



Accounting & Auditing Information Letter 06-039

Joint IASB/FASB BOARD MEETING – October 23-24, 2006

November 3, 2006

THE SUMMARY IN THIS MEMORANDUM IS BASED ON OBSERVATIONS OF THE MEETING AND REPRESENTS AN UNOFFICIAL INTERPRETATION OF THE DISCUSSION.

The Board discussed the following matters:

- 1 Financial instruments: liabilities and equity – the FASB updated the IASB on three possible accounting approaches for financial instruments with characteristics of equity, liabilities, or both. The FASB plans to issue a Preliminary Views for comment in May 2007.
- 2 Conceptual framework - the Boards discussed (a) procedures for finalizing the framework, (b) status and future plans for the elements phase, and (c) research on measurement bases.
- 3 Insurance contracts - the IASB updated the FASB on the status of phase II of the IASB's project on insurance contracts. The IASB expects to publish its discussion paper in the first quarter 2007. The FASB will publish its Invitation to Comment, which will include the IASB's discussion paper, shortly thereafter.
- 4 Memorandum of Understanding – the Boards discussed plans for achieving the project milestones in the February 2006 “Memorandum of Understanding between the FASB and the IASB.”
- 5 Business combinations – the Boards redeliberated the proposed guidance in the June 2005 Exposure Draft, *Business Combinations*, about the measurement attribute for (a) assets and liabilities assumed in a business combination and (b) a noncontrolling interest in a partial or step acquisition.
- 6 Financial statement presentation - the Boards continued their discussion about applying the project's working principles, specifically (a) defining the short-term and long-term subcategories in the operating category, (b) presenting information about liquidity in the notes to the financial statements, (c) defining financing liabilities, treasury assets, and investments, (d) applying the measurement working principle, and (e) presenting other comprehensive income items.
- 7 Revenue recognition - the Boards discussed the nature of the due process document on revenue recognition that is expected to be issued by the end of 2007.

Summary

1. Financial Instruments

The Boards discussed the current status of the FASB's Liabilities and Equity project. The project's objective is to develop a comprehensive standard of accounting and reporting for financial instruments with characteristics of equity, liabilities, or both. The Boards discussed three possible accounting approaches currently being developed by the FASB:

- The ownership settlement approach
- The ownership approach (a narrower view of equity)
- The reassessed expected outcomes approach

The FASB and the IASB are conducting this project under a modified joint approach. Under that approach, the initial due process document issued by the FASB will be in the form of a Preliminary Views, which is expected to be published for comment in Q2 2007. That document will be concurrently published by the IASB for comment by its constituents. The Boards plan to use the input received on those initial due process documents as the basis for a joint project to develop a common standard.

The Board also plans to address the following remaining issues before issuing the Preliminary Views:

- Computing EPS
- Identifying substantive and nonsubstantive features for instruments that may embody constructive obligations
- Interaction with FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*

2. Conceptual Framework

The Boards discussed (a) procedures for finalizing the framework, (b) status and future plans for the elements phase, and (c) research on measurement bases.

Procedures for Finalizing the Framework

The Boards agreed, within the context of its current GAAP hierarchy, to finalize the framework as chapters as opposed to waiting until the completion of all of the project's phases. Each chapter will be exposed for public as completed. The Boards also recognized that it may be necessary revisit this decision when they each consider the

placement of the new jointly developed common framework within the IASB and FASB hierarchies.

Status and Future Plans for the Elements Phase (Phase B)

The Boards agreed to consult on an informal basis with technical experts and others such as the Board's advisory committees on the definition of an asset (Milestone I) and options over assets (Milestone II) without waiting for the completion of the remaining eight milestones. The Boards also noted that Phase B is now scheduled to be completed in late 2007.

Measurement Bases (Phase C)

The Boards discussed an inventory of current and proposed measurement bases for assets and liabilities, for purposes of developing a common set of terms and definitions that is intended to improve communication about measurement bases during the conceptual framework project. The Boards will continue to work on the inventory and terminology and will develop discussion papers which will be addressed at an initial round of measurement roundtable discussions scheduled for January and February 2007. Following the roundtable discussions, these papers will be taken to the Boards again for further deliberations.

3. Insurance Contracts

The IASB updated the FASB on the status of phase II of the IASB's project on insurance contracts and discussed some of the key topics to be addressed in the project. The IASB expects to publish a discussion paper with its preliminary views in the first quarter of 2007. The FASB will publish its Invitation to Comment containing the IASB's discussion paper, shortly thereafter. Based on the comments received from respondents, the FASB will decide whether or not to add a joint project with the IASB to develop a comprehensive standard on the accounting for insurance contracts.

4. Memo of Understanding

The Boards discussed plans for achieving the various project milestones included in the February 2006 "Memorandum of Understanding between the FASB and the IASB". No decisions were reached at the meeting. The status of the major convergence projects and the short-term convergence projects is included in the meeting handout, which is available on the FASB's website at www.FASB.org.

5. Business Combinations II

Measurement Alternatives

The Exposure Draft proposes that assets acquired and liabilities assumed as part of a business combination be recognized at their acquisition date fair values. The FASB Board clarified in the recently published FASB Statement No. 157, *Fair Value Measurements*, that the measurement objective of a fair value measurement is an exit

price as opposed to an entry price. During the meeting the Boards discussed whether the final Statement would include a converged measurement attribute, based on either an exit or entry price notion of fair value, or would each Board retain its existing definition of fair value. The IASB voted unanimously that in the final Business Combinations standard the term fair value would be as defined in IFRS 3. The IASB will reconsider the measurement attribute in a business combination when it has concluded its deliberations on fair value measurements. The FASB Board members will perform an analysis of whether there are likely to be significant differences between fair value measured in accordance with Statement 157 as compared to IFRS 3, before making its final decision.

Noncontrolling Interests

During the meeting, the Boards considered whether the measurement attribute for a noncontrolling interest (NCI) acquired in a partial or step acquisition should be fair value. Under this approach, goodwill would be calculated as the difference between (a) the fair value of the consideration transferred and the fair value of the NCI, and (b) the fair value of the identifiable net assets acquired. No decisions were reached during the meeting.

6. Financial Statement Presentation

The Financing Section and Investing category

The Boards decided that the financing section should include financial assets and financial liabilities, as defined in the standards, that management views as part of the financing of the entity's business activities. Financing assets and financing liabilities would be classified in separate categories in each of the financial statements.

The Boards decided that the investing category within the business section should include assets and liabilities not classified in the financing section that in management's view are not integral to the entity's main business activities. Investing assets and liabilities would represent items that in management's view were not integral to the entity's main business activities. Investing assets and liabilities and related changes would be classified in the investing category in each of the financial statements.

The Boards agreed to develop similarly broad guidelines (as opposed to prescriptive guidelines) for classifying assets and liabilities in the operating category in the business section. An entity would be required to explain, as a matter of accounting policy, its basis for classifying assets and liabilities in the financing categories, the investing category, and the operating category. The Boards agreed that any change in the basis of classification would be viewed as a change in accounting policy.

The Boards agreed that the financial statement presentation project should address pension-related presentation issues, based on the current net reporting requirements for pensions, in both the statement of financial position and the statement of recognized income and expense. Thus, an entity's net pension obligation (or asset) would be classified in a single category in the statement of financial position (presumably the

operating category) and the related net pension cost and cash flows would be classified in that same category in the statements of recognized income and expense and cash flows, respectively.

Information about the short-term and long-term nature of assets and liabilities

The Boards agreed that an entity should be required to present short-term and long-term subcategories in each of the categories or sections on the face of the statement of financial position. An asset or liability would be classified as short-term if the shorter of its (a) contractual maturity and (b) expected realization or settlement is within one year.

Based upon that decision, the Boards agreed that no other information about liquidity should be required to be presented in the financial statements except for details of the maturities of long-term assets and liabilities that have a contractual term (such as contractual receivables and lease obligations). Total short-term assets, total long-term assets, total assets, and similar totals for liabilities also would be disclosed in the notes to financial statements. The Boards also agreed that the deferred taxes should be classified using the approach described in FASB Statement No. 109, *Accounting for Income Taxes*.

Measurement Bases

The Boards agreed to modify the project's working principle related to measurement. In applying that working principle, the Boards decided that an entity would be required to disclose information about the measurement basis used to measure assets and liabilities included in the statement of financial position in the summary of significant accounting policies.

The Boards agreed that the Financial Statement Presentation standard should require an entity to describe any significant uncertainty in the current measure of assets and liabilities (due to measurement precision or measurement bias) and explain why the measured amount was selected.

The Boards agreed that the financial statements should provide information that will allow a user to distinguish between the various changes in assets and liabilities that are due to remeasurements and changes that are not. The Board will discuss how that information should be presented in the financial statement at a future meeting.

Other Comprehensive Income and the Mechanism of Recycling

The Boards agreed that the project should develop a financial statement presentation format that would be consistent with their long-term goal of having all recognized income and expense items classified in the same manner. However, in the short term, it might be necessary to keep some recognized income and expense items in a separate section of the statement of recognized income and expense.

The Boards agreed that in the long term none of the subtotals on the statement of recognized income and expense should have a 'timing' difference; in other words, the

subtotals should be based on changes in assets and liabilities that have occurred in the current period, thus the mechanism of recycling should be eliminated. However, in the short term the changes in assets and liabilities that are currently reclassified (recycled) between other recognized income and expense and profit or loss might need to be shown separately from the current period changes. The Boards acknowledged that given those decisions and the proposed working format there would not be a profit or loss subtotal in the statement of recognized income and expense.

The Boards directed the staff to develop a presentation format that could be used in the interim (until the long-term goal can be achieved). The Boards also directed the staff to develop a plan for achieving that long-term goal, such as whether those issues would be addressed in separate projects or as part of the financial statement presentation project.

7. Revenue Recognition

Over the past four years, the Boards have been developing an asset and liability model for revenue recognition. In this model, revenue is viewed as a function of changes in assets and liabilities, consistent with the existing definition of revenue, and not overridden by tests based on the notions of realization and the completion of an earnings process. Additionally, the Boards have narrowed the possible implementation of the asset and liability model to two broad models. In one (the fair value model) the performance obligations are initially measured at fair value, and in the other (the customer consideration model) they are initially measured by allocating the customer consideration amount.

The Boards decided that the due process document should explain and compare these models. The models will be fully developed by the staff, with the support of Board members, before being formally presented to the Boards for deliberation. The due process document is expected to be issued by the end of 2007.

*The FASB issues a final summary of the Board's meeting on the Thursday following the meeting. The summary is included in its weekly publication, **Action Alert**, and is available at www.fasb.org. Generally accepted accounting principles are not amended, modified, rescinded, or enacted as part of the public meeting deliberations. The Statements in this summary pertain to projects still under consideration by the FASB. Nothing is intended to indicate how to comply with yet-to-be-issued FASB Statements. Companies addressing the provisions of the finally adopted Statements should base their accounting on the requirements applicable at the time they report and consultation with accounting and legal advisors.*