PROPOSED NULLIFICATIONS AND AMENDMENTS TO THE EITF D-TOPICS

The SEC staff recommends nullifying the following three D-Topics:

- ✓ **Topic No. D-63, "Call Options 'Embedded' in Beneficial Interests Issued by a Qualifying Special-Purpose Entity":** As noted in the *Subsequent Developments* section of Topic D-63, paragraphs 9c, 48, 50, and 85-88 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities,* address the issues raised in Topic D-63.

  Following the issuance of Statement 140, Topic D-63 could have been deleted but at the time was not because the SEC staff was considering providing additional guidance. Since no additional guidance is planned, Topic D-63 can be removed.

- ✓ **Topic No. D-73, "Reclassification and Subsequent Sale of Securities in Connection with the Adoption of FASB Statement No. 133":** FASB Statement No. 133, *Accounting for Derivative instruments and Hedging Activities*, was generally implemented in 2001 for public and private companies and therefore there is no longer a continuing need for the guidance.

- ✓ **Topic No. D-88, "Planned Major Maintenance Activities":** The FASB staff plans to issue an FASB Staff Position on planned major maintenance prior to the end of the 3rd Quarter of 2006. The FSP as proposed will address the issues raised in Topic D-88 and therefore, presuming the FSP is issued as planned, there is no longer a continuing need for the guidance.

The SEC staff recommends amending the following three D-Topics: ***Refer to Appendices A through C for draft revisions of each of these D-Topics***

- ✓ **Topic No. D-53, "Computation of Earnings per Share for a Period That Includes a Redemption or an Induced Conversion of a Portion of a Class of Preferred Stock":** Topic D-53 contains references to the AICPA Accounting Interpretation No. 44, "If Converted Method at Actual Conversion," which is an interpretation of the superseded APB Opinion No. 15, *Earnings per Share.* While FASB Statement No. 128, *Earnings per Share*, supersedes Opinion 15, it does not address the issues considered in Topic D-53. Therefore, the SEC staff proposes deleting the references to AIPCA Interpretation 44 and Opinion 15 and adding a reference to Statement 128.

- ✓ **Topic No. D-86, "Issuance of Financial Statements":** Footnote 4 references examples included in previously deleted EITF Issues No. 95-18, "Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements," and No. 99-11, "Subsequent Events Caused by Year 2000." Since, these references were added as examples only and do not contribute to the ultimate conclusion, the SEC staff proposes that the footnote be deleted in its entirety.

- ✓ **Topic No. D-98 "Classification and Measurement of Redeemable Securities":** The SEC staff recommends two amendments to Topic D-98, which are as follows:

    1. *Paragraph 19 – Change the term "preferential distribution" to "distribution different from other common shareholders":* The D-Topic considers circumstances in which a specific shareholder has received a "preferential" dividend relative to the remaining shareholders. However, the SEC staff has encountered the reverse circumstance, where remaining shareholders actually received the "preferential" dividend. Therefore, the SEC staff proposes changing the term *preferential distribution* to *a distribution different from other common shareholders* to accommodate such situations.

    2. *Reference to FASB Statement No. 155,* Accounting for Certain Hybrid Financial Instruments: The SEC staff proposes adding a new paragraph 31 that highlights the notion included in Statement 155, footnote 6bb, that hybrid financial instruments that are classified in stockholders' equity are not included in the scope of Statement 155 and therefore the guidance in Topic D-98 continues to be applicable.

Appendix A

Topic No. D-53

Topic: Computation of Earnings per Share for a Period That Includes a Redemption or an Induced Conversion of a Portion of a Class of Preferred Stock

Date Discussed: September 18-19, 1996

The SEC Observer made the following announcement of the SEC staff's position on the computation of earnings per share (EPS) for a period that includes a redemption or an induced conversion of a portion of a class of preferred stock.

As summarized in *EITF Abstracts*, Appendix D, Topic No. D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock," the SEC staff has taken the position that the excess of the fair value of the consideration transferred to holders of preferred stock over the carrying amount of the preferred stock (excess consideration) represents a return to the preferred stockholders. Topic D-42 also sets forth the staff's position that the excess of the fair value of the consideration transferred to holders of preferred stock, pursuant to an inducement offer, over the fair value of securities issuable pursuant to the original conversion terms (excess consideration) represents a return to the preferred stockholders. In both cases, the excess consideration is treated in a manner similar to the treatment of dividends paid to the holders of preferred stock in the computation of EPS. Topic D-42 further expresses the staff's view that when the excess consideration is a negative amount (that is, when a redemption or conversion is effected at a discount to the carrying amount or original terms of the preferred security), the computation of EPS should reflect that negative amount.

When a registrant effects a redemption or induced conversion of only a portion of the outstanding securities of a class of preferred stock, the SEC staff believes that any excess consideration should be attributed to those shares that are redeemed or converted. Accordingly, ~~consistent with the guidance provided in AICPA Accounting Interpretation 44, " If Converted Method at Actual Conversion," of APB Opinion No. 15, *Earnings per Share*,~~ the staff believes that, for the purpose of determining whether the "if-converted" method is dilutive for the period, the shares redeemed or converted should be considered separately from those shares that are not redeemed or converted. The staff does not believe that it is appropriate to aggregate securities with differing effective dividend yields when determining whether the "if-converted" method is dilutive, which would be the result if a single, aggregate computation was made for the entire series of preferred stock.

To illustrate the SEC staff's application of Topic D-42 to a partial redemption, assume that a registrant has shares of common stock and 100 shares of convertible preferred stock outstanding at the beginning of the period. The convertible preferred stock was issued at fair value, which was equal to its par value of $10 per share, and has a stated dividend of 5 percent, and each share of preferred stock is convertible into 1 share of common stock. During the period, 20 preferred shares were redeemed by the registrant for $12 per share.

In this example, the SEC staff believes that the registrant should determine whether conversion is dilutive (1) for 80 of the preferred shares by applying the "if-converted" method from the beginning of the period to the end of the period using the stated dividend of 5 percent and (2) for 20 of the preferred shares by applying the "if-converted" method from the beginning of the period to the date of redemption using both the stated dividend of 5 percent and the $2 per share redemption premium.

Accordingly, assuming that the dividend for the period for the preferred stock was $0.125 per share, a determination of whether the 20 redeemed shares are dilutive should be made by comparing the $2.125 per-share effect of assuming those shares are not converted to the effect of assuming those 20 shares were converted into 20 shares of common stock, weighted for the period for which they were outstanding. The determination of the "if-converted" effect of the 80 shares not redeemed should be made separately, by comparing the EPS effect of the $0.125 per-share dividend to the effect of assuming conversion into 80 shares of common stock.

Subsequent Developments

FASB Statement No. 128, *Earnings per Share*, was issued in February 1997. Statement 128 supersedes APB Opinion No.15, *Earnings per Share*, and AICPA Accounting Interpretation 44, "If Converted Method at Actual Conversion"; however, Statement 128 does not address how to determine whether a convertible security is anti-dilutive when there has been a partial redemption or conversion (refer to paragraph 172). Therefore, the guidance in this Topic continues to be applicable.

Appendix B

Topic No. D-86

Topic: Issuance of Financial Statements

Date Discussed: January 19–20, 2000

The SEC staff has received a number of inquiries regarding when financial statements are considered to have been issued. In considering this issue, the SEC staff observed that Rules 10b-5 and 12b-20 under the Securities Exchange Act of 1934 and General Instruction C(3) to Form 10-K specify that financial statements must not be misleading as of the date they are filed with the Commission. For example, assume that a registrant widely distributes its financial statements but, before filing them with the Commission, the registrant or its auditor becomes aware of an event or transaction that existed at the date of the financial statements that causes those financial statements to be materially misleading. If a registrant does not amend those financial statements so that they are free of material misstatement or omissions when they are filed with the Commission, the registrant will be knowingly filing a false and misleading document. In addition, registrants are reminded of their responsibility to, at a minimum, disclose subsequent events,[1] while independent auditors are reminded of their responsibility to assess subsequent events[2] and evaluate the impact of the events or transactions on their audit report.[3]

A registrant and its independent auditor have responsibilities with regard to post-balance-sheet-date subsequent events, as well as the application of authoritative literature applicable to such events.~~[4]~~ Referring to AICPA Statement on Auditing Standards No. 1, *Subsequent Events* (SAS 1 or AU 560), paragraph 3 states:

> The first type [of subsequent event] consists of those events that provide additional evidence with respect to conditions that existed at the date of the balance sheet and affect the estimates inherent in the process of preparing financial statements. All information that becomes available prior to the issuance of the financial statements should be used by management in its evaluation of the conditions on which the estimates were based. The financial statements should be adjusted for any changes in estimates resulting from the use of such evidence.

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[1] See AICPA Codification of Statements on Auditing Standards, AU Section 560, *Subsequent Events*, paragraphs 5 and 8.

[2] See AU 560 and AU Section 561, *Subsequent Discovery of Facts Existing at Date of the Auditor's Report.*

[3] See AU Section 530, *Dating of the Independent Auditor's Report*, and AU 560, paragraph 9.

~~[4] For example, see Issues No. 95-18, "Accounting and Reporting for a Discontinued Business Segment When the Measurement Date Occurs after the Balance Sheet Date but before the Issuance of Financial Statements," and No. 99-11, "Subsequent Events Caused by Year 2000."~~

Generally, the staff believes that financial statements are "issued" as of the date they are distributed for general use and reliance in a form and format that complies with generally accepted accounting principles (GAAP) and, in the case of annual financial statements, that contain an audit report that indicates that the auditors have complied with generally accepted auditing standards (GAAS) in completing their audit. Issuance of financial statements then would generally be the earlier of when the annual or quarterly financial statements are widely distributed to all shareholders and other financial statement users[5] or filed with the Commission. Furthermore, the issuance of an earnings release does not constitute issuance of financial statements because the earnings release would not be in a form and format that complies with GAAP and GAAS.

[5] Posting financial statements to a registrant's web site would not be considered wide distribution to all shareholders and other financial statement users as not all such parties necessarily have the ability to access a registrant's web site or be aware that such a posting had occurred.

Appendix C

Topic No. D-98

Topic: Classification and Measurement of Redeemable Securities

Dates Discussed: July 19, 2001; May 15, 2003; March 17–18, 2004; September 15, 2005

1. The SEC staff has received inquiries about the financial statement classification and measurement of securities subject to mandatory redemption requirements or whose redemption is outside the control of the issuer. [Note: See Subsequent Developments section below.]

Scope

2. Rule 5-02.28 of Regulation S-X[1] requires preferred securities that are redeemable for cash or other assets to be classified outside of permanent equity if they are redeemable (1) at a fixed or determinable price on a fixed or determinable date, (2) at the option of the holder, or (3) upon the occurrence of an event that is not solely within the control of the issuer. Although the rule specifically describes and discusses preferred securities, the SEC staff believes that Rule 5-02.28 of Regulation S-X also provides analogous guidance for other equity instruments including, for example, common stock and derivative instruments that are classified as equity pursuant to Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock."

3. As noted in Accounting Series Release No. 268 (ASR 268), the Commission reasoned that "[t]here is a significant difference between a security with mandatory redemption requirements or whose redemption is outside the control of the issuer and conventional equity capital. The Commission believes that it is necessary to highlight the future cash obligations attached to this type of security so as to distinguish it from permanent capital."[2] Upon a reporting entity's adoption of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, certain instruments that previously were reported as part of shareholder's equity (including temporary equity) will be reported as liabilities. [Note: See Subsequent Developments section below.] Consequently, the presentation requirements outlined in ASR 268 (Rule 5-02.28 of Regulation S-X), and the interpretive guidance in this staff announcement, do not apply to those instruments after the effective date of Statement 150. ASR 268 and the interpretive guidance in this staff announcement continue to be applicable for instruments that are not within the scope of Statement 150.

[1] Adopted in Accounting Series Release No. 268, *Presentation in Financial Statements of "Redeemable Preferred Stocks."*
[2] See ASR 268, July 27, 1979.

Classification

4. Rule 5-02.28 of Regulation S-X requires securities with redemption features that are not solely within the control of the issuer to be classified outside of permanent equity. The SEC staff believes that all of the events that could trigger redemption should be evaluated separately and that the possibility that *any* triggering event that is not *solely* within the control of the issuer could occur—without regard to probability—would require the security to be classified outside of permanent equity.

5. The SEC staff believes that ordinary liquidation events, which involve the redemption and liquidation of all equity securities, should not result in a security being classified outside of permanent equity. In other words, if the payment of cash is required only upon final liquidation of the company, then that potential event need not be considered when applying the rule. However, deemed liquidation events that require one or more particular class or type of equity security to be redeemed cause those securities to be classified outside of permanent equity.

6. Determining whether an equity security is redeemable at the option of the holder or upon the occurrence of an event that is solely within the control of the issuer can be complex. Accordingly, the SEC staff believes that all of the individual facts and circumstances should be considered in determining how an equity security should be classified.

<u>Examples in which permanent equity classification is not appropriate</u>

7. Assume that a preferred security has a redemption provision that states it may be called by the issuer upon an affirmative vote by the majority of its board of directors. While some might view the decision to call the security as an event that is within the control of the company, the SEC staff believes that if the preferred security holders control a majority of the votes of the board of directors through direct representation on the board of directors or through other rights, the preferred security is redeemable at the option of the holder and its classification outside of permanent equity is required. In other words, any provision that requires approval by the board of directors cannot be assumed to be within the control of the issuer. All of the relevant facts and circumstances must be considered.

8. In another example, consider a security with a deemed liquidation clause that provides that the security becomes redeemable if the stockholders of the issuing company (that is, those immediately prior to a merger or consolidation) hold, immediately after such merger or consolidation, stock representing less than a majority of the voting power of the outstanding stock of the surviving corporation. This change-in-control provision would require the security to be classified outside of permanent equity because a purchaser could acquire a majority of the voting power of the outstanding stock, without company approval, thereby triggering redemption.

9. Securities with provisions that allow the holders to be paid upon the occurrence of events that are not solely within the issuer's control should be classified outside of permanent equity. Such events include:

- The failure to have a registration statement declared effective by the SEC by a designated date
- The failure to maintain compliance with debt covenants
- The failure to achieve specified earnings targets
- A reduction in the issuer's credit rating.

Examples in which permanent equity classification is appropriate

10. Other events are solely within the control of the issuer, and, accordingly, classification as part of permanent equity would be appropriate. For example, a preferred stock agreement may have a provision that the decision by the issuing company to sell all or substantially all of a company's assets and a subsequent distribution to common stockholders triggers redemption of the preferred equity security. In this case, the security would be appropriately classified as part of permanent equity if the preferred stockholders cannot trigger or otherwise require the sale of the assets through representation on the board of directors, or through other rights, because the decision to sell all or substantially all of the issuer's assets and the distribution to common stockholders is solely within the issuer's control. In other words, if there could not be a "hostile" asset sale whereby all or substantially all of the issuer's assets are sold, and a dividend or other distribution is declared on the issuer's common stock, without the issuer's approval, then classifying the security as part of permanent equity would be appropriate.

11. As another example, a preferred stock agreement may have a provision that provides for redemption of the preferred security if the issuing company is merged with or consolidated into another company, and pursuant to state law, approval of the board of directors is required before any merger or consolidation can occur. In that case, assuming the preferred stockholders cannot control the vote of the board of directors through direct representation or through other rights, the security would be appropriately classified as part of permanent equity because the decision to merge with or consolidate into another company is within the control of the issuer. Again, all of the relevant facts and circumstances must be considered when determining whether the preferred stockholders can control the vote of the board of directors.

12. An equity security may become redeemable upon the disability of the holder. In addition, an equity security may become redeemable upon the death of the holder, at the option of the holder's heir or estate. In this narrow, limited exception in which the redemption upon death (at the option of the holder's heir or estate) or disability will be funded from the proceeds of an insurance policy that is currently in force and which the company has the intent and ability to maintain in force, classifying the security as part of permanent equity would be appropriate. This is a narrow exception that should not be analogized to for other transactions, including circumstances in which an equity security must be redeemed upon the death of the holder.[3]

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[3] Pursuant to Statement 150, shares of stock that are required to be redeemed by the issuer upon the death of the holder are classified as a liability, because redemption is required upon an event (that is, death) that is certain to occur. Mandatorily redeemable shares are classified as liabilities under Statement 150 even if an insurance policy would fund the redemption.

Measurement

13. In adopting ASR 268 in 1979, the Commission stated that it was not its "intention to deal with the conceptual issue of whether redeemable preferred stock is a liability." Further, the Commission stated that it was not its "intention to alter existing practice or authoritative guidelines relative to accounting for elements of stockholders' equity . . . (for example, the determination of the carrying value of redeemable preferred stock . . .). [ASR 268] is intended to represent only an interim solution until the FASB, in connection with its conceptual framework project, addresses the related conceptual issues."

14. In May 2003, the FASB issued Statement 150, which addresses how an issuer classifies in its statement of financial position and measures certain financial instruments that have characteristics of both liabilities and equity. [Note: See Subsequent Developments section below.] Statement 150 does not address all of the instruments to which ASR 268 (Rule 5-02.28 of Regulation S-X) and the interpretive guidance in this staff announcement had originally applied. The SEC staff has the following observations about the valuation of redeemable preferred stock that is not within the scope of Statement 150.

15. The SEC staff believes the initial carrying amount of redeemable preferred stock should be its fair value at date of issue. This SEC staff announcement does not change the accounting for derivative instruments or embedded derivatives that are within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* (as amended), which must be accounted for in accordance with the provisions of that Statement. If redeemable currently (for example, at the option of the holder), the security should be adjusted to its redemption amount at each balance sheet date. The redemption amount at each balance sheet date should include amounts representing dividends not currently declared or paid but which will be payable under the redemption features or for which ultimate payment is not solely within the control of the registrant (for example, dividends that will be payable out of future earnings). If the security is not redeemable currently (for example, because a contingency has not been met), and it is not probable that the security will become redeemable, subsequent adjustment is not necessary until it is probable that the security will become redeemable. In that case, the SEC staff would expect disclosure of why it is not probable that the security will become redeemable.

16. If it is probable that the security will become redeemable, the staff will not object to either of the following accounting methods:

a. Accrete changes in the redemption value over the period from the date of issuance (or from the date that it becomes probable that the security will become redeemable, if later) to the earliest redemption date of the security using an appropriate methodology, usually the interest method. Changes in the redemption value are considered to be changes in accounting estimates and accounted for, and disclosed, in accordance with APB Opinion No. 20, *Accounting Changes*.

b. Recognize changes in the redemption value (for example, market value) immediately as they occur and adjust the carrying value of the security to equal the redemption value at the end of each reporting period. This method would view the end of the reporting period as if it were also the redemption date for the security.

17. The SEC staff will expect consistent application of the accounting method selected, along with appropriate disclosure of the selected policy in the footnotes to the financial statements. Moreover, disclosure of the redemption value of the security as if it were redeemable is required for registrants that elect to accrete changes in redemption value over the period from the date of issuance to the earliest redemption date.

Earnings per Share

18. Regardless of the accounting method selected, the resulting increases or decreases in the carrying amount of a redeemable security other than common stock shall be treated in the same manner as dividends on nonredeemable stock and shall be effected by charges against retained earnings or, in the absence of retained earnings, by charges against paid-in capital. Increases or decreases in the carrying amount shall reduce or increase income applicable to common stockholders in the calculation of earnings per share and the ratio of earnings to combined fixed charges and preferred stock dividends. If charges or credits are material to income, separate disclosure of income applicable to common stockholders on the face of the income statement should be provided.

19. Similarly, regardless of the accounting method selected, the resulting increases or decreases in the carrying amount of redeemable common stock shall be treated in the same manner as dividends on nonredeemable stock and shall be effected by charges against retained earnings or, in the absence of retained earnings, by charges against paid-in capital. However, increases or decreases in the carrying amount of a redeemable common stock should not affect income applicable to common shareholders. Rather, the SEC staff believes that to the extent that a common shareholder has a contractual right to receive at share redemption (other than upon ordinary liquidation events) an amount that is other than the fair value of such shares, then that common shareholder has, in substance, received a distribution different from other common shareholders ~~preferential distribution~~. Under FASB Statement No. 128, *Earnings per Share*, paragraph 60(b), entities with capital structures that include a class of common stock with different dividend rates from those of another class of common stock but without prior or senior rights, should apply the two-class method of calculating earnings per share. Therefore, when a class of common stock is redeemable at other than fair value, increases or decreases in the carrying amount of the redeemable security should be reflected in earnings per share using a method akin to the two-class method.[4] For common stock redeemable at fair value, the SEC staff would not expect the use of a method akin to the two-class method, as a redemption at fair value does not amount to a ~~preferential~~ distribution different from other common shareholders ~~distribution~~.

[4] The two-class method of computing earnings per share is addressed in Statement 128 and Issue No. 03-6, "Participating Securities and the Two-Class Method under Statement No. 128."

Transition

20. When this announcement was made in July 2001, it was to be applied retroactively in the first fiscal quarter ending after December 15, 2001, by restating the financial statements of prior periods in accordance with the provisions of paragraphs 27–30 of Opinion 20.

21. At the September 15, 2005 meeting, the SEC staff also 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.

Subsequent Developments

22. In May 2003, the FASB issued Statement 150, which establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or as an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. For public entities, Statement 150 is effective for all financial instruments entered into or modified after May 31, 2003, and otherwise effective at the beginning of the interim period beginning after June 15, 2003.

23. Statement 150 addresses three types of freestanding financial instruments that embody obligations of the issuer:

- Mandatorily redeemable financial instruments: Financial instruments issued in the form of shares that embody an unconditional obligation requiring the issuer to redeem the instruments by transferring its assets at a specified or determinable date (or dates) or upon an event that is certain to occur.

- Obligations to repurchase the issuer's equity shares by transferring assets: Financial instruments, other than outstanding equity shares, that at inception embody an obligation to repurchase the issuer's equity shares (or that are indexed to such an obligation) and that require or may require the issuer to settle the obligation by transferring assets. Examples include forward purchase contracts or written put options on the issuer's equity shares that are to be physically settled or net cash settled.

- Certain obligations to issue a variable number of shares: Financial instruments that embody an unconditional obligation, or financial instruments other than outstanding equity shares that embody a conditional obligation, that the issuer must or may settle by issuing a variable number of its equity shares if, at inception, the monetary value of the obligation is based solely or predominantly on (a) a fixed monetary amount known at inception, (b) variations in something other than the fair value of the issuer's equity shares, or (c) variations inversely related to changes in the fair value of the issuer's equity shares. Examples include a payable settleable with a variable number of the issuer's equity shares, a financial instrument indexed to the S&P 500 and settleable with a variable number of the issuer's equity shares, and a written put option that could be net share settled.

24. Instruments within the scope of Statement 150 should be classified and measured in accordance with that Statement. ASR 268 (Rule 5-02.28 of Regulation S-X) and the interpretive guidance in this staff announcement no longer apply for those instruments after the effective date of Statement 150.

25. At the November 12–13, 2003 meeting, the SEC Observer announced the SEC staff's position relating to the application of Topic D-98 to certain mandatorily redeemable securities for which the relevant portions of Statement 150 were recently deferred in FSP FAS 150-3, "Effective Date, Disclosures, and Transition for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Noncontrolling Interests under FASB Statement No. 150." The SEC Observer clarified that SEC registrants with instruments that qualify for the deferral should refer to Topic D-98 for guidance related to classification and/or measurement, as applicable, for those securities that, for the time being, will not be accounted for in accordance with Statement 150.

26. At the March 17–18, 2004 meeting, the SEC Observer clarified the SEC staff's position relating to the interaction of Topic D-98 and Statement 150 for conditionally redeemable preferred shares. If a company issues preferred shares that are conditionally redeemable, for example, at the holder's option or upon the occurrence of an uncertain event not solely within the company's control, the shares are not within the scope of Statement 150 because there is no unconditional obligation to redeem the shares by transferring assets at a specified or determinable date or upon an event certain to occur. If the uncertain event occurs, the condition is resolved, or the event becomes certain to occur, then the shares become mandatorily redeemable under Statement 150 and would require reclassification to a liability. Paragraph 23 of that Statement requires the issuer to measure that liability initially at fair value and reduce equity by the amount of that initial measure, recognizing no gain or loss. This reclassification of shares to a liability is akin to the redemption of such shares by issuance of debt. Similar to the accounting for the redemption of preferred shares (refer to Topic No. D-42, "The Effect on the Calculation of Earnings per Share for the Redemption or Induced Conversion of Preferred Stock"), to the extent that the fair value of the liability differs from the carrying amount of the preferred shares, upon reclassification that difference should be deducted from or added to net earnings available to common shareholders in the calculation of earnings per share.

27. At the September 15, 2005 meeting, the SEC Observer announced the SEC staff's position on the impact of certain redeemable securities on earnings per share calculations. Paragraph 19 was modified to clarify the SEC staff's position and paragraph 21 was added to address the timing of the application of the position. The SEC Observer also reiterated the SEC staff's positions on several issues and provided additional guidance related to the application of Topic D-98 to share-based payment arrangements with employees. These positions are included in paragraphs 28–30 below.

28. In Staff Accounting Bulletin No. 107, *Interaction Between FASB Statement No. 123(R), and Certain SEC Rules and Regulations Regarding the Valuation of Share-Based Payment*

Arrangements for Public Companies, the SEC staff clarified that registrants must evaluate whether the terms of instruments granted in conjunction with share-based payment arrangements with employees that are not classified as liabilities under FASB Statement No. 123 (revised 2004), *Share-Based Payment*, result in the need to present certain amounts outside of permanent equity in accordance with ASR 268 and Topic D-98. The SEC staff expects that this guidance be applied concurrently with the adoption of Statement 123(R). Upon transition, awards previously classified as permanent equity that are now required to be classified outside of permanent equity should be reclassified at the amount required to be presented outside of permanent equity.

29. In SAB 107, the SEC staff clarified that instruments granted in conjunction with share-based payment arrangements with employees that do not by their terms require redemption for cash or other assets (at a fixed or determinable price on a fixed or determinable date, at the option of the holder, or upon the occurrence of an event that is not solely within the control of the issuer) would not be assumed by the staff to require net cash settlement for purposes of applying ASR 268 and Topic D-98 in circumstances in which paragraphs 14–18 of Issue 00-19 would otherwise require the assumption of net cash settlement.

30. Certain employee awards contain provisions for either direct or indirect repurchase of shares issued upon exercise of employee options in order to meet the employer's minimum statutory withholding requirement resulting from the exercise. Statement 123(R) does not require awards with this specific provision, described in paragraph 35, to be classified as liabilities. The SEC staff would not expect SEC registrants to classify such employee awards outside of permanent equity, if the direct or indirect repurchase of shares is done solely to satisfy the employer's minimum statutory tax withholding requirements.

<u>31. In February 2006, the FASB issued Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*. Statement 155 establishes standards designed to simplify accounting for certain hybrid financial instruments by permitting fair value remeasurement for any hybrid instrument that contains an embedded derivative that otherwise would require bifurcation. In accordance with Statement 155, footnote 6bb amends paragraph 16 of Statement 133 to clarify that the guidance applies to hybrid financial instruments that are classified as assets and liabilities under Statement 133 and does not apply to hybrid financial instruments classified in permanent or temporary equity. Therefore, the guidance in this Topic continues to be applicable for hybrid financial instruments classified in permanent or temporary stockholders' equity.</u>