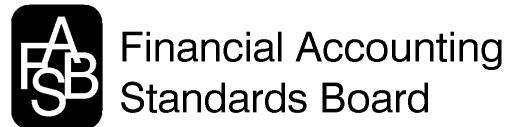


MINUTES



To: Board Members

From: Convergence Team
(Rohrkemper, ext. 284)

Subject: Minutes of the October 23, 2003 Board Meeting **Date:** October 29, 2003

cc: Bielstein, Leisenring, Petrone, Smith, Swift, Polley, Gabriele, Project Team
(Belot, Cassel, Coburn, J. Johnson, Rohrkemper, Vernuccio) Tovey,
Thompson, Allen (GASB), Bean (GASB), FASB Intranet (e-mail), Sutay

Topics: Short-Term Convergence Update and Scope, Liability Classification, Income Taxes

Basis for Discussion: Board memoranda dated October 8 and 14, 2003, and IASB Agenda Paper 11

Length of Discussion: Starting Time: 10:25 a.m. Concluding Time: 12:05 p.m.

Attendance:

Board members present: FASB: Herz, Batavick, Crooch, Schieneman,
 Schipper, Seidman, Trott

 IASB: Tweedie, Barth, Bruns, Cope, Garnett, G  lard,
 Jones, Leisenring, McGregor, O'Malley, Schmid, J. Smith,
 Whittington, Yamada

Board members absent: None

Staff in charge of topic: FASB: Johnson
 IASB: Bugg, McGeachin

Other staff at Board table: FASB: Bielstein, Cassel, Rohrkemper
 IASB: Upton, Fleming, Stevenson

Outside Participants: None

Summary for ACTION ALERT:

The FASB and the IASB discussed the state of the project on short-term convergence and possible additions to its scope. The Boards affirmed that the scope of Phase II of the project should comprise issues related to convergence on income taxes, interim reporting, and research and development. The Boards decided not to add any further convergence issues to the scope of the project at this time.

The FASB and the IASB decided that a liability for which, at the balance sheet date, a loan agreement has been breached but the creditor has agreed to effect a grace period during which the debt is not callable due to the breach for a period less than 12 months should be classified as a current liability, even if the breach is (a) expected to be rectified prior to the expiration of the grace period, or (b) rectified after the balance sheet date but before the financial statements are issued. The FASB decided to change its definition of current liability to match that of the Exposure Draft of revised IAS 1, *Presentation of Financial Statements*, which reads:

A liability shall be classified as current when it:

- (a) is expected to be settled in the normal course of the entity's operating cycle; or
- (b) is due to be settled within twelve months of the balance sheet date.

All other liabilities shall be classified as non-current.

The Boards decided on the general approach to be taken for convergence between FASB Statement No. 109, *Accounting for Income Taxes*, and IAS 12, *Income Taxes*. Under this approach, the IASB would first consider all of the differences between the standards and reach tentative conclusions as to what it believes are the highest quality solutions. The IASB would then present for deliberation by the FASB what it believes to be the highest quality converged standard. Any differences between the IASB's tentative conclusions and the conclusions to be reached by the FASB in its deliberations will then be reconsidered.

Matters Discussed:

Project Update and Scope

The FASB and the IASB discussed the state of the project on short-term convergence and possible additions to its scope. The staff updated the Boards on the progress made on Phase I of the project, which involves the two Boards examining each other's recent publications to see whether they provide a better solution than existing requirements.¹ The staff noted that Phase II involves both Boards examining the remaining differences between US GAAP and IFRS that are not covered by major projects. The scope of this phase currently comprises issues related to convergence on income taxes, interim reporting, and research and development. The staff examined issues of divergence between the FASB and IASB proposed possible additions to the scope of Phase II of the project on short-term convergence.

The Boards discussed whether to pursue convergence on the issue of the components approach to depreciation within the short-term convergence project. The staff reported on this issue of divergence. IAS 16, *Property, Plant and Equipment*, requires that components of an asset that have different useful lives be accounted for separately, including the costs of a major inspection. Current US GAAP is silent on the issue of componentization, but an AICPA draft Statement of Position not yet reviewed by the FASB proposes a components approach that is similar, but not identical to, the approach in IAS 16. Under the AICPA proposal, the costs of planned major maintenance activities could not be regarded as a separate component.

Mr. Trott expressed concern about converging on the components approach to depreciation given limited staff resources and an abundance of other convergence issues that constituents have identified as needing change. Mr. Leisenring pointed out that the AICPA draft Statement of Position, if issued, would create divergence on the issue of

¹ As part of Phase I, the FASB is expecting to publish in the fourth quarter of 2003 Exposure Drafts on issues arising from the IASB improvements project. Those Exposure Drafts will propose changes to the accounting for (a) accounting changes and error corrections, (b) inventory measurement, (c) exchanges of nonmonetary assets, and (d) earnings per-share. The IASB as part of Phase I has proposed or will propose changes to the accounting for (a) disposal of noncurrent assets, (b) employee benefits, and (c) government grants. Also as part of Phase I, the FASB and IASB will expose for comment changes in the classification of certain liabilities discussed at the October 23, 2003 joint meeting.

replacement in addition to the difference in the components approach to depreciation noted by the staff. The Boards decided not to add the issue of components to the scope of the project on short-term convergence and directed the staff to further consider the convergence implications of the forthcoming AICPA Statement of Position.

The Boards discussed whether to pursue within the short-term convergence project convergence on equity accounting issues for associates acquired and held for disposal and for conformity of accounting policies. Mr. Herz expressed concern that a higher quality standard on equity accounting could be reached if the Boards considered the issues in the context of a major joint project rather than addressing only specific convergence issues within the short-term convergence project. Messrs. Leisenring and Trott agreed. Ms. O'Malley pointed out that existing IFRS permits, but does not require, the equity accounting required under US GAAP. Therefore, no reconciling items are necessary for equity accounting. The Boards decided not to add this issue to the scope of the project on short-term convergence.

The Boards discussed whether to make limited amendments to the accounting for post-retirement benefits in the interest of convergence. The staff proposed as possible amendments to IAS 19, *Employee Benefits*, (1) removing the options for deferred recognition and (2) prohibiting the presentation of an expected return on assets separate from other changes in the plan assets' value. Members of each Board expressed concern regarding whether it is possible to improve some aspects of IAS 19 (a) without reconsidering other major issues such as the measurement of the plan liabilities and (b) in the absence of a revised statement of comprehensive income. The Boards directed the staff in charge of the project on short-term convergence to further consider the scope of a limited project on post-employment benefits.

The Boards decided not to consider issues of disclosure as part of the joint project on short-term convergence. The Boards view differences in recognition and measurement as issues of higher priority than differences in display.

The Boards discussed whether to include in the scope of the short-term convergence project issues resulting from divergent interpretations of converged principles. The staff noted that it might be beneficial to review existing EITF and IFRIC interpretations (1)

from the point of view of convergence and (2) to see if the guidance therein should be incorporated into a standard or relegated to material of an educational nature. Ms. Schipper noted that issues of interpretational divergence are in some ways more important than issues of divergent principles. In her view, divergent interpretations of converged principles are problematic in that they result in equally prevalent but “buried” differences. The Boards directed the staff to further consider the extent to which there exist divergent EITF and IFRIC interpretations of standards that are converged in principle.

Liability Classification of Debt Callable because of a Breach of Covenant

The Boards discussed the classification of debt that is callable because of a breach of a debt covenant at the balance sheet date, but is otherwise due to be settled more than 12 months after the balance sheet date, if the following conditions apply:

- (a) The lender has agreed *by the balance sheet date* to provide a grace period – a period over which the debt will not be callable because of the breach of the covenant;
- (b) That grace period will expire *within 12 months of the balance sheet date* (or within one operating cycle, if longer); and
- (c) At the time that the financial statements are issued, the grace period is ongoing and either:
 - (i) The breach has already been rectified, or
 - (ii) It is *probable*² that the breach will be rectified before the end of the grace period.

The staff noted that the debt described above would be classified as noncurrent under the tentative decisions of the FASB, and as current under the tentative decisions of the IASB. Attachment A summarizes the tentative decisions of each Board.

The Boards agreed to classify the above-described debt as current. [Three FASB members objected: LFS, EWT, GJB; no IASB members objected.] Proponents of this view argued that absent having the unencumbered right to not settle the debt for 12 months (or one operating cycle, if longer), the entity should classify the debt as current because the decision to call the debt is not within the control of the entity. Ms. Seidman disagreed. She expressed concern that classifying this type of debt as current would be

² *Probable* is defined in FASB Statement No. 5, *Accounting for Contingencies*, as “likely to occur” and is used in the same sense here.

inconsistent with the classification of the assets used to pay off this debt, since asset classification, under both US GAAP and IFRS, permits consideration of management's expectations of whether the breach would be rectified.

The staff recommended that, given the FASB's decision to converge with the IASB's classification of the above-described debt, the FASB adopt the definition of a current liability in IAS 1, *Presentation of Financial Statements*, as revised by the Exposure Draft of Proposed Improvements to International Accounting Standards. That definition reads:

A liability shall be classified as current when it:

- (c) is expected to be settled in the normal course of the entity's operating cycle; or
- (d) is due to be settled within twelve months of the balance sheet date.

All other liabilities shall be classified as non-current.

The Board agreed with the staff recommendation. [Three members objected: LFS, EWT, GJB.]

Income Taxes

The IASB staff updated the Boards on the progress to date on their consideration of income taxes within Phase II of the project on short-term convergence. The staff found that the Statement 109 and IAS 12 have the same general principle—the balance sheet liability approach whereby an entity recognizes deferred tax assets and liabilities for temporary differences (differences between the carrying amount of an asset or liability in the balance sheet and its tax base) and for operating loss and tax credit carryforwards. However, in their respective standards, each Board provided numerous exceptions to the basic principle—some exceptions being similar, and some being different. The IASB has examined some of these differences and reached tentative conclusions on what it believes are the highest quality solutions.

The Boards decided on the general approach to be taken for convergence between FAS 109 and IAS 12. Under this approach, the IASB would first consider all of the differences between the standards and reach tentative conclusions as to what it believes are the highest quality solutions. The IASB would then present for deliberation by the FASB what it believes to be the highest quality converged standard. Any differences

between the IASB's tentative conclusions and the conclusions to be reached by the FASB in its deliberations will then be reconsidered.

Follow-up Items:

The Boards directed the staff to further consider within the joint project on short-term convergence:

1. The forthcoming Statement of Position from the AICPA on components depreciation and the extent of its convergence with the requirements of IAS 16, *Property, Plant and Equipment*,
2. The scope of a limited project on post-employment benefits, and
3. The extent to which there exist divergent EITF and IFRIC interpretations of standards that are converged in principle.

General Announcements:

None.