

MINUTES



Financial Accounting
Standards Board

To: Board Members
From: Murphy (ext. 208)
Subject: Minutes of the May 18, 2005 Board Meeting **Date:** May 25, 2005

cc: FASB: Bielstein, Smith, Petrone, Leisenring, Mahoney, Gabriele, Swift, Polley, Getz, Golden, Oakley, Zeyher, Moss, Richards, Kramer

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: FASB Staff Position EITF 00-19-a, "Application of EITF Issue No. 00-19 to Freestanding Financial Instruments Originally Issued as Employee Compensation"

Basis for Discussion: Board Memoranda dated May 10, 2005 and May 11, 2005

Period of Discussion: 10:15 a.m. to 10:50 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Schipper, Seidman, Trott, Young (via phone)

Board members absent: None

Staff in charge of topic: Oakley

Other staff at Board table: Smith, Golden, Zeyher, Kramer, Murphy

Outside participants: None

Summary of Decisions Reached:

The Board discussed whether to finalize proposed FSP EITF 00-19-a, “Application of EITF Issue No. 00-19 to Freestanding Financial Instruments Originally Issued as Employee Compensation,” and directed the staff to proceed to a draft of a final FSP for vote by written ballot.

The Board had previously decided the following at its May 11, 2005 meeting:

- 1) An evaluation of the substantive terms of instruments subject to the guidance in the proposed FSP is appropriate (that is, retain paragraph 6 of the proposed FSP).
- 2) Explicit guidance about the classification of instruments with multiple settlement alternatives should not be included in the final FSP.

The Board also decided to amend FASB Statement No. 123 (revised 2004), *Share-Based Payment*, to defer indefinitely the provisions of Statement 123(R) that make freestanding financial instruments subject to the recognition and measurement requirements of other GAAP when the rights conveyed by the instrument are no longer dependent on employment.

Objective of Meeting:

The objective of the meeting was for the Board to consider whether to finalize FSP EITF 00-19-a subsequent to a final decision whether to amend FASB Statement No. 123(R), *Share-Based Payment*. The objective of the meeting was met.

Matters Discussed and Decisions Reached:

1. Mr. Oakley began the meeting by providing a brief background of the issue. He stated that public comment letters to the proposed FSP EITF 00-19-a highlighted the impact of the inconsistencies in classification between FASB Statement 123(R) and other GAAP on certain financial instruments

traditionally granted to employees as compensation. As a result, the Board decided to consider amending Statement No. 123(R) to remove the requirement to evaluate other GAAP when an award ceases to be subject to Statement 123(R), prior to finalizing the proposed FSP.

2. Ms. Schipper stated that she supports View B, under which the Board would not amend Statement 123(R) to eliminate the flip from Statement 123(R) to other applicable GAAP. She noted that the Board, in deliberating the revisions to Statement 123, held the view that employment should give rise to special accounting, but that special accounting should cease when employment is terminated. She stated that if employment matters so much that it should get special accounting even after employment ceases, the questions then become what is the nature of employment that would be sufficiently substantive to allow the special accounting and how long would that special accounting continue.
3. Mr. Batavick stated that he supports View A, an amendment to Statement 123(R) to indicate that the classification requirements continue to apply for the life of a share-based payment award, unless the terms of that award are subsequently changed. He posited that there are many more examples of employees who have had long careers with the same companies than there are examples of employees who have worked for a particular company for a short period of time. Consequently, he believes that employees retiring and still retaining the employee classification would offset any concerns of potential abuse arising from the continued application of the original classification. He further noted that the accounting required under View A would simplify accounting guidance.
4. Mr. Trott stated that he supports View B, because instruments with the same features should have the same accounting.

5. Mr. Crooch stated that he supports View B. He recalled that the Board had previously affirmed that View B was the proper accounting and he now sees no reason to change that decision.
6. Ms. Seidman stated that the Board would not be dealing with this issue if it had a fully developed conceptual model for instruments with characteristics of both liabilities and equity. Further, she voiced her concern that the Board does not have a strong conceptual reason for choosing to address the registered share exception that is the subject of proposed FSP EITF 00-19-a over the other inconsistencies that the Board will most likely receive in the future. She would prefer the Board spend time improving the fundamental model (that is, the model in the liability and equity project) so that there is a consistent approach going forward. Ms. Seidman stated that she supports a targeted amendment of Statement 123(R) so that companies wouldn't have to reclassify share-based payment awards for potentially short periods of time before they are exercised.
7. Mr. Golden suggested that the Board consider whether such a targeted amendment might take the form of a deferral of the requirement in Statement 123(R) to evaluate other GAAP. The deferral would automatically expire upon completion of the liabilities and equity project. That is, when the liabilities and equity project is complete, the requirement in Statement 123(R) to evaluate other GAAP would become applicable. He characterized this alternative as View A Prime. Ms. Seidman and Mr. Batavick indicated their support for View A Prime.
8. Mr. Herz expressed that he supports View A Prime as well. He believes that portions of the other applicable GAAP, into which the accounting flips from Statement 123(R), is rules-based and produces financial accounting results that are inferior to the results achieved from applying the principles-based guidance in Statement 123(R). He stated that View A Prime would produce

better financial reporting in the period until completion of the liabilities and equity project.

9. Mr. Young stated that he supports View A because the accounting for an employee's share-based payment should be consistent before and after an employee's termination unless there is a substantive change in the original agreement.
10. Mr. Smith summarized that Mr. Young supports View A, Messrs. Herz and Batavick and Ms. Seidman support View A Prime, and Messrs. Trott and Crooch and Ms. Schipper support View B. He recommended a deferral of the decision as to whether the Board should preemptively adopt the yet-to-be completed liabilities and equity model. That is, the deferral of the requirement to evaluate other GAAP should not expire automatically upon completion of the liabilities and equity project. Rather, the Board should consider the appropriateness and applicability of any new model to instruments originally issued as employee compensation as the model nears completion.
11. Mr. Trott asserted that he would have a dissenting view on View A, but likely would not on A Prime, because View A Prime acknowledges the concept that instruments should receive the same accounting once they are paid for.
12. Mr. Herz proposed the following solution: Amend Statement 123(R) to indefinitely defer the requirement in Statement No. 123(R) to evaluate other GAAP when an instrument is no longer tied to employment rather than eliminate that requirement or make the deferral contingent on the completion of the liabilities and equity project. That alternative would acknowledge the concept that instruments should receive the same accounting once they are paid for (as previously supported by Mr. Trott) and provide the flexibility to consider the results of the liabilities and equity project prior to reintroducing the requirement to evaluate other GAAP, as suggested by Mr. Smith. Mr.

Herz noted that the effect of the deferral would be that the classification requirements in Statement No. 123(R) continue to apply for the life of an SBP award, unless the terms of that award are subsequently changed. He also stated that the amendment to Statement 123(R) should include an observation that the SBP award must be for substantive employee service, as this would help deter companies from structuring transactions that involve the acquisition of goods or services from third parties as employee transactions in order to qualify for the recognition and measurement principles of Statement 123(R) rather than existing liabilities and equity guidance.

13. Mr. Herz asked if any Board members objected to the proposal. Messrs. Trott and Crooch and Ms. Schipper indicated they objected to the proposal, but that whether their objection would rise to the level of an alternative view was subject to the actual wording used in the amendment to Statement 123(R).

14. Mr. Golden suggested that the Board expose an FSP reflecting the Board's decision on Statement 123(R) for a 30 day comment period. The Board agreed with that recommendation. Mr. Trott suggested, for the benefit of early adopters of Statement 123(R), that FSP EITF 00-19-1 should be posted as written with a notice that another FSP could expand on its guidance. The Board also agreed with that recommendation.

Follow-up Items:

None.

General Announcements:

None.