



MINUTES OF MEETING

Financial Accounting Standards Advisory Council
March 23, 2004

The Advisory Council met at the offices of the Financial Accounting Standards Board in Norwalk, Connecticut.

Members Attending

Richard J. Swift, Chairman
W. Steve Albrecht
Richard H. Booth

Janet L. Pegg
Kevin B. Reilly
John F. Richards

Raymond J. Bromark
Leslie Culbertson
Robert E. Friedman

David B. Rickard
L. Hal Rogero
James R. Ryan

Charles L. Hall
Joe Joseph
Marc E. Lackritz

Colleen A. Sayther
Rita J. Spitz
Mary S. Stone

Alan G. Levin
Russell V. Meyers
Elizabeth F. Mooney

Scott M. Waite
Gregory G. Weaver
Michael R. Young

Mark W. Nelson
Edward E. Nusbaum
Klaus D. Patzak

Members Not Attending

Alan W. Anderson
Kelly Bulloch
Gary P. Fayard
Donald D. Humphreys

David M. Jones
Joseph L. Scalafani
David M. Walker

Others Attending

Financial Accounting Standards Board:
Robert H. Herz, Chairman
Katherine Schipper

Leslie F. Seidman
G. Michael Crooch

FASB Staff:

Suzanne Q. Bielstein, Director of Major Projects and Technical Activities
 Niall G. Campbell, Project Manager
 L. Todd Johnson, Senior Technical Advisor
 Jeffrey J. Johnson, Project Manager
 Bonnie P. Miller, Postgraduate Technical Assistant
 Kimberley R. Petrone, Director of Planning, Development, and Support Activities
 Lawrence W. Smith, Director of Technical Application and Implementation
 Activities
 Randall S. Sogoloff, Practice Fellow
 Donald B. Thomas, Project Manager

Others:

Donald T. Nicolaisen, Chief Accountant—SEC
 Douglas R. Carmichael, Chief Auditor—PCAOB
 Teresa S. Polley, Executive Director—FASAC

Introduction and Approval of Minutes

Mr. Swift called the meeting to order at 9:00 a.m. and welcomed the meeting participants, including the new Council members attending their first FASAC meeting.

Council members approved the minutes of the December 4, 2003 Council meeting after a correction to the minutes was proposed and approved.

Report of the FASB Chairman

Mr. Herz reported on the following strategic and technical matters:

- The expected issuance by the end of the first quarter of an Exposure Draft of a proposed Statement, *Share-Based Payment*, an amendment of FASB Statements No. 123 and No. 95.
- The planned issuance during June 2004 of two Exposure Drafts relating to the purchase method procedures project (a joint project with the IASB), including FASB Exposure Drafts, *Business Combinations*—a replacement of FASB Statement No. 141, *Business Combinations*, addressing the accounting for purchase method procedures, and *Consolidated Financial Statements*—a replacement of ARB 51 addressing the accounting for noncontrolling interests.
- The progress of the project on revenue recognition, including the planned issuance by the end of 2004 of an Exposure Draft relating to general principles for revenue recognition, accompanied by an amendment to FASB

Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*.

- The roundtable discussions planned for May 2004 to discuss practice issues such as legal isolation related to the FASB Exposure Draft, *Qualifying Special-Purpose Entities and Isolation of Transferred Assets*—an amendment of FASB Statement No. 140, issued in June 2003.
- The progress of the project on fair value measurement, including the expected issuance in late May 2004 of an Exposure Draft that would codify in a single document existing guidance on the measurement of fair value.
- The continued efforts to produce more principles-based accounting standards in response to the SEC report to Congress on the adoption of a principles-based accounting system.
- The formation of the Small Business Advisory Committee and planned discussions about whether and to what extent differing accounting standards might be appropriate for small businesses, nonpublic enterprises, or some combination thereof.
- The status of the Board's ongoing process effectiveness initiatives.
- The Board and director retreat recently held to discuss strategic planning issues including ways to make standards more comprehensible and consideration of challenges in the current reporting environment and the implications for standard setting.
- The projects most recently added to the Board's agenda, including those relating to mortgage servicing rights, beneficial interests, and liability recognition under FASB Statement No. 143, *Accounting for Asset Retirement Obligations*.
- The Board's current efforts to address simplification and codification, including the possibility of moving the GAAP hierarchy from the auditing literature to the accounting literature. In addition, the Board is in the early planning stages of considering the creation of a codification of all U.S. accounting literature.

In response to a question about the causes of the majority of financial statement restatements for 2003, Mr. Herz stated that according to a Huron Consulting Group study, revenue recognition issues continue to be a source of many restatements.

Mr. Nicolaisen stated that the SEC staff also continues to be concerned about restatements, specifically about the high number of restatements involving revenue recognition.

Report of the SEC

Mr. Nicolaisen reported on the following matters:

- The SEC staff will be issuing a report to Congress later this year on off-balance-sheet matters. The study will include a review of selected Forms 10-K filed for 2003, with a focus on disclosures relating to leases, pension plans, and derivative and hedging activities. In addition, the SEC staff continues to review FIN 46(R) disclosures and the estimated impact on the financial statements.
- The Commission is hopeful about registrants disclosing key performance indicators and providing an executive overview in MD&A.
- The SEC staff continues to support progress toward international convergence and the elimination of the requirement for international filers to reconcile their financial statements to U.S. GAAP. No timetable has been set for elimination of the reconciliation. The SEC staff's efforts include coordination with the operational group of the Committee of European Securities Regulators (CESR) charged with coordinating the endorsement and enforcement of financial reporting standards in Europe (CESR-Fin). The SEC staff expects that the number of SEC filers using IAS and IFRS as their primary reporting basis will increase substantially in 2005.
- The SEC staff plans to recommend that the PCAOB's rule on the audit of internal control be exposed by the SEC for a 30-day public comment period; following analysis of comments, the SEC staff will make a recommendation to the SEC Commissioners on whether to approve it as a final rule.
- The SEC staff is in the early stages of an initiative to improve the usefulness of financial disclosures and will consider both additions to and deletions from current requirements.
- The SEC staff encourages constituents to be open-minded with respect to the issue of accounting for stock-based compensation and to allow the Board's due process to work.

Report of the PCAOB

Mr. Carmichael reported on the following matters:

- The membership of the standing advisory group, including several permanent observer seats, will be finalized soon; that group will hold its first meeting in May or June 2004. At that meeting, the PCAOB will seek input on its priorities with respect to improving audits. The PCAOB also will seek policy advice on the "second-partner" or engagement review.
- The PCAOB's rule on the audit of internal control is awaiting SEC approval. Consideration is being given to forming implementation groups comprising auditors and preparers.
- Forthcoming proposed auditing standards are expected to make conforming changes to existing standards and to address audit documentation and definitions of certain terms.

Current Business and Financial Reporting Environment

Mr. Swift stated that Council members discussed this issue at the December 2003 meeting and asked whether the concerns expressed at that meeting still hold true, now that the year-end reporting period has passed. He noted that Council members had expressed concerns about an overload of new regulations and accounting guidance, a shortage of resources, and difficulties obtaining timely accounting judgments from auditors.

Council members, primarily from the preparer community, had the following comments:

- The closing process generally was slower than in the past for several reasons, among them the need for more internal consultation, more auditor input, which also was slower because of the audit firm's need to check with its national office before making judgments, and a lower materiality threshold.
- The implementation of the PCAOB's rule on internal controls will be a challenge, given other demands such as new accounting rules expected to be issued and an even shorter filing deadline for 2004 reporting.
- Entities already have begun the assessments of their internal controls. If the PCAOB issues implementation guidance late in the process, some are concerned that their good-faith efforts to comply with the rule will need to be revisited.

Council members, primarily from the auditor community, had the following comments:

- A filing deadline that will be 15 days shorter for 2004 annual reporting combined with the internal control assessment and attestation requirements will result in the 2004 reporting period being more challenging than 2003.
- Auditors will encourage clients to accelerate their assessments of internal controls so that auditors can begin attestation work on internal controls sooner in the year.

Council members, primarily from the user community, had the following comments:

- Accounting standards have become increasingly complex and have not necessarily improved the quality of financial reporting.
- Complex accounting standards are the result of business transactions that have become increasingly complex.
- More disaggregated information in the financial statements would be helpful to users.

Mr. Herz noted that the message for standard setters from such comments is that the FASB should be cognizant of the constraints on the

business and reporting environment when considering the ability of companies to handle accounting changes.

Several Council members noted that standards issued near year-end that have effective dates as of year-end are the most problematic for companies.

The FASB's Conceptual Framework

Mr. Johnson reviewed the history of the FASB's conceptual framework and the need to revisit the framework to refine, update, and complete its components. Mr. Johnson sought Council member input on whether the Board should undertake its revisit of the conceptual framework as a joint project with the IASB with the objective of developing a common framework. He also asked for input on the approach that the Board should take in revisiting the framework.

Council members generally supported the Board's revisiting the conceptual framework. Some members expressed the view that this is the most important project for the Board to address. They encouraged devoting additional resources to its completion ahead of other projects that may be affected significantly, such as revenue recognition and reporting financial performance. Other Council members agreed that the project is important but that projects such as revenue recognition also are vital to the business environment. Progress on those projects should not be impeded.

Council members also generally supported undertaking the revisit of the conceptual framework as a joint project with the IASB. Some commented that this effort would be a good platform to move toward principles-based standards internationally. Members generally supported an approach that would focus on particularly troublesome issues that arise in different projects, rather than a complete reconsideration of each of the major components of the conceptual framework.

FASB-IASB Coordination of Technical Agendas

Ms. Bielstein introduced the FASB staff's proposal on the major agenda projects to be considered for a coordinated technical agenda with the IASB. She noted that the FASB and IASB would discuss the coordination of their technical agendas at the joint April meeting in London. She asked Council members for their comments on whether any projects should be added to the proposal and whether the right balance and priority had been given to proposed projects.

Council members generally supported the proposal, although some questions arose about the expected outcome of a coordinated, longer-term technical agenda between the FASB and IASB. One member noted that implementation guidance also would have to be coordinated to avoid creating convergent principles with divergent practice. Some expressed concern that

regulators in Europe would interpret standards differently than regulators in the United States.

Several Council members expressed concern about the allocation of staff resources, the sequencing of the projects, and what some viewed as an aggressive timeline. Some questioned whether there would be sufficient time for improvements to the conceptual framework to filter into other projects meaningfully, given the proposed agenda and timeline.

Ms. Bielstein noted that the primary objective of the proposed timeline is to illustrate the proposed sequencing of projects relative to one another. The actual sequencing of projects and estimates of time to complete projects will be refined as the Boards move forward.

Short-Term International Convergence

Mr. Crooch summarized the status of this project, noting that four Exposure Drafts relating to the first phase of the project are currently out for comment. That comment period ends April 13, 2004. He gave an overview of the next steps in the short-term convergence project, which are to consider differences between U.S. GAAP and IFRS in balance sheet classification, accounting for income taxes, and accounting for research and development costs.

On the income tax issue, several Council members expressed the view that the Board should not remove the Statement 109 exception relating to foreign subsidiaries, as that would have a significant impact on systems and planning aspects of multinational enterprises and may not reflect the economic reality of transactions without the exception.

On the issue of research and development costs, several Council members expressed concern about the direction of the project, noting that the proposed approach seems to be piecemeal, rather than considering the area of research and development comprehensively. Several Council members from the user community said that research and development costs are viewed by some as soft assets and that improved disclosures might be more useful and more informative than simply capitalizing certain costs.

Ms. Bielstein noted that this project is still in the analysis phase, the objective of which is to determine whether the issues could be resolved in a short-term project or if they would be more appropriately addressed in a major project.

Interpretation of FASB Statement No. 143

Ms. Schipper summarized the differing views on the application of Statement 143 to legal obligations to perform asset retirement activities when the retirement of the asset is conditional upon a future event.

Many Council members expressed the view that Statement 143 applies to legal obligations to perform asset retirement activities when the entity is legally obligated to perform asset retirement activities *if and when* the asset is retired. The uncertainty with respect to *if and when* the asset will be retired should be factored into the measurement of the fair value of the liability.

Other Council members expressed the view that Statement 143 applies to legal obligations to perform asset retirement activities only when the entity is legally obligated to retire the asset. Some members supported this view only if the triggering event is within the entity's control.

Several Council members suggested that improved disclosures about these obligations, rather than recognition, may be more useful to users. However, some noted that those disclosures would be less useful when companies have many such obligations.

Several Council members noted that this issue emphasizes the need for the Board to work on the conceptual framework to improve the definitions of assets and liabilities.

Executive Session and Adjournment

Mr. Swift thanked the Board and Council members for attending the meeting and closed the meeting to public observation at 2:00 p.m. Council members held an executive session to discuss administrative matters with the Board. Mr. Swift adjourned that session at 2:30 p.m.