

FASB STAFF POSITION

No. FAS 150-2

Title: Accounting for Mandatorily Redeemable Shares Requiring Redemption by Payment of an Amount That Differs from the Book Value of Those Shares, under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*

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Some companies have outstanding shares, all of which are subject to mandatory redemption on the occurrence of events that are certain to occur. Assume on the date of adoption that the redemption price of the shares is more than the book value of those shares (which is the difference between the recorded amounts of the company's assets and its liabilities other than the shares subject to mandatory redemption).¹ On the date of adoption, the company would recognize a liability for the redemption price of the shares that are subject to mandatory redemption, reclassifying the amounts previously recognized in the equity accounts. Any difference between the redemption price on the date of adoption and the amounts previously recognized in equity is reported in the statement of income as a cumulative effect transition adjustment loss. The redemption price may be a fixed amount or may vary based on specified conditions.

Q—How should the cumulative transition adjustment and subsequent adjustments to reflect changes in the redemption price of the shares be reported if they exceed the company's equity balance?

A—The cumulative transition adjustment and any subsequent adjustments should be reported as an excess of liabilities over assets (a deficit) and changes thereto even though the mandatorily redeemable shares are reported as a liability.

If the redemption price of the mandatorily redeemable shares is less than the book value of those shares, the company should report the excess of that book value over the liability reported for the mandatorily redeemable shares as an excess of assets over liabilities (equity).

Depending on the settlement terms, Statement 150 requires that mandatorily redeemable shares be measured at either the present value of the amount to be paid at settlement or the amount of cash that would be paid under the conditions specified in the contract if settlement occurred at

¹ If the redemption price is the book value of the shares on the redemption date, Statement 150 requires the mandatorily redeemable shares to be reported as a liability, measured at that book value. At the date of adoption of Statement 150, all amounts previously recognized in the equity accounts are eliminated (as shown in paragraph A16 of Statement 150). Subsequently, the liability is the book value of the entity's assets net of its other liabilities, with the change from the previous period being reported as interest cost (separately from other interest). Therefore, while the entity may report an amount of income before interest on mandatorily redeemable shares (change in redemption amount), the net income (loss) in the statement of income would be zero.

the reporting date, recognizing the resulting change in that amount as interest cost (change in redemption amount).

Paragraph A30 of Statement 150 indicates that, for mandatorily redeemable shares measured initially at present value using the rate implicit at inception of the contract, the cumulative transition adjustment is the difference between the carrying amount and the present value of the liability. For mandatorily redeemable shares that will be redeemed at a variable amount (fair value in the examples presented), the initial measure of the liability is the amount that would be paid under the conditions specified in the contract if settlement occurred at the reporting date (the fair value of the shares on that date). Therefore, the cumulative transition adjustment for shares redeemable at fair value is the difference between the carrying amount and fair value at transition. The carrying amount of the mandatorily redeemable shares is their book value, which includes all amounts attributable to those shares.

Transition

The guidance in this FSP is effective immediately for mandatorily redeemable shares of entities for which the requirements of Statement 150 have already been applied. The guidance should be applied for other entities as part of the adoption of Statement 150. If this guidance results in changes to previously reported information, the cumulative effect shall be reported according to the provisions of Statement 150, in the first period beginning after the effective date of this FSP.

Illustrations of Accounting for Mandatorily Redeemable Shares with a Redemption Value That Differs from the Company's Book Value²

Example 1

Assume a company adopts Statement 150 on January 1, 20XX, and that the fair value (which equals the redemption value) of the mandatorily redeemable shares is \$20 million and the book value of those shares is \$15 million, of which \$10 million is paid-in capital. On the date of adoption, the company would recognize a liability of \$20 million by transferring \$15 million out of equity and recognizing a cumulative transition adjustment loss of \$5 million. Subsequently, net income attributable to the mandatorily redeemable shares is \$1 million for the year 20XX and the fair value of those shares at the reporting date of December 31, 20XX, is \$21.2 million. Also assume that the company did not pay any cash dividends.

The following illustrates the statement of position at January 1, 20XX, and December 31, 20XX, and the statement of income for the year ended December 31, 20XX (income tax considerations have been disregarded):

² The illustrations presented in this FSP assume that all shares of the entity are mandatorily redeemable and are, therefore, consistent with required presentation and disclosures in paragraphs 19 and 28 of Statement 150. However, if the entity has other classes of shares outstanding and classified in equity, there are no special presentation and disclosure requirements.

Statements of Financial Position:

	<u>January 1, 20XX</u>	<u>December 31, 20XX</u>
Total Assets	\$ 25,000,000	\$ 26,000,000
Liabilities other than shares	\$ 10,000,000	\$ 10,000,000
Shares subject to mandatory redemption*	20,000,000	21,200,000
Total Liabilities	\$ 30,000,000	\$ 31,200,000
Excess of Liabilities over Assets (deficit)	\$ (5,000,000)	\$ (5,200,000)
Total	\$ 25,000,000	\$ 26,000,000

Notes to Financial Statements:

*Shares, all subject to mandatory redemption upon death of the holders, consist of:

Common Stock--\$100 par value, 200,000 shares authorized, 100,000 shares issued and outstanding	\$ 10,000,000	\$ 10,000,000
Retained Earnings attributable to those shares	5,000,000	6,000,000
Excess of redemption amount over common stock and retained earnings attributable to those shares	5,000,000	5,200,000
	\$ 20,000,000	\$ 21,200,000

Partial Statement of Income (For the Year Ended December 31, 20XX):

Income before interest on mandatorily redeemable shares	\$ 1,000,000
Less: Interest on mandatorily redeemable shares (change in redemption amount)	<u>1,200,000</u>
Income (loss) before cumulative effect of a change in accounting principle	\$ (200,000)
Cumulative effect of change in accounting principle	<u>(5,000,000)</u>
Net loss	<u><u>\$ (5,200,000)</u></u>

Example 2

Assume the same facts as in Example 1 except that the shares are to be redeemed at an amount (\$11 million) that is less than their book value. On the date of adoption, January 1, 20XX, the company would recognize a liability of \$11 million by transferring \$11 million out of equity.

The following illustrates the statement of position at January 1, 20XX:

Statement of Financial Position (as of January 1, 20XX):

Total Assets	\$ 25,000,000
Liabilities other than shares	\$ 10,000,000
Shares subject to mandatory redemption*	<u>11,000,000</u>
Total Liabilities	\$ 21,000,000
Excess of Assets over Liabilities (Equity)	<u>\$ 4,000,000</u>
Total	<u><u>\$ 25,000,000</u></u>

Notes to Financial Statements:

*Shares, all subject to mandatory redemption upon death of the holders, consist of:

Common Stock--\$100 par value, 200,000 shares authorized, 100,000 shares issued and outstanding	\$ 10,000,000
Retained earnings attributable to those shares	5,000,000
Excess of common stock and retained earnings attributable to those shares over redemption amount	<u>(4,000,000)</u>
	<u><u>\$ 11,000,000</u></u>