

MINUTES



To: Board Members

From: Financial Instruments: Liabilities and Equity Team (Belot, ext. 363)

Subject: Minutes of the October 1, 2003 Liabilities and Equity Board Meeting **Date:** October 9, 2003

cc: Leisenring, Bielstein, Smith, Cassel, Financial Instruments Liabilities and Equity Team, Mahoney, Swift, Polley, Sutay, Gabriele, Petrone, Thompson, FASB Intranet

Topic: Financial Instruments:
Economic characteristics and other features of various freestanding and compound financial instruments

Basis for Discussion: Board memorandum dated September 25, 2003, and audience handout

Length of Discussion: 2:15 p.m. to 4:00 p.m.

Attendance:

Board members present:	Herz, Crooch, Seidman, Schieneman, Schipper, and Batavick
Board members absent:	Trott
Staff in charge of topic:	Bullen, Richards
Other staff at Board table:	Bielstein and Belot
Outside participants:	None

Summary for ACTION ALERT:

The Board discussed examples of freestanding and compound financial instruments to gain a common understanding of those instruments. That discussion focused on:

1. The counterparty's relationship with the issuer, including the payoff to the counterparty at settlement, the boundaries of the relationship, and how the payoff changes as the issuer's share price changes
2. Graphs of the counterparty's payoff compared to the share price.

The meeting was educational; no decisions were reached. The examples were presented to assist the Board as it considers possible changes to the definitions of liabilities, equity, and assets. During the Board's discussions of the issues in this project, those examples will be used as test cases.

Copies of the examples and graphs presented at the meeting are available on the FASB website at <http://www.fasb.org/project/liabeq.shtml>.

Matters Discussed and Decisions Reached:

The Board discussed the economic characteristics and other features of various freestanding and compound financial instruments to gain a common understanding of those instruments. The staff presented 19 examples that will be used as test cases during the Board's redeliberations on Phase 2 of the Liabilities and Equity project. That presentation focused on:

1. The counterparty's relationship with the issuer, including the payoff to the counterparty at settlement, the boundaries of the relationship, and how the payoff changes as the issuer's share price changes
2. Graphs of the counterparty's payoff compared to the share price.

The staff's goal in presenting numerical and graphical depictions of each financial instrument is for use as a tool for classifying those instruments as assets, liabilities, or equity.

During the staff's presentation, the Board raised some points of clarification. Ms. Schipper noted that, because a share cannot be valued at less than zero, that assumption should not be included in graphical representations of financial instruments.

Following the staff's presentation, the Board discussed the direction of the liabilities and equity project going forward. In general, Board members expressed concern about whether providing accounting guidance for complex financial instruments will lead to the use of new transactions structured specifically to avoid unfavorable accounting treatments. Ms. Schipper suggested that one component of transaction structuring arises from inconsistent remeasurement methods used in current accounting literature. Mr. Herz said that financial instruments are best analyzed in the context of their effect on comprehensive income, specifically, the extent to which movement in share prices affects comprehensive income. However, he expressed concern that analysis of that type would result in a circular relationship between financial statements and share price, and he posed the question of the extent to which changes in an entity's share price should be reflected in its financial statements. The staff stated its plan to first determine the accounting for simple financial instruments and revise the definitions of liabilities and equity, if necessary. Then, the staff plans to apply the reasoning behind the accounting for simple financial instruments to derive the accounting for more complex instruments.

Follow-Up Items:

None.

General Announcements:

None.