MINUTES

Financial Accounting Standards Board

To: Board Members

From: Business Combinations—Purchase Method Procedures Team (B. Wilson, ext. 275)

Subject: Minutes of the December 11, 2002 Board Meeting

Date: December 16, 2002

Code: A: BC-PURMT

cc: FASB: Bielstein, Smith, Petrone, Bossio, Tamulis, Munro, Manders, B. Wilson, Such, P. Wilson, Swift, Polley, Cropsey, Thompson, Gabriele, Sutay, Lapolla, Financial Instruments and Liability and Equity Teams, FASB Intranet; IASB: Leisenring, Ryltsova, Kimmitt; CICA: Walsh; AICPA: Hekker; Purchase Method Procedures Working Group Members (E-mail)

Topic: Business Combinations—Purchase Method Procedures: Issues related to Noncontrolling Interests, Project Scope, and Clarification of Fair Value Measurement Guidance

Basis for Discussion: Three memorandums dated November 27, 2002 and attached audience handouts

Length of Discussion: 9:00 a.m. to 11:00 a.m.

Attendance:

Board members present: FASB: Herz, Crooch, Foster, Trott, Schieneman (by phone), Schipper, and Wulff
IASB: Leisenring

Board members absent: None

Staff in charge of topic: Tamulis, Manders, Munro

Other staff at Board table: Bielstein, Bossio, B. Wilson

Other participants: Ryltsova (by phone)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board continued its discussion of issues involving the accounting and reporting of controlling and noncontrolling (minority) interests in consolidated financial statements, which includes redeliberating certain of the proposals in the October 2000 Exposure Draft, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*. The Board also discussed certain project scope issues, and the proposed clarifications to the fair value measurement guidance for measuring assets acquired and liabilities assumed in a business combination.

1. For an entity with one or more less-than-wholly-owned subsidiary, the Board reached the following decisions:
   - Amounts for both net income attributable to noncontrolling interests and net income attributable to the controlling interest should be presented on the face of the consolidated income statement in addition to presenting consolidated net income. Further, the Board decided in presenting those amounts, net income attributable to the noncontrolling interest should be presented as a reduction to consolidated net income to arrive at the amount attributable to the controlling interest. The staff will explore whether the effects of capital transactions for purchases (and sales) of subsidiary shares from (to) noncontrolling shareholders that generally are shown in a statement of changes in shareholders' equity should be required to be displayed on the face of the consolidated income statement.
   - Amounts for both comprehensive income attributable to the controlling interest and comprehensive income attributable to the noncontrolling interests should be reported on the face of the financial statement in which comprehensive income is presented in addition to presenting consolidated comprehensive income
   - Individual line items in the consolidated income statement and components of other comprehensive income should be presented on a consolidated basis on the face of the financial statements. The amounts attributable to the controlling and noncontrolling interests for these individual line items would not be required to be presented on the face of the consolidated financial statements.
   - Losses of a subsidiary should be attributed to both the controlling and noncontrolling interests on the basis of their ownership interests and contractual rights and obligations, if any, even if the losses exceed the noncontrolling interests' investment. The staff will explore further whether the existence of a guarantee or other type of agreement should change the way losses are attributed between controlling and noncontrolling interests.
2. The Board decided to address certain issues previously excluded from the scope of this joint project with the objective of determining whether convergence with the

IASB is possible. These issues include the accounting for in-process research and development, acquired constructive obligations, and certain employee benefit issues.

3. The Board decided to clarify and modify the hierarchical guidance for measuring the fair value of assets acquired and liabilities assumed in a business combination. This revised guidance is included in the update to this project on the FASB website (and attached audience handout). Several Board members acknowledged that this level of fair value measurement guidance does not address certain important questions regarding fair value measurement and suggested that additional guidance should be developed to address those questions through a separate effort outside the FASB's project on business combinations.

DISCUSSION

Issues Involving the Accounting and Reporting of Controlling and Noncontrolling Interests

The Board discussed Issues 1 and 1A (handout attached) regarding how to display net income attributable to the controlling and noncontrolling interests in the consolidated income statement. Ms. Tamulis noted that the staff recommends Alternative One. That is, in addition to presenting consolidated net income, report amounts for both net income attributable to noncontrolling interests and net income attributable to the controlling interest on the face of the consolidated income statement. She added that for Issue 1A the staff recommends that the Board permit both Display A and Display B (see attached handout). She added that, as discussed at the educational meeting held last week, Mr. Trott proposed an additional requirement to display on the face of the consolidated income statement the effects of capital transactions for purchases (and sales) of subsidiary shares from (to) noncontrolling shareholders.

On Issue 1, the Board decided that amounts for both net income attributable to noncontrolling interests and net income attributable to the controlling interest should be presented on the face of the consolidated income statement in addition to presenting consolidated net income (Alternative One). However, Mr. Wulff indicated that he prefers Alternative Two (that is, he would prefer to deduct the amount attributable to noncontrolling interests to arrive at consolidated net income).

On Issue 1A, the Board decided in presenting those amounts that net income attributable to the noncontrolling interest should be required to be presented as a reduction to consolidated net income to arrive at the amount attributable to the controlling interest (that is, Display B). However, three Board members (Herz, Foster, and Schipper) indicated that they would not mandate Display B; rather, they would permit both Display A and Display B.

The Board discussed an example for presentation of transfers between controlling and noncontrolling interests on the face of the consolidated income statement proposed by Mr. Trott. He suggested that presenting these transfers along with the results of operations could help bridge different philosophical views among Board members. One Board member (Wulff) characterized the example as a compromise between the parent company and the economic unit concepts of financial statement presentation that he would support. Other Board members expressed concern about whether this proposal would open the door for display on the face of the income statement of transfers between other classes of equity or other types of equity transactions. Certain Board members expressed general concern about putting any equity items (transactions with owners) on the income statement. The Board directed the staff to explore further whether only the effects of capital transactions for purchases and sales of subsidiary shares to or from noncontrolling shareholders that generally are shown in a statement of changes in shareholders' equity could be required to be presented on the face of the consolidated income statement, or if there are other types of equity transactions that, as a result of this proposal, also should be displayed on the income statement.

The Board discussed Issue 2 and agreed that entities with less-than-wholly-owned subsidiaries should display amounts for both comprehensive income attributable to the controlling interest and comprehensive income attributable to the noncontrolling interests on the face of the financial statement in which comprehensive income is presented in addition to presenting consolidated comprehensive income.

The Board discussed Issue 3 and agreed that the individual line items in the consolidated income statement and components of other comprehensive income should be presented on a consolidated basis on the face of the financial statements. The amounts attributable to the controlling and noncontrolling interests for these individual line items would not be required to be presented on the face of the consolidated financial statements.

The Board discussed Issues 4A and 4B. Mr. Wulff suggested that unlike the staff recommendation on Issue 4B, he believes that in the event of losses in excess of the noncontrolling interests, the default should be to reflect all losses as attributable to the controlling interests (parent shareholders). He believes to do otherwise will lead to other complications and may overstate the results of operations and net income attributable to the primary users of the consolidated financial statements.

The Board decided that the losses of a subsidiary should be attributed to both the controlling and noncontrolling interests on the basis of their ownership interests and contractual rights and obligations, if any, even if the losses exceed the noncontrolling interests' investment. Mr. Trott and Mr. Wulff dissented stating that losses in excess of the noncontrolling interests' investment should be attributed entirely to the parent.

The Board asked the staff to explore further whether the existence of a guarantee or other type of agreement should change the way losses are attributed between controlling and noncontrolling interests.

Project Scope Issues

The Board decided to address certain issues previously excluded from the scope of this joint project with the objective of determining whether convergence with the IASB is possible. These issues include the accounting for in-process research and development (IPR&D), acquired constructive obligations, and certain employee benefit issues. Many of the Board members expressed support to address the three scope issues. However, some Board members acknowledged that they might not reach the same conclusion as the IASB on selected issues. Mr. Trott added that for certain of the employee benefit issues the differences resulting from the scope decisions are relatively minor. Board members expressing specific reservations about addressing the issues noted the lack of a common definition of a constructive obligation, the complexities associated with addressing acquired IPR&D prior to comprehensively addressing all IPR&D, and the potential for the resolution of these differences to delay the issuance of the Exposure Draft.

Mr. Herz asked Board members to indicate whether they support addressing the three issues within the scope of this project. A majority of the Board members supported addressing the issues within the scope of this project primarily because the Board has made a commitment to convergence and the decisions in joint projects should seek to reflect that commitment. Messrs. Foster and Trott indicated that they do not favor reopening all three issues.

Proposed Clarification to the Fair Value Measurement Guidance for Measuring Assets Acquired and Liabilities Assumed in a Business Combination

In response to a request by the Board at the December 4 educational session, the staff considered the interaction of the proposed clarifications to the hierarchical guidance for measuring assets acquired and liabilities assumed in a business combination with the fair value hierarchy used in other projects, particularly the financial instruments project. The staff noted that this proposed fair value hierarchy is consistent with previous Board decisions regarding fair value measurement in the financial instruments project and that the hierarchy could be applied to measuring the fair value of financial instruments. The staff noted, however, that the financial instruments project more narrowly defines fair value as the "exit value," which differs from the definition of fair value in U.S. GAAP and as defined in the business combinations project. The staff recommended, and the Board agreed, that there should be only one definition of fair value and that it should remain the current U.S. GAAP definition. Rather than being characterized as part of the definition of fair value, the "exit value" notion in the financial instruments project could be considered guidance in applying the fair value definition to a financial instrument.

A Board member inquired as to how Level 3 of the hierarchy would apply when measuring the fair value of an enterprise, specifically when entity-specific synergies are contemplated in the purchase price. The staff responded that the hierarchy, as currently drafted, was not intended to apply to measuring the fair value of an enterprise as a whole and noted that the staff is addressing that issue separately.

The Board decided to modify the hierarchical guidance for measuring the fair value of assets acquired and liabilities assumed in a business combination as included in the attached audience handout to these minutes. However, several Board members acknowledged that this level of fair value measurement guidance does not address certain important questions regarding fair value measurement. The Board suggested that, before they decide that this fair value hierarchy should be applicable across all existing and proposed accounting standards, further study should be conducted to determine the impact of the application of the hierarchy to situations such as valuing an entity as a whole, and that further refinement of the hierarchy may be necessary.

Therefore, the staff recommended, and the Board agreed, that additional guidance should be developed to address important unanswered questions regarding fair value measurement through a priority effort outside the joint project on business combinations. Ms. Ryltsova indicated that the staff of the IASB would welcome the opportunity to participate in and contribute to such an effort.

Financial Accounting Standards Board

Board Meeting Handout

December 11, 2002 Norwalk, CT
Business Combinations II—Purchase Method Procedures

At today's meeting, Board will discuss (a) certain issues involving the accounting and reporting of controlling and noncontrolling (minority) interests in consolidated financial statements, (b) whether certain items previously excluded from the scope of the project should continue to be excluded from the project's scope, and (c) proposed clarifications to the fair value measurement guidance for measuring assets acquired and liabilities assumed in a business combination.

Issues Involving the Accounting and Reporting of Controlling and Noncontrolling Interests

1. How should net income attributable to the controlling and noncontrolling interests be presented on the face of the consolidated income statement?

   Alternative One: In addition to presenting consolidated net income, report amounts for both net income attributable to noncontrolling interests and net income attributable to the controlling interest on the face of the consolidated income statement.

   Alternative Two: Deduct the portion of net income attributable to noncontrolling interests in computing consolidated net income.

   1A. If Alternative One is selected, should alternative presentation formats (as illustrated and proposed by the 2000 Liabilities and Equity Exposure Draft) be permitted or should a specific format be required?

2. Should comprehensive income attributable to the controlling and noncontrolling interests be required to be presented on the face of the financial statement in which comprehensive income is reported?

   2A. If not required on the face of a statement of comprehensive income or statement of changes in equity, should those amounts be required disclosures in notes to financial statements?

3. Should the amounts of any other individual line items attributable to the controlling and noncontrolling interests be required to be presented on the face of the financial statement in which that line item is reported?

   3A. If not required on the face of a financial statement, should those amounts for any individual line item be required disclosures in notes to financial statements?

4. How should losses be attributed between the controlling and noncontrolling interests?
   - 4A. Should losses of a subsidiary be attributed to both the controlling and noncontrolling interests on the basis of their ownership interests?
   - 4B. Should losses of a subsidiary in excess of the noncontrolling interests' investment continue to be attributed to both the controlling and noncontrolling interests on the basis of their ownership interests or attributed entirely to the controlling interest?
   - 4C. If losses in excess of the noncontrolling interests' investment are attributed entirely to the controlling interest, should future income be attributed first to the controlling interest to the extent of the excess losses absorbed?

Project Scope Issues

Should the FASB include the following issues in the scope of the Business Combinations—Purchase Method Procedures project?

1. Amendments to employee benefit plans that are (a) a condition of the business combination or (b) intended changes by the acquirer to employee benefit plans of the acquiree
2. Constructive obligations
3. In-process research and development (IPR&D) of the acquiree at the date of acquisition.

Proposed Clarification to the Fair Value Measurement Guidance For Measuring Assets Acquired and Liabilities Assumed in a Business Combination

1. Should the fair value hierarchy be revised (as shown on the Attachment)?
2. Should additional fair value measurement guidance be provided through expansion of the fair value hierarchy?
3. Should additional "how to" fair value measurement guidance be provided in the Exposure Draft for this joint project for specific assets (or liabilities) for which observable market prices do not exist for the asset in its current location or condition (for example, items of inventory or used equipment)?

Attachment

Proposed Fair Value Hierarchy

Level 1—The estimate of fair value shall be determined by reference to observable prices of market[1] transactions for identical assets or liabilities at or near[2] the measurement date whenever that information is available.

Level 2—If observable prices of market transactions for identical assets or liabilities at or near the measurement date are not available, the estimate of fair value shall be determined by adjusting observable prices of market transactions for similar assets or liabilities that occur at or near the measurement date. A similar asset or liability is one that is reasonably comparable, for example, one having similar patterns of cash flows that can be expected to respond similarly to those of the item being measured to changes in economic conditions. Generally, when an asset or liability is sufficiently similar to an asset or liability being measured, adjustments for any differences are objectively determinable.[3]

Level 3—If observable prices of market transactions for identical or similar assets or liabilities at or near the measurement date are not available, the estimate of fair value shall be determined using other valuation techniques. Valuation techniques shall be consistent with the objective of estimating fair value and incorporate assumptions that marketplace participants would use whenever market-based information is available without undue cost and effort. If market-based information is not available without undue cost and effort, an entity may use as inputs its own assumptions as a practical expedient; however, for any valuation technique, market inputs shall be maximized and use of internal estimates and assumptions shall be minimized. For example, if an entity is aware of unique advantages or disadvantages that it possesses, such as favorable labor rates, or superior processing or manufacturing technologies, it shall adjust its entity-specific assumptions such that the inputs into the valuation process or model reflect those that marketplace participants would incorporate in an estimate of fair value.

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[1] "Market" refers to the markets to which the entity has reasonable access.

[2] Prices of market transactions near the measurement date (rather than at the measurement date) could be used to the extent that there were no changes in market conditions between the measurement date and the observable transaction date.

[3] For example, similar assets could be identical in all respects except for location. If the only difference between two assets were the location, the fair value would equal the observable price of an identical item in a different location plus costs to ship the item to the identical location as the asset being measured.

Excerpt from Page 5 of November 27, 2002 Memo 1 of 3

	Alternative One		Alternative
	Display A	**Display B**	**Two**
Revenues	$X,XXX	$X,XXX	$X,XXX
Expenses	XXX	XXX	XXX
Operating income	X,XXX	X,XXX	X,XXX
Portion of income attributable to noncontrolling shareholders in subsidiaries			(XXX)
Other income (expense)	XXX	XXX	XXX
Income before taxes	XXX	XXX	XXX
Income taxes	XXX	XXX	XXX
Consolidated net income	$X,XXX	X,XXX	$X,XXX
Net income attributable to noncontrolling shareholders in subsidiaries	$ XXX	(XXX)	
Net income attributable to controlling interest (shareholders of Parent Company)	$X,XXX	$X,XXX	

The following examples for the display of noncontrolling interests in the consolidated balance sheet and income statement was proposed by Ed Trott and discussed at December 4th educational session:

Balance Sheet

Current assets		$ XXX	Current liabilities		$ XX
			Non-current liabilities		XX
Non-current assets	**XXX**				
			Noncontrolling equity		XX
			Controlling equity:		
			Common stock		XX
			Paid-in capital		XX
			Other comprehensive income		XX
			Retained earnings	**XX**	
			Total controlling equity	**XXX**	
Total assets	**$X,XXX**		Total liabilities and equity	**$X,XXX**	

Income Statement

Sales		$XXX
Cost of goods sold	**(XX)**	
		XXX
Selling, general and administrative		XX
Interest expense	**X**	
Income before taxes		XXX
Income tax expense	**XX**	
Consolidated net income		XX
Net income allocated (to)/from noncontrolling equity		(X)
Net income attributable to controlling equity	**$ XX**	

Income Statement with Purchase of Noncontrolling Interest

Sales		$XXX
Cost of goods sold	**(XX)**	
		XXX
Selling, general and administrative		XX
Interest expense	**X**	
Income before taxes		XXX
Income tax expense	**XX**	
Consolidated net income		XX
Net income allocated (to)/from noncontrolling equity		(X)
Net income attributable to controlling equity	**XX**	
Transfer to/(from) controlling equity to noncontrolling equity		(X)
Change in controlling equity's net assets from operations and transfers to/from noncontrolling equity	**$ XX**	