

MINUTES



**To:** Board Members  
**From:** Vaheb (ext. 298)  
**Subject:** Minutes of the January 23, 2008 Board Meeting (Short-Term Convergence, Earnings per Share) **Date:** February 6, 2008  
**cc:** FASB: Golden, Bielstein, MacDonald, Cosper, Leisenring, Chookaszian, Posta, Lott, Klimek, Project Team, Switter, Lipe, Stevens, Allen, C. Smith, Gabriele, FASB Intranet; IASB: Upton, Stewart, Clark, Buschhueter

*The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.*

Topic: Short-Term Convergence—Earnings per Share

Basis for Discussion: Memorandum 13 dated January 9, 2008; Addendum to Memorandum 13 dated January 17, 2008

Length of Discussion: 9:00 to 9:45 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Smith, Linsmeier, Young, and Seidman

Board members absent: None

Staff in charge of topic: Wyatt

Other staff at Board table: Vaheb, Bielstein, and Cassel

Other participants: Clark and Buschhueter (IASB)

Summary of Decisions Reached:

The Board reached the following decisions in addressing the drafting issues related to the earnings per share (EPS) project:

Earnings per share. The Board reached the following decisions in addressing the drafting issues of the revised Exposure Draft:

1. The Board affirmed its decision that instruments that may be settled in cash or shares and are measured at fair value with changes in fair value recognized in earnings would be excluded from the denominator of the diluted earnings per share. The Board acknowledged that in some cases, which they think would be rare, inclusion of those instruments in earnings per share under the treasury stock and reverse treasury stock methods would be dilutive.
2. A financial instrument or contract subject to FASB Statement No. 123 (revised 2004), *Share-Based Payment*, that is recognized (or will be recognized upon satisfaction of a performance or service condition) as a liability and measured under that Statement's fair-value-based measurement approach would also be excluded from the denominator of diluted earnings per share.
3. The Board decided not to require additional disclosures relating to those instruments in items 1 and 2 above, but directed the staff to include questions in the notice for recipients about the need for additional disclosure.

Objective of Meeting:

The objective of the meeting was for the Board to consider the issues that have arisen in drafting the proposed Statements on the amendments to FASB Statement No. 128, *Earnings per Share*. The staff addressed the following issues: (a) the Board's basis for excluding from the denominator of the computation of diluted EPS instruments that can be settled in cash or shares and are measured at fair value with changes in fair value recognized in earnings for the reporting period (the fair value method), (b) whether share-based payment awards subject to Statement 123(R) that are recognized (or will be

recognized upon satisfaction of a performance or service condition) as a liability and measured using that Statement's fair-value-measurement approach should also be subject to the fair value method, and (c) whether disclosures should be required for instruments subject to the fair value method. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

1. Ms. Wyatt began by stating that the purpose of this meeting is to discuss certain issues that have arisen in drafting the proposed Statement on the amendments to Statement 128.

*Instruments that can be settled in cash or shares and are measured at fair value with changes in fair value recognized in earnings for the reporting period*

**Staff Recommendation**

2. Ms. Wyatt stated that in drafting the preballot draft, the staff included what it believed was the rationale for excluding from the denominator of diluted EPS instruments that can be settled in cash or shares and are measured at fair value with changes in fair value recognized in earnings for the reporting period (the fair value method). Those reasons include the following:
  - a. The changes in fair value recognized in earnings reflect the economic effect of these instruments on current shareholders. Excluding these instruments from the computation of EPS also satisfies the Board's objective of simplifying EPS.
  - b. The inclusion of the carrying value of a liability that is measured at fair value with changes in fair value recognized in earnings in computing incremental shares under the modified treasury stock and reverse treasury stock methods will **always** be antidilutive; therefore, why not eliminate these instruments from the computation of EPS?
3. Ms. Wyatt stated that the staff determined that the second reason may not always be true under the reverse treasury stock method, specifically, when the fair value of the instrument is less than the intrinsic value of the option (or embedded option). The situation in which an instrument may have been dilutive under the treasury stock, reverse treasury stock, or if-converted methods is not limited to written put options. The fair value of an instrument may be subject to a multitude of different variables

(for example, interest rates, credit risk, probabilities, and liquidity risk) that may result in the fair value of the instrument being less than its intrinsic value.

4. Ms. Wyatt stated that the staff believes that the Board ultimately decided to adopt the fair value method because the changes in the fair value of those instruments reflect the economic effect of those instruments on current shareholders for the reporting period. Ms. Wyatt stated that the staff would like to confirm that the Board's view on the fair value method would not change because the inclusion of the carrying value of a liability (that is marked-to-market each reporting period) as an assumed proceed in the treasury stock and reverse treasury stock methods may not always be antidilutive.
5. The staff does not believe that disclosures related to instruments subject to the fair value method should be required as part of the Board's short-term convergence project. Rather, the staff recommended asking constituents in the Exposure Document whether (a) they agree with the basis for excluding those instruments from the denominator of the computation of diluted EPS and (b) they agree that no additional disclosures should be required for those instruments.

#### **Board Vote**

6. The Board agreed with the staff's characterization of the Board's basis for adopting the fair value method. The Board agreed with the staff's recommendation on disclosures by a vote of six (RHH, LFS, LWS, GMC, GJB, TJL) to one (DMY). Mr. Young will provide an alternative view on the fair value method and the lack of disclosures for instruments subject to the fair value method.

#### **Board Comments**

7. Mr. Young stated that his dilemma with the fair value method is specific to convertible debt instruments that are recognized at fair value due to an entity's election of the fair value option under FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. His concern is that an investor would not have an indication of potential dilution that could reduce earnings to shareholders if a change in fair value occurs in a period not represented in the current

period financial statements. An investor would have to go back and analyze every financial statement from the issuance of that convertible instrument to capture the economics of dilution. Mr. Young agrees with the staff on all other applications of the fair value method.

8. Ms. Seidman suggested that the staff include a question about the effect of these conclusions on convertibles since more of these instruments will potentially either be considered embedded derivatives or bifurcated pursuant to proposed FSP APB 14-a, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)*. Mr. Linsmeier agreed with Ms. Seidman. However, Mr. Linsmeier stated that the Exposure Draft should include detailed questions that describe the issues that have been raised and views that have been expressed to enable constituents to provide a more detailed response.
9. Mr. Herz stated that the issues Mr. Young has and the issues in Mr. Stephen Cooper's alternative method (from the IASB) are both broader questions that are affected by the liabilities and equity project. Mr. Herz stated that these questions will be more appropriately resolved upon completion of the both the liabilities and equity and financial statement presentation projects. Mr. Smith agreed to move forward with an Exposure Draft. Mr. Smith liked Mr. Cooper's alternative approach, and thought that it is logical but very different from how the FASB has approached it historically. Mr. Smith stated that asking questions and getting feedback will help make progress.
10. Ms. Bielstein stated that she believes that the Board will be forced to look at the computation of EPS upon completion of the liabilities and equity project. Based on today's discussion, she noted that the Board appears to be battling between improving the computation of EPS and simply converging. Mr. Cassel expressed concern that detailed questions will result in a request to redevelop the computation of EPS and he questioned whether the Board would be willing to change the objective of the project from convergence to a full reconsideration of EPS. Mr. Cassel indicated that the staff has currently drafted the question to constituents as follows:

This proposed Statement does not require that specific disclosures be provided about an instrument (freestanding or separately accounted for as a component of a compound instrument) that was excluded in determining the denominator of the computation of diluted EPS because it can be settled in cash or shares and is measured at fair value with changes in fair value recognized in earnings each reporting period. Do you agree? If not, what additional disclosures should be provided and why?

Mr. Cassel stated that this question is more simple than providing a variety of alternatives that could result in a bigger project. Mssrrs. Batavick, Smith, and Herz and Ms. Seidman agreed with the question as described by Mr. Cassel.

11. Mr. Linsmeier stated that his reason for asking broader questions is because the changes to EPS being made in this project may be providing information that is not useful to users. If responses from constituents indicate that the current and proposed EPS models are fundamentally broken, then he would recommend stopping the convergence project and readdressing EPS in total upon completion of the liabilities and equity and financial statement presentation projects. Mr. Linsmeier stated that he does not believe that the Board should continue the convergence project just to get the denominator correct if the information that will be provided is not useful.

12. Mr. Young stated that this project has many good changes to the computation of EPS. However, he believes that disclosures should be provided to show and help users understand the fundamental changes to the presentation of EPS that will occur because of the fair value method. Mr. Young agreed to create an alternative view if the Board decides not to require disclosures. Ms. Bielstein stated that Mr. Cooper will also create an alternative view for the IASB Exposure Draft.

***Clarification of fair value for share-based payment awards subject to Statement 123(R)***

**Staff Recommendation**

13. Ms. Wyatt stated that the staff proposes clarifying that a financial instrument or contract subject to Statement 123(R) that is recognized as a liability and measured under that Statement's fair-value-based measurement approach would be considered to be recognized at fair value for purposes of applying the proposed Statement. Additionally, a portion of certain share-based payment awards may not be recognized

as a liability on the grant date because the requisite service period is not expected to be rendered. The staff would like to clarify that share-based payment awards that will be recognized as a liability upon satisfaction of a performance or service condition should also be subject to the fair value method.

### **Board Vote**

14. The Board agreed with the staff's recommendation. (All Board members agreed.)

### **Board Comments**

15. Mr. Linsmeier stated that he agrees with the recommendation but disagrees with the phrasing of the recommendation. Mr. Linsmeier would prefer stating that share-based payment awards recognized as a liability and measured using Statement 123(R)'s fair-value-based measurement approach are eligible for the fair value method as opposed to stating that these awards are considered to be recognized at fair value. Mr. Herz stated that an example may be needed to help clarify the issue.

### Follow-up Items:

None

### General Announcements:

None