MINUTES

To: Board Members

From: Business Combinations: Applying the Acquisition Method Team (Vessels, Ext. 456)

Subject: Minutes of the April 24, 2007 Joint Meeting **Date:** May 7, 2007

cc: FASB: Bielstein, Smith, MacDonald, Bossio, Tamulis, Posta, Vessels, Willis, Cafini, Delmonico, Rhine, Glotzer, Lapolla, Chookaszian, Polley, Lott, Gabriele, Sutay, Carney, Allen, FASB Intranet; IASB: Leisenring, Upton, Hickey, Teixeira, Buschhueter, Quiring, Eastman, Kwiatkowska

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Topics: Sweep Issues and Cost-Benefit Analysis

Basis for Discussion: Board Memorandums No. 57 and No. 58

Length of Discussion: 9:00 to 10:45 a.m.

Attendance:

Board members present: FASB: Herz, Batavick, Crooch, Linsmeier, Seidman, Trott, and Young

IASB: Tweedy, Barth, Bruns, Cope, Danjou, Engström, Garnett, Gélard, Jones, Leisenring, McGregor, O'Malley, Smith, and Yamada

Staff in charge of topic: Tamulis and Teixeira

Other staff at Board table: Eastman, Buschhueter, and Quiring

Summary of Decisions Reached:

The FASB and the IASB discussed remaining convergence issues and a request from the staff to begin the drafting and preballoting process for the final Statements on business combinations and noncontrolling interests.

1. The Boards discussed and reached convergence on the following issues for which the Boards had reached different conclusions in redeliberations:
   a. The IASB decided to converge with the FASB and require that an acquirer measure and recognize an asset subject to an operating lease at its acquisition date fair value without considering the terms of the operating lease. If the terms of an operating lease are favorable (unfavorable) relative to market terms as of the acquisition date, the acquirer would recognize an intangible asset (liability) separately from the asset subject to the operating lease.
   b. The FASB decided to converge with the IASB and retain the guidance in paragraph 32 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets,* that allows an acquirer to classify long-lived assets as held for sale if the sale is expected to be completed within one year and the other criteria in Statement 144 are probable of being met within a short period from the acquisition date (usually within three months). That guidance is similar to the guidance in IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations.*
   c. The Boards decided that if, in a business combination, an acquirer assumes a liability but requires the former owners of the acquiree to reimburse the acquirer if and when the acquirer pays the liability, the acquirer should recognize the asset for the reimbursement (indemnification) at the same amount as the related assumed liability.
   d. FASB Statement No. 141, *Business Combinations,* allows an acquirer to designate as the effective date the end of an accounting period between the date the business combination is initiated and the date the business combination is consummated. The Boards agreed that the final business combinations Statement should not retain that guidance.
   e. The FASB agreed to adopt the approach preferred by the IASB and include a principle in the final business combinations Statement that an acquirer should classify or designate the assets, liabilities, and equity instruments acquired or assumed based on the conditions that exist at the acquisition date. The Boards agreed that leases and insurance contracts acquired in a business combination are exceptions to that principle and should be classified based on the terms and conditions that existed at their inception (or at the date of the last substantive modification).
2. The Boards did not reach convergence on the measurement of noncontrolling interests in a business combination. The FASB decided to require that

noncontrolling interests be measured at fair value at the acquisition date. The IASB decided to **permit** an acquirer to measure noncontrolling interests at fair value or as its proportionate interest in the acquiree's identifiable net assets on an acquisition-by-acquisition basis. The Boards decided that while they would have preferred to have a converged measurement attribute for noncontrolling interests, they agreed that the proposed Statements will substantially converge the accounting for business combinations.

3. The Boards discussed the costs and benefits of the proposed Statements and agreed that the benefits of the improved accounting that will result from the proposed Statements outweigh the costs of compliance. The Boards also agreed that there are no issues that would cause the Boards to re-expose either proposed Statement since all of the changes made during redeliberations were in response to comments from respondents and will make the Statements easier for preparers to implement. Therefore, the Boards instructed the staff to begin the drafting and preballoting process for the final business combinations and noncontrolling interests Statements.

Objective of the Meeting:

The objective of the meeting was for the Boards to:

1. Reach convergence on any remaining issues or conclude that convergence was not necessary to issue final Statements
2. Discuss the costs and benefits of the Statements and consider whether re-exposure of either the proposed business combinations or noncontrolling interests Statements is necessary
3. Obtain permission to begin the drafting process for the final business combinations and noncontrolling interests Statements

The objectives were met.

Matters Discussed and Decisions Reached:

TOPIC 1: SWEEP ISSUES

Ms. Tamulis asked the Boards to consider the following sweep issues that were identified by the staff as a result of the Boards redeliberations to date:

a. Accounting for an off-market portion of an operating lease in which the acquiree is a lessor
b. Classifying non-current assets as held for sale in a business combination
c. Accounting for an indemnification asset and the related liability
d. Designating an effective date other than the acquisition date

e. Classifying and designating assets, liabilities, and equity instruments acquired or assumed in a business combination

f. Measuring noncontrolling interests in a business combination.

Accounting for an Off-Market Portion of an Operating Lease in which the Acquiree Is a Lessor

In February 2007, the IASB and the FASB reached different conclusions related to the accounting for the above- or below-market terms of an operating lease in which the acquiree is a lessor. Because of this divergence, Ms. Tamulis asked the Boards to again consider whether the off-market value attributable to the lease should be aggregated with or recognized separately from the underlying asset.

The IASB decided to converge with the FASB and require that an acquirer measure and recognize an asset subject to an operating lease at its acquisition date fair value without considering the terms of the operating lease. If the terms of an operating lease are favorable (unfavorable) relative to market terms as of the acquisition date, the acquirer would recognize an intangible asset (liability) separately from the asset subject to the operating lease.

Classifying Non-Current Assets as Held for Sale in a Business Combination

During redeliberations, the FASB tentatively decided to eliminate the guidance in paragraph 32 of Statement 144 that allows an acquirer to classify long-lived assets as held for sale if the sale is expected to be completed within one year and the other criteria in Statement 144 are probable of being met within a short period from the acquisition date (usually within three months). The IASB did not decide to remove the similar guidance in IFRS 5 during redeliberations. The FASB reconsidered its earlier decision and decided to retain the guidance in paragraph 32 of Statement 144. The FASB agreed with the IASB that allowing an acquirer to classify long-lived assets as held for sale at the acquisition date might provide better information and reduce the costs to measure the assets and liabilities if the acquiree had been actively marketing the disposal group as a whole.

Accounting for an Indemnification Asset and the Related Liability

The Boards discussed the potential inconsistency that might arise when measuring an asset for an indemnification at fair value at the acquisition date while the related liability would be recognized using a different recognition threshold or measured using a different measurement attribute at the acquisition date (for example, a liability for a tax uncertainty that is measured in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, or IAS 12, *Income Taxes)*.

The Boards decided that if, in a business combination, an acquirer assumes a liability but requires the former owners of the acquiree to reimburse the acquirer if and when the acquirer pays the liability, the acquirer should recognize the asset for the reimbursement (indemnification) at the same amount as the related assumed liability.

Designating an Effective Date Other Than the Acquisition Date

For convenience, Statement 141 allows an acquirer to designate as the effective date the end of an accounting period between the date the business combination is initiated and the date the business combination is consummated. The Boards considered retaining that guidance, but ultimately decided not to allow the acquirer to designate an effective date other than the acquisition date.

Classifying and Designating Assets, Liabilities, and Equity Instruments Acquired or Assumed in a Business Combination

In April 2007, the IASB and the FASB reached different tentative conclusions about classifying and designating assets, liabilities, and equity instruments acquired or assumed in a business combination. The staff noted that the absence of guidance in IFRSs means that the IASB could not adopt the FASB's preferred approach of referring to existing guidance.

The FASB agreed to adopt the approach preferred by the IASB and include a principle in the final business combinations Statement that an acquirer should classify or designate the assets, liabilities, and equity instruments acquired or assumed based on the conditions that exist at the acquisition date. The Boards agreed that leases and insurance contracts acquired in a business combination are exceptions to that principle and should be classified based on the terms and conditions that existed at their inception (or at the date of the last substantive modification). By not making an exception for embedded derivatives, the accounting requirements for such instruments acquired in a business combination will be converged.

Measuring Noncontrolling Interests in a Business Combination

The staff noted that the IASB and the FASB reached different conclusions about the measuring of noncontrolling interests in a business combination during redeliberations. As a result, the Boards were given an opportunity to reconsider the measurement attribute for noncontrolling interests.

The Boards did not reach convergence on the measurement of noncontrolling interests in a business combination. The FASB decided to require that noncontrolling interests be measured at fair value at the acquisition date. The IASB decided to **permit** an acquirer to measure noncontrolling interests at fair value or as its proportionate interest in the acquiree’s identifiable net assets on an acquisition-by-acquisition basis.

Both Boards decided that, although they would have preferred to have a converged measurement attribute for noncontrolling interests, the Boards have considered and converged on as many differences as practicable. There are several areas for which the Boards are not able to converge because of differences in the U.S. GAAP or IFRS requirements outside a business combination. The Boards agreed that the final Statements will align most of the accounting for business combinations.

TOPIC 2: COST-BENEFIT ANALYSIS AND PERMISSION TO BEGIN DRAFTING FINAL STATEMENTS

The Boards considered the cost-benefit analysis prepared by the staff and instructed the staff to begin the drafting process for the final business combinations and noncontrolling interests Statements because:

a. The benefits of the improved accounting that will result from the proposed Statements outweigh the costs of compliance

b. There are no issues that would cause the Boards to re-expose either proposed Statement since all of the changes made during redeliberations were in response to comments from respondents and will make the Statements easier for preparers to implement.

Ms. Barth and Messrs. Smith and Garnett, from the IASB, stated that they plan to dissent to the final business combinations standard. Ms. Barth and Mr. Smith noted that they were dissenting based on the IASB's decision to permit an acquirer the option to measure noncontrolling interests at fair value.

Messrs. Garnett, Gélard, Engström, Yamada, and Danjou, from the IASB, stated that they plan to dissent to the final noncontrolling interests standard.

Ms. Seidman, from the FASB, stated that she plans to dissent to the business combinations and noncontrolling interests Statements. Ms. Seidman dissented to both Statements for the following primary reasons. She stated her view that there is a disconnection between the consideration paid, which is based on a meeting of the minds at the agreement date and the subsequent values ascribed to the components of the business, which are based on values as of the (later) acquisition date. Those values, under FASB Statement No. 157, *Fair Value Measurements,* will be exit prices at the acquisition date, which will not be the same as the "entry price" at the agreement date because of fluctuations in value and differences in the valuation premise for some items such as assets acquired for defensive reasons and some liabilities. Those effects, along with changes in the value of the consideration itself, and the exceptions made for recognition and measurement of certain items will be absorbed in goodwill. Therefore, goodwill is essentially a plug, not an asset recorded at its fair value. Selection of the acquisition date contributes to the likelihood of a "bargain purchase," which would be less likely to arise under an agreement date approach in which the consideration paid is presumptively the fair value of the transaction as a whole. This difference also would arise in partial acquisitions, which makes the conceptual argument for recognizing full goodwill less compelling.

Ms. Seidman also objects to the accounting for subsequent transactions involving noncontrolling interests. She stated that when an entity gains or loses control, she objects to the previous investment (or remaining investment) being remeasured through earnings because, under current accounting standards, gains and losses on cost-method investments are only recognized in earnings when a security is sold (other than impairment). She noted that when all financial instruments are carried at fair value, that issue will go away. She also noted that classifying noncontrolling interests as equity is an issue that will be affected by the Board's deliberations on liabilities and equity, so she thinks it is premature to make that conceptual change now.

Follow-Up Items:

None.

General Announcements:

None.