



MINUTES OF MEETING

Financial Accounting Standards Advisory Council
September 21, 2006

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

Members Attending

Richard J. Swift, Chairman
Richard H. Booth
James L. Brown

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

Stephen J. Cosgrove
Leslie Culbertson
Timothy J. Curt

Samuel J. Ranzilla
Kevin B. Reilly
David B. Rickard

Robert E. Friedman
Charles L. Hall
Gregory J. Jonas

Steven A. Rogers
Rita J. Spitz
Arleen R. Thomas

Joe Joseph
Marc E. Lackritz
Richard D. Levy

E. Anson Thrower
Scott M. Waite
Terry D. Warfield

Nellie Liang
Elizabeth F. Mooney
John B. Morse, Jr.

Gregory G. Weaver
Brent A. Woodford
William L. Yeates
Michael R. Young

Members Not Attending

Colleen Cunningham

Others Attending

Financial Accounting Standards Board:
Robert H. Herz, Chairman
George J. Batavick
Thomas J. Linsmeier

Leslie F. Seidman
Edward W. Trott
Donald M. Young

FASB Staff:

Suzanne Q. Bielstein, Director of Major Projects and Technical Activities
Shannon B. Detling, Postgraduate Technical Assistant
Russell G. Golden, Senior Technical Advisor

Others:

Robert F. Dacey, Chief Accountant, Government Accountability Office
Neal J. Hannon, Director of Financial Reporting Technologies, FAF
Conrad Hewitt, Chief Accountant, Securities and Exchange Commission
Teresa S. Polley, Executive Director, FASB Advisory Groups, Financial
Accounting Standards Advisory Council
Thomas Ray, Chief Auditor, Public Company Accounting Oversight Board

Introduction

1. Mr. Swift called the meeting to order at 9:00 a.m. He welcomed the FASAC members and stated that several individuals were attending for the first time, including Tom Linsmeier, a former FASAC member and now an FASB Board member; Conrad Hewitt, the new chief accountant of the SEC; and Terry Warfield, a new FASAC member replacing Mr. Linsmeier. He stated that the FAF Board of Trustees had appointed eight new FASAC members whose terms will begin on January 1, 2007.

Report from the FASB Chairman

2. Mr. Herz reported on the following matters:
 - a. The issuance of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, in June 2006.
 - b. The issuance of FASB Statement No. 157, *Fair Value Measurements*, in September 2006.
 - c. The planned issuance of FASB Statement No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, which addresses the first phase of the FASB's comprehensive reconsideration of the accounting for postretirement benefit obligations. That Statement is expected to be issued by the end of September 2006.
 - d. The finalization of an Exposure Draft on combinations of not-for-profit entities.
 - e. The addition of a lease accounting project to the Board's agenda. The project will comprehensively reconsider the existing accounting for leases and will be a joint project with the IASB. The initial due process document will be a discussion paper that expresses the Boards' preliminary views.

In addition, a joint international working group will be formed to provide input to both the IASB and the FASB.

- f. The progress on the financial statement presentation project (formerly called performance reporting). A joint discussion document with the IASB is planned for issuance in the second quarter of 2007. The current phase of the project addresses the fundamental issues for presentation of information on the face of the financial statements. Although the Board currently is focusing on financial statement presentation from a manufacturing company perspective, the Board also will consider financial statement presentation for financial services companies.
- g. The consideration of a potential Invitation to Comment (ITC) on valuation issues. The ITC would address whether a need exists for valuation guidance or standards in addition to Statement 157. The FASB has an interest in the application of consistent standards to measure items reported on the financial statements.
- h. The issuance of an IASB press release on the effective dates of future standards. The IASB has stated that no new major standards will be effective until 2009. The effective date of the FASB's business combinations project may be delayed as a result. The IASB also has stated that future standards on major projects would not become effective until at least one year after the release date of the standard.
- i. The issuance of a joint press release from the SEC and the Committee of European Securities Regulators (CESR) on a joint work plan focused on financial reporting. This work plan evidences the move to convergence not only on the part of the standard setters but on the part of the regulators as well.
- j. The status of the codification project. The staff has completed the mapping phase of the project and is now well into the authoring phase of the project. The authoring phase likely will be completed by the end of 2007.
- k. Personnel matters. Jeff Mechanick has been hired to work on not-for-profit reporting issues. Paul Glotzer has been hired to work on private company reporting issues. Chandy Smith has been hired to enhance the activities with users and investors and bring more of their perspective on financial reporting issues.

Report from the SEC

3. Mr. Hewitt reported on the following matters:
 - a. The issuance by the Office of the Chief Accountant (OCA) of a letter on the appropriate application of stock option accounting literature. This letter discusses the accounting implications under APB Opinion No. 25, *Accounting for Stock Issued to Employees*, of dating of option awards to

predate the actual award date, option grants with administrative delays, uncertainty of the validity of the grant, and other related circumstances. This letter only discusses the accounting ramifications and does not address legal consequences.

- b. The issuance of SEC Staff Accounting Bulletin No. 108, which provides interpretive guidance on how the effects of carryover or reversal of prior year misstatements should be considered when quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in a material misstatement when considering the other quantitative and qualitative factors. The SEC staff will not object if a registrant makes a one-time cumulative effect adjustment to correct errors that had previously been considered immaterial. SAB 108 describes when it would be appropriate to do so and discusses the disclosure requirements for making such an adjustment.
- c. The status of the following actions related to Section 404 of the Sarbanes-Oxley Act:
 - (1) A Concept Release was issued about management guidance. The release asked for comments to help the Commission develop guidance on how management should perform its assessment of internal control over financial reporting. The SEC staff is beginning to review the comments received.
 - (2) The Committee of Sponsoring Organizations of the Treadway Commission (COSO) issued guidance on the use of the COSO framework to address the needs of smaller companies in fulfilling the requirements of Section 404.
 - (3) The Commission granted certain foreign private issuers (accelerated filers, but not large accelerated filers) an additional one-year extension on the filing of the auditor attestation report. Approximately 23 percent of 1,200 foreign private issuers would be affected by this extension.
 - (4) The Commission proposed to grant relief to smaller public companies by extending the date by which nonaccelerated filers must start providing a report by management assessing the effectiveness of internal control over financial reporting.
 - (5) The Commission also proposed to extend the date by which nonaccelerated filers must comply with the requirement to provide an auditor's attestation report in their annual reports.
 - (6) According to the August 9, 2006 SEC press release, approximately 44 percent of the domestic companies and 38 percent of the foreign private issuers that file periodic reports with the Commission are nonaccelerated filers.

- (7) The Commission also proposed a transition period for newly public companies. Under this proposal, a company would not be required to provide a management report or an auditor's assessment report until it has previously filed one annual report with the Commission.
- d. The issuance of final rules on executive compensation. Investors will be provided with one number for the total annual compensation for each named executive officer. The clarity and comparability of this one number will be complemented by the principles-based narrative disclosures in the new compensation discussion and analysis section and by the requirement that this disclosure be made in plain English.
 - e. The status of XBRL activities. Beginning this year, the Commission staff implemented an interactive data test group where participants will receive accelerated reviews of their registration and annual financial statement filings in exchange for submitting data in XBRL format. Approximately 24 companies have agreed to participate. Overall, 35 companies have submitted 67 filings with XBRL documents to date. The SEC staff will evaluate the results of the program and gather feedback from the volunteers and other market participants.

Report of the PCAOB

4. Mr. Ray reported on the issuance of Staff Audit Practice Alert One, *Matters Related to Timing and Accounting for Options Grants*, in response to the serious issues that have been raised on options backdating. The alert:
 - a. Addresses the relevant accounting and the practices that have come to light so auditors understand the implications of those practices in their audits of financial statements.
 - b. Instructs auditors to assess the risks that the financial statements could be misstated as a result of those practices.
 - c. Provides guidance on that risk assessment.
 - d. Reminds auditors about their responsibilities pursuant to existing auditing standards in responding to those risks.

Current Business and Financial Reporting Issues

5. Mr. Swift stated that the purpose of this discussion is to provide input to the FASB on current issues that participants in the business environment are facing.
6. Council members and others expressed the following views:
 - a. Some of the direct costs of compliance with Sarbanes-Oxley have stabilized. Many of the ancillary costs, however, have continued to increase. The need for more intensive internal audits, systems initiatives to provide information, costs due to hiring resources to comply, and costs associated with expanded processes have all increased compliance costs.

- The benefits have been realized and appear to be sustainable. The costs, however, do not appear to have justified the benefit. The costs of external audits for Section 404 are decreasing somewhat. Information technology has been used to lower costs and increase controls and efficiency.
- b. The number and severity of delinquent filers have increased recently. Once registrants fail to file on time, many of them seem to take a long time to file timely reports again. Once a company becomes delinquent in its filings, multiple investigations and reviews are usually started, resulting in further delays. Delinquent filings have the following negative effects:
 - (1) Users cannot get information to make decisions on a timely basis.
 - (2) The company violates debt covenants.
 - (3) Bondholders take increasingly aggressive actions in requiring acceleration of debt or requiring a substantial economic penalty for the company when granting waivers.
 - (4) Delinquent filers are losing access to the public markets.
 - c. There may be a role for the FASB and the OCA of the SEC in reducing the frequency and impact of delinquent filings. Preparers sometimes have difficulty determining the correct accounting for a transaction because of the complexity of GAAP. In some cases, different members of management disagree on the correct accounting treatment. If the OCA had a mechanism to address disputes, the process might move faster and result in fewer delinquent filings.
 - d. The Board should consider further outreach on Interpretation 48. Many preparers seem unaware of the impact of Interpretation 48, including the documentation they may need and the role of the auditor.
 - e. The impact of the Sarbanes-Oxley Act on the U.S. capital markets should be studied. While the direct costs of compliance have decreased, many of the benefits are very difficult to quantify. Managements report they have better internal control systems, but it is difficult to judge whether greater compliance about disclosure has really enhanced transparency in the financial markets about firm value and firm risk. The market does not seem to significantly penalize firms that have material weaknesses. Companies are listing in foreign exchanges to avoid the costs of Sarbanes-Oxley requirements. In addition, Sarbanes-Oxley compliance may be distracting management from operating and directing the business.

Results of the 2006 FASAC Survey

7. Ms. Polley stated that the FASAC response rate to the survey was 100 percent and that the top 5 priorities for FASAC members are the same as in last year's survey: the conceptual framework, revenue recognition, leases, financial statement presentation, and postretirement benefit obligations including pensions. Board members' top five priorities are the same as

FASAC's, although the order is different. The preliminary results from User Advisory Council (UAC) members indicate that the UAC also had the same top five priorities, although in a different order as well.

8. Ms. Polley stated that for the remainder of the discussion, she would highlight the projects on revenue recognition and business combinations because those are two areas of diversity in input between FASAC members and Board members.
9. Twenty-two FASAC members included revenue recognition as one of the top five priorities of the Board. Members of FASAC have different views, however, about the best approach to take on the project. Some advocate the Board's current conceptual approach. Of those that advocate the current approach, some say the Board needs to move faster and others say the Board should continue the current deliberative process.
10. Other FASAC members believe the Board's current approach is too theoretical; the Board should focus on improving or codifying the current model but should not completely redo the model.
11. Four Board members included revenue recognition as one of their top five priorities. One of those Board members suggests narrowing the focus from a conceptual level and moving it to more of a standard-setting mode. Two Board members believe the revenue recognition project needs a change in direction, and one Board member believes the project should be dropped from the agenda.
12. On the business combinations project, seven FASAC members (including one user) advocate dropping or at least changing direction on the project. Four Board members also believe that a change in direction on that project might be needed. Ms. Polley stated that some believe that the incremental value to users of the extensive changes proposed may not be sufficiently great to justify the high cost.
13. FASAC members expressed the following views:
 - a. While a revenue recognition standard is sorely needed, it is unclear how to create a revenue recognition standard without first completing the conceptual framework. The Board would expend a significant amount of resources on revenue recognition only to have to revisit the subject when the conceptual framework project is complete. The revenue recognition project is an example of the tension between the efforts to develop principles-based standards and the preparer's desire for very specific guidance.
 - b. The Board should work on both the revenue recognition and conceptual framework projects simultaneously. The Board should not wait until the conceptual framework is complete because revenue recognition guidance is needed urgently. The further passage of time exacerbates the revenue recognition problem because new business arrangements are being

developed quickly, the pace of change is increasing, and the standards are not keeping up.

14. Several Board members stated that much of the current revenue recognition guidance is based on rules. The revenue recognition standards should be based on principles. Some Board members are skeptical about whether a principles-based revenue recognition standard would be accepted by preparers, auditors, and users. While many have urged the FASB to write more principles-based standards, some preparers and auditors resist principles-based standards and request that the FASB create rules and exceptions.
15. Ms. Polley then summarized the results of the other sections of the survey. On future financial reporting issues, three main themes emerged: fair value, complexity, and strategic alliances.
16. On international convergence, Ms. Polley stated that FASAC members overwhelmingly support the notion of international convergence and believe that in a world of converged standards, the FASB and other national standard setters would continue to have an important role in standard setting. On the issue of how the Board should weigh convergence versus making timely improvement to U.S. financial reporting, nearly all FASAC members believe that timely improvement to U.S. standards should take precedence over international convergence.
17. Ms. Polley stated that the survey asked for input on how the Board can help ensure that today's and tomorrow's accountants are adequately prepared. Most respondents suggested that the Board should emphasize to educators the importance of the conceptual framework so that it is included in the curriculum. The survey also asked for input on whether the Board should be more involved in developing educational and training materials. Some believe that developing educational materials is not a role for the Board; rather, other organizations like the AICPA, state CPA societies, or commercial vendors should continue to fulfill that role. Others believe that the Board should be heavily involved in developing educational and training materials.
18. Ms. Polley stated that the full results of the survey would be available by the end of October.

Private Company Financial Reporting

19. Mr. Batavick summarized the efforts that led to the Invitation to Comment, *Enhancing the Financial Accounting and Reporting Standard-Setting Process for Private Companies*. The comment period on the ITC ended on August 15, 2006.
20. The ITC received a significant level of support from respondents, who generally believe that if the recommendations are implemented, private company financial reporting would improve and user needs would be better met. Respondents were comfortable with the idea of having one set of GAAP

with differences for private companies being based on user needs and cost-benefit considerations.

21. Some respondents did express concern, however, over certain issues. One area of concern was funding. The ITC proposed joint funding between the FASB and the AICPA. Some respondents expressed concern that if the committee was jointly funded, the independence of the FASB would be impacted negatively. Some respondents also expressed concern about joint selection of members; those respondents view that as the FASB ceding its standard-setting authority or giving one constituent group (the AICPA) a preference in the selection of the committee members. Approximately half of the respondents believe that all committee members, not only the chair, should be paid; the others believe members should not be compensated beyond reimbursement of travel expenses. Mr. Batavick noted that the FASB would be meeting with the AICPA in the near future to discuss the next steps and asked FASAC members for their input.
22. Members of FASAC expressed the following views:
 - a. The FASB should fully fund the committee to avoid any perception of a lack of independence. The amount of funding probably would not be significant. The FASB should appoint the members; the AICPA could be one source of nominations.
 - b. The joint funding structure as proposed in the ITC is appropriate. The FASB is funded by public companies and is designed to focus on public company matters. The AICPA should help fund the committee because the committee is for private companies. The committee will act in an advisory role and would not have authority to set standards so the concern about ceding authority back to the AICPA is not a major issue. In addition, the AICPA should have input in appointing members because of its extensive contacts with private companies and accountants.
 - c. The Board should consider compensation for all committee members because smaller businesses may not have the resources to support a member. Compensation arrangements should be flexible.
 - d. The meetings should be held in cities around the country to encourage more participation.

XBRL Activities

23. Mr. Hannon stated that many FASAC members are already familiar with XBRL and that XBRL has the potential to improve the business reporting supply chain and to make significant contributions to financial reporting.
24. Mr. Hannon stated that although XBRL has existed for years, its use has not been widespread. Earlier this year, Mr. Herz and Robert DeSantis, FAF president, met with SEC Chairman Christopher Cox and discussed the obstacles to more widespread acceptance of XBRL. One obstacle was the

development of XBRL taxonomies, the electronic dictionary or the standard way of coding data to ensure consistency.

25. It was decided to explore moving responsibility for U.S. financial reporting taxonomies to the FAF. The FAF trustees authorized a feasibility study to consider the issues. A request to the financial community was sent out to obtain feedback on the FAF proposed taxonomy model. Several meetings have taken place to aid in the development of the feasibility study, which will be presented to the FAF trustees in the near future. A tentative operating plan also has been developed. The focus within the study has been on financial reporting centric taxonomies, including footnotes. The goal is to create an excellent and sustainable model for development of the taxonomies. Many sources must be engaged to ensure that the model will be robust, usable, and accepted.
26. The XBRL project team currently is working on acquiring the intellectual property rights from the XBRL committee that was a part of the AICPA. It is intended that taxonomies be available at no charge to users. The XBRL project team also is considering various funding models as part of the study to determine the costs involved if the FAF undertakes XBRL taxonomy development.
27. Members of FASAC expressed the following views:
 - a. The role of XBRL in private company financial reporting is uncertain.
 - b. The FAF feasibility study should address how XBRL is different from the data currently provided by data aggregators such as FactSet.
 - c. XBRL will be very useful to the user community because it will help ensure completeness of analysis, enhance comparability, and increase the speed at which analyses can be performed. It will allow companies to present information in what they feel is the most meaningful way and also will allow users to manipulate the data for their analysis.
 - d. XBRL has implications beyond the technology, although technology is the enabler. Those implications are the presentation and display of financial information. If XBRL is more widely used and accepted, then the published financial statements may have less importance.
 - e. In the current approach there does not seem to be enough consideration of standard setter and regulatory oversight, input, and right of veto.
 - f. Comparability is very important and needs to be a cornerstone in the taxonomy development. It may be appropriate to create comparability flags in the XBRL tags so that users can differentiate between companies that make different accounting choices and policy decisions.
 - g. Industries are different, users have various needs, and the business environment is constantly changing. XBRL taxonomies must be flexible and responsive; the organization that controls the taxonomies must be able to respond quickly to changes and update the taxonomies. The

- market may be better served by having a private entity, rather than a not-for-profit organization, controlling the taxonomies, at least initially. A for-profit company might have the ability to respond more quickly to changes in the marketplace. Another factor to consider, however, is that the market may not be receptive to a for-profit entity making money on this service.
- h. The creation of XBRL taxonomies and the electronic distribution of data may not belong in the strategic mission of the FAF and the FASB.
28. In response to several of the comments, Mr. Hannon stated that the FAF is concentrating on developing the taxonomies for public reporting but that the model also would be applicable to private companies. He noted that while data aggregators currently exist, they control how an entity's information will be aggregated and presented. With an XBRL tag, the company reporting the data has more control over the presentation of the data. Some of the inconsistencies or errors that result from the changes made by the data aggregator would disappear if XBRL is used.
29. Mr. Hannon stated that the conceptual design of the taxonomies is that companies can report information using three levels of XBRL tags. The first core level of tags is the commercial and industrial taxonomies, which would apply to approximately 85 percent of companies. Next, specific industries would have specific industry extensions. Beyond that, each company could create its own set of extensions provided certain guidelines are followed. The company-specific tags could later be incorporated into industry tags if there is sufficient participation and agreement that those tags should be incorporated.
30. Whether XBRL reporting eventually will become a requirement is unknown. The FAF is considering only the development of taxonomies. Even when taxonomies have been developed, there may not be a demand for XBRL. Consequently, it is unclear whether it will ever be required and, if so, when that would occur.

ADJOURNMENT

31. Mr. Swift thanked the Board and Council members for their participation and closed the meeting to public observation at 12:15 p.m. Council members attended a closed administrative session from 1:15 pm to 2:30 p.m.