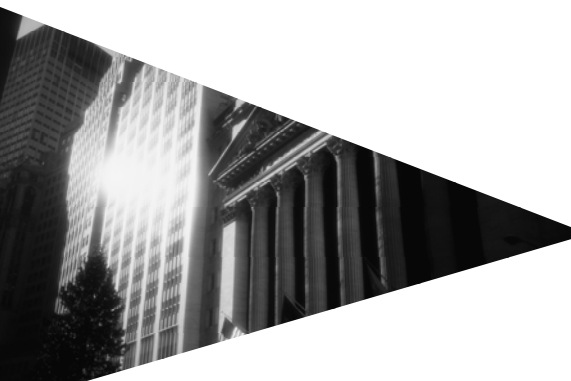


EITF Update

EITF meeting highlights



Emerging Issues Task Force

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9-10 September 2009 meeting highlights

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

- ▶ Issue 08-1 – Revenue Arrangements with Multiple Deliverables
- ▶ Issue 09-3 – Certain Arrangements That Include Software Elements¹

The final consensuses are largely consistent with the EITF’s previous consensuses-for-exposure and are subject to ratification as Accounting Standards Updates by the FASB at its 23 September 2009 meeting. The most significant change to both Issues increased entities’ choices in the timing and method of adoption.

The EITF reached a **consensus-for-exposure** on the following issues:

- ▶ Issue 09-2 – Research and Development Assets Acquired in an Asset Acquisition
- ▶ Issue 09-B – Consideration of an Insurer’s Accounting for Majority-Owned Investments When the Ownership is through a Separate Account
- ▶ Issue 09-E – Accounting for Distributions to Shareholders with Components of Stock and Cash in the Calculations and Presentations of Earnings per Share

The above Issues, if ratified as consensuses-for-exposure by the FASB at its 23 September 2009 meeting, will be exposed for comment and are subject to approval as final consensuses by the EITF at its 19 November 2009 meeting. Given the time frame between the September and November 2009 EITF meetings, we anticipate that these issues will become available for comment near the end of September and the comment period will be around three to four weeks long.

The SEC Observer noted a change to EITF Topic D-86 regarding the SEC staff’s views on when financial statements are issued. That change would indicate that the posting of complete financial statements on a company website would represent issuance, which would help address certain practice issues in connection with the completion of subsequent events reviews.

¹ Formerly, “Applicability of AICPA Statement of Position 97-2 to Certain Arrangements That Include Software Elements.”

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

Final consensus

Issue 08-1 – Revenue Arrangements with Multiple Deliverables

Issue

An entity's sale of products or services may consist of multiple deliverables for which, under certain circumstances, revenue may be recognized separately for each deliverable. The absence of objective and reliable evidence of fair value of the undelivered item in a multiple-element revenue arrangement is one of the most common reasons entities are unable to separate deliverables in an arrangement according to ASC 605-25.² This often results in accounting that might not reflect the underlying economics of a transaction (in many cases, revenue recognition is deferred until all elements are delivered).

Further information

This issue will have a significant effect on revenue recognition for many entities and some are hoping to adopt as early as the third quarter 2009. Therefore, we are planning to provide additional analysis of this final consensus in the near future through our A&A News distribution and on our EYAccountingLink website. Also, we anticipate hosting a webcast that will further discuss the accounting and practical implications of Issue 08-1.

The EITF reached a final consensus on Issue 08-1, which is largely consistent with the recent draft abstract that was exposed for comment. This final consensus is subject to ratification by the FASB at its 23 September 2009 meeting.

The Accounting Standards Update (ASU) resulting from this consensus will supersede certain guidance in ASC 605³ and require an entity to allocate arrangement consideration at the inception of an arrangement to all of its deliverables based on their relative selling prices (i.e., the relative-selling-price method). The consensus eliminates the use of the residual method of allocation (i.e., in which the undelivered element is measured at its estimated selling price and the delivered element is measured as the residual of the arrangement consideration) and requires the relative-selling-price method in all circumstances in which an entity recognizes revenue for an arrangement with multiple deliverables subject to Issue 08-1.

When applying the relative-selling-price method, the determination of the selling price for each deliverable must be consistent with the objective of determining vendor-specific objective evidence of fair value (VSOE); that is, the price at which the entity does or would sell the element on a stand-alone basis. This determination requires the use of a hierarchy designed to maximize the entity's use of available, objective evidence to support its selling price. The entity must consider market conditions as well as entity-specific factors when estimating this selling price.

The ASU will require both ongoing disclosures regarding an entity's multiple-element revenue arrangements as well as certain transitional disclosures during periods after adoption. The objective of the ongoing disclosures is to provide information regarding the significant judgments and estimates made in the application of this Issue and their impact on revenue recognition. Additionally, disclosures will be made when changes in either those judgments or the application of this Issue may significantly affect the timing or amount of revenue recognition. The ASU will require an entity to aggregate these disclosures for similar types of arrangements.

Implications

We believe that Issue 08-1's changes to the selling price threshold within ASC 605 are significant. Issue 08-1 will result in the requirement to separately record revenue for more elements within an arrangement, which will result in less revenue deferral. The adoption of Issue 08-1 should result in revenue recognition which better reflects the economics of multiple-element arrangements. We also believe

² ASC 605-25, *Revenue Recognition—Multiple-Element Arrangements*, (formerly, EITF 00-21, "Revenue Arrangements with Multiple Deliverables")

³ ASC 605, *Revenue Recognition* (formerly, EITF 00-21, "Revenue Arrangements with Multiple Deliverables")

that the hierarchy for determining selling price will require entities to maximize their use of available, objective evidence when estimating the selling prices of deliverables within their arrangements.

We believe that the requirement to use the relative-selling-price method to allocate arrangement consideration represents a significant change for many entities. This requirement will have an effect on preparers who have developed VSOE or relevant third-party evidence of selling price for undelivered elements of an arrangement and used the residual method to allocate arrangement consideration to delivered elements in accordance with the provisions of ASC 605. Application of the relative-selling-price method may require additional effort and the development of processes and systems to separately calculate and account for the implied discount on each multiple element arrangement, particularly for entities that have a material range in pricing or significant variations in how products or services are bundled.

We also believe that entities may wish to reevaluate certain business practices after adoption of Issue 08-1; for example, in circumstances when entities have incurred significant costs, such as creating or maintaining separate processes or sales channels in order to create VSOE for certain elements in an arrangement but the determination of the separate selling price of an undelivered element can be reasonably estimated by the entity with other evidence. Additionally, the ability to estimate the selling price of elements may give entities greater flexibility in how they choose to bundle products and services. See further discussion under Issue 09-3.

Finally, the increase in ongoing disclosures for multiple element revenue arrangements, as well as the transition disclosures discussed below, could cause concerns among preparers in terms of the cost to accumulate information to prepare the disclosures (subject to appropriate internal controls).

Effective Date and Transition

If ratified at the 23 September 2009 FASB meeting, the ASU will provide some flexibility in when and how an entity adopts Issue 08-1. All entities must have adopted the ASU no later than the beginning of their first fiscal year beginning on or after 15 June 2010. Entities may elect to adopt the Issue through either prospective application for revenue arrangements entered into, or materially modified, after the effective date or through retrospective application to *all* revenue arrangements for all periods presented. Entities may elect earlier application.

If entities elect to adopt the ASU in a period which is not the first reporting period in their fiscal year, and have selected prospective application, the guidance in the ASU must be applied as if the Issue had been effective from the beginning of that fiscal year and therefore be applied to all *new* arrangements entered into, or materially modified, during the fiscal year of adoption. For example, if a calendar year entity adopts Issue 08-1 in the fourth quarter of fiscal year 2009, it must apply the provision to all new transactions initiated or materially modified after 1 January 2009.

Full retrospective application is prohibited if the entity cannot adhere to the practicability requirements of ASC 250.⁴ For example, because retrospective application of Issue 08-1 requires significant estimates, retrospective application is not permitted if it is impossible to identify objective information that provides evidence of circumstances that existed at the retrospective application dates and would have been available when those financial statements would have been issued to support those estimates.

In the year of adoption, an entity is required to disclose information that describes the effect of the change in accounting principle on revenue trends. To satisfy that objective, an entity is required to disclose certain qualitative information by similar types of arrangements. If the effect of adopting this final consensus is material, an entity is also required to supplement the qualitative information with quantitative information to satisfy the objective. The EITF modified the transition disclosures from those specified in the consensus-for-exposure to allow an entity greater flexibility in how it achieves the disclosure objective. For example, an entity might conclude that the effect of adoption could be effectively conveyed by disclosing (a) current period revenues as if Issue 00-21 continued to be applied, (b) prior year revenues as if Issue 08-1 had been adopted in the preceding year, or (c) the amount of revenue recognized in the reporting period from applying the guidance in Issue 00-21 and the amount of revenue recognized in the reporting period from applying the guidance in Issue 08-1.

⁴ ASC 250, *Accounting Changes and Error Corrections* (formerly, FASB Statement No. 154, *Accounting Changes and Error Correction*)

Issue 09-3 – Certain Revenue Arrangements That Include Software Elements

Issue

The Task Force consensus in Issue 08-1 revises the selling price threshold in ASC 605-25 to permit the use of the seller's best estimate of the selling price to separate deliverables in a multiple-element arrangement. The consensus in Issue 08-1 will result in an entity always separating multiple deliverables for arrangements within the scope of ASC 605-25. ASC 985-605,⁵ which applies to tangible products that include software that is "more than incidental" to the product, permits separation of multiple deliverables only if VSOE for the undelivered item is available.

Due to the significant differences in the level of evidence required for separation of multiple deliverables under Issue 08-1 (which will always require separation) and ASC 985-605 (which only permits separation if VSOE for the undelivered item is available), the EITF has undertaken a project to reconsider the scope of ASC 985-605.

The EITF reached a final consensus on Issue 09-3, which is subject to ratification by the FASB at its 23 September 2009 meeting.

The EITF concluded that the scope of ASC 985-605 should be modified such that the following products would be considered non-software deliverables and therefore excluded from the scope of ASC 985-605:

- ▶ Tangible products that contain software elements and non-software elements that function together to deliver the tangible product's essential functionality.
- ▶ Undelivered elements that relate to software that is essential to the above-described tangible product's functionality.

The Accounting Standards Update (ASU) resulting from this consensus will include several factors to assist in the determination of whether a product that includes both software and non-software elements should be excluded from the scope of ASC 985-605. Specifically, the EITF concluded that if sales of the tangible product without the related software elements are infrequent, it is a significant indicator that the software elements are essential to the functionality of the tangible product, and therefore are outside the scope of ASC 985-605. Additionally, the Task Force concluded that the non-software elements of the tangible product must substantively contribute to the tangible product's essential functionality to be excluded from the scope of ASC 985-605. That is, the non-software elements of the tangible product cannot simply provide a mechanism for delivery of software to the customer. The ASU will include several examples of the application of the principle and associated factors provided in Issue 09-3. The ASU will reflect some clarifying amendments to the factors and examples included in Issue 09-3's draft abstract, which is available on the FASB's website, based on comments received during the comment process.

In its discussions, the EITF clarified that the tangible product component of a revenue arrangement that includes software is *always* outside the scope of ASC 985-605. Additionally, the EITF clarified that the consensus in Issue 09-3 would apply to lease arrangements for purposes of determining whether software elements within the arrangement are in the scope of ASC 985-605 and therefore outside the scope of ASC 840.⁶

Implications

The functionality of an increasing array of products is being improved or expanded with embedded software. As software has become a more significant component of those products, many companies have struggled with the determination of whether that software has become "more than incidental" to the product such that the accounting for the entire arrangement is subject to ASC 985-605. As discussed previously, ASC 985-605 requires VSOE for undelivered elements in order to

⁵ ASC 985-605, *Software-Revenue Recognition* (formerly, SOP 97-2, *Software Revenue Recognition*)

⁶ ASC 840, *Leases* (formerly, FASB Statement No. 13, *Accounting for Leases*)

recognize revenue for the delivered elements. Because VSOE often is not available for future deliverables (e.g., software upgrades) for software-enabled devices, in many cases, no revenue can be recognized when the device is delivered to the customer. This consensus will result in the increased separation of deliverables into separate units of accounting. Therefore, many of these devices will likely be accounted for under Issue 08-1.

Issue 08-1 will introduce greater subjectivity to the allocation of revenue for some arrangements. Accordingly, entities will need to institute processes and controls to estimate the selling prices of many products that maximize the use of objective information. However, we believe that the consensus will result in financial statements that better reflect the economics of the sales of many software-enabled devices.

Effective date and transition

The EITF concluded that the effective date and transition alternatives for Issue 09-3 will be the same as for Issue 08-1, as discussed previously in this publication. An entity is required to utilize the same transition method for both Issue 08-1 and Issue 09-3.

Consensuses-for-exposure

Issue 09-2 – Research and Development Assets Acquired in an Asset Acquisition

Issue

Research and development assets acquired in a business combination after the effective date of Statement 141 (R) (codified as ASC 805)⁷ are initially recognized and measured at fair value. Pursuant to ASC 730-10,⁸ research and development assets acquired in an asset acquisition are only capitalized if the assets have a future alternative use; otherwise, the assets are expensed at the acquisition date. Tangible and intangible assets that meet the future alternative use criterion are initially measured at allocated cost.

Prior to the effective date of Statement 141 (R), the accounting for acquired in-process research and development was the same whether acquired in a business combination or an asset acquisition. The change resulting from Statement 141 (R) causes similar transactions to be accounted for differently depending on the method of acquisition.

The EITF reached a consensus-for-exposure on Issue 09-2.

Under the consensus-for-exposure, the allocated cost of all research and development assets acquired in an asset acquisition will be capitalized regardless of whether those assets have a future alternative use. The assets will subsequently be accounted for by applying the model used for research and development assets acquired in a business combination. This model results in the research and development asset being considered indefinite-lived until the completion or abandonment of the related research and development activities. The asset is evaluated for impairment in accordance with ASC 350-30-35-18⁹ while it is considered indefinite-lived. When the related project is completed, the asset is assigned a useful life in accordance with ASC 350-30-35. Payments for services and internal costs incurred to develop research and development assets will continue to be expensed.

Agreements to acquire research and development assets often include future payments to the seller that are contingent on the outcome of further research and development. The future services can be provided by the seller, the buyer or a third-party. The consensus-for-exposure will require that such contingent consideration for research and development assets acquired in an asset acquisition should be accounted for in accordance with existing US GAAP. For example, if the contingent consideration meets the definition of a derivative, ASC 815¹⁰ would require that it be recognized at fair value. If the contingent consideration does not meet the definition of a derivative, it should be accounted for in accordance with ASC 450;¹¹ that is, recognized if it is probable the contingent consideration will be payable.

In the notice for recipients of the consensus-for-exposure, the EITF will solicit comments about whether factors should be provided in the final consensus to assist entities in determining whether contingent payments are (a) a payment for services (which generally would be expensed) or (b) an additional cost of the asset acquired (which would be capitalized) and if so, solicit input on what factors would be helpful in making the determination.

At its September 2009 meeting, the EITF also tentatively concluded that an entity should disclose a description of the contingent consideration arrangement, the basis for determining the payments, and what the accounting treatment of contingent

⁷ ASC 805, *Business Combinations* (formerly, FASB Statement No. 141 (R), *Business Combinations*)

⁸ ASC 730-10, *Research and Development—Overall* (formerly, FASB Statement No. 2, *Accounting for Research and Development Costs*)

⁹ ASC 350-30-35, *Intangibles—Goodwill and Other—General Intangibles Other than Goodwill—Subsequent Measurement* (formerly, FASB Statement No. 142, *Goodwill and Other Intangibles*)

¹⁰ ASC 815, *Derivatives and Hedging* (formerly, FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*)

¹¹ ASC 450, *Contingencies* (formerly, FASB Statement No. 5, *Accounting for Contingencies*)

payments will be when recognized (e.g., expensed as services or capitalized as an additional cost of the asset).

Implications

The consensus-for-exposure would significantly change the accounting for research and development assets acquired in an asset acquisition. While this change would more closely align the asset acquisition model with the business combination model, there would still be important differences between the two models. For example, assets generally are measured at fair value in a business combination, which requires the recognition of contingent consideration at fair value and precludes capitalization of transaction costs. In an asset acquisition, assets are recognized at allocated cost (or cost, if only one asset is acquired) based on the ratio of the fair value of the asset to the fair value of all the net assets acquired. The cost of the acquisition includes certain direct transaction costs but does not include contingent consideration until it is probable the contingent consideration will be payable. Differences in the initial recognition and measurement of both the assets and the subsequent measurement of any contingent consideration could result in materially different amounts reflected on an entity's balance sheet based on the form of the transaction and whether it qualifies as a business combination or not.

In some cases, assets will be recognized when it is likely that the assets will not result in a commercial product and will subsequently be written-off. Additionally, internally-developed intangible assets will still not be recognized. Accordingly, an acquirer may capitalize the initial payment for an in-process research and development asset and subsequently expense additional research and development efforts with respect to that capitalized asset. These situations can arise currently in a business combination.

Effective Date and Transition

The consensus-for-exposure, if affirmed, would be effective for transactions occurring in fiscal years, and interim periods within those fiscal years, beginning on or after 15 December 2009. Early adoption will not 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. To facilitate the pass-through of this investment return risk, a “separate account” is established that legally isolates the assets that support the obligation to the contract holder from the other assets of the insurance company, which are commonly referred to as assets of the “general account.” This structure legally protects contract holders with separate accounts from the general creditors of the insurance company should the insurance entity become insolvent. Pursuant to ASC 944,¹² certain separate accounts qualify for summarized reporting in the financial statements of the insurance company. In 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.

An insurance entity may hold a majority interest in a mutual fund solely through the ownership of the assets in the separate account or through a combination of its investment through the separate account and its general account. At issue is whether an insurance company should be required to consolidate a majority-owned investment when that majority ownership is either (a) solely through the separate account or (b) through a combination of investments in the separate account and the general account. Additionally, if such a majority-owned investment is required to be consolidated, it is unclear how the noncontrolling interest should be reflected in the financial statements.

The EITF reached a consensus-for-exposure on Issue 09-B.

The EITF clarified that Issue 09-B does not apply to instances in which an insurer consolidates a majority-owned investment because the insurer holds majority-ownership of the investment based solely on the ownership interests in the insurer’s general account.

The EITF reached a consensus-for-exposure that an insurer will apply ASC 946,¹³ which specifies specialized industry accounting for investment companies, to investments held within a qualifying separate account. ASC 810-10-25-15¹⁴ specifies that when a subsidiary applies specialized accounting principles at the subsidiary level, those principles should be retained in consolidation. Certain separate accounts must produce separate stand-alone financial statements and, in those financial statements, apply ASC 946. However, as separate accounts generally do not reside in a separate subsidiary of the insurer, separate accounts did not clearly fall within the scope of ASC 810-10-25-15. In accordance with ASC 946-810, consolidation or use of the equity method by an investment company of a non-investment-company investee is not permitted. SEC Regulation S-X, Rule 6-03(c)(1)(i) indicates that financial statements of an investment-company registrant may only be consolidated with statements of subsidiaries that also are investment companies. Neither ASC 946 nor Rule 6-03 indicates that consolidation of investment-company investees is required. Therefore, in practice, if a separate account holds a majority interest in a mutual fund, the separate account generally has not consolidated the mutual fund in its stand-alone financial statements. Instead, the separate account reflects its ownership of the fund in its stand-alone financial statements at the fair value of the fund similar to a master-feeder fund or fund of funds in accordance with ASC 946. The result of the consensus-for-exposure is that an insurer is not required to consolidate a majority-owned investee if the ownership within the general account alone does not represent a majority of the voting interests. The consensus-for-exposure applies when the insurer holds majority ownership within the separate account. Similarly, the EITF reached a consensus-for-exposure that an insurer is not required to consolidate a majority-owned investment when it has a majority ownership through a combination of the interests held by its separate and general accounts, but the general account alone does not have a majority interest.

The EITF discussed the presentation of investments held by the general account when the insurer holds majority ownership within the separate account or when it has a majority ownership through a combination of the interests held by its separate

¹² ASC 944, *Financial Services–Insurance* (formerly, SOP 03-1, *Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts*)

¹³ ASC 946, *Financial Services – Investment Companies* (formerly, *the AICPA Audit and Accounting Guide: Investment Companies*)

¹⁴ ASC 810-10-25-15, *Consolidation – Overall – Recognition – Retention of Specialized Accounting for Investments in Consolidation* (formerly, EITF Issue No. 85-12, “Retention of Specialized Accounting for Investments in Consolidation”)

and general accounts, but did not reach a conclusion. The notice for recipients of the consensus-for-exposure will solicit views about current practice for this presentation and whether the presentation should be addressed by the EITF in this Issue.

Implications

We believe that the tentative conclusions would largely codify existing practice within the insurance industry. To our knowledge, most insurers have not grossed up the balance sheet to reflect non-controlling interests in majority-owned investments when the majority-ownership interest is through a separate account.

Effective date and transition

The consensus-for-exposure that will be issued following ratification by the FASB in late September will propose that Issue 09-B 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 would be prohibited.

Issue 09-E – Accounting for Distributions to Shareholders with Components of Stock and Cash in the Calculations and Presentation of Earnings per Share

Issue

ASC 260¹⁵ establishes guidance for computing and presenting earnings per share (EPS) and applies to entities with publicly-held common stock or potential common stock. ASC 260-10-55-12 states that if the number of common shares outstanding increases as a result of a stock dividend, the computations of basic and diluted EPS should be adjusted retroactively for all periods presented to reflect that change in capital structure.

ASC 505-20-05-3¹⁶ states that after a stock dividend "the proportional interest of each shareholder remains the same." Further, ASC 505-20-15-3(d) indicates that transactions "in which each shareholder is given an election to receive cash or shares" are not in the scope of ASC 505-20.

Real Estate Investment Trusts (REITs) are required to distribute 90 percent of their taxable income in accordance with US tax regulations. In certain circumstances, REITs may satisfy these distribution requirements in cash and stock. Shareholders elect the form of their distribution, subject to a minimum (and generally a maximum) amount of the dividend to be paid in cash.

The issue is whether or not the stock portion of a distribution to shareholders that contains components of cash and stock and allows shareholders to select their preferred form of the distribution should be accounted for as a stock dividend for EPS purposes.

The EITF reached a consensus-for-exposure on Issue 09-E.

At the September 2009 meeting, the EITF tentatively concluded that when a distribution contains components of cash and stock, the minimum portion that may be distributed as stock (on an overall basis, and not with respect to individual shareholders) should be considered a stock dividend for purposes of computing basic and diluted EPS. For example, assume an entity declares an aggregate dividend of \$10 million that is payable in cash and shares and the total cash component is limited to \$2 million (20% of the total). Under the terms of this distribution, the minimum value of the shares distributed will be \$8 million (80% of the total value distributed). Accordingly, the EITF's consensus-for-exposure on Issue 09-E requires an entity to consider the shares issued to satisfy \$8 million of the total distribution to be a stock dividend for purposes of computing basic and diluted EPS. In these situations, we believe that the dividend declared represents a financial instrument that embodies an obligation to deliver a fixed monetary amount that will be settled in a variable number of shares. As a result, the dividend declared would be recognized as a liability as of the declaration date in accordance with ASC 480.¹⁷

The EITF concluded that entities should retroactively adjust the number of shares used in the computations of both basic and diluted EPS for a stock dividend as of the later of (a) the ex-dividend date, or (b) the date when the number of actual shares to be distributed is known. Between the dividend declaration date and the date that the financial statements are retroactively adjusted, an entity should disclose the fact that EPS will change in the future based on the pending dividend and disclose the number of shares that would have been distributed had the distribution occurred as of the end of the reporting period. However, neither basic nor diluted EPS will reflect the dividend during this interim period.

The EITF was narrowly divided in reaching this consensus-for-exposure. As a result, the notice for recipients for the consensus-for-exposure will request comments on the alternative view discussed by the EITF; i.e., that these distributions do not represent stock dividends, because the distribution alters the proportional interests of individual shareholders.

Implications

There is currently diversity in practice among REITs as to whether the stock portion of these stock and cash distributions were considered stock dividends for the purpose of determining EPS. A final consensus on Issue 09-E will eliminate that diversity.

¹⁵ ASC 260, *Earnings Per Share* (formerly, FASB Statement No. 128, *Earnings per Share*)

¹⁶ ASC 505-20, *Equity- Stock Dividends and Stock Splits* (formerly, Accounting Research Bulletin No. 43, *Restatement and Revision of Accounting Research Bulletins*)

¹⁷ ASC 480, *Distinguishing Liabilities from Equity* (formerly, FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*)

Entities that had not considered the stock portion of these distributions to be stock dividends will be required to retrospectively apply this consensus and adjust the shares used in their historical basic and diluted EPS calculations.

While these dividends structures are most common among REITs due to their distribution requirements under US tax regulations, the scope of this issue is not limited to REITs. This issue also affects other entities that make similar distributions. Further, all entities that declare stock dividends are affected by the conclusion that entities should retrospectively adjust EPS as of the later of (a) the ex-dividend date, or (b) the date when the number of actual shares to be distributed is known.

Effective Date and Transition

As proposed, Issue 09-E will be effective for interim and annual periods ending on or after 15 December 2009. The consensus-for-exposure requires retrospective application.

Issues discussed without conclusion

Issue 08-9 – Milestone Method of Revenue Recognition

<p>Issue</p> <p><i>Entities often enter into revenue arrangements that involve multiple nonrefundable payment streams for a single unit of accounting (e.g., upfront and milestone payments for research and development services). The single unit of accounting may be a single deliverable or multiple deliverables that must be accounted for as a single unit of accounting under ASC 605. If delivery of a single unit of accounting spans multiple accounting periods, an entity must determine how to allocate revenue to each accounting period. The issue is how to recognize revenue when contingent milestone payments are received, as there is only a single unit of accounting and performance is not yet complete.</i></p>	<p>The EITF did not reach a final consensus on Issue 08-9.</p> <p>The EITF previously reached a consensus-for-exposure on Issue 08-9 at its March 2009 meeting. The EITF tentatively defined a milestone as an event (a) that can only be achieved based in whole or in part on the vendor's performance or on the occurrence of a specific outcome resulting from the vendor'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, if achieved. 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. The consensus-for-exposure concluded that each payment term in an arrangement should be evaluated individually to determine whether or not the payment term is a milestone to which the milestone method may be applied. Further, the consensus-for-exposure specified that the application of the milestone method is an accounting policy election in accordance with ASC 250. The milestone method is not required and is not the only acceptable method of revenue recognition for arrangement consideration contingent upon achievement of a milestone. Accordingly, a change to adopt the milestone method must be accounted for in accordance with ASC 250, which would require the preparer and its independent auditor to conclude that the milestone method was preferable.</p> <p>At its September 2009 meeting, the EITF spent considerable time discussing the scope of Issue 08-9, including whether the Issue should apply only to milestone payments (as defined) or whether it should apply to all performance-related contingent payments. Further, the EITF discussed whether the Issue should apply only to revenue arrangements related to the development of assets, such as those in the pharmaceutical and biotechnology industries, whether the Issue should apply to all "development" activities, or whether the Issue should apply broadly to all revenue arrangements with contingent payments for which there is no other applicable GAAP. Certain EITF members expressed concern with applying the milestone method as defined in Issue 08-9 to all revenue arrangements without understanding how other transactions may be affected. Other EITF members observed that the notion of "substantive uncertainty" was based on development examples from the pharmaceutical and biotechnology industries and may need to be better defined if it is to be applied to other transactions for which the extent of uncertainty is less clear for the milestone payment.</p>
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The EITF ultimately directed the FASB staff to evaluate possible alternatives for the scope and transition for Issue 08-9 and to present its analysis at a future meeting.

Implications

We believe that the proposed guidance on applying the milestone method generally will validate an acceptable alternative already applied in practice. Accordingly, we expect minimal change in practice as a result of this consensus, if affirmed. It is unclear, however, how broad the scope of Issue 08-9 will be and how such practices will be affected in instances in which an entity is not applying a milestone method aligned with that in Issue 08-9.

Effective date and transition

Transition methods and the effective date will be discussed further at a future meeting.

Issue 09-4 – Seller Accounting for Contingent Consideration

Issue

Business combinations often involve contingent consideration; that is, an obligation of the buyer to transfer additional assets or equity interests to the seller if specified future events occur. Current authoritative literature does not always address the seller's accounting for contingent consideration.

In instances in which the seller loses control of a subsidiary, ASC 810¹⁸ requires that the seller initially measure the fair value of any consideration received in calculating the gain or loss recognized upon deconsolidation of the acquiree. ASC 810, however, does not specifically address the measurement of contingent consideration.

Additionally, while some contingent consideration arrangements meet the definition of a derivative under ASC 815 and thus must be subsequently remeasured at fair value through current period earnings, many contingent consideration arrangements are not derivatives within the scope of ASC 815. There is no authoritative guidance with respect to the measurement of contingent consideration that is not accounted for as a derivative.

The EITF was unable to reach a consensus and does not expect to further discuss the Issue.

Certain EITF members believe that the language in ASC 810 that requires all consideration received to be measured at fair value upon deconsolidation of a subsidiary includes any contingent consideration received. Other EITF members, however, questioned whether the FASB intended for the calculation to include contingent consideration and believe that contingent consideration should be recognized by the seller in accordance with the guidance for gain contingencies in ASC 450. After considerable discussion and debate, the EITF was unable to reach a consensus on the issue.

The issue summary also asked the EITF to consider how a seller should subsequently account for contingent consideration. Given the lack of consensus on the initial measurement of contingent consideration upon deconsolidation, the Task Force did not address how the seller should account for contingent consideration subsequent to initial measurement.

Because the EITF was unable to reach a consensus, the EITF Chairman indicated that he will recommend that the FASB consider whether to address this unresolved issue as part of the broader financial instruments project or potentially as a separate project. The EITF is not expected to discuss this Issue further.

Implications

The EITF's failure to reach a consensus on Issue 09-4 will result in continued diversity in practice for seller accounting for contingent consideration upon initial deconsolidation of a subsidiary. Given the significant difference between recording contingent consideration at fair value and accounting for contingent consideration as a contingent gain, we believe the choice of methods represents an accounting policy election that should be disclosed and consistently applied. Furthermore, a seller should disclose the nature of any outstanding contingent consideration arrangements, indicating how the contingent consideration was initially recognized and the basis for any changes to the recognized amount since initial recognition. If the contingent consideration is accounted for as a contingent gain, the disclosures required by ASC 450 should also be provided.

¹⁸ ASC 810, *Consolidation* (formerly, FASB Statement No. 160, *Noncontrolling Interests in Consolidated Financial Statements*)

SEC staff announcement

Issue

Under ASC 855¹⁹ and AU 560,²⁰ a registrant and its independent auditor have responsibilities with respect to events or transactions that occur after the balance sheet date but before financial statements are issued. Specifically, entities must determine appropriate recognition and disclosure of these events.

Financial statements are considered issued under ASC 855 when they are widely distributed to shareholders and other financial statement users for general reliance and use in a form and format that complies with GAAP. The SEC staff's view is that a registrant's financial statements are issued as of the earlier of when they are widely distributed or filed with the SEC, as discussed in ASC 855-10-S99-2. Historically the SEC staff's view was that posting financial statements to a registrant's website would not be considered wide distribution to all shareholders and other financial statement users.

At the September 2009 EITF meeting, the SEC Observer noted that EITF Topic D-86 (ASC 855-10-S99-2) currently states that posting financial statements to a registrant's web site *would not* be considered wide distribution to all shareholders and other financial statement users. The SEC Observer noted that the SEC has interpreted Regulation FD, *Fair Disclosure*, as permitting the posting of materials to a corporate website as qualifying for "wide distribution" under certain circumstances. As a result, the SEC staff will update its views in ASC 855-10-S99-2 to conform to the SEC's interpretations of Regulation FD.

In addition, the SEC Observer noted that the SEC staff is in the process of updating various other SEC staff announcements in EITF D-Topics to remove superseded guidance, make them more user-friendly, and to align the D-Topics with the references in the Accounting Standards Codification. The changes being made, however, are not intended to alter the SEC staff's views, other than the change described above for Topic D-86.

Implications

ASC 855 requires entities to disclose in their financial statements the date through which it has evaluated subsequent events; i.e., the date that the financial statements are issued for public entities. SEC registrants must also consider the guidance in ASC 855-10-S99-2 to determine when they issued their financial statements. Subject to the final drafting of the SEC staff's revised view, entities may be able to issue their financial statements by posting them to their web site before the financial statements are filed with the SEC via EDGAR in a Form 10-K or Form 10-Q. Issuing financial statements by posting them to the entity's website before filing them with the SEC may address some of the implementation issues that preparers and independent auditors have noted regarding some of the disclosure provisions of ASC 855.

For example, a registrant may have completed its subsequent events procedures related to its annual financial statements after the SEC's EDGAR filing system no longer accepts submissions on Day 1, so it must file its annual financial statements in Form 10-K on Day 2 when EDGAR is first available. As a result, the registrant would be required to update its subsequent events procedures through Day 2 and adjust the disclosure in its financial statements accordingly, which may also affect the date of its auditor's report. After the expected changes to ASC 855-10-S99-2, if

¹⁹ ASC 855, *Subsequent Events* (formerly, FASB Statement No. 165, *Subsequent Events*)

²⁰ AICPA Codification of Statements on Auditing Standards, AU Section 560, *Subsequent Events*

the registrant posted its financial statements on its company website, subject to the requirements of the revised SEC staff view, on Day 1, it would consider Day 1 the date that the financial statements were issued, and it would disclose Day 1 as the date through which it reviewed subsequent events.

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