

MINUTES



To: Board Members
From: Bellantoni (ext. 445)
Subject: Minutes of the September 21, 2005 Board Meeting—Proposed FSP FAS 123(R)-c **Date:** September 28, 2005
cc: Leisenring, Smith, Bielstein, Petrone, Golden, Cassel, Oakley, Sarno, Tovey, Richards, Wilkins, Bellantoni, Gibbons, Murphy, Gabriele, Carney, Vernuccio, Polley, Mahoney, FASB Internet

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Topic: Proposed FSP FAS 123(R)-c

Basis for Discussion: Memorandums dated September 12 and 19, 2005

Length of Discussion: 8:55 a.m. to 9:21 a.m.

Attendance:

Board members present: FASB: Batavick, Crooch, Herz, Schipper, Seidman, Trott, and Young

Board members absent: None

Staff in charge of topic: Sarno

Other staff at Board table: Bellantoni, Oakley, and L. Smith

Outside participants: None

Summary of Decisions Reached:

The Board discussed issues related 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," that would provide guidance on a transition alternative for determining the APIC pool from the date of adoption of FASB Statement No. 123 (revised 2004), *Share-Based Payment*, back to the effective date of the original FASB No. Statement 123, *Accounting for Stock-Based Compensation*. The Board decided to add this project to its agenda and directed the staff to proceed to draft a proposed FSP for vote by written ballot. The Board made the following decisions:

1. Practical guidance should be provided in the form of a proposed FSP that establishes an elective transition alternative related to the accounting for the tax effects of share-based payment awards.
2. An entity will be allowed to elect to follow the transition guidance in paragraph 81 of Statement 123(R) or the following elective transition alternative:
 - a. The beginning balance of an entity's APIC pool should be calculated as follows:
 - (1) All increases of additional-paid-in capital recognized in an entity's financial statements related to tax benefits from stock-based compensation during fiscal periods subsequent to the adoption of Statement 123 but prior to the adoption of Statement 123(R).
 - (2) Less: The product of the cumulative gross compensation cost either (a) recognized in the entity's financial statements pursuant to Statement 123 or (b) disclosed in the entity's financial statements pursuant to the provisions of Statement 123, multiplied by the entity's current blended statutory tax rate, inclusive of federal, state, local, and foreign taxes.
 - b. Tax benefits realized in accordance with Statement 123(R) and recognized in equity subsequent to the adoption of Statement 123(R)

that relate to an award that was fully vested prior to the adoption of Statement 123(R) should increase the APIC pool.

- c. The impact on the APIC pool of an award that is partially vested upon or granted after the adoption of Statement 123(R) should be determined in accordance with the principles of Statement 123(R). That is, the tax deduction realized for a partially vested award should be compared to the sum of compensation cost recognized or disclosed for that award under Statement 123 and Statement 123(R). Any resulting excess tax deduction should increase the APIC pool; any deficiency should be deducted from the APIC pool.
3. In determining the appropriate classification in the statement of cash flows, the Board agreed on the following guidance for an entity that elects the transition alternative prescribed in the FSP:
 - a. Tax benefits realized in accordance with Statement 123(R) and recognized in equity subsequent to the adoption of Statement 123(R) that relate to an award that was fully vested prior to the adoption of Statement 123(R) should be included as a cash inflow from financing activities and a cash outflow from operating activities within the statement of cash flows.
 - b. The impact on cash flows of an award that is partially vested upon or granted after the adoption of Statement 123(R) should be determined in accordance with the principles of Statement 123(R). That is, any tax excess should be determined as if the entity has always followed a fair value based method of recognizing compensation cost in their financial statements and included as a cash inflow from financing activities and a cash outflow from operating activities within the statement of cash flows.
 4. With respect to effective date, transition, and comment period of the proposed FSP, the Board decided the following:

- a. The guidance in this FSP shall be effective upon the later of an entity's initial adoption of Statement 123(R) or the date this FSP is finalized and posted to the FASB website.
- b. An entity may make a one-time policy election to adopt either (a) the elective transition alternative or (b) the transition method described in paragraph 81 of Statement 123(R).
- c. The elective transition alternative is available to an entity regardless of the transition method used to adopt Statement 123(R).
- d. An entity may 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 finalize its election.
- e. Pursuant to this FSP, an entity would be required to disclose the method of transition related to the accounting for the tax effect of share-based payment awards. That is, whether an entity is elected to follow the transition guidance in paragraph 81 of Statement 123(R) or the elective transition alternative described in this FSP.
- f. The proposed FSP should be exposed for a 15-day public comment period.

Objective of Meeting:

The purpose of this meeting was for the Board to consider (a) whether to provide practical guidance related to an elective transition alternative for APIC pool, (b) if they agreed to provide practical guidance, what form that guidance should take, (c) the effects of that practical guidance on the statement of cash flows, and (d) the appropriate transition period for the practical guidance.

Matters Discussed and Decisions Reached:

Alternative Election for APIC Pool

1. Mr. Sarno opened the meeting by introducing the issue. He stated that the staff has received numerous comments from constituents regarding the computation of the net excess tax benefits available for offset against future deficiencies (the APIC pool) in the period from the date of adoption of Statement 123(R) back to the effective date of the original Statement 123. Those comments cite situations (a) where an entity may not have the relevant information for calculating its APIC pool or (b) there may be significant cost or complexities involved in determining the full historical APIC pool back to the original effective date of Statement 123. Based on those comments, it is clear that few companies appropriately applied the guidance in Statement 123 as it related to accounting for the tax consequences of equity awards and that few entities currently have the balance of the APIC pool readily available, even excluding the changes resulting from Statement 123(R). Therefore, the staff recommends, as a practical solution, that the Board add a project to its agenda to provide for an elective transition alternative for determining the APIC pool from the date of adoption of Statement 123(R) back to the effective date of the original Statement 123.

2. Ms. Schipper explained that she had participated in multiple internal meetings and small groups discussing this topic. She had also reviewed a staff draft that describes the objective of this FSP and several approaches for accomplishing that objective. Ms. Schipper stated her support for the FSP, based on language in the FSP that clarifies the necessity for the Board to take on this project. Ms. Schipper added that the FSP also stated that when the Board promulgated Statement 123(R), it was acting on the information that it had received from its constituents, which did not include statements that they had implemented the requirements of Statement 123 in ways that caused them not to have the information that the Board assumed they had.

3. Mr. Batavick agreed with Ms. Schipper's comments and stated his support for the proposed FSP, including the clarifying language that she suggested. Ms. Seidman also stated her support for the Board to provide guidance on this matter

to aid constituents to have an orderly transition and be able to apply the key provisions of Statement 123(R). Mr. Crooch stated that the staff recommendation was reasonable and that he supported it. Mr. Trott agreed with Mr. Crooch and supported the FSP.

4. Mr. Sarno stated that the staff had previously provided the Board with a draft FSP that laid out the elective transition alternative that companies would be able to use in calculating the beginning balance of their APIC pool. Given the Board's decision to take on a project relating to this matter, Mr. Sarno asked the Board if it agreed with the method the staff provided in the draft FSP.

5. Mr. Trott, Ms. Schipper, Mr. Batavick, Ms. Seidman, and Mr. Crooch all agreed to the proposed FSP. No objections or drafting comments were made.

6. Mr. Sarno stated that Statement 123(R) requires the excess tax benefit associated with an individual share-based payment award be included as a cash inflow from financing activities and a cash outflow from operating activities. The information necessary to determine the appropriate classification in the statement of cash flows under that guidance is similar to the information required to perform the retrospective calculation of the APIC pool. The lack of availability of such information in certain cases is one of the reasons the elective transition alternative is necessary. Therefore, the staff recommends the Board provide the following guidance should an entity elect the transition alternative prescribed in the FSP:

- a. Tax benefits realized in accordance with Statement 123(R) and recognized in equity subsequent to the adoption of Statement 123(R) that relate to an award that was fully vested prior to the adoption of Statement 123(R) should be included as a cash inflow from financing activities and a cash outflow from operating activities within the statement of cash flows.
- b. The impact on cash flows of an award that is partially vested upon or granted after the adoption of Statement 123(R) should be determined

in accordance with the principles of Statement 123(R). That is, any tax excess should be determined as if the entity has always followed a fair value based method of recognizing compensation cost in their financial statements and included as a cash inflow from financing activities and a cash outflow from operating activities within the statement of cash flows.

7. Ms. Schipper stated that she agreed with the staff's recommendation. Mr. Batavick, Mr. Trott, and Ms. Seidman also stated agreement with the recommendation. No objections were noted.

8. Mr. Sarno stated, with respect to effective date, transition, and comment period the staff recommends the following:

- a. The guidance in this FSP shall be effective upon the later of an entity's initial adoption of Statement 123(R) or the date this FSP is finalized and posted to the FASB website.
- b. An entity may make a one-time policy election to adopt either (a) the elective transition alternative or (b) the transition method described in paragraph 81 of Statement 123(R).
- c. The elective transition alternative is available to an entity regardless of the transition method used to adopt Statement 123(R).
- d. An entity may 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 finalize its election.
- e. Pursuant to this FSP, an entity would be required to disclose the method of transition related to the accounting for the tax effect of share-based payment awards. That is, whether an entity elected to follow the transition guidance in paragraph 81 of Statement 123(R) or the elective transition alternative described in this FSP.
- f. The proposed FSP should be exposed for a 15-day public comment period.

9. Ms. Schipper questioned why the comment period was only 15 days. Mr. Sarno noted that a company with a June 30 year-end has already adopted Statement 123(R) and essentially needs this guidance if they have a zero balance in their APIC pool at the date of adoption.

10. Mr. Herz questioned why a one-year period was being provided for entities to evaluate the available transition alternatives and finalize their elections. Mr. Oakley responded that the staff recognized that companies would need time to build the necessary records needed to comply with the full provisions of Statement 123(R). The staff put in the one-year period to prevent potential abuse by a company postponing the election indefinitely.

11. Mr. Batavick, Ms. Seidman, and Mr. Crooch agreed to the transition provisions proposed by the staff. No objections were noted.

Follow-up Items:

12. A ballot draft of the proposed FSP was distributed on September 28, 2005. The proposed FSP was also posted to the FASB website on September 28, 2005 for a comment period of 15 days.

General Announcements:

13. None.