

## MINUTES



**To:** Board Members

**From:** Financial Instruments: Liabilities and Equity Team (Wilson, ext. 275)

**Subject:** Minutes of the July 9, 2003 Board Meeting      **Date:** July 15, 2003

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

Topic: Financial instruments: Accounting for Instruments with Characteristics of Equity and of Liabilities, Assets, or Both – Plan for Phase 2 Redeliberations

Basis for Discussion: Memorandum dated June 27, 2003 and audience handout

Length of Discussion:      Starting Time: 10:15 a.m.      Concluding Time: 11:00 a.m.

Attendance:

Board members present:	FASB: Herz, Crooch (by phone), Trott, Seidman, Schieneman, Schipper
	IASB: Leisenring
Board members absent:	None
Staff in charge of topic:	Bullen, Richards
Other staff at Board table:	Bielstein, Wilson
Outside participants:	Paul (by phone)

## Summary for ACTION ALERT

The Board discussed the scope, objectives, and planning for its redeliberations in the second phase of the project. The Board decided that:

- 1) The project scope will include financial instruments (and, potentially, components of financial instruments) with characteristics of both assets and equity.
- 2) The objectives of the second phase are to:
  - a. Improve accounting and reporting by issuers for financial instruments that contain characteristics of equity and of liabilities, assets, or both.
  - b. Amend and improve on the definitions of liability, equity, and perhaps assets in FASB Concepts Statement No. 6, *Elements of Financial Statements*, such that decisions made in FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and the second phase are consistent with those definitions.

The Board also provided the staff with suggestions and guidance on several aspects of the project plan. In particular, the Board noted the importance of considering international convergence as each issue is deliberated. The Board favored the staff's plan to begin with definition and classification questions before taking up issues related to the unit of accounting, that is, whether to separate financial instruments and, if so, how to separate them.

The Board supported the staff's plan to form an outside resource group to assist in Phase 2 issues and noted that re-exposure seems more likely than proceeding directly to final Statements.

### Matters Discussed and Decisions Reached:

The Board discussed the objectives and planning aspects for its redeliberation of the second phase of the liabilities and equity project. The staff provided background information regarding the history of the project to date and some of the challenges that lie ahead for. The staff noted that part of the second phase will focus on examining financial instruments that embody obligations (or rights) either to transfer assets or issue equity shares. The purpose of that focus is to determine the relationship that those financial instruments establish between the issuer of the instruments and the counterparty.

The staff also noted that the project's scope needs to be clarified. The staff recalled issues that arose during prior redeliberations regarding separation of compound instruments and the development of Statement 150. In particular, even though Statement 150 requires asset classification for certain financial instruments that contain characteristics of liabilities, equity,

and assets, the project's original scope leaves out freestanding instruments that contain characteristics of equity and assets, but not liabilities. The staff believes that the second phase of the project cannot ignore the fact that many of the financial instruments at issue also contain characteristics of assets.

The Board decided to expand the project scope to include financial instruments and, potentially, components of financial instruments with characteristics of both assets and equity. The Board also agreed that the objectives of the second phase should include [All Board Members Agreed]:

- a. Improving accounting and reporting by issuers for financial instruments that contain characteristics of both liabilities and equity, assets and equity, or a combination of all three.
- b. Amending and improving upon the definitions of elements in FASB Concepts Statement No. 6, *Elements of Financial Statements*, such that decisions made in FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, and Phase 2 are consistent with those definitions.

The Board was in general agreement with the staff's proposal; however, several Board members raised questions as to the types of financial instruments with characteristics of assets and equity that could potentially be included or excluded in the project. Messrs. Leisenring and Trott noted the distinction between instruments that would be included, such as purchased options, callable preferred stock, or potentially, callable debt, and instruments that would be excluded, such as a note receivable. The former have characteristics of both equity and assets in equity and liabilities while the latter has only asset characteristics.

Ms. Schipper stated the importance of expanding the definition of a liability found in Concepts Statement 6 to include a notion of the "nature of the relationship." She further stated that the present definition of a liability focuses on the form of settlement classification. She also stated that several pieces of important and prevalent financial instrument literature, such as FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and EITF Issue No. 00-19 "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock," focus on the form of settlement notion. Ms. Schipper noted the importance of the staff moving forward in the project to clearly identify what aspects of the definition of an asset this project will be addressing.

The Board also discussed and provided the staff with suggestions and guidance for developing a more comprehensive project plan. The Board approved the staff's plan to begin with definition

and classification questions, followed by issues related to the unit of accounting (whether to separate financial instruments) and how to separate (using measurement methods) those instruments. Ms. Schipper stated that an iteration approach cycling between definition and classification was likely the means necessary to accomplish the project objectives.

The Board noted the importance of achieving international convergence. The Board discussed whether the staff's proposed approach to the project would be an impediment to convergence with the IASB. Board members were in favor of convergence as a goal for the project, but were also in general agreement that progress in the FASB liabilities and equity project should not be diminished because of divergence from existing IASB standards. Therefore, Board members agreed on approaching convergence issue by issue in Phase 2. Ms. Schipper noted that areas of potential divergence could be very extensive.

The Board supported the staff's plan to establish an outside resource group to assist in Phase 2 issues and agreed that re-exposure would probably be necessary. The staff noted that many constituent groups have expressed an interest in participating. The staff stated that several candidates for the resource group were those who also assisted in developing Statement 150.

Follow-up Items:

None

General Announcements:

None