

MINUTES



**To:** Board Members  
**From:** Bellantoni (ext. 445)  
**Subject:** Minutes of the October 12, 2005 Board Meeting—Proposed FSP FAS 123(R)-b **Date:** October 20, 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)-b

Basis for Discussion: Memorandums dated October 5 and 7, 2005

Length of Discussion: 9:00 a.m. to 9:18 a.m.

Attendance:

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

Board members absent: None

Staff in charge of topic: Sarno

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

Outside participants: None

## **Summary of Decisions Reached**

The Board discussed comments received from respondents on the proposed FSP FAS 123(R)-b, "Practical Exception to the Application of Grant Date as Defined in Statement 123(R)." Specifically, the Board addressed the transition provisions in the FSP, performance conditions in which all the key terms and conditions of an award are not communicated to an employee, and certain drafting considerations. The Board decided:

1. The transition provisions in the final FSP will be modified so that entities that have already adopted Statement 123(R) would be able to apply the FSP, once its been issued, in the earliest reporting period for which financial statements or interim reports have not been issued.
2. Communication of specific performance targets is consistent with the principles of mutual understanding included in the definition of grant date in Statement 123(R).
3. Explicit modification guidance regarding changes in the key terms and conditions of an award subsequent to the criteria established in the proposed FSP (that is, a grant date) would not be added to the final FSP.

The Board directed the staff to proceed with a draft of the 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. Sarno opened the meeting by introducing the issue. He stated that the staff received 18 comment letters (4 from accounting firms, 10 from preparers, 2 from consulting firms, and 2 from constituent organizations) as of the comment period deadline. Those respondents generally agreed with the conclusions in the

proposed FSP and supported the issuance of a final FSP. However, the respondents made certain recommendations for improvement.

2. Mr. Sarno stated that the first recommendation for the Board to consider is a change in the transition requirements in the FSP. The proposed FSP indicated that entities that have adopted Statement 123(R) prior to the issuance of a final FSP shall apply the guidance in the FSP in the first reporting period beginning after the date the FSP is posted to the FASB website. Two respondents indicated that entities should be able to apply the provisions of a final FSP in the earliest reporting period for which the financial statements have not been issued. The Board unanimously agreed with the change in transition requirements.

3. Mr. Sarno stated that the second recommendation for the Board to consider is the application of this FSP to a performance-based award. One respondent described a situation in which share-based payment awards (containing a performance condition) are issued to employees. All of the terms and conditions of the award are established by an entity's board (or management with the relevant authority); however, the specific performance target is not communicated to the employees because management considers the performance target to be confidential and believes dissemination of the target broadly to employees would compromise that confidentiality. For example, consider an award that vests if earnings per share increases at a rate of 10 percent annually over three years, which correlates to the issuer's strategic plan. The general terms and conditions of the award including the metric that is being used to determine vesting (earnings per share growth rate) are communicated to the grantees, but the percentage (10 percent) is not communicated. The respondent noted that some constituents believe that, in this example, a grant date has not been achieved prior to the time the 10 percent threshold is communicated to the grantee. The respondent does not believe communication of the 10 percent threshold should determine whether a grant date has occurred. In addition to the sensitive nature of certain performance targets, the respondent also indicated that not communicating the performance target (in this case, the required percentage increase in earnings per share) may be viewed by some as

consistent with sound corporate governance. That is, by not communicating the specific performance target broadly, some believe the incentive to manage to the achievement of the target to the long-term detriment of the entity is reduced. Mr. Sarno noted that the Board could proceed in one of three directions:

- a. Proceed with the FSP as drafted, considering the other comments received in the exposure process.
- b. Amend Statement 123(R) to eliminate the concept of mutual understanding that currently exists within the definition of grant date in Statement 123(R).
- c. Instruct the staff to explore a position that would preserve the concept of mutual understanding generally but that would provide additional guidance about the terms of an award that must be communicated in order to conclude a grant date has occurred.

4. Mr. Sarno also noted that if the Board decides to proceed with either the second or third alternative, the staff would need to:

- a. Consider potential amendments to the base standard, the implementation guidance, and the basis for conclusions.
- b. Ask the Board to consider re-exposure.

5. Mr. Sarno stated that the majority of the staff believes that communicating the specific performance targets (a) does not negatively impact corporate governance to any significant degree and (b) is consistent with the principles of mutual understanding included in the definition of grant date in Statement 123(R). He noted that a majority of the staff recommended that the Board continue with the current FSP as drafted.

6. Mr. Trott stated that he supported the Board proceeding with the current FSP as drafted. He then asked for an explanation of the minority view among the staff. Mr. Oakley explained that the minority view of the staff included two components for the concept of mutual understanding. First, the key terms of the award need to be set; an entity should not be able to change the terms of the

award after the grant date. Second, the employees should understand the fair value of the award they receive as compensation for the services they provide. Mr. Oakley noted that, even when specific performance targets are communicated, the employee does not always have a true understanding of the fair value of the award. In addition, he noted that an entity's concern about its officers managing to a specific target number could be considered valid. Mr. Trott stated that if an entity is concerned about its officers managing to a specific number, it should be the entity's responsibility to design an award with appropriate incentives. Mr. Young agreed with Mr. Trott that the Board should continue with the current FSP as drafted.

7. Mr. Batavick stated that he supported the minority view of the staff. Referencing the example in paragraph 3 above, he stated that the employee needs to know that the award is based on earnings per share growth rate for the key terms to be communicated. He stated that it was not necessary for the employee to know the specific target (10 percent in the example above) for the key terms to be understood. Mr. Batavick noted that the employee should have faith in the entity that the specific target set for any given metric would be reasonable. He stated that the other key element of establishing the grant date is that the employee begins to be affected by changes in the stock price, and as long as that was occurring, the award would be considered granted. Mr. Batavick noted that, while he supported the minority view, he would not object to the Board continuing with the current FSP as drafted.

8. Ms. Schipper agreed with the majority view that the Board should proceed with the current FSP as drafted. Mr. Crooch stated that a performance option meant that an employee needed to know the specific target. He agreed with the majority view of the staff. Ms. Seidman and Mr. Herz also agreed that the Board should proceed with the current FSP as drafted.

9. Mr. Herz noted that the title of the FSP should be changed from "practical exception" to "practical expedient." This FSP is guidance on how to understand the definition of grant date, not an exception for it.

10. Mr. Sarno stated that the final recommendation for the Board to consider is a drafting consideration. At a prior Board meeting, the Board concluded that an entity that changes the key terms and conditions of an award subsequent to the criteria established in this FSP (that is, a grant date) that change shall be accounted for as a modification. Some respondents to the FSP cite a preference toward explicitly stating that modification guidance in the final FSP. Mr. Sarno asked the Board if it wanted to add the explicit guidance requested by the respondents.

11. Ms. Schipper clarified that the guidance requested for this FSP was already explicitly stated in Statement 123(R). She stated that the explicit guidance was not necessary. The Board unanimously agreed that explicit modification guidance would not be added.

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

**Follow-up Items:**

13. The staff has proceeded to create a ballot draft for the Board's consideration on October 13, 2005 and expects to issue the final FSP on October 18, 2005.

**General Announcements:**

14. None.