

MINUTES



To: Board Members
From: Chesney (ext. 447)
Subject: Minutes of the March 5, 2008 Board Meeting—FSP EITF 03-6-a, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities* **Date:** March 20, 2008
cc: Leisenring, Golden, Bielstein, MacDonald, Chookaszian, Posta, Cosper, Bolash, Wyatt, Stevens, Richter, Gabriele, Allen, FASB Intranet

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: Proposed FASB Staff Position EITF 03-6-a, *Determining Whether Instruments Granted in Share-Based Payment Transactions are Participating Securities*

Basis for Discussion: Memorandum No. 4

Length of Discussion: 9:10 a.m. to 10:20 a.m.

Attendance:

Board members present: Herz, Batavick, Linsmeier, Seidman, Young, and Leisenring (IASB)

Board members absent: Crooch and Smith

Staff in charge of topic: Bolash

Other staff at Board table: Chesney, Cosper, and Golden

Outside participants: None

Summary of Decisions Reached:

The Board discussed issues raised by respondents to proposed FSP EITF 03-6-a, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities*. The Board affirmed that unvested share-based payment awards that are entitled to receive nonforfeitable dividends or dividend equivalents are participating securities and that both distributed and undistributed earnings should be allocated to participating securities. The Board also decided that:

1. Only those unvested share-based payment awards that are expected to vest are participating securities.
2. A change in an entity's estimated forfeiture rate should not be captured as an adjustment to the computation of basic earnings per share pursuant to the two-class method.
3. The final FSP should require full retrospective application and become effective on the same date as a revised Statement on FASB Statement No. 128, *Earnings Per Share*.

The Board directed the staff to proceed to a draft of a final FSP for vote by written ballot.

Objectives of Meeting:

The objectives of the meeting were to discuss comments received on the proposed FSP, the staff's analysis and recommendations on significant issues raised by respondents, and whether the staff should proceed with drafting a final FSP for vote by written ballot. The objectives of the meeting were met.

Matters Discussed and Decisions Reached:

PROCEED TO FINAL DRAFT

Staff Recommendation

1. The staff recommended that the Board proceed to a final draft of the FSP for vote by written ballot.

Board Vote

2. The Board unanimously agreed with the staff's recommendation.

Board Comments

3. Mr. Linsmeier asked whether there is diversity in practice on this issue and questioned whether the Board should issue such detailed guidance. Mr. Bolash noted that the accounting firms generally believe that share-based payment awards are participating securities. Some preparers and preparer organizations agree with the accounting firms, while others do not believe such awards are participating securities. Mr. Golden clarified that the accounting firms many times conclude in audits that these awards are not participating. He added that the Investors Technical Advisory Committee supports issuing a final FSP to address the valuation and disclosure of information about these awards.
4. Ms. Seidman stated that there is a double counting issue, but whether it would be worthwhile for the Board should spend time solving the problem is questionable. Several current projects, such as the short-term convergence project on earnings per share and the liabilities and equity project, have the potential to address this issue. Ms. Seidman added that it is important to address diversity in practice that users would like to see eliminated, but the Board cannot continually undertake such narrow issues. Mr. Herz agreed that the Board should not undertake such projects, which may hinder convergence efforts.
5. Mr. Batavick said that he supports the final FSP, but believes that users should not place so much emphasis on the earnings per share calculation. Mr. Golden noted that users believe that earnings per share is one of the most useful metrics. Mr. Young noted that users are generally more concerned with diluted earnings per share and the additional cost of dilutive shares. This issue could affect diluted earnings per share and the difference between basic earnings per share and diluted earnings per share, which are both important to users.

COMMENT LETTER SUMMARY AND SIGNIFICANT ISSUES

6. Mr. Bolash said that the staff received thirteen comment letters on the proposed FSP. Five respondents generally supported the conclusions reached in the proposed FSP and support the issuance of a final FSP, while seven respondents generally opposed

the conclusions reached in the proposed FSP and do not support the issuance of a final FSP. The staff believes three significant issues raised by respondents warrant Board reconsideration.

ISSUE 1—ALLOCATION OF DISTRIBUTED AND UNDISTRIBUTED EARNINGS—“DOUBLE COUNTING” DIVIDENDS

7. Mr. Bolash stated that five respondents were concerned that the two-class method of computing basic EPS effectively double counts the rights to dividends or dividend equivalents. Those respondents believe that the greater compensation expense reduces earnings and appropriately captures the dilutive impact of dividend protection rights. They also believe that allocating both distributed and undistributed earnings to dividend-protected share-based payment awards result in double counting the dividend rights in calculating EPS.

View A

8. The proposed FSP supports the view that earnings available to common shareholders is appropriately reduced to reflect the compensation paid to employees in the form of share-based compensation and the decision to allow holders of those instruments the ability to participate in current period earnings, regardless of whether those earnings are distributed. Proponents of this view believe that the earnings allocation of the two-class method attempts to achieve this separation.

View B

9. Some respondents view distributed earnings as being double counting in the EPS numerator. Since those earnings are factored into the determination of the share-based payment award's fair value, they have already reduced net income available to common shareholders and participating securities. Those respondents believe that undistributed earnings are not double counted since undistributed earnings are not factored in determining the award's fair value. Proponents of this view would allocate undistributed earnings to a participating share-based payment award for which the requisite service has not yet been rendered based on the award's participation rights.

Issue 1 Staff Recommendation

10. The staff recommended that unvested share-based payment awards that are entitled to receive nonforfeitable dividends or dividend equivalents be participating securities and that both distributed and undistributed earnings should be allocated to common

shareholders and unvested share-based payment award holders that are considered participating securities (View A). This recommendation is consistent with the proposed FSP.

Issue 1 Board Vote

11. The Board unanimously supported the staff's recommendation.

Issue 1 Board Comments

12. Messrs. Herz, Linsmeier, and Ms. Seidman noted that View B is economically correct, but quantifying the assumptions of that view would be difficult.

13. Ms. Seidman noted that View A would result in the same numerator for both basic earnings per share and diluted earnings per share. This would reduce users' ability to estimate the additional cost of dilutive shares by calculating the difference between the two numerators. Mr. Golden added that, without the two-class method, the numerator would also be the same, which might be a misleading signal to users.

ISSUE 2a—EFFECT OF ESTIMATED FORFEITURES ON TWO-CLASS COMPUTATION: ALLOCATING UNDISTRIBUTED EARNINGS TO AWARDS NOT EXPECTED TO VEST

14. Mr. Bolash said that the proposed FSP does not include in the earnings allocation dividends or dividend equivalents that are actually paid and accounted for as compensation expense because the unvested share-based payment award does not vest or is not expected to vest. One respondent believes that undistributed earnings should be allocated to unvested awards not expected to vest until those awards are actually forfeited. The respondent also believes that awards forfeited during the period should be included in the two-class calculation for the period those unvested awards were still outstanding.

Issue 2a Staff Recommendation

15. The staff recommended including in the FSP an illustration demonstrating that (a) dividends or dividend equivalents that are actually paid and, because the unvested share-based payment award is not expected to vest (or does not vest), are accounted for as compensation cost shall not be included in the earnings allocation in computing basic EPS and (b) undistributed earnings should be allocated to all outstanding unvested share-based payment awards, including those that, according to an entity's estimate of expected forfeitures, are not expected to vest.

Issue 2a Board Vote

16. Messrs. Batavick, Herz, Linsmeier, Young, and Ms. Seidman did not support the staff's recommendation. Mr. Smith supported the staff's recommendation.

Issue 2a Board Comments

17. Mr. Herz stated that awards that are expected to be forfeited are not participating since they will not become shares. While they receive dividends, they have no contractual rights to undistributed earnings. Ms. Seidman agreed that a share-based payment award either is or is not participating. The treatment of the dividend and the treatment of the earnings for awards that are expected to be forfeited would be inconsistent. Ms. Seidman observed that awards expected to be forfeited lead to dollar-for-dollar double counting in net income.

ISSUE 2b—EFFECT OF ESTIMATED FORFEITURES ON TWO-CLASS COMPUTATION: EFFECTS OF CHANGE IN AN ENTITY'S EXPECTED FORFEITURE RATES

Issue 2b Staff Recommendation

18. The staff recommended that a change in an entity's estimated forfeiture rate would not be captured as an adjustment to the computation of basic EPS pursuant to the two-class method.

Issue 2b Board Vote

19. The Board unanimously supported the staff's recommendation.

ISSUE 3—EFFECTIVE DATE AND TRANSITION

20. Mr. Bolash stated that the Board could either make the final FSP active for the annual reporting period following posting to the FASB website or align the effective date with the effective date of the revised FASB Statement No. 128, *Earnings per Share*.

Issue 3 Board Vote

21. Messrs. Batavick, Herz, Linsmeier, and Ms. Seidman voted to align the effective date of the proposed FSP with the effective date of revised Statement 128. Messrs. Smith and Young voted to make the proposed FSP effective the first annual period after the FSP is posted to the FASB website.

22. The Board voted for full retrospective application of the proposed FSP. However, Mr. Batavick and Ms. Seidman preferred partial retrospective application.

Issue 3 Board Comments

23. Mr. Young stated that finalizing the FSP for an effective date that could be years away would not be helpful. Mr. Herz responded that the Board should not require

entities to repeatedly implement changes in calculating earnings per share. Mr. Young stated that other Board decisions affect earnings per share, and that the Board should try to make its decisions collectively effective on an annual basis.

24. Ms. Seidman suggested that the FSP be applied retrospective for awards that are currently outstanding, which is consistent with the proposed transition provisions for Statement 128(R). Mr. Batavick stated that full retrospective application would result in a better trend going forward. Mr. Golden said that this application would require awards vested as of the date of adoption to be retrospectively included as participating, even if they were unvested before adoption. If an entity changes its compensation philosophy from providing dividend rights, it would not want to apply the final FSP retrospectively.
25. Mr. Herz said that an entity should retroactively apply the FSP as of the terms at the previous period. He added that an entity would want to be able to dilute prior period earnings per share. Mr. Herz said that an entity likely would not change the terms of its compensation awards. Mr. Young said that allowing for different transition methods depending on the terms of the awards would not be desirable.

Follow-Up Items:

The staff will draft a final FSP for vote by written ballot.

General Announcements:

None.