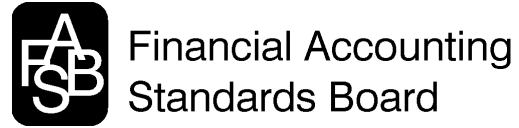


MINUTES



To: FASB Board Members

From: Financial Instruments with Characteristics of Equity Team
(Clark x443)

Subject: Minutes of the January 28, 2009, Board Meeting: *Financial Instruments with Characteristics of Equity* **Date:** January 29, 2008

cc: Leisenring, Bielstein, Switter, Golden, Bossio, Lott, Allen, Klimek, Chookaszian, Posta, Malcolm, Mills, Glotzer, C. Smith, Stoklosa, Proestakes, Sutay, Mechanick, Bhave, Petrone, Schonefeld, Hood, Clark, Gabriele, Finden (GASB), Liz Figgie (IASB), Gavin Francis (IASB), LiLi Lian (IASB), Ian Hague (IASB), FASB Intranet

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, Interpretation, or FASB Staff Position.

Topic: Conceptual Definitions of Liabilities and Equity; Classifying Puttable and Mandatorily Redeemable Instruments

Basis for Discussion: Agenda Paper 11, 11A, 11B

Length of Discussion: 8:00–8:20 a.m.

Attendance:

Board members present: FASB: Herz, Seidman, Siegel, and L. Smith

IASB: Leisenring

Board members participating by phone: FASB: Linsmeier

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|-----------------------------|--|
| Board members absent: | None |
| Staff in charge of topic: | Switzer (FASB), Lott (FASB) |
| Other staff at Board table: | FASB: Clark, Schonefeld IASB: Figgie (by phone) |

Summary of Decisions Reached:

The Board discussed the classification of puttable and mandatorily redeemable instruments with characteristics of equity. The Board decided to further analyze an approach that would divide such instruments into two categories:

1. Instruments that are puttable or mandatorily redeemable upon the occurrence of an event that is certain to occur (such as death or retirement)
2. All other puttable and mandatorily redeemable instruments.

At a future meeting, the Board will discuss classification and possible separation of instruments in each category. One possible outcome would be to classify instruments in category 1 as equity while either classifying instruments in category 2 as liabilities or separating them into liability and equity components.

The Board also discussed the conceptual definitions of a liability and of equity. The Board directed the staff to further develop an approach focused on separating recognition decisions from classification decisions. That approach will entail:

1. Developing a concept to be used to decide which things qualify for potential recognition
2. Developing additional standards-level or concepts-level principles for distinguishing between liabilities and equity.

Objectives of Meeting:

The objectives of the meeting were to discuss (a) the conceptual definitions of liabilities and equity and (b) the classification of mandatorily redeemable and puttable instruments.

The objectives were met.

Matters Discussed and Decisions Reached:

1. Ms. Switter stated that the meeting would be divided into two parts. The objective of the first part of the meeting was to discuss the conceptual definitions of liabilities and equity in the context of the conceptual framework project. The objective of the second part of the meeting was to discuss the classification of mandatorily redeemable and puttable instruments in the context of the financial instruments with characteristics of equity project.

Issue 1: Conceptual Definitions of Liabilities and Equity

2. Mr. Lott stated that the Board is currently attempting to make the definitions of liabilities and equity serve two purposes: (a) determine which things are potentially recognizable and (2) which recognized things can affect comprehensive income. He noted that this approach has been relatively unsuccessful.

3. **Staff Recommendation:** The staff recommended that the Board change its approach to developing definitions of elements of the statement of financial position. Rather than defining two elements (liabilities and equity), define one element (claims or rights against the entity). Then establish separate principles for distinguishing between liabilities (which affect comprehensive income) and equity (which does not affect comprehensive income).

4. Ms. Switter stated that the IASB agreed with the staff's recommendation at its January 21, 2009 Board meeting.

5. **Board Vote:** All Board members agreed with the staff's recommendation.

6. Mr. Leisenring and Ms. Seidman emphasized the need to make a distinction between liabilities and equity. Ms. Seidman further noted that constituents may understand the definitions more easily if they are communicated in the same or a similar form as they are now.

Issue 2: Classification of Puttable and Mandatorily Redeemable Instruments

7. Ms. Switter presented five alternatives to classifying puttable and mandatorily redeemable instruments, which were as follows:

- a. **Alternative 1**—Develop an approach that would require all perpetual and some redeemable instruments¹ to be classified as equity.

Equity classification would consist of the most subordinated property rights and the most subordinated rights to compel. The classification would not necessarily be limited to the single most subordinated rights.² A “natural” line could be considered to exist for any entity that issues perpetual interests (property rights with no associated right to compel). That perpetual interest and anything subordinated to it would be classified as equity. For entities that have not issued any perpetual interests, equity would consist of the most subordinated interest or interests if there are equally subordinated interests at the bottom of the subordination chain.

- b. **Alternative 2**—Separate redeemable instruments into equity and non-equity components.
- c. **Alternative 3**—Develop rules-based requirements for determining which redeemable instruments should be classified as equity. (This is the general approach taken by the IASB in its Amendments to IAS 32, *Financial Instruments: Presentation*, and IAS 1, *Presentation of Financial Statements, Puttable Financial Instruments and Obligations Arising on Liquidation*.)
- d. **Alternative 4**—Classify all redeemable instruments as liabilities.
- e. **Alternative 5**—Separate redeemable instruments into two categories:

(1) Instruments that are redeemable upon an occurrence of an event that is certain to occur and results in the holder ceasing to participate in the activities of the entity, for example, death or retirement—These instruments are redeemable upon events that are certain to occur, but the date or the timing of the event is unknown.

(2) All other redeemable instruments—This category would include instruments that are redeemable on a certain date, over a range of dates, or at anytime.

¹The staff is using the term *redeemable instruments* as a convenient way to describe instruments that are puttable (redeemable at the option of the holder) or mandatorily redeemable and that would clearly be equity if not for those features. This term does not include equity instruments that are callable (redeemable at the option of the issuer).

² This is not the same as the recent amendments to IAS 32 or the basic ownership approach as described in the FASB Preliminary Views, *Financial Instruments with Characteristics of Equity*.

8. Ms. Switter noted that the first four classification alternatives would be applied to all mandatorily redeemable and puttable instruments. She added that at the January 14, 2009 education session, Mr. Leisenring proposed an alternative approach, which is included as alternative five. Alternative five would separate redeemable instruments into two categories.

9. The first category includes instruments that are redeemable upon an occurrence of an event that is certain to occur and results in the holder ceasing to participate in the activities of the entity, for example, death or retirement. It is likely that most people would agree that those instruments are “equity-like.”

10. The second category includes all other redeemable instruments, for example, instruments that are redeemable on a certain date, over a range of dates, or at any time. The Board could decide to classify some or all of these instruments as liabilities or to separate all or some of the instruments.

11. Ms. Switter stated that the staff has not yet fully analyzed alternative five or classification alternatives for the instruments that are included in the second category (paragraph 7(e)(ii)), but that the staff believes that the alternative five is worth pursuing. She added that at its January 12, 2009 meeting, the IASB directed the staff to perform additional analysis on alternative five and present the results at a future meeting.

12. **Staff Recommendation:** The staff stated that it was in favor of pursuing alternative 5.

13. **Board Vote:** All Board members agreed with the staff’s recommendation.

14. Mr. Smith asked whether those instruments that fall into the second category would still be subject to alternatives 1–4. Ms. Switter stated that the Board would still have to decide whether to separate all or some of the instruments or whether to classify some or all of the instruments as liabilities or equity in their entirety. She further noted that some of the issues the staff identified with alternative two may be resolved under alternative five. For example, she explained that the staff concluded that separating a puttable or mandatorily redeemable share may be difficult for a private company. That is because determining the fair value of a derivative (a put or forward) that is embedded in an equity

instrument can be difficult unless there is a quoted price for similar options. She added that under alternative five it is possible that many of the puttable and mandatorily redeemable instruments issued by private companies will be included in the first category. She stated that the staff is researching the population of instruments in the second category and will develop classification recommendations for the Board to consider at a later date.

15. Mr. Smith asked how alternative five resolved the issues associated with cooperative shares. Mr. Leisenring stated that, often times, cooperative shares are puttable when a member ceases to participate as a member of the cooperative, which is similar to ceasing to be an employee of a company (retirement) or death. Mr. Lott added that not all cooperatives are alike, so Mr. Leisenring's analysis would depend on the characteristics of an entity. Some cooperative shares do require that a member put their interest back to the entity on a fixed date for a fixed amount. He also added that dependent upon the terms of a cooperative member's share, separation of the put from the share may result in most of the instrument's value being allocated to the put (a liability), whereas other times the instrument's value may be allocated mostly to the share (equity).

16. Mr. Linsmeier stated his preference for pursuing alternative five as long as the instruments in category two are all separated or all classified as liabilities. Mr. Siegel and Mr. Smith agreed.

Follow-up Items:

None.

General Announcements:

None.