

MINUTES



To: Board Members
From: Bellantoni (ext. 445)
Subject: Minutes of the October 19, 2005 Board Meeting—Proposed FSP FAS 123(R)-c **Date:** October 25, 2005
cc: Leisenring, Smith, Bielstein, Petrone, Golden, Cassel, Oakley, Sarno, Tovey, Richards, Wilkins, Bellantoni, Gibbons, Murphy, Gabriele, Carney, Vernuccio, Polley, Mahoney, FASB Internet

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic: Proposed FSP FAS 123(R)-c

Basis for Discussion: Memorandum dated October 13, 2005

Length of Discussion: 11:08 a.m. to 11:36 a.m.

Attendance:

Board members present: Batavick, Crooch, Herz, Schipper, Seidman, Trott, and Young
Board members absent: None
Staff in charge of topic: Oakley
Other staff at Board table: Bellantoni, Golden, Sarno, and L. Smith
Outside participants: None

Summary of Decisions Reached:

The Board discussed comments received from respondents to the proposed FASB Staff Position (FSP) FAS 123(R)-c, “Transition Election Related to Accounting for the Tax Effects of Share-Based Payment Awards.” Specifically, the Board addressed an alternative method for the APIC pool calculation, three modifications to the proposed calculation, the addition of guidance on blended statutory tax rates, and a modification to the proposed transition requirements. The Board made the following decisions:

1. The method for the APIC pool calculation will remain the same as the method exposed in the proposed FSP.
2. The simplified method will be revised to consider only the cumulative compensation cost disclosed under FASB Statement No. 123, *Accounting for Stock-Based Compensation*, as a deduction in arriving at the beginning balance of the APIC pool.
3. The simplified method will be revised to exclude compensation cost associated with partially vested awards from the cumulative compensation cost that is deducted in arriving at the beginning balance of the APIC pool.
4. The simplified method will be revised to exclude the compensation cost associated with awards that are not ordinarily deductible for tax purposes (for example, incentive stock options) from the cumulative compensation cost that is deducted in arriving at the beginning balance of the APIC pool, unless the award has resulted in a tax deduction prior to the adoption of FASB Statement No. 123(*revised 2004*), *Share-Based Payment* or unless information is not available to determine the compensation cost associated with such awards.
5. The Board will not provide additional guidance in this FSP for calculating the blended tax rate.
6. The Board clarified the transition provisions in this FSP to be the following:
 - a. Prior to finalizing its one-time election, an entity should apply the transition guidance in paragraph 81 of Statement 123(R) and the guidance in paragraph 68 of Statement 123(R) relative to classification of amounts in the statement of cash flows.
 - b. If an entity subsequently elects the simplified transition provisions of this FSP, it should account for any resulting impact on the income

statement or statement of cash flows by retrospectively applying the guidance in this FSP to periods subsequent to the adoption of Statement 123(R).

7. The Board directed the staff to proceed to a draft of a final FSP for vote by written ballot.

Objective of Meeting:

The purpose of this meeting was for the Board to consider (a) comments received from respondents during the exposure period and (b) whether to proceed to drafting a final FSP.

Matters Discussed and Decisions Reached:

1. Mr. Oakley opened the meeting by introducing the issue. He stated that the staff has received 11 comment letters (4 from accounting firms, 5 from preparers, and 2 from constituent organizations). Those respondents generally agree with the conclusions in the proposed FSP and support the issuance of a final FSP. One respondent supported the Board's effort to address the recordkeeping and implementation issues associated with the retrospective calculation of the APIC pool but recommended an alternative method than that currently reflected in the FSP. Several respondents also requested changes to the proposed method related to the treatment of partially vested awards or awards for which compensation cost was recognized in the financial statements prior to the adoption of Statement 123(R). Other respondents made certain recommendations for improvement or clarification. Many of the comments were considered editorial in nature and did not change the guidance in the proposed FSP.

Alternative Calculation for APIC Pool

2. Mr. Oakley stated that the first recommendation for the Board to consider is an alternative method for calculating the beginning balance of the APIC pool. The respondent suggests that the Board consider allowing companies an election to calculate the historical APIC pool back to the earliest fiscal year for which the company is able and willing to perform the calculation. The calculation of the APIC pool would be in accordance with paragraph 81 of Statement 123(R), except that a company would not be

required to calculate the cumulative balance for all years subsequent to the adoption of Statement 123.

3. Mr. Oakley noted that the method proposed by the respondent would not address the implementation matters identified with the retrospective calculation of the APIC pool or the accounting for awards exercised after the adoption of Statement 123(R) but granted in periods as far back as 1996. Mr. Oakley stated that the staff recommended that the Board continue with the method exposed in the proposed FSP. The Board unanimously agreed with the staff recommendation.

Double-counting of Compensation Cost

4. Mr. Oakley stated that respondents were concerned that the calculation of the beginning balance of the APIC pool under the simplified method would penalize entities that adopted the fair value recognition provisions of Statement 123. They noted that since compensation cost and related deferred tax assets are recognized in the financial statements for awards accounted for under the fair value method, any credit realized in equity for that award is already reduced by the tax effect of the recognized compensation cost.

5. Mr. Oakley noted that the staff agreed that the simplified method gives a punitive result for an entity that has adopted the recognition provisions of Statement 123 prior to the adoption of Statement 123(R). To avoid this punitive effect on entities that adopted the recognition provisions of Statement 123 early, the staff recommended revising the simplified method to consider only the cumulative compensation cost disclosed under Statement 123 as a deduction in arriving at the beginning balance of the APIC pool. The Board unanimously agreed with the staff recommendation.

6. Mr. Oakley stated that respondents were concerned that the guidance in the FSP on awards that are partially vested upon adoption of Statement 123(R) results in a double charge against the APIC pool if the partially vested award subsequently gives rise to a deficiency. The double counting occurs because the tax effect of compensation cost associated with a partially vested award is deducted in arriving at the beginning balance

of available APIC pool and again in determining the extent of any deficiency when the award is exercised, due to the guidance in paragraph 7 of the proposed FSP.

7. Mr. Oakley noted that the staff agreed that the compensation cost associated with a partially vested award may reduce the APIC pool balance twice in certain situations. The staff recommended that the Board maintain the existing requirements of the proposed method for awards that generate excesses subsequent to the adoption of Statement 123(R) but revise the simplified method to eliminate the double counting of hypothetical deficiencies related to partially vested awards by excluding compensation cost associated with partially vested awards from the cumulative compensation cost that is deducted in arriving at the beginning balance of the APIC pool. The Board unanimously agreed with the staff recommendation.

Inventive Stock Options (ISOs)

8. Mr. Oakley stated that respondents requested that the Board clarify whether compensation costs associated with incentive stock options (ISOs) should impact the APIC pool under the simplified method described in the FSP. Under the simplified method, no distinction is made between compensation cost disclosed under Statement 123 associated with awards that will ultimately give rise to a tax deduction and those awards that will never give rise to a deduction. From a conceptual standpoint, ISOs should not have an impact on the APIC pool under the existing provisions of Statement 123(R). Mr. Oakley noted that the staff recommended that the Board revise the simplified method to exclude the compensation cost associated with awards that are not ordinarily deductible for tax purposes from the cumulative compensation cost that is deducted in arriving at the beginning balance of the APIC pool unless the award has resulted in a tax deduction prior to the adoption of Statement 123(R). The Board unanimously agreed with the staff recommendation.

Nature of Changes

9. Mr. Oakley noted that the simplified method was initially designed to use information available in the financial statements of every preparer. If the changes to the simplified method described above are required, the information necessary to utilize the simplified

method would no longer be available in the financial statements, thereby increasing the complexity of the proposed method. Alternatively, if the changes are elective rather than required, the simplified method could be adopted in a variety of ways; however, the comparability between entities would be reduced. Mr. Oakley then asked the Board if the changes noted above should be required or elective.

10. Mr. Trott stated that he believed all of the necessary information would be available to an entity to calculate the APIC pool using the changes in the simplified method above. Therefore, he supported making the changes to the simplified method required. Mr. Herz asked the staff whether or not the information would be available for companies to perform the calculation if the changes above were required. Mr. Oakley stated that the staff had not done specific research to verify their opinion, but the staff believes that the information should be readily available to the entity.

11. Mr. Herz stated that he was uncertain if an entity would possess the necessary information related to ISOs to be able to perform the calculation under the simplified method if the changes above were required. Mr. Herz suggested that the Board make the other changes (noted above) required in the calculation, and the change related to ISOs required unless an entity was unable to obtain the information necessary to determine the amount of such cost. The Board unanimously agreed with his suggestion.

Blended Tax Rate

12. Mr. Oakley noted that respondents requested clarifying guidance on how to determine the appropriate blended tax rate to cumulative compensation in the simplified method. Specifically, they requested guidance on how to weight jurisdictions and how the impact of nondeductibility or tax credits in specific jurisdictions should be determined. The staff recommended that the Board refrain from providing further guidance on this matter. The Board unanimously agreed with the staff recommendation. Ms. Seidman noted that the Board's intent is to allow people to make a reasonable approximation of the rate that would apply to these awards.

Transition

13. Mr. Oakley stated that the proposed model exposed for public comment provided that an entity could take up to one year from the later of its initial adoption of Statement 123(R) or the effective date of this FSP to evaluate its available transition alternatives and make its one-time election. This one-year period was included to allow preparers to fully explore recreating the information necessary to comply with the existing transition provisions of Statement 123(R). When originally drafted, the staff did not believe that it was likely that this one-year period would have an impact on financial reporting. Subsequently, the Board provided guidance on the issue of classification in the statement of cash flows for awards granted prior to the adoption of Statement 123(R). That guidance differs from the cash flow reporting requirements applicable under the full transition provisions of Statement 123(R). As a result of the differing cash flow guidance, the one-year election period may have an impact on financial reporting. The staff recommended that the Board clarify that, prior to finalizing its one-time election, an entity should apply the transition guidance in paragraph 81 of Statement 123(R) and the guidance in paragraph 68 of Statement 123(R) relative to classification of amounts in the statement of cash flows. If an entity subsequently elects the simplified transition provisions of this FSP, it should account for any resulting impact on the income statement or statement of cash flows by retrospectively applying the guidance in this FSP to periods subsequent to the adoption of Statement 123(R).

14. The Board unanimously agreed with the staff recommendation. Mr. Trott noted that if entities are concerned that this decision increases the complexity of the transition, that complexity can be offset by making an election decision early. Mr. Golden stated that in the periods prior to the election, the companies are not required to compute all of their existing APIC credits; they are required to compute only those APIC credits needed to offset a deficiency.

Follow-up Items:

15. The staff has proceeded to create a ballot draft for the Board's consideration and expects to issue the final FSP during the week ending October 28, 2005.

General Announcements:

16. None.