	IASB/FASB Meeting January 2010	IASB agenda reference	**5**
		FASB memo reference	**79**

Project	**Financial instruments with characteristics of equity**
Topic	**Cover memo**

Introduction

1. This Board package contains the following:
   - (a) **Agenda Paper 5A/FASB Memo 80** describes Approach 4.2 to distinguish between instruments classified as assets or liabilities and instruments classified as equity.
   - (b) **Agenda Paper 5B/FASB Memo 81** [not used at this meeting – this paper will now be discussed at a future meeting].
   - (c) **Agenda Paper 5C/FASB Memo 82** discusses how a subsidiary's equity instruments should be classified in the consolidated financial statements.
   - (d) **Agenda Paper 5D/FASB Memo 83** discusses whether an instrument should ever be classified as a liability if the issuer feels compelled to settle or redeem because not doing so imposes significant negative economic consequences.

Statement of Stockholder Equity

2. In December, we issued a paper discussing possible additional requirements in the statement of stockholders equity that would provide information about dilution of derivatives classified as equity. We do not think those requirements are necessary

because Approach 4.2 would require classification as equity for three fairly narrow classes of instruments that an entity is required to settle (and has the ability to settle) by issuing its own shares. The instruments classified as equity would be short term in nature; therefore, there would be little if any dilutive effects.

3. The additional requirements in the statement of stockholders equity described in the December paper could be applied to employee stock options since the boards decided to retain the classification requirements under Topic 718 of the Accounting Standards Codification on stock compensation and IFRS 2, *Share-based Payment*. We believe that would be extremely complicated for a number of reasons; however, the most obvious reason is that the compensation cost of a share-based-payment award classified as equity is recognized over the vesting period.

Linkage

4. In December, we issued a paper discussing possible linkage criteria. Because of the limited number of instruments classified as equity, we do not think linkage criteria are necessary under Approach 4.2. The two linkage situations most frequently discussed in the past involved put options and convertible debt. Put options would be accounted for consistently whether embedded or issued separately. Options embedded in convertible debt would be liabilities if issued separately. We would appreciate hearing about any situations in which you believe instruments might need to be linked.

This Board Meeting and Next Steps

5. We realize that Approach 4.2 is probably not anyone’s first choice. However, given that neither Approach 4.0 nor Approach 4.1 had majority support of both boards, we hope that both can agree to accept Approach 4.2 as a reasonable compromise.

6. If, after the boards discuss the papers described in paragraph 1, there is sufficient support for Approach 4.2, there are very few issues left to discuss. The boards will still need to decide on appropriate disclosures and how to account for settlement, conversion, expiration, or modification (which is not a significant issue if convertible debt is not bifurcated). We also plan to explain how this classification approach would affect earnings per share. We believe all of that can be accomplished in one more board meeting.

7. If there is sufficient support for Approach 4.2, we will ask board members for permission to begin drafting a document that will eventually lead to an Exposure Draft, as well as whether any board members expect to dissent to the proposed Exposure Draft.

Questions for the Boards
1. Should the staff begin drafting a document that will lead to an Exposure Draft? 2. If so, does any board member expect to dissent to an Exposure Draft proposing Approach 4.2?