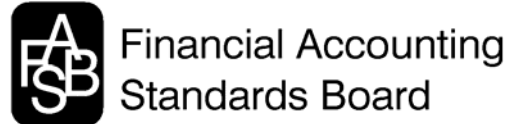


MINUTES



**To:** Board Members  
**From:** Reager (ext. 393)  
**Subject:** Minutes of June 25, 2008 Board Meeting: Ratification of EITF Consensuses and Consensus-for-Exposure  
**Date:** Jul 9, 2008  
**cc:** Golden, Cosper, Bielstein, MacDonald, Stoklosa, Elsbree, Leverenz, Nickell, Malcolm, Maples, Stevens, Switter, Wyatt, Zecher, Wilks, Reager, Allen, Gabriele, Posta, Chookaszian, Richter, Leisenring, Bean, FASB Intranet

*The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. Official consensus positions of the EITF are presented in EITF meeting minutes and in EITF Abstracts. Board ratification of a consensus-for-exposure permits the exposure of a draft abstract for public comment. Board ratification of an EITF consensus completes the overall due process of developing a consensus as set forth in EITF Abstracts, Topic No. D-1, "Implications and Implementation of an EITF Consensus."*

Topic: Board ratification of the consensuses reached on EITF Issues Nos. 07-5, 08-3, and 08-4, and the consensus-for-exposure reached on EITF Issue No. 08-5

Basis for Discussion: Board Memorandum dated June 19, 2008

Length of Discussion: 10:10 a.m. to 10:40 a.m.

Attendance:

Board members present: Herz, Batavick, Linsmeier, Seidman, Smith, and Young  
Staff in charge of topic: Paul and Malcolm  
Other staff at Board table: Cosper, Golden, Stoklosa, and Reager  
Outside participants: None

Summary of Decisions Reached:

The Board considered and ratified consensuses reached at the June 12, 2008 EITF meeting on Issues No. 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock," No. 08-3, "Accounting by Lessees for Nonrefundable Maintenance Deposits," and No. 08-4, "Transition Guidance for Conforming Changes to Issue No. 98-5."

The Board also considered and ratified the consensus-for-exposure reached at the June 12, 2008 EITF meeting on Issue No. 08-5, "Issuer's Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement."

Mr. Herz announced the removal of issues from the Task Force's agenda including Issues No. 02-D, "The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a)(1) of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*," and No. 08-2, "Lessor Revenue Recognition for Maintenance Services."

Mr. Herz also announced the removal from the Board's agenda of proposed Statement 133 Implementation Issue No. C21, "Whether Options (Including Embedded Conversion Options) Are Indexed to both an Entity's Own Stock and Currency Exchange Rates" (proposed DIG Issue C21).

Objective of Meeting:

The objective of the meeting was for the Board to ratify the consensuses reached on three Issues and the consensus-for-exposure reached on one additional Issue. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

**RATIFICATION OF CONSENSUSES**

**Issue 07-5, "Determining Whether an Instrument (or Embedded Feature) Is Indexed to an Entity's Own Stock"**

1. Ms. Malcolm summarized the consensus reached by the Task Force on Issue 07-5 . Ms. Malcolm said that the objective of this Issue was to provide guidance for determining whether an equity-linked financial instrument or embedded feature is indexed to an entity's own stock. She stated that the Task Force affirmed as a consensus the consensus-for-exposure previously reached at the March 12, 2008 EITF meeting, which were exposed for public comment. She said that the Task Force also approved clarifying language (including the addition of a definition for the term "exercise contingency") and decided to add three additional illustrative examples.

**Issue 07-5 Board Vote**

2. The Board agreed to ratify the consensus reached in Issue 07-5 (Mr. Herz dissented).

**Issue 07-5 Board Comments**

3. Mr. Linsmeier stated that it is disconcerting that Issue 07-5 is necessary to help implement the current model. Mr. Linsmeier said that the current model for liabilities and equity needs to be changed. Mr. Linsmeier stated that if so much explanation is necessary to determine when an instrument is indexed to an entity's own stock then it calls into question whether indexing to an entity's own stock is an equity event. He said that Issue 07-5 can be seen as an addition to the complexity of US GAAP and that Issue 07-5 may also be difficult to apply uniformly. Mr. Linsmeier questioned the financial statement benefit gained by users from Issue 07-5 and he also expressed his discontent with the current liabilities and equity model, which he feels should include a narrower view of equity than the current model. He also said that Issue 07-5 is very rules based, which can be problematic, but he did agree to ratify the consensus on Issue 07-5. Mr. Linsmeier added that the notion that consideration of another entity's hedge costs when determining whether something is equity or not does not make sense.
4. Mr. Young stated that he did not think users would receive that much information from the ratification of the Issue 07-5 consensus. He said that from a preparer point of view, he felt that this Issue may create more problems than it is solving. Mr. Young said that a new liabilities and equity model is needed. He felt that Issue 07-5 is a band-aid approach that could add complexity. Mr. Smith said that he also thinks a

new liabilities and equity model is needed, but he said that ratifying the consensus on Issue 07-5 should help preparers apply the current literature.

5. Ms. Seidman said that the complexity of Issue 07-5 is related to the underlying GAAP that this Issue is trying to interpret, which is a very complicated model. Ms. Seidman said that she worked on the predecessor to Issue 07-5, EITF Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock,” which she said was simpler and focused on whether instruments were settled in shares, but she said that many criteria were subsequently added to Issue 00-19. She said that the consensus on this Issue should help stabilize practice. Ms. Seidman stated that ISDA agreements and issues related to the classification of liabilities and equity are being experienced around the world and it is appropriate to address these issues in Issue 07-5. Ms. Seidman said that this Issue will continue to be relevant under US GAAP if the Board does not proceed with a narrow view of equity. She said that it was good to establish the parameters that would not cause a liabilities and equity classification issue. Ms. Seidman stated that this Issue is relevant under ownership settlement and IAS 32, *Financial Instruments: Presentation*, and should be addressed by the Board. Ms. Seidman stated that this Issue also addresses the accounting for market-based employee stock option valuation.
6. Ms. Seidman stated that she disagreed with the consensus on the foreign currency issue in Issue 07-5 and she had previously disagreed with proposed Implementation Issue C-21. However, Ms. Seidman said that she did not object to the consensus reached in Issue 07-5.
7. Mr. Herz stated that he rejected the consensus reached in Issue 07-5. He said that the benefits of the consensus reached on Issue 07-5 are that it answers the questions raised regarding the accounting for market-based employee stock option valuation instruments and by proposed Implementation Issue C-21. Mr. Herz said that Issue 07-5 may help stabilize practice, but it also may not help stabilize practice. He stated that the language in Issue 07-5 about discontinuities in the hedge and inputs in the fair value model may raise even more questions.

8. Mr. Herz stated that practice has stretched past the original intent of the literature. Mr. Herz referred to paragraph 286 in the basis of conclusions of FASB Statement No. 133, "Accounting for Derivative Instruments and Hedging Activities," which says that until the liabilities and equities project is finished, contracts that provide for settlement in shares of an entity's stock but that are indexed in part or in full to something other than the entity's stock are to be classified as assets or liabilities and not as part of stockholders' equity. Mr. Herz said that the guidance in paragraph 286 of Statement 133 seems fairly clear, but constituents have questioned the intent of that paragraph because stock options have an interest component and a time value component. Mr. Herz stated that as a result, the Board ratified EITF Issue No. 01-6, "The Meaning of 'Indexed to a Company's Own Stock,'" which broadened the definition of equity. Mr. Herz said that the Issue 01-6 consensus says that the instrument settlement amount is based solely on the issuer's stock, but that there is also a contingency that allows an instrument to be indexed to the issuer's operations, but not indexed to something like gold or another index.
9. Mr. Herz stated that the proposed consensus in Issue 07-5 seems to significantly broaden equity to allow features that have already been written into existing agreements. He said that some of these features may be typical of anti-dilution events, but that other features may extend beyond anti-dilution events and clearly provide protections that are not afforded to the stock to which an instrument is indexed. Mr. Herz said that these features go beyond the anti-dilution events and requirements in FASB Statement No. 123 (*revised 2004*), *Share-Based Payment*. He stated that the problem with the proposed guidance is that the adjustment or make whole features are okay as long as they relate to any of the inputs used to fair value an equity option or forward. That seems to have a number of results; one of which is that the holders of these instruments have protections that are greater than the protections granted to holders of the underlying stock. Mr. Herz said that he understands the commercial reasons for this; which include the counterparty demanding protections and if the counterparty does not receive protections, the counterparty raising the price or not accepting the deal. Mr. Herz said that the commercial reasons for providing additional protections to the counterparty are understandable, but the commercial reasons for

arranging a transaction in a certain way should not dictate the accounting for that transaction.

10. Mr. Herz stated that the current liabilities and equity model needs to be changed and that there is a Preliminary Views document in the FASB's liabilities and equity project, which includes a narrower view of equity. Mr. Herz said that his decision to object to the ratification of Issue 07-5 is not related to the progress of the liabilities and equity project. Instead, he said that his objection to the ratification of Issue 07-5 is based on his opinion that Issue 07-5 does not reflect the underlying concepts that exist in the current liabilities and equity model. Mr. Herz stated that he is worried about the add on in Issue 07-5 related to the inputs in the fair value model and wording related to discontinuity in the price and hedging. Mr. Herz stated that he is concerned with what the accounting and earnings per share treatment is when there is an adjustment that protects the counterparty. Mr. Herz said that he believes that if there is an adjustment to protect the counterparty and there is a value addition or compensation, there should at least be a charge against earnings available to common because it would come to a non pro-rata distribution. Mr. Herz said that upon further inquiry with the staff he learned that there may not be an adjustment to earnings available to common in this circumstance, which Mr. Herz finds concerning.
11. Mr. Herz said that Issue 07-5 does answer the ESORs question and the proposed Implementation Issue C-21 question, and it does provide some immediate guidance relating to some of these existing arrangements. However, Mr. Herz said that Issue 07-5 extends the literature and adds enormous potential complexity. He also said that he finds 16(c) and 16(d) of Example 16 in Issue 07-5 troubling. Mr. Herz stated that he does not support the model in Issue 07-5, but he might support a model that is fixed-for-fixed with an adjustment for time value.
12. Mr. Linsmeier stated that he is afraid that Issue 07-5 may expand the definition of equity.

**Issue 08-3, “Accounting by Lessees for Nonrefundable Maintenance Deposits”**

13. Ms. Malcolm referred the Board to the Board Meeting Memorandum and the Board Meeting Handout for a summary of the consensus reached by the Task Force.

14. Ms. Malcolm said that certain members of the Board had expressed concern that the word “nonrefundable” in the title of the Issue might be confusing. She said that technically the maintenance deposits referred to are refundable if certain maintenance activities are performed. Ms. Malcolm stated that the maintenance deposits referred to in this Issue are only forfeited if maintenance activities are not performed. She said that revisions have been made to the wording of this Issue to address that concern and those revisions will be reflected in the EITF Minutes.

**Issue 08-3 Board Vote**

15. The Board agreed to ratify the consensus reached in Issue 08-3 (no Board members objected).

**Issue 08-4, “Transition Guidance for Conforming Changes to Issue No. 98-5”**

16. Ms. Malcolm referred the Board to the Board Meeting Memorandum and the Board Meeting Handout for a summary of the consensus reached by the Task Force.

**Issue 08-4 Board Vote**

17. The Board agreed to ratify the consensus reached in Issue 08-4 (no Board members objected).

**RATIFICATION OF CONSENSUS-FOR-EXPOSURE**

**Issue 08-5, “Issuer’s Accounting for Liabilities Measured at Fair Value with a Third-Party Credit Enhancement”**

18. Ms. Malcolm referred the Board to the Board Meeting Memorandum and the Board Meeting Handout for a summary of the consensus-for-exposure reached by the Task Force.

**Issue 08-5 Board Vote**

19. The Board agreed to ratify the consensus-for-exposure reached in Issue 08-5 (no Board members objected).

Follow-up Items:

20. Mr. Herz announced the removal of Issues from the Task Force's agenda including Issues No. 02-D, "The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a)(1) of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities," and No. 08-2, "Lessor Revenue Recognition for Maintenance Services."
21. Mr. Herz also announced the removal from the Board's agenda of proposed Statement 133 Implementation Issue No. C21, "Whether Options (Including Embedded Conversion Options) Are Indexed to both an Entity's Own Stock and Currency Exchange Rates."

General Announcements:

22. None