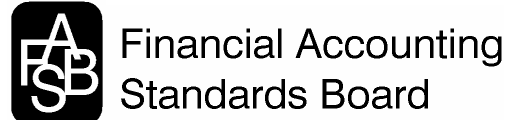


MINUTES



To: Board Members
From: Kazazean, ext. 327
Subject: Minutes of January 14, 2004
Technical Plan and Agenda Requests Board Meeting
Date: January 21, 2004

cc: Bielstein, Smith, Petrone, Polley, Swift, Leisenring, Cropsey, Laurenzano, Proestakes, Westerlund, Wilkins, Vincent, Sutay, Thompson, Gabriele, Bean, Allen, Intranet

Topic: Technical Plan as of January 2004 and Agenda Requests

Basis for Discussion:

Technical Plan: January 5, 2004 Priorities for First Half 2004, including:
Attachment 1: Technical Plan Table Draft
Attachment 2: Report summarizing 4th quarter goals/progress on 1st quarter goals
Attachment 3: Staffing Availability/Requirements as of Jan. 2004
January 7, 2004: Technical Plan document

Agenda Requests: Memoranda dated December 24, 2003, December 31, 2003, and January 5, 2004

Length of Discussion: 11:00 a.m. to 12:15 p.m., and 2:15 p.m. to 2:45 p.m.

Attendance:

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

Board members absent: None

Staff in charge of topics: Bielstein, Cropsey, Laurenzano, Proestakes, Westerlund, Wilkins

Other staff at Board table: Leisenring, L. Smith, Petrone, E. Smith, Donoghue, Kazazean, Salo

Outside participants: None

Summary of Decisions Reached:

Technical Plan

The Board approved for publication in THE FASB REPORT its January 2004 plan for research and technical activities. As outlined in that plan, the Board plans to achieve the following goals in the first half of 2004:

- Business combinations—issue Exposure Drafts in the second quarter of 2004 on the purchase method procedures (including combinations between mutual enterprises) and noncontrolling interests projects.
- Equity-based compensation—issue an Exposure Draft in the first quarter of 2004 and hold roundtable discussions on the Exposure Draft in the second quarter of 2004.
- Fair value measurement—issue an Exposure Draft in the second quarter of 2004.
- Short-term convergence—issue an Exposure Draft on the liability classification portion of phase one of the project in the first quarter of 2004.
- Qualifying special-purpose entities and isolation of transferred assets— issue a revised Exposure Draft in the first quarter of 2004 and a final Statement in the second quarter of 2004. The Board noted, however, that the timing of that revised Exposure Draft may be directly affected by work on its new projects related to beneficial interests in securitized financial assets and mortgage servicing rights.

- Interpretation of Statement 87 (cash balance pension plans)—issue an Exposure Draft in the second quarter of 2004.

The Board noted the following other changes to its October 1, 2003 technical plan timetable:

- Removed from its agenda its inactive major project on disclosures about intangible assets and its inactive research projects on accounting for unconsolidated entities and fresh-start (new basis) accounting. The Board acknowledged the importance of the financial reporting issues that would be addressed by those projects but agreed the nature and timing of such projects should be considered in the context of its plans for a coordinated agenda with the IASB. The FASB and IASB plan to discuss coordination of their technical agendas in a joint meeting scheduled for April 2004.
- Moved the issuance of Exposure Drafts for its projects on combinations of not-for-profit organizations and on financial instruments: liabilities and equity to the second half of 2004.
- Directed the staff to begin research on the next phase of a potential project on consolidation policy.
- Directed the staff to broaden the scope of the short-term convergence project as it relates to research and development. Specifically, the Board directed the staff to consider all differences between the IFRS and US GAAP relating to requirements for recognition of intangible assets.

Agenda Requests

In accordance with its Rules of Procedure, the Board considered written requests received from constituents in the past six months suggesting that it reexamine certain effective Statements of Financial Accounting Standards. With respect to those requests, the Board decided:

1. To add a project to its agenda that would address the accounting for mortgage servicing rights at fair value. The project's scope, including

whether both initial and subsequent measurements should be addressed, will be discussed at future meetings related to this topic.

2. To add a project to its agenda to address the issues that led to the “Staff Interim Guidance” in Statement 133 Implementation Issue No. D1, “Application of Statement 133 to Beneficial Interests in Securitized Financial Assets.” The Board directed the staff to consider the interrelationship of the two new projects (mortgage servicing rights and beneficial interests) that might amend FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, and its current project on qualifying special-purpose entities (SPEs), which will result in an amendment of Statement 140. The Board noted that work on the two new projects may affect the timing of the issuance of the revised Exposure Draft on the qualifying SPE project.
3. To direct the staff to research whether an FASB Staff Position (FSP) should be issued to address the accounting for life insurance contracts by the purchaser/holder or whether the issue should be referred to the Emerging Issues Task Force (EITF).
4. Not to add to its agenda a project to reconsider the accounting for certain investments held by life insurance companies under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*.
5. To direct the staff to draft an FSP to provide guidance for assessing risk transfer in certain reinsurance arrangements.
6. To add a project to its agenda to address the application of FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, to legal obligations to perform asset retirement activities that are conditional on a future event.
7. Not to add to its agenda a project on the accounting for pensions at this time. However, recognizing the need for improvement to existing guidance and the importance of this issue, the Board indicated that it would discuss

with the IASB the possibility of addressing pensions jointly at their joint meeting to be held in April 2004.

Matters Discussed and Decisions Reached:

The Board considered and discussed written requests received from constituents in the past six months suggesting that it reexamine certain effective Statements of Financial Accounting Standards. A summary of the discussion for each of those requests follows.

Accounting for Mortgage Servicing Rights at Fair Value

Mr. Laurenzano introduced the topic and noted that constituents have expressed a desire for the Board to reconsider the accounting for mortgage servicing rights (MSRs) at fair value. Statement 140 currently provides guidance for MSRs. The concern is that MSRs are subject to significant interest rate risk and, to mitigate that, companies use derivatives to hedge them. MSRs are carried at the lower of cost or market; therefore, unless a company applies hedge accounting to the derivatives, the company may be exposed to income statement volatility. In rising interest rate environments, decreases in the fair value of derivatives are reflected in the income statement, but increases in the fair value of MSRs are not reflected in the income statement. It is understood that many preparers and users believe that the current accounting for MSRs and the related economic hedge methodologies does not appropriately reflect the economics of the hedging techniques and that meeting current hedge criteria strains the resources of the mortgage banking industry.

Board members asked Mr. Laurenzano to clarify a few issues. Mr. Trott asked whether consideration of MSRs would relate to both initial and subsequent valuations of MSRs at fair value, and Mr. Laurenzano responded that that issue would need to be resolved. Mr. Leisenring asked whether Statement 140 would be amended as a result of this project, and Mr. Laurenzano noted that it would. In addition, Mr. Laurenzano clarified that MSRs arise only when a mortgage loan is serviced for a third-party investor.

Ms. Seidman noted that she would like to consider whether this fair value accounting could be done on an elective basis. She also noted that consideration must be given as to whether the project scope would include all servicing rights, in addition to MSRs.

Board members agreed to add this project to its agenda. [All agreed except Mr. Crooch.]

Accounting for Beneficial Interests

Mr. Wilkins stated that, in June 2000, interim guidance on the accounting for beneficial interests was issued in Implementation Issue D1. That guidance concluded that beneficial interests in securitized financial assets are not subject to the provisions of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. He noted that this guidance was intended to be a temporary solution to a concern that was not addressed in Statement 133. Although constituents have not expressed an urgent need for a review of this guidance, Mr. Wilkins indicated that the guidance should be reconsidered and updated.

Mr. Wilkins indicated that the scope of the new guidance should initially be broad, in contemplation of many possible outcomes. For example, he noted that consideration of the topic could result in: 1) an amendment to Statement 133, 2) a change to the criteria in Statement 140 for an SPE to be a qualifying SPE, or 3) other revisions to Statement 140. He also pointed out that the Board's deliberations on this project could delay the issuance of a revised Exposure Draft on the qualifying SPE project.

Ms. Seidman expressed support for adding this project to the agenda, noting that the issue should be considered before the issuance of a revised Exposure Draft on qualifying SPEs. She expressed concern that addressing the topic after that issuance might lead to changes to the document after its release for public comment. Mr. Schieneman and Ms. Schipper agreed, and Ms. Schipper noted that there are "economies of scope" if this and similar issues are addressed

concurrently. Mr. L. Smith noted that it is an opportune time to add the project in terms of current staff resources and staff expertise in this matter.

Mr. Herz disagreed with the potential addition of this project, noting that he did not consider it to be of as high a priority as the existing qualifying SPE project that it might delay. Mr. Schieneman expressed concern that the project would be too sweeping. Mr. Trott expressed concern about the current accounting for beneficial interests, noting that it yielded different accounting depending on whether a transaction is accomplished through a securitization or not.

Board members agreed to add this project to its technical agenda. [All agreed except Mr. Herz.] The Board directed the staff to determine the impacts this project, the mortgage servicing rights project, and the qualifying SPE project might have upon each other and to consider the format of the guidance to be provided for each project.

Accounting for Life Insurance Contracts by the Purchaser/Holder

Mr. Laurenzano noted that current accounting for life insurance contracts in FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*, requires the use of the cash surrender value method of accounting for life insurance contracts. He noted that the guidance does not contemplate the trading and holding of life insurance contracts as investment assets, which has become a common practice. He asked the Board to reconsider this accounting.

Ms. Seidman described this situation as a financial reporting issue in which the accounting does not reflect the economics of the transaction. She noted that a project to address this could have a narrow scope (that is, the project could only address life insurance contracts that are purchased at a significant premium over the cash surrender value). Mr. Trott and Mr. Herz agreed. She suggested that the issue be considered for referral to the EITF.

Ms. Schipper asked Mr. Laurenzano whether viatical and life settlements are pervasive in practice. He responded that the market for this type of investment can be significant, and significant growth is expected given the amount of insurance policies in place currently that are eligible for life settlement. Mr.

Laurenzano noted that insurance companies and sophisticated investors looking to diversify their portfolios purchase these contracts as investments. Ms. Schipper expressed concern about the difficulty of crafting guidance to apply only to situations in which insurance contracts are used as investments. She also expressed concern that the accounting for life insurance contracts might vary depending on the holder (that is, whether the original purchaser holds the contract or whether it has been sold to a third party as an investment), thus affecting comparability.

Mr. Leisenring echoed Ms. Schipper's concerns about comparability, noting that different accounting would create an asymmetrical measurement of the same right. He noted that the biggest concern is that the life insurance contract currently is measured at its cash surrender value, and he indicated that that is not the best accounting for any holder of an insurance contract.

Board members directed the staff to evaluate whether the project would be most effectively addressed in an FSP or by the EITF. [All Board members agreed.]

Accounting for Certain Investments Held by Life Insurance Companies

Mr. Cropsey stated that concern had been expressed by the life insurance industry that the use of fair value measurement to value insurance assets, as prescribed by Statement 115 creates a "mismatch" when compared against insurance liabilities. Insurers have expressed concern that this creates misleading volatility. Mr. Cropsey noted that the IASB also is receiving similar requests from its constituents and will consider them in its deliberations of its ED 5, *Insurance Contracts*. Mr. Cropsey noted that this concern does not present any new information that the Board did not previously consider in its deliberations of Statement 115 and recommended that the guidance not be reconsidered.

Board members agreed that a project should not be added to address this issue. [All Board members agreed.]

Risk Guidance for Certain Reinsurance Arrangements

Mr. Cropsey noted that the Accounting Standards Executive Council and the Insurance Expert Panel of the AICPA had submitted a paper to the FASB

concerning the assessment of risk transfer relating to the reinsurance of short-duration insurance contracts, focusing on the risk transfer criteria in FASB Statement No. 113, *Accounting and Reporting for Reinsurance of Short-Duration and Long-Duration Contracts*. That paper requested that the Board provide guidance to clarify: 1) when a reinsurance contract should be bifurcated with risk transfer being evaluated separately for each bifurcated segment, 2) the meaning of the term *reinsured portions* as used in assessing risk transfer, and 3) the scope of the exclusion from certain risk transfer guidance as described in paragraph 11 of Statement 113. Mr. Cropsey indicated that the issue could be considered by the Board or it could be referred to the EITF; however, there might be a significant amount of training and education required by either group to address this topic.

Mr. Batavick acknowledged that a large learning curve would be necessary for the Board and staff to take on this project. He noted that the issue seems to be too narrow to be addressed by the Board, as most of the Board's current projects are broader. He suggested that the issue be referred to the EITF.

Mr. Trott and Mr. L. Smith noted that the EITF would have an equally significant learning curve but would have less time to devote to understanding the issue. Mr. Trott suggested that the staff address the concerns through the issuance of an FSP. Mr. Crooch and Mr. Schieneman agreed.

Ms. Seidman compared this issue to the base insurance contracts issues addressed by the Derivatives Implementation Group. She expressed a preference for the staff issuing an FSP on the issue but asked that the Board be able to provide substantial feedback on the content of the FSP. Ms. Schipper expressed a preference for the Board to adopt the project as part of its agenda.

Most Board members agreed that the issue should be addressed in an FSP, noting that work on this FSP might require more Board involvement than usual. [All agreed except Ms. Schipper.]

Application of Statement 143 to Legal Obligations to Perform Asset Retirement Activities that Are Conditional on a Future Event

Mr. Westerlund asked the Board to consider whether a project should be added to its agenda that would clarify the application of Statement 143 to legal obligations to perform asset retirement activities that are conditional on a future event. He noted that in June 2003, the FASB staff proposed an FSP on accounting for an obligation to remove and dispose of asbestos. Some respondents to that FSP expressed concern that the issue extends beyond asbestos and might affect a broader range of circumstances that are fundamental to the application of Statement 143. He clarified that the proposed project is not a reconsideration of the liability recognition provisions of Statement 143 but is an interpretation of the provisions when the obligation to perform retirement activities is triggered by a future event.

Mr. Batavick questioned whether there was a relationship between the conditional liability in this issue and the contingent liability being considered under the Board's Business Combinations—Purchase Method Procedures project. Mr. Trott responded that, for the issue in Statement 143, a future event triggers the timing of the settlement of the obligation. He also noted that the Statement 143 issue is a measurement issue, although others believe that it is a recognition issue.

Mr. Larry Smith noted that the [majority of the] staff interprets the standard differently than a significant portion of current practice and that an interpretation is required to clarify the application of the liability recognition provisions of the standard. Further, Mr. Smith noted that he believes that a significant portion of current practice does not interpret the standard in the manner intended by its authors.

Board members agreed that the issue is fundamental to the application of Statement 143, and they agreed to add the project to the agenda. [All Board members agreed.]

Pensions

Mr. Proestakes stated that some constituents recently submitted a letter to the Board that asked it to consider adding a short-term convergence project to its

technical agenda and to consider moving towards the U.K. Financial Reporting Standard (FRS) 17, *Retirement Benefits*. In addition, other constituents and the Financial Accounting Standards Advisory Council have suggested that the Board reconsider how postretirement benefits are recognized. Many of these requests have indicated that the Board should consider eliminating the smoothing mechanisms prescribed by FASB Statement No. 87, *Employers' Accounting for Pensions*, that amortize actuarial gains and losses over a 10-year period. Mr. Proestakes noted that the IASB may be interested in reconsidering the accounting for pensions (potentially jointly with the FASB) in the future. Mr. Proestakes asked Board members to consider whether a project should be added to the agenda to address these issues. Mr. Proestakes noted that among the Board's possible courses of action were to:

1. Not add a project at this time, possibly instead considering a joint project with the IASB
2. Add a comprehensive project to fundamentally reconsider all measurement and recognition issues
3. Add a short-term limited-scope project addressing recognition of actuarial gains and losses, amortization of prior service costs, and use of a market-related value for plan assets.

Mr. Proestakes recommended a short-term limited-scope project.

Ms. Bielstein indicated that a short-term improvements project (rather than a broad-scoped reconsideration of pension accounting) might be the best strategy for addressing constituent concerns in the context of the Board's currently limited resources.

Mr. Crooch stated that adopting a broader project would be a preferable approach. Mr. Trott agreed, noting that he would not add the project to the agenda at this time, given the potential depth and time that would be involved in addressing the issue thoroughly. He disagreed with the addition to the agenda of a limited-scope project, stating that the effort necessary to make limited changes would be an inefficient approach. He proposed that the FASB work with the IASB

to determine an appropriate time at which it would be possible to jointly consider a broad-scoped project. Ms. Seidman, Mr. Crooch, and Mr. Batavick agreed.

Mr. Schieneman supported adding a limited-scope project to the agenda and noted that recognizing information in other comprehensive income, rather than the notes, provides users with more transparent information. He noted that the change would improve the balance sheet. Mr. Schieneman suggested that the Board consider requiring separate presentation of the operating and financing elements of net pension cost in the income statement.

Ms. Schipper agreed with Mr. Schieneman and supported a limited-scope project but noted that the FASB should discuss with the IASB whether a joint project could be undertaken. [Mr. Herz also agreed.] She noted two concerns: 1) the reliance on outcome versus normalized numbers and 2) “recycling” (classifying gains and losses as part of other comprehensive income and moving them to the income statement depending on various circumstances).

Mr. Herz agreed with Ms. Schipper and Mr. Schieneman regarding a limited-scope project, noting that the current model is flawed and needs attention. He noted that a project with the IASB to address this would be among his top agenda priorities, as it would provide an opportunity for both improvement and convergence. He expressed an interest in gaining a better understanding of the relationship between plan sponsors and pension plans and indicated that the plan might be somewhat akin to a variable interest entity.

The Board decided not to add a project to the technical agenda at this time but agreed to discuss a potential comprehensive project with the IASB when the Boards meet in April 2004. [All Board members agreed.]

Follow-up Items: None.

General Announcements: An updated technical plan table reflecting today’s decisions will be posted to the website shortly.