MINUTES

Financial Accounting Standards Board

To: Board Members

From: Mike Kramer (ext. 273)

Subject: Minutes of the January 5, 2005 Board Meeting **Date:** January 6, 2005

cc: L. Smith, Bielstein, Moss, Golden, Leisenring, Polley, Gabriele, BC Project Team, Sutay, FASB Intranet

Topics: Accounting by an Investor for Other Comprehensive Income of an Investee Accounted for Under the Equity Method Upon a Loss of Significant Influence

Basis for Discussion: Board memorandum dated November 29, 2004.

Length of Discussion: 9:00 a.m. to 9:20 a.m.

Attendance:

Board members present: Herz, Batavick, Crooch, Seidman, Trott, Young

IASB Board/Staff present: None

Board members absent: Schipper

Staff in charge of topics: Moss

Other Staff at Board table: L. Smith, Golden, Kramer

Outside Participants: None

Summary of Decisions Reached:

The Board decided to proceed with a Board-directed FSP on accounting for an investor's proportionate share of an investee's equity adjustments for other comprehensive income (OCI) upon a loss of significant influence. The Board decided that the investor's proportionate share of an investee's equity adjustments for OCI should be offset against the carrying value of the investment at the time significant influence is lost and the application of the equity method of accounting is discontinued.

Objective of the Meeting:

The objective of the meeting was to discuss a proposed FSP on accounting for an investor's proportionate share of an investee's equity adjustments for other comprehensive income upon a loss of significant influence. The objective of the meeting was achieved.

Matters Discussed and Decisions Reached:

1. Mr. Moss provided background for the issue. Paragraph 121 of FASB Statement No. 130, *Reporting Comprehensive Income*, provides the current authoritative literature which addresses the accounting by an investor for its proportionate share of an investee's equity adjustments. This paragraph references Paragraph 19(e) of Opinion 18 and states that "a transaction of an investee of a capital nature that affects the investor's share of stockholders' equity of the investee should be accounted for as if the investee were a consolidated subsidiary. Therefore, an investor records its proportionate share of the investee's equity adjustments for other comprehensive income (OCI) as increases or decreases to the investment account with corresponding adjustments in equity." After speaking with constituents, diversity in practice appears to exist in the accounting for an investor's proportionate share of an investee's equity adjustments for OCI upon a loss of significant influence and the application of the equity method of accounting is discontinued. Additionally, some constituents noted that, in practice, many

entities do not report their proportionate share of an investee's equity adjustments in OCI.

2. Mr. Moss presented three alternative views to the Board. View A is that the investor's proportionate share of an investee's equity adjustments for OCI should be offset against the carrying value of the investment at the time significant influence is lost. View B is that an investor should recognize its proportionate share of an investee's equity adjustments for OCI as a component of the gain or loss on sale of investment in relative proportion to the amount sold (that is, the balance will remain a component of the investor's stockholders' equity until all or a portion of the investment is sold or otherwise disposed of). View C is to record the entire amount of OCI in income at the time significant influence is lost. Due to the diversity in practice that has been identified, the staff believes that the issuance of a Board-directed FSP would be beneficial to constituents. The staff recommended View A.

3. Mr. Batavick agreed that an FSP should be issued to address the diversity in practice. He supports View A because it provides more accurate financial reporting. When influence is lost, the investor no longer has a share in the OCI of the investee. View B is not relevant financial information because it leaves the investor's proportionate share on the books. View C is not as good because loss of influence is not an event that should result in earnings recognition. View C may be a convergence issue with international standards, and may be revisited in the future, but View A is the best approach for this narrow issue.

4. Mr. Crooch supported View C. He noted that OCI is a holding account for gains and losses that are awaiting recognition in income. This is a transaction that would cause the OCI to be recognized as the significant influence is lost. It is better to write the OCI off to income at the date of loss of significant influence.

5. Ms. Seidman believes that it is important to consider the future relationship between OCI and income. When an investor has significant influence, they have more of an ability to assess the realization of gains and losses of an investee. When significant influence is lost, the investor has no ability to make this assessment. It is understandable how a misinterpretation of the

current guidance could lead accountants to currently use View B, but the best financial reporting would result from the use of View A.

6. Mr. Crooch noted that with View A, entities would write off the adjustments against the basis of the investment and it would carry through into the trading account. The basis of the shares is unrelated to the fair value of the investment, but the shares would be marked-to-market if in a trading account. If they were considered available-for-sale, it would just create OCI again. Once the loss of influence changes the investment accounting, changes in value will have to still have to go through either income or OCI.

7. Mr. Young asked the staff what the disclosure requirements would be if View C was adopted. Mr. Moss explained the disclosure requirements for View C would include the nature and the overall amount of the OCI. Mr. Golden believed that View C would lead to accounting similar to that for a realized gain in available-for-sale securities. The OCI income is moved to the income statement and is reconciled and taken out of accumulated OCI. Mr. Smith explained that the disclosure would be in the statement of comprehensive income, and large gains and losses may require additional disclosure.

8. Mr. Trott supported View A. He indicated that View C is not appropriate because no event occurs that gives rise to a realized gain or loss. Ideally, the loss of significant influence should be a remeasurement event, remeasured at the price of the investee at that point in time. This would be more representationally faithful to the transaction that occurred and the investment that is held by the reporting entity. This would require more than just a Board-directed FSP. View C would be a gain or loss event, even without the disposal of shares or any action taken regarding that investment.

9. Mr. Crooch believed that that logic is similar to logic used in the Business Combinations project, which requires a restatement of the continuing ownership stake at fair value when there is a change from control to no control. It does not make sense that items that are a gain or loss in OCI will come through as a reduction of the basis of an investment.

10. Ms. Schipper submitted in writing that she would accept either View A or B, but prefers View A. Mr. Young supports View A. Mr. Herz prefers View A. There are no objections to the adoption of View A.

11. Mr. Crooch noted that entities that have not been correctly accounting for their proportionate share of an investee's equity adjustments for OCI should not be excused by this FSP. Ms. Seidman agrees and believes that it is important to link Statement 130 and APB Opinion No. 18, *The Equity Method of Accounting for Investments,* more clearly to eliminate any current confusion regarding their interaction.

12. Mr. Trott requested that the staff prepare a draft FSP and return to the board to discuss transition issues.

<u>Follow-up Items</u>:

None

<u>General Announcements</u>:

None