MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Business Combinations: Applying the Acquisition Method Team (Cronin, ext. 443)
Subject:	Minutes of the January 25, 2006 Board Meeting: Business Combinations – Comment Letter Summaries and Preliminary Planning
Date:	February 1, 2006
cc:	FASB: Bielstein, Smith, Petrone, Bossio, Tamulis, Posta, Vessels, Cronin, Bennett, Gerard, Todorova, Lapolla, Polley, Gabriele, Sutay, Carney, Mahoney, FASB Intranet; IASB: Upton, Hickey, Teixeira, Buschhueter, Quiring

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topic:	Business Combinations and Noncontrolling Interests Comment Letter Summaries and Preliminary Planning
Basis for Discussion:	Board Memorandum No. 4 dated January 13, 2006
Length of Discussion:	9:45 a.m. to 11:40 p.m.

Attendance:

Board members present:	Batavick, Crooch, Herz, Schipper, Seidman, Trott, and Young
Staff in charge of topic:	Tamulis and Vessels
Other staff at Board table:	Bielstein, Bossio, Bennett, and Cronin
Outside participants:	Teixeira, Buschhueter, and Quiring (by phone)

Summary of Decisions Reached:

The Board discussed the comment letters received on its Exposure Drafts, *Business Combinations*, and *Consolidated Financial Statements, Including Accounting and Reporting of Noncontrolling Interests in Subsidiaries*. The Board also affirmed the project's objectives and the staff's plan for redeliberations.

Objectives of Meeting:

The objectives of the meeting were for the Board to consider and affirm or modify the project's objectives and the staff's plan for redeliberations. Those objectives were met.

Matters Discussed and Decisions Reached:

1. Ms. Tamulis stated that the staff analyzed the comment letters received on the business combinations Exposure Draft (BC ED) and the noncontrolling interests Exposure Draft (NCI ED) and prepared separate summaries of those analyses to facilitate the planning of the redeliberation process. She noted that the summaries are available to the public and stated that the purpose of this meeting is to address the staff's plan for redeliberations.

2. Ms. Tamulis stated that the staff does not intend for the Board to vote or formally affirm any individual issues in the EDs. The staff will bring back each principle and the related issues later in the redeliberations, and the Board will have an opportunity to affirm or change its conclusions at that time.

Discussion of Project Objectives and Principles

3. Ms. Tamulis noted that the primary objective of the business combinations project is to develop a single high-quality standard for accounting for business combinations that can be used for both domestic and cross-border financial reporting. To accomplish that objective, the staff plans to develop FASB and IASB standards on business combinations and noncontrolling interests that:

a. Are converged on a common set of principles that provide decision-useful information

b. Contain converged guidance that minimizes exceptions to those principles

c. Are written in plain English, and use the same language to the extent possible to minimize differences in the application in the US and internationally

d. Provide authoritative implementation and application guidance to the extent necessary for consistent application by different entities.

Ms. Tamulis asked the Board to confirm that these project objectives are still valid. The Board unanimously agreed that the project's objectives are appropriate and valid.

4. Ms. Tamulis noted that the staff identified the following nine principles in the BC ED:

Principle 1: A business combination is a transaction or other event in which an acquirer obtains control of one or more businesses.

Principle 2: The acquisition date is the date the acquirer obtains control of the acquiree.

Principle 3: An acquirer shall be identified in every business combination.

Principle 4: The acquirer shall measure and recognize the fair value of the acquiree, as a whole, on the acquisition date.

Principle 5: The acquisition-date fair value of the consideration transferred shall be used to measure the fair value of the acquiree except when it can be demonstrated that the consideration transferred is not the best evidence.

Principle 6: The acquirer shall measure and recognize the fair value of the acquiree by recognizing the fair value of the acquiree's identifiable assets and liabilities as of the acquisition date.

Principle 7: Some assets and liabilities shall be measured and recognized in accordance with other standards rather than fair value for practical reasons and to avoid Day 2 complexities. (For example, assets held for sale, income taxes, operating leases, employee benefit plans.)

Principle 8: Only what is actually part of the exchange for the acquiree shall be accounted for as part of the business combination.

Principle 9: The acquirer is allowed reasonable time to obtain the information necessary to identify and measure the acquisition-date fair values of the acquiree and the assets acquired and liabilities assumed (measurement period).

She stated that the staff will use these principles as a starting point for redeliberations. That is, each individual issue within the project will be discussed in context with its related principle. The staff then will ask the Board to affirm an individual issue and its related principle at the same time. She stated that some IASB Board members believe that the first four items are truly principles, while the remaining items are merely application guidance related to a specific principle. She also noted that another proposed principle is whether obtaining or losing control of a business qualifies as a remeasurement event. She asked if the Board fundamentally disagrees with any of the principles or whether there is anything that should be added, deleted, or modified.

5. Ms. Schipper stated that identifying the appropriate principles is essential to creating a principles-based standard. In the development of a principles-based standard, the agreed-upon principles must guide the resolution of issues discussed in redeliberations. She stated that Principle 7 does not provide a guide for resolving issues in the same way that the other principles do because it is a statement (with which she agrees) that it is sometimes necessary to resolve conflicts between existing guidance and the principles stated in this standard; however, Principle 7 provides no basis for those resolutions. Ms. Schipper also believes that Principle 9 is a statement of practical reality as opposed to a principle.

6. Mr. Herz stated that he does not agree with Principle 3 as indicated in one of his alternative views in the ED. He also noted some lingering doubts about Principle 5 based on a decision made that the acquirer's equity securities issued as consideration should be measured on the acquisition date rather than the agreement date. Ms. Seidman stated she is most concerned with Principles 4 and 6 and agrees with Mr. Herz that these items will represent a crux of future discussions. Mr. Trott and Ms. Seidman agreed that this is a useful way of grouping the major issues in the project that need to be discussed during

redeliberations, while noting that some might be characterized better as implementation guidance rather than principles. Messrs. Batavick and Crooch also concurred that the staff's approach is appropriate.

Staff Analysis of Comment Letters

7. Ms. Tamulis noted that the staff divided the constituents' comments into two categories. The first category includes those comments with which constituents raised new issues that the staff and Board had not previously considered. The staff believes that additional analysis of these issues is necessary before the staff will ask the Board to affirm a specific proposal. The second category includes those responses in which the arguments raised by respondents, while being good and valid points, had already been analyzed and deliberated by the Board before the Exposure Drafts were issued. Therefore, the staff does not intend to spend significant time conducting additional research or analysis on those comments. Ms. Tamulis clarified that all issues will be brought back before the Board so the Board will have an opportunity to discuss the issues again and the comments received. However, the staff does not plan to reanalyze the issues in the second category.

8. Ms. Tamulis noted that the staff used the following four criteria to decide which issues needed further staff research and analysis:

a. If respondents raised issues that the Boards did not previously consider.
b. If a Board member had an alternative view in the Exposure Drafts.
c. If one Board wants or needs to review a proposal then it will be brought back to both Boards.
d. If respondents were overwhelmingly opposed to a proposal.

Ms. Tamulis stated that the fourth criterion is the most controversial among Board members. Some Board members do not believe that overwhelming opposition is a reason to redeliberate and reanalyze an issue. While the staff agrees, the staff believes that where there is overwhelming opposition to a proposal, the staff will need to spend more time reviewing the comment letters to ensure that nothing was missed. Thus, those issues will take more of the staff's time. Ms. Tamulis asked the Board if it agreed on the staff's analysis and classification of issues.

Issues Requiring Additional Research and Staff Time

9. The Board affirmed that the following issues will require additional research and staff analysis before they are redeliberated:

a. Definition of a business combination

b. Whether the definition of *mutual entity* in the BC ED is appropriate for cooperatives

c. Whether applying the acquisition method would result in some cooperatives being in conflict with certain laws in some jurisdictions

d. Whether the model developed in the project on combinations of not-for-profit organizations could be applied by mutual entities for cost-benefit reasons

e. Definition of a business

f. Recognition of goodwill in a partial and step acquisition

g. Allocation of goodwill in a partial acquisition

h. Enhancing the fair value measurement guidance, specifically in regards to control premiums

i. Recognition of a separate valuation allowance against the contractual amount of the receivables to achieve a net fair value

j. Accounting for contingencies

k. Accounting for insurance contracts

l. Subsequent accounting for in-process research and development assets

m. Accounting for preexisting relationships and reacquired rights

n. The necessity of a separate reliable measurement criterion for intangible assets

o. Valuation of intangible assets using a market participant view

p. Assets held for sale

q. Exceptions from fair value measurement requirement:

    (1) Certain issues related to income taxes

(2) Whether Statement 112 postemployment benefits accounted for on an actuarial basis should be given the same scope exception as Statements 87 and 106 benefits

r. Implementation guidance for determining what is part of a business combination

s. Disclosure requirements

t. Effective date.

10. Ms. Tamulis reported that a number of comment letters were received from cooperatives that apply IFRS. The staff would like to evaluate claims that the definition of a mutual entity is not appropriate for cooperatives (Issue B) and that application of the acquisition method would conflict with certain laws in their jurisdictions (Issue C). Mr. Herz asked the staff to further analyze the potential applicability of guidance in the project on combinations of not-for-profit organizations to mutuals and cooperatives based on cost-benefit grounds. Ms. Seidman asked the staff to consider the convergence implications of removing mutuals and cooperatives from the scope of this document (Issue D).

11. Ms. Tamulis noted that some respondents did not understand the conceptual justification for having separate models for asset acquisitions and business combinations. The staff wanted to find out from the Board if the staff should start analyzing the effects of including asset acquisitions within the scope of this project. Mr. Batavick noted that much effort has gone into creating definitions that distinguish between a business and a bundle of assets. He stated that this standard should continue to focus on business combinations and, therefore, he does not believe the scope should be expanded to include asset acquisitions. He also noted that expanding the scope would almost certainly require re-exposure, thus prolonging the issuance of a final standard. Ms. Seidman stated that the Board should wait until the core issues in the project have been redeliberated in order to gain an understanding of the magnitude of differences between business combinations and asset acquisitions before deciding if asset acquisitions should be included in the scope of this project. Messrs. Herz, Trott, and Crooch agreed. However, Mr. Herz asserted that because the principle of neutrality is violated when economically similar

transactions receive different accounting treatment, he believes that issues will arise if the Board does not address asset acquisitions. Ms. Schipper agreed that inconsistent treatment is undesirable; however, she stated that the FASB should not contemplate asset acquisitions any further as a part of the business combinations project but, instead, could address it separately in another project.

12. Ms. Tamulis stated that controversy arose in comment letters surrounding the accounting for contingencies (Issue J). She noted that the IASB's redeliberation of IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* is taking place, so the staff will need to perform additional work to understand convergence implications before providing the Board with a final recommendation. Mr. Batavick stated that the FASB cannot merely accept what the IASB decides with regard to contingencies, but instead must evaluate the comment letters received from constituents and arrive at an agreed-upon approach for contingencies.

13. Ms. Tamulis stated that the staff believes the Board should consider providing guidance for valuing intangible assets using the market participant view (Issue O). Mr. Trott believes that intangible assets should be valued using the market participant view. He does not believe that an entity should be allowed to use "entity-specific" measures rather than fair value. However, he noted that exceptions might exist in which an "entity-specific" valuation might be necessary but stated that this document should not contain a different definition of fair value. Therefore, he would like the staff to conduct further research into potential exceptions. Ms. Seidman stated that the Board needs to provide guidance for impairment testing intangible assets that are valued using the market participant view but not used by the entity.

14. Ms. Tamulis stated that most respondents commented that the bold-type, plain-type style made the document more readable and understandable; however, the staff believe that this topic is a more pervasive FASB issue that needs to be resolved administratively, rather than within an individual project.

Mr. Crooch added that implementing this format could cause some problems with the ongoing codification process.

Issues to Be Redeliberated Without Requiring Additional Staff Analysis

15. The Board affirmed that the following issues do not require additional research or staff analysis before being redeliberated by the Board:

a. Scope issues:
   (1) Applicability to mutual entities
   (2) Applicability to business combinations achieved by contract alone
   (3) Scope exception for joint ventures
   (4) Scope exception for common control transactions
b. Designation of an effective date other than the acquisition date
c. Criteria for identifying the acquirer
d. Recognition of identifiable net assets at fair value in a partial or step acquisition
e. Measurement of previously held noncontrolling equity interests in a step acquisition
f. Bargain purchases
g. Overpayments
h. Contingent consideration
i. Measurement date of acquirer's equity securities issued as consideration
j. Transaction costs
k. Recognition by acquirer of acquiree's receivables at fair value at the acquisition date
l. Restructuring costs
m. Initial recognition of in-process research and development assets
n. Exceptions from fair value measurement requirement:
   (1) Deferred taxes
   (2) Operating leases
   (3) Employee benefit plans
o. Transition provisions.

16. Mr. Trott stated that the staff should further analyze the proposed transition provisions for additional acquisitions of noncontrolling interests after the date of the business combination. He believes more work will need to be done at a later date, depending on the outcome for step acquisitions.

Staff Analysis – Noncontrolling Interests Exposure Draft

17. Ms. Vessels stated that the staff is aware of the concerns raised by respondents and believes that the Board has previously addressed many of those concerns before issuing the NCI ED. However, due to the confusion and concern expressed by constituents, the staff plans to bring a comprehensive analysis of the NCI issues to the Board that compares current practice and the proposed accounting included in the ED. The staff believes that compiling a comprehensive package of NCI issues will provide an opportunity to reeducate the Board and its constituents in an attempt to clarify the proposal. The Board unanimously agreed to this approach. Ms. Seidman asked the staff to communicate with the CFA Institute to reconcile their position in their comment letter on the Conceptual Framework project (dated November 2, 2005), and their endorsement of the Business Combinations Exposure Draft in their comment letter (dated November 26, 2005), which would result in the exact reporting that they criticized.

Preliminary Planning Schedule for Redeliberations

18. Ms. Tamulis noted that while the staff originally planned to address the issues around step acquisitions and partial acquisitions separately from the NCI issues, the IASB was largely not supportive of that approach. The staff now intends to address the step and partial acquisitions along with NCI issues at the March 2006 meeting. The staff then will address at the April joint meeting the core convergence issues that were not resolved at the February and March meetings.

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

None.

General Announcements:

None.