

EITF Update

EITF meeting highlights



Emerging Issues Task Force

Contents

SEC Staff Announcement	3
Final consensuses.....	5
Issue 08-9 – Milestone Method of Revenue Recognition	5
Issue 09-B – Consideration of an Insurer’s Accounting for Majority-Owned Investments When the Ownership Is through a Separate Account	7
Issue 09-F – Casino Jackpot Liabilities.....	8
Issue 09-I – Effect of a Loan Modification When the Loan Is Part of a Pool that is Accounted for as a Single Asset	9
Issue 09-J – Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in which the Underlying Equity Security Trades	10
Consensuses-for-exposure.....	11
Issue 09-H - Selected Healthcare Organization Issues (Revenue Recognition; Presentation of Insurance Claims and Related Insurance Recoveries; and Measuring Charity Care for Disclosure)	11
Issues discussed without final conclusion.....	13
Issue 09-G – Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts	13

18 March 2010 meeting highlights

The SEC Observer made an announcement regarding certain foreign currency remeasurement and translation issues related to Venezuelan subsidiaries. The announcement requires additional disclosures and also may affect entities’ accounting in the initial quarter after Venezuela is considered hyper-inflationary, which is the quarter ending 31 March 2010 for calendar year-end companies.

The EITF reached a **final consensus** on the following issues:

- ▶ Issue 08-9 - Milestone Method of Revenue Recognition
- ▶ Issue 09-B - Consideration of an Insurer’s Accounting for Majority-Owned Investments When the Ownership Is through a Separate Account
- ▶ Issue 09-F – Casino Jackpot Liabilities
- ▶ Issue 09-I – Effect of a Loan Modification When the Loan Is Part of a Pool that is Accounted for as a Single Asset
- ▶ Issue 09-J – Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in which the Underlying Equity Security Trades

The scope of the new revenue recognition guidance in Issue 08-9 was narrowed and will apply only to revenue transactions involving research or development. In contrast, the scope of Issue 09-B was expanded to encompass an insurance entity’s investments in both voting and variable interest entities, when the interest is held in a separate account for the benefit of policy holders. The other final consensuses are largely consistent with the EITF’s previous consensuses-for-exposure. All of the final consensuses are subject to ratification by the FASB at its 31 March 2010 meeting after which final Accounting Standards Updates (ASUs) will be posted to the Codification.

The EITF reached a **consensus-for-exposure** on two presentation and disclosure issues related to healthcare organizations in Issue 09-H - Selected Healthcare Organization Issues. If ratified as a consensus-for-exposure by the FASB at its 31 March 2010 meeting, a proposed ASU will be exposed for comment related to these two issues and will be subject to approval as a final consensus by the EITF at a future meeting. Note that one of the consensuses-for-exposure on this issue dealing

This and many of the publications produced by our US Professional Practice Group, are available free on AccountingLink at ey.com/us/accountinglink

with presentation of contingent liabilities and insurance recoveries could have implications for companies other than healthcare organizations. The EITF discussed a third issue on revenue recognition for healthcare organizations and asked the FASB staff to perform additional analysis, which the EITF expects to discuss at a future meeting.

The EITF also discussed Issue 09-G – Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts. The EITF reaffirmed the conclusions previously reached at its 19 November 2009 meeting (dealing with the scope of acquisition costs that are eligible for deferral, which would among other things prohibit deferral of costs associated with unsuccessful efforts) that were exposed for comment. However, the EITF anticipates discussing two issues related to Issue 09-G at its June 2010 meeting before reaching a final consensus.

The consensuses exposed by the EITF are not always clearly articulated at the EITF meeting. Its conclusions, if ratified by the FASB, are exposed for comment and must be subsequently affirmed by the EITF and again ratified by the FASB before becoming US GAAP. Accordingly, this summary should not be relied on in making a determination about the appropriate accounting for a transaction. The final EITF minutes will be made available in EY GAAIT as soon as they are published by the FASB. In EY GAAIT, see U.S. Accounting and Auditing-EITF-Updates to EITF Documents.

SEC Staff Announcement

Issue

Two exchange rates have existed in Venezuela for several years: the official rate of Bolívar fuerte (BsF) to USD and the parallel rate. The "official rate" of exchange between BsF and liquid world currencies such as the USD has been held constant by the Venezuelan government. However, there are other means to convert BsF to USD through a series of transactions via a broker in what is known as the parallel market. The average rate of exchange in the parallel market ("parallel rate") is variable and recently has been significantly different from the official rate.

Additionally, based on an analysis of recent indexes that indicate cumulative inflation of approximately 100 percent or more over a 3-year period, the SEC staff indicated at the December 2009 AICPA National Conference on Current SEC and PCAOB Developments that companies following US GAAP should plan to apply highly inflationary accounting to their Venezuelan entities as of the beginning of the next reporting period, or 1 January 2010 for a calendar-year company.

In response to the recent designation of the Venezuelan economy as "highly inflationary," the SEC received inquiries concerning the application of the guidance on foreign currency translation when multiple exchange rates are present.

At the 18 March 2010 EITF meeting, the SEC Observer noted that Venezuela has met the thresholds for being considered highly inflationary. Accordingly, calendar-year entities will begin applying highly-inflationary accounting for their Venezuelan investment as of 1 January 2010.

The SEC staff believes that in cases in which reported balances for financial reporting purposes differ from the actual US dollar denominated balances (as more fully described in the draft SEC staff announcement), a registrant should make disclosures that inform users of the financial statements of the nature of these differences. When material, the disclosures in the financial statements should, at a minimum, include the following:

- ▶ Disclosure of the rates used for remeasurement and translation
- ▶ A description of why the actual US dollar-denominated balances differ from the amounts reported for financial reporting purposes, including the reasons for using two different rates with respect to remeasurement and translation
- ▶ The difference between the amounts reported for financial reporting purposes versus the underlying US dollar-denominated values and where this difference is reported in the financial statements
- ▶ To the extent possible, disclosure of the amount that will be recognized through the income statement (as well as the impact on the other financial statements) as part of highly-inflationary accounting beginning in 2010

These disclosures should be included in financial statements of affected registrants filed after the Staff Announcement on 18 March 2010, if possible. We understand that the SEC staff may be flexible if registrants filed on or shortly after the date of the announcement and might have been unaware of the announcement or would have had difficulties in providing the required disclosures and still meeting their filing deadlines.

The SEC Observer also noted that upon application of highly-inflationary accounting (i.e., 1 January 2010 for calendar-year registrants), registrants must follow the accounting guidance outlined in ASC 830, *Foreign Currency Matters*, which states that "[t]he financial statements of a foreign entity in a highly inflationary economy shall be remeasured as if the functional currency were the reporting currency." Therefore, as a result of moving to highly-inflationary status, a US reporting currency parent and subsidiary will utilize the same functional currency (i.e., US dollars) and no differences will exist between the amounts reported for financial reporting purposes and the amount of any underlying US dollar-denominated assets or liabilities that are held by the subsidiary.

The SEC staff has indicated that any differences that may have existed before 1 January 2010 between the reported balances for financial reporting and the actual US dollar-denominated balances should be recognized in the income statement unless the registrant can demonstrate that the difference was previously recognized as a cumulative translation adjustment. In those instances, the difference should be recognized as an adjustment to the cumulative translation adjustment in equity. The SEC staff believes that these differences should be recognized in 2010 at the time of

adoption of highly-inflationary accounting. The SEC staff noted that differences recognized previously in the cumulative translation adjustment would be unusual.

The SEC staff noted that the EITF will be discussing certain issues related to foreign currency, including the accounting for subsidiaries when multiple exchange rates are present. That discussion is expected at the June 2010 EITF meeting. Consequently, the guidance in this D-Topic is intended to be interim guidance pending any standard setting by the EITF as a result of its deliberations.

A complete copy of the draft SEC staff announcement can be found at:

http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156709270

The final SEC staff announcement will be included with the minutes of the 18 March 2010 EITF meeting, which are generally released two to three weeks after the date of the meeting.

Final consensuses

Issue 08-9 – Milestone Method of Revenue Recognition

Issue

Entities often enter into revenue arrangements that involve multiple nonrefundable payment streams (e.g., upfront and milestone payments for research and development services). The issue is what criteria must be met to recognize revenue for contingent milestone payments under the "milestone method."

Under the milestone method, contingent consideration is recognized in the period in which the entity receives the right to collect a nonrefundable milestone payment, even if performance under the overall contract is not complete.

The EITF reached a final consensus on Issue 08-9 that is subject to ratification by the FASB and must be codified in a final ASU before becoming authoritative.

Under the final consensus, the milestone method is a valid application of the proportional performance revenue recognition model when applied to research or development arrangements. The EITF limited the application of the milestone method to research or development arrangements when the entity satisfies its performance obligations over time and a portion or all of the consideration is contingent upon uncertain future events. The narrow scope is a change from the EITF's proposed ASU.

A milestone is defined as an event (a) that can only be achieved based in whole or in part on the entity's performance or on the occurrence of a specific outcome resulting from the entity's performance; (b) for which there is substantive (e.g., not trivial) uncertainty at the date the arrangement is entered into that the event will be achieved and (c) that would result in additional payments being due to the vendor. Under the milestone method, revenue may be recognized in its entirety upon achievement of a substantive milestone if the consideration for achieving the milestone relates solely to past performance. Each payment in an arrangement should be evaluated individually to determine whether or not the payment is a substantive milestone to which the milestone method may be applied.

The milestone method is an accounting policy election; therefore, it is not required and is not the only acceptable method of revenue recognition for milestone payments. The nature of the alternate policy depends in part on the specifics of the arrangement, but would be a form of proportional performance. For example, in a R&D arrangement including multiple deliverables, an entity might allocate the milestone payment to all of the deliverables in the arrangement based on their relative selling price—an application of ASC 605-25.¹ The portion of the arrangement consideration allocated to those deliverables that had been completed would be recognized upon achievement of the milestone, and the portion allocated to deliverables not yet completed would be deferred.

However, if an entity elects to apply the milestone method, it must do so fully in compliance with the guidance in this ASU. If an entity previously applied a milestone method that does not conform to the guidance in the final ASU, entities should follow the transition guidance discussed below. Entities that had adopted alternate accounting policies for milestone payments may elect to adopt the milestone method at the effective date of this guidance and would also follow the transition guidance described. Subsequent to the effective date of this ASU, entities wanting to change their accounting policy for milestones must comply with ASC 250,² which requires the

¹ ASC 605-25, *Revenue Recognition—Multiple-element Arrangements*

² ASC 250, *Accounting Changes and Error Corrections*

preparer and its independent auditor to conclude that the new policy (including the milestone method) was preferable to the existing policy.

Implications

We believe that the guidance on applying the milestone method generally will validate an acceptable alternative that is already applied in practice. However, entities that have historically applied some form of a milestone method should review their policy to ensure it is consistent with the provisions of the final ASU. Entities with a policy that differs from the ASU that wish to adopt the milestone method should consider doing so as of the effective date. Election upon adoption will permit entities a one-time opportunity to do so without having to demonstrate preferability and will provide more flexibility with respect to the transition method.

For those entities applying the milestone method in a manner consistent with the final ASU, the only change resulting from this guidance will be additional disclosure requirements.

Effective Date and Transition

This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after 15 June 2010. The guidance should be applied on a prospective basis to milestones achieved after the date of adoption. Entities also have the option to apply the guidance retrospectively to all periods presented. Early adoption will be permitted.

Issue 09-B – Consideration of an Insurer’s Accounting for Majority-Owned Investments When the Ownership Is through a Separate Account

Issue

Life insurance companies offer certain products that provide an investment return. For such products, contract holders direct the allocation of their deposits to various investment options, and the insurance entity receives an asset management fee on the invested assets. Often, the invested assets (and any investment return) are managed in a “separate account” as a means to legally isolate those assets from the other assets (i.e., the “general account”) of the insurance entity.

Pursuant to insurance accounting guidance,³ if certain separate accounts qualify for summarized reporting, the portion of separate account assets supporting the obligation to the contract holder is reported as a single line item in the balance sheet, and the investment return earned on the assets and the amount credited to the contract holder is netted to zero in the statement of operations.

The issue is whether an insurance company should consider interests held in separate accounts as its own when determining whether an investment must be consolidated. Additionally, if such an investment is required to be consolidated, it is unclear how the noncontrolling interest should be reflected in the financial statements.

The EITF reached a final consensus on Issue 09-B that is subject to ratification by the FASB and must be codified in a final ASU before becoming authoritative.

The guidance will clarify that insurance entities will not consider equity interests held in a separate account for the benefit of contract holders when determining if the insurance entity holds a controlling interest in an investee and therefore must consolidate that investee. That is, the decision on whether to consolidate an investment should be based only on the ownership interest held by the general accounts of the insurance entity.

In response to comments from constituents, the scope of the guidance was expanded from the original proposal to include interests in variable interest entities (VIEs). Therefore, an insurance entity generally will not be required to consolidate a majority-owned voting-interest entity or a VIE held by a separate account if the investment is not or would not be consolidated in the standalone financial statements of the separate account.

In those instances that the insurance entity does control an investment fund through interests held in its general account, the insurer should consolidate the investment fund. The portion of the fund assets representing the contract holders’ separate account interests are recorded as a single line item with a corresponding single liability. The remaining fund assets (including the portion owned by the noncontrolling interest) are recorded in the general account of the insurer. Any noncontrolling interest would be reported as such within the equity of the insurance entity.

Implications

We believe that the ASU will largely codify existing practice within the insurance industry. As a result of this consensus, many investments through separate accounts will not be consolidated. However, insurance entities will need to assess the particular details of these arrangements to determine whether an insurance entity’s interests held through its general account represent a VIE, the insurance entity is the primary beneficiary, and it would be required to consolidate the VIE.

The following examples are situations in which consolidation may be necessary:

- ▶ The investee is a voting-interest entity, and a majority voting interest is held by the general account
- ▶ The investee is a VIE that is not eligible for the deferral in ASU 2010-10⁴ (because the insurance entity has a variable interest in the form of a commitment to fund losses of the VIE), and the insurance entity has power over the VIE
- ▶ The investee is eligible for the deferral in ASU 2010-10, and the insurance entity has power over the VIE and absorbs a majority of the expected returns or expected losses of the entity through variable interests outside the separate account

Effective date and transition

This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning after 15 December 2010, through retrospective application to all periods presented. Early adoption will be permitted.

³ ASC 944, *Financial Services—Insurance*

⁴ ASU 2010-10, *Amendments for Certain Investment Funds*

Issue 09-F – Casino Jackpot Liabilities

Issue

Many casino jackpots are progressive (i.e., the amount of winnings increases based on the amount of play on the machine or a group of linked machines). There are two components of a progressive jackpot - a base amount and an incremental amount. The base amount is funded by the casino and represents the minimum jackpot amount available to a player. The incremental amount is the increase in the available jackpot over time due to continued play on that machine.

Typically, gaming entities are unable to avoid awarding the incremental portion of the jackpot because it is required (by law or regulation) to be paid whether the jackpot is won or not. However, in many gaming jurisdictions, gaming entities are not required to award the base amount of a jackpot (e.g., if machines are removed from the gaming floor). Thus, if a machine is removed before the jackpot has been won, it is possible that the base jackpot will not be awarded.

This Issue addresses diversity in practice regarding the timing of recognition of the liability associated with casino jackpots.

The EITF reached a final consensus on Issue 09-F, which is largely consistent with the proposed ASU. The guidance is subject to ratification by the FASB and must be codified in an ASU before becoming authoritative.

The final guidance aligns the industry-specific accounting guidance for casino jackpots with the general liability guidance in CON 6.⁵ Specifically, the guidance will clarify that gaming entities should not accrue a liability for either the base or the incremental amount of a jackpot if payment of that amount can be avoided. Instead, when a gaming entity has an obligation to pay the jackpot it will recognize a liability in the amount of the obligation. For example, in jurisdictions in which the gaming entity has the ability to avoid payment of the base jackpot because it could legally remove the machine from the gaming floor without payment of the base amount, a liability for the base amount would not be recognized until that jackpot is won.

Conversely, if a gaming entity is unable to avoid payment of the jackpot (base or incremental) due to the legal requirements of its gaming jurisdiction, the jackpot would be accrued when the obligation becomes unavoidable. In most cases, the incremental amount would be accrued over the period of play.

Implications

We believe that the proposed guidance on accounting for casino jackpot liabilities will eliminate diversity in practice and align treatment of jackpot liabilities with general liability guidance.

Effective Date and Transition

This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after 15 December 2010. The final consensus will be adopted through a cumulative effect adjustment as of the beginning of the fiscal year in which the Issue is initially applied. Early adoption will be permitted.

⁵ FASB Concepts Statement No. 6, *Elements of Financial Statements*, defines a liability as a present obligation to transfer assets as a result of a past event.

Issue 09-I – Effect of a Loan Modification When the Loan Is Part of a Pool that is Accounted for as a Single Asset

Issue

Recently, there has been an increase in the number of loans acquired with deteriorated credit quality. For these loans, it is probable at acquisition that the investor will be unable to collect all contractually required payments. When an entity acquires loans with deteriorated credit quality, the guidance in ASC 310-30⁶ allows loans with “common risk characteristics” to be accounted for in the aggregate as a single pooled asset.

The issue is whether the troubled debt restructuring (TDR) criteria⁷ should be applied to modifications of individual loans within a pool. Additionally, if the loan modification is a troubled debt restructuring, should the modified loan be removed from the pool and accounted for as an impaired loan⁸ or should the guidance on loans acquired with deteriorated credit quality continue to be applied. That guidance states that a pool, once assembled, must be maintained.

The EITF reached a final consensus on Issue 09-I, which is largely consistent with the proposed ASU. The final guidance is subject to ratification by the FASB and must be codified in a final ASU before becoming authoritative.

The final guidance will clarify that modifications of loans that are accounted for within a pool would not result in the removal of those loans from the pool even if the modifications of those loans would otherwise be considered a TDR. Entities still must consider whether the pooled asset in which the loan is included is impaired if the total expected cash flows for the pool deteriorate.

When loans are accounted for in the aggregate as a single pooled asset, the applicable accounting guidance requires that the integrity of the pool must be maintained.⁹ Loans may be removed from the pool of loans “only if the investor sells, forecloses, or otherwise receives assets in satisfaction of the loan, or the loan is written off, and it shall be removed at its carrying amount.” The EITF considered whether guidance should be provided regarding how to determine the carrying amount of the loan to be removed and decided not to specify a single method. The EITF believes that there are several acceptable methods for calculating the carrying amount of a loan removed from a pool that do not affect the accretable yield of the pool. Therefore, selection of a particular method will continue to be an accounting policy election.

The final ASU will not specify additional disclosure requirements for impaired loans. However, the FASB’s existing project related to disclosures about the credit quality of financing receivables and the allowance for credit losses is expected to address the need for disclosures related to an entity’s loan modification activities, including loans accounted for as a single pooled asset.

Implications

We believe that the amendments in the ASU are consistent with predominant industry practice, although some diversity exists. We understand that most entities do not apply TDR accounting to acquired loans with deteriorated credit quality that are accounted for as a pool.

Effective Date and Transition

This guidance will be effective for the first reporting period, including interim periods, ending after 15 July 2010, through prospective application. Early adoption will be permitted.

Upon adoption, the guidance will permit a one-time election to change the unit of accounting from a pool basis to an individual loan basis determined pool by pool. Making this election will not preclude acquisitions after the effective date from being accounted for as a pool.

⁶ ASC 310-30, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality*

⁷ ASC 310-40, *Receivables—Troubled Debt Restructurings by Creditors*

⁸ ASC 310-10, *Receivables—Overall*

⁹ ASC 310-30-40-1, *Receivables—Loans and Debt Securities Acquired with Deteriorated Credit Quality—Derecognition*

Issue 09-J – Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in which the Underlying Equity Security Trades

Issue

An entity may grant employee stock options with an exercise price fixed in a currency that is neither the entity's functional currency nor the payroll currency of the employee. For example, Company A's stock trades only in Country X, so Company A chooses to grant its employees stock options denominated in the currency of Country X. Company A's functional currency and payroll currency is from Country Z.

When calculated in the entity's functional currency, the price of these awards is affected by changes in exchange rates. Therefore, these awards could be considered to be subject to a condition that is not a service, performance or market condition and thus classified as liabilities under the stock compensation guidance. The stock compensation guidance¹⁰ is unclear on how to classify these types of awards.

This Issue addresses whether share-based payment awards that are denominated in the currency of the market in which the underlying equity security trades should be classified as liabilities or equity.

The EITF reached a final consensus on Issue 09-J, which is largely consistent with the proposed ASU. The final guidance is subject to ratification by the FASB and must be codified in a final ASU before becoming authoritative.

The final guidance will clarify that employee stock options that have exercise prices denominated in the currency of any market in which a substantial portion of the entity's equity securities trade should be classified as equity, assuming all other criteria for equity classification are met.

The ASU will not contain any new disclosure requirements. However, the ASU Summary will include a reminder that the stock compensation guidance requires an entity to disclose the nature and terms of share-based payment arrangements that existed during the period. Presumably, if an entity has a material amount of share-based payment awards denominated in the currency of the market in which the underlying equity security trades and that differs from the entity's functional currency, this likely would be a significant term requiring disclosure.

Implications

We believe entities that previously concluded that denominating an equity award in a currency in which the underlying equity award trades would preclude equity treatment generally chose not to denominate the exercise price of awards in that currency. Further, we believe that the predominant view in practice (as described in section S5.2.4.1 of our Financial Reporting Developments publication, *Share-Based Payment*) is consistent with the final consensus and generally will validate existing practice for outstanding awards. Some entities may wish to reconsider their policy for denominating equity awards to the extent that they believe it would be preferable to denominate awards in the currency in which their shares trade.

Effective date and transition

This guidance will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after 15 December 2010. The final consensus will be adopted through a cumulative effect adjustment as of the beginning of the fiscal year in which the ASU is initially applied. Early adoption will be permitted.

¹⁰ ASC 718, *Compensation—Stock Compensation*

Consensuses-for-exposure

Issue 09-H - Selected Healthcare Organization Issues (Revenue Recognition; Presentation of Insurance Claims and Related Insurance Recoveries; and Measuring Charity Care for Disclosure)

Issue 1

Revenue recognition policies for Healthcare Organizations (HCOs) are diverse and often in conflict with revenue recognition principles required by other GAAP. Amounts charged generally are adjusted for policy or contractual discounts. Additionally, uninsured (or self-pay) patients are subject to a relatively high bad debt provision. Thus, it is unclear whether a presentation of gross revenue with a corresponding bad debt expense is appropriate or if collectibility of amounts billed should be reasonably assured before revenue is recognized.

Issue 2

HCOs purchase insurance policies for medical malpractice or similar claims. It is not always clear if these policies transfer the risk of loss for insured events and, thus, if a liability should be recognized. The issue is whether a presentation that permits the netting of prepaid insurance and insurance recoveries against an HCO's estimated accrual for medical malpractice and other claims is appropriate.

Issue 3

HCOs provide charity care to patients meeting certain criteria without expectation of payment. Industry guidance requires disclosure of the level of charity care provided but does not specify a measurement method. As reported levels have the potential to affect the allocation of limited state and local government resources, it is unclear whether disclosure under a uniform measurement method should be required. If so, it is unclear whether the rate applied should be the actual cost of care or an average rate charged to paying patients for similar services.

Issue 1 - Revenue Recognition

The EITF discussed but did not reach a consensus on the recognition of revenue when collectibility of the amount billed to a particular payer is not assured. The EITF expects to discuss this issue further at its June 2010 meeting.

Based on the discussion, the majority of the EITF favors one of two alternatives for revenue recognition. Under the first, the HCO would record revenue, at the amount it estimates is ultimately collectible, when the service is performed. The other alternative would maintain current practice but classify at least the initial estimate of bad debts (as of the date the service was provided) as a reduction of gross revenue rather than as an expense.

The EITF asked the FASB staff to perform additional analysis regarding these alternatives including how they compare to the tentative conclusions reached by the FASB and the IASB in the joint project on revenue recognition and what alternatives should be considered for the recognition and presentation of changes in the estimated cash collections subsequent to initial recognition.

A final consensus reached on this issue could have a significant effect on HCOs' revenue recognition.

Issue 2 - Presentation of Insurance Claims and Related Insurance Recoveries

The EITF reached a consensus-for-exposure that netting of prepaid insurance and insurance recoveries with an organization's estimated liability for medical malpractice claims will not be permitted, unless the criteria for offsetting in ASC 210-20¹¹ are met. As this guidance specifies that a right of setoff involves only two parties, we would not expect that any liabilities for medical malpractice claims would meet these criteria. While the scope of this issue is limited to healthcare organizations, the proposed ASU will indicate that the criteria required to offset assets and liabilities must be met by all organizations.

The proposed transition will be through recognition of a cumulative effect adjustment as of the beginning of the fiscal year in which the Issue is initially applied. The proposal will not include an effective date but will solicit input on when constituents believe they can reasonably adopt the proposed changes.

¹¹ ASC 210-20, *Balance Sheet—Offsetting*

Issue 3 - Measuring Charity Care for Disclosure

The EITF reached a consensus-for-exposure to retain the charity care disclosure requirement. The consensus-for-exposure will propose a single basis for measuring charity care based on the direct and indirect costs of the services provided. The notice for recipients of the proposed ASU will solicit comments about whether recipients believe that measuring charity care based on the average rates charged to paying patients for similar services would provide a more relevant and useful disclosure.

Implications

The tentative conclusions on Issues 2 and 3 would significantly affect certain HCOs as industry practice differs from the guidance being proposed by the EITF.

Currently, HCOs typically offset receivables for expected recoveries from insurers against the recognized liability for medical claims. The proposed ASU, if affirmed by the FASB, will represent a significant change that will result in such amounts being presented gross on the balance sheet. The EITF proposed not to require retrospective application as a result of concern that entities may not have the information necessary to determine the gross amounts that would have been recorded in prior periods.

Under the current requirements, measurement of charity care for disclosure may be presented using a variety of options. Although measurement based on direct and indirect costs may differ from an HCO's current disclosures, the information will often be readily available by reference to the entity's IRS Form 990, Schedule H, which requires that similar information be filed.

Effective Date and Transition

If affirmed, the consensus-for-exposure on netting of insurance claims against related policies (Issue 2) will be adopted through a cumulative effect adjustment as of the beginning of the fiscal year in which the consensus is initially applied.

If affirmed, the consensus-for-exposure on charity care disclosures (Issue 3) will require retrospective application. Early adoption will be permitted.

The discussion of effective dates is deferred to a future EITF meeting pending receipt of comments on the consensus-for-exposure. After the EITF has had an opportunity to evaluate the comments and finalize transition methods, the effective dates will be determined for the topics in this Issue.

Issues discussed without final conclusion

Issue 09-G – Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts

Issue

Insurance entities capitalize and amortize certain costs related to the acquisition of new or renewal contracts. These deferred acquisition costs may only be capitalized if they “vary with and are primarily related to the acquisition of insurance contracts” under the acquisition costs guidance.¹²

Diversity in practice exists with respect to which costs “vary with and are primarily related to the acquisition of insurance contracts” (e.g., whether it is appropriate to include advertising costs incurred during a period).

The EITF did not reach a final consensus on Issue 09-G and expects to discuss the issue further at its June 2010 meeting.

The EITF affirmed that only the following costs incurred in the acquisition of new and renewal contracts would be capitalizable in accordance with the amendments in the proposed ASU:

- ▶ Incremental direct costs of a successful contract acquisition—e.g., costs for an agent or broker commission (or bonus) and third-party medical or inspection fees
- ▶ The portion of the insurance entity employee’s total compensation and payroll-related fringe benefits directly related to time spent performing acquisition activities for a contract that has actually been acquiring—i.e., underwriting, policy issuance and processing, medical and inspection, and contract selling

In response to comments from constituents, the guidance will contain an election that permits an entity to continue using its current accounting policy if it results in fewer costs being capitalized than will be required under the final guidance.

The EITF affirmed that all other acquisition-related costs, such as costs incurred by the insurer for soliciting potential customers, market research, training, administration, unsuccessful acquisition of renewal efforts and product development, would be charged to expense as incurred. Administrative costs, rent, depreciation, occupancy, equipment and all other general overhead costs would also be charged to expense as incurred.

The EITF confirmed its proposal that advertising costs should be capitalized only if specifically permitted by other guidance in US GAAP.¹³ However, the EITF directed the FASB staff to perform an analysis of how the amortization and impairment guidance related to capitalized direct-response advertising costs interacts with the amortization and impairment guidance for deferred acquisition costs. This analysis is expected to be presented and discussed at the June 2010 meeting.

Implications

The proposed ASU, if ultimately affirmed by the EITF and ratified by the FASB (which would occur no earlier than June 2010), will represent a significant change for many insurance companies who were capitalizing costs associated with unsuccessful contract acquisition or renewals and other costs not permitted under the proposed model. Additionally, in light of the FASB’s and IASB’s pending joint insurance project, we recommend that insurance entities consider how to leverage their current systems

¹² ASC 944, *Financial Services—Insurance*

¹³ ASC 720, *Other Expenses*, and ASC 340-20, *Other Assets and Deferred Costs—Capitalized Advertising Costs*, as applicable

and processes to minimize the costs of implementation in case additional changes are required by that project when finalized.

Effective Date and Transition

The proposed ASU noted that the amendments will be effective for fiscal years, and interim periods within those fiscal years, beginning on or after 15 December 2010, through prospective application. Early adoption would be permitted. Retrospective application to all prior periods upon the date of adoption also would be permitted, but not required. However, at the 18 March 2010 meeting, the EITF decided to re-evaluate the effective date and transition provisions at its June 2010 meeting when it plans to discuss the remaining issues described above.

Your gateways to Ernst & Young technical accounting guidance

AccountingLink at ey.com/us/accountinglink offers easy access to many of the publications produced by our US Professional Practice Group. AccountingLink is available free of charge.

Our **Global IFRS website** at ey.com/ifrs offers online resources that provide more detail about IFRS, as well as issues to consider as you research the potential impact of IFRS on your company.

GAAIT-Client Edition contains Ernst & Young's comprehensive proprietary technical guidance, as well as all standard-setter content. GAAIT-Client Edition is available through a paid subscription.

Ernst & Young

Assurance | Tax | Transactions | Advisory

© 2010 Ernst & Young LLP.
All Rights Reserved.

SCORE No. BB1915

Ernst & Young refers to the global organization of member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients.

Ernst & Young LLP is a client-serving member firm of Ernst & Young Global and of Ernst & Young Americas operating in the US.

This publication has been carefully prepared but it necessarily contains information in summary form and is therefore intended for general guidance only; it is not intended to be a substitute for detailed research or the exercise of professional judgment. The information presented in this publication should not be construed as legal, tax, accounting, or any other professional advice or service. Ernst & Young LLP can accept no responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. You should consult with Ernst & Young LLP or other professional advisors familiar with your particular factual situation for advice concerning specific audit, tax or other matters before making any decision.