MINUTES

Financial Accounting Standards Board

To:	Board Members
From:	Business Combinations— Purchase Method Procedures Team (B. Wilson, ext. 275)
Subject:	Minutes of the December 4, 2002 Board Meeting
Date:	December 12, 2002
Code:	A: BC-PURMT
cc:	FASB: Bielstein, Smith, Petrone, Bossio, Tamulis, Munro, Manders, B. Wilson, Such, P. Wilson, Swift, Polley, Cropsey, Thompson, Gabriele, Sutay, Lapolla, Financial Instruments and Liability and Equity Teams, FASB Intranet; IASB: Leisenring, Ryltsova, Kimmitt; CICA: Walsh; AICPA: Hekker; Purchase Method Procedures Working Group Members (E-mail)

Topic:	Business Combinations—Purchase Method Procedures: Issues Related to Noncontrolling Interests and Recognition and Measurement of Deferred Tax Assets
Basis for Discussion:	Two memorandums dated November 21, 2002
Length of Discussion:	9:00 a.m. to 10:30 a.m.

Attendance:

Board members present:	FASB: Herz, Crooch, Foster, Trott, Schieneman, Schipper, and Wulff IASB: Leisenring
Board members absent:	None
Staff in charge of topic:	Tamulis, Manders
Other staff at Board table:	Bielstein, Bossio, B. Wilson
Other participants:	Ryltsova (by phone)

MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION

The Board continued its discussions of issues associated with the accounting and reporting of noncontrolling interests, which includes redeliberating certain of the proposals in the October 2000 Exposure Draft, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*. The Board reached the following decisions:

1. If an acquirer obtains control of an acquiree through a series of acquisitions of two or more investments in the acquiree (a business combination referred to as a *step acquisition*), preacquisition investments held by the acquirer at the acquisition date (the date control is obtained) should be remeasured at their fair value and any unrealized holding gains or losses on those preacquisition investments should be recognized in consolidated net income for the period. The cumulative amount of unrealized holding gains or losses on preacquisition investments that have been recognized in other comprehensive income for investments classified as available-for-sale securities under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which are measured at fair value, should be reversed out of accumulated other comprehensive income and reported as a reclassification adjustment (deduction) from other comprehensive income into net income for the period.
2. After a parent acquires control of a subsidiary, subsequent increases or decreases in the ownership interests of the subsidiary by members of the consolidated group while the parent controls the subsidiary should be accounted for as capital transactions (investments by owners and distributions to owners) in the consolidated financial statements. Premiums or discounts, if any, for amounts paid (or received) for subsequent investments purchased from (or sold to) noncontrolling shareholders in excess (or deficit) of the carrying basis of the ownership interest purchased (or sold) should be recognized directly in equity (paid-in capital).
3. If a parent disposes a subsidiary through a sale of ownership interests in that subsidiary by the parent or members of the consolidated group (a decrease in ownership that results in a loss of control by a parent), any gain or loss on the sale should be recognized in consolidated net income of the period. The gain or loss should be calculated as the difference between (a) the proceeds from the sale that resulted in the loss of control and (b) the carrying amount of the subsidiary's net assets in the consolidated financial statements, less the carrying amount of any noncontrolling interests in the consolidated financial statements, and less the fair value of any investment remaining in the entity sold.

The Board also discussed the guidance for the subsequent recognition of deferred tax benefits acquired in a business combination provided by paragraph 30 of FASB

Statement No. 109, *Accounting for Income Taxes,* that require the reduction of goodwill, other noncurrent intangible assets, and income tax expense. The Board decided to amend Statement 109 to require the reduction of income tax expense for the subsequent recognition of deferred tax benefits.

DISCUSSION

Noncontrolling Interest Issues

The Board continued its discussions of issues associated with the accounting and reporting of noncontrolling interests, which includes redeliberating certain of the proposals in the October 2000 Exposure Draft, *Accounting for Financial Instruments with Characteristics of Liabilities, Equity, or Both*.

Accounting for Step Acquisitions

The majority of the Board members agreed with the staff's recommendation that if an acquirer obtains control of an acquiree through a series of acquisitions of two or more investments in the acquiree (a business combination referred to as a *step acquisition*), preacquisition investments held by the acquirer at the date control is obtained (acquisition date) should be remeasured at their fair value and any unrealized holding gains or losses on those preacquisition investments should be recognized in consolidated net income for the period. The staff's recommendation is based on the premise that when control is obtained, an investor in effect exchanges its investment in an investee for all of the assets and liabilities of that investee. Some Board members agreed with the staff recommendation, but supported their conclusions by analyzing whether control should trigger a remeasurement event rather than the staff's rationale. Another concurring Board member noted the need to communicate, in summary form, instances in existing guidance in which the Board reached different conclusions on similar issues. Mr. Trott discussed the current requirements of APB Opinion No. 29, *Accounting for Nonmonetary Transactions,* regarding recognition of gains and losses on exchange transactions and expressed concern about recent, conflicting EITF decisions. Mr. Wulff stated that he agreed with the staff on the recognition aspect of the step acquisitions conditioned on a clear distinction of the presentation of the gain or loss in the income statement display. However, he did express concern about the reliability of measurement of the gain or loss. Mr. Herz and Mr. Schieneman dissented on this decision. Mr. Herz expressed concern over gaming opportunities and the income recognition on earlier investments when additional shares are purchased. Mr. Herz would prefer to not have goodwill measured at its full fair value rather than recognizing a gain or loss. Mr. Schieneman would prefer to record any gain or loss in *other comprehensive income* instead of in net income.

Based on the above decision, all Board members agreed that the cumulative amount of unrealized holding gains or losses on preacquisition investments that have been recognized in other comprehensive income for investments classified as available-for-sale securities under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, which are measured at fair value, should be reversed out of accumulated other comprehensive income and reported as a reclassification adjustment (deduction) from other comprehensive income into net income for the period.

Accounting for Subsequent Increases or Decreases in Ownership of a Subsidiary by Members of the Consolidated Group after the Parent Obtains Control of the Subsidiary That *Do Not* Result in Obtaining or Losing Control

The majority of Board members agreed that after a parent acquires control of a subsidiary, subsequent increases or decreases in the ownership interests of the subsidiary by members of the consolidated group while the parent controls the subsidiary should be accounted for as capital transactions (investments by owners and distributions to owners) in the consolidated financial statements. Premiums or discounts, if any, for amounts paid (or received) for subsequent investments purchased from (or sold to) noncontrolling shareholders in excess (or deficit) of the carrying basis of the ownership interest purchased (or sold) should be recognized directly in equity (paid-in capital). The discussion focused on the transfers between controlling interests and noncontrolling interests and the corresponding display of such interests. Board members agreed that the subsequent increases or decreases of ownership are equity transactions and language such as "transfers to/from" may be used to describe those transactions. Some of the Board members stated that the focus should be on the display of the parent company. Mr. Wulff expressed concern about recognizing in the income statement a gain or loss for a rather small increase in ownership (for example, from 49 to 51 percent) that results in obtaining control, but not recognizing a gain or loss in the income statement for a rather large increase in ownership (for example, from 51 to 98 percent). Board members requested the staff to consider the impact of the decision and the calculation of earnings per share.

Subsequent Decreases in Ownership of a Subsidiary by Members of the Consolidated Group that Result in a Loss of Control ("Disposition of a Subsidiary")

All Board members agreed that if a parent disposes a subsidiary through a sale of ownership interests in that subsidiary by the parent or members of the consolidated group (a decrease in ownership that results in a loss of control by a parent), any gain or loss on the sale should be recognized in consolidated net income of the period. The gain or loss should be calculated as the difference between (a) the proceeds from the sale that resulted in the loss of control and (b) the carrying amount of the subsidiary's net assets in the consolidated financial statements, less the carrying amount of any noncontrolling interests in the consolidated financial statements, and less the fair value any investment remaining in the entity sold.

Mr. Trott agreed that this approach would avoid some of the complications of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishment of Liabilities*. Board members requested the staff to further research "gaming" scenarios where multiple linked sales of a controlling interest resulting in a loss of control would result in different accounting than a single sale of the controlling interest that results in a loss of control.

Acquired Deferred Income Tax Benefits

The Board also discussed the guidance for the subsequent recognition of deferred tax benefits acquired in a business combination provided by paragraph 30 of FASB Statement No. 109, *Accounting for Income Taxes,* that requires the reduction of goodwill, other noncurrent intangible assets, and income tax expense. The Board agreed with the staff's recommendation and decided to amend Statement 109 to require the reduction of income tax expense for the subsequent recognition of deferred tax benefits. Board members supported the staff recommendation as it is consistent with the subsequent treatment of other acquired assets and assumed liabilities in that goodwill and other noncurrent intangible assets are not adjusted for events that occur subsequent to the acquisition. As a point of clarification, Mr. Leisenring stated that the use of the word *probable* in IAS 12, *Income Taxes,* is not substantially equivalent to the recognition criteria for a valuation allowance in Statement 109 of *more likely than not* (a likelihood of more than 50 percent). The staff noted the differences in interpretation. This issue is being addressed as part of the Board's short-term convergence project with the IASB.

GENERAL ANNOUNCEMENTS

None

SUMMARY FOR ACTION ALERT

See MATTERS DISCUSSED, DECISIONS REACHED, AND FOLLOW-UP ACTION.