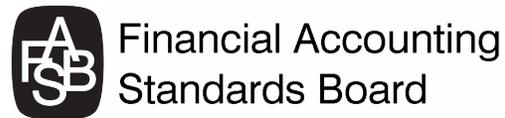


REVISED MINUTES



**To:** Board Members

**From:** Business Combinations: Applying the Acquisition Method Team (Cronin, Ext. 443; Bennett, Ext. 229)

**Subject:** Minutes of the May 31, 2006 Board Meeting      **Date:** June 12, 2006

**cc:** FASB: Bielstein, Smith, MacDonald, Bossio, Tamulis, Posta, Vessels, Cronin, Bennett, Todorova, Proestakes, Cassel, Cafini, Hood, Strange, Zimmerman, Lapolla, Polley, Gabriele, Sutay, Carney, Allen, FASB Intranet; IASB: Leisenring, 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.*

Topics: Reasons for Making Exceptions and Possible Exceptions: Assets Held for Sale, Employee Benefit Obligations, and Operating Leases

Basis for Discussion: Board Memorandums No. 17–20

Length of Discussion: 10:30 to 11:55 a.m.

Attendance:

Board members present: FASB: Batavick, Crooch, Herz, Schipper, Seidman, Trott, and Young  
IASB: Leisenring

Staff in charge of topic: Tamulis, Teixeira, and Vessels

Other staff at Board table: Bielstein and Bennett

Outside participants: Buschhueter and Quiring (by phone)

## Summary of Decisions Reached:

The Board continued its redeliberations of the June 2005 FASB Exposure Draft, *Business Combinations*. The Board focused on an approach for making exceptions to the recognition and fair value measurement principles that it affirmed in past meetings. The Board made the following decisions:

### *Assets Held for Sale*

1. The Exposure Draft proposed an exception to the fair value measurement principle for assets held for sale (it proposed that those assets be measured at fair value less cost to sell). The Board decided instead that those assets should be measured at fair value and decided to amend FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, to replace “fair value less cost to sell” with “fair value.”
2. The Board also decided to amend Statement 144 to eliminate the special guidance for determining whether an acquired asset meets the held-for-sale criteria (that guidance, contained in paragraph 32 of Statement 144, allowed the acquirer to classify a long-lived asset as held for sale if it was probable that the acquirer could meet the recognition criteria **within three months** of the acquisition date). Thus, the Board decided that an acquirer would have to meet **all** of the recognition criteria **at the acquisition date** to classify a long-lived asset as held for sale at that date.

### *Employee Benefit Obligations*

1. The Exposure Draft proposed an exception to the fair value measurement principle for obligations associated with defined benefit postretirement benefit plans. The Board affirmed that exception and also extended it to all employee benefit obligations (except for obligations associated with share-based payment arrangements, which the Board plans to consider at a later date). That is, all benefit obligations would be measured based on guidance in existing standards rather than fair value. If a standard allows employee benefit obligations to be measured or recognized in various ways, the acquirer should be required to measure those assumed obligations in a manner consistent with its existing accounting policies.
2. The Board affirmed the proposed amendments to FASB Statements No. 87, *Employers' Accounting for Pensions*, and No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, that would require an acquirer to recognize any changes to the acquiree's employee benefit plans (such as amendments, curtailments, or terminations) that it expects to make as postcombination expenses rather than include such changes in the measurement of the assumed benefit plan obligations.
3. The Board also discussed the measurement of obligations associated with multiemployer benefit plans assumed in a business combination. It

decided that an acquirer should recognize an expected withdrawal liability from a multiemployer plan in accordance with the existing guidance in Statements 87 and 106—that is, if withdrawal from the plan is probable at the acquisition date.

### *Operating Leases*

1. The Board affirmed the implementation guidance proposed in the Exposure Draft under which an acquirer recognizes the rights and obligations related to an operating lease in which the acquiree is the lessee as a net amount rather than as a separate asset and a separate liability.
2. The Board also affirmed the proposed requirement that an acquirer recognize an intangible asset or a liability if the terms of an acquired operating lease are favorable or unfavorable relative to market terms at the acquisition date.
3. Several respondents to the Exposure Draft commented that an operating lease might have value for reasons other than terms that are favorable relative to market prices—most likely arising from a related intangible asset. The Board agreed with those respondents and decided that an acquirer should recognize such intangible assets in the same manner as other intangible assets acquired in a business combination.

### Objectives of Meeting:

The objectives of the meeting were for the Board to discuss the reasons for making exceptions to either the fair value measurement principle or the recognition principle and to redeliberate three exceptions that were proposed in the FASB's and the IASB's joint Exposure Draft, *Business Combinations*. Those proposed exceptions are:

1. Assets held for sale
2. Employee benefit obligations
3. Operating leases.

Those objectives were met.

Matters Discussed and Decisions Reached:

**TOPIC 1: REASONS FOR MAKING EXCEPTIONS**

1. Mr. Teixeira stated that the staff is developing a framework to help the Board decide when to make exceptions to or develop guidance for the recognition and measurement principles. He noted that the staff is still assessing the relative costs and benefits of applying the recognition and measurement principles and allowing departures from those principles and that the staff is not ready to present a formal framework. The staff will present the formal framework for assessing exceptions and guidance at future Board meetings.

2. Mr. Teixeira stated that application of the recognition principle is likely to merit further analysis when IFRS or U.S. GAAP prohibits the recognition (or separate recognition) of an asset or a liability related to a transaction. However, the proposed business combinations standard requires that recognition. An example of such a circumstance is operating leases. He noted that further analysis of the measurement principle would be required in circumstances in which an entity reporting under IFRS or U.S. GAAP would report an immediate gain or loss as a result of a change in the accounting measurement attribute and not as a result of a change in the economic condition of the asset or liability.

3. The staff will also analyze transactions that:

- a. Respondents believe should not be accounted for in accordance with the proposed principles
- b. Were characterized in the business combinations Exposure Draft exceptions (assets held for sale, deferred taxes, operating leases, employee benefit obligations, and goodwill).

4. Mr. Teixeira suggested that some reasons for allowing exceptions or providing additional guidance might be:

- a. To enhance consistency in the application of a principle or current guidance

- b. Because the application of the fair value measurement attribute would be impracticable (for example, deferred taxes)
- c. Because the current accounting is so complex and diverse that requiring fair value as a measurement attribute would add to that complexity and diversity.

The staff is considering the costs and benefits of the reasons for allowing exceptions and has incorporated those thoughts in its analyses of assets held for sale, employee benefit obligations, and operating leases.

5. Ms. Schipper stated that providing defensible reasons for making exceptions as part of this project would be helpful and also might be useful in other projects as well. She suggested that readily resolvable conflicts that would involve changing old guidance might be an additional consideration in determining whether to make a scope exception or allow a treatment alternative. Examples of items that would be readily resolvable by changing old guidance are in-process research and development and assets held for sale. In-process research and development items meet the accounting definition of an asset but are not a recognized asset under current guidance. Requiring the recognition of in-process research and development poses no measurement issues because it is already measured at fair value for expense purposes. Requiring that assets held for sale be recognized at fair value instead of fair value less costs to sell do not raise measurement issues because the item is already measured at fair value and a separate calculation is performed for the costs to sell.

## **TOPIC 2: ASSETS HELD FOR SALE**

### ***Measurement Attribute for Assets Held for Sale***

6. Ms. Tamulis stated that in March 2006, the Board affirmed the fair value measurement principle for applying the acquisition method, which states that in a business combination the acquirer measures each recognized asset acquired and each liability assumed at its acquisition date fair value. She noted that adhering to this principle means that an acquirer would measure long-lived assets held for sale at their acquisition date fair values. However, there are

concerns that under Statement 144 and IFRS 5 the acquirer would immediately remeasure those assets to fair value less cost to sell, thereby causing a day-one gain or loss that would be the result of a change in the accounting measurement attribute rather than a change in the economic value of an asset. Ms. Tamulis noted that the staff agrees that fair value is the most relevant measurement attribute for assets held for sale regardless of whether those assets were previously held and used or acquired in a business combination. Therefore, an exception to the fair value measurement principle should not be made for assets held for sale. Ms. Tamulis stated that some staff members recommend amending Statement 144 to eliminate the cost to sell notion. Ms. Tamulis asked the Board if an acquirer is able to satisfy the recognition criteria for assets held for sale in Statement 144, should the acquirer initially measure those assets at fair value or at fair value less cost to sell and if an amendment to Statement 144 is appropriate.

7. The Board concluded that assets held for sale should not be an exception to the fair value measurement principle and noted that assets held for sale should be accounted for at fair value and not at fair value less cost to sell. To accomplish this, the Board decided to amend Statement 144 to replace “fair value less cost to sell” with “fair value.” Additionally, the Board decided to remove paragraph 32 from Statement 144, which would effectively require an acquirer to meet the recognition criteria at the acquisition date to qualify for asset-held-for-sale treatment rather than if it is probable that the acquirer could meet the recognition criteria within three months of the acquisition date (five Board members agreed; two did not (LFS, GJB)).

8. Mr. Crooch stated that the costs to sell an asset held for sale represent a self-imposed obligation to pay that does not meet the definition of a liability. As such, he proposed that these costs not be netted against fair value. He supported an amendment to Statement 144 to provide consistency in the fair value measurement of assets held for sale without the reduction for costs to sell. Ms. Schipper noted that the measurement of assets held for sale falls into the

readily resolvable category referred to earlier in the discussion. As such, she supported the staff's recommendation.

9. Mr. Batavick stated his belief that net realizable value is a more appropriate measurement attribute than fair value for assets held for sale since that value more accurately reflects the anticipated proceeds from the disposal of the asset. Mr. Batavick does not agree with reconsidering the measurement attribute for assets held for sale in Statement 144 as a part of the business combinations project. Ms. Seidman agreed with Mr. Batavick and stated that she is not prepared to decide that fair value less cost to sell is no longer the proper measurement attribute for assets held for sale. She would prefer to address this issue as a part of the comprehensive discussion of how to select measurement attributes within the conceptual framework project. Ms. Seidman suggested two alternatives to provide internal consistency. First, an exception to the fair value measurement principle in the final business combinations Statement could be made to require initial and subsequent measurement of assets held for sale at fair value less cost to sell. Alternatively, she suggested that the Board could decide to specify the subsequent accounting for an asset held for sale in a business combination to be measured at fair value, which would be consistent with approaches taken by the Board in other situations such as contingencies.

### **TOPIC 3: EMPLOYEE BENEFIT OBLIGATIONS**

10. Ms. Vessels stated that the business combinations Exposure Draft proposes that an acquirer measure pension and postretirement employee benefit obligations using the measurement guidance in Statements 87 and 106 rather than fair value. She stated that if the Board affirms the proposed measurement guidance, that proposal would be an exception to the fair value measurement principle.

11. Ms. Vessels informed the Board that most respondents to the business combinations Exposure Draft that addressed employee benefits agreed with the proposed measurement exception. She stated that although the staff believes

that measuring the benefit liabilities at fair value would likely provide more decision-useful and transparent financial information, the staff believes the Board would need to provide guidance for measuring those liabilities at fair value. The staff believes that comprehensive reconsideration or modification of the guidance related to employee benefits in Statements 87 and 106 is outside the scope of the business combinations project.

***Allowing an Exception to the Fair Value Measurement Principle for All Employee Benefits***

12. Ms. Vessels stated that some respondents questioned the reasons for not including employee benefits in the scope of other standards, aside from Statements 87 and 106, as exceptions in the Exposure Draft. Those comments caused the staff to think about employee benefit obligations more broadly. The various types of employee benefits within the scope of the following standards were not proposed as exceptions to the fair measurement principle in the Exposure Draft:

- a. APB Opinion 12, *Omnibus Opinion—1967*
- b. FASB Statement No. 88, *Accounting for Settlement and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*
- c. FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*
- d. FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

13. Ms. Vessels noted that those standards provide different and varying amounts of recognition and measurement guidance for employee benefits. The staff believes there are two alternatives for the Board to consider:

- a. **Alternative One: A broad exception for all employee benefit obligations.** Therefore, the acquirer would measure and recognize all employee benefits using the guidance in existing standards rather than fair value. The acquirer would be required to recognize employee benefit obligations within the scope of the other standards by carrying forward its accounting policies to those newly acquired

employee benefit obligations and accounting for them in accordance with those standards.

- b. **Alternative Two: An exception to the measurement principle for only those employee benefit obligations that existing standards permit to be measured using the guidance in Statements 87 and 106.** Therefore, the proposed exception in the Exposure Draft would be expanded to include postemployment benefits in the scope of Statement 112 that are measured using the guidance in Statements 87 and 106.

14. Ms. Vessels stated that the staff is divided on its recommendation. Some staff members support Alternative One because of its simplicity. A broad scope exception would eliminate the need to apply two different accounting methods for the same benefit obligation depending on how the obligation was incurred. Those staff members also noted that the guidance in particular existing standards might often produce measures that do not differ significantly from fair value. Other staff members support Alternative Two because they believe the measurement complexities that exist in Statements 87 and 106 do not exist for other employee benefit obligations. Thus, there is no reason to depart from the fair value measurement principle for those other obligations. Those staff members also noted that Alternative Two is consistent with current requirements under FASB Statement 141, *Business Combinations*, and that constituents have not cited the measurement and recognition of those other employee benefits at fair value as practice problems.

15. The Board decided to make a broad exception for all employee benefit obligations (Alternative One). That decision was reached because the current guidance for employee benefits is so voluminous and complex that it would be impracticable to require an acquirer to use the fair value measurement attribute for employee benefits in a business combination (all Board members agreed).

***Proposed Amendments to Statements 87 and 106 That Would Require an Acquirer to Recognize Expected Changes to the Acquiree's Defined Benefit Plans in Postcombination Financial Statements***

16. Ms. Vessels stated that this issue relates to whether expected changes to an acquiree's defined benefit plan should be recognized as part of the liabilities assumed in a business combination or as a postcombination event. Statements 87 and 106 currently require an acquirer to consider the effects of expected plan amendments, terminations, or curtailments in the measurement of the projected benefit obligation assumed at the acquisition date. In the business combinations Exposure Draft, the Board proposed amending that guidance in Statements 87 and 106 to require the effects of those actions be recognized by the acquirer when made in its postcombination financial statements. Those proposed amendments were proposed to clarify that an acquirer should recognize assets it acquires and liabilities it assumes and to converge with IAS 19, *Employee Benefits*. IAS 19 already requires that gains or losses on the curtailment or settlement of a defined benefit plan be recognized when the curtailment or settlement actually occurs.

17. Ms. Vessels recommended that the Board affirm the proposed amendments to Statements 87 and 106 so that changes to the acquiree's employee benefit plans that the acquirer expects to make would be a postcombination expense rather than included in the measurement of the assumed benefit plan liabilities.

18. The Board affirmed the proposed amendments to Statements 87 and 106 in the Exposure Draft (all Board members agreed). Mr. Herz stated that a disclosure for the curtailment or settlement of defined benefit plans would be beneficial for financial statement users.

***Expected Withdrawal Liabilities from Multiemployer Plans at the Acquisition Date***

19. Ms. Vessels stated that the standard sections of Statements 87 and 106 do not provide recognition and measurement guidance for multiemployer plans in

a business combination. However, the basis for conclusions in Statements 87 and 106 state that an acquirer should recognize a withdrawal liability from a multiemployer plan in a business combination when the withdrawal liability is probable. Outside of a business combination, an acquirer would recognize a withdrawal liability using the guidance in FASB Statement No. 5, *Accounting for Contingencies*, if it is probable (or disclose the liability if it is reasonably possible). The staff notes that to be consistent with the proposed amendments to Statements 87 and 106, an acquirer should be prohibited from recognizing expected withdrawal liabilities at the acquisition date. However, if the Board decided to amend Statements 87 and 106 to prohibit an acquirer from recognizing expected withdrawal liabilities in a business combination, the amendment would create an inconsistency between accounting for a withdrawal liability in a business combination and accounting for a withdrawal liability outside of a business combination.

20. The Board concluded that withdrawal liabilities in a business combination should be recognized consistent with the current requirements in Statements 87 and 106 for accounting for withdrawal liabilities. That is, the acquirer would apply the recognition criteria in Statement 5 if the withdrawal liability is probable (six Board members agreed; one did not (GMC)). Mr. Crooch believes that a withdrawal liability should be a postcombination expense, which is consistent with the Board's previous decision for accounting for expected plan amendments to defined benefit plans in a business combination.

#### **TOPIC 4: OPERATING LEASES**

21. Ms. Tamulis stated that the business combinations Exposure Draft proposes that assets and liabilities related to operating leases in which the acquiree is the lessee should be recognized as a net amount rather than separately recognized, which would be an exception to the combined recognition and measurement principle. She noted that nearly all respondents who commented on the proposed guidance for leases agreed with the proposal but requested that the Board clarify:

- a. That the separate lease asset and related liability are not recognized because they are netted together.
- b. Whether the measurement attribute for the net asset or liability related to an acquiree's operating leases is fair value.
- c. Whether recognizing a market-rate lease at an amount greater than zero would be permitted.

***Operating Lease in Which the Acquiree Is the Lessee***

22. Ms. Tamulis stated that the Exposure Draft proposes that for operating leases in which the acquiree is the lessee, only the acquirer would be required to recognize an intangible asset (liability) for the acquiree's interest in a net beneficial (onerous) contract rather than being required to separately recognize an asset and a related liability. Without that guidance, the recognition principle might be interpreted as requiring the acquirer to recognize a separate asset for the acquiree's rights to use assets according to the lease agreement, including related renewal options and other rights, and a separate liability for its obligations to make required lease payments. However, Ms. Tamulis noted that FASB Statement No. 13, *Accounting for Leases*, and IAS 17, *Leases*, prohibit separate recognition of assets and liabilities related to a lessee's operating leases. If the final business combinations Statement required or allowed separate recognition of the asset and related liability, the Board would need to address how the asset and the liability should be accounted for after the acquisition date. This could create the need to develop a new model for operating lease accounting in the business combinations project. She stated that the staff does not believe that is appropriate, especially since the leases project team is in the process of developing an agenda proposal and plan for a joint project. Therefore, the staff believes the Board should affirm the guidance proposed in the Exposure Draft for operating leases in which the acquiree is the lessee.

23. The Board affirmed the guidance in the Exposure Draft for the reasons provided by the staff. Furthermore, the Board decided that the net recognition guidance for operating leases should be characterized as implementation guidance in the final Statement (all Board members agreed).

### ***Operating Lease at Market Terms with Greater Net Value Than Zero***

24. Ms. Tamulis stated that respondents to the Exposure Draft requested clarification as to whether an operating lease at market terms may be recognized at an amount greater than zero. She noted that this question arose because of paragraph B173 of Statement 141, which states:

. . .the [FASB] Board has been informed that in current practice, the amount assigned to acquired operating lease contracts (when the acquired entity is the lessor) and customer contracts often is based on the amount by which the contract terms are favorable relative to market prices at the date of acquisition. Thus, in some cases, no amount is assigned to lease and other contracts that are “at the money”—that is, when the contract terms reflect market prices at the date of acquisition. **The Board observed, however, that such “at the money” contracts are bought and sold in exchange transactions—the purchase and sale of airport gates (an operating lease) within the airline industry and customer contracts in the home security industry are two examples of those exchange transactions. The Board believes that those transactions provide evidence that a contract may have value for reasons other than terms that are favorable relative to market prices. The Board therefore concluded that the amount by which the terms of a contract are favorable relative to market prices would not necessarily represent the fair value of that contract. [Emphasis added.]**

25. Ms. Tamulis noted that operating lease contracts at market terms might have value for reasons other than terms that are favorable relative to market prices. For example, an operating lease contract might have value because an entity is willing to pay more than the market rate to gain entry into a market with limited access or to obtain access to existing customer relationships. She stated the staff’s belief that in such circumstances the intangible asset to which that value is attributable should be recognized separately. That is, even if an acquiree’s operating lease contract is at market terms, the acquirer must still recognize any intangible assets that create value in an at-market contract. Ms. Tamulis asked for the Board’s views on this issue.

26. Ms. Seidman questioned whether it would be possible to distinguish between the “in-the-moneyness” of a lease and the value relating to intangible factors, such as access to a market. She also questioned whether it made sense

to separately account for a liability for an off-market lease and an asset relating to the intangible associated with that right to use. Mr. Trott noted that the intangible might be assumed to be implicitly renewable whereas the lease would not be assumed to be renewable. Mr. Leisenring agreed and noted that the intangible might therefore have a different useful life than the lease term, which would necessitate separate accounting.

27. The Board concluded that the acquirer should separately recognize any intangible assets that create value in an at-market contract for the reasons provided by the staff (all Board members agreed).

Follow-Up Items:

28. At the May 25, 2006 IASB Board meeting, the IASB Board raised an issue regarding accounting for operating leases in which the acquiree is the lessor. The issue deals with whether a lease affects the fair value of the leased asset. The staff plans to further analyze that issue and present its findings at a future Board meeting.

General Announcements:

None.