MINUTES

Financial Accounting Standards Board

To: Board Members

From: Nesta, ext. 330

Time Code: A PERFRPT

Subject: Minutes of the November 27, 2002 Board Meeting

Date: December 3, 2002

cc: Bielstein, Leisenring, Petrone, Smith, Swift, Polley, Project Team, Thompson, FASB Intranet (e-mail), Sutay, Gabriele

Topic:	Discussion of recent IASB decisions and the project's next step
Basis for Discussion:	Staff memorandum dated November 22, 2002
Length of Discussion:	<u>Starting Time:</u> 9:00 a.m. <u>Concluding Time:</u> 11:30 a.m.
Attendance:	
Board members present:	Herz, Crooch, Foster, Schieneman, Schipper, Trott, and Wulff
Board members absent:	None
Staff in charge of topic:	Sullivan and Bossio
Other staff at Board table:	Bielstein, Leisenring, Nesta
Outside participants:	Richard Barker (IASB, via phone)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

Ms. Sullivan opened by stating that the staff had requested the meeting to seek input from Board members on the IASB's differentiation of *income flows* and *remeasurements*, as well as asking how the FASB staff should proceed forward with this project. She then asked Board members if they believe that this project should develop a primary objective or principle that would underpin decisions about display of revenue, expenses, gains, and losses in the statement of comprehensive income and, if so, what that objective should be. She noted in the memo that the staff had stated that predictive and feedback value be considered the principle objective for the project. However, based upon individual discussions with Board members and responses to the questionnaire that was circulated with the Board memo, Board members had differing views on that objective. Ms. Sullivan then asked if Board members would discuss their views related to the primary objective.

Mr. Foster commented that the predictive and feedback value objective sounds good but that the work performed by the IASB to date does not achieve that objective. He stated that the predictive value and feedback value objective is so broad that any decision made wouldn't conflict with it. He added that the principles articulated in FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, could be used to identify a narrower objective.

Ms. Sullivan indicated that the staff is trying to tie the objective of this project to the Conceptual Framework. She noted that Concepts Statement 1 is too broad to use as a guide in determining what differentiation or disaggregation should be presented in the statement of comprehensive income. Additionally, that objective is directly related to relevance of accounting data as discussed in FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information.* However, if Board members believe that there should be another objective, rather than those discussed in the Concepts Statements, the staff would like to understand those objectives

Mr. Trott stated that using the Concepts Statements as a guide is a good idea but the predictive and feedback value objective is at too high a level to be useful in making decisions related to presentation issues on the statement of comprehensive income. He added that the IASB's principle objective does not assist in decision making by users either. He suggested that the staff develop a narrower objective as a way to differentiate information in the statement of comprehensive income. Mr. Trott noted that an appropriate level of differentiation may be to present information that is recurring from information that is nonrecurring, or that another way might be to present items that are objectively measured from information that is subjectively measured. He added that narrower objectives may be more useful in making decisions about how and whether information should be differentiated in the statement of comprehensive income.

Mr. Wulff stated that Concepts Statement 1 is helpful in establishing an objective. He indicated that, in his view, the starting point for a primary objective should be based on the objective of financial reporting information noted in Concepts Statement 1 that says that financial reporting information should help users assess the amounts, timing, and uncertainty of an entity's future cash flows. Based on that view, he suggested that the primary objective should be to focus on a differentiation that would allow users to make decisions on operating cash flows apart from financing cash flows. He added that the objective could also lead to mark-to-market adjustments being differentiated from other types of financial information but, for operational reasons, he would define mark-to-market adjustments more narrowly than the IASB's current definition of remeasurements.

Mr. Schieneman questioned the usefulness of the Concepts Statements in developing a primary objective for the project. He agreed that one could not argue with the objective of predictive value. However, he added that he believes consolidated financial statements have little predictive value. He stated that financial reporting is used mainly for feedback purposes and that the objective should be developed around feedback value alone. He also commented that he is concerned with the project's direction and that the Board has strayed from what was agreed to in the project's prospectus. Mr. Schieneman stated that in the prospectus the Board agreed to examine the use of metrics and that he viewed this project as implementing only incremental changes to the current statement of income. He stated that many constituents thought that the project would mitigate the use of pro forma earnings; however, he believes that the project's current direction would instead exacerbate the use of pro forma earnings. He added that convergence between the FASB and the IASB is a two-way street and that the Board has gotten bogged down with the IASB's approach.

Ms. Schipper stated that, in response to Ms. Sullivan's initial question, there needed to be a principle objective because without one there would be chaos. She disagreed with the notion that predictive value and feedback value are unobjectionable and unoperational and noted that there has been no better principle presented. She also stated that both the IASB and FASB have concerns about the operationality and consistency of the IASB's approach. She stated that the Board would need to determine whether convergence was a top priority and, therefore, that the FASB should continue to follow the IASB and recommend changes, or if the FASB does not prefer the IASB approach for segregating revenues, expenses, gains, and losses it would need to develop a better method of differentiating financial information that would more appropriately satisfy the objective. She warned that working entirely independent of the IASB would not further convergence but would most likely cause divergence.

Mr. Leisenring stated that, like Mr. Foster, he was skeptical of the IASB approach. However, he added that he could not prove that the IASB's approach is entirely without merit. He stated that the IASB's objective does not mention feedback value but that he believes the model has appropriately captured the concept. He added that although this is the case, the IASB has failed to articulate what feedback value means.

Mr. Crooch stated that when he considered whether a certain differentiation and display approach would enhance the predictive or feedback value of financial information he determined that this was an empirical question that he does not currently have enough background support to answer. He stated that he viewed a differentiation of information such as whether an item of revenue, expense, gain, or loss was realized or a fair value adjustment may be an objective because the Board is planning to implement an increase of fair value measurements into the financial statements. He added that he was not opposed to creating a better model than the IASB currently has but that he does not think the IASB model is a bad one. He stated that he did disagree with some of the proposed IASB splits but felt that the FASB Board and staff could improve upon the IASB's model.

Mr. Bossio stated that the staff has looked at convergence and determined that the objectives of the IASB and the FASB aren't far apart. He stated that the main question is whether convergence is the overriding objective for the Board or whether the Board would like to develop its own approach, which might not parallel the IASB's approach.

Mr. Herz stated that the overriding objective of enhancing the predictive and feedback value of information presented in the statement of comprehensive income is a good objective. He stated that the way the IASB has approached their project is the way he would have thought about financial information from an economic standpoint. However, he noted that operationalizing the IASB approach might be too difficult because of the current mixed-attribute model of accounting, which does not record or report financial information the way an economist would require. He stated that the Board must decide whether to accept or reject the IASB's conceptual approach including the exceptions and inconsistencies that exist in the current model. He stated that if the Board believes the IASB approach is worth a try, then the FASB should continue along the same path and communicate any concerns regarding the direction of the project to the IASB. If the Board does not believe the IASB's approach is worth a try, then the FASB should try to develop some incremental enhancements to the information that is currently provided In the statement of comprehensive income. He added that he has doubts that the IASB model can be made more robust. He noted that if the FASB were to proceed on its own it might conduct a less ambitious project than the one contemplated by the IASB. He stated that convergence can be accomplished by either agreeing on the same answer or by producing a competitive model and testing to see which one better serves the needs of the users.

Mr. Trott stated that he would prefer the FASB to develop its own model and then compare that model with the IASB's model. He noted that the staff would most likely encounter many of the same problems faced by the IASB. Additionally he noted that any method used to differentiate information should be based on providing new and meaningful information to the marketplace. Mr. Trott believes that the IASB's definition of remeasurement does not provide more meaningful information to financial statement users.

Mr. Schieneman agreed that the FASB should develop a model apart from the IASB.

Mr. Wulff stated that he believes the Board could modify the IASB's definition of remeasurement to make it operational. He stated that the IASB's remeasurement column currently contains items whose measurements are commonly thought of by users to be less reliable than more solid transaction amounts. He noted that if remeasurement was defined as only mark-to-market type adjustments the IASB's approach would more appropriately satisfy its primary objective of enhancing predictive value.

Mr. Foster stated that he is very concerned about the IASB's approach. He believes that their definitions create many exceptions and, therefore, the inability to consistently differentiate transactions and events by means of the definition alone does not satisfy the IASB's principle objective. He noted that the quantity of exceptions calls into question the underlying objective and/or definition. He added that the FASB should attempt to develop its own model that could focus on a differentiation criteria based on either recurring and nonrecurring items or transactional items and changes in estimates. He added that he believes such a differentiation could be made operational.

Ms. Schipper stated that she strongly supports convergence and believes that the IASB approach can be improved. She added that the Board must be careful in using predictive and feedback value as the principle objective because whether an item has predictive value or feedback value depends, in part, on what you are predicting. She also noted that the Board should guard against using words to make a differentiation that are already defined or have a commonly understood meaning, for example, persistence. She indicated that it might not be possible to redefine these words to convey a meaning other than that which is already understood.

Mr. Herz summarized that the majority of the Board agrees that the staff should develop, for the Board's consideration, other methods of differentiating and displaying items of comprehensive income as an alternative to the IASB's approach. Ms. Schipper and Mr. Crooch disagreed with the Board's decision.

Ms. Sullivan then stated that since there was some disparity in Board member's views on the primary objective, the staff would like each Board member to discuss their view on what the overriding objective for the FASB's model should be at this meeting so that other Board members could understand and consider all views.

Mr. Trott stated that he would use predictive value and feedback value as the principle objective, but would develop and use more specific criterion consistent with the principle objective to differentiate and display items of comprehensive income.

Mr. Foster stated that the predictive value of information is fundamental to Concepts Statement 1; however, he added that he has concerns regarding the subjectivity of some financial statement information. He stated that for that reason he would prefer to make a differentiation that is based on whether a revenue, expense, gain, or loss arose through a transaction or through a change in estimate.

Ms. Schipper stated that while Mr. Foster supports the principle objective, his proposed differentiation would not accomplish the objective of enhancing the predictive and feedback value of information. She added that although the Board had decided to develop its own model it should still consider the IASB's approach and convergence as it proceeds through the project.

Mr. Crooch stated that the IASB's model has been tainted by allowing too many exceptions to their application of the definition of remeasurement and that, for this reason, the IASB needs to continue to work on the definition of remeasurement. He also stated that while he is not entirely in agreement with the current status of the IASB's project, he believes the FASB should work to improve the IASB's model. He added that he was not opposed to using predictive value and feedback value as the principle objective of the FASB project.

Mr. Herz stated that enhancing both predictive and feedback value is an appropriate objective. He stated that information such as returns to different providers of capital, valuation adjustments that are not based on observable market prices, historical cost reserve adjustments, and other items that affect comparability of financial statement information could be segregated. He added that the differentiation of information would not all necessarily be displayed on the face of financial statements but could instead be provided as a supplemental disclosure.

Mr. Wulff stated that he liked the IASB's differentiation between operating and financing but believes they should be more clearly defined. He added that the differentiation of information related to mark-to-market type adjustments should be made based on enhancing predictability rather than based upon the reliability of the information.

Mr. Schieneman stated that he did not believe comparability between entities would be possible for every line item on the statement of comprehensive income. Therefore, he stated that the FASB should focus on adding supplemental disclosures similar to what is required by the UK's Accounting Standards Board. He stated that those type of disclosures would provide detailed support for operating profit and would assist users in making predictions. He added that he would give management the discretion to choose what presentation would enhance the predictive and feedback value of its financial information.

Mr. Herz summarized that in developing the model the staff should consider whether the method of differentiation that it recommends is consistent with the principle objective of enhancing predictive and feedback value. Additionally, the staff should also consider whether the method used to differentiate financial information is operational. He added that if the method of differentiating information fails to meet either criterion, then it should be discarded.

GENERAL ANNOUNCEMENTS

None

SUMMARY FOR ACTION ALERT

The Board decided that an objective of the project should be to enhance the predictive and feedback value of the information that is presented in the statement of comprehensive income. This objective is similar to the objective identified by the International Accounting Standards Board (IASB) in its project on reporting financial performance that is being conducted jointly with the UK's Accounting Standards Board. The Board directed the staff to develop additional objectives, consistent with that objective, which would serve as a basis for making decisions in this project. The Board also discussed decisions reached by the IASB in its project on reporting financial performance, in particular, the IASB's tentative decision to present the statement of comprehensive income with a columnar distinction that separates revenues, expenses, gains, and losses into income flows and remeasurements. The Board directed the staff to develop for its consideration other methods of aggregating and displaying items of comprehensive income as an alternative to the IASB's approach.