

MINUTES



To: Board Members
From: Belot (ext. 363)
Subject: Minutes of the October 15, 2003 Board Meeting **Date:** October 22, 2003
cc: Bielstein, Leisenring, Petrone, Smith, Swift, Polley, Gabriele, Project Team (Belot, Cassel, Coburn, J. Johnson, Rohrkemper, Vernuccio) Tovey, Thompson, Allen (GASB), Bean (GASB), FASB Intranet (e-mail), Sutay

Topic: Convergence Clean-up Issues

Basis for Discussion: Memorandum dated October 7, 2003

Length of Discussion: 9:00a.m. to 10:30 a.m.

Attendance:

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

Board members absent: None

Staff in charge of topic: J. Johnson, Coburn

Other staff at Board table: Belot, Bielstein, Cassel, Rohrkemper

Outside participants: IASB by phone

Summary for ACTION ALERT:

The Board discussed several remaining issues related to the drafts of the proposed Statements on earnings per share, inventory costs, asset exchanges, and accounting changes. The Board reached the following decisions:

1. Paragraph 4 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, would be amended to eliminate the scope exception for exchanges of equity method investments for similar productive assets.
2. Transactions that embody a transfer of assets to an entity in exchange for an interest in that entity would be excluded from the scope of the proposed Statement on asset exchanges. The scope of the proposed Statement also would exclude transactions involving the exchange of a part of an operating interest owned for a part of an operating interest owned by another party that are subject to paragraph 47(e) of FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*. Paragraph 44 of Statement 19 will be amended to indicate that a transfer of assets used in oil- and gas-producing activities (including both proved and unproved properties) in exchange for other assets also used in oil- and gas-producing activities is subject to the provisions of the proposed Statement.
3. The scope exception for exchanges of real estate for other real estate would remain in FASB Statement No. 66, *Accounting for Sales of Real Estate*.
4. A transfer of a nonmonetary asset in which the transferor has continuing involvement in the transferred asset such that all of the risks and rewards of ownership are not transferred would not be an exchange covered within the scope of the proposed Statement.
5. After-tax cash flows would be used to determine whether a transaction has commercial substance. Cautionary language would be included in the standard indicating that commercial substance must not be predicated on tax cash flows that arise solely because the tax business purpose is based on achieving a specified financial reporting result.
6. Shares that would be issued upon conversion of a mandatorily convertible security should be included in basic earnings per share from the date the security becomes mandatorily convertible. A mandatorily convertible security is one that would be converted into a fixed number of common shares at a fixed future date.
7. Language would be added to the proposed Statement on accounting changes to clarify what constitutes a significant management estimate for which retrospective application is not practicable.

8. The accounting changes effected by the issuance of each of the proposed Statements on accounting changes, inventory costs, and asset exchanges would be applied prospectively. The accounting changes effected by the issuance of the proposed Statement on earnings per share would be applied retrospectively.
9. The effective dates for each of the proposed Statements would be December 15, 2004.
10. The comment period for the bundled Exposure Draft of the proposed Statements on earnings per share, inventory costs, asset exchanges, and accounting changes would be 90 days.

The Board expects to issue the proposed Statement in the fourth quarter of 2003.

Matters Discussed and Decisions Reached:

Ms. Coburn asked the Board to decide whether the scope exception in Statement 140 for exchanges of equity method investments for similar productive assets should be eliminated. She also stated the staff's recommendation to amend paragraph 4 of Statement 140 to eliminate the scope exception, because that would be consistent with the Board's intent to include all financial instruments within the scope of Statement 140. All Board members agreed with the staff's recommendation. In addition, Ms. Seidman noted that an equity method investment that is in substance an exchange of real estate will still be accounted for under Statement 66.

Ms. Coburn then asked the Board if the guidance for exchange transactions described in FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*, should be changed to reflect the proposed amendment to Opinion 29. Ms. Coburn stated that Statement 19 prescribes the accounting for two types of exchange transactions, namely:

1. A transfer of assets used in oil and gas producing activities in exchange for other assets also used in oil and gas producing activities, and
2. The exchange of a part of an operating interest owned for a part of an operating interest owned by another party.

She then stated the staff's recommendation to amend Statement 19 to include the exchange transactions described above within the scope of Opinion 29 as amended.

Some Board members expressed concern over the latter issue described, an arrangement commonly called a ‘joint venture,’ because the Board does not define joint venture in current guidance. Therefore, it is difficult to distinguish ‘joint venture’ transactions from similar transactions that would be included in the scope of Statement 19.

Some Board members preferred to exclude transactions described in Statement 19 from the scope of the proposed guidance, due to the idiosyncratic nature of transactions in the oil and gas industry. Other Board members believed that excluding a whole industry from the scope of the proposed guidance is inappropriate and preferred to analyze transactions based on their form.

Mr. Herz then articulated the following options for the Board:

1. Follow the staff recommendation
2. Exclude the formation of a joint venture from the scope of the proposed guidance
3. Exclude transactions that embody a transfer of assets to an entity in exchange for an interest in that entity from the scope of the proposed guidance
4. Exclude all transactions described in Statement 19 from the scope of the proposed guidance.

The Board voted for alternative 3. [6 members agreed; MGC disagreed] Ms. Seidman also stipulated that the issue should specifically be addressed in the notice to recipients of the proposed Statement. The Board’s decision implies that transactions described in paragraph 44 of Statement 19 will be included in the scope of Opinion 29, while transactions described in paragraph 47(e) of Statement 19 will be excluded from the scope of that Opinion.

Ms. Coburn asked the Board to decide whether to eliminate the scope exception contained in Statement 66 for exchanges of real estate for other real estate. She stated the staff’s recommendation for the Board to retain the scope exception contained in Statement 66 for exchanges of real estate for other real estate, noting that those transactions should be accounted for under the proposed Statement. She stated that exchanges of real estate for real estate are currently accounted for under Opinion 29, and that certain of those exchanges qualify for fair value accounting under Opinion 29. She

noted that the proposed Statement would expand the population of exchanges of real estate for real estate that would be accounted for at fair value. In addition, the staff noted that Statement 66 was written to account for cash transactions involving real estate; therefore, it does not accommodate nonmonetary transactions. In general, Board members agreed with the staff's proposal, but expressed concern regarding the subjective nature of the term 'exchange.' Those Board members recommended that the staff clarify that a transfer of a nonmonetary asset in which the transferor has continuing involvement in the transferred asset such that all of the risks and rewards of ownership are not transferred would not be an exchange transaction within the scope of the proposed Statement. All Board members agreed with the staff's recommendation and with the additional suggestion that the staff clarify the term 'exchange.'

Mr. Johnson presented the issue of how tax related cash flows should be considered in the determination of whether an exchange transaction has commercial substance. He stated that the staff became aware of a concern that if the Board considered transactions structured to achieve tax benefits to have commercial substance, there is circularity between the commercial substance provisions of the proposed Standard and the "business purpose" doctrine applied for tax accounting. Mr. Johnson recommended that the Board choose to incorporate after-tax cash flows into the determination of whether a transaction has commercial substance and also to include cautionary language in the standard regarding tax-motivated transactions. He finished by reading the proposed language for the Board's consideration. The Board supported the staff's recommendation; however, Ms. Schipper suggested the following language in place of the last sentence of the staff's proposed language: "Commercial substance must not be predicated on tax cash flows that arise solely because the tax business purpose is based on achieving a specified financial reporting result." She explained that an exchange can have commercial substance even if the change in cash flows or entity specific value arises solely from tax effects. All Board members agreed with the staff's recommendation and with Ms. Schipper's proposed language.

Mr. Johnson asked the Board to decide whether shares that will be issued upon conversion of a mandatorily convertible security should be included in basic earnings per

share (EPS) prior to their conversion. He stated that the IASB decided to include those securities in basic EPS at the date of issuance, and in the spirit of converging with the IASB, the staff recommends that the FASB do the same. Some Board members inquired whether the IASB staff considered modifying the numerator used in the basic EPS calculation by adding back the interest related to the convertible securities, but were informed by the IASB staff that the issue was not considered. The Board tentatively voted to converge on this issue, but will await the IASB and FASB staffs' recommendation on whether to adjust the numerator of basic EPS. [5 members agreed, LFS and RHH disagreed]

Mr. Johnson requested that the Board decide whether to clarify what constitutes a significant management estimate for which retrospective application would not be practicable. At issue was the decision that retrospective application requiring significant management estimates as of a prior period is impracticable. The staff recommended that the Board vote to clarify the condition, and accordingly, read proposed language that would accomplish that clarification. Mr. Trott expressed concern regarding the inclusion of references to 'Type I' and 'Type II' estimates because those terms are related to auditing literature. All Board members agreed to clarify the condition using the staff's proposed language, with the exception of the 'Type I' and 'Type II' references.

Mr. Johnson recommended to the Board that the accounting changes effected by the issuance of each of the proposed Statements on accounting changes, inventory costs, and asset exchanges should be applied prospectively. The accounting changes effected by the issuance of the proposed Statement on earnings per share should be applied retrospectively. All Board members agreed.

Mr. Johnson suggested that the effective dates for each of the proposed Statements should be December 15, 2004, which is consistent with the guidance proposed by the IASB. All Board members agreed.

Mr. Johnson recommended to the Board that the comment period for the bundled Exposure Draft of the proposed Statements on earnings per share, inventory costs, asset exchanges, and accounting changes should be 90 days. All Board members agreed.

Follow-Up Items:

The staff will work with the IASB staff on the question of how to treat the interest factor related to mandatorily convertible securities in the numerator of the basic EPS calculation, and will return to the Board with a recommendation.

General Announcements:

None.