

PROPOSED FASB STAFF POSITION

No. EITF 00-19-a

Title: Application of EITF Issue No. 00-19, “Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company’s Own Stock,” to Freestanding Financial Instruments Originally Issued as Employee Compensation

Comment Deadline: April 15, 2005

1. The Board directed the FASB staff to issue this FASB Staff Position (FSP) to clarify the application of Issue 00-19 to freestanding financial instruments originally issued as employee compensation. The guidance in this FSP is consistent with the Board’s intent in issuing FASB Statement No. 123 (revised 2004), *Share-Based Payment*.

Background

2. Paragraph A231 of Statement 123(R) indicates that a freestanding financial instrument ceases to be subject to Statement 123(R) and becomes subject to the recognition and measurement requirements of other applicable GAAP when the rights conveyed by the instrument are no longer dependent on the holder being an employee. Paragraph B202 of Statement 123(R) indicates that Issue 00-19 is one source of other GAAP that may be applicable to instruments that cease to be accounted for under Statement 123(R). Paragraphs A231 and A232 and related footnotes 123 and 124 of Statement 123(R) provide guidance about when an award is no longer linked to employment.

3. Issue 00-19 provides recognition, measurement, and classification guidance for certain freestanding financial instruments that are indexed to, and potentially settled in, an entity’s own stock. Issue 00-19’s classification provisions are based on an issuer’s control over the form of ultimate settlement of an instrument. An issuer is deemed to control the form of settlement if it has both the contractual right to settle in equity shares and the ability to deliver equity shares. When the issuer controls the form of settlement, an instrument is generally classified as equity. If an issuer does not control the form of

settlement, cash settlement is assumed and an instrument is classified as an asset or liability. Issue 00-19 provides guidance on how to assess whether an issuer has the ability to control the form of settlement and describes conditions and events that are not within the control of the issuer. One condition that is considered outside the control of the issuer is a contractual requirement to deliver registered shares, unless the shares are registered as of the inception of the contract and there are no further timely filing or registration requirements.

4. Certain entities that offer share-based employee compensation arrangements are required to deliver registered shares pursuant to those arrangements. Frequently, entities have sufficient registered shares at inception of such a contract but are required to make timely filings to ensure the shares continue to be registered. Under Issue 00-19, this requirement precludes an issuer from asserting that it has the ability to deliver registered shares and, therefore, the ability to control the form of settlement. As noted above, when an issuer does not control the form of settlement, Issue 00-19 assumes cash settlement and would require the related instrument to be classified as an asset or liability. However, as indicated in footnotes 20 and 152 of Statement 123(R), the Board did not intend that share-based compensation arrangements, such as employee share options, be classified as liabilities based solely on the notion in Issue 00-19 that delivery of registered shares is generally considered outside the control of a company.

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5. Freestanding financial instruments originally issued as employee compensation¹ that can be settled only by delivering registered shares shall not be assumed to require cash settlement when applying the provisions of Issue 00-19.

6. An entity shall evaluate the substantive terms of an instrument that can be settled only by delivering registered shares to determine whether it qualifies as a liability.

¹This FSP is intended to apply to those instruments issued in share-based payment transactions with employees accounted for under Statement 123(R), FASB Statement No. 123, *Accounting for Stock-Based Compensation*, or APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and to instruments issued in a business combination in exchange for share-based payment awards of the acquired business that are held by employees of that business.

Paragraph 34 of Statement 123(R) provides relevant guidance in evaluating the substantive terms of an award.

Effective Date and Transition

7. The guidance in this FSP shall be applied in accordance with the effective date and transition provisions of Statement 123(R).