

MINUTES



To: Board Members
From: Nesta (ext. 330)
Subject: Revised Minutes of the April 9, 2003 Board Meeting **Date:** April 11, 2003
cc: Bielstein, Leisenring, Petrone, Smith, Swift, Polley, McKenna, Metcalfe, Nesta, Thompson, FASB Intranet, Sutay, Gabriele, Vincent

Topic: Valuation of Restricted Securities

Basis for Discussion: Memorandum dated March 18, 2003

Length of Discussion: 10:00 a.m. to 10:30 a.m.

Attendance:

Board members present: Crooch, Foster, Herz, Schipper, Trott, Wulff

Board members absent: Schieneman

Staff in charge of topic: McKenna

Other staff at Board table: Bielstein, Leisenring, Lott, Nesta

Outside participants: None

Summary for ACTION ALERT:

The Board discussed the valuation of restricted stock and decided the following:

1. To include guidance within the proposed Statement to clarify the applicability of the measurement decisions made to date to restricted stock. The proposed Statement also will require an entity to document its methodology for valuing restricted stock and will list qualitative characteristics that entities valuing restricted stock should consider when

- measuring the fair value of those securities. Those characteristics include the fair value and volatility of an unrestricted share of the same stock, the nature and duration of the restriction, and the risk-free rate.
2. To require that an investment in an equity security that is subject to governmental, contractual, or other trading restrictions be measured at fair value if the fair value of an identical equity security, except for the restrictions, is readily determinable. To implement this decision, FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities* will be amended to delete footnote 2 and the last sentence of paragraph 3(a).

Matters Discussed and Decisions Reached:

Ms. McKenna opened the discussion by stating that the Board's decisions made to date in this project can be applied when measuring the fair value of restricted securities. She stated the staff recommends that the proposed Statement clarify the applicability of the existing decisions to fair value measurement of restricted stock rather than have the staff perform additional research into the impact on valuation of specific types of restrictions. She noted that the research performed thus far has shown that the valuations of restricted securities are facts-and-circumstances specific and that new research likely would not yield any more insight for the Board. She added that the wording of the proposed Statement would instruct preparers to consider both the nature and the duration of the restrictions imposed on stock when determining its fair value.

The Board decided to include guidance within the proposed Statement to clarify the applicability of the measurement decisions made to date to restricted stock. The proposed Statement also will require an entity to document its methodology for valuing restricted stock and will list qualitative characteristics to be considered in measuring the fair value of restricted stock. Board members noted that applying a standard percentage discount in the valuation of restricted stock is not consistent with the fair value measurement decisions made in this project and that clarifying the applicability of the decisions is, therefore, important. One Board member noted that the Board's decision to disallow the use of block

discounts differed from this decision because block discounts are a consequence of the way an entity executes its business model, whereas discounts on restricted stock from the quoted market price of an unrestricted security arise because of contractual or other restrictions, not because of the entity's business model.

Ms. McKenna stated that another issue for the Board to address is the definition of restricted stock found in Statement 115. Statement 115 includes a footnote that exempts a restricted share of stock from being reported at the price of an unrestricted share of that stock, except if that restriction expires within one year. The staff recommended that this exception be removed from the current guidance so that the fair value measurement of restricted stock, regardless of when the restrictions terminate, incorporates the impact of the restriction. The staff also recommended that the proposed Statement require that the restricted stock be reported at the price of the freely traded share if the holder of the restricted position has the power to cause the restriction to be lifted immediately.

The Board agreed with the staff's recommendations. Board members noted that a restriction on a security affects the security's fair value regardless of the restriction's duration and, therefore, concluded that a restricted security should not be measured using the quoted market price of an unrestricted security. Board members also clarified that their intent was to require restricted stock to be measured at fair value under Statement 115, if unrestricted shares of the same stock are publicly traded.

Follow-up Items:

None.

General Announcements: