



**Board Meeting Handout
Statement 140—Transfers of Financial Assets
May 30, 2007**

PURPOSE OF THE MEETING

The purpose of this meeting is for the Board to discuss the initial feedback received from the Servicer Discretion Resource Group on the Passive Asset/Liability (PAL) model and to discuss the staff's research on a Linked-Presentation (LP) model as an alternative to the PAL model.

BACKGROUND—THE PAL MODEL

The PAL model is an approach that would limit the activities of a qualifying special-purpose entity (SPE) to those that involve only basic servicing (defined in the model) and would restrict the permitted assets and liabilities of a qualifying SPE to those financial instruments that are passive, in the strict sense of the word *passive*. The model also includes revisions to paragraph 9(b) of Statement 140 to permit sale accounting for assets that are transferred to a variable interest entity that is constrained from pledging and exchanging its assets by allowing a transferor to apply paragraph 9(b) to those transfers in a manner similar to how it is applied to transfers to a qualifying SPE. However, that variable interest entity would be subject to the consolidation rules of Interpretation 46(R).

The staff previously provided resource group members with an outline of the PAL model and asked them to explain how the model might impact current practice and to offer input on how to make the model workable in practice. The staff also asked for responses to specific questions about the PAL model. The resource group consists of members from a wide range of organizations, including the commercial and residential mortgage securitization industry, accounting firms, the Securities and Exchange Commission (SEC), and the banking industry.

The overall tone of the response from the resource group members was generally consistent. For various reasons, respondents were nearly unanimous in their reluctance to support a strict interpretation of the concept of passivity (as proposed in the PAL model) as a workable solution to the issues in this project. Based on these comments and additional research, it is evident to the staff that applying the PAL model

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would result in similar financial reporting to a complete removal of the qualifying SPE concept. Therefore, the staff has performed initial research on an alternative to the PAL model, that is, the LP model.

THE BASIC LP MODEL

In its simplest form, the LP model removes the qualifying SPE concept from Statement 140 and creates specific criteria to determine when assets and liabilities arising from a transfer of assets (which are not derecognized) should be presented as **linked** on the face of the balance sheet. The LP model is not a *net-presentation* model. The LP model requires that the gross assets and liabilities are displayed on the balance sheet (with additional footnote disclosures). However, they are presented as linked, on the left side of the balance sheet (or, possibly, when the financial statement presentation project is completed, under the financing category), if specific criteria are met.

The objective of this model is to (a) reduce complexity in Statement 140 by removing the qualifying SPE concept and (b) to record transfers of financial assets in accordance with the economics of the transaction.

Removing the qualifying SPE concept from Statement 140 would result in the following change to paragraph 9(b) [deleted text is ~~struck out~~]:

Each transferee (~~or, if the transferee is a qualifying SPE (paragraph 35), each holder of its beneficial interests~~) has the right to pledge or exchange the assets (~~or beneficial interests~~) it received, and no condition both constrains the transferee (~~or holder~~) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor (paragraphs 29–34).

In the staff's view, LP would be required when a financing meets the following principle:

Where a transfer of financial asset(s) is recorded as a secured borrowing, but the financing sequesters the financial asset(s) such that:

- a) The finance will be repaid only from proceeds generated by the specific item it finances (or by transfer of the item itself) and there is no possibility whatsoever of a claim on the entity being established other than against funds generated by that item (or the item itself),
- b) The entity has unconditionally committed to pass-through the cash flows received on that asset(s)

The finance should be shown deducted from the gross amount of the item it finances on the face of the balance sheet within a single asset caption (a 'linked presentation'). The gross amounts of the item and the finance should be shown on the face of the balance sheet and not merely disclosed in the notes to the financial statements.

BEYOND THE BASIC MODEL

The proposed LP model creates a number of follow-up issues that will need to be addressed as part of the project. The key follow-up issues include:

- a) Derecognition threshold—effect of amending paragraph 9(b)
- b) Scope of transfers eligible for the LP model
- c) Interaction with and implications of removing the scope exception for qualifying SPEs from Interpretation 46(R)
- d) Criteria for determining when to link assets and liabilities
- e) Measurement attribute for the linked assets and liabilities (fair value versus historical cost)
- f) Analysis of specific transactions

Question 1: *Does the Board believe that removing the qualifying SPE concept from Statement 140 is an approach worthy of further research as a solution to the issues in the short term project to amend Statement 140?*

ISSUE 1: DERECOGNITION THRESHOLD

The removal of the qualifying SPE concept amends paragraph 9(b) such that if the transferee is constrained from pledging or exchanging the transferred assets and such constraint provides more than a trivial benefit to the transferor, the transaction would be accounted for as a secured borrowing. Therefore, securitizations in which the transferor has a continuing involvement, which generally impose constraints on the securitization trust (to protect the beneficial interest holders), would not qualify for derecognition.

This raises a significant issue in adopting a LP model—should the model provide an alternative derecognition threshold for transactions that restrict the transferee’s right to pledge or exchange the assets it received?

The following are four alternatives for the direction of future research on an alternative derecognition threshold:

View A: **No.** Transfers in which the transferee is constrained and the transferor maintains continuing involvement with the transferred assets should not result in derecognition. However, basic servicing for market-based compensation would not be

considered continuing involvement. This view maintains paragraph 9(b), as amended under the basic LP model.

View A': **No.** This view removes paragraph 9 of Statement 140 in its entirety and replaces it with the simplified principle that financial assets are only derecognized when the transferor has no continuing involvement. Removing paragraph 9 will also address the legal isolation issues that are part of the Statement 140 Amendment project.

View B: **Yes.** Derecognition should be allowed for transactions in which the transferor does not maintain a **majority of the risks and rewards** of the transferred assets. The threshold for determining whether the transferor has transferred a majority of the risks and rewards should be consistent with Interpretation 46(R). That is, derecognition is appropriate when the transferor is not considered the primary beneficiary of the transferee (the previously qualifying SPE).

This view would amend paragraph 9(b) as follows [added text is underlined, deleted text is ~~struck out~~]:

Each transferee (or, if the transferee is a ~~qualifying SPE (paragraph 35)~~ variable interest entity and the transferor is not the primary beneficiary, each holder of its beneficial interests) has the right to pledge or exchange the assets (or beneficial interests) it received, and no condition both constrains the transferee (or holder) from taking advantage of its right to pledge or exchange and provides more than a trivial benefit to the transferor (paragraphs 29–34).

View C: **Yes.** Derecognition should be allowed for transactions in which the transferor does not maintain a **majority of the risks and rewards** of the transferred assets. However, unlike View B, the new threshold for derecognition should apply to all asset transfers, not only to transfers to entities. This change would be achieved by removing paragraph 9(b) of Statement 140 in its entirety.

Question 2: *Which alternative derecognition threshold (Issue 1) does the Board believe should be researched further?*

ISSUE 2: ELIGIBILITY FOR LINKED-PRESENTATION

The removal of the qualifying SPE concept from GAAP will affect both transferors (under Statement 140) and primary beneficiaries of entities that were previously qualifying SPEs (under Interpretation 46R). Therefore, the staff believes that the Board should discuss the following five situations as potentially eligible for LP:

- a) Transferors that **are not** the primary beneficiary of the transferee/VIE
- b) Transferors that **are** the primary beneficiary of the transferee/VIE
- c) Non-transferors that are the primary beneficiary of a transferee/VIE (that is, there must have been a Statement 140 transfer of financial assets)
- d) Non-transferors that are the primary beneficiary of a VIE (that is, there does not need to be a Statement 140 transfer of financial assets, but rather, any primary beneficiary would be eligible)
- e) Entities that consolidate a voting interest entity (in accordance with ARB 51).

Question 3: *Which entities does the Board believe should be eligible for LP (Issue 2)?*

NEXT STEPS

With the Board's approval, the staff intends to perform further research on a LP model as a solution to the issues being addressed in the short-term project to amend Statement 140. This research will focus on the areas identified by the Board in Issues 1 and 2, above. Additionally, the staff intends to obtain input on this research from members of the resource group and others.



**Board Meeting Handout
Proposed FSP 140-3, Repurchase Financing Agreements
May 30, 2007**

BACKGROUND AND OBJECTIVE OF THE MEETING

At the May 8, 2007 Board meeting, the Board discussed how to apply FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, to transactions involving a transfer of a financial asset and a repurchase financing of that asset that involve the same parties to the initial transfer. The Board decided to provide guidance in a FASB Staff Position (FSP) to differentiate between transfers and repurchase financings that should be treated as a single transaction and transfers and repurchase financings that should be considered as two separate transactions. The purpose of this meeting is to discuss the effective date and transition provisions of that FSP.

TRANSACTIONS IN QUESTION

In the transactions at issue, the initial transferor transfers a financial asset to an initial transferee and then enters into a repurchase financing. In the repurchase financing, the initial transferee transfers the financial asset back to the initial transferor as collateral for a note and the initial transferor agrees to return the financial asset (or substantially the same asset) when the note is paid at a fixed amount at a certain date.

TRANSITION ALTERNATIVES FOR CONSIDERATION

The staff provides the following alternatives for transition:

- a. Prospective application only to new transactions entered into after the effective date
- b. Prospective application to new transactions plus transactions that are modified on or after the effective date
- c. Prospective application to new transactions plus transactions that are modified after the effective date and to outstanding repurchase agreements as of the effective date
- d. Retrospective application to all transactions.

In most cases, once the repurchase financing is settled, there would be very little difference in the financial statements whether the entity had treated the transactions as a sale and a secured borrowing or as a single transaction (likely a forward contract). Therefore, retrospective application to all transactions would likely have little effect on settled repurchase financings. In addition, retrospective application would be impracticable because the information to make the required assessments may not be available.

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Requiring all prior transfers with unsettled repurchase agreements to be evaluated to determine linkage is likely to be costly and to provide little, if any, benefit. The population of these transactions is likely to be small, given the short-term nature of most repurchase arrangements. If an entity were to conclude that the previous accounting treatment was clearly inconsistent with Statement 140, then it should be viewed as an error and the entity should apply the guidance on error corrections contained in FASB Statement No. 154, *Accounting Changes and Error Corrections*. Providing explicit guidance on determining whether an error has occurred in this FSP may not be necessary or practical.

EFFECTIVE DATE

One alternative is to make this FSP effective as of the beginning of the first fiscal quarter following the date the FSP is issued, because this FSP is a clarification of the existing requirements in Statement 140. Another alternative is to make the effective date the beginning of the first fiscal year that begins after the issuance of this FSP to avoid the possibility that transactions in different periods of a fiscal year would be accounted for differently. However, this alternative could delay improved accounting treatment for these transactions for several quarters.

Although early application of this guidance will ensure that the principles behind Statement 140 are being followed sooner rather than later, it may also provide less consistency among entities (since some might apply the guidance early, while others might not). The Board may want to consider prohibiting early application of this guidance in order to ensure as much consistency as possible.

QUESTIONS FOR THE BOARD

1. Which transition alternative does the Board prefer?
2. Which effective date alternative does the Board prefer?



**Board Meeting Handout
Going Concern and Liquidation Basis of Accounting
May 30, 2007**

OBJECTIVE OF THE MEETING

1. The purpose of this meeting is for the Board to consider adding a limited scope project to its agenda on an entity's assessment of its ability to continue as a going concern and the adoption of the liquidation basis of accounting. If the Board wishes to add the limited scope project, the staff also requests input with respect to the following:
 - a. Should the proposed standard converge with the guidance in International Accounting Standard 1, *Presentation of Financial Statements*, and International Accounting Standard 10, *Events after the Balance Sheet Date*, supplemented by the disclosure requirements prescribed in U.S. auditing literature (AU Section 341) and additional guidance on the form and content of liquidation basis financial statements?
 - b. Should the proposed standard conform to IAS 1 and IAS 10 with no significant modifications (that is, the standard would essentially be a 'lift and drop' of the IAS 1 and IAS 10)?
 - c. Should the standard codify existing U.S. auditing guidance from (1) AICPA Statement on Auditing Standards No. 1, *Codification of Auditing Standards and Procedures*, Section 341, "The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern" (AU Section 341) and (2) the various AICPA literature on the liquidation basis of accounting while providing clarification of certain terms used in that guidance?

BACKGROUND

Current U.S. Guidance

2. The most comprehensive U.S. guidance for considering an entity's ability to continue as a going concern is located in AU Section 341 of the U.S. auditing literature. Other U.S. guidance regarding an entity's ability to continue as a going concern is found in several different authoritative sources. The principal concern of many constituents is that none of these sources **explicitly** state that management has the primary responsibility for assessing an entity's ability to continue as a going concern.

3. Guidance on the liquidation basis of accounting is disseminated throughout mostly non-authoritative U.S. auditing literature. Paragraph .34 of AU Section 9508, “Reports on Audited Financial Statements: Auditing Interpretations of Section 508”, indicates that a liquidation basis of accounting may be considered GAAP for entities in liquidation or for which liquidation appears imminent and provides guidance on how auditors should report on financial statements prepared on a liquidation basis.

Current International Guidance

4. International financial accounting standards differ primarily from U.S. guidance on the going concern assumption in that the IASB standards explicitly state that management has primary responsibility in assessing going concern. The IASB addresses the issue of going concern in IAS 1. International financial accounting standards do not provide explicit guidance on the liquidation basis of accounting. However, a change in the basis of accounting in liquidation is contemplated in paragraph 23 of IAS 1. IAS 10 reiterates the same directives as IAS 1, but from a point in time subsequent to the balance sheet date.

BASIS FOR THE STANDARD

Alternative 1

5. Alternative 1 is a proposal for the development of a standard that incorporates both the fundamental guidance from IAS 1 and IAS 10, and also includes the disclosure guidance in AU Section 341. The standard would converge with paragraphs 23 and 24 of IAS 1 and paragraphs 14 and 15 of IAS 10 along with a portion of text inserted from paragraph .10 of AU Section 341 on related disclosures. Additionally, the standard would clarify when an entity should adopt a liquidation basis of accounting and include guidance on the form (that is, the financial statements to be presented) and content (that is, the amount that assets and liabilities should be reported at and the inclusion of costs of liquidation) of liquidation basis financial statements. Upon adoption of a liquidation basis of accounting, assets would be recognized at the present value of the future cash inflows less the present value of cash outflows necessary to obtain those inflows, and liabilities would be recognized at the present value of future cash outflows or settlement amounts, if known. When assets are recorded at the present value of the future cash inflows less the present value of future cash outflows, the entity should accrue all costs that are expected to be incurred during the process of liquidation. This alternative would change current practice as summarized in the following grid.

Changing factors in assessing the going concern assumption and the adoption of a liquidation basis of accounting under Alternative 1		
	Current U.S. Audit Literature	Alternative 1
Primary Responsibility for Assessing the Going Concern Assumption	Under AU Section 341, the auditors have primary responsibility for this assessment; however, management is responsible since they must assert and support this position to the auditors.	Management has primary responsibility for assessing going concern.
Time Horizon	“a reasonable period of time, not to exceed one year beyond the date of the financial statements”	“at least, but...not limited to, twelve months from the balance sheet date”
Threshold of Doubt	“substantial”	“significant”
Type of Evidence	“knowledge of relevant conditions and events that exist at or have occurred prior to the completion of fieldwork”	“all available information about the future”
Preparation of Liquidation Basis Financial Statements	“liquidation is imminent”	“liquidation is certain to occur”
Measurement of Assets and Liabilities when Liquidation Basis is Presented	Assets at net realizable value and liabilities at estimated remaining obligation	Assets at present value of cash inflows less present value of cash outflows necessary to obtain those inflows and liabilities at present value of cash outflows or settlement amounts, if known.
Costs of Liquidation	No guidance	Estimate costs expected to be incurred during liquidation and reduce net assets

Alternative 2

- Alternative 2 is similar to Alternative 1—a proposal to “lift and drop” paragraphs 23 and 24 of IAS 1 and paragraphs 14 and 15 of IAS 10 (with certain clarifying modifications) into an authoritative standard without any additional disclosure guidance from U.S. auditing standards.

Alternative 3

- Alternative 3 is a proposal to codify existing U.S. auditing standards into FASB literature. The FASB will have to redraft the relevant auditing standards to change the perspective from that of the auditor to that of the preparer. This would essentially constitute the development of a new standard. However, the standard would be constrained by the intent and guidance originally provided in AU Section 341.

TRANSITION AND EFFECTIVE DATE

- The assessment of the ability to continue as a going concern or the transition to the liquidation basis of accounting is not anticipated to impact the application of GAAP or the measurement of assets and liabilities in previously issued financial statements. In the event that any changes arise from the alternatives outlined above on previously issued financial statements, the staff would expect those changes to result in additional disclosures being required by the reporting entity earlier than were required under existing requirements. Accordingly, the staff is recommending prospective transition for this limited scope project. Given this project may require action by U.S. auditing standard setters, the staff will need to liaise with staff members of those organizations before proposing an effective date.

QUESTIONS FOR THE BOARD

- Does the Board wish to add a limited scope project to its agenda to codify existing literature on going concern and liquidation basis of accounting?
- If yes to question 1, which alternative does the Board prefer for an approach to this limited scope project?
- If Alternative 1 is chosen for question 2, the staff would like to clarify the following aspects of that decision.
 - Does the Board wish to limit the time horizon for consideration of information regarding the going concern assumption to (1) one year from the balance sheet date (U.S. Auditing Literature), (2) at least, but not limited to, twelve months from the balance sheet date (IAS 1) or (3) some other time period?
 - Does the Board wish to specify the type or nature of information that is to be considered when assessing going concern?
 - In determining the threshold for liquidation basis, does the Board wish to use the term “liquidation appears **imminent**” (U.S. literature), “management **intends** to liquidate” (term in IAS 1), or a new phrase – “liquidation is **certain to occur**”?
- Does the Board agree with the staff’s recommendation on the transition?



Board Meeting Handout
SUBSEQUENT EVENTS

May 30, 2007

PURPOSE

The purpose of this meeting is to (a) present the issues that the staff plans to address in conjunction with developing a comprehensive draft for the Board's consideration and to solicit the Board's feedback on those items; (b) discuss the date through which subsequent events should be considered in financial statements; and (c) discuss how conflicts in existing standards should be addressed in this project.

BACKGROUND

At its August 17, 2005 meeting, the Board decided to add a project to its agenda to establish general standards of accounting for and reporting of events that occur subsequent to the balance sheet date. The Board decided not to undertake a fundamental reexamination of this area. Rather, it plans to develop standards that reflect the principles underpinning current subsequent events guidance in existing accounting standards and in the auditing requirements contained in AICPA Codification of Statements on Auditing Standards, AU Section 560, *Subsequent Events*.

The Board also decided that an objective of the project would be to consider whether certain minor differences between U.S. GAAP and the corresponding international financial reporting standard, IAS 10, *Events After the Balance Sheet Date*, could be eliminated or minimized. Those efforts will focus on guidance related to:

- a. The date through which subsequent events are considered for adjustment to or disclosure in the financial statements
- b. The reissuance of financial statements
- c. The examples used to illustrate the accounting requirements.

The Board further decided that the project would not address inconsistencies or differences between U.S. GAAP and international financial reporting standards in the following areas, which the Boards plan to examine in their joint project on reporting financial performance:

- a. Refinancing of short-term obligations
- b. Curing breaches of borrowing covenants
- c. Going concern issues. (Going Concern and Liquidation Basis of Accounting is a separate project also being discussed at the May 30, 2007 Board meeting.)

Subsequent to the preparation of materials for this meeting, the staff has learned that the Board's project on Financial Statement Presentation will not address the balance sheet classification of short-term obligations expected to be refinanced or the classification of long-term debt with covenant violations that have been cured prior to the issuance of the financial statements. These items may be addressed in later stages of the Financial Statement Presentation project, but will not be addressed in the Preliminary Views document currently scheduled for issuance in the fourth quarter of this year.

The staff will ask the Board whether there are any other issues that the Board believes should be considered in conjunction with this project. The staff recommends that the Board not address refinancing of short-term obligations or curing breaches in borrowing covenants in this project.

COMMENT LETTERS

On May 16, 2007, the Board received a comment letter from the Private Company Financial Reporting Committee (PCFRC). The PCFRC made recommendations regarding Issue 1, the date through which subsequent events should be considered in the financial statements, and refinancing of short-term obligations or curing breaches in borrowing covenants.

DISCUSSION OF ISSUES AND ALTERNATIVES

Issue 1: The appropriate date through which subsequent events should be considered for adjustment to or disclosure in the financial statements.

View A: Current practice in the U.S. should be retained, and subsequent events should be considered through the date that financial statements are issued.

Proponents of View A note that View A is consistent with current U.S. practice, both from the perspective of the auditing literature, as discussed above, and from the perspective of the accounting literature. Proponents of View A believe that the date of issuance provides the most current information to users of financial statements. Opponents to View A believe that its approach is not practical for smaller nonpublic entities.

View B: A new standard on subsequent events should converge with IFRS, and subsequent events should be considered through the date that financial statements are authorized for issuance by the appropriate corporate governance authority.

Proponents of View B believe that View B is preferable because it converges with IFRS and is less complex for nonpublic entities to implement. Opponents to View B counter that while many small- and medium-sized private business entities may rely on their accountants for the issuance of the financial statements, the financial statements are the responsibility of management. Opponents to View B believe that View B opens the door for management to "manipulate" the date through which subsequent events are considered.

View C: The PCFRC recommended in its May 16, 2007 comment letter that private companies should "disclose in a policy note to the financial statements the cut-off date in which subsequent events were considered by management for the purposes of subsequent events analysis and disclosure."

The PCFRC states the following in its comment letter:

The strict notion of "issuance date" of the financial statements in the private company environment has little or no meaning because companies do not have a typical, universally understood issue date. For example, it is not uncommon for a private company to complete all work on the GAAP financial statements (including receiving an auditor's opinion or an accountant's report from an independent public accountant) on one date, send the financial statements to one of its end users on a later date, and then send the financials to yet another user on an even later date.

The PCFRC noted the importance of financial statements, clearly identifying the date to which subsequent events were considered by management. Considering the example set forth by the PCFRC, a user would be alerted to the fact that they are receiving financial statements after the

subsequent events work was completed and, therefore, might consider performing some follow up procedures with company management to understand if there were any subsequent events between the date disclosed in the policy note and the date of receiving the financials.

Opponents of View C believe that different standards for public and nonpublic entities increase the complexity of the financial reporting system. In addition, several existing standards discuss "after the date of an enterprise's financial statements, but before those financial statements are issued." Opponents of View C are also concerned with the risk of abuse that results from the date through which subsequent events are considered being completely at the discretion of management

Discussion Question 1—What does the Board believe is the appropriate date through which subsequent events should be considered for adjustment to or disclosure in the financial statements?

Staff recommendation: The staff recommends retaining existing practice in the U.S. as discussed in View A. In order to accommodate nonpublic entities, the staff proposes the following description of the date through which the consideration of subsequent events extends:

The date that the financial statements are first made available to interested third parties, including, but not limited to, current or future investors, creditors, or customers, and regulators or parties responsible for corporate governance.

Issue 2: Disposition of conflicts in existing standards.

Many existing standards include guidance that is inconsistent with the basic principles of AU 560; that is, the standards do not recognize the distinction between so-called Type I and Type II subsequent events. Such standards usually require that the post-balance sheet date event in question be by default considered a Type II event. The issue for the Board to discuss is whether any of the conflicting standards should be amended to be consistent with a new subsequent events standard or whether any of the conflicting standards should be excluded from the scope of a new subsequent events standard.

View A: The scope of the subsequent events accounting standard issued as a result of this project should contain scope exceptions for any standard that conflicts with it.

Proponents of View A believe that the "exceptions" to existing subsequent events guidance was seen by the Board and other standards setters as necessary. Those standards setters would have concluded at the time that a departure from existing subsequent events principles was justified in certain situations. However, proponents of View A insist that the guidance in those existing standards should remain in force and should not be supplanted by a new subsequent events standard that is essentially the same as current literature.

View B: All U.S. GAAP standards should be amended to conform to the new standard.

Proponents of View B believe that a single principle for evaluating subsequent events would be less complex for users, preparers, and auditors of financial statements. Issuing a new standard that is prefaced by a list of scope exceptions does not further the Board's goal of reducing complexity in financial statements.

Discussion Question 2—How does the Board believe conflicts with existing standards should be resolved?

Staff recommendation: The staff recommends View A.