MEMORANDUM

To:	Board Members
From:	Stock Comp Team (Maffei ext. 273)
Subject:	Minutes of November 13, 2002 Board Meeting — **Date:** November 13,2002
cc:	Bielstein, Smith, Leisenring, Petrone, Swift, Polley, Gabriele, Durbin, Such, Bullen, Vincent, Sutay (4), Thompson, Allen and Bean (GASB), FASB Intranet (e-mail)

Topic: Statement 123 Transition and Disclosure

Basis for Discussion: Memorandums dated November 6 and November 11, 2002

Length of Discussion: Starting Time: 11:15am **Concluding Time:** 12:00pm

Attendance:

Board members present:	Herz, Crooch, Foster, Schieneman, Schipper, Trott, Wulff
Staff in charge of topic:	Durbin
Other staff at Board table:	Bielstein, Smith, Cassel, Maffei

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION:

The Board discussed the comments received on the FASB Exposure Draft, *Accounting for Stock-Based Compensation—Transition and Disclosure*, and affirmed its previous decisions with the following modifications:

- The prospective transition method in FASB Statement No. 123, *Accounting for Stock-Based Compensation*, which results in the "ramp up" effect, will no longer be available for enterprises that elect to initially apply the fair value method of accounting for stock-based employee compensation for fiscal years beginning after December 15, 2003.

- For those enterprises that elect to restate prior periods for comparative purposes, that restatement should be consistent with the pro forma effects on net income and earnings per share that were required by paragraph 45 of Statement 123 for those periods.

The Board authorized the staff to proceed with drafting a final Statement and to add examples of the application of the transition effect, arising from either the modified prospective method or the retroactive restatement method, as described in paragraph 2(b) of the Exposure Draft.

Mr. Durbin explained that 60 comment letters had been received prior to close of business on November 5, 2002 in response to the Exposure Draft, and several more had been received subsequent to the end of the comment period. Mr. Durbin noted that respondents generally disagreed with the Board's decision to permit multiple transition alternatives and the requirement to include the pro forma disclosures relating to stock-based compensation in the *Summary of Significant Accounting Policies*; however, the respondents generally agreed with the decision to require a specific tabular presentation of the pro forma information and the inclusion of that information in the interim financial statements. The number of respondents favoring the retroactive restatement method was about the same as the number of respondents favoring the prospective method currently prescribed by Statement 123.

The Board decided to retain the provision of the proposed Statement that permits three transition methods. While Board members generally agreed that the retroactive restatement method is the most conceptually sound, several Board members noted possible practical impediments in applying the retroactive restatement method, such as in cases where the entity has recently completed a business combination, or where the entity's previous auditor no longer exists. Other Board members disagreed with the decision, noting that IASB's proposed transition provisions would not permit multiple transition methods.

Some Board members stated that the prospective method is the least preferable but that they did not want to eliminate the method because some companies have already elected to adopt the fair value provisions of Statement 123 based on the transition provisions prescribed therein. Mr. Wulff suggested that the prospective method could be continued for a short period of time and then be prohibited for future changes to the fair value method. After a discussion of the possible dates for eliminating the prospective transition method, the Board decided that the prospective method should not be available for initial application of the fair value method in fiscal years beginning after December 15, 2003.

The Board agreed that the optional restatement of prior period results, as permitted in paragraph 2(a)(c) of the Exposure Draft, should be clarified to specify that the restatement should be consistent with the pro forma effects on net income and earnings per share that were required by paragraph 45 of Statement 123 for those periods.

The Board also agreed that the staff should develop illustrative guidance to assist preparers with the application of the transition effect arising under the modified prospective method.

In addressing respondents' comments regarding the required placement of the pro forma disclosures, Mr. Durbin stated that the requirement to include the pro forma information on stock-based compensation in the *Summary of Significant Accounting Policies* was an attempt to define a "prominent" disclosure. It was also noted that the pro forma information on stock-based compensation warrants amplification because it has a potentially significant impact on the reported results. Ms. Schipper disagreed with the Board's decision, citing that the Board was mandating the location and format for this particular information with no conceptual basis and had not fully considered the consequences of such an action on future issues. Mr. Foster stated that the pro forma information does not relate to the entity's accounting policy and does not belong in the *Summary of Significant Accounting Policies*. The Board decided to retain the requirement that the pro forma disclosures be included in the *Summary of Significant Accounting Policies*.

Board members found no compelling arguments to require any additional disclosures regarding stock-based employee compensation—including those related to the classification of stock-based compensation expense and other disclosures regarding the potential dilutive effects to shareholders of outstanding stock options—and decided to retain the disclosure requirements of the proposed Statement.

The Board affirmed the other decisions reached prior to issuance of the Exposure Draft without further discussion. Those decisions are as follows:

- The transition effect should be recorded as an adjustment to paid-in capital.
- Additional paid-in capital arising from excess tax deductions should be determined pursuant to the transition method selected.
- Pro forma disclosures should be presented in a tabular form.
- Pro forma disclosures should be included in interim financial information.
- Effective date for transition and annual disclosures should be fiscal periods ending after December 15, 2002, with earlier application in interim and annual financial statements permitted if those statements have not been issued by the date of issuance of a final Statement.
- Effective date for quarterly disclosures should be in financial statements for interim periods beginning after December 15, 2002.

SUMMARY FOR ACTION ALERT:

Same as the first paragraph of "Matters Discussed, Decisions Reached, and Follow-up Action."