MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Financial Instruments: Liabilities and Equity Team (Belot, ext. 363)
Subject:	Minutes of the August 27, 2003 Liabilities and Equity Board Meeting
Date:	September 3, 2003
cc:	Leisenring, Bielstein, Smith, Cassel, Financial Instruments Liabilities and Equity Team, Mahoney, Swift, Polley, Sutay, Gabriele, Petrone, Thompson, FASB Intranet

Topic:	Financial Instruments: Reconsideration of Statement 150's Applicability to Mandatorily Redeemable Shares of Nonpublic Entities
Basis for Discussion:	Board memorandum dated August 14, 2003, and audience handout
Length of Discussion:	11:55 a.m. to 1:35 p.m.

Attendance:

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

Summary for ACTION ALERT:

The Board discussed whether nonpublic entities should be exempt from applying, or given further time to apply, the provisions of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, requiring mandatorily redeemable shares to be classified as liabilities. The Board decided:

1. Not to exempt nonpublic entities from applying the provisions of Statement 150 requiring mandatorily redeemable shares to be classified as liabilities.
2. For mandatorily redeemable financial instruments of a nonpublic entity, Statement 150 should be effective for existing or new contracts for fiscal periods beginning after December 15, 2004, instead of December 15, 2003.

The Board instructed the staff to draft a change to the effective date for Statement 150's applicability to mandatorily redeemable financial instruments of nonpublic companies, which will be issued in a proposed FASB Staff Position (FSP).

The staff also announced the posting of two proposed FSPs to the FASB website for a 30-day comment period. They are:

1. Proposed FSP FAS 150-a, "Issuer's Accounting for Freestanding Financial Instruments Composed of More Than One Option or Forward Contract Embodying Obligations under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*"

2. Proposed FSP FAS 150-b, "Accounting for Mandatorily Redeemable Shares Requiring Redemption by Payment of an Amount that Differs from the Book Value of Those Shares, under FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*"

Comments are due on or before September 27, 2003.

Matters Discussed and Decisions Reached:

The Board discussed whether to reconsider the applicability of FASB Statement No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*, to mandatorily redeemable financial instruments of nonpublic entities. The staff provided a brief history of the issue and summarized the 17 comment letters recently received relating to this issue. The majority of comment letters expressed the following concerns about classifying mandatorily redeemable shares of nonpublic entities as liabilities:

1) It will result in little or no equity creating the appearance of insolvency.
2) It may result in violation of loan covenants and bonding requirements.
3) Nonpublic construction companies will be at a disadvantage in competing for contracts against public companies.

The staff stated that the comment letters provided no new information beyond what the Board considered at its August 7, 2002 meeting.

Ms. Seidman expressed concern that it is difficult to distinguish certain mandatorily redeemable financial instruments from common stock that is puttable upon the occurrence of an event that is outside the control of the issuer. She argued that for mandatorily redeemable shares in which redemption is required upon either death or retirement, the event is certain to occur. However, the date that those shares will be redeemed is not fixed, nor is it readily determinable. She noted that puttable common stock contingent upon an event outside of the control of the issuer will be discussed in Phase 2 of the liabilities and equity project, and therefore, she suggested that the change to the accounting for the shares redeemed upon death or retirement should be deferred until those deliberations. The staff responded that IAS 32, *Financial Instruments: Disclosure and Presentation*, currently requires shares to be classified as liabilities if they provide for "mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or give the holder the right to require the issuer to redeem the shares at or after a particular date for a fixed or determinable amount." Furthermore, the staff stated that the IASB considers death or retirement to be at a determinable future date and, thus, it is included as an event that triggers mandatory redemption. The IASB has no current plans to change that requirement in its proposed amendments of IAS 32.

The Board agreed that mandatorily redeemable shares of nonpublic entities will not be exempt from the requirements of Statement 150, but debated the effective date for those financial instruments. [All Board members agreed]

The staff noted that Statement 150 is effective for existing or new mandatorily redeemable financial instruments of a nonpublic entity for fiscal periods beginning after December 15, 2003. Board members expressed concern about the interpretation and application of that effective date. Mr. Herz stated his belief that the Board's intention during past deliberations was for the effective date to apply at the end of an annual fiscal period, rather than a monthly or quarterly interim period. That interpretation of the effective date would defer implementation and the reporting of interest expense for nonpublic entities until December 31, 2004. He also pointed out the language in FASB Interpretation No. 46, *Consolidation of Variable Interest Entities*, which determines the effective date to be the "end of applicable annual period." However, Statement 150 refers to fiscal periods beginning on a certain date.

Some Board members also said they had assumed that most nonpublic companies do not prepare interim financial statements. Some Board members expressed concern that, under the current effective date and transition for Statement 150, nonpublic entities would have to restate interest expense recorded at the beginning of the year to apply the cumulative effect of a change in accounting principle as of the beginning of the period.

Ms. Schipper articulated the Board's options as follows:

1. Clarify the intention of the effective date of Statement 150 as applying to annual fiscal periods after December 15, 2003.

2. Amend Statement 150 to require transition at the end of 2004, rather than at the beginning of the year.

3. Defer the effective date of Statement 150's applicability to nonpublic entities to "fiscal periods beginning after December 15, 2004."

The staff stated that an implication of choosing alternatives 2 or 3 is that the definition of nonpublic entities presented in Statement 150 includes certain SEC registrants (for example, entities having only public debt or more than 500 private shareholders) and that inconsistent reporting for SEC registrants would result. The Board voted for alternative 3, to delay the effective date for mandatorily redeemable shares of nonpublic entities for 1-year (that is, for fiscal periods beginning after December 15, 2004). [Four members agreed; KAS, EWT and GMC disagreed] The staff inquired whether the effective date should also be delayed for certain nonpublic entities that are SEC registrants. The Board instructed the staff to resolve that matter, in consultation with the SEC staff, in drafting the guidance.

The staff next inquired about the form of issuing the guidance to amend the effective date of Statement 150. The Board suggested issuing a FASB Staff Position (FSP), because this type of communication can be distributed efficiently and can be accessed by many constituents. Mr. Smith stated that this use of an FSP is not consistent with other FSPs, because this issue has been publicly debated and is an amendment of a Statement. However, Technical Bulletins have been used in the past to effect a delay in an effective date, with a 15-day comment period. FSPs have replaced Technical Bulletins and provide a longer comment period (30 days). Public discussion of this issue along with a 30-day comment period provides more due process than a Technical Bulletin provided in the past. Therefore, the staff suggested that the Board should be comfortable with this use of the FSP in place of a Technical Bulletin. The Board agreed, without dissent.

Follow-Up Items:

The staff will draft a proposed FSP to amend the effective date for nonpublic entities to classify mandatorily redeemable financial instruments as liabilities. As part of this process, the staff will consult with the SEC staff regarding the definition and application of the delayed effective date for SEC registrants that are nonpublic entities.

General Announcements:

The staff announced that two proposed FSPs will be posted to the FASB website for a 30-day comment period ending September 27, 2003. Those proposed FSPs are the staff's positions on issues that arose during the implementation of Statement 150.