

# Defining Issues<sup>®</sup>

KPMG LLP



## Alert

©2001-2006 KPMG LLP, the U.S. member firm of KPMG International, a Swiss cooperative. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative. All rights reserved. 13205STM

Photo: GettyImages/Stop/Halldark 71552402

## Four FASB Staff Positions Proposed

The FASB recently published four proposed Staff Positions that would require rapid application by affected companies if and when the positions are approved and posted.<sup>1</sup> One would require companies that issue securities and agree to register them to recognize a liability if a payment to investors for failing to fulfill the agreement is probable and its amount can be reasonably estimated. Another would clarify how to determine whether an unvested share-based-payment award is a right to participate in dividends with common stock and therefore should be included in computing earnings per share under the two-class method. The third would provide guidance on how companies should measure nonfinancial assets required to be measured at fair value in business combinations and impairment tests before the adoption of Statement 157.<sup>2</sup> And the fourth would address how to classify and whether to depreciate a long-lived asset that a company plans to sell in a transaction in which it would retain an interest in the asset through ownership of an equity-method investment.

### Registration Payment Arrangements

In a registration payment arrangement, a company that issues securities agrees to undertake registering the securities with the SEC. The company is typically required to use its “best efforts” or “commercially reasonable efforts” to file a registration statement and have it declared effective by the end of a specified grace period. The arrangement may also require the company to maintain the registration statement’s effectiveness or to maintain listed status on a stock exchange. A company that fails to meet these requirements may be required to pay the investor until a registration statement is declared effective or its effectiveness is maintained for a prescribed period. The amount to be paid to the investor is often calculated as a percentage of the entire proceeds from the issuance of the securities.

The Staff Position is intended to address diversity in practice in accounting for registration payment arrangements. Some treat the arrangements as freestanding derivatives. Others include them in the evaluation of whether the securities issued are debt or equity.<sup>3</sup>

The proposed Staff Position would require the contingent obligation in a registration payment arrangement to be separately analyzed under Statement 5 and Interpretation 14.<sup>4</sup> As a result,

<sup>1</sup> Proposed FASB Staff Position, Nos. EITF 00-19b, Accounting for Registration Payment Arrangements, EITF 03-6-a, Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities, FAS 141-b, 142-e, and 144-b, Fair Value Measurements in Business Combinations and Impairment Tests, and FAS 144-c, Classifying and Accounting for a Depreciable Asset as Held-for-Sale When an Equity Method Investment Is Obtained, available at [www.fasb.org](http://www.fasb.org).

<sup>2</sup> FASB Statement No. 157, Fair Value Measurements, September 2006, available at [www.fasb.org](http://www.fasb.org).

<sup>3</sup> EITF Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled In, a Company’s Own Stock, available at [www.fasb.org](http://www.fasb.org).

<sup>4</sup> FASB Statement No. 5, Accounting for Contingencies, March 1975, and FASB Interpretation No. 14, Reasonable Estimation of the Amount of a Loss, September 1976, both available at [www.fasb.org](http://www.fasb.org).

while the registration payment arrangement may be considered part of the proceeds received, it would not affect the initial classification of the securities or their subsequent accounting. The proposal would exempt registration payment arrangements from the requirements of Statement 133 and Interpretation 45.<sup>5</sup>

Payments under a registration payment arrangement that are probable and can be reasonably estimated at the inception of the arrangement would be recorded as a contingent liability using the measurement guidance in Statement 5. The remaining proceeds would be allocated to the financial instrument or instruments issued in conjunction with the arrangement based on the provisions of other applicable GAAP. For example, if the securities issued concurrently with the arrangement include a debt instrument and an equity-classified warrant, the proceeds remaining after recognizing and measuring a liability for the registration payment arrangement under Statement 5 would be allocated on a relative fair-value basis between the debt and the warrant as prescribed by Opinion 14.<sup>6</sup>

If the payment first becomes probable and estimable after the inception of a registration payment arrangement, or if the measurement of the liability recognized at inception changes in a subsequent period, the changes would be recognized in earnings.

The final Staff Position would become effective immediately for new and modified registration payment arrangements. Registration payment arrangements that were entered into before the Staff Position is issued would become subject to its guidance

for fiscal years beginning after December 15, 2006 by recognizing a cumulative-effect adjustment in retained earnings as of the beginning of the year of adoption. Adoption of the Staff Position may result in reclassification of some securities from liabilities to equity. Early adoption would be permitted as of the beginning of an interim period if the financial statements for that period have not yet been issued. Retrospective application to periods for which financial statements have been issued would be prohibited. The deadline for submitting comments is December 4, 2006.

### Participating Securities Granted as Share-Based Payment

This proposed Staff Position would require companies to use the two-class method when calculating earnings per share under Statement 128 if unvested share-based-payment awards are entitled to dividends that are nonforfeitable, even if the share-based payment award is forfeited.<sup>7</sup>

For example, if unvested shares give employees nonforfeitable dividend rights, the securities would be considered participating securities when calculating basic earnings per share. In contrast, a share option payment award with an exercise price that is adjusted when distributions are made to common shareholders would not be considered a participating security, because the transfer of value is contingent on the exercise of the award.

The final Staff Position would be effective in the first reporting period beginning after it is posted to the FASB Web site. Retrospective application for all periods presented would be required. The deadline for submitting comments is December 19, 2006.

### Fair Value in Business Combinations and Impairment Tests

The FASB's proposal would clarify that companies are not required to apply the provisions of Statement 157 for fair-value measurements made when applying the provisions of Statements 141, 142, and 144 until Statement 157's effective date.<sup>8</sup> The Staff Position would also require companies that use a present-value technique in a fair-value measurement under those three Statements to base the measurement on the best information available and reflect available assumptions market participants would use in pricing the asset or liability. The proposed guidance would remind companies that the three Statements require market-participant information to be considered to the extent that it is reasonably available without undue cost and effort. Assumptions would permissibly be based on a company's own information if a market participant is likely to use similar assumptions and no contradictory evidence is apparent. Companies would not be required to "undertake all possible efforts to obtain information about" market participants' assumptions.

The final Staff Position would be effective prospectively for fiscal years beginning after December 15, 2006. Early adoption would be encouraged. The final Staff Position would remain effective until the adoption of Statement 157, at which point Statement 157's provisions would have to be applied to fair-value-measurements under Statements 141, 142, and 144. The deadline for submitting comments is November 22, 2006.

<sup>5</sup> FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, June 1998, and FASB Interpretation No. 45, Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, November 2002, both available at [www.fasb.org](http://www.fasb.org).

<sup>6</sup> APB Opinion No. 14, Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants, March 1969.

<sup>7</sup> EITF Issue No. 03-6, Participating Securities and the Two-Class Method under FASB Statement No. 128, and FASB Statement 128, Earnings per Share, February 1997, both available at [www.fasb.org](http://www.fasb.org).

<sup>8</sup> FASB Statement Nos. 141, Business Combinations, June 2001, 142, Goodwill and Other Intangible Assets, June 2001, and 144, Accounting for the Impairment or Disposal of Long-Lived Assets, August 2001, all available at [www.fasb.org](http://www.fasb.org).



This is a publication of KPMG's  
Department of Professional  
Practice—Audit  
212-909-5600

#### Contributing authors:

Michael D. Foley  
Matthew Drucker  
Landon B. Westerlund  
Brian W. Fields

Earlier editions are available at:  
[www.aro.kpmg.com](http://www.aro.kpmg.com)

Defining Issues® is a registered trademark of KPMG LLP. © 2001-2006 KPMG LLP, the U.S. member firm of KPMG International, a Swiss cooperative. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative. All rights reserved. 13205STM

### Held-for-Sale Depreciable Assets

The proposed Staff Position addresses accounting for a long-lived asset that a company plans to sell in a transaction in which it would retain an interest in the asset through ownership of an equity-method investee.<sup>9</sup> A company might, for example, plan to sell a majority of its ownership interest in a subsidiary that includes a long-lived asset and to retain an interest sufficient to give it significant influence over the investee. The proposed Staff Position would require the long-lived asset to be classified as held-for-sale when it meets the relevant criteria under Statement 144, and the company would stop depreciating the long-lived asset when it meets those Statement 144 criteria. When the controlling interest is sold as planned, with the company retaining an investment sufficient to give it significant influence, the company would apply the existing literature on accounting for an equity-method investment.

The final Staff Position would be applied prospectively to long-lived assets that initially meet the held-for-sale criteria in the first reporting period beginning after the final Staff Position is posted to the FASB Web site. Early adoption would be permitted if financial statements for that period have not yet been issued. Companies would continue to follow their current accounting policy for long-lived assets initially classified as held-for-sale prior to the effective date of the Staff Position. The deadline for submitting comments is December 15, 2006.

### Potential Narrow Scope Exception from Statement 133

The FASB at its October 25, 2006 meeting authorized its staff to draft guidance that would permit a narrow scope exception from Statement 133 for securitized interests in prepayable financial assets that meet all of the following criteria.\*

- The investor cannot exercise the right to accelerate the settlement of the securitized interest;
- The underlying financial assets do not contain an embedded derivative subject to bifurcation under Statement 133; and
- The securitized interest itself does not contain an embedded derivative subject to bifurcation under Statement 133 (including an interest-rate-related derivative), which is not solely related to the reallocation of prepayment risk inherent in the underlying financial assets.

A securitized interest that contains any other terms that affect some or all of the cash flows or the value of other exchanges required by the contract in a manner similar to a derivative would be subject to the requirements of paragraph 13(b) of Statement 133 (for example, an inverse floater).

The effect of the potential guidance would be to create a narrow scope exception from Statement 133 for many asset-backed securities, including mortgage-backed securities, that contain only embedded prepayment options. If the criteria in the proposed guidance are met, the embedded derivatives (prepayment options) in those asset-backed securities would not have to be bifurcated under the Statement.

The staff draft would have a 30-day public comment period. That would allow for deliberation in December and final guidance in early 2007, before most reporting deadlines for periods ending December 31, 2006.

\* FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, June 1998, available at [www.fasb.org](http://www.fasb.org).

The descriptive and summary statements above are not intended to be a substitute for the text of the four proposed FASB Staff Positions or any other cited, actual, or potential requirements. Reporting entities complying with adopted requirements or with SEC filing requirements should consult the texts of the applicable documents that set out GAAP and SEC requirements, consider the particular circumstances to which the requirements are to be applied, and consult their accounting and legal advisors.

<sup>9</sup> APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*, March 1971.