

MINUTES



To: Board Members

From: Maffei, Ext. 273

Subject: Minutes of May 14, 2003 Board Meeting

Date: May 15, 2003

cc: Bielstein, Smith, Petrone, Leisenring, Team, Bullen, T. Johnson, Lott, Mahoney, Thompson, Gabriele, and McKenna; Swift and Polley (FASAC); Bean and Patton (GASB), FASB Intranet, and via email: Barker (IASB)

Topic: Financial Performance Reporting Project: Definition of Financing Activities

Basis for Discussion: Staff Memoranda dated May 7 and May 13, 2003

Length of Discussion: 9:00 a.m. to 10:15 a.m.

Attendance:

Board members present: Herz, Crooch, Foster, Schieneman, Schipper, Trott, and Wulff

Board members absent: None

Staff in charge of topic: Sullivan

Other staff at Board table: Bielstein, Bossio, Lusniak, Maffei

Summary for ACTION ALERT:

The Board continued its discussion of the April 16, 2003 decision to require a single statement of comprehensive income that would display at least three major categories: business activities, financing, and other gains and losses. Specifically, the Board discussed issues related to the development of the financing category of the statement of comprehensive income. The Board decided that the financing category should include the following:

- a. All expenses related to the passage of time for all types of liabilities
- b. Income related to the passage of time that is earned on cash and cash equivalents
- c. Gains and losses associated with the issuance, restructuring, and extinguishment of debt.

Matters Discussed and Decisions Reached:

Ms. Sullivan explained that the purpose of the meeting was to obtain guidance from the Board regarding what types of transactions and events should be included within the financing category on the statement of comprehensive income. She noted that during the education session it was clear that Board members had several questions that cut across the five alternatives described in the staff memo, she stated that the staff had broken these issues into three questions.

Question 1: Should the financing activities category on the statement of comprehensive income include interest income from financial assets?

Five Board members (Foster, Herz, Schieneman, Schipper, Wulff) agreed that the financing category should include interest income from certain assets because that income represents excess cash that could be used to pay off debt (that is, the financing category should incorporate the notion of net debt that exists in valuation theory). Ms. Schipper stated that, in her opinion, the objective of this project is to better align the statement of comprehensive income in a way consistent with how valuation analysis is performed. She pointed out that the notion of net debt is a well known theory of financial statement analysis, both in literature and textbooks. However, those sources often differ on which specific assets are considered as part of net debt.

Mr. Trott disagreed with the decision, stating that the financing category should represent only financing costs that are generated by liabilities, consistent with the IASB model. He stated that he is unable to determine which assets should be included within financing. Additionally, he noted that interest income could be

segregated from business activities by inclusion in the other gains and losses category. Mr. Crooch stated that the concept of net debt and inclusion of interest income within financing would create unnecessary complications in the model. He explained that as long as these types of transactions and events were displayed as separated line items in the statement of comprehensive income, users would be able to use the information in a manner to suit their needs.

Question 2: What balance sheet items should determine the revenues, expenses, gains, and losses that should be included in the financing category of the statement of comprehensive income?

Ms. Sullivan noted that the decision reached in Question 1 requires identification of both asset and liability items that should be considered the generators of revenues, expenses, gains, and losses to be included in the financing category of the statement of comprehensive income.

Liability Side

Five Board members (Crooch, Foster, Herz, Schipper, Trott) agreed that the financing category should include any expenses related to the passage of time for all liabilities (Alternative 3 from the handout). Mr. Trott stated that the financing category should allow users to distinguish the costs associated with short-term debt, long-term debt, and other long-term obligations (such as asset retirement obligations and environmental liabilities). Ms. Schipper stated that she considers the IASB definition of the financing category to be arbitrary, but that she supports Alternative 3 provided the objective is to capture all expenses related to the passage of time on all liabilities.

Mr. Schieneman and Mr. Wulff stated that they did not consider costs related to changes in a discount rate (such as those incurred in asset retirement obligations and environmental liabilities) to be part of the financing category, but rather, they would prefer those costs to be included within the business activities category because these costs generally result from the nature of the entity's business. Mr.

Wulff stated that he preferred Alternative 2 because the financing category should include only those costs related to “capital” that is provided by investors.

Mr. Schieneman and Mr. Wulff stated that they would not object to Alternative 3 as long as accretion costs were shown separately within the financing category, thus allowing users to segregate the information from that category if desired.

Mr. Herz stated that accretion cost needs to be captured on the statement of comprehensive income. He said that although he would not include accretion costs within the business activities category, he was indifferent whether it should be in the financing or the other gains and losses category.

Asset Side

Five Board members (Crooch, Herz, Schipper, Trott, Wulff) agreed that financing category should include any revenues, gains, or losses related to the passage of time that is earned on cash and cash equivalents. Board members generally stated that these assets can be regarded as negative debt since they are available to pay off liabilities. Therefore, income earned on these assets should be shown in the same category as the expenses associated with the passage of time for liabilities. Mr. Herz said that the objective of the financing category should be to present only the cost of financing the entity. Therefore, only cash and cash equivalents should be included, and income on noncash assets (such as marketable securities and other investments), which represent investing activities, should be included in the other gains and losses category. Ms. Schipper stated that because she was unable to develop a conceptual basis on which to include certain assets and exclude others, she is in favor of including only cash and cash equivalents for ease of implementation.

Mr. Schieneman stated that, like Mr. Herz and others, he would exclude gains and losses on marketable securities from the business activities category. He added, however, that in addition to cash and cash equivalents, he supports including income from marketable securities and held-to-maturity securities in the financing

category. Mr. Foster stated that he supports including in the financing category income associated with any asset that is readily convertible into cash, because any of those assets could be used to settle any liability.

Question 3: Should gains and losses associated with the issuance, restructuring and extinguishment of debt be included in the financing category on the statement of comprehensive income?

All Board members agreed that gains and losses associated with the issuance, restructuring, and extinguishment of debt should be included in the financing category.

Follow-up Items:

The staff will finalize a definition of financing and will continue work on developing definitions for business activities and the other gains and losses categories.

General Announcements:

None.