities offerings.
- Streamline prospectus delivery requirements.
- Expedite and require additional disclosures in Exchange Act reports.
- Ease current restrictions on switching from public to private offerings and vice-versa.

Other E&Y Sources:
Comment Letter (No. CC0104).

American Institute of Certified Public Accountants

Final Pronouncements

Accounting by Producers and Distributors of Film (SOP 00-2—June 2000)

Summary:

SOP 00-2, *Accounting by Producers and Distributors of Film*, replaces FASB Statement 53, *Financial Reporting by Producers and Distributors of Motion Picture Films* (which is rescinded by FASB Statement 139—see earlier discussion in the FASB section). Since the issuance of Statement 53 in 1981, extensive changes have occurred in the motion picture industry. Concurrent with those changes in the industry, significant variations in the application of Statement 53 have arisen.

The SOP defines films as feature films, television specials, television series, or similar products that are sold, licensed, or exhibited, whether produced on film, video tape, digital, or other formats. AcSEC concluded in the SOP that a fair value approach would be used to determine the impairment of unamortized film costs but the approach would not take into consideration all of the aspects of Statement 121. Under the revised approach, an entity would compare the unamortized film cost to the fair value of the film at each balance sheet date. Any amount in excess of fair value would be written off. However, the entity would not perform and would not need to fail the Statement 121 test of comparing the carrying amount of the asset to undiscounted cash flows as a "trigger" of fair value measurement.

AcSEC also concluded that advertising costs should be accounted for under the provisions of SOP 93-7, *Reporting on Advertising Costs*, and all exploitation costs, including marketing costs, should be expensed as incurred.

In addition, the SOP discusses such topics as revenue recognition (fixed fees and minimum guarantees in variable fee arrangements) and fee allocation in multiple films.

Effective Date:

This SOP is effective for financial statements issued for fiscal years beginning after December 15, 2000. Adoption is through a cumulative effects adjustment. Disclosure of the pro forma effects of retroactive application is not required. Previously issued financial statements should not be restated.

Audit and Accounting Guide, *Audits of Investment Companies* (November 2000)

Summary:

The Audit and Accounting Guide replaces the AICPA Audit and Accounting Guide, *Audits of Investment Companies,* which was issued in 1987. The Guide incorporates new accounting and financial reporting requirements issued by the FASB and the effects of auditing standards issued by the AICPA since the Investment Companies Guide was last revised. The Guide is intended to address how to enhance the usefulness of investment company financial statements for their users. Among other things, it provides new guidance on accounting for offering costs, amortization of premium or discounts on bonds, liabilities for excess expense plans, reporting complex capital structures, payments by affiliates, and financial statement presentation and disclosures for investment companies and nonpublic investment partnerships.

AcSEC has a related project on its agenda to develop an SOP to clarify the scope of the Guide. A task force also has been formed and is drafting a prospectus to address the issue of whether an entity within the scope of the Guide should use a blockage factor to estimate the fair value of an unrestricted investment that has a quoted market price in an active market. In the interim, the Guide indicates that if an entity's accounting policy, in financial statements issued for fiscal years ending on or before May 31, 2000, was to use a blockage factor in estimating the fair value of an unrestricted investment that has a quoted market price in an active market, that entity may continue to apply that policy for those and similar investments. Otherwise an entity may not elect to adopt such a policy pending completion of AcSEC's project and the FASB project on the fair value of financial investments.

Audit and Accounting Guide, *Audits of Life and Health Insurance Entities* (June 2000)

Summary:

The Audit and Accounting Guide supersedes the 1972 Guide, *Audits of Stock Life Insurance Companies*, and incorporates new accounting and financial reporting requirements issued by the FASB and the effects of auditing standards issued by the AICPA. The Guide discusses those aspects of accounting and auditing unique to life and health insurance entities. It was developed to assist life and health insurance entities in preparing financial statements in conformity with GAAP and statutory accounting principles (SAP) and to assist independent auditors in auditing and reporting on those financial statements. The Guide contains significant discussions of statutory accounting practices, which comprise laws, regulations, and administrative rulings adopted by various states that govern the operations and reporting requirements of life insurance entities.

Proposals Under Consideration—SOP's, Bulletins, and Guides

Accounting for Investors' Interests in Unconsolidated Real Estate Investments (Exposure Draft—November 2000)

Comment Period:

Ends April 15, 2001.

Summary:

AcSEC added this project to its agenda in 1991 in response to inconsistent practice, especially in the area of loss recognition and a lack of guidance on reporting on unincorporated entities. The proposed SOP would establish guidance for accounting for an investor's interest in unconsolidated real estate investments, and addresses when the equity method must be used. The proposed SOP would supersede SOP 78-9, *Accounting for Investments in Real Estate Ventures*. The ED would require that the hypothetical liquidation at book value (HLBV) method be used in applying the equity method. Under the HLBV method—a balance sheet oriented approach—an investor determines its share of the earnings or loss of an investee by determining the difference between its "claim on the investee's book value" at the end and the beginning of the period. The claim is calculated as the amount the investor would receive or pay if the investee were liquidated.

Effective Date:

The provisions of the proposed SOP would be effective for financial statements issued for fiscal years beginning after December 15, 2001. Adoption would be through a cumulative catch-up.

Amendment of SOP 95-2, *Financial Reporting by Non-Public Investment Partnerships* (Exposure Draft—August 2000)

Comment Period:

Ended November 15, 2000.

Summary:

The proposal indicates that SOP 95-2 should apply to investment partnerships that are commodity pools subject to regulation under the Commodity Exchange Act of 1974. A final SOP is expected to be issued in the first quarter of 2001.

Effective Date:

The provisions of the proposed SOP would be effective for financial statements issued for periods ending after June 15, 2001. Earlier application is encouraged.

Other E&Y Sources:

- Comment Letter on the Exposure Draft (No. BB0887).

Accounting by Certain Financial Institutions and Entities That Lend to or Finance the Activities of Others (Exposure Draft—June 2000)

Comment Period:

Ended October 31, 2000.

Summary:

The purpose of the proposed SOP is to reconcile the specialized accounting and financial reporting guidance established in the existing Audit and Accounting Guides for three similar industries: banks and savings institutions, credit unions, and finance companies. The proposed SOP eliminates differences in accounting and disclosure established by the respective Guides, but is not intended to create new accounting guidance. The final provisions would be incorporated in a combined Guide. AcSEC expects to issue a final document during the second quarter of 2001.

Effective Date:

The provisions of the proposed SOP would be effective for financial statements issued for fiscal years beginning after December 15, 2000, and for financial statements for interim periods in fiscal years after the year in which the proposed SOP is first applied. Earlier application is encouraged.

Other E&Y Sources:

- Comment Letter on the Exposure Draft (No. BB0888).

Accounting by Insurance Enterprises for Demutualizations and Formations of Mutual Insurance Holding Companies and for Certain Long-Duration Participating Contracts (Exposure Draft—April 2000)

Comment Period:

Ended June 5, 2000.

Summary:

The proposed SOP would provide guidance on accounting by insurance enterprises for demutualizations and the formation of mutual insurance holding companies (MIHCs). The AICPA Insurance Companies Committee identified this project because of the growing trend for mutual insurers to form mutual holding companies or to demutualize. Among other things, the proposal addresses accounting for expenses related to a demutualization and the formation of a MIHC, distribution from an MIHC to its members, retained earnings and other comprehensive income, and financial statement presentation of closed block. The proposal also would apply to those stock insurance enterprises that apply SOP 95-1, *Accounting for Certain Insurance Activities of Mutual Life Insurance Enterprises*, to account for certain long-duration participating policies. In November, the FASB cleared for final issuance the proposed SOP. AcSEC plans to issue a final standard around year-end.

Effective Date:

This proposed SOP would be effective for annual financial statements for years beginning after December 15, 2000, with early adoption encouraged. The effect of initially applying this SOP would be reported retroactively through restatement of all previously issued financial statements presented for comparative purposes. The cumulative effect of adopting this SOP would be included in retained earnings in the earliest year restated.

Other E&Y Sources:

- Comment Letter on the Exposure Draft (No. BB0875).

Certain Health and Welfare Benefit Plan Transactions (Exposure Draft—March 2000)

Comment Period:

Ended June 22, 2000.

Summary:

In recent years, many employers have amended their plans to reduce benefits provided, to introduce cost-sharing arrangements, or both. To the extent that cost sharing was introduced or increased, the total cost of the benefits remained essentially the same, while the portion of the total cost paid by the plan sponsor decreased. Such benefit reductions and cost-sharing arrangements were not prevalent when SOP 92-6 was issued, and thus they were not addressed in SOP 92-6. In addition, since SOP 92-6 was issued, there has been diversity in implementing a number of its requirements.

This proposed SOP:

- Revises the standards for measuring, reporting, and disclosing estimated future postretirement benefit payments that are to be funded partially or entirely by plan participants.
- Specifies the presentation requirements for benefit obligation information.
- Establishes standards of financial accounting and reporting for certain postemployment benefits provided by health and welfare benefit plans.
- Clarifies the measurement date for benefit obligations.

A final SOP is expected to be issued around the end of the year.

Effective Date:

The provisions of this proposed SOP would be effective for financial statements for plan years beginning after December 15, 2000, with earlier application encouraged. Financial statements for prior plan years would be required to be restated to comply with the provisions of this proposed SOP.

Other E&Y Sources:

- Comment Letter on the Exposure Draft (No. BB0876).

Accounting for Certain Purchased Loans (formerly known as *Discounts Related to Credit Quality*) (Exposure Draft—December 1998)

Comment Period:

Ended April 29, 1999.

Summary:

The proposal would apply to all companies that acquire loans for which it is probable at the acquisition date that all contractual amounts due under the acquired loans will not be collected. The proposal addresses accounting for differences between contractual and expected future cash flows from an investor's initial investment in certain loans when such differences are attributable, in part, to credit quality. The scope also includes such loans acquired in purchase business combinations. If adopted, the proposed SOP would supersede Practice Bulletin 6, *Amortization of Discounts on Certain Acquired Loans*. AcSEC plans to issue a final SOP during the first quarter of 2001.

Effective Date:

The provisions of the proposed SOP would be effective for financial statements issued for fiscal years beginning after June 15, 2001 with restatement of previously issued financial statements prohibited. Previously issued annual financial statements would not be restated. Initial application of this SOP would be as of the beginning of the investor's fiscal year.

The carrying amounts of loans within the scope of this SOP that were acquired before the date of adoption would be adjusted as follows:

a. The excess, as of the adoption date of this SOP, of the loan's (*1*) contractual payments receivable, net of any previous write-downs or chargeoffs, over its (*2*) expected future cash flows would be reclassified as nonaccretable difference.

b. The excess, as of the adoption date of this SOP, of the loan's expected future cash flows, over its carrying amount, would be reclassified and recognized as accretable yield and accounted for as a change in estimate in conformity with APB Opinion 20, with the amount of periodic accretion adjusted over the remaining life of the loan.

For the period of adoption, the investor would disclose in the notes to the financial statements the recorded amount of loans adjusted in conformity with this SOP and the related amount reclassified to nonaccretable difference

Other E&Y Sources:

Comment Letter on the Exposure Draft (No. BB0786).

Other AICPA Projects

The AICPA is working on several other projects that affect accounting and financial reporting, but has not yet issued Exposure Drafts on those topics. Those projects include the following proposals:

Proposed SOP, *Accounting for Real Estate Time-sharing Arrangements*

This project was added to AcSEC's agenda because of the diversity in practice with regard to the accounting for real estate time-sharing arrangements. The SOP would apply guidance only to sellers of time-sharing arrangements and would address (a) which profit recognition method should be used, (b) how allowances for uncollectible amounts would be determined, and (c) what kinds of selling costs would be deferred. AcSEC expects to issue an Exposure Draft during the first or second quarter of 2001.

Proposed SOP, *Cost Capitalization—Property, Plant, and Equipment*

In January 1999, AcSEC added a project to its agenda to develop an SOP that would address accounting and disclosure issues related to costs associated with real estate assets. The project focuses on which costs should be capitalized as improvements and which should be expensed as repairs and maintenance. As a result of communications with the SEC in March 2000, the scope of the project has been extended to cover all property, plant, and equipment and to address and possibly prohibit the "accrue-in-advance" method of accounting for overhaul costs. AcSEC plans to issue an Exposure Draft in the first quarter of 2001.

Proposed SOP, *Non-Traditional Long-Duration Contracts*

The proposed SOP will address the classification and valuation of liabilities as well as disclosures for nontraditional annuity and life insurance contracts issued by insurance enterprises. The AICPA Insurance Companies Committee identified this project because of the growing trend in insurers offering such contracts. An Exposure Draft is expected to be issued during the second quarter of 2001.

Clarification of the Scope of the Investment Company Guide

In February 1999, the FASB cleared a prospectus for a project to develop an SOP to address the scope of the AICPA Audit and Accounting Guide, *Audits of Investment Companies*. This project will address whether more specific attributes of an investment company can be identified to determine if an entity is within the scope of the Guide. An Exposure Draft is expected to be issued during the first or second quarter of 2001.

Proposed SOP, *Allowance for Loan Losses*

The proposed SOP would provide additional guidance on the application of GAAP as it relates to determining periodic loan loss provisions and the allowance for loan losses. The project may result in amendment to the AICPA Audit and Accounting Guide, *Banks and Savings Institutions*, any such amendments being subject to and within the provisions of FASB Statement Nos. 5 and 114, *Accounting for Contingencies,* and *Accounting by Creditors for Impairment of a Loan*, respectively.

Governmental Accounting Standards Board

Final Pronouncements

Q&A on Governmental Financial Reporting Model (May 2000)

Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, issued in June 1999, is one of the most comprehensive financial reporting standards in the history of governmental accounting standards setting. GASB Statement 34 will become effective in three phases beginning with: fiscal years ending after June 15, 2002, for governments with total revenues of $100 million or more; fiscal years ending after June 15, 2003, for governments with annual revenues between $10 million and $100 million; and fiscal years ending after June 15, 2004, for governments with total annual revenues below $10 million.

Because of the breadth of its scope, Statement 34 provides almost unlimited opportunities for implementation questions for preparers of governmental financial statements. Recognizing the need for timely implementation guidance, the GASB recently issued an Implementation Guide to help preparers and auditors understand and apply the provisions of Statement 34. In addition to the complete Standards section of Statement 34, the guide includes nearly 300 questions and answers, over 50 illustrative financial statement exhibits, and 10 "how-to" exercises. The GASB will continue to update this implementation guidance and plans to issue a second updated edition early in 2002. In addition, the GASB also issued guides to assist users in understanding the effects of Statement 34—one for general purpose local governments and another for school districts.

Recipient Reporting for Certain Shared Nonexchange Revenues (GASB Statement 36—April 2000)

Summary:

Statement 36 supersedes paragraph 28 of GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, to provide symmetrical accounting treatment for certain shared revenues. Statement 33 requires governments that share portions of their derived tax or imposed nonexchange revenues to account for the sharing as a voluntary or government-mandated nonexchange transaction, as appropriate. However, paragraph 28 of that Statement currently requires governments that receive those shared portions to account for the sharing as a derived tax or imposed nonexchange transaction—that is, differently than the provider government. As a result, in certain circumstances, the provider and recipient governments would recognize the sharing of revenues at different times. This Statement eliminates that timing difference by requiring recipient governments to account for the sharing of revenues in the same manner as provider governments.

Effective Date:

This Statement should be implemented simultaneously with GASB Statement 33. Statement 33 is effective for periods beginning after June 15, 2000. Accrual-basis revenue recognition for governmental activities becomes effective with the implementation of GASB Statement 34.

Disclosures about Year 2000 Issues—a Rescission of GASB Technical Bulletins 98-1 and 99-1 (Technical Bulletin 2000-1—March 2000)

Summary:

Technical Bulletin (TB) 2000-1 rescinds TBs 98-1 and 99-1 that addressed Year 2000 disclosures made by state and local governments. Because governments successfully made the transition through the New Year without experiencing significant year 2000-related problems, state and local governments are no longer required to make Year 2000 preparedness disclosures prescribed by TBs 98-1 and 99-1 for financial statements issued after February 22, 2000. Other disclosure requirements, such as contingent liabilities or significant commitments, continue to apply to Year 2000 events should they occur.

Recognition and Measurement of Certain Liabilities and Expenditures in Governmental Fund Financial Statements (GASB Interpretation 6—March 2000)

Summary:

The Interpretation clarifies the application of standards for modified accrual recognition of certain liabilities and expenditures in governmental fund financial statements, focusing on areas where differences have arisen in interpretation and practice.

Effective Date:

The effective date of Interpretation 6 coincides with the effective date of Statement 34 for the reporting government.

Proposals Under Consideration—Exposure Drafts

Certain Financial Statement Note Disclosures (Exposure Draft—June 2000)

Comment Period:

Ended September 29, 2000.

Summary:

The GASB is working on a project to reexamine existing note disclosure requirements. The results of this GASB project will attempt to balance the need to disclose useful information with the need to condense, combine, and simplify while retaining understandability. The GASB also issued a plain-language supplement to the proposed standard. The GASB held public hearings on the proposal in the fall. A final standard is anticipated during the second or third quarter of 2001.

Other E&Y Sources:

- Comment Letter on the Proposal (No. BB0890)

Other GASB Projects

The GASB also is working on the following projects affecting accounting and financial reporting, but has not yet issued Exposure Drafts on those topics.

Reporting Model—Omnibus

The objective of this project is to address issues raised in the development of the Statement 34 Implementation Guide. The GASB determined that certain issues raised in the implementation of Statement 34 may need a higher level of authoritative status to support or clarify Statement 34 guidance. An Exposure Draft is expected at the end of 2000 or early 2001.

The Financial Reporting Entity—Affiliated Organizations

The GASB is considering alternative methods for defining and reporting affiliated organizations. Based on the expectation that GASB deliberations will lead to an answer that is significantly different from its original proposal that was issued in 1994, a revised Exposure Draft is anticipated at the end of 2000 or early in 2001.

Conceptual Framework—Communications

The objective of this portion of the conceptual framework project is to establish definitions of the various methods of communicating financial information to users (basic statements, notes, required supplementary information, other supplementary information), as well as criteria for using each of the methods. An Exposure Draft is expected in 2001.

Deposit and Risk Disclosures

The objective of this project is to examine disclosures about deposits and investment risks. The existing standards regarding custodial credit risk will be evaluated in light of current practices and the financial environment. The GASB plans to begin discussions at the end of the fourth quarter of 2000 and issue an Exposure Draft early in 2001.

Conceptual Framework—Elements

The objective of the elements portion of the conceptual framework project is to establish definitions of key financial statement elements (for example, assets, liabilities, revenues, expenses, and expenditures). Deliberations on this project are scheduled to resume in 2001 and an Exposure Draft is expected to be issued in 2002.

Other Postemployment Benefits

The GASB is working on a project that would provide accounting and financial reporting (including disclosure) standards for other postemployment benefits other than pensions. An Exposure Draft is expected to be issued by the fourth quarter of 2001.

Emerging Issues Task Force

The following are summaries of the issues discussed at the EITF meetings from January, 2000 through November, 2000. Consensuses generally are to be applied prospectively from the date of the meeting unless otherwise indicated.

Final Consensuses (In ascending order by Issue No.)

Determining Whether a Nonmonetary Transaction Involves Receipt of Productive Assets or a Business (EITF Issue 98-3; consensus reached January 2000)

The issue is whether a transferred group of assets and activities received in a nonmonetary exchange is or is not a business. If it is a business, consistent with the SEC's stated views in Topic D-81, the receipt is to be accounted for as a fair value transaction under the guidance of APB Opinion No. 16, *Business Combinations*. This would result in a gain if the fair value of the business received is more than the book value of the nonmonetary asset exchanged. Otherwise, the transaction is to be accounted for as a nonmonetary exchange in accordance with APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. The Task Force concluded that a business is a self-sustaining integrated set of activities and assets conducted and managed for the purpose of providing a return to investors. For a transferred set of activities and assets to be a business, it must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set is separated from the transferor, which includes the ability to sustain a revenue stream by providing its outputs to customers.

Determination of the Measurement Date for the Market Price of Securities Issued in a Purchase Business Combination (EITF Issue 99-12; consensus reached January 2000)

The issue addresses what date should be used as the measurement date to value the acquirer's shares issued in a purchase business combination if the number of shares changes pursuant to a formula in the initial arrangement. The EITF concluded that the first date on which the number of shares becomes fixed without subsequent revision is the measurement date (referred to as the look-back approach). The Task Force also concluded the shares should be valued based on market prices a few days before and after the measurement date, except that a "few days after" should not extend beyond the consummation date.

Accounting for Transactions with Elements of Research and Development Arrangements (EITF Issue 99-16; consensus reached May 2000)

The issue addresses the accounting for those arrangements in which a sponsor: (1) capitalizes a new company with cash and rights to the technology developed by the sponsor in exchange for common stock, (2) distributes the common stock to shareholders while providing the research and development activities, and (3) retains an option to purchase all of the common stock.

The Task Force concluded that the sponsor should reclassify the funds provided to the new company to another asset caption (such as restricted cash) and should recognize research and development expense as those activities are performed. The Task Force also concluded that the distribution of the common stock should be accounted for as a dividend based on its fair value at distribution, with an increase in minority interest. If the option is exercised, the difference between the cash paid and the carrying amount of the minority interest would be treated as completed or in-process research and development, as appropriate.

Transition is prospective for new transactions entered into after May 17, 2000. For prior transactions, any significant changes to the transaction, including the addition of assets not contemplated in the original transaction, would require compliance with the consensus through a cumulative effect catch-up at the date of change.

Accounting for Advertising Barter Transactions (EITF Issue 99-17; consensus reached January 2000)

The issue is whether barter transactions that involve a nonmonetary exchange of advertising should result in recorded revenues and expenses, and if so, whether those revenues and expenses should be recognized at the more readily determinable fair value of the advertising surrendered or received in exchange. The Task Force concluded that revenue and expense should be recognized at fair value from an advertising barter transaction only if the fair value of the advertising surrendered in the transaction is determinable based on the entity's own historical practice of receiving cash, marketable securities, or other consideration that is readily convertible to a known amount of cash for similar advertising from buyers unrelated to the counterparty in the barter transaction. An exchange between the parties to a barter transaction of offsetting monetary consideration, such as a swap of checks for equal amounts, does not evidence the fair value of the transaction. If the fair value of the advertising surrendered in the barter transaction is not determinable, the barter transaction should be recorded based on the carrying amount of the advertising surrendered, which likely will be zero. Although Issue 99-17 is written in the context of Internet companies, the consensus is applicable to advertising barter transactions in all industries.

Reporting Revenue Gross as a Principal versus Net as an Agent (EITF Issue 99-19; consensus reached July 2000)

This issue interprets SAB 101 and addresses when a company should report revenue at the gross amount billed to a customer versus the net amount earned by the company in the transaction. The Task Force provided a set of indicators, and numerous examples illustrating application of the indicators that would assist in evaluating the company's role in the exchange transaction with the customer.

The Task Force believes that the primary obligor, general inventory risk, and pricing latitude are the strongest indicators that would point to recording revenue gross. However, these three indicators are not presumptive—their absence would not require that revenue should be recorded net. Instead, all indicators would need to be evaluated carefully on a facts and circumstances basis to determine the appropriate accounting for revenue. The Task Force observed that gross amounts billed to customers may be disclosed in the notes or displayed parenthetically on the income statement. In addition, the SEC Observer indicated that Regulation S-X provides quantitative thresholds for when revenue must be disaggregated (that is, when gross (product sales) and net (distribution sales), should be separate line items).

The Task Force amended the consensus to allow transition to mirror the required implementation date for SAB 101. For SEC registrants, the consensus should be applied in the fourth quarter of a registrant's fiscal year beginning after December 15, 1999. A non-registrant should apply the consensus in annual financial statements for the fiscal year beginning after December 15, 1999. Upon application of the consensus, prior period financial statements should be reclassified to conform to the consensus unless it is impractical to do so, in which case that fact should be disclosed. After the EITF modified this consensus, the SEC Observer indicated that constituents should be cognizant that Topic D-85 disclosure requirements may apply (see section on EITF Announcements).

Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets (EITF Issue 99-20; consensus reached July 2000)

This issue addresses how to record interest income and to measure impairment on retained and purchased beneficial interests. The Task Force concluded that the holder of a beneficial interest should recognize interest income over the life of the investment based on an anticipated yield determined by periodically estimating cash flows. Interest income would be revised prospectively for changes in cash flows. If the fair value of the beneficial interest has declined below its carrying amount and the decline is other-than-temporary, an entity should apply impairment of securities guidance similar to Statement 115 (fair value method). However, if the assets in an SPE are equity instruments, companies are required to use Issue 96-12's retrospective method for recognizing interest income and its guidance on impairment.

In November, the EITF amended the transition date for this issue, from all fiscal quarters beginning after December 15, 2000 to all fiscal quarters beginning after March 15, 2001 (that is, a delay of one quarter). The Task Force observed that Statement 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities,* is effective for transfers and servicing of financial assets after March 31 which may affect the instruments subject to Issue 99-20.

Balance Sheet and Income Statement Display Under the Equity Method for Investments in Certain Partnerships and Other Unincorporated Joint Ventures (EITF Issue 00-1; consensus reached May 2000)

This issue addresses whether there are circumstances in which proportionate gross presentation (i.e., proportional consolidation) is appropriate for an investment in a jointly controlled entity under APB 18. The Task Force observed that long-standing practice supports use of the proportionate gross presentation in the extractive and construction industries and reached a consensus that this presentation is *not* appropriate (except where there really are undivided interests meeting the exception in an AICPA interpretation to APB 18) for entities outside those industries and, consistent with the SEC's staff position, this presentation is *not* appropriate for investments by any entities in corporate entities. The Task Force also reached a consensus that Opinion 18 applies to investments in the common stock of all corporate entities if the investor has significant influence over the investee and, therefore, that the guidance in paragraph 19(c) of Opinion 18 requiring single-amount display in accounting for such investments in corporate entities must be followed. This consensus is applicable to all financial statements issued for periods ending after June 15, 2000. Previously issued financial statements should be reclassified to conform with the current year presentation.

Accounting for Website Development Costs (EITF Issue 00-2; consensus reached March 2000)

This issue addresses how an entity should account for costs incurred to develop a website. The Task Force developed a model that would account for specific website development costs based on the nature of each cost. The model, similar to that in SOP 98-1 on internal use software, has four stages: planning (expense), web application and infrastructure (capitalize), graphics development (capitalize), and operation (expense). The Task Force decided that accounting for costs related to obtaining website content will be addressed separately. The consensus is effective prospectively for all costs incurred for quarters beginning after June 30, 2000, although early adoption is encouraged. Companies also have the option of adopting by cumulative catch-up adjustment.

Application of AICPA Statement of Position 97-2, *Software Revenue Recognition*, to Arrangements that Include the Right to Use Software Stored on Another Entity's Hardware (EITF Issue 00-3; consensus reached March 2000)

This issue addresses situations in which vendors offer arrangements in which end users of the software do not take possession of the software. Rather, the software application resides on the vendor's or a third party's hardware and the customer accesses and uses the software on an as-needed basis over the Internet or via a dedicated line. The Task Force concluded that revenue may be recognized when delivery occurs if (1) the customer has the right to take possession of the software at anytime during the hosting period without significant penalty and it is feasible for the customer to either run the software on its own hardware or contract with another party unrelated to the vendor to host the software and (2) vendor specific objective evidence of fair value (for multiple element arrangements) and other criteria under SOP 97-2 are met. Otherwise, the arrangement is to be accounted for as a service contract and revenue is to be recorded over the related service period. However, the Task Force noted that these hosting arrangements also may include other elements, such as upgrade rights. Accordingly, revenue should be recognized based on an allocation of the respective fair values.

Majority Owner's Accounting for the Minority Interest in a Subsidiary and a Derivative (EITF Issue 00-4; consensus reached July 2000)

The Issue is how an enterprise that owns a controlling majority interest in a business and enters into a derivative transaction that exposes it to risks and rewards related to changes in the minority interest should account for that arrangement. This is similar to Issue 00-6 but for this issue, the third party enters into the derivative at the same time it acquires the minority interest. The Task Force concluded that situations where a forward contract, put and call options with the same terms and exercise price, or a total return swap is used to buy the minority interest at a future date, the transaction should be accounted for as a form of financing, similar to mandatorily redeemable stock.

Determining Whether a Nonmonetary Transaction Is an Exchange of Similar Productive Assets (EITF Issue 00-5; consensus reached September 2000)

The issue, which excludes joint venture formations, addresses APB 29 practice issues focusing on the factors that should be considered in the assessment of whether or not the two productive assets are similar under APB 29. An exchange of similar productive assets is accounted for on a carryover (versus fair value) basis under APB 29. At the September 2000 meeting, the Task Force reached consensuses as follows:

- The similar criteria in APB 29 of same general "type" and perform same general "function" should be applied to singular or multiple singular assets and that the "same line of business" criterion only applies to a productive asset that is comprised of a group of assets.
- In order to conclude that two productive assets are in the same line of business, the two productive assets must be similar with regard to both: (1) the nature of the products and services that the productive assets sell or provide and (2) the nature of the production process used to manufacture or develop those products and services.
- For a productive asset that is comprised of more than one asset, the similar assessment should be examined at the asset group level. That is, one would not look through to the singular assets to perform the "similar assessment."
- The way in which the entity intends to use the productive asset received impacts the "similar assessment," but (1) the activities necessary to convert the asset from one line of business to another (for example, receive an apartment building for a hotel but intend to convert the apartment building into a hotel) must be initiated by the end of the quarter immediately following the quarter in which the exchange transaction closes, (2) the activities must be completed within a reasonable period of time, and (3) the cost to convert the asset cannot exceed 25% of the fair value of such productive asset before or after conversion.

Accounting for Freestanding Derivative Instruments Indexed to; and Potentially Settled in; the Stock of a Consolidated Subsidiary (EITF Issue 00-6; consensus reached July 2000)

This issue addresses derivatives entered into by a parent company that will be settled in the stock of a consolidated subsidiary (for example, a forward contract to buy a 20 percent minority interest at a fixed price). These instruments are outside the scope of Statement 133.

The Task Force concluded that forward sale contracts should be accounted for as a sale on the date the forward contract is settled as long as the forward does not create a loss or increase goodwill during the period beginning when the forward is entered into and ending on settlement date. The Task Force also concluded that forward purchase contracts should be accounted for as a purchase on the date the forward contract is settled.

The Task Force was unable to reach a conclusion on written option contracts. The SEC Observer emphasized its long-standing position that written option contracts should be accounted for as a liability at fair value through earnings until the date of settlement.

The Task Force concluded that premiums on purchased options should be accounted for as part of the exercise price if the option is exercised, or included in earnings upon expiration if the option expires unexercised.

Transition is prospective for contracts outside the scope of Statement 133. On the other hand, if the contract is within the scope of Statement 133 (some may have previously interpreted the scope of Statement 133 differently) two alternatives result:

- If Statement 133 has been previously adopted, adoption of this consensus is required through a cumulative catch-up adjustment in the first quarter after July 19, 2000 (unless the company elects a cumulative catch-up as of beginning of the year restating previous quarters)
- If Statement 133 has not yet been adopted, the consensus would be included in a cumulative effect of the change in accounting principle during the period Statement 133 is adopted.

Application of EITF Issue 96-13 to Equity Derivative Transactions That Contain Certain Provisions That Require Cash Settlement If Certain Events Occur (EITF Issue 00-7; consensus reached March 2000)

The issue arose because the EITF became aware that derivative instruments in a company's own common stock that were classified as equity instruments under 96-13 may require (through the International Securities Dealer Association (ISDA) Master Agreement) net cash settlement upon certain events, such as bankruptcy. The Task Force concluded that a derivative contract with *any* provision, even if a remote contingency, that could require net cash settlement cannot be accounted for as equity of the issuer. Instead, it must be classified as an asset/liability contract under Issue 96-13 and marked-to-market through earnings. See Issue 00-19 for additional modifications to this approach.

Accounting by a Grantee for an Equity Instrument to be Received in Conjunction with Providing Goods or Services (EITF Issue 00-8; consensus reached March 2000)

This issue addresses, for transactions in which an entity provides goods or services in exchange for equity instruments, what date(s) should the provider use to measure the fair value of those equity instruments received for revenue recognition purposes. The Task Force concluded that the provider of the goods or services should measure the fair value of the equity instruments, for revenue recognition purposes, on the earlier of: (a) the date the parties come to a mutual understanding of the terms of the equity-based compensation arrangement and enter into a binding contract that includes a performance commitment by the provider (as defined in Issue 96-18) or (b) the date on which the provider's performance necessary to earn the equity instruments is completed. The approach for determining the amount of revenue, including when there are performance conditions, generally is symmetrical with how the issuer would determine the amount of cost to recognize under Issue 96-18. The consensus is to be applied prospectively to new arrangements and to modifications of existing arrangements that occur after March 16, 2000.

Classification of Gain or Loss from a Hedge of Debt That Is Extinguished (EITF Issue 00-9; consensus reached May 2000)

The issue addresses how the gain or loss on fair value or cash flow hedges of certain debt transactions should be classified in the income statement when the debt is extinguished. The Task Force concluded that the component of the gain or loss resulting from an adjustment to the debt's carrying amount for a fair value hedge should be classified in accordance with FASB Statement No. 4, *Reporting Gains and Losses from Extinguishment of Debt*, which, in most cases, would be classified as extraordinary when that debt is extinguished. For cash flow hedges of debt and forecasted debt transactions, the component in other comprehensive income should *not* be classified as extraordinary (that is, it should be included in income from continuing operations) in the income statement when the debt is extinguished.

Statement 4 requires that a gain or loss from the early extinguishment of debt be classified as an extraordinary item. Although none of the provisions in FAS 133 provide for extraordinary classification, FAS 133, paragraph 24, requires that adjustments to the carrying amount of a hedged item be accounted for in the same manner as other elements of the carrying amount. The FASB staff observes that while this Issue is presented in the context of (1) a fair value hedge of a call feature embedded in the debt, (2) a cash flow hedge of an existing debt instrument, and (3) a hedge of a forecasted debt transaction, the views expressed also would apply to other hedging relationships, such as a fair value hedge of credit risk that results in hedge accounting adjustments to the carrying amount of the debt instrument.

Accounting for Shipping and Handling Fees and Costs (EITF Issue 00-10; consensus on billings reached July 2000, consensus on costs reached September 2000)

This issue addresses how the seller in a sale transaction for goods should classify amounts billed and incurred for shipping and handling in the income statement, and the composition or types of costs that would be required to be classified as costs of goods sold. It has no impact on net income. The Task Force concluded that all shipping and handling billings to a customer in a sale transaction represent the fees earned for the goods provided and, accordingly, amounts billed related to shipping and handling should be classified as revenue.

The Task Force amended the consensus to allow transition to mirror the required implementation date for SAB 101. For SEC registrants the consensus should be applied in the fourth quarter of a registrant's fiscal year beginning after December 15, 1999. A non-registrant should apply the consensus in annual financial statements for the fiscal year beginning after December 15, 1999. Upon application of the consensus, prior period financial statements should be reclassified to conform to the consensus unless it is impractical to do so, in which case that fact should be disclosed.

With regard to shipping and handling costs, the EITF reached a consensus that the classification of shipping and handling costs is an accounting policy decision that should be disclosed pursuant to APB 22. A company may adopt a policy of including shipping and handling costs in cost of goods sold. If shipping and handling costs are significant and are not included in cost of goods sold, a company should disclose both the amount of such costs and which line item on the income statement includes that amount. In addition, the Task Force indicated that a company cannot net the shipping and handling costs against the shipping and handling revenues in the financial statements.

Accounting by an Investor for Costs Incurred on Behalf of an Equity Method Investee (EITF Issue 00-12; consensus reached July 2000)

The first issue addresses stock-based compensation granted by an investor to employees of an equity method investee and, therefore, pursuant to FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation*, cannot be accounted for under APB Opinion No. 25, *Accounting for Stock Issued to Employees*. The Task Force concluded that the investor should recognize an expense in the same amount (for example, 100% even if the investor only owns 40% of the investee) and at the same time as the investee accounting for the stock-based compensation. The transaction would be accounted for at fair value in accordance with FASB Statement No. 123, *Accounting for Stock-Based Compensation*, and Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*.

The second issue addresses how the other investors of the equity method investee would account for stock-based compensation costs incurred by another investor on behalf of the investee when no proportionate funding by the other investors occurs. The Task Force concluded that the other investors should recognize their percentage share of earnings or losses in the investee and recognize income equal to the amount that their interest in the investee's net book value increased (that is, their percentage of contributed capital). The Task Force observed that the investor's expense in the above issue and the other investor's income in this second issue may be presented on the same income statement line as "equity in earnings." The SEC Observer indicated that if a material amount of income results from this second issue, registrants should make appropriate disclosures.

Determining When Equipment is "Integral Equipment" Subject to FASB Statements 66, *Accounting for Sales of Real Estate*, and 98, *Accounting for Leases* (EITF Issue 00-13; consensus reached May 2000)

This issue addresses how to determine whether equipment is integral to real estate. If it is "integral," it is subject to the more stringent accounting tests in Statements 66, *Accounting for Sales of Real Estate*, and 98, *Accounting for Leases, an Amendment of FASB Statements No. 13, 66 and 91 and a Rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11*. The Task Force concluded that the determination should be based on a significance test. The test would add the cost to remove the equipment from its existing location to the decrease in the value of the equipment as a result of that removal by comparing its "fair value-installed" with its "fair market value-removed." If the combined total of both the cost to remove plus the decrease in value exceeds 10 percent of the fair value of the asset, the equipment is integral. For leasing transactions, the significance test should only be performed once at the beginning of the lease term. In addition, current values should be used in the determination—assumptions about future costs should not be used.

Accounting for Certain Sales Incentives (EITF Issue 00-14; consensus reached May 2000)

This issue addresses the accounting for sales incentives offered voluntarily by a vendor without charge to customers that can be used in, or that are exercisable by a customer as a result of a single exchange transaction. The Task Force concluded that, generally, the cost of the incentive (for example, $1 off a box of cereal) should be recognized at the date of sale. If the sales incentive will result in a loss, the loss should be recognized at the date of sale. However, the Task Force noted the sales incentive might indicate an impairment of existing inventory.

When recognized, a cash incentive should be classified as a reduction of revenue. Non-cash sales incentives (for example, the cost of a free television) would be recognized as an expense, not as a reduction of revenue. (The Task Force did not address the classification of that expense.)

In November, the EITF amended the transition provisions for this issue. Companies will not be required to apply the consensus until June 30, 2001 (that is, the quarter then ended for a calendar year company). Early adoption is allowed. Until adoption, certain disclosures would be required in the annual and interim financial statements between November 16, 2000, and June 30, 2001. The effect of the adoption of the consensus, if it affects net income, should be reported as a cumulative effects adjustment as of the beginning of the year of adoption. Prior period financial statements presented for comparative purposes should be reclassified.

Classification in the Statement of Cash Flows of the Income Tax Benefit Received by a Company upon Exercise of a Nonqualified Employee Stock Option (EITF Issue 00-15, consensus reached July 2000)

This issue addresses how a company should classify the income tax benefit realized from the exercise of nonqualified employee stock options in the statement of cash flows and whether disclosure is required. The Task Force concluded that the income tax benefit realized should be classified as an operating cash flow and disclosure for the amount is required, if that amount is material and not presented as a separate line item on the face of either the statement of cash flows or the statement of changes in stockholders equity.

The consensus is applicable to all financial statements issued for quarters ending after July 20, 2000. Previously issued cash flow statements should be reclassified to conform with the current period presentation.

Recognition and Measurement of Employer Payroll Taxes on Employee Stock-Based Compensation (EITF Issue 00-16; consensus reached July 2000)

This issue addresses how an entity should account for employer payroll taxes on stock-based compensation under APB 25 and FAS 123**.** The stock-based compensation may be options, restricted stock awards, stock appreciation rights, or other arrangements covered by the guidance.

Costs incurred by companies for employer payroll taxes on employee stock-based compensation have become more significant for US companies. Consequently, the predominant current practice of recognizing those costs when the event that triggers payment to the taxing authority occurs (for an option, that event is employee exercise) has been called into question.

Topic D-83, *Payroll Taxes and Stock Option Exercises*, addresses the FASB staff's view that employer payroll taxes on the exercise of stock options should be charged to operating expenses, but does not discuss *when* those taxes should be recognized or how the tax obligation should be measured.

The Task Force concluded that the event that triggers measurement and payment of the payroll tax to the taxing authority is the obligating event and no liability should be recognized until that event occurs. For example, in the US for a nonqualified stock option generally the obligating event is the stock option exercise date.

Measuring the Fair Value of Energy-Related Contracts in Applying EITF Issue No. 98-10, *Accounting for Contracts Involved in Energy Trading and Risk Management Activities* (EITF Issue 00-17; consensus reached July 2000)

This issue addresses how the fair value for energy-related contracts and any related energy purchase and sales contracts should be measured. In particular, the issue addresses whether a company engaging in an arbitrage strategy with separate contracts should link those contracts for purposes of estimating their fair value. The Task Force concluded that the contracts should *not* be linked, instead each contract should be valued separately. In valuing the contracts, the company would first look to the market price (which is generally available per industry representatives) and if no market price exists, then the Company would utilize a modeling technique to estimate fair value. The Task Force also decided to address a related issue of whether an energy-related contract is a lease at a future meeting.

Transition is prospective unless the company elects to do a cumulative catch-up adjustment back to the beginning of the year.

Determination of Whether Share Settlement Is within the Control of the Company for Purposes of Applying EITF Issue No. 96-13, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock* (EITF Issue 00-19; consensus reached September and November 2000)

The issue addresses whether specific contract provisions or other circumstances cause a net share or physical settlement alternative to be within or outside the control of the issuer. The questions that were raised focused on the specific terms of the contract and the legal or regulatory obstacles a company could encounter in trying to execute a net share or physical settlement. If settlement is not within the control of the issuer and it would be cash settled, the derivative is accounted for as an asset or liability and changes in value are recognized as incurred.

At the September meeting, the Task Force reached a consensus that a derivative indexed to, and potentially settled in, a company's own stock should be classified in stockholders' equity only if *all* of seven conditions are met. If all the specified criteria are not met, then the instrument should be accounted for as either an asset/liability or temporary equity, as appropriate, based on the settlement terms.

In addition, the Task Force reached a consensus that the contracts under this issue would be reassessed at the end of each reporting period and reclassified (based on the above criteria) on the date that their previous classification is no longer appropriate. For example, if a contract previously met the criteria, but no longer meets that criteria at the end of the current reporting period (e.g., because stock options were issued without an additional issuance of authorized shares) the contract classification would change from equity to asset/liability.

At the September meeting, the Task Force noted that the consensus in Issue 00-19 would also apply to certain derivatives that were issued in public offerings, which created transition problems. Prior to this observation, the focus of the discussion of Issue 00-19 was on individually negotiated, over-the-counter transactions between a company and a single financial institution. At the November meeting, the EITF reached a consensus to grandfather these as well as other technical issues under the Issue 00-19 model.

EITF 00-19 has different transition provisions for contracts entered into prior and after the date the consensus was reached.

Issues Related to the Accounting for Stock Compensation under APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and FASB Interpretation No. 44, *Accounting for Certain Transactions Involving Stock Compensation* (EITF Issue 00-23; consensus reached September 2000)

At the September and November EITF meetings, the Task Force reached a consensus on several of the 31 practice issues related to Interpretation 44 that the SEC requested the EITF to address, generally concurring with the conclusions of its working group. These issues address a variety of issues including repricings, purchase business combinations, change in grantee status, and grants to employees of entities under common control.

Application of EITF Issue 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, to Certain Convertible Instruments (EITF Issue 00-27; consensus reached November 2000)

This issue addresses whether the existing Issue 98-5 model (intrinsic value) is operational as well as how 13 practice issues should be resolved. The EITF reached a consensus to retain the current intrinsic value model and also reached a consensus on several of the practice issues that will change practice. The remaining issues were held over for further discussion and evaluation by the working group.

Transition generally is prospective for all transactions committed to after November 16, 2000. However, the SEC Observer stated that the transition for the issue dealing with how an issuer should calculate the intrinsic value of a conversion option which arises in a situation where there is a debt discount should be a cumulative catch up adjustment for the quarter including November 16, 2000.

Open Issues to Be Addressed in 2001

Accounting by a Joint Venture for Businesses Received at Its Formation (EITF Issue 98-4)

Current practice generally has been to report the assets that a business contributes to a joint venture at historical cost unless certain conditions are met. The EITF will address what characteristics must exist in order for the entity to qualify for historical cost accounting.

Recognition by a Purchaser of Impairment Losses on Firmly Committed Executory Contracts (EITF Issue 99-14)

The issue is when, if ever, a purchaser under a firmly committed executory contract (for example, operating leases) should recognize an impairment of its remaining contractual right asset under the contract (even though it is off balance sheet) and how that impairment loss should be measured if the purchaser will continue to use the asset. At the September 2000 EITF meeting, the title of this issue was changed from *Recognition of Losses on Firmly Committed Executory Contracts* to *Recognition by a Purchaser of Losses on Firmly Committed Executory Contracts,* to differentiate it from Issue 00-26, *Recognition by a Seller of Losses on Firmly Committed Executory Contracts.*

Meeting the Ownership Transfer Requirements of FASB Statement 13, *Accounting for Leases*, for Leases of Real Estate (EITF Issue 00-11)

The issue is how the requirement of Statement 13 for the "transfer of ownership" of assets subject to Statement 66, *Accounting for Sales of Real Estate*, should be interpreted when no statutory title registration system exists for the transferred asset. In other words, what does it mean to pass title for items such as fixtures that are an integral part of real estate (see Issue 00-13), when no system exists for recording or registering title to personal property. If "title" is not deemed to have passed at the end of the lease, sales-type lease accounting cannot be used. Because Interpretation 43 makes more assets an integral part of real estate, more lease transactions are becoming subject to this issue. The Task Force tentatively concluded that ownership of the asset should be determined by analogy through use of the guidance set forth in the U.C.C. It is likely that attorneys would have to make such a determination if the effect was significant. Companies affected by transactions covered in the scope of this issue, particularly those with an indefeasible right of use for optic cable capacity transactions, are encouraged to provide the Task Force with their view on how practical the tentative conclusion would be if adopted as a final consensus. This issue was last discussed at the September 2000 meeting.

Accounting Recognition for Certain Transactions Involving Equity Instruments Granted to Other Than Employees (EITF Issue 00-18)

EITF Issue 96-18 addresses the measurement date for equity instruments granted to other than employees from the standpoint of the grantor. Issue 00-8 addresses the measurement date from the standpoint of the grantee.

This issue addresses the following:

- the grantor's accounting for a contingent obligation to issue equity instruments (subject to vesting requirements) when a grantee performance commitment exists but the equity instrument has not yet been issued.
- the grantee's accounting for the contingent right to receive an equity instrument when a grantee performance commitment exists prior to the receipt (vesting) of the equity instrument.
- for equity instruments that are fully vested and nonforfeitable on the date the parties enter into an agreement, the period(s) and manner in which the grantor should recognize the fair value of the equity instruments.

The Task Force discussed their preliminary views on each issue but did not reach any consensuses.

Accounting for Costs Incurred to Acquire or Originate Information for Database Content and Other Collections of Information (EITF Issue 00-20)

This issue addresses how costs of developing or acquiring databases and collections of information should be accounted for (that is, capitalized and amortized or expensed as incurred). In order to better define the scope of the issue, the FASB staff is going to provide examples of public company disclosures and provide alternative approaches for proceeding with this issue (for example, drop the issue, disclosure only, establish parameters around capitalizing costs and subsequent accounting for capitalized costs). This issue was last discussed at the September 2000 meeting.

Accounting for Multiple-Element Revenue Arrangements (EITF Issue 00-21)

Multiple-element accounting issues arise because many companies offer complete solutions to their customers' needs for a single price. Those solutions may involve the delivery or performance of multiple products, services, rights to use assets, and performance may occur at different points in time or over different periods of time. In many cases the arrangements are accompanied by initial installation, initiation, or activation services and involve either a fixed fee or a fixed fee coupled with a continuing payment stream.

This issue addresses how to account for these multiple-element revenue arrangements and focuses on when a revenue arrangement should be separated into components or deliverables, or alternatively, when smaller deliverables or elements should be combined for purposes of recognizing revenue.

The Task Force discussed the working group's proposed model of when a deliverable should be excluded from the multiple-element arrangement, and therefore, accounted for by accruing a liability for the vendor's incremental cost at the time revenue is recognized. The Task Force did not reach a conclusion on the proposed model.

The working group will reconsider the proposed model and related issues as well as the interrelationship between SAB 101, and the SAB 101 FAQ. This issue was last discussed at the November 2000 meeting.

Accounting for "Points" and Certain Other Time-Based or Volume-Based Sales Incentive Offers, and Offers for Free Products or Services to Be Delivered in the Future (EITF Issue 00-22)

This issue addresses loyalty programs, which consist of vendor-sponsored programs that offer awards consisting of the vendor's products or services (frequent flyer rules), broad-based programs operated by program operators whose business consists solely of administering the loyalty program, and combination programs operated by vendors for their own customers as well as other participating vendors and their customers. Loyalty programs will be impacted by the deliberations on Issue 00-21.

The Task Force tentatively concluded that vendor rebates or refunds to a customer of a specified amount of cash, when the agreement requires that the customer complete a specified cumulative level of revenue transactions or remain a customer for a specified time period, should be accounted for as a reduction of revenue in the income statement. For example, a rebate of 1 percent offered to customers with credit card purchases of $100,000 would be reflected as a reduction of the $100,000 revenue, not as a cost.

In addition, the Task Force tentatively concluded that the vendor should recognize a liability based on the estimated amount of earned benefits and accrue the liability as the revenue is earned (a reduction of revenue) as opposed to when the specific threshold is achieved. The issue was last discussed at the November 2000 meeting.

Revenue Recognition: Sales Arrangements That Include Specified-Price Trade-in Rights (EITF Issue 00-24)

Certain vendors offer specified-price trade-in arrangements on equipment being sold that give customers the right to trade in that equipment toward the purchase of new equipment at some point in the future. These programs are common in the corporate jet and heavy equipment markets but have recently emerged in the personal computer industry. The trade-in right may be exercisable by the customer at a specified point in time or during a specified period of time (for example, at the end of five years or during the third to fifth years). In addition, the trade-in rights may be offered at a fixed price or the price may be indexed to an industry standard.

Currently, views are diverse about how to account for specified-price trade-in rights. Some believe that the right should not affect revenue recognition on the underlying equipment and that any loss resulting from the right should be accounted for under Statement 5. Others contend that specified-price trade-in rights are a separate unit of accounting (a deliverable) of the initial exchange transaction (the multiple-element method). Still others believe that the overall arrangement is, in substance, a lease and should be accounted for in accordance with lease accounting pursuant to Issue 95-1 (the lease method). Finally, others believe such rights are similar to a right of return and should be accounted for in accordance with Statement 48 (the Statement 48 method). This issue was last discussed at the September 2000 meeting.

Accounting for Consideration from a Vendor to a Retailer in Connection with the Purchase or Promotion of the Vendor's Products (EITF Issue 00-25)

Since the EITF reached a consensus on Issue 00-14, questions have been raised regarding the income statement classification of consideration, other than that directly addressed in Issue 00-14, from a vendor (typically a manufacturer or distributor) to a customer (typically a retailer or wholesaler) in connection with the sale to the customer of the vendor's products, or to promote sales of the vendor's products by the customer.

Under the working group's proposed model, there is a presumption that, unless the vendor meets certain conditions, consideration from a vendor to a retailer is a reduction of revenue. The conditions to overcome the presumption are that the vendor has or will receive a direct, identifiable benefit (that is, goods or services) *and* the vendor has sufficient, reliable, and objective evidence to estimate fair value of that benefit. In many cases, it will be difficult for vendors to meet these conditions and if finalized these companies would have to reduce revenue for these payments which would result in a significant change in practice. The working group will reconsider the proposed model as well as any feedback or suggestions from companies affected by this model. The issue was last discussed at the November 2000 meeting.

EITF Announcements

Accounting for Subsequent Investments in an Investee After Suspension of Equity Method Loss Recognition When an Investor Increases Its Ownership Interest from Significant Influence to Control through a Market Purchase of Voting Securities (Topic D-84)

The SEC Observer indicated that in the circumstances in which an investor increases its ownership interest from one of significant influence to one of control through a purchase of additional voting securities in the market, and where no commitment or obligation to provide financial support existed prior to obtaining control, the acquisition should follow step acquisition accounting. This issue arose in a situation where the investee was incurring losses but the investor did not recognize its share of these losses because its investment was reduced to zero and later makes an additional cash investment. The SEC Observer stated that recognition of a "loss on purchase" or a restatement of prior period financial statements would be inappropriate in these circumstances. The EITF plans to address this issue further at a future meeting.

Application of Certain Transition Provisions in SEC Staff Accounting Bulletin 101, *Revenue Recognition in Financial Statements* (Topic D-85)

The SEC staff stated its views on certain transition provisions of SAB 101, *Revenue Recognition in Financial Statements*. With regard to two income statement presentation issues—gross versus net and retailers' presentation of revenue from sales of leased or licensed departments—the SEC staff expects retroactive application to all periods presented in the next set of financial statements (whether interim or annual) filed with the SEC after January 20, 2000, if that information is available, rather than wait for the SAB 101 effective date. At the July 19-20, 2000 EITF meeting, the SEC Observer noted that this same guidance applies to the consensuses reached on EITF Issues 00-10, *Shipping and Handling Fees and Costs*, and 00-14, *Accounting for Certain Sales Incentives*.

Issuance of Financial Statements (Topic D-86)

The SEC staff announcement states that generally the SEC staff believes that financial statements are "issued" as of the date they are distributed for general use and reliance in a form and format that complies with generally accepted accounting principles (GAAP) and, in the case of annual financial statements, that contain an audit report that indicates that the auditors have complied with generally accepted auditing standards (GAAS) in completing their audits. This generally would be the earlier of when the annual or quarterly financial statements are widely distributed to all shareholders and other financial statement users or filed with the Commission. Issuance of an earnings release does not constitute issuance of financial statements because the earnings release would not be in a form or format that complies with GAAP and GAAS. The SEC also clarified that posting financial statements to a registrant's website would not be considered wide distribution to all shareholders and other financial statement users as not all such parties necessarily have the ability to access the registrant's website or know that it has been updated.

For example, assume that a registrant widely distributes its financial statements but, before filing them with the Commission, the registrant or its auditor becomes aware of an event or transaction that existed at the date of the financial statements that causes those financial statements to be materially misleading. If a registrant does not amend those financial statements so that they are free of material misstatements or omissions when they are filed with the Commission, the registrant will be knowingly filing a false and misleading document.

The staff announcement also reminds registrants and independent auditors of their responsibilities under the applicable authoritative literature (SAS 1 or AU560) with regard to post-balance-sheet-date subsequent events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. The announcement states that all information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based and that the financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.

Determination of the Measurement Date for Consideration Given by the Acquirer in a Business Combination When That Consideration Is Securities Other Than Those Issued by the Acquirer (Topic D-87)

The FASB staff has received inquiries regarding the date that should be used to measure the consideration given by the acquirer to shareholders of an acquired company in a purchase business combination when that consideration is securities other than those issued by the acquirer. EITF Issue 99-12, *Determination of the Measurement Date for the Market Price of Acquirer Securities Issued in a Purchase Business Combination*, provides guidance on the appropriate date to be used to value securities of the acquirer issued as consideration for a purchase business combination. It does not address other securities, such as investment securities accounted for under FASB Statement 115, *Accounting for Certain Investments in Debt and Equity Securities*, or APB Opinion 18, *The Equity Method of Accounting for Investments in Common Stock,* that are given as consideration in a purchase business combination.

The FASB staff believes that securities transferred to shareholders of an acquired company as consideration in a purchase business combination, other than securities issued by the acquirer, should be measured on the date the business combination is consummated. The FASB staff believes that this accounting is consistent with the requirement of paragraph 94 of APB Opinion 16, *Business Combinations*, and with FASB Statement 125, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities.*

Planned Major Maintenance Activities (Topic D-88)

AcSEC added a project to its agenda in January 1999 to develop a Statement of Position (SOP) that would address accounting and disclosure issues related to determining which costs related to real estate assets should be capitalized as improvements and which should be expensed as repairs and maintenance. The SOP also would address the capitalization of indirect and overhead costs and the componentization of real estate assets for depreciation purposes. At the SEC's request, AcSEC has agreed to expand the scope of its project to address (a) all types of property, plant, and equipment and (b) the accrual of a liability in advance of a planned major maintenance activity. The SEC staff further understands that AcSEC expects to issue an Exposure Draft early in 2001 with the goal of issuing a final SOP no later than August 2001. However, pending issuance of a final SOP, the SEC Observer indicated that the staff will expect registrants to disclose their accounting policies for repair and maintenance costs incurred in connection with planned major maintenance activities. In addition, any reserves for such costs shall be disclosed in Schedule II pursuant to Regulation S-X. The SEC Observer also indicated that the staff will object to a registrant that is applying the "accrue-in-advance" method by classifying the credit as something other than a liability (for example, as additional accumulated depreciation).

Accounting for Costs of Future Medicare Compliance Audits (Topic D-89)

A number of health care providers have entered into settlement agreements with the U.S. government regarding allegations of Medicare fraud. In addition to the promise to pay specified penalties to the U.S. government, the settlement agreements impose an obligation on the health care provider to engage an independent review organization to test and report on compliance with Medicare requirements each year for the following five years. The FASB staff has received inquiries regarding whether the commitment to incur the costs of future Medicare compliance audits may be accrued as a liability (equal to the present value of the estimated costs of the audits) when the settlement is agreed to. In the view of the FASB staff, the obligating event for the costs of the future compliance audits is not entering into the settlement agreement. Therefore, the provider should not recognize a liability for the future Medicare compliance audits on the date the settlement is agreed to.

Grantor Balance Sheet Presentation of Unvested, Forfeitable Equity Instruments Granted to a Nonemployee (Topic D-90)

The SEC staff has received inquiries on the appropriate balance sheet presentation of arrangements where unvested, forfeitable equity instruments are issued to an unrelated nonemployee (the counterparty) as consideration for future services. The arrangements addressed by the staff entitle the grantor to recover the specific consideration paid, plus a substantial mandatory penalty, as a minimum measure of damages for counterparty nonperformance. Consequently, pursuant to EITF Issue No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods or Services*, sufficiently large disincentives for counterparty nonperformance exist such that a performance commitment and measurement date have been achieved as of the date of issuance. The fair value of these arrangements is measured in accordance with FASB Statement No. 123, *Accounting for Stock-Based Compensation*. The SEC staff announced that if the issuer receives a right to receive future services in exchange for unvested, forfeitable equity instruments, the fair value of such equity instruments should not create an asset at the measurement date. Consequently, there would be no recognition at the measurement date.

Application of APB 25 (Topic D-91)

At the July 19-20, 2000 meeting, the FASB staff provided an example that they believe, through a sequence of actions, provides evidence that an effective repricing has occurred. In the example, the new award is linked through a cancellation provision to the previous granted out-of-the-money award. The Board believes that any modification or sequence of actions by a grantor to directly or effectively reduce the exercise price of an award causes variable accounting for the repriced award for the remaining life. This announcement should be applied prospectively; therefore, if the replacement or "second" option is issued after July 20, 2000, variable accounting is required for the option until the option is exercised, forfeited or expires unexercised. Transactions prior to July 20, 2000 are not effected.

Rescission of FAS 135 Technical Correction Re: FAS 87/106 (Topic D-92)

In Statement 135, the Board revised both Statements 87 and 106 to reflect the disclosure requirements made by Statement 132. The technical corrections in Statement 135 deleted from the definition of the gain or loss component (of net periodic benefit cost) the difference between the actual return on plan assets and the expected return on plan assets. These technical corrections inadvertently changed the definition of the gain or loss component for purposes of measurement under Statements 87 and 106. Thus, the technical corrections could be viewed as eliminating the delayed recognition of changes in the value of plan assets.

At the July 19-20, 2000 meeting, the FASB staff pointed out that the intent of the technical corrections in Statement 135 was to fix disclosure not to change the accounting for net periodic benefit costs and therefore, the technical corrections to the gain or loss component were made in error. The erroneous paragraphs will be shaded and deleted in a future Statement.

Auditing Standards Board

Final Pronouncements

Omnibus Statement on Auditing Standards—2000 (SAS 93—October 2000)

Summary:

The SAS amends:

- SAS No. 58, *Reports on Audited Financial Statements,* to include a reference in the auditor's report to the country of origin of the accounting principles used to prepare the financial statements and the auditing standards that the auditor follows in performing the audit.
- SAS No 84, *Communications Between Predecessor and Successor Auditors,* to clarify the definition of predecessor auditor.

Effective Date:

This amendment was effective upon issuance.

Auditing Derivative Instruments, Hedging Activities, and Investment Securities (SAS 92—September 2000)

Summary:

SAS 92 provides a framework for auditors to use in planning and performing auditing procedures for assertions about all financial instruments. The ASB is concurrently developing a companion Audit Guide to help practitioners implement the new SAS. The Audit Guide will be available early in 2001.

Effective Date:

This SAS is effective for audits of financial statements for fiscal years ending on or after June 30, 2001.

Auditing Health Care Third-Party Revenues and Related Receivables (SOP 00-1—March 2000)

Summary:

This Statement of Position provides guidance to auditors regarding uncertainties inherent in health care third-party revenue recognition. It discusses auditing matters to consider in testing third-party revenue and related receivables, including the effects of settlements (both cost-based and noncost-based, third-party payment programs), and provides guidance regarding the sufficiency of health care entities exposed to material uncertainties.

Effective Date:

This SOP's provisions are effective for audits of periods ending on or after June 30, 2000. Early application is permitted.

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