PROPOSED FASB STAFF POSITION

No. FAS 150-b

Title: 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*

Comment Deadline: September 27, 2003

Some companies have outstanding shares, all of which are subject to mandatory redemption on the occurrence of events that are certain to occur. The redemption price is to be the fair value of the shares on the redemption date. Assume on the date of adoption that the fair value of the shares is more than the book value of those shares (which is the difference between the recorded amounts of the company's assets and its liabilities other than the shares subject to mandatory redemption). On the date of adoption, the company would recognize a liability for the redemption price of the shares that are subject to mandatory redemption, eliminating the amounts previously recognized in the equity accounts. The excess is reported in the statement of income as a cumulative effect transition adjustment loss.

Q—How should the cumulative adjustment and any subsequent adjustments be reported if they exceed the company's equity balance?

A—The cumulative transition adjustment and any subsequent adjustments to the carrying amount of the liability causing losses in the statement of income that exceed book value should be reported as a deficit in equity, even though the mandatorily redeemable shares are reported as a liability.

If the fair value of the mandatorily redeemable shares is less than the book value of those shares, the company should report the excess of that book value over the liability reported for the mandatorily redeemable shares as equity.

Depending on the settlement terms, Statement 150 requires that mandatorily redeemable shares be measured at either the present value of the amount to be paid at settlement or the amount of cash that would be paid under the conditions specified in the contract if settlement occurred at the reporting date, recognizing the resulting change in that amount as interest cost.

Paragraph A30 of Statement 150 indicates that, for mandatorily redeemable shares measured initially at present value using the rate implicit at inception of the contract, the cumulative transition adjustment is the difference between the carrying amount and the present value of the liability. For mandatorily redeemable shares that will be redeemed at fair value, the initial measure of the liability is the amount that would be paid under the conditions specified in the contract if settlement occurred at the reporting date (the fair value of the shares on that date). Therefore, the cumulative transition adjustment for shares redeemable at fair value is the difference between the carrying amount and fair value at transition. The carrying amount of the mandatorily redeemable shares is their book value, which includes all amounts attributable to those shares.

Transition

The guidance in this FSP is effective immediately for mandatorily redeemable shares of entities for which the requirements of Statement 150 have already been applied. The guidance should be applied for other entities as part of the adoption of Statement 150. If this guidance results in changes to previously reported information, the cumulative effect shall be reported according to the provisions of Statement 150, in the first period ending after the final FSP is posted to the FASB website.

Illustrations of Accounting for Mandatorily Redeemable Shares with a Redemption Value that Differs from the Company's Book Value

<u>Example 1</u>

Assume a company adopts Statement 150 on January 1, 20XX, and that the fair value (which equals the redemption value) of the mandatorily redeemable shares is $20 million and the book value of those shares is $15 million, of which $10 million is paid-in capital. On the date of adoption, the company would recognize a liability of $20 million by transferring $15 million out of equity and recognize a cumulative transition adjustment loss of $5 million. Subsequently, net income attributable to the mandatorily redeemable shares is $1 million for the year 20XX and the fair value of those shares at the reporting date of December 31, 20XX, is $21.2 million. Also assume that the company did not pay any cash dividends.

The following illustrates the Statement of Position at January 1, 20XX and December 31, 20XX, and the Statement of Income for the year ended December 31, 20XX. (Income tax considerations have been disregarded.):

	January 1, 20XX	December 31, 20XX
Total Assets	$ 25,000,000	$ 26,000,000
Liabilities other than shares	$ 10,000,000	$ 10,000,000
Shares subject to mandatory redemption*	20,000,000	21,200,000
Total Liabilities	$ 30,000,000	$ 31,200,000
Total Equity (deficit)	$ (5,000,000)	$ (5,200,000)
Total Liabilities and Equity (deficit)	$ 25,000,000	$ 26,000,000

Notes to Financial Statements:

*Shares, all subject to mandatory redemption upon death of the holders, consist of:

Common Stock--$100 par value, 200,000 shares authorized, 100,000 shares issued and outstanding	$ 10,000,000	$ 10,000,000
Retained Earnings attributable to those shares	5,000,000	6,000,000
Excess of redemption amount over common stock and retained earnings attributable to those shares	5,000,000	5,200,000
	$ 20,000,000	$ 21,200,000

Income before interest on mandatorily redeemable shares	$ 1,000,000
Less: Interest on mandatorily redeemable shares	1,200,000
Income (loss) before cumulative effect of a change in accounting principle	$ (200,000)
Cumulative effect of change in accounting principle	(5,000,000)
Net loss	$ (5,200,000)

Example 2

Assume the same facts as in Example 1 except that the shares are redeemed at an amount ($11 million) that is less than their book value. On the date of adoption, January 1, 20XX, the company would recognize a liability of $11 million by transferring $11 million out of equity.

The following illustrates the Statement of Position at January 1, 20XX:

Statement of Financial Position (As of January 1, 20XX):

Total Assets	$ 25,000,000
Liabilities other than shares	$ 10,000,000
Shares subject to mandatory redemption*	11,000,000
Total Liabilities	$ 21,000,000
Total Equity	$ 4,000,000
Total Liabilities and Equity	$ 25,000,000

Notes to Financial Statements:

*Shares, all subject to mandatory redemption upon death of the holders, consist of:

Common Stock--$100 par value, 200,000 shares authorized, 100,000 shares issued and outstanding	$ 10,000,000
Retained earnings attributable to those shares	5,000,000
Excess of common stock and retained earnings attributable to those shares over redemption amount	(4,000,000)
	$ 11,000,000