

FASB User Advisory Council
MINUTES OF THE MEETING
October 3, 2006

The FASB User Advisory Council met at The Helmsley Hotel in New York City.

Members Present

Rob Axel
Jeremy Bean
Neri Bukspan
Julie Burke
Robert Ehudin
Alison Emmerich
Robert Friedman
James Goff
Trevor Harris
Charles Hill
Adam Hurwich

Joe Joseph
Michelle Kaufman
Mark Newsome
Georgene Palacky
Janet Pegg
Steve Percoco
Lawrence Pohlman
Hal Schroeder
Rick Sherlund
Damon Silvers
Christianna Wood

Members Absent

Jane Adams
Ann Duignan
Neville Grusd
Gregory Jonas
Elizabeth Mooney

Sudhir Nanda
F. Barry Nelson
Adam Quinton
Rita Spitz
James Wei

Others Attending

Financial Accounting Standards Board:

Robert H. Herz, Chairman
George J. Batavick, Board Member
G. Michael Crooch, Board Member
Thomas J. Linsmeier, Board Member
Leslie F. Seidman, Board Member
Edward W. Trott, Board Member
Donald M. Young, Board Member

FASB Staff:

Suzanne Q. Bielstein, Director of Major Projects and Technical Activities
 Ronald W. Lott, Senior Technical Advisor
 Bradley H. McGrath, Postgraduate Technical Assistant
 Kimberley R. Petrone, Senior Project Manager
 Chandy C. Smith, Senior Technical Advisor

Others:

James J. Leisenring, Member, International Accounting Standards Board
 Mark C. LaMonte, Vice President—Senior Credit Officer, Moody's Investors Service
 Teresa S. Polley, Executive Director, FASB Advisory Groups
 Greg Scates, Associate Chief Auditor, Public Company Accounting Oversight Board
 Gary S. Schieneman, Former Board Member, Financial Accounting Standards Board
 Scott A. Taub, Deputy Chief Accountant, Securities and Exchange Commission
 Chad Yeftich, Senior Analyst, Maverick Capital, Ltd.

Introduction

1. Mr. Young called the meeting to order at 9:00 a.m. and welcomed members of the Council, members of the Board and the FASB staff, and observers. He thanked the Council members for attending and noted that the purpose of the meeting is for the Council to give the Board input on users' needs in the financial reporting process. Mr. Young introduced three new members of the UAC who were attending their first official meeting: Georgene Palacky from the CFA Centre for Financial Market Integrity, Hal Schroeder from Carlson Research/Connecticut, Inc., and Julie Burke from Fitch Ratings. He also introduced two substitutes in attendance for UAC members: Mark LaMonte for Gregory Jonas of Moody's Investors Services, and Chad Yeftich for Jane Adams of Maverick Capital, Ltd.

Report of the FASB Chairman

2. Mr. Herz stated that the FASB had recently issued three major pronouncements. FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, requires a uniform method by which companies should account for uncertainties in their tax positions. FASB Statement No. 157, *Fair Value Measurements*, provides a definition of fair value and guidance on how to approach fair value measurements. FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, requires employers to recognize the funded or unfunded status of defined benefit pension and other postretirement plans on their balance sheets.
3. Mr. Herz noted that the FASB formally added lease accounting to its agenda in July 2006. That project will be conducted jointly with the IASB.

4. Mr. Herz stated that the FASB and the IASB issued a memorandum of understanding with a convergence plan for the next few years that supports the “roadmap” that was previously developed by the two Boards and agreed to by the SEC and the European Commission. The roadmap describes conditions for the elimination of the SEC’s reconciliation requirements. Mr. Herz noted that the IASB has stated that no new major standards will be effective until 2009. The IASB also has stated that it will allow for at least one year between the publication date of any new standard and the effective date of that standard.
5. Mr. Herz explained that the SEC and the Committee of European Securities Regulators (CESR) have published a work plan to guide the SEC-CESR dialogue in the future. The main focus of the work plan is the application of International Financial Reporting Standards (IFRS) and U.S. GAAP by internationally active companies. Efforts like this demonstrate that while the FASB and IASB work together to converge accounting standards, progress is being made in the auditing and regulatory environments as well.

Report of the SEC

6. Mr. Taub stated that on September 13, the SEC staff issued Staff Accounting Bulletin 108, which provides interpretive guidance on how the effects of carryover or reversal of prior year misstatements should be considered when quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in a material misstatement when considering the other quantitative and qualitative factors. SAB 108 also indicates that it would be acceptable to make a one-time cumulative effect adjustment this year to correct errors that had previously been considered immaterial and discusses the disclosure requirements for making such an adjustment.
7. Mr. Taub stated that the Office of the Chief Accountant (OCA) had recently issued a letter on the application of APB Opinion No. 25, *Accounting for Stock Issued to Employees*, to certain stock option grants. The letter discusses the accounting implications under Opinion 25 of dating of option awards to predate the actual award date, option grants with administrative delays, uncertainty of the validity of the grant, and other related circumstances.
8. A Council member asked why the OCA letter did not require companies to make changes to their financial statements to reflect the practice of spring loading.
9. Mr. Taub noted that Opinion 25 states that compensation expense should be measured on the measurement date and that the reference point is the quoted market price on that date. Mr. Taub stated that the OCA letter does not discuss whether the practice of spring loading is ethical or legal; the letter merely confirms that no accounting adjustment is required, based on the provisions of Opinion 25.

10. Mr. Taub stated that the SEC staff has implemented a pilot program for companies to submit their registrations and annual financial statements in XBRL format. The program currently has 35 participants who are voluntarily filing their SEC documents using XBRL. The SEC has received feedback from those participants to identify problems with XBRL. A key problem identified by those participants is that XBRL taxonomies are still not detailed enough for financial reporting under U.S. GAAP. Mr. Taub stated that the SEC recently allocated \$5.5 million to XBRL US Inc. to expand XBRL taxonomies. He noted that it could take 12-18 months to develop adequate XBRL taxonomies. The SEC has contracted with software developers to develop an application that will help users view filings in XBRL. Mr. Taub stated that the SEC will soon host a roundtable to gather information about XBRL and its application to small businesses. He noted that the SEC was still in the process of identifying hurdles that could prevent the widespread adoption of XBRL for financial reporting. He stated that there are no imminent rules that would require the use of XBRL; however, that could be a possibility in the future.
11. On activities related to Section 404 of the Sarbanes-Oxley Act, Mr. Taub stated that the SEC staff is reviewing comments received on a Concept Release on how management should perform its assessment of internal control over financial reporting. In addition, Mr. Taub noted that accelerated foreign private issuers will be issuing reports in compliance with Section 404 for the first time this year. The SEC has granted certain foreign private issuers (accelerated filers, but not large accelerated filers) an additional one-year extension on the filing of the auditor attestation report. The SEC is considering a proposal to extend the filing dates for nonaccelerated filers (both U.S. and foreign) to require a management report in 2007 and the auditor attestation report in 2008.
12. Mr. Taub stated that the SEC has issued final rules on executive compensation. Among other things, the new guidance requires companies to disclose one number for the total annual compensation for each named executive officer.

Fair Value of Financial Instruments

13. Mr. Lott stated that the FASB and IASB agree with the concept that all financial instruments should be measured at fair value with realized and unrealized gains and losses recognized in the period in which they occur. He noted that the Boards have not determined where in the financial statements those gains and losses would be recognized. Mr. Lott stated that using a fair value approach for financial instruments is beneficial because fair value:
 - a. Reflects a current assessment of value
 - b. Reflects expectations of market participants rather than entity-specific expectations
 - c. Facilitates comparisons over time and between entities

- d. Reflects changes in market conditions as they occur, making apparent the consequences of decisions to hold assets or to incur liabilities (whereas historical cost only reflects the changes in market conditions when assets or liabilities are sold)
 - e. Reports market volatility, which helps users assess the potential volatility of future returns
 - f. Reduces complexities and inconsistencies inherent in mixed-attribute measurements.
14. Mr. Lott stated that several issues still must be resolved before fair value can become a reality, including scope, presentation and disclosure of gains and losses, measurement issues specific to financial instruments, and optionality. Mr. Lott clarified the scope issue by explaining that a financial instrument is any instrument that ultimately will be settled with either cash or equity. The Board has not yet decided whether to address certain financial instruments separately, as it has done in the past with pensions, leases, insurance, etc.
15. Mr. Lott then described several recent Statements that the Board has issued. He noted that the FASB is also considering proposed standards on a fair value option.

Statement 157

16. Mr. Lott stated that Statement 157 provides a consistent definition of fair value and establishes a framework for measuring fair value. The Statement applies not only to financial instruments, but to anything measured at fair value. Fair value is based on a market exit price in a primary market or the most advantageous market. Statement 157 eliminates the use of block discounts in valuing large volumes of traded assets. Mr. Lott noted that Statement 157 does not require the use of fair value in any particular circumstance; rather, it provides a guide for measuring fair value in any situation in which a fair value measurement is used or required.
17. A Council member asked why the Board decided to eliminate block discounts. Mr. Trott stated that there is no consistent way to measure block discounts and that adjusting the price for the size of the position would introduce management intent into the measurement. Eliminating block discounts results in comparable reporting.
18. Several Board members stated that the Board did consider various methods of valuing block discounts. However, the Board could not find a method that could be applied consistently across industries. Some methods considered the value of the block over time, but fair value must be measured as of a point in time, rather than over a period in time. Additionally, the Board had received feedback that the issue of block discounts was not an important issue to large broker-dealers.
19. A Council member asked whether the Board considered requiring the disclosure of the volatility in security values. Mr. Lott stated that the issue of security value volatility is an issue unique to financial instruments, which is why it was not

addressed in Statement 157; however, that issue may be considered in other projects dealing with financial instruments.

20. A Council member asked why the guidance in Statement 157 was issued as a Statement of Financial Accounting Standards, rather than as a Concepts Statement. Mr. Lott stated that a Concepts Statement does not have the force of GAAP authority, whereas a Statement of Financial Accounting Standards does.
21. A Council member asked whether the Board considered requiring a company to match the fair value recorded by a counterparty for an asset or liability. Mr. Lott stated that it is not possible to have such a requirement; there may be legitimate differences between the fair values from the perspectives of the seller and the buyer.
22. Mr. Lott stated that Statement 157 eliminates the reliability threshold for fair value measurement of certain derivatives. Instead, Statement 157 establishes disclosure requirements for fair value measurements that are based on little or no market data. Board members noted that Statement 157 defines fair value in terms of an asset or liability's transfer value, taking into account any adjustment of the price that would be demanded in the market for uncertainty related to unobservability of the inputs.
23. Mr. Lott noted that investors will not have all the information about the impact of fair value on the earnings release date; that information will be included with the financial statements. Mr. Young stated that the FASB has no authority over what is included in the earnings release, and he asked Council members if they believe that disclosures about fair value should be included in the earnings release. Several Council members noted that users must always deal with the tradeoff between timeliness and the quality of information.
24. Several Council members asked for greater clarity in the distinction between realized and unrealized gains and losses due to changes in fair value. One Council member suggested requiring cash flow information that would show how much of the gain or loss from fair value was realized.

Statements 155 and 156

25. Mr. Lott stated that FASB Statement No. 155, *Accounting for Certain Hybrid Financial Instruments*, permits hybrid instruments to be measured at fair value with gains and losses recorded in earnings. Rather than bifurcating an embedded derivative under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and reporting it separately at fair value, the whole hybrid instrument may be recorded at fair value under Statement 155. Statement 155 applies to any hybrid instrument, many of which will be beneficial interests in securitized assets with embedded derivatives. Beneficial interests were temporarily excluded from the scope of Statement 133, but that exemption was eliminated under Statement 155. The fair value option for hybrid instruments may be taken at the instrument level.

26. Mr. Lott stated that FASB Statement No. 156, *Accounting for Servicing of Financial Assets*, permits servicing rights to be measured at fair value with gains and losses recorded in earnings. The fair value option for servicing rights must be taken by class rather than by instrument. Under both Statements 155 and 156, the decision to record the instrument or servicing right at fair value is irrevocable.

Fair Value Option

27. Mr. Lott stated that earlier this year, the Board issued an Exposure Draft that would permit nearly any financial instrument to be measured at fair value. Several exceptions include a company's own stock, pensions, or investments in subsidiaries. Mr. Lott stated that the Board currently is redeliberating the proposal. The fair value option would be elected on an instrument-by-instrument basis, and it would be irrevocable. Mr. Lott stated that companies who elect the fair value option would be required to disclose the amounts of gains and losses from fair value. That disclosure would not provide pro forma information as if the fair value option had not been elected; the disclosure would show the effect of measuring assets and liabilities at fair value. Companies also would be required to show, on the face of the balance sheet, which items are measured at fair value and which items are not.
28. Mr. Lott noted that a potential issue with allowing a fair value option is a lack of comparability between companies that elect the option and companies that do not. Another issue is the information delay for the disclosures, because earnings releases might not highlight which items were measured at fair value. Another potential issue is year-to-year comparability. For example, a company could choose to measure an asset at fair value one year, sell the asset, and then repurchase it (or a similar asset) in the following year and not measure it at fair value. Mr. Lott stated that another issue is difficulty in distinguishing between similar assets or liabilities that are measured differently; however, the requirement to identify the items measured at fair value on the balance sheet is intended to address that.
29. Council members expressed the following about the fair value option project:
- a. The fair value option will introduce greater confusion to financial reporting. Even with increased disclosure, investors will have difficulty finding and deciphering that information.
 - b. The fair value option raises some conceptual issues about the definition of a financial asset or liability. Items that could remotely be considered a financial asset or liability, such as a joint venture into oil drilling, could be marked to market.
 - c. Ratings agencies will have to deploy additional resources to "unwind" fair value and view the financial statements on a comparable basis.

- d. Even if all assets and liabilities were recorded at fair value, ratings agencies would want information on amortized cost of debt to evaluate a company's liquidity.
 - e. The mixed attribute environment created by the fair value option, when combined with rules about impairment, could lead to situations in which a liability is marked down while the asset remains the same, or vice versa. Mr. Herz noted that the FASB is revisiting impairment rules to converge with international standards, which might solve this problem.
 - f. The fair value option could allow a company to recognize a gain on its debt when its credit is downgraded. Mr. Herz stated that in redeliberations, the Board has decided to require disclosure of situations in which an entity has recognized a significant gain on its debt because of a downgrade in credit.
 - g. The elective nature of the fair value option makes it more difficult for users to compare financial statements across companies.
 - h. Because the fair value option is considered to be an interim step in addressing the mixed measurement attribute model, the Board should continue moving toward recording the full balance sheet at fair value. Mr. Herz stated that Phase 2 of the fair value option project will consider nonfinancial assets and liabilities.
 - i. Electing the fair value option on an instrument basis, rather than on a class basis, provides the opportunity for "cherry picking."
30. Mr. Lott stated that the Board will soon consider how to account for value changes due to the passage of time, changes in the probability of collection, and changes in market conditions, when the financial instrument is recorded at fair value.
31. Ms. Seidman stated that the Board will carefully consider the input received on the fair value option Exposure Draft.

Financial Statement Presentation

32. Ms. Petrone stated that the objective of the financial statement presentation project is to issue a standard that addresses the presentation of information in the financial statements. The project is being conducted jointly with the IASB. Ms. Petrone stated that the standard would apply to all business entities, although the Board currently is focusing on nonfinancial institutions. The Board has decided that a complete set of financial statements would include a statement of financial position, statement of comprehensive income, statement of cash flows, and a statement of changes in equity. Ms. Petrone noted that the project is not comprehensively revisiting financial statement footnotes; however, to the extent that an issue cannot be addressed on the face of the financial statements, the Boards will consider footnote disclosure.

33. Ms. Petrone stated that the governing principle of the financial statement presentation project is cohesiveness. Under that approach, an asset or liability's classification on the statement of financial position would drive the classification of the changes in that asset or liability on the other financial statements. Ms. Petrone stated that this approach will clarify the relationships between financial statements.
34. Ms. Petrone stated that the statement of financial position, statement of comprehensive income, and the statement of cash flows would be divided into four sections: business, financing, discontinued operations, and income taxes. Under that model, discontinued operations would continue to be presented separately from continuing operations. Within continuing operations, business activities would be presented separately from financing activities. Ms. Petrone stated that because the income tax section would be reported separately, all items, including discontinued operations, would be reported on a pretax basis. Also, there would be no separate presentation for extraordinary items.
35. Ms. Petrone stated that the benefit of separating business and financing activities within continuing operations would be to distinguish an entity's "value creating" activities from its "funding" activities. The business section would be separated further into operating and investing categories, while the financing section would be separated into financing, treasury, and equity.
36. Ms. Petrone stated that treasury assets within the financing section would include, at a minimum, cash and cash equivalents. The Board is still considering other financial assets that may be included in that section. The Board also is considering which financial liabilities would be included in the financing section. All equity items would be included in the financing section.
37. Council members made the following comments and suggestions:
 - a. Distinguishing between interrelated components of an entity in the business and financing activities would be difficult. It is unclear whether the financing section could include a customer financing division or whether it only encompasses an entity's own funding.
 - b. Because management can best determine the key profit drivers of the business, management should decide how to distinguish between business and financing components. Those distinctions could be based on how the company allocates capital to different divisions.
 - c. Distinguishing operating investments from financing investments could be difficult. A separate category should be permitted for strategic investments.
 - d. Having a treasury asset subdivision in the financing section could cause confusion, because companies sometimes have surplus cash and sometimes have a shortfall.

- e. The Board should reconsider the accounting for segment reporting in conjunction with this project.
 - f. Disaggregation is the most pressing issue in this project.
 - g. Allowing companies to decide which units are operating and which units are financing would lead to widespread diversity in practice and a loss of comparability. The Board should develop a simple and flexible framework for defining operating income and nonoperating income.
 - h. Discontinued operations and other disaggregated information should be displayed on an after-tax basis because it would be difficult for investors to estimate the taxes associated with those items and it would provide more predictive information.
38. Ms. Petrone stated that the Board soon will discuss whether a short-term item should be limited to one year or whether the concept of an operating cycle should be used. The Board also will discuss the concept of liquidity and ways of displaying liquidity information in the financial statements or the notes.
39. Several Council members stated that limiting the operating cycle to one year would not provide useful information, particularly in industries that are heavily involved in long-term contracting. They suggested that it would be more helpful to display the duration of all assets and liabilities. Then, users could evaluate the liquidity of the entity for themselves.
40. Ms. Petrone stated that presenting income taxes in a separate section would eliminate arbitrary intraperiod tax allocations. Another benefit of this approach is presenting taxes as a discrete managerial function.
41. Council members had mixed views on whether intraperiod tax allocations provide useful information. Some believe that the tax information is useful in predicting and valuing a company's future cash flows, while others believe that the tax allocation is too arbitrary to be useful. Some users support a separate section for income tax information, provided the intraperiod allocation is disclosed in the notes.
42. Ms. Petrone stated that discontinued operations would be reported on a single line in a separate section of each statement. Operations already disposed of would not be separated from operations not yet disposed of. Assets and liabilities of discontinued operations would be shown net. Mr. Trott added that at a recent meeting of the Joint International Group (JIG) on Financial Statement Presentation in London, many group members expressed the view that information on discontinued operations is not meaningful.
43. Council members expressed the following about discontinued operations:

- a. Discontinued operations should be separated in the financial statements and disclosure should be expanded.
 - b. Segregating discontinued operations from continuing operations is useful for predicting future cash flows and return of capital.
 - c. Discontinued operations should be shown gross (rather than net) on the face of the financial statements (rather than in the footnotes) to provide users with more information about discontinued operations. Doing so would not impose a burden on preparers because that information is available for potential buyers.
 - d. Displaying discontinued operations as a single line on the face of the financial statements, with additional detail in the footnotes, would be sufficient.
44. Ms. Petrone stated that the comprehensive income statement would present line items by function. Some functional items would be separated further by nature of the item. Several Council members suggested using a matrix format for the comprehensive income statement to show the nature of items by function.
45. Council members asked about the relationship between the financial statement presentation project and developments in XBRL. Mr. Herz stated that by the time a final standard is issued on financial statement presentation, XBRL may already be a big part of the standard-setting process. Mr. Linsmeier added that exploring issues with the financial statement presentation project may help map out the taxonomies currently being developed by XBRL. Mr. Taub stated that the taxonomies should be developed with flexibility in mind so that changes can be made as new accounting developments occur.
46. Ms. Petrone stated that some of the issues remaining in the project are how to display fair value changes in assets and liabilities, whether items included in other comprehensive income should be recycled to profit and loss, and how to report cash flows. Ms. Petrone stated that the Board plans to issue an initial discussion document in the second quarter of 2007.

Priorities of the FASB

47. Ms. Polley stated that the purpose of the annual survey is to obtain constituents' views on the Board's agenda. She thanked the 23 UAC members who completed the survey and noted that UAC and Financial Accounting Standards Advisory Council (FASAC) member responses clustered around the same six topics, although the order of priority varied. Those six topics are financial statement presentation, postretirement benefit obligations including pensions, leases, fair value, revenue recognition, and the conceptual framework.
48. Ms. Polley briefly summarized the reasons UAC respondents selected those priorities. On the pensions project, UAC respondents mentioned the elimination of smoothing as a top issue to be addressed in Phase 2. On leases, UAC respondents believe that the current accounting distorts economic reality. Fair value issues,

including the fair value option and fair value measurement, also are a top priority of the UAC, with some advocating a move to full fair value for financial instruments as soon as possible and others advocating a cautious approach. On revenue recognition, many UAC respondents believe that the Board should move the project forward. Some advocate an approach that is disclosure-driven so as to achieve some progress on a shorter-term basis. On the conceptual framework, many UAC respondents noted its importance as a foundation for future standard setting.

49. Council members expressed the following about the Board's agenda:
- a. The Board should have a formal feedback process to evaluate accounting standards after they have become effective.
 - b. The Board should make impairments one of its top priorities.
 - c. The Board should focus on more short-term projects to fix problems in the capital markets rather than focusing on long-term projects that take years.
 - d. Leases should be a top priority of the Board. Because the leases project will most likely take several years, the Board should improve disclosures about leases in the short term.
 - e. The Board should require more disclosure about credit risk. One Council member suggested requiring comparative distribution curves about credit risk in the footnotes.
 - f. The Board should convene more industry groups to help identify the problems that exist in practice.

Adjournment

50. At 1:00 p.m., Mr. Young closed the meeting to public observation. The Council adjourned for lunch and for a working session to discuss initiatives to increase and improve investors' input in the Board's processes. Mr. Young adjourned the meeting at 2:00 p.m.