



Financial Reporting

Accounting Year In Review: 2005

BDO Seidman, LLP prepared this *Financial Reporting* letter to help our clients anticipate and respond to questions that may arise in connection with financial statements for 2005.

2005 was a year of continued pressure for companies and for financial reporting. The top challenges included:

- Risks and uncertainties associated with natural disasters, airline bankruptcies, rising interest rates, and spiraling energy costs.
- Fresh insights provided by the intense regulatory scrutiny of the past few years, especially initial experiences with internal control reporting.
- A record-breaking number of restatements by public companies.
- Mounting controversy over the benefits of expanded consolidation criteria to users of private company financial statements.
- Staggered effective dates and numerous implementation issues for complex standards, such as accounting for stock options.

More than ever before, the key to successful reporting is to sort through the lessons learned, go beyond the minimum requirements, and select the practices best suited to your business and the users of your financial statements. Throughout this *Financial Reporting* letter, you will find comments on basics and best practices. We hope you find these summaries useful in preparing your 2005 financial statements and in the months to come.

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Contents

Key areas of changes, including the basics and best practices that affect financial reporting this year.

➤ Consolidation of Variable Interest Entities (VIEs) and Limited Partnerships	2
Basics and best practices.....	5
➤ Accounting for Share-Based Payment	5
Basics and best practices.....	8
➤ Revisions and Restatements of Prior Years' Financial Statements	9
Basics and best practices.....	11
➤ Disclosures in a Year of Uncertainty	12
Basics and best practices.....	13
➤ Other Recent Developments in Accounting and Reporting	14
Table of Pronouncements	23
Summary of Effective Dates	28
For More Information.....	41

Consolidation of VIEs and Limited Partnerships

Accounting guidance on consolidation practices continues to evolve, leaving companies to consider adding more entities to consolidated statements in 2005.

In response to investor outcries about off-balance sheet entities, the FASB rushed out a new model of consolidation in 2003. This model is designed to take into account risky entities whose losses or debt might need to be absorbed by the reporting entity. The guidance took effect in stages, and it has been continually refined as large public companies pointed out the rough edges.

New guidance issued during the past year clarifies the consolidation criteria for implicit interests in variable interest entities (VIEs). All companies, regardless of the extent to which they have already applied the prior guidance on VIEs, need to consider the effects of the new guidance on their 2005 financial statements.

How have the requirements evolved, and what is the most recent guidance on VIEs?

The consolidation criteria for variable interest entities (VIEs) are spelled out in FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, and related revisions. The resulting requirements took effect in 2003 and 2004 for public companies and newly established VIEs of private companies.

For 2005 financial statements, the latest guidance consists of the revised version of the standard, Interpretation 46(R), plus a series of FASB Staff Positions (FSPs) culminating in issuance of FSP FIN 46(R)-5, "Implicit Variable Interests under FASB Interpretation No. 46(R)."

Though the path has been difficult, private companies have benefited. The

resolution of implementation issues has left these companies with a clearer view of the requirements when applying the standard for the first time in 2005 to entities that predate the 2003 Interpretation.

What lessons about accounting for VIEs were learned during the past few years?

The upshot of the changes over the past few years is that the FASB has kept the basic VIE model, narrowed the entities that must be evaluated for possible consolidation, and clarified some of the more complex areas.

- *The basic model.* Under the basic consolidation model for VIEs, the most definitive characteristic of a VIE is that it can't stand on its own, that is, the entity has insufficient equity to finance its activities without additional subordinated financial support. A second characteristic is that the entity has a group of equity owners that through their equity holdings do not control decisions involving the entity's activities, absorb the entity's expected losses, or receive expected residual returns. A third characteristic is that the entity has an investor who conducts substantially all the entity's activities with disproportionately few decision-making rights relative to his rights and obligations to absorb losses or receive residual returns. Any one of these three traits can suffice to make an entity a VIE.
- *The entities to be evaluated.* Initially the model required evaluation for possible consolidation of many

conventional entities, such as joint ventures and partnerships. To narrow the entities that need to be evaluated, the revised version of the Interpretation scoped out business entities, except for those cases where the reporting entity and/or its related parties participated significantly in the design or redesign of the entity. The revised version also provided grounds for excluding joint ventures and franchisees, with the result that many of these entities do not need to be evaluated for possible consolidation.

- *The clarifications.* The more significant clarifications include FSP FIN 46(R)-2 and FSP FIN 46(R)-5. FSP 46(R)-2 clarified the meaning of expected losses. This is a critical term because it plays a pivotal role in the identification of the primary beneficiary, (i.e., the company that consolidates the VIE). The primary beneficiary is the holder of variable interests that absorb a majority of the entity's expected losses or receive a majority of the entity's expected residual returns. The FSP reiterated that the term "expected losses" means unfavorable variability rather than actual reported losses under generally accepted accounting principles. FSP FIN 46(R)-5 further clarified that variable interests can be implicit, (i.e., rights and obligations can arise under oral agreements).

Are there any open issues yet to be resolved?

One significant issue remains unresolved—what type of variability should be considered in identifying variable interests. Accountants have debated whether the type of variability is risks of fluctuations in cash flows, fair values of assets, both, or risks that the VIE was "designed" to bear. This is a fundamental issue, yet it has proved difficult to resolve.

Neither the FASB's resource group on Interpretation 46 issues nor the Emerging Issues Task Force was able to resolve it. At the end of November, the FASB issued proposed FSP FIN 46(R)-c, embracing the "design" approach, for comment. At this writing it has not been issued in final form.

Fortunately, for most VIEs, all four approaches yield a similar result. For highly structured VIEs with significant derivatives positions, the approaches can yield different results.

What judgments must companies make in analyzing implicit variable interests?

Often the owners of private companies own the real estate used in the business, and they make it available to the business under an operating lease agreement. If there isn't any separate entity, then the standard doesn't apply. But, if a family-owned leasing entity is involved, there may be a need to consolidate the entity, and the company should ask itself a series of questions.

1) *Is the leasing entity a VIE?*

The answer to this question will depend on the adequacy of the entity's capital. The FASB has provided a quantitative guideline that an equity investment of less than 10 percent of the fair value of an entity's assets indicates that the entity is a VIE. But that is only a guideline, and companies should also consider qualitative factors in determining if the entity is a VIE. Some red flags that would indicate the leasing entity may be a VIE:

- Guarantees from other entities or the owner.
- Subordinated debt (e.g., second mortgages or intercompany loans).
- Above-market lease payments or management fees.

If the entity is a VIE, the company then goes to the next question.

2) *Does the operating company have a variable interest in the VIE?*

The answer to this question requires an understanding of both oral and written agreements to determine who absorbs favorable or unfavorable fluctuations in the cash flows or asset values of the leasing entity and the reasons why it was set up the way it was. The key test of a variable interest is whether the relationship is such that the operating company will participate in the risks and rewards of the leasing entity. This can be accomplished via any of the red flags mentioned above. Some specific techniques:

- Spreading ownership of the operating and leasing companies across different generations of family members, with an understanding that the operating company will absorb losses of the leasing entity.
- Providing a guarantee of the residual value of the leased property or equipment.
- Giving the operating company an option to purchase the leased assets at a fixed or formula price or to renew the lease at a fixed or formula price.

If the leasing entity is a VIE and the operating company has any variable interest, the company then goes to the next question.

3) *Who is the primary beneficiary?*

The answer to this question involves a determination of the individual family member or company that is most closely associated with the leasing entity. If the leasing entity leases exclusively (or almost exclusively) to the operating company, then the operating company is generally considered the most closely associated party, with the result that it must consolidate the leasing entity.

The establishment of adequate controls to ensure identification and evaluation of all VIEs can be a challenging task.

How can companies be sure they have identified all their VIEs?

Public companies are required to have controls in place over their accounting practices. The establishment of adequate controls to ensure identification of all VIEs can be a challenging task, and the consequences of missing one can affect control reporting. If the external auditor discovers a VIE that the company did not disclose to the auditor, the auditor must consider whether a significant control deficiency or material weakness exists that should be reported.

The challenges can be equally difficult for privately held companies because these companies are more likely to have implicit variable interests and less likely to have formal control procedures in place to identify all VIEs and variable interests in them.

There are a variety of techniques available to help companies ensure they have identified their entire population of VIEs. The techniques for explicit interests tend to be easier to describe and verify.

- *Explicit interests.* Techniques for identifying explicit interests generally involve analysis of investment and sales transactions, including equity investments or ownership interests, loans or notes receivable, guarantees, insurance contracts, derivatives, management and other service contracts, leases, and research and development activities.

Financial Reporting

- *Implicit interests.* The identification of potential VIEs based on implicit variable interests generally demands a sound and thorough understanding of the business and the relationships between entities and shareholder groups.

Both explicit and implicit interests need to be verified in an audit, and companies can expect that auditors will seek supporting evidential matter. Common audit procedures are to inquire as to the existence of any unwritten agreements with other entities, whether related or unrelated, and to obtain information about the financial capability of the counterparties to certain transactions. Auditors may also confirm significant information with counterparties, intermediaries, banks, guarantors, agents or attorneys.

A good aid to help identify and understand the documentation that companies should compile, as well as the questions they should be asking about VIEs, is the AICPA's Practice Alert 2005-1, *Auditing Procedures with Respect to Variable Interest Entities*. The alert is written for auditors, but much of its content will be of help to companies too. The alert is available on the AICPA's web site.

Will users of financial statements benefit from the changes in the consolidation standards?

Interpretation 46(R) and the related FSPs were prepared in response to the outcries of investors in public companies, but the standard has triggered controversy over the benefits to users of private company financial statements, particularly in view of the added costs and information required to include VIEs in consolidated financial statements.

It is not uncommon for private company leasing entities to have only income-tax-basis accounting records. Additional costs might be necessary to upgrade their bookkeeping systems

and maintain them on a regular basis. Further, some leasing entities may never have been audited before, and a first-time audit of them would add to the cost of audited financial statements. Then too, some owners of private companies may wonder if the users of their financial statements, such as bankers, need to see the consolidated statements.

Interpretation 46(R) has triggered controversy over the benefits to users of private company financial statements.

If consolidated financial statements are onerous to private companies, the owners can consider injecting more capital into the leasing entities so that these entities do not meet the definition of a VIE. Alternatively, they can consider a qualified report from their auditors or switching to an accounting basis other than GAAP. In the final analysis, decisions about the utility to users of private company financial statements must be made on an individual basis, based on the respective facts and circumstances.

How should companies treat limited partnerships that are not VIEs?

2005 also saw a major change in consolidation guidance for limited partnerships and similar entities. In June 2005, the Emerging Issues Task Force (EITF) reached a consensus on Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights."

Basically, the consensus indicates that the general partner is presumed to con-

trol a limited partnership and therefore should consolidate the partnership and show the limited partners' interests as minority interests, unless the limited partners have either substantive "kick-out rights," or substantive participating rights.

- *Kick-out rights* refer to the ability to dissolve the limited partnership or otherwise remove the general partners without cause. Substantive kick-out rights are those that can be exercised by a vote of a simple majority of the limited partner voting interests, provided there are no significant barriers to the exercise of the rights.
- *Participating rights* refer to the ability to effectively participate in significant decisions that are expected to be made in the ordinary course of the limited partnership's business. Substantive participating rights are similar to the rights described in EITF Issue No. 96-16, "Investor's Accounting for an Investee When the Investor has a Majority Shareholder or Shareholders Have Certain Approval or Veto Rights."

The consensus was effective on June 29, 2005 for new and modified partnership agreements. For pre-existing agreements that are not modified, the consensus is effective the first fiscal reporting period beginning after December 15, 2005.

The FASB made a conforming change in the accounting guidance for real estate partnerships so the same framework will apply for real estate partnerships as for any other kind of limited partnership. This change is reflected in FSP SOP 78-9-1, "Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5."

Basics and Best Practices

What's Required. All companies, both public and private, must comply with Interpretation 46(R) and related FSPs in 2005 financial statements that are prepared in accordance with GAAP. All companies, both public and private, must comply with EITF Issue 04-5 and the related FSP in 2005 financial statements for newly created limited partnerships and in 2006 financial statements for pre-existing limited partnerships.

What's Voluntary. Depending on their individual facts and circumstances, companies may wish to:

- Read AICPA's Practice Alert 2005-1, *Auditing Procedures with Respect to Variable Interest Entities* and consider if additional controls might help ensure all VIEs are identified and evaluated.
- Weigh the costs and benefits of injecting additional capital into leasing entities or other entities that involve implicit variable interests.
- Consider the pros and cons of other changes that would enable a leasing entity or other VIE to have sufficient equity to stand on its own so it would not meet the definition of a VIE.
- In the case of a private company that finds consolidation of its VIEs onerous, consider the purposes for which audited financial statements are required and the needs of the users of those financial statements, then consult with your accounting firm. Perhaps a special purpose presentation would be more suitable than GAAP financial statements.

Accounting for Share-Based Payment

Many of the largest public companies got a temporary reprieve on FASB Statement 123(R), but issues identified by early adopters can help other companies.

When the FASB released Statement No. 123(R), *Share-Based Payment*, the Board's expectation was that large public companies would adopt the standard in the second half of 2005, six months before smaller public companies and private companies. But the SEC leveled the playing field in April 2005 by effectively providing a six-month reprieve for the larger calendar year companies. Now companies of all sizes are required to adopt the standard in 2006. The experiences of early adopters may help pave the way.

What are the main changes required by Statement 123(R)?

The main focus of Statement 123(R) is on awards to *employees*. The Statement applies to transactions in which a company grants shares of common stock, stock options, or other equity instruments to its employees. Included in this category are restricted stock, share-settled appreciation rights (SARs), cash-settled SARs, and employee stock purchase plans.

Five key changes made by the Statement are summarized below:

1. Statement 123(R) requires that the fair value of stock options and other share-based compensation be deducted from earnings and shown as an expense in the financial statements. Formerly, the information was required in the footnotes.
2. With rare exceptions, Statement 123(R) indicates that the *intrinsic value method* of accounting can no longer be used to measure stock-based compensation awards. Instead, the *fair value method* must be used.

The intrinsic value method provides a simple measure of what an employee would get if he or she cashed in an option. The value is zero if the exercise price equals the price of the underlying share at the grant date. A prior accounting standard, APB Opinion No. 25, *Accounting for Stock Issued to Employees*, allowed the use of this method for expense recognition, resulting in zero expense for many awards of stock options.

The fair value method required by Statement 123(R) demands assumptions about future conditions because it requires companies to take into account the time value of options. In effect, this is the value to a hypothetical outsider who would take into account the probabilities of future outcomes, including the probability that the stock will go up in value during an option's life.

3. Under Statement 123(R), substantially all plans are considered compensatory, with the result that companies must recognize compensation cost for employee services received in exchange for equity instruments. Opinion 25 treated a significant number of qualified broad-based stock purchase plans as non-compensatory.

4. When applying the fair value method, the accounting for compensatory plans depends on whether the rights under the plan constitute equity interests or liabilities. A key difference is that the fair value of a liability award is reestimated every period from grant until exercise; whereas for equity awards the fair value is estimated only once, at grant date.

Financial Reporting

For awards classified as equity, the compensation cost is measured at the estimated grant-date fair value of the award. Compensation is accrued for the awards expected to vest, based on estimated forfeitures and the expected outcome of certain conditions that affect vesting. The cost is recognized over the requisite service period (usually the vesting period). Compensation cost is adjusted to reflect actual forfeitures. Forfeited awards generally result in no compensation cost.

5. Most of the guidance in Statement 123(R) applies to both public and nonpublic companies, but some provisions apply only to nonpublic companies. For example, nonpublic companies can use alternative valuation methods not available to public companies.

What judgments are needed in expensing share-based payment?

Although it may seem a simple matter to take a number from the footnotes and move it into the statements, the standard has been plagued by controversy and fraught with implementation issues. Three key questions that companies may need to ask themselves are as follows:

1) *Has the company accurately determined if the plan creates a liability or equity?*

Awards are classified as liabilities if they have one or more of the following traits: (a) they possess conditions or features indexed to something other than a market, performance or service condition, (b) they require a company to pay an employee (either on demand or on a specified date) cash or other assets, (c) they are exchanged for mandatorily redeemable preferred stock or another instrument that, after the award is exercised, would be classified as a liability under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and*

Equity, or (d) they have repurchase features that would permit an employee to avoid assuming the risks and rewards normally associated with stock ownership.

If an award is not classified as a liability, then it is classified as equity.

2) *Has the company chosen the most suitable pricing model and most accurate assumptions?*

The Statement provides that companies should use valuation models if suitable market prices are not publicly available. The best-known families of models are lattice (for example, binomial) and closed-form (for example, Black-Scholes) models. Both require assumptions about forward-looking data, such as expected option terms (i.e., the length of time employees will hold options before exercising them) and expected future volatility, (i.e. the degree to which the price of the company's shares fluctuates in the marketplace).

When choosing between the two types of models, the important considerations include the facts that the Black-Scholes model is generally easier to use and audit, while the binomial model provides more flexibility to address unique aspects of employee options.

3) *Has the company made the right choice of the alternative methods available for private companies?*

Nonpublic companies have some simplified alternatives. For liability awards, they can measure the compensation cost of awards at intrinsic value each period through the date of settlement. For equity awards (and for liability awards if they don't choose intrinsic value), they can use a calculated value method in which the volatility assumption is based on an appropriate industry-sector index. The minimum value method, which uses a

volatility assumption of zero, is no longer permitted.

Will users of financial statements understand and accept the expense?

Some level of confusion is expected. This is based on the experiences of early adopters and the mixed reactions of the Wall Street securities analysts who follow larger public companies.

At least one major company that early adopted Statement 123(R) has announced a formal SEC inquiry into the way it announced its adoption of the standard. The problems surfaced because the per share impact given to analysts differed from the actual per share impact later reported to shareholders.

In addition, analysts disagree on the usefulness of taking the fair value compensation numbers from the footnotes and putting them in the income statement. Some analysts have said their forecasts will follow the GAAP treatment. Others have been openly skeptical of the largely subjective nature of the forward-looking assumptions required under Statement 123(R). These analysts say they prefer to add back the expense subtracted for accounting purposes, and they will use pro forma earnings that exclude the options expense. As a middle ground and interim measure, still others say they will provide forecasts both with and without options expense, at least until the end of 2006.

Arguably one factor that has fueled the skepticism among analysts and others is an early report involving a study of Russell 1000 companies conducted by Nashville-based research firm New Constructs. A key finding of the study is that one in five companies had revised their volatility assumptions downward in 2004, the year before they expected to start expensing options. As a result, these companies were able to significantly lower their

options expense for the succeeding year. (Cutting through the complicated models, the underlying logic is simple: Lower volatility means a lower probability that an option will land deep in the money, and that in turn lowers the estimated fair value at the grant date.)

The SEC staff cautioned registrants that employee compensation from share-based awards should be classified in the same line on the income statement as other forms of compensation. Also, if a company chooses to present pro forma earnings excluding share-based compensation, that is a non-GAAP measure that excludes a recurring expense and would be subject to the SEC's disclosure requirements.

What should companies disclose about accelerated vesting of share-based payment awards during 2005?

SEC Staff Accounting Bulletin (SAB) 107 reiterates the disclosures recommended by the SEC staff at the 2004 AICPA Conference on Current SEC Developments—disclosure that vesting was accelerated, the effect on recorded and pro forma compensation in 2005, and an explanation of the business reasons why vesting was accelerated.

What are the special challenges and solutions for smaller public companies?

The skepticism about meaningful estimates of fair value may be especially acute when it comes to the numbers reported by smaller public companies. A small change in the assumptions can make a big difference in the amount expensed, and the assumptions can be especially troublesome for smaller public companies in at least four areas.

1. *Expected volatility.* Smaller public companies may not be able to use historical data as a benchmark for estimating expected volatility. This is especially true of thinly

traded companies. As a work-around, these companies may wish to use weekly or monthly quotes instead of daily ones to calculate their historical volatility. Then too, they may wish to incorporate data from similar companies at the same stage of their life cycles.

2. *Estimated forfeitures.* Like other companies, smaller public companies must estimate forfeitures. Typically, this calculation takes into account an assumption about the number of employees who will leave before their options vest and thereby forfeit their awards. These can be difficult estimates for smaller public companies because they have granted options to relatively fewer people, and they don't have a big enough sample from which to draw statistically valid inferences. As a result, these companies may wish to aggregate their data with that of other companies in similar circumstances.
3. *Expected terms of options.* Statement 123(R) requires assumptions about the length of time employees will hold options before exercising them. SAB 107 provides a shortcut for 2006 and 2007 under which a company may use an arithmetic average of the time elapsed between vesting dates and expirations dates. Companies may wish to consider the shortcut while accumulating their own data about employee exercise behavior. At the end of two years, they may have enough company-specific data; if not, they may wish to look for data on comparable companies.
4. *Separate employee groups.* Companies are required to stratify their assumptions based on data from separate groups with different vesting or exercise patterns, (e.g., executives and rank-and-file employees). Smaller public companies in which options have not been widely distributed may need to assess whether there are sufficient

grant recipients to break down the employees into separate groups and get a meaningful result.

Accountants may need to expand their reading lists to benefit fully from the FASB's informal reviews of implementation issues.

What lessons can companies learn from the experiences of larger public companies?

Smaller public companies can benefit from the experiences of larger public companies, but the lessons learned are only partly reflected in the accounting literature. As a result, accountants may need to expand their reading lists to benefit fully from a new process the FASB has put in place for informal review of implementation issues on accounting for share-based payment.

1) *How can companies learn from the implementation issues raised by others?*

The FASB's new process for identifying implementation issues revolves around a resource group comprised of preparers, auditors, and consultants, with observers from the SEC and PCAOB staffs. Similar in some ways to the EITF, the resource group has as its objective the timely resolution of emerging issues, with an emphasis on identification of issues that may require more guidance from the FASB.

For questions that were not referred to the Board for additional guidance, companies can consult the minutes of meetings of the FASB's resource group. The group met three times in 2005. Summaries of the meetings are available on the website of Financial Executives International.

Financial Reporting

2) *Can companies simplify the accounting for the income tax effects of share-based payments?*

Questions have arisen about the income tax effects because the tax deductions for share-based compensation are based on intrinsic value and taken at the time of exercise (options) or vesting (restricted stock).

Companies accrue deferred taxes for tax-deductible share-based payment awards as they accrue the accounting compensation expense, but the actual tax benefit realized typically differs from the deferred tax benefit.

If the actual tax benefit realized exceeds the deferred tax benefit (a “windfall”), the excess is credited to capital. If the actual tax benefit realized is less than the deferred tax benefit, the shortfall is offset against prior credits to capital. If the prior credits are insufficient, the shortfall is charged to income.

To simplify these calculations, Statement 123(R) permits a pooling of amounts that are reflected in additional paid-in capital (the APIC pool). To many companies’ surprise, the beginning balance of the APIC pool is not the actual amount the employer credited to shareholders’ equity in prior years. Instead, it is the hypothetical amount that the employer would have credited to capital since 1995 if it had followed the fair value method of original Statement 123. Because companies may not have the information needed to establish the beginning balance of the APIC pool, the FASB issued FSP FAS 123(R)-3, “Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards,” to provide an alternative elective “shortcut” transition method for calculating a company’s historical pool of windfall tax benefits upon its adoption of Statement 123(R).

3) *Can companies simplify their accounting for grants to retirement-eligible employees?*

Questions have arisen about grants to retirement-eligible employees because Statement 123(R) requires that compensation expense be recognized over the period when services are provided by employees.

When applied to grants to retirement-eligible employees who are permitted to retain their awards upon retirement, this requirement means that the company must accrue compensation over the period from grant date to the earliest retirement date. This represents a change from prior practice under which many companies accrued the compensation over the stated service period, and it may require systems upgrades to track awards granted to retirement-eligible employees.

To help simplify the accounting, the SEC staff indicated that companies meeting certain conditions for past practice should apply this requirement prospectively to new grants awarded after adoption of the standard. Those companies should continue to apply their historical accounting policy for previous awards by accruing compensation over the stated service period, with appropriate disclosure.

4) *Can companies simplify their accounting for share-based compensation included in inventory or self-constructed assets?*

In SAB 107, the staff noted that many companies may not yet have integrated systems that accumulate share-based compensation with their cost accumulation systems for inventory or for self-constructed assets. The staff noted that it would be acceptable to make reasonable estimates of the amount of share-based compensation that should be capitalized in these assets rather than incurring costs to immediately integrate these systems.

In addition, the SEC has provided guidance on valuation issues in SAB 107 and in a report by the Office of Economic Analysis on the evaluation of various market-based approaches for estimating the grant-date fair value of employee stock options.

Basics and Best Practices

What’s Required. Calendar-year companies must adopt Statement 123(R) in 2006. This means first quarter 2006 for public companies and as of the beginning of the year for non-public companies. As part of adoptions, companies should:

- Test any software programs or spreadsheets used to develop accounting entries for compliance with the requirements of the Statement.
- Estimate forfeitures on all outstanding awards and accrue compensation going forward based on estimates of awards that will vest.
- If the outstanding grants include awards with graded vesting, decide whether to use the straight-line method to accrue compensation in 2006 and future years.
- Disclose the impact of adopting Statement 123(R).

What’s Voluntary. To go beyond the minimum, companies should:

- Read the minutes of the meetings of the FASB resource group.
- Evaluate the need for systems upgrades or data on comparative companies.
- Monitor the reactions of users of financial statements.
- Reevaluate key assumptions, such as volatility assumptions, prior to adoption of the standard and exercise care in communicating any revisions.
- Carefully communicate the effects of adoption, especially in a period for which the company is reporting earnings results that might be seen as disappointing.

Revisions and Restatements of Prior Years' Financial Statements

FASB Statement 154 brings the reporting for accounting changes more in line with restatements, signaling a need for more revisions and careful communications.

In May 2005, the FASB issued Statement No. 154, *Accounting Changes and Error Corrections*. The statement, which was issued as part of the Board's efforts to converge U.S. with international standards, will result in more frequent revisions of prior years' financial statements.

How does Statement 154 increase the number of revisions of prior years' statements?

The FASB says that revising prior years' financial statements (called retrospective application) is now the default method of adopting new accounting standards. Unless the FASB specifically decides that another transition method is preferable for an individual standard or EITF issue, they will use retrospective application.

In addition, in a departure from past practice, retrospective application is now the normal method for reflecting voluntary changes in accounting principles. An example would be a change from the LIFO to FIFO method of inventory valuation for financial statement purposes. Under this approach, the cumulative effect of the change is taken into beginning retained earnings for the earliest period presented, and the prior years' statements are restated as if the company had always used the new principle.

In contrast, the prior accounting standard, (APB Opinion No. 20, *Accounting Changes*) generally required that the cumulative effect of a

change in accounting principle be recognized in net income in the year of change. The prior period financial statements were not restated, but supplemental pro forma disclosures were required.

Will retrospective application differ from restatements for error corrections?

Statement 154 treats retrospective application substantially the same as corrections of errors in prior periods, except that the revisions differentiate between direct and indirect effects and retrospective application is not required when impracticable.

- *Restatement of direct effects.* Only the direct effects of a change in accounting principle, net of any related income tax effects, are adjusted under Statement 154. Indirect effects, such as a current or future payment related to a profit-sharing plan in a prior period, are reported in the period the accounting change is made—not in the prior period. This treatment differs from the one used for error corrections because there is no distinction between direct and indirect effects in a restatement to correct an error.
- *An exception for impracticability.* Statement 154 provides relief from retrospective application for changes in accounting principle at times when it is impracticable to determine (a) the effects on a specific period or (b) the cumulative

effect of the change on all prior periods presented in the financial statements. In these cases, companies must apply the accounting principle in the earliest period practicable and make certain disclosures.

Has the FASB provided a clear test of "impracticability"?

Statement 154 permits companies to avail themselves of the impracticability exception if they are unable to meet the requirement to adjust prior years' statements after making every *reasonable effort* to do so.

For example, some retrospective applications may require assumptions about management's intent in a prior period, and the intent cannot be independently substantiated. Other retrospective applications may require significant estimates of amounts in prior years for which objective information is unavailable or hindsight is unavoidable.

But there is no clear test of what is significant or what constitutes a reasonable effort. These determinations will require judgment.

Will changes in accounting estimates require retrospective application?

Consistent with past practice, changes in accounting estimates do not require restatement of prior periods under Statement 154. Instead, the effects of these changes are reported prospectively—with no prior period adjustments or pro forma disclosures.

The reason for prospective treatment is that changes in accounting estimates are based on the discovery of new information or subsequent developments. In contrast, changes in accounting

Financial Reporting

principles and error corrections do not involve new information.

Which kinds of changes require demonstration of preferability?

For all voluntary changes in accounting principles, a company must demonstrate that the new method is preferable to the existing one.

Changes in accounting estimates require demonstration of preferability, if they fall into the category known as "changes in accounting estimates effected by changes in accounting principles," (i.e., the change in an accounting estimate is inseparable from the effect of a related change in accounting principle). An example would be a switch from an accelerated method of depreciation to the straight-line method.

What costs are associated with revisions and restatements?

Revisions and restatements involve the following types of costs:

- *Time and effort for revisions.* More time is typically needed to restate financial statements than to prepare pro forma disclosures.
- *Audit costs.* If the PCAOB does not change current auditing standards, companies that have switched auditors may need to engage the prior auditors to audit retrospective adjustments of prior year financial statements on which they opined. If the prior auditors are not independent, a company may need to incur costs to have their current auditors re-audit prior period statements.

- *Communications costs.* Another cost is the added effort involved in explaining changes to users of financial statements. Under Statement 154, the 2005 financial statements could look different each time they are presented, (e.g., in the 2006 and subsequent years' annual reports.)

Will investors or other users confuse retrospective application with restatements?

Without a clear message from management, investors and other users of financial statements may have difficulty distinguishing retrospective applications of new accounting principles (the good "R") from those that result from corrections of errors or fraud (the bad "R"). To overcome this challenge, companies should word their disclosures carefully.

Accounting Changes and Error Corrections Before and After Statement 154

Accounting Change	Accounting Treatment		Preferability Requirement?	Reactions of Users
	Before Statement 154	After Statement 154		
Changes in accounting principles				
Changes required by the FASB	Follow the transition guidance in the standard.	Follow the transition guidance in the standard. Retrospective application is likely to be required more often.	Not necessary for changes required by the FASB.	May depend on the transition guidance. Use careful wording, if retrospective application is required.
Voluntary changes	Do not restate prior period financial statements. Recognize the cumulative effect in net income.	Restate prior period financial statements. Adjust beginning retained earnings.	Yes. Companies must demonstrate preferability.	Confusion is possible. Use careful wording.
Changes in accounting estimates				
A change in estimate effected by a change in accounting principle	Apply the change prospectively.		Yes. Companies must demonstrate preferability.	n/a
All other changes in accounting estimates	Apply the change prospectively.		No, unless required by a specific standard.	n/a
Error corrections				
A mistake discovered by the company or its auditors or an error whose correction is mandated by regulators.	Restate prior period financial statements. Adjust beginning retained earnings.		n/a	Negative reactions have historically been the norm. But attitudes may be changing.

Will Statement 154 affect the frequency of voluntary changes in accounting principles?

Voluntary changes from one acceptable accounting method to another preferable accounting method are relatively infrequent. Now that Statement 154 requires many such voluntary changes to be applied by retrospective application, those changes will be more costly to implement for the reasons discussed above.

On balance, the decision of whether the benefits of a voluntary change are worth the costs will be a matter of individual facts and circumstances, and the reactions of users of financial statements should be considered.

Can useful insights be gleaned from recent restatements?

Tough audits and greater regulatory scrutiny under the Sarbanes-Oxley Act, as well as growing demands for corporate accountability, have led to a record-breaking number of restatements in the past few years. Many of the errors appear to have been identified by registrants rather than the SEC. This trend may help shape investors' attitudes about future revisions and restatements.

According to a study by Huron Consulting Group, the number of restatements filed with the SEC increased 77 percent from 2000 to 2004. Research by Glass Lewis found that restatements grew more than 50 percent from 2004 to 2005. Citing research statistics compiled by Glass Lewis, the *New York Times* reported 1,031 restatements through the end of October 2005, compared with 650 for all of 2004 and only 270 in 2001, the year that Enron collapsed.

A significant factor adding to the number of restatements in 2005 was the

desire to avoid being caught in an issues "sweep" in which regulators identify an issue with one registrant, then expand their investigations to other companies likely to be affected by the same issue.

The issues that sparked waves of restatements in 2005 included industry-specific reviews, (e.g., oil and gas issues). But they also involved cross-cutting issues, such as accounting for leases. The lease accounting issues were most likely to affect restaurants or retailers, but they also arose in other industries. The resulting restatements and adjustments did not follow a change prescribed by an accounting standard-setter or regulator, and they seemed to take many companies by surprise.

A recent wave of restatements may help shape investors' attitudes about revisions of prior years' statements.

How can companies spot the warning signs of a wave of impending restatements?

Suggested steps for staying informed about restatements:

- Read the Technical Practice Aids released by the AICPA.
- Monitor SEC filings of competitors or other registrants in similar lines of business to identify the reasons for restatements on Form 8-K. Under SEC Release No. 33-8400, effective in August 2004, a Form 8-K must be filed for restated financial statements within four business days of the date when it is determined that previ-

ously issued statements should no longer be relied upon.

- Monitor the news for reports of SEC information requests and/or enforcement actions. Recent headlines have focused on such issues as the assumptions used for pension accounting and possible misapplication of the "shortcut" method of accounting for hedges.
- Participate in industry and trade associations.
- Consult with your audit firm.

Basics and Best Practices

What's Required. Companies that prepare their financial statements in accordance with generally accepted accounting principles (GAAP) must adopt Statement 154 no later than 2006.

What's Voluntary. To go beyond the minimum requirement and stay ahead of the trends, companies can:

- Read the Technical Practice Aids published by the AICPA.
- Monitor SEC filings and news headlines.
- Consult with accounting firms or industry and trade associations.

For many companies, it comes down to a matter of identifying and putting in place the type of "early warning system" that is best suited to the company's size and industry.

Disclosures in a Year of Uncertainty

Natural disasters, rising interest rates, changing tax laws, increased regulatory scrutiny, milestones in internal control reporting – all help shape disclosures for 2005.

To provide adequate and meaningful disclosures in the footnotes to 2005 financial statements, companies should consider how the level of subjectivity in the statements might have changed in a year of regulatory and economic uncertainty.

What types of events and trends need to be disclosed?

Natural disasters, rising energy prices, increasing interest rates and risks of inflation, pending pension legislation, changes in tax laws, labor unrest over benefit cutbacks, and product safety concerns are all examples of events and trends that can affect accounting estimates and result in risks and uncertainties that may need to be disclosed.

The specific disclosure requirements reside in various places in the accounting and SEC literature. In addition, AICPA Statement of Position (SOP) No. 94-6, *Disclosure of Certain Significant Risks and Uncertainties*, provides a basic framework for footnote disclosures not specifically required in other parts of GAAP.

Among other things, the SOP requires disclosures in the following areas:

- *Uncertainties about changes in estimates.* Disclosures are required about an accounting estimate if it is at least reasonably possible that the estimate will change in the near term and the effect of the change will be material to the financial statements.
- *Risks due to concentration of customers or suppliers.* Disclosures

are required about a company's dependence on doing business with a particular customer, or in a particular geographic region, or with a particular source of supply or labor force, if any of these factors make the company vulnerable to the risk of a near-term severe impact.

Are there any areas of heightened risks and uncertainties for 2005 financial reporting?

There are several areas of disclosures that are of heightened concern in 2005 financial statements. Depending on the nature of its business and the composition of the users of its financial statements, a company may need to use extra care on disclosures related to interest rates, consumer spending patterns, and supply chain disruptions. Following are examples of questions a company might ask itself.

1. *Does the company's pension discount rate reflect current interest rates?*

The SEC has been challenging assumptions about the discount rates used by public companies in calculating the present value of their pension obligations.

Discount rates typically rise and fall with interest rates. Although FASB Statement No. 87, *Employers' Accounting for Pensions*, explains that discount rates should reflect either the rates of return on high-quality bonds or the rates implicit in annuity contracts, significant variations in assumed discount rates persist.

Recently, the SEC staff indicated that registrants with material pension obligations should disclose information about how the discount rate was determined and what source rate was used. The disclosure can be made either in the footnotes or in the "critical accounting policies" section of Management's Discussion and Analysis

The SEC's position goes beyond the requirements of GAAP and may sensitize investors and other users of financial statements to expect similar disclosures from nonpublic companies.

2. *Has the company made realistic assumptions about gift cards and sales incentives?*

Retailers may need to consider the level of uncertainty in their assumptions about consumer spending patterns in general and breakage of sales incentives in particular. An example of breakage that has come to the attention of the SEC staff involves the percentage of gift cards that are expected to expire unredeemed.

With interest rates and inflation rising at the same time that the volume and varieties of gift certificates and rebates continue to expand, companies may not have sufficient experience on which to base their assumptions about the percentage that will be used or claimed. The difference in assumptions can be important to users of financial statements because it can have a significant effect on performance measures, including key ratios and earnings per share.

Nonpublic companies that wish to stay informed of the types of information requested by the SEC staff about assumptions used in revenue recognition and pension or OPEB (post retirement benefit obligations other than pension) calculations can monitor the SEC comment letters that are now publicly available on the SEC's website.

Financial Reporting

3. Are the company's customer or supply chains vulnerable to disruption?

In the wake of natural disasters, such as Hurricane Katrina, the area of risk preparedness has surfaced as a concern to creditors and other users of financial statements. A study commissioned by FM Global and conducted by Harris Interactive in 2005 found supply chain disruptions were considered the Number One threat to revenues. The study involved financial executives of large companies based in North America.

These findings underscore the growing importance of protecting supply chains in an era of rising insurance premiums and changing claims practices. In response to this changing environment, disclosures about risk reduction techniques may take on added significance.

Are there any changes in tax-related disclosures?

The American Jobs Creation Act of 2004 requires disclosure of certain information about tax penalties related to tax shelters, including penalties on reportable and listed transactions. Corporations, S-corporations, partnerships, trusts, and individuals are all subject to these penalties.

The need for disclosure of penalties in annual reports is limited to large public companies. These companies must disclose the penalties on their Forms 10-K (or similar annual report forms for other companies required to file periodic reports with the SEC). If the disclosures are not made, the companies are subject to additional penalties. Details are provided in IRS Rev. Proc. 2005-51.

Not required by GAAP but of concern to some shareholders is the intended use of funds repatriated to the U.S. under tax incentives provided by the Jobs Act. The Act contained a special one-time opportunity to repatriate earnings at a lower tax rate, provided

that those earnings are invested in the U.S. pursuant to a plan of permitted uses. The effective tax rate impact of these repatriated funds may appear as a separate line item on the company's tax rate reconciliation.

The area of control weakness mentioned most often was accounting for income taxes.

Looking beyond the footnotes, what were the accounting areas most frequently mentioned in 2005 internal control reporting?

Moody's Investors Service analyzed the management and auditor reports on internal control for the first year of filings by large public companies. In a report dated April 2005, Moody's said that approximately 5 percent of the companies it rated had reported material weaknesses in internal control.

The areas of accounting mentioned most frequently were:

Control Weakness	% reporting
Income tax accounting	15%
Lease accounting	10%
Revenue and related receivables	8%
Accounts payable and accrued liabilities	7%
Inventory accounting	4%

Moody's noted that weaknesses related to controls over specific account balances or transaction-level processes, such as the above, were considered less severe because auditors could generally audit around these weaknesses. The more troubling weaknesses were related to company-level controls, such as an ineffective control environment, ineffective personnel, or weak financial reporting processes.

Are there lessons in controls for smaller companies?

Several organizations are looking into lessons for smaller public companies. The organizations include the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and the SEC's Advisory Committee on Smaller Public Companies. COSO has published an exposure draft of "Guidance for Smaller Public Companies Reporting on Internal Control over Financial Reporting."

As an overall observation, the initial experiences with control reporting have focused considerable attention on the complexity of accounting. Responses are still evolving. The preliminary recommendations of the Accounting Standards Subcommittee of the SEC's Advisory Committee include:

- Allowing certain smaller public companies to use the same effective dates as private companies for new accounting standards and to report two (instead of three) years of financial information.
- Encouraging the FASB to take into account simplicity and the ease of application when setting new accounting standards.

Basics and Best Practices

What's Required. All companies, both public and private, must disclose significant risks and uncertainties.

What's Voluntary. Depending on their individual facts and circumstances, companies may wish to:

- Monitor the SEC comment letters for emerging disclosure issues.
- Monitor the activities of **COSO** and the **SEC's Advisory Committee on Smaller Public Companies**.

Other Recent Developments in Accounting and Reporting

Summaries of FASB Statements 123(R) and 154, as well as Interpretation 46(R), EITF Issue No. 04-5, and FSP FIN 46(R)-5 were provided in the preceding pages. Additional guidance issued or effective in 2005 is summarized below, with details of effective dates provided in Table 2.

FASB Statements

Statement 150, Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.

Statement 150 changed the accounting for financial instruments in situations where a company is obligated to redeem shares of its own stock.

There were two key changes: (1) The instruments must be classified as liabilities rather than as equity or in the “mezzanine” section of balance sheets where they were formerly permitted. (2) Payments to the holders must be recorded as interest expense, rather than dividends, and changes in value must be recorded in earnings.

The changes took effect in stages. The final stage dealing with instruments that are mandatorily redeemable on fixed dates for amounts that are fixed or determinable, took effect for private companies in periods beginning after December 15, 2004.

Certain provisions remain indefinitely deferred. See Table 2.

Statement 151, Inventory Costs—an Amendment of ARB No.43, Chapter 4.

Statement 151 provides that abnormal amounts of idle facility expense, freight, handling costs, and wasted

materials (spoilage) should be recognized as current-period charges. It also provides that allocation of fixed production overhead to the costs of conversion should be based on the normal capacity of the production facilities.

Statement 152, Accounting for Real Estate Time-Sharing Transactions—an amendment of FASB Statements No. 66 and 67.

Statement 152 was issued in conjunction with AICPA Statement of Position (SOP) 04-2, *Accounting for Real Estate Time-Sharing Transactions*. It amends FASB Statements 66 and 67 to refer to the new SOP.

Statement 153, Exchanges of Nonmonetary Assets—an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions.

Statement 153 addresses exceptions to the use of fair value for nonmonetary exchanges.

The former standard, APB Opinion 29, prohibited the use of the fair value for nonmonetary exchanges of *similar productive assets*. Statement 153 removed that exception and replaced it with a general exception for exchanges of nonmonetary assets that do not have *commercial substance*. The definitions:

- The term *similar productive assets* used in Opinion 29 means assets that are (a) held for or used in the production of goods or services by an enterprise, and (b) are of the same general type, perform the same function, or are employed in the same line of business. Under Opinion 29, exchanges of these assets are valued at the recorded amount of the nonmonetary assets

exchanged (after reduction for an indicated impairment of value, if appropriate).

- An exchange has *commercial substance* as defined in Statement 153 if (a) the configurations of future cash flows (risk, timing, and amount) of the assets differ significantly, or (b) the entity-specific value of the assets received differs significantly from the entity-specific value of the assets exchanged.

Considerable judgment may be required to determine whether an exchange has commercial substance and whether the change in cash flows is significant in relation to the fair value of the assets exchanged.

FASB Interpretations

Interpretation 47, Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143.

The purpose of Interpretation 47 is to provide for more consistent recognition of liabilities relating to asset retirement obligations. Toward that end, the Interpretation clarifies the accounting treatment for obligations that are *conditional*, meaning the timing or method of settlement may be uncertain because it is beyond the control of the reporting entity.

The Interpretation indicates that recognition is required of a liability for a legal obligation to perform asset retirement activities, even if the retirement of the asset is conditional on a future event. An example would be the legal obligation to remove and dispose of asbestos, when a building is renovated or demolished.

The liability should be recorded for the fair value, if it can be reasonably estimated, of the conditional asset

retirement obligation when the liability is incurred, (i.e., generally upon acquisition, construction, or development of the asset or through the normal operation of the asset). Uncertainty about the timing or method of settlement should be factored into the measurement of the liability when sufficient information exists.

EITF Consensuses

The FASB's Emerging Issues Task Force reached consensuses in 2005 on the following issues.

Issue No. 96-16, "Investor's Accounting for an Investee When the Investor has a Majority Shareholder or Shareholders Have Certain Approval or Veto Rights."

The Task Force agreed to revise the description of protective rights in Issue 96-16 to be consistent with the consensus reached on EITF Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights."

Issue No. 01-9, "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)."

The Task Force agreed to revise Issue 01-9 to indicate that the timing of the customer's receipt of cash should not change the fact that the cost of certain sales incentives should be recognized at the later of the date the related revenue is recognized or the sales incentive is offered. This accounting treatment applies to incentives that are offered as consideration voluntarily and without charge, that become exercisable by a customer as a result of a single exchange transaction, and that will not result in a loss on the sale of a product or service.

Issue No. 04-6, "Accounting for Stripping Costs Incurred during Production in the Mining Industry."

The Task Force reached a consensus on the accounting for stripping costs, (i.e., costs of removing materials known as overburden or waste materials), incurred during the production of a mine. These costs are variable production costs that should be included in the costs of the inventory produced during the period that the stripping costs are incurred.

Issue No. 04-10, "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds."

The Task Force reached a consensus on the application of the criteria that should be used when determining whether to combine the information of small segments that do not meet the quantitative thresholds to produce a reportable segment under FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

Companies should combine small operating segments only if the small segments have similar economic characteristics (generally, similar profitability) and meet a majority of five aggregation criteria: The criteria address the similarity of the segments in the following areas:

- a) The nature of the products and services.
- b) The nature of the production processes.
- c) The type or class of customer for their products and services.
- d) The methods used to distribute products or provide services.
- e) If applicable, the nature of the regulatory environment, for example, banking, insurance, or public utilities.

Issue No. 04-13, "Accounting for Purchases and Sales of Inventory with the Same Counterparty."

The Task Force reached a consensus that there are conditions under which a nonmonetary exchange should be recognized at fair value when it involves a transfer of finished goods inventory in exchange for the receipt of raw materials or work-in-process inventory within the same line of business. The conditions:

- (1) Fair value is determinable within reasonable limits, and
- (2) The transaction has *commercial substance*, a term defined in Statement 153.

All other nonmonetary exchanges of inventory within the same line of business should be recognized at the carrying amount of the inventory transferred.

The consensus also indicates that inventory purchases and sales transactions that are entered into in contemplation of one another should be combined for purposes of applying APB Opinion 29 as amended by Statement 153. To help companies apply this guidance, the EITF Abstract for Issue 04-13 provides a list of factors that may indicate a purchase transaction and a sales transaction with the same counterparty were entered into in contemplation of one another.

Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.'"

The Task Force reached a consensus on which types of convertible debt instruments should (or may) be considered "conventional" and thereby escape complex derivative accounting rules.

Financial Reporting

The guidelines:

- a) Instruments that provide the holder with an option to convert into a fixed number of shares (or equivalent amount of cash at the discretion of the issuer) for which the ability to exercise the option is based on the passage of time or a contingent event *should* be considered conventional.
- b) Convertible preferred stock with a mandatory redemption date *may qualify* as conventional if the economic characteristics indicate the instrument is more akin to debt than equity.

The conversion rights embedded in instruments that do not meet these criteria may need to be separated from the underlying instrument, classified as liabilities, and carried at fair value with changes recorded in earnings.

Separately, the SEC staff has noted a rash of errors in classifying conversion options as equity rather than liabilities. This area is one that often affects the filings of small business issuers who are more likely than large public companies to rely on convertible debt instruments to raise money.

Issue No. 05-5, "Accounting for Early Retirement or Postemployment Programs with Specific Features (such As Terms Specified in Altersteilzeit Early Retirement Arrangements)."

The Task Force reached a consensus on the accounting for plans that allow employees to phase gradually into retirement. In some countries, the government may provide a subsidy for the employer.

The consensus covers the accounting treatment for the salary components of these arrangements, the termination benefits accrued under the plans, and the criteria for recognizing the government subsidies.

Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination."

The Task Force reached a consensus that leasehold improvements that are not contemplated at the beginning of a lease and are placed into service significantly later should be amortized over the shorter of (a) the useful life of the assets, or (b) a term that includes required lease periods and renewals deemed to be reasonably assured at the date the leasehold improvements are purchased.

Similarly, leasehold improvements acquired in a business combination should be amortized over the shorter of (a) the useful life of the assets, or (b) a term that includes required lease periods and renewals deemed to be reasonably assured at the date of acquisition.

Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Securities and Related Issues."

The Task Force agreed that the change in the fair value of the embedded conversion option should be included in the analysis required by EITF Issue No. 96-19 to determine if the modification must be accounted for as an extinguishment of debt. This part of the consensus extends to private companies the same guidance that was provided for SEC registrants in a 2004 speech by the SEC staff.

For modifications that result in a change in the fair value of the embedded conversion option but do not qualify for treatment as debt extinguishment under the revised test, the Task Force agreed on the following guidance:

- a) The changes in fair value should affect subsequent recognition of interest expense for the associated debt instrument. To determine the

relevant change in fair value, the issuing company should compare the fair values of the conversion option immediately before and after the modification. The value exchanged by the holder for the modification is recognized as a discount (or premium) with a corresponding increase (or decrease) in paid-in capital.

- b) The issuer should not recognize a beneficial conversion feature or reassess an existing beneficial conversion feature upon modification of a convertible debt instrument.

Issue No. 05-8, "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature."

The Task Force clarified the accounting treatment for the tax effects of issuing convertible debt with a beneficial conversion feature, (i.e., a security with a nondetachable conversion feature that is "in-the-money.") These tax effects result from differences in the tax and book treatments:

- *Tax treatment.* Under the U.S. Federal Income Tax Code, the entire amount of the proceeds received at the issuance of the debt is treated as the tax basis of the convertible debt security.
- *Accounting treatment.* Under U.S. GAAP, the convertible security is recorded at par value with a discount for a portion of the proceeds representing the intrinsic value of the conversion feature. The portion treated as a discount is allocated to paid-in capital in accordance with EITF Issue No. 00-27, "Application of Issue No. 98-5 to Certain Convertible Instruments."

The Task Force agreed that companies should be required to record deferred taxes on the difference between the book and tax basis. This difference

should be considered a temporary difference for purposes of applying FASB Statement No. 109, *Accounting for Income Taxes*. The recognition of deferred taxes for the temporary difference resulting from a beneficial conversion feature should be recorded as an adjustment to additional paid-in capital.

EITF Announcements

The SEC Observer made several announcements in 2004 and 2005 that are codified in Topics D-98 and D-108.

Topic No. D-98, SEC Staff Announcement, "Classification and Measurement of Redeemable Securities."

In 2004 and 2005, the SEC staff made the following announcements about the staff's position on redeemable securities:

- If a company issues preferred shares that are conditionally redeemable, the shares are outside the scope of Statement 150. If the required condition is met, then the shares become mandatorily redeemable under Statement 150 and would require reclassification to a liability.
- Increases or decreases in the carrying amount of redeemable common stock should be treated as preferential distributions using a method similar to the two-class method for calculating earnings per share.
- Employee awards that contain provisions for buybacks of shares issued upon exercise of employee stock options do not need to be classified outside of permanent equity, if the sole purpose of the buyback is to satisfy the employer's minimum statutory tax withholding requirement resulting from the exercise.

Separately, the staff added in a speech its view that, if a mandatorily redeemable security is also convertible, the carrying amount should be accreted to the redemption amount, regardless of the likelihood of conversion.

Topic No. D-108, SEC Staff Announcement. "Use of the Residual Method to Value Acquired Assets Other Than Goodwill."

In 2004, the SEC Observer announced the SEC staff's view that the residual method does not meet the requirements of FASB Statement No. 141, *Business Combinations*, for valuing identifiable intangible assets.

The residual method involves assigning a purchase price to other identifiable assets and liabilities, then recognizing the residual amount as an indistinguishable intangible asset. Some SEC registrants have used this method in the past to value intangibles arising from legal and contractual rights (identifiable intangible assets) on the grounds that these assets could not be directly and separately valued.

SEC registrants that have used this method should perform an impairment test on the affected intangible assets using the direct value method no later than the beginning of the first fiscal year after December 15, 2004.

FASB Staff Positions

The following represent selected FSPs that were issued in 2005 or affect standards that took effect in 2005.

FSPs Related to FASB Statements

FSP FAS 13-1, "Accounting for Rental Costs Incurred During A Construction Period."

This FSP requires that rent expense incurred during a construction period (e.g., under ground or building operating leases) be charged to expense.

FSP FAS 19-1, "Accounting for Suspended Well Costs."

This FSP clarifies that exploratory-well costs should continue to be capitalized when a sufficient quantity of reserves has been discovered in the well to justify its completion as a producing well and the entity is making sufficient progress in assessing the reserves and the project's economic and operating viability.

FSP FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003."

This FSP establishes that the subsidy available under the Medicare Act of 2003 is treated as an actuarial gain under FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. This means the effects of the Act on the employer's accumulated postretirement benefit obligation is combined with all other actuarial gains and losses rather than recorded as a one-time gain.

FSP FAS 109-1, "Application of FASB Statement No. 109, *Accounting for Income Taxes*, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004."

This FSP indicates that companies should account for the production incentives under the American Jobs Creation Act as a special deduction rather than as a rate reduction. This means that companies will recognize the tax benefits gradually, year-by-year, not as a large non-recurring adjustment. Any benefit from the deduction should be reported during the year for which the deduction is claimed on the tax return.

Financial Reporting

FSP FAS 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004."

This FSP gave companies more time to evaluate the impact of the Jobs Act on their plans for reinvestment or repatriation of certain foreign earnings for purposes of applying Statement 109. Without this added time, companies would have been required to apply Statement 109 in 2004, even if they had not yet decided whether to keep funds from foreign earnings permanently reinvested outside the U.S. or to return them to the U.S.

FSP FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments."

This FSP suspends indefinitely all parts of the consensus reached in EITF Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments," except for the disclosure requirements that were in effect at the end of 2004.

The parts of the consensus that were suspended indefinitely contain a new model for recognizing and measuring other-than-temporary impairment of investments. That model was more detailed and more stringent than the one described in the existing literature, and it was the subject of considerable controversy.

Other than the added disclosure requirements noted above, the FSP retains the existing guidance in FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, FASB Statement No. 124, *Accounting for Certain Investments Held by Not-for-Profit Organizations*, and APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*.

FSP FAS 141-1 and FAS 142-1, "Interaction of FASB Statements No. 141, Business Combinations, and No. 142, Goodwill and Other Intangible Assets, and EITF Issue No. 04-2, 'Whether Mineral Rights Are Tangible or Intangible Assets.'"

This FSP amends Statements 141 and 142 to reflect a consensus reached by the EITF that mineral rights should be accounted for as tangible assets.

FSP FAS 123(R)-1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)."

This FSP defers for an indefinite period the requirement under Statement 123(R) that a freestanding financial instrument originally subject to the Statement, such as an employee stock option, becomes subject to the recognition and measurement requirements of other applicable GAAP when the employee's rights no longer depend on the employee being employed.

The guidance in this FSP supercedes FSP EITF 00-19-1 and addresses concerns that the original provisions of Statement 123(R), combined with other applicable GAAP, would have caused many options to become liabilities once the holder's employment status no longer affected his or her rights.

FSP FAS 123(R)-2, "Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)."

This FSP provides a practical accommodation for determining the grant date of a share-based payment award. Statement 123(R) indicates that a grant date is not considered established until there is a mutual understanding by the employee and the employer of the key terms and conditions of a share-based award. FSP FAS 123(R)-2 allows companies to treat the directors' approval date as the grant date for

accounting purpose and further indicates that companies are expected to communicate the key terms of the award to all the recipients within a relatively short time period after the date of approval.

FSP FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards."

This FSP provides an optional "shortcut" method for calculating a company's historical pool of windfall tax benefits upon its adoption of Statement 123(R) (see page 8). The shortcut method is a simplified way to establish the beginning balance of the APIC pool and determine the subsequent impact when actual tax benefits realized from awards are less than the deferred tax assets related to those awards. This method is helpful to companies that do not have the records and/or resources required to calculate the pool of windfall tax benefits required by the Statement.

FSP FAS 140-2, "Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement 140."

This FSP clarifies that a key test of a qualifying special purpose entity (QSPE) must be passed only at the time of initial transfer or when a passive derivative instrument needs to be replaced upon the occurrence of an event outside the control of the transferor.

The test involves an assessment of whether derivatives held by a QSPE exceed the amount of beneficial interests held by third parties. This assessment should be based on the expected assets for the QSPE and the expected amount of the beneficial interests held.

In effect, the FSP clarifies that unexpected subsequent events would not impair the qualified status of the QSPE. An example of an unexpected subsequent event is a prepayment of

assets that was not contemplated at the time the initial assessment was made.

FSP FAS 142-2, “Application of FASB Statement No. 142, Goodwill and Other Intangible Assets, to Oil- and Gas-Producing Entities.”

This FSP clarifies that the drilling and mineral rights of oil- and gas-producing entities are included in a Statement 142 scope exception that applies to disclosures. However, companies may voluntarily provide information that goes beyond the disclosures required by FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*.

FSP FAS 143-1, “Accounting for Electronic Equipment Waste Obligations.”

This FSP provides guidance on how companies should account for obligations under EU Directive 2002/96/EC on Waste Electrical and Electronic Equipment.

Commercial users of electronic equipment subject to the Directive should recognize an asset retirement obligation for requirements related to the electrical and electronic equipment they own.

Producers of electronic equipment known under the Directive as “historical waste” that is held by private households must recognize a share of the waste management obligation each measurement period.

FSP FAS 150-5, “Issuer’s Accounting under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable.”

This FSP clarifies that all freestanding warrants (and other similar instruments) to acquire shares that are either puttable by the holder or mandatorily redeemable are liabilities under Statement 150.

Warrants that don’t fall under Statement 150 must be evaluated for derivative accounting under Statement 133, *Accounting for Derivative Instruments and Hedging Activities*, and/or EITF Issue 00-19 to determine if they are liabilities or equity.

Separately, the SEC staff has identified this area as a target for recent staff reviews. In *Current Accounting and Disclosure Issues*, the staff cites the two most common reasons why warrants should be accounted for as liabilities:

1. The warrants could be required to be settled in cash if certain events occurred, such as delisting from the registrant’s primary stock exchange, or if a registration statement covering the shares underlying the warrants was not declared effective by a certain date.
2. Significant liquidated damages could be required to be paid to the holder of the warrants in the event the issuer fails to register the underlying shares by a certain date or fails to keep the registration statement effective.

Additional guidance on the effects of certain issues related to freestanding warrants may be forthcoming in EITF Issue 05-4, “The Effect of a Liquidated Damages Clause on a Freestanding Financial Instrument Subject to EITF Issue No. 00-19, ‘Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock.’”

FSPs Related to FASB Interpretations

FSP FIN 45-3, “Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners.”

The FSP indicates that minimum revenue guarantees fall within the scope of FASB Interpretation No. 45, *Guarantor’s Accounting and Disclosure*

Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. A minimum revenue guarantee typically provides that the revenue of a business will be at least a specified amount during a particular period of time.

FSPs Related to EITF Issues

FSP EITF 00-19-1, “Application of EITF Issue No. 00-19 to Freestanding Financial Instruments Originally Issued as Employee Compensation.”

This FSP was superseded by FSP FAS 123(R)-1.

FSPs Related to AICPA Pronouncements

FSP APB 18-1, “Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence.”

This FSP clarifies that an investor’s proportionate share of an investee’s equity adjustments for other comprehensive income should be offset against the carrying value of the investment at the time significant influence is lost. To the extent that the offset results in a carrying value of the investment that is less than zero, an investor should (a) reduce the carrying value of the investment to zero, and (b) record the remaining balance in income.

FSP SOP 78-9-1, “Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5.”

This FSP was issued in conjunction with EITF Issue 04-5. It revises the guidance in Statement of Position 78-9, *Accounting for Investments in Real Estate Ventures*, to conform with the consensus in Issue 04-5.

Financial Reporting

FSP SOP 94-6-1, “Terms of Loan Products That May Give Rise to a Concentration of Credit Risk.”

This FSP does not provide new guidance. It serves as a reminder of the disclosure requirements and other accounting considerations for nontraditional loan products, such as interest-only loans.

FSP AAG INV-1 and SOP 94-4-1, “Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans.”

This FSP describes the limited circumstances in which the net assets of an investment company should reflect the contract value (which generally equals the principal balance plus accrued interest) of certain investments that it holds. It also provides a definition of a fully benefit-responsive investment contract, and it provides guidance on the financial statement presentation and disclosure of fully benefit-responsive investment contracts.

AICPA Statements of Position

The Accounting Standards Executive Committee (AcSEC) of the AICPA has released several SOPs that affect financial reporting for 2005.

SOP 03-3, Accounting for Loans or Certain Debt Securities Acquired in a Transfer.

This SOP addresses accounting for differences between contractual cash flows and cash flows expected to be collected from an investor’s initial investment in loans or debt securities (loans) acquired in a transfer if those differences are attributable, at least in part, to credit quality. Included in the scope of the SOP are loans acquired in business combinations. The SOP also applies to all nongovernmental entities,

including not-for-profit organizations. It does not apply to loans originated by the entity.

SOP 04-2, Accounting for Real Estate Time-Sharing Transactions.

This SOP addresses diversity in practice caused by a lack of guidance specific to real estate time-sharing transactions. Examples include accounting for uncollectibles, recovery or repossession of time-sharing intervals, selling and marketing costs, operations during holding periods, developer subsidies to interval owners associations, and upgrade and reload transactions.

SOP 05-1, Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts.

This SOP defines an internal replacement as a change to the benefits or coverages of a policy through amendment of the policy or exchange of an existing policy for a new policy. If the amended or new policy is substantially unchanged, it is accounted for as a continuation of the original policy. If the amended or new policy is substantially changed, it is accounted for as an extinguishment of the original policy, and unamortized policy acquisition costs are written off.

AICPA Technical Practice Aids

TPA 1200, Accounting by Noninsurance Enterprises for Property and Casualty Insurance Arrangements That Limit Insurance Risk.

This TPA includes a series of questions and answers that focus on the use of, and accounting for, finite property and casualty insurance contracts between an insured party (policy holder) and its insurance company.

TPA 5600.07, Determining a Lease Term for Accounting Purposes.

This TPA addresses a number of issues relating to lease accounting, including the determination of the life of a lease for accounting purposes, the rent expense and revenue in an operating lease, amortization and depreciation of leasehold improvements, and landlord incentive allowances.

TPA 6930.09, Accounting and Disclosure Requirements for Single-Employer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

This is the first of two TPAs that provide guidance on how an employee benefit plan should account for Medicare prescription-drug subsidies under the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

For a single-employer plan, the effects of the plan sponsor’s (employer’s) Medicare prescription drug subsidy *should not be* taken into consideration when calculating the health and welfare plan’s postretirement benefit obligation, because the subsidy is paid to the plan sponsor and does not flow to the plan.

TPA 6930.10, Accounting and Disclosure Requirements for Multiemployer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

This is the second of two TPAs that provide guidance on how an employee benefit plan should account for Medicare prescription-drug subsidies under the Medicare Prescription Drug, Improvement and Modernization Act of 2003.

For a multiemployer plan, the effects of the Medicare prescription drug subsidy *should be* taken into consideration when calculating the health and wel-

fare plan's postretirement benefit obligation, because the multiemployer plan trust receives the subsidy amount directly.

TPA on questions about applying Statement of Position (SOP) No. 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*.

This TPA addresses questions that arose in connection with SOP 03-3.

TPA 5400.05, *Accounting and Disclosures Guidance for Losses from Natural Disasters - Nongovernmental Entities*

This TPA discusses questions that may arise in accounting for losses from natural disasters, such as Hurricane Katrina. The questions include the following:

- How should losses from a natural disaster of a type that is reasonably expected to re-occur be classified in the statement of operations?
- When should an asset impairment loss related to a natural disaster be recognized?
- When should a liability for non-impairment losses and costs related to a natural disaster be recognized?
- What is the accounting for insurance recoveries to cover losses sustained in a natural disaster? Also, what are the additional considerations related to business interruption insurance recoveries?
- What are the required disclosures regarding the impact of a natural disaster?

GASB Pronouncements

This section contains selected releases of the Governmental Accounting Standards Board.

GASB Concepts Statement No. 3, *Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements*.

This Concepts Statement clarifies the relationship of basic financial statements, notes to basic financial statements, and supporting information presented with basic financial statements within the framework of general purpose external financial reporting.

The Statement defines and provides criteria for selecting among various communication methods, including recognition in basic financial statements, disclosure in notes to basic financial statements, and presentation as required supplementary information.

GASB Statement No. 43, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*.

Statement 43 establishes accounting guidance for OPEB plans that are included as trust funds in the financial reports of plan sponsors or employers, or issued in standalone financial reports.

GASB Statement No. 44, *Economic Condition Reporting - The Statistical Section -- An Amendment of NCGA Statement 1*.

Statement 44 enhances and updates the statistical section that accompanies a state or local government's basic financial statements.

GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

Statement 45 provides guidance on how to account for and report the costs and obligations related to postemployment healthcare and other forms of OPEB. The accounting requirements are based on actuarial-determined amounts similar to requirements for pensions. The OPEB cost is generally the actuarial-determined amount that, if paid on an ongoing basis, would provide sufficient resources to pay benefits as they come due.

GASB Statement No. 46, *Net Assets Restricted by Enabling Legislation - An Amendment of GASB Statement No. 34*.

Statement 46 provides that a government's net assets should be reported as restricted when their use is limited by an external party, constitutional provision, or enabling legislation, (i.e., a law that authorizes new resources but imposes limits on the use of the resources).

GASB Statement No. 47, *Accounting for Termination Benefits*.

Statement 47 establishes accounting standards for termination benefits. Key points:

- In financial statements prepared on the accrual basis of accounting, employers should recognize a liability and expense for *voluntary* termination benefits (for example, early-retirement incentives) when the offer is accepted and the amount can be estimated. A liability and expense for *involuntary* termination benefits (for example, severance benefits) should be recognized when three conditions are met: (a) a plan of termination has been approved by those with the authority to commit the government to the plan, (b) the plan has

Financial Reporting

been communicated to the employees, and (c) the amount can be estimated.

- In financial statements prepared on the modified accrual basis of accounting, liabilities and expenditures for termination benefits should be recognized to the extent the liabilities are normally expected to be liquidated with expendable available financial resources.
- Healthcare-related termination benefits that are provided as the result of a large-scale, age-related program, (e.g., an early-retirement incentive program that affects a significant portion of employees), should be measured at their discounted present values based on projected total claims costs (or age-adjusted premiums approximating claims costs) for terminated employees, with consideration given

to the expected future healthcare cost trend rate.

GASB Technical Bulletin No. 2004-2, Recognition of Pension and Other Postemployment Benefit [OPEB] Expenditures/Expense and Liabilities by Cost-Sharing Employers.

Technical Bulletin 2004-2 provides guidance on questions that may arise in applying GASB Statements 27, *Accounting for Pensions by State and Local Governmental Employers*, and 45 to cost-sharing employers. Cost-sharing refers to the practice of pooling by employers of their benefit obligations and assets under a pension or OPEB plan.

Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits.

This guide provides the answers to over 250 questions. Topics include:

- Differences between OPEB benefits and other forms of employee benefits, such as compensated absences, termination benefits, and pensions
- The timing and frequency of actuarial valuations associated with OPEB, selection of methods and assumptions, and application of criteria related to the projection of benefits for employers that participate in community-rated plans
- Treatment of implicit rate subsidies that arise when retirees are insured in a group with current employees.

The guide also includes questions and answers, along with expanded illustrations, for certain employers and plans with small plan memberships.

Table 1

Listing of Recent Pronouncements

This table provides a listing of recent accounting pronouncements for reference purposes.

Type of Pronouncement	Title and Date of Issuance
FASB Statements	<p>Statement 123(R). <i>Share-Based Payment (Revised 2004)</i>. (Issued: December 2004.)</p> <p>Statement 150. <i>Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity</i>. (Issued: May 2003.)</p> <p>Statement 151. <i>Inventory Costs</i>. (Issued: November 2004.)</p> <p>Statement 152. <i>Accounting for Real Estate Time-Sharing Transactions</i>. (Issued: December 2004.)</p> <p>Statement 153. <i>Exchanges of Nonmonetary Assets</i>. (Issued: December 2004.)</p> <p>Statement 154. <i>Accounting Changes and Error Corrections</i>. (Issued: May 2005.)</p>
FASB Interpretations	<p>Interpretation 46(R). <i>Consolidation of Variable Interest Entities (Revised 2003)</i>. (Issued: December 2003.)</p> <p>Interpretation 47. <i>Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143</i>. (Issued: March 2005.)</p>
EITF Issues	<p>EITF Issue No. 96-16. "Investor's Accounting for an Investee When the Investor has a Majority Shareholder or Shareholders Have Certain Approval or Veto Rights." (Modified consensus ratified: June 2005.)</p> <p>EITF Issue No. 96-19. "Debtor's Accounting for a Modification or Exchange of Debt Instruments." (Modified consensus ratified as part of Issue 05-7: September 2005.)</p> <p>EITF Issue No. 01-9. "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)." (Modified consensus ratified: June 2005.)</p> <p>EITF Issue No. 04-5. "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights." (Consensus ratified: June 2005.)</p> <p>EITF Issue No. 04-6. "Accounting for Stripping Costs Incurred during Production in the Mining Industry." (Consensus ratified: March 2005, modified consensus ratified: June 2005.)</p> <p>EITF Issue No. 04-10. "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds." (Consensus ratified: September 2004, modified consensus ratified: November 2004 and June 2005.)</p> <p>EITF Issue No. 04-13. "Accounting for Purchases and Sales of Inventory with the Same Counterparty." (Consensus ratified: September 2005.)</p> <p>EITF Issue No. 05-2. "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.'" (Consensus ratified: June 2005.)</p>

Listing of Recent Pronouncements (continued)

Type of Pronouncement	Title and Date of Issuance
EITF Issues (continued)	<p>EITF Issue No. 05-5. "Accounting for Early Retirement or Postemployment Programs with Specific Features (Such As Terms Specified in Altersteilzeit Early Retirement Arrangements)." (Consensus ratified: June 2005.)</p> <p>EITF Issue No. 05-6. "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination." (Consensus ratified: June 2005; modified consensus ratified: September 2005.)</p> <p>EITF Issue No. 05-7. "Accounting for Modifications to Conversion Options Embedded in Debt Securities and Related Issues." (Consensus ratified: September 2005.)</p> <p>EITF Issue No. 05-8. "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature." (Consensus ratified: September 2005.)</p>
Announcements made at EITF Meetings	<p>EITF Topic No. D-98. SEC Staff Announcement, "Classification and Measurement of Redeemable Securities." (Revised: September 2005.)</p> <p>EITF Topic No. D-108. SEC Staff Announcement. "Use of the Residual Method to Value Acquired Assets Other Than Goodwill." (Announced: September 2004.)</p>
AICPA Statements of Position	<p>SOP 03-3. <i>Accounting for Loans or Certain Debt Securities Acquired in a Transfer.</i> (Issued: December 12, 2003.)</p> <p>SOP 04-2. <i>Accounting for Real Estate Time-Sharing Transactions.</i> (Issued: December 2004.)</p> <p>SOP 05-1. <i>Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications or Exchanges of Insurance Contracts.</i> (Issued: September 2005.)</p>
FASB Staff Positions (FSPs)	<p>FSPs Related to FASB Statements</p> <p>FSP FAS 13-1. Accounting for Rental Costs Incurred During A Construction Period. (Released: October 6, 2005.)</p> <p>FSP FAS 19-1. Accounting for Suspended Well Costs. (Released: April 4, 2005.)</p> <p>FSP FAS 97-1. Situations in Which Paragraphs 17(b) and 20 of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, Permit or Require Accrual of an Unearned Revenue Liability. (Released: June 18, 2004.)</p> <p>FSP FAS 106-2. Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003. (Released: May 19, 2004.)</p> <p>FSP FAS 109-1. Application of FASB Statement No. 109, <i>Accounting for Income Taxes</i>, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004. (Released: December 21, 2004.)</p>

Table 1

Listing of Recent Pronouncements (continued)

Type of Pronouncement	Title and Date of Issuance	
FASB Staff Positions (FSPs) (continued)	FSP FAS 109-2. Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004. (Released: December 21, 2004.)	
	FSP FAS 115-1 and FAS 124-1. The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments. (Released: November 3, 2005.)	
	FSP FAS 123(R)-1. Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R). (Released: August 31, 2005.)	
	FSP FAS 123(R)-2. Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R). (Released: October 18, 2005.)	
	FSP FAS 123(R)-3. Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards. (Released: November 10, 2005.)	
	FSP FAS 140-2. Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement 140. (Released: November 9, 2005.)	
	FSP FAS 141-1 and FAS 142-1. Interaction of FASB Statements No. 141, <i>Business Combinations</i> , and No. 142, <i>Goodwill and Other Intangible Assets</i> , and EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets." (Released: April 30, 2005.)	
	FSP FAS 142-2. Application of FASB Statement No. 142, <i>Goodwill and Other Intangible Assets</i> , to Oil- and Gas-Producing Entities. (Released: November 9, 2005.)	
	FSP FAS 143-1. Accounting for Electronic Equipment Waste Obligations. (Released: June 8, 2005.)	
	FSP FAS 150-5. Issuer's Accounting under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable. (Released: June 29, 2005.)	
	FSPs Related to FASB Interpretations	
	FSP FIN 45-3. Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners. (Released: November 10, 2005.)	
	FSP FIN 46(R)-1. Reporting Variable Interests in Specified Assets of Variable Interest Entities as Separate Variable Interest Entities under Paragraph 13 of FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i> . (Released: February 12, 2004.)	
	FSP FIN 46(R)-2. Calculation of Expected Losses under FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i> . (Released: February 12, 2004.)	
FSP FIN 46(R)-3. Evaluating Whether as a Group the Holders of the Equity Investment at Risk Lack the Direct or Indirect Ability to Make Decisions about an Entity's Activities through Voting Rights or Similar Rights under FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i> . (Released: February 12, 2004.)		

Listing of Recent Pronouncements (continued)

Type of Pronouncement	Title and Date of Issuance
FASB Staff Positions (FSPs) (continued)	<p>FSP FIN 46(R)-4. Technical Correction of FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i>, Relating to Its Effects on Question No. 12 of EITF Issue No. 96-21, "Implementation Issues in Accounting for Leasing Transactions Involving Special-Purpose Entities." (Released: April 30, 2004.)</p> <p>FSP FIN 46(R)-5. Implicit Variable Interests Under FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i>. (Released: March 3, 2005.)</p> <p>FSPs Related to EITF Issues</p> <p>FSP EITF 85-24-1. Application of EITF Issue No. 85-24, "Distribution Fees by Distributors of Mutual Funds That Do Not Have a Front-End Sales Charge," When Cash for the Right to Future Distribution Fees for Shares Previously Sold Is Received from Third Parties. (Released: March 11, 2005.)</p> <p>FSP EITF 00-19-1. Application of EITF Issue No. 00-19 to Freestanding Financial Instruments Originally Issued as Employee Compensation. (Released: May 31, 2005.) This FSP has been superseded by FSP FAS 123(R)-1.</p> <p>FSPs Related to AICPA Pronouncements</p> <p>FSP APB 18-1. Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence. (Released: July 12, 2005.)</p> <p>FSP SOP 78-9-1. Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5. (Released: July 14, 2005.)</p> <p>FSP SOP 94-6-1. Terms of Loan Products That May Give Rise to a Concentration of Credit Risk. (Released: December 19, 2005.)</p> <p>FSP AAG INV-1 and SOP 94-4-1. Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans. (Released: December 29, 2005.)</p>
AICPA Technical Practice Aids	<p>TPA 1200. Accounting by Noninsurance Enterprises for Property and Casualty Insurance Arrangements That Limit Insurance Risk. (Released: February 2005.)</p> <p>TPA 5400.05. Accounting and Disclosures Guidance for Losses from Natural Disasters - Nongovernmental Entities. (Released: September 2005.)</p> <p>TPA 5600.07. Determining a Lease Term for Accounting Purposes. (Released: November 2005.)</p> <p>TPA 6930.09. Accounting and Disclosure Requirements for Single-Employer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003. (Released: August 2005.)</p> <p>TPA 6930.10. Accounting and Disclosure Requirements for Multiemployer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003. (Released: August 2005.)</p>

Table 1

Listing of Recent Pronouncements (continued)

Type of Pronouncement	Title and Date of Issuance
AICPA Technical Practice Aids (continued)	TPA that addresses numerous questions about applying Statement of Position (SOP) No. 03-3, <i>Accounting for Certain Loans or Debt Securities Acquired in a Transfer</i> . (Released: December 2005.)
GASB Statements, Technical Bulletins, and Implementation Guides	<p>Concepts Statement No. 3. <i>Communication Methods in General Purpose External Financial Reports That Contain Basic Financial Statements</i>. (Issued: April 2005.)</p> <p>Statement No. 40. <i>Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3</i>. (Issued: March 2003.)</p> <p>Statement No. 42. <i>Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries</i>. (Issued: November 2003.)</p> <p>Statement No. 43. <i>Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans</i>. (Issued: April 2004.)</p> <p>Statement No. 44. <i>Economic Condition Reporting - The Statistical Section -- An Amendment of NCGA Statement 1</i>. (Issued: May 2004.)</p> <p>Statement No. 45. <i>Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions</i>. (Issued: June 2004.)</p> <p>Statement No. 46. <i>Net Assets Restricted by Enabling Legislation - An Amendment of GASB Statement No. 34</i>. (Issued: December 2004.)</p> <p>Statement No. 47. <i>Accounting for Termination Benefits</i>. (Issued: June 2005.)</p> <p>Technical Bulletin No. 2004-2. <i>Recognition of Pension and Other Postemployment Benefit [OPEB] Expenditures/Expense and Liabilities by Cost-Sharing Employers</i>. (Issued: December 2004.)</p> <p>Guide to Implementation of GASB Statements 43 and 45 on Other Postemployment Benefits. (Issued: August 2005.)</p> <p>Guide to Implementation of GASB Statement 44 on the Statistical Section. (Issued: December 2005.)</p>

Summary of Effective Dates

The following summary of effective dates was prepared for reference purposes using excerpts from the pronouncements wherever practicable.

Pronouncement	Effective Date
<p>FASB Statement No. 123(R), <i>Share-Based Payment</i></p>	<p><u>Original effective date:</u> Statement 123(R) originally was effective as follows:</p> <ul style="list-style-type: none"> – Public entities that do not file as small business issuers were required to adopt the standard as of the beginning of the first interim or annual reporting period that begins after June 15, 2005. – Public entities that file as small business issuers were required to adopt as of the beginning of the first interim or annual reporting period that begins after December 15, 2005. – Nonpublic entities were required to adopt as of the beginning of the first annual reporting period that begins after December 15, 2005. <p>Statement 123, as originally issued, is effective until the provisions of Statement 123(R) are adopted.</p> <p><u>Revised effective dates for SEC registrants:</u> In April 2005, the SEC issued final rules indicating that:</p> <ul style="list-style-type: none"> – Registrants that do not file as small business issuers were required to adopt Statement 123(R) by the first interim period of the registrant's first fiscal year beginning on or after June 15, 2005. – Small business issuers are required to adopt Statement 123(R) by the first interim period of the registrant's first fiscal year beginning on or after December 15, 2005.
<p>FASB Statement No. 150, <i>Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity</i></p>	<p><u>Original effective date:</u> For mandatorily redeemable shares of private companies, Statement 150 originally was effective for fiscal periods beginning after December 15, 2003. For all other instruments in the scope of Statement 150, the effective dates were as follows:</p> <ul style="list-style-type: none"> – Immediately, for instruments entered into or modified after May 31, 2003. – The first interim period beginning after June 15, 2003 for preexisting instruments. <p><u>Revised effective dates:</u> As a result of the partial deferrals made by FSPs, the effective dates for the standard are now as follows:</p> <ul style="list-style-type: none"> • <i>Private companies.</i> For instruments that are mandatorily redeemable on fixed dates for amounts that are fixed or determinable Statement 150 is effective for fiscal periods beginning after December 15, 2004. For other mandatorily redeemable shares issued by private companies, the requirements are deferred indefinitely. • <i>All companies.</i> For noncontrolling interests in consolidated subsidiaries that are deemed mandatorily redeemable only because the issuing entity has a limited life, the classification and measurement provisions are deferred indefinitely (and early adoption is precluded). For other types of mandatorily redeemable noncontrolling interests in consolidated subsidiaries created before November 5, 2003, the measurement provisions of Statement 150 are deferred indefinitely. <p>There was no change in the effective dates for other types of instruments.</p>

Table 2

Summary of Effective Dates (continued)

Pronouncement	Effective Date
FASB Statement No. 151 , <i>Inventory Costs – An Amendment of ARB No. 43, Chapter 4</i>	Statement 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. Earlier application is permitted for inventory costs incurred during fiscal years beginning after November 24, 2004. The provisions of this Statement should be applied prospectively.
FASB Statement No. 152 , <i>Accounting for Real Estate Time-Sharing Transactions</i>	Statement 152 is effective for fiscal years beginning after June 15, 2005. Restatement of previously issued financial statements is not permitted.
FASB Statement No. 153 , <i>Exchanges of Nonmonetary Assets</i>	Statement 153 is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after December 16, 2004. The provisions of this Statement should be applied prospectively.
FASB Statement No. 154 , <i>Accounting Changes and Error Corrections</i>	Statement 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. Early adoption is permitted for accounting changes and corrections of errors made in fiscal years beginning after the date this Statement is issued. This Statement does not change the transition provisions of any existing accounting pronouncements, including those that are in a transition phase as of the effective date of this Statement.
Interpretation 46(R) , <i>Consolidation of Variable Interest Entities</i>	<p>Interpretation 46(R) applies at different dates to different types of enterprises and entities, and special provisions apply to enterprises that have fully or partially applied Interpretation 46 prior to issuance of Interpretation 46(R).</p> <ul style="list-style-type: none"> – Application of Interpretation 46 or Interpretation 46(R) is required in financial statements of public entities that have interests in variable interest entities or potential variable interest entities commonly referred to as special-purpose entities for periods ending after December 15, 2003. – Application by public entities (other than small business issuers) for all other types of entities is required in financial statements for periods ending after March 15, 2004. – Application by small business issuers to entities other than special-purpose entities and by nonpublic entities to all types of entities is required at various dates in 2004 and 2005.
Interpretation 47 , <i>Accounting for Conditional Asset Retirement Obligations—an interpretation of FASB Statement No. 143</i>	Interpretation 47 is effective no later than the end of fiscal years ending after December 15, 2005 (December 31, 2005, for calendar-year enterprises). Retrospective application for interim financial information is permitted but is not required. Early adoption of this Interpretation is encouraged.

Summary of Effective Dates (continued)

Pronouncement	Effective Date
EITF Issue No. 96-16 , "Investor's Accounting for an Investee When the Investor has a Majority Shareholder or Shareholders Have Certain Approval or Veto Rights."	The June 2005 amendment to this Issue is effective concurrently with related provisions of Issue No. 04-5, "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights." The provisions of this amendment should be applied prospectively to new investments and to investment agreements that are modified after June 29, 2005, the date of ratification of the amendment by the Board.
EITF Issue No. 96-19 , "Debtor's Accounting for a Modification or Exchange of Debt Instruments."	The September 2005 amendment to this Issue is effective concurrently with related provisions of Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Securities and Related Issues." The revised consensus is effective for future modifications of debt instruments beginning in the first interim or annual reporting period beginning after December 15, 2005. Early application of this guidance is permitted in periods for which financial statements have not yet been issued. The disclosures required by Statement 154 should be made excluding those disclosures reflecting the effects of retrospective application.
EITF Issue No. 01-9 , "Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor's Products)."	The June 2005 amendment to Issue 01-9 is effective for transactions or arrangements entered into after the beginning of an entity's next reporting period beginning after June 29, 2005, the date of ratification of the amendment by the Board.
EITF Issue No. 04-5 , "Determining Whether a General Partner, or the General Partners as a Group, Controls a Limited Partnership or Similar Entity When the Limited Partners Have Certain Rights."	Issue No. 04-5 is effective as follows: <ul style="list-style-type: none"> – For general partners of all new limited partnerships formed and for existing limited partnerships for which the partnership agreements are modified, the guidance is effective after June 29, 2005. – For general partners in all other limited partnerships, the guidance in this Issue is effective no later than the beginning of the first reporting period in fiscal years beginning after December 15, 2005.
EITF Issue No. 04-6 , "Accounting for Stripping Costs Incurred during Production in the Mining Industry."	Issue No. 04-6 is effective for the first reporting period in fiscal years beginning after December 15, 2005, with early adoption permitted.
EITF Issue No. 04-10 , "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds."	Issue 04-10 is effective for fiscal years ending after September 15, 2005. The corresponding information for earlier periods, including interim periods, should be restated unless it is impractical to do so. Early application of the consensus is permitted.
EITF Issue No. 04-13 , "Accounting for Purchases and Sales of Inventory with the Same Counterparty."	Issue 04-13 is effective for new arrangements entered into, or modifications or renegotiations of existing arrangements, beginning in the first interim or annual reporting period beginning after March 15, 2006. Early application is permitted in periods for which financial statements have not been issued.

Table 2

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>EITF Issue No. 05-2, "The Meaning of 'Conventional Convertible Debt Instrument' in EITF Issue No. 00-19, 'Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock.'"</p>	<p>Issue 05-2 is effective for new instruments entered into and instruments modified in reporting periods beginning after June 29, 2005.</p>
<p>EITF Issue No. 05-5, "Accounting for Early Retirement or Postemployment Programs with Specific Features (such as Terms Specified in Altersteilzeit Early Retirement Arrangements)."</p>	<p>Issue No. 05-5 is effective for fiscal years beginning after December 15, 2005, and should be reported as a change in accounting estimate effected by a change in accounting principle as described in paragraph 19 of Statement 154.</p>
<p>EITF Issue No. 05-6, "Determining the Amortization Period for Leasehold Improvements Purchased after Lease Inception or Acquired in a Business Combination."</p>	<p>Issue 05-6 is effective for leasehold improvements (within the scope of this Issue) that are purchased or acquired in reporting periods beginning after June 29, 2005. Early application of the consensus is permitted in periods for which financial statements have not been issued.</p> <p>The consensus in this Issue does not apply to preexisting leasehold improvements. Therefore, the consensus in this Issue should not be used to justify the reevaluation of the amortization period for preexisting leasehold improvements for additional renewal periods that are reasonably assured when new leasehold improvements are placed into service significantly after and are not contemplated at or near the beginning of the lease term.</p>
<p>EITF Issue No. 05-7, "Accounting for Modifications to Conversion Options Embedded in Debt Instruments and Related Issues."</p>	<p>Issue 05-7 is effective for future modifications of debt instruments beginning in the first interim or annual reporting period beginning after December 15, 2005. Early application of this guidance is permitted in periods for which financial statements have not yet been issued. The disclosures required by Statement 154 should be made excluding those disclosures reflecting the effects of retrospective application.</p>
<p>EITF Issue No. 05-8, "Income Tax Consequences of Issuing Convertible Debt with a Beneficial Conversion Feature."</p>	<p>Issue 05-8 is effective for financial statements beginning in the first interim or annual reporting period beginning after December 15, 2005. The Issue should be applied by retrospective application pursuant to Statement 154 to all instruments with a beneficial conversion feature accounted for under Issue 00-27 included in financial statements for reporting periods beginning after December 15, 2005. Therefore, this Issue would also be applicable to debt instruments that were converted (or extinguished) in prior periods but are still presented in the financial statements. Early application is permitted in periods for which financial statements have not been issued.</p>

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>EITF Topic No. D-98, SEC Staff Announcement, "Classification and Measurement of Redeemable Securities."</p>	<p>The SEC staff clarified the impact of certain redeemable securities on earnings per share calculations in paragraph 19. The guidance in paragraph 19 should be applied in the first fiscal period beginning after September 15, 2005 (the date of the announcement). Prior period earnings per share amounts presented for comparative purposes should be retroactively adjusted to conform to the guidance.</p>
<p>EITF Topic No. D-108, SEC Staff Announcement, "Use of the Residual Method to Value Acquired Assets Other Than Goodwill."</p>	<p>Registrants should apply a direct value method to such assets acquired in business combinations completed after September 29, 2004. Further, registrants who have applied the residual method to the valuation of intangible assets for purposes of impairment testing shall perform an impairment test using a direct value method on all intangible assets that were previously valued using the residual method by no later than the beginning of their first fiscal year beginning after December 15, 2004. Impairments of intangible assets recognized upon application of a direct value method by entities previously applying the residual method should be reported as a cumulative effect of a change in accounting principle. Related deferred tax effects should also be reported as part of the cumulative effect of a change in accounting principle. Reclassification of recorded balances between goodwill and intangible assets immediately prior to adoption of this SEC staff announcement is prohibited. Early adoption of a direct value method is encouraged.</p>
<p>AICPA SOP No. 03-3, <i>Accounting for Loans or Certain Debt Securities Acquired in a Transfer</i></p>	<p>SOP 03-3 is effective for loans acquired in fiscal years beginning after December 15, 2004. Previously issued annual financial statements should not be restated. Early application of this SOP is encouraged, but not required, for transfers of loans subsequent to the issuance of this SOP but prior to the effective date.</p>
<p>AICPA SOP No. 04-2, <i>Accounting for Real Estate Time-Sharing Transactions</i></p>	<p>SOP 04-2 is effective for fiscal years beginning after June 15, 2005. Earlier application is encouraged as of the beginning of fiscal years for which financial statements or information have not been issued. Previously issued financial statements should not be restated.</p>
<p>AICPA SOP 05-1, <i>Accounting by Insurance Enterprises for Deferred Acquisition Costs in Connection with Modifications of Exchanges of Insurance Contracts</i></p>	<p>SOP 05-1 is effective for internal replacements occurring in fiscal years beginning after December 15, 2006, with earlier adoption encouraged. Retrospective application of this SOP to previously issued financial statements is not permitted. Initial application of this SOP should be as of the beginning of an entity's fiscal year (that is, if the SOP is adopted prior to the effective date, all prior interim periods of the year of adoption should be restated).</p>

Table 2

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>FSP FAS 13-1, "Accounting for Rental Costs Incurred During A Construction Period."</p>	<p>FSP FAS 13-1 is effective the first reporting period beginning after December 15, 2005. Early adoption is permitted for financial statements or interim financial statements that have not yet been issued. A lessee shall cease capitalizing rental costs as of the effective date of this FSP for operating lease arrangements entered into prior to the effective date of this FSP. Retrospective application in accordance with FASB Statement No. 154, <i>Accounting Changes and Error Corrections</i>, is permitted but not required.</p>
<p>FSP FAS 19-1, "Accounting for Suspended Well Costs."</p>	<p>FSP FAS 19-1 is effective the first reporting period beginning after April 4, 2005. The guidance should be applied prospectively to existing and newly capitalized exploratory well costs. Any capitalized exploratory well costs that are expensed upon the application of this guidance shall be recognized in income from continuing operations and either shall be presented as a separate component of operations or shall be disclosed in the notes to the financial statements. An enterprise shall quantify and describe the projects to which those costs relate. Capitalization of exploratory well costs that were previously expensed is not permitted. Early application of this guidance is permitted in periods for which financial statements have not yet been issued.</p>
<p>FSP FAS 97-1, " Situations in Which Paragraphs 17(b) and 20 of FASB Statement No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments, Permit or Require Accrual of an Unearned Revenue Liability."</p>	<p>FSP FAS 97-1 is effective the first reporting period beginning after June 18, 2005. If applying the FSP results in changes to previously reported information, the cumulative effect of the accounting change shall be reported as of the beginning of the first fiscal period beginning after June 18, 2004.</p>
<p>FSP FAS 106-2, "Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003."</p>	<p>Except for certain nonpublic entities, FSP FAS 106-2 is effective for the first interim or annual period beginning after June 15, 2004. For a nonpublic entity, as defined in FASB Statement No. 87, <i>Employers' Accounting for Pensions</i>, that sponsors one or more defined benefit postretirement health care plans that provide prescription drug coverage but of which no plan has more than 100 participants, this FSP is effective for fiscal years beginning after December 15, 2004. Earlier application of this FSP is encouraged.</p>
<p>FSP FAS 109-1, "Application of FASB Statement No. 109, <i>Accounting for Income Taxes</i>, to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004."</p>	<p>FSP FAS 109-1 was effective upon issuance on December 21, 2004.</p>

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>FSP FAS 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004."</p>	<p>FSP FAS 109-2 was effective upon issuance on December 21, 2004.</p>
<p>FSP FAS 115-1 and FAS 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments."</p>	<p>FSP FAS 115-1 and FAS 124-1 IS effective for reporting periods beginning after December 15, 2005. Earlier application is permitted.</p>
<p>FSP FAS 123(R)-1, "Classification and Measurement of Freestanding Financial Instruments Originally Issued in Exchange for Employee Services under FASB Statement No. 123(R)."</p>	<p>FSP FAS 123(R)-1 is effective upon initial adoption of Statement 123(R). An entity that adopted Statement 123(R) prior to the issuance of this FSP should apply this guidance in either (a) the first reporting period beginning after the date the FSP is posted to the FASB website or (b) an earlier period, if the financial statements for that period have not been issued.</p>
<p>FSP FAS 123(R)-2, "Practical Accommodation to the Application of Grant Date as Defined in FASB Statement No. 123(R)."</p>	<p>FSP FAS 123(R)-2 is effective upon initial adoption of Statement 123(R). An entity that adopted Statement 123(R) prior to the issuance of this FSP and did not apply the provisions of this FSP shall apply the guidance in this FSP to the first reporting period after October 18, 2005, for which financial statements or interim reports have not been issued.</p>
<p>FSP FAS 123(R)-3, "Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards."</p>	<p>FSP FAS 123(R)-3 is effective after November 10, 2005.</p>
<p>FSP FAS 140-2, "Clarification of the Application of Paragraphs 40(b) and 40(c) of FASB Statement No. 140."</p>	<p>FSP FAS 140-2 was effective upon issuance on November 9, 2005. The guidance regarding unexpected events described in paragraph 9 should be applied prospectively to all qualifying SPEs for unexpected events that occur after November 9, 2005. The guidance regarding a transferor's purchases of beneficial interests from outside parties as described in paragraph 10 of this FSP is effective immediately for such purchases and for transferors' previous purchases of beneficial interests from outside parties that were consistent with the guidance in this FSP.</p>
<p>FSP FAS 141-1 and FAS 142-1, "Interaction of FASB Statements No. 141, <i>Business Combinations</i>, and No. 142, <i>Goodwill and Other Intangible Assets</i>, and EITF Issue No. 04-2, "Whether Mineral Rights Are Tangible or Intangible Assets.""</p>	<p>FSP FAS 141-1 and FAS 142-1 is effective the first reporting period beginning after April 29, 2004. If the guidance in this FSP results in the recharacterization of an asset, prior-period amounts on the statements of financial position should be reclassified. Any effects on amortization or depreciation of the asset should be accounted for prospectively. Early application of this guidance is permitted in periods for which financial statements have not yet been issued.</p>

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>FSP FAS 142-2, "Application of FASB Statement No. 142, <i>Goodwill and Other Intangible Assets</i>, to Oil- and Gas-Producing Entities."</p>	<p>FSP FAS 142-2 is effective for reporting periods beginning after September 2, 2004. If the guidance in this FSP results in the reclassification of an asset, prior-period amounts on the statements of financial position should be reclassified. Early application of this guidance is permitted in periods for which financial statements have not yet been issued.</p>
<p>FSP FAS 143-1, "Accounting for Electronic Equipment Waste Obligations."</p>	<p>FSP FAS 143-1 is effective the later of the first reporting period ending after June 8, 2005 or the date of the adoption of the law by the applicable EU-member country. Earlier application is encouraged in periods for which financial statements have not yet been issued when the FSP is finalized if the law has been adopted in those periods by the applicable EU-member country.</p>
<p>FSP FAS 150-5, "Issuer's Accounting under Statement 150 for Freestanding Warrants and Other Similar Instruments on Shares That Are Redeemable."</p>	<p>FSP FAS 150-5 is effective the first reporting period beginning after June 30, 2005. If the guidance in this FSP results in changes to previously reported information, the cumulative effect shall be reported according to the transition provisions of Statement 150 in the first reporting period beginning after June 30, 2005.</p>
<p>FSP FIN 45-3, "Application of FASB Interpretation No. 45 to Minimum Revenue Guarantees Granted to a Business or Its Owners."</p>	<p>FSP FIN 45-3 is effective for new minimum revenue guarantees issued or modified on or after the beginning of the first fiscal quarter following November 10, 2005. Earlier application is permitted. The guarantor's previous accounting for minimum revenue guarantees issued prior to the date of the FSP's initial application should not be revised or restated to reflect the effect of the recognition and measurement provisions of Interpretation 45.</p>
<p>FSP FIN 46(R)-1, "Reporting Variable Interests in Specified Assets of Variable Interest Entities as Separate Variable Interest Entities under Paragraph 13 of FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i>."</p>	<p>The guidance in this FSP is subject to the effective date and transition provisions of Interpretation 46 (revised December 2003).</p>
<p>FSP FIN 46(R)-2, "Calculation of Expected Losses under FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i>."</p>	<p>The guidance in this FSP is subject to the effective date and transition provisions of Interpretation 46 (revised December 2003).</p>

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>FSP FIN 46(R)-3, "Evaluating Whether as a Group the Holders of the Equity Investment at Risk Lack the Direct or Indirect Ability to Make Decisions about an Entity's Activities through Voting Rights or Similar Rights under FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities.</i>"</p>	<p>The guidance in this FSP is subject to the effective date and transition provisions of Interpretation 46 (revised December 2003).</p>
<p>FSP FIN 46(R)-4, "Technical Correction of FASB Interpretation No. 46 (Revised December 2003), <i>Consolidation of Variable Interest Entities</i>, Relating to Its Effects on Question No. 12 of EITF Issue No. 96-21, 'Implementation Issues in Accounting for Leasing Transactions Involving Special-Purpose Entities.'"</p>	<p>The guidance in this FSP is subject to the effective date and transition provisions of Interpretation 46 (revised December 2003).</p>
<p>FSP FIN 46(R)-5, "Implicit Variable Interests under FASB Interpretation No. 46 (revised December 2003), <i>Consolidation of Variable Interest Entities.</i>"</p>	<p>FSP FIN 46(R)-5 is applicable to both nonpublic and public reporting enterprises. Implicit variable interests tend to occur more frequently in arrangements involving related parties.</p> <p>For entities to which Interpretation 46(R) has been applied, the guidance in this FSP should be applied in the first reporting period beginning after March 3, 2005 in accordance with the transition provisions of Interpretation 46(R). Restatement to the date of the initial application of Interpretation 46(R) is permitted but not required. Early application is permitted for periods for which financial statements have not yet been issued. For entities to which Interpretation 46(R) has not been applied, the guidance in this FSP should be applied in accordance with the effective date and transition provisions of Interpretation 46(R).</p>
<p>FSP EITF 85-24-1, "Application of EITF Issue No. 85-24, 'Distribution Fees by Distributors of Mutual Funds That Do Not Have a Front-End Sales Charge,' When Cash for the Right to Future Distribution Fees for Shares Previously Sold Is Received from Third Parties."</p>	<p>FSP EITF 85-24-1 is effective for reporting periods beginning after March 11, 2005. The effect of initially applying this guidance should be recognized as a cumulative effect of a change in accounting principle pursuant to the guidance in FASB Statement No. 3, <i>Reporting Accounting Changes in Interim Financial Statements</i>, and APB Opinion No. 20, <i>Accounting Changes</i>. This guidance should be applied based on the terms of the arrangements that exist at the end of the reporting period for which the guidance is first effective.</p>
<p>FSP EITF 00-19-1, "Application of EITF Issue No. 00-19 to Freestanding Financial Instruments Originally Issued as Employee Compensation."</p>	<p>FSP EITF 00-19 was intended to be applied in accordance with the effective date and transition provisions of Statement 123(R). This FSP has been superseded by FAS 123(R)-1.</p>

Table 2

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>FSP APB 18-1, "Accounting by an Investor for Its Proportionate Share of Accumulated Other Comprehensive Income of an Investee Accounted for under the Equity Method in Accordance with APB Opinion No. 18 upon a Loss of Significant Influence."</p>	<p>FSP APB 18-1 is effective as of the first reporting period beginning after July 12, 2005.</p>
<p>FSP SOP 78-9-1, "Interaction of AICPA Statement of Position 78-9 and EITF Issue No. 04-5."</p>	<p>For general partners of all new partnerships formed and for existing partnerships for which the partnership agreements are modified, the guidance in FSP SOP 78-9-1 is effective after June 29, 2005. For general partners in all other partnerships, the guidance in this FSP is effective no later than the beginning of first reporting period in fiscal years beginning after December 15, 2005, and the application of either transition methods as described in the FSP are permitted.</p>
<p>FSP SOP 94-6-1, "Terms of Loan Products That May Give Rise to a Concentration of Credit Risk."</p>	<p>The guidance in Question 1 of FSP SOP 94-6-1 is effective for interim and annual periods ending after the date the FSP is posted to the FASB website. An entity shall provide the disclosures required by Statement 107 for products that are determined to represent a concentration of credit risk in accordance with the guidance in Question 1 for all periods presented.</p> <p>Question 2 of this FSP references only existing effective literature; therefore, no effective date or transition guidance is required.</p>
<p>FSP AAG INV-1 and SOP 94-4-1, "Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribution Health and Welfare and Pension Plans."</p>	<p>FSP AAG INV-1 and SOP 94-4-1 is effective as follows:</p> <ul style="list-style-type: none"> - The financial statement presentation and disclosure guidance in paragraphs 8–11 of this FSP, considering the special transition guidance outlined in paragraph 13, is effective for financial statements for annual periods ending after December 15, 2006. The revised definition of fully benefit-responsive in paragraph 7 of this FSP shall be effective for all investment contracts as of the last day of the annual period ending after December 15, 2006. Earlier application to interim or annual periods is permitted. If comparative financial statements are presented, the guidance in this FSP shall be applied retroactively to all prior periods presented. If an investment contract is considered fully benefit-responsive under the revised definition as of the last day of the annual period ending after December 15, 2006, that contract shall be considered fully benefit-responsive for all periods presented, provided that contract would have been considered fully benefit-responsive in accordance with the then existing provisions of SOP 94-4. - To be considered within the scope of the guidance in this FSP as of the effective date and thereafter, any portion of the net assets of the investment company attributable to a particular plan investee that is not held in trust for the benefit of participants in a qualified employer-sponsored defined-contribution plan is not permitted to increase after January 15, 2006, except for reinvestment of income earned. Investment companies that are not considered within the scope of this FSP as of the effective date for reasons described in this paragraph shall report all investment contracts, regardless of whether they are considered fully benefit-responsive, at fair value effective for financial statements for annual periods ending after December 15, 2006, with retroactive application to all prior periods presented.

Summary of Effective Dates (continued)

Pronouncement	Effective Date
GASB Statement No. 40, Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3	GASB Statement 40 is effective for financial statements for periods beginning after June 15, 2004. Earlier application is encouraged.
GASB Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries	GASB Statement 42 is effective for financial statements for periods beginning after December 15, 2004. Earlier adoption is encouraged. Accounting changes adopted to conform to the provisions of this Statement should be applied retroactively by restating financial statements, if practical, for all prior periods presented. If restatement is not practical, the cumulative effect of applying this Statement, if any, should be reported as a restatement of beginning net assets, fund balances, or fund equity, as appropriate, for the earliest period restated. In the period this Statement is first applied, the financial statements should disclose the nature of any restatement and its effect. Also the reason for not restating prior periods presented should be explained. Previously reported impairments, if any, resulted in a new cost basis for the impaired capital asset and should not be restated.
GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans	<p>The requirements of GASB Statement 43 for OPEB plan reporting are effective <i>one year prior</i> to the effective date of the related Statement for the employer (single-employer plan) or for the largest participating employer in the plan (multiple-employer plan). The requirements of the related Statement are effective in three phases based on a government's total annual revenues, as defined in that Statement, in the first fiscal year ending after June 15, 1999—the same criterion used to determine a government's phase for implementation of Statement No. 34, <i>Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments</i>.</p> <ul style="list-style-type: none"> – Plans in which the sole or largest participating employer is a <i>phase 1 government</i> (those with total annual revenues of \$100 million or more) are required to implement this Statement in financial statements for periods beginning after December 15, 2005. – Plans in which the sole or largest participating employer is a <i>phase 2 government</i> (total annual revenues of \$10 million or more but less than \$100 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2006. – Plans in which the sole or largest participating employer is a <i>phase 3 government</i> (total annual revenues of less than \$10 million) are required to implement this Statement in financial statements for periods beginning after December 15, 2007. <p>If comparative financial statements are presented, restatement of the prior-year financial statements is required. Early implementation of this Statement is encouraged.</p>

Table 2

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>GASB Statement No. 44, <i>Economic Condition Reporting - The Statistical Section -- An Amendment of NCGA Statement 1</i></p>	<p>The provisions of GASB Statement 44 are effective for statistical sections prepared for periods beginning after June 15, 2005. Governments that prepare a statistical section for the first time in response to this Statement (or that previously prepared a statistical section but did not present certain information) are encouraged, but not required, to report all required years of information retroactively. Governments are encouraged, but not required, to implement the government-wide information required by this Statement retroactively to the year they implemented Statement 34. If information required by this Statement differs from information previously reported by governments, governments are encouraged, but not required, to restate or revise the information for previous years. If the information for previous years is not restated or revised, governments should clearly indicate the year of implementation of the information required by this Statement and explain the nature of the differences from prior information.</p>
<p>GASB Statement No. 45, <i>Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions</i></p>	<p>GASB Statement 45 generally provides for prospective implementation—that is, that employers set the beginning net OPEB obligation at zero as of the beginning of the initial year. Implementation is required in three phases based on a government's total annual revenues in the first fiscal year ending after June 15, 1999. The definitions and cutoff points for that purpose are the same as those in Statement No. 34, <i>Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments</i>. This Statement is effective for periods beginning after December 15, 2006, for <i>phase 1 governments</i> (those with total annual revenues of \$100 million or more); after December 15, 2007, for <i>phase 2 governments</i> (those with total annual revenues of \$10 million or more but less than \$100 million); and after December 15, 2008, for <i>phase 3 governments</i> (those with total annual revenues of less than \$10 million). Earlier implementation is encouraged.</p>
<p>GASB Statement No. 46, <i>Net Assets Restricted by Enabling Legislation - An Amendment of GASB Statement No. 34</i></p>	<p>The requirements of GASB Statement 46 are effective for financial statements for periods beginning after June 15, 2005. Earlier application is encouraged. Accounting changes adopted to conform to the provisions of this Statement should be applied retroactively by reclassifying net asset information, if practical, in financial statements for all prior periods presented. In the period this Statement is first applied, the financial statements should disclose the nature of any reclassification and its effect. Also, the reason for not reclassifying net asset information for prior periods presented should be explained.</p>
<p>GASB Statement No. 47, <i>Accounting for Termination Benefits</i></p>	<p>The requirements of this Statement are effective in two parts. For termination benefits provided through an existing defined benefit OPEB plan, the provisions of this Statement should be implemented simultaneously with the requirements of Statement 45. For all other termination benefits, this Statement is effective for financial statements for periods beginning after June 15, 2005. Earlier application is encouraged.</p> <p>In the initial year of implementation, the requirements of this Statement should be applied to any previous commitments of termination benefits that remain unpaid at the effective date of the Statement. The cumulative effect of applying this Statement should be reported as a restatement of beginning net assets (or equity or fund balance, as appropriate). Financial statements for prior periods are not required to be restated.</p>

Table 2

Summary of Effective Dates (continued)

Pronouncement	Effective Date
<p>GASB Technical Bulletin No. 2004-2, <i>Recognition of Pension and Other Postemployment Benefit [OPEB] Expenditures/Expense and Liabilities by Cost-Sharing Employers</i></p>	<p>For pension transactions, GASB Technical Bulletin 2004-2 is effective for financial statements for periods ending after December 15, 2004; earlier application is encouraged.</p> <p>For OPEB transactions, the provisions of GASB Technical Bulletin 2004-2 should be applied simultaneously with the requirements of Statement 45.</p>

Accounting Year In Review: 2005

A Financial Reporting letter



For More Information

If you would like further information or to discuss the implications of the matters discussed in this Financial Reporting letter, please contact the BDO Seidman engagement partner serving you or one of the following partners: Ben Neuhausen or Wayne Kolins.

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Material discussed in this *Financial Reporting* letter is meant to provide general information and should not be acted upon without first obtaining professional advice appropriately tailored to your individual circumstances.
