MINUTES

To:	Board Members
From:	Project Team (Benson x 446)
Subject:	Minutes of the May 8, 2007 Conceptual Framework Board Meeting
Date:	May 16, 2007
cc:	Leisenring, Bielstein, Smith, MacDonald, Allen, Polley, Glotzer, Carney, Lott, Gabriele, Sutay, Project Team, FASB Intranet, Upton, Hickey, Crook, Lian, Hague, Villmann, Willis, GASB: Reese, Patton

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Topic: Phase D: *Reporting Entity* Outstanding Issues

Basis for Discussion: Memorandum No. 56

Length of Discussion: 3:00 p.m. to 4:30 p.m.

Attendance:

Board members present:	Batavick, Crooch, Herz, Linsmeier, Seidman, Trott, and Young
Board members absent:	None
IASB members present:	Leisenring
Staff in charge of topic:	Crook (by phone)
Other staff at Board table:	Bossio, L.T. Johnson, Bielstein, Beckendorff, and Benson

Summary of Decisions Reached:

At its May 8, 2007 meeting, the FASB discussed outstanding issues related to Phase D: *Reporting Entity*. The Board decided the following:

(1) The composition of a group entity should be based upon control. Typically, a group would comprise a parent and other entities under its control. In addition, there might be occasions when general purpose external financial reports may be prepared for a group of entities under common control, such as combined financial statements for two or more entities under the control of a single investor.

(2) A parent entity may only have one set of general purpose financial statements, which are its consolidated financial statements that present information about all of the assets and liabilities and activities of the parent and its subsidiaries. The Board acknowledged that, generally, it is more useful to present information about the assets and liabilities and activities of subsidiaries in a disaggregated form, but there may be certain circumstances in which aggregated (one-line) summary information is more decision-useful. Those circumstances would be addressed at the standards-level.

(3) The staff should proceed with drafting a Discussion Paper/Preliminary Views document on the reporting entity concept that reflects the FASB's and IASB's most recent decisions after the IASB discusses the remaining issues at its meeting on May 16, 2007.

Objective of Meeting:

The objective of the meeting was for the Board to discuss outstanding issues related to Phase D: *Reporting Entity* and decide whether the staff should proceed with drafting the Discussion Paper/Preliminary Views document for Phase D. The objective of the meeting was met.

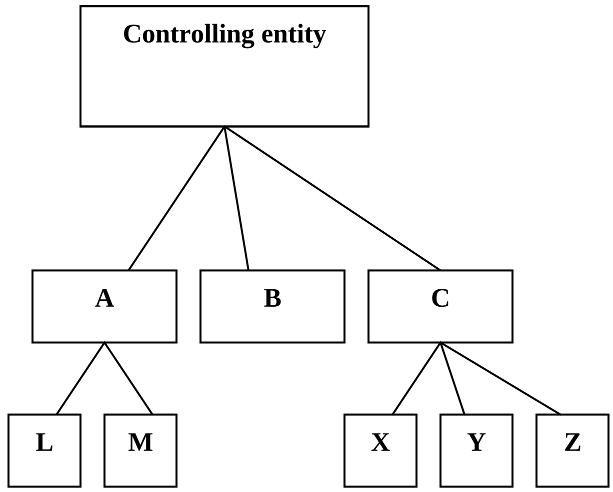
<u>Matters Discussed and Decisions Reached</u>:

1. Kimberley Crook led the discussion concerning outstanding issues related to Phase D: *Reporting Entity*. She stated that there are two outstanding issues for Board discussion:
   (a) Determining the composition of a group entity, including whether the control concept should be used in much the same way as it is used today, or whether it should be extended, such that a group could comprise entities under common control.
   (b) Parent-only financial statements and consolidated financial statements—determining which set of financial statements (or both) should be included in a general purpose external financial report prepared for a parent entity.
2. Ms. Crook stated that in addition to requesting Board decisions regarding the outstanding issues, the staff will ask the Board whether it wants to proceed with drafting the Discussion Paper/Preliminary Views document for the reporting entity.

ISSUE 1: CONTROL CONCEPT

3. Concerning the first issue, the Boards have discussed three models in past meetings: (a) controlling entity model, (b) common control model, and (c) risks and rewards model. Under the controlling entity model, the group comprises the parent entity and other entities under its control. Under the common control model, the group may comprise the parent entity and other entities under its control, or entities under common control without including the parent entity. The Boards previously discussed the risks and rewards model but have agreed not to proceed with that model.
4. Ms. Crook stated that a fourth model arose during conversations with IASB members since the last FASB and IASB meetings on the reporting entity, which is described as the synergistically managed assets model. She asked the FASB to discuss the controlling entity model, the common control model, and the synergistically managed assets model to decide which model the Board prefers. She noted that the staff prefers the common control model, followed by the controlling entity model.

5. In discussing which control concept should be adopted by the Board, FASB members referred to the following diagram provided in the memorandum and Board handout:



6. Mr. Batavick asked Ms. Crook whether the controlling entity model is part of the common control model. Ms. Crook responded that the common control model allows all of the group formations of the controlling entity model and adds additional group formations beyond those allowed under the controlling entity model. She noted that the IASB previously referred to the common control model as the “extended controlling entity model.”
7. Mr. Batavick stated that he is concerned that the common control model allows L and M to be combined without A, when in fact A is essential to the relationship between L and M. He noted that entities grouped together without the common parent may provide **some** useful information, but he is unsure whether such a grouping provides the **most** useful information. He explained that he thinks the **most** useful information is provided by groupings that include a common parent, which corresponds with the controlling entity model. However, if the goal of having a reporting entity concept in the conceptual framework is to provide **some** decision-useful information, he would not object to adopting the common control model.
8. Mr. Leisenring stated that he supports the common control model. If A is an individual who owns two corporations, L and M, which engage in many transactions with each other, A should consolidate L and M so that the

relationship between L and M is represented in the financial statements. However, A should not need to include his house or other assets within the consolidated financial statements of L and M, as such information is not relevant to the business relationship between L and M. If the Board adopts the controlling entity model, A's individual assets would have to be included in the consolidated financial statements of L and M, which is inappropriate.

9. Ms. Seidman stated that the situation described by Mr. Leisenring should not determine the model that the Board adopts. She stated that there is a lack of conceptual explanation for the common control model, and it is unclear what the conceptual reasoning is behind allowing L and M to be combined without A. The principle that the Board should use in adopting a control concept is to include all the entities under the control of the parent entity. If there is a special purpose need to make an exception to that general principle, then the Board can address those exceptions at the standards-level. For example, an exception could be made for situations in which the parent entity is an individual.
10. Mr. Trott stated that he prefers the common control model because it does not preclude consolidation of L and M without A. He noted that he does not want to preclude at the conceptual level the consolidation of entities that do not have a parent-subsidiary relationship. The common control model provides boundaries on what is deemed to be a circumscribed area of economic interest, and he does not think it necessary to limit the composition of a group entity beyond that.
11. Mr. Batavick asked Mr. Trott if he would advocate determining the circumstances in which L and M should be consolidated without A at the standards-level. Mr. Trott responded that he probably would advocate such a standard, and in some cases would require L and M to prepare consolidated financial statements.
12. Mr. Leisenring noted that companies controlled by the same entity, such as L and M, could easily transfer and share profits based on which company needs the profits to meet earnings expectations. Precluding

such companies as L and M from preparing consolidated financial statements without A (which would be the case if the controlling entity model is adopted) would not allow a parent company (A) to show such a relationship between two sister subsidiaries (L and M). Ms. Seidman responded that L and M need the common control of A to allow the two subsidiaries to easily transfer profits. As such, the Board should require that A be included in the consolidated financial statements to transparently show the entire relationship between parent entity and sister subsidiaries. She noted that the question that Board members must address is what parts of A must be included in the consolidated financial statements of L and M. Allowing consolidated financial statements for L and M without including the common parent, A, does not seem conceptually sound.

13. Mr. Linsmeier stated that the controlling entity model focuses on predicting future cash flows, but it does not address the fact that there are multiple parties that general purpose external financial reports (GPEFR) must serve. He stated that in his view, GPEFR should serve the range of users of financial reports that do not have privileged access to information. Many users have claims to some of an entity's asset base, and thus users will want to know what the asset base is that generates their returns. Mr. Linsmeier stated that he thinks the Board should focus on a model which identifies the net asset base on which the majority of users base their returns. Synergistically managed assets would be aggregated in the financial statements, and assets which are not synergistically managed would appear as single line-items.

14. Mr. Trott stated that the determination of synergistically managed assets to be aggregated could be accomplished at the standards-level. Mr. Linsmeier replied that he is concerned that if the common control model is adopted by the Board, almost all of the criteria for determining when entities should be consolidated would be left for standards-level guidance. He added that almost any combination of entities can be combined or presented separately under the common control model.

15. Mr. Leisenring stated that he does not favor the synergistically managed assets approach because such an approach allows parent entities great flexibility in determining when to combine subsidiary entities. If a parent entity does not want to consolidate two subsidiaries, it must simply decide that the two subsidiaries do not have synergistically managed assets. Mr. Herz responded that the synergistically managed assets model does not allow parent entities as much flexibility as Mr. Leisenring stated. If an entity reports to a group of capital providers, it must determine what asset base generates the returns for those capital providers. The asset base that generates the capital providers' returns dictates the reporting entity. Mr. Herz added that the synergistically managed assets model is based on the concept that the reporting entity should be comprised of those assets that provide the economic returns for users.
16. Mr. Linsmeier stated that the synergistically managed assets model more strongly correlates with Chapter 1 of the proposed framework, *Objectives of Financial Reporting*, than the common control model or controlling entity model because it is based on user needs.
17. Mr. Bossio noted that the Boards had previously agreed that a branch could be a reporting entity. He asked Board members whether they thought two branches could be a reporting entity.
18. Ms. Crook stated that in previous meetings, the Boards discussed what constitutes an individual entity. The Boards focused on breaking down a company into its branches or segments and determining the smallest incremental piece of a company that may be classified as a reporting entity. In those discussions, the Boards did not contemplate whether adding two branches together would constitute a reporting entity, which is similar to the question that Board members are currently addressing regarding L and M. The issue that Board members must address is when two entities should be aggregated together for purposes of preparing GPEFR.
19. Mr. Bossio noted that there is a current tension among Board members' comments regarding flexibility in allowing various combinations of entities

to prepare GPEFR versus a desire for a sound concept that may be used as a tool for understanding when GPEFR is required for a certain combination of entities. Board members must decide when two entities comprise a circumscribed area of economic interest for users and should prepare GPEFR. Mr. Linsmeier stated that deciding to whom there is a circumscribed area of economic interest is the most important factor to consider.

20. Mr. Bossio stated that he thinks the synergistically managed assets model may give an indication of when a circumscribed area of economic interest exists, but it is not a model for which a standard or concept can be written. Mr. Linsmeier responded that he thinks the common control and controlling entity models do not give sufficient guidance concerning when two entities should prepare consolidated financial statements.

21. Mr. Crooch referenced the control structure diagram and asked what the financial statements would present if Controlling Entity was an individual who owned A, B, C, L, M, X, Y, and Z. Mr. Leisenring responded that he would consolidate all of Controlling Entity's subsidiaries but would not include the individual assets of Controlling Entity, such as Controlling Entity's house, car, and personal investments. Mr. Linsmeier asked Mr. Leisenring if he would require the consolidation of all of Controlling Entity's subsidiaries, or if he would permit consolidation in the conceptual framework. Mr. Leisenring answered that he thinks consolidation should be required for the set of subsidiaries.

22. Mr. Crooch stated that if Controlling Entity were an individual, he would consolidate L and M into A, and X, Y, and Z into C. Mr. Herz stated that if the only external lender to all of the subsidiaries of Controlling Entity loaned to A, the question is whether that lender cares about the financial performance of B or C, which is facts- and circumstances-specific. He noted that he would not automatically require consolidated financial statements for A, B, and C because the business functions of A, B, and C may be unrelated. There may be circumstances in which Controlling Entity should consolidate A, B, C, L, M, X, Y, and Z because the

businesses are so interrelated that the lender of A needs to understand the financial performance of all of the entities. However, there will also be circumstances in which consolidation of all of the entities is unnecessary for users.

23. Ms. Seidman stated that in order to determine whether L and M should be combined, one must consider the relationship of the entities with A. The contractual ownership and control by A is necessary to determine whether consolidation is appropriate. The interrelatedness of L and M requires the control of A.

24. Mr. Trott asked Board members if they want to include within the Preliminary Views (PV) document the controlling entity model or the common control model, or if Board members think more work must be done before the PV may be drafted. He stated that he prefers that the common control model be presented in the PV, and he does not think more work on consolidation principles is necessary before exposing the PV for comment.

25. Mr. Herz stated that he thinks an approach that focuses on the economics that provide returns for users is most conceptually sound. However, he acknowledged that the Boards previously rejected such a model when the Boards discarded the risks and rewards model. Mr. Bossio noted that Mr. Herz's notion of focusing on the economics that provide returns seems to be embedded within the concept of identifying an entity based on a circumscribed area of economic interest to a group of external users. Mr. Herz stated that he would prefer a control concept that focuses on returns for users, which is not the main focus of either the common control model or the controlling entity model.

26. Mr. Linsmeier stated that the synergistically managed assets model is underdeveloped and should not be pursued by Board or staff members further. However, if the controlling entity and common control models are described in the PV, it would be beneficial to include a question for constituents regarding whether there should be conceptual guidance on when entities should or should not prepare consolidated financial

statements. He acknowledged that it is fairly clear when entities should be combined under the controlling entity model, but it is far less clear under the common control model. If A is an individual who owns L and M, the common control model **permits** A to consolidate L and M, but does not **require** consolidation. Mr. Herz added that he and Mr. Linsmeier think there should be a higher level principle above the common control model which dictates when consolidation is required.

27. Mr. Batavick stated that he thinks consolidation of L and M is appropriate if there is an interdependency between L and M. Mr. Bossio added that separate financial statements representing information about L or M may also be useful even if L and M are interrelated, as some lenders may only have claims to assets of L or M and not rights to the assets of the other entity.

28. Mr. Batavick stated that he supports the common control model, as long as the controlling entity model is not precluded by adoption of the common control model. He added that the IASB favored the common control model at its December 2006 meeting concerning the reporting entity, and he does not think it wise for the FASB to support a competing model in the PV.

29. Ms. Seidman stated that she prefers the controlling entity model. She suggested that model stipulate that an entity must include all of the assets and liabilities that it controls. She stated that if the majority of FASB members votes for the common control model, she recommends the PV be written so that the common control model has a stand-alone definition that does not refer to the controlling entity model. She noted that in the current Board memorandum, the common control model is described in relation to the controlling entity model, which makes the concept of the common control model weak. She noted that if the common control model is included in the PV, constituents must be able to understand how that model differs from what is currently done in practice.

30. Mr. Linsmeier stated that no matter which model is adopted by the Board, he hopes the PV will include questions to constituents regarding (a) the

guiding principles for identifying a reporting entity within the conceptual framework, and how those guiding principles can be extended to standards-level guidance, (b) the usefulness of relating the control concept in the conceptual framework to the users listed in Chapter 1 of the framework, and (c) how the interrelatedness of entities should affect consolidation decisions. He stated that gathering input on these issues is more important to him than choosing either the controlling entity or common control models.

31. Ms. Crook suggested that in terms of deciding when two entities **should** prepare consolidated financial statements versus **can** prepare consolidated financial statements, the Board could assert that two entities **should** consolidate when one entity controls another (that is, A, L, and M), and **can** consolidate when they are under common control (that is, L and M). The PV could state that the factor that causes the two entities to interact is the common parent, and standards-level guidance could address when the Board encourages entities under common control to consolidate.
32. Mr. Linsmeier stated that he supports the common control model if the Board adopts Ms. Crook's suggestion, as long as standards-level guidance dictates the distinction between when a company **should** or **can** consolidate. In addition, standards-level guidance must address the needs of minority shareholders, and whether financial reports for those shareholders are special purpose or general purpose.
33. Mr. Herz stated that he supports the common control model with Ms. Crook's suggestion. The Board voted for the common control model (five Board members agreed; two did not [LFS and DMY]).

ISSUE 2: PARENT-ONLY AND CONSOLIDATED FINANCIAL STATEMENTS

34. Ms. Crook stated that the second issue for Board consideration concerns parent-only and consolidated financial statements. Within that issue, there are two sub-issues:

(a) An entity issue: determining whether both sets of financial statements relate to the same entity, or two different entities.

(b) A presentation issue: determining which set of financial statements (or both) meets the objective of general purpose external financial reporting by providing decision-useful information to present and potential investors, creditors, and other external users with a financial interest in the parent entity.

35. Concerning the presentation issue, the staff identified three approaches for the Board's consideration:

(a) Approach One: The parent entity can have only one set of GPEFS, but it would be a standards-level issue to determine how the parent should present information about the subsidiary's assets, liabilities, and activities.

(b) Approach Two: The parent entity can have only one set of GPEFS, which are its consolidated financial statements, because consolidated financial statements present information about all the parent's assets, liabilities and other activities, whereas parent-only financial statements do not. This should be explained at the concepts level.

(c) Approach Three: The parent entity can have only one set of general purpose external financial statements, but it can include other financial information within its single set of general purpose external financial reports. In particular, the parent's GPEFR could include both consolidated and parent-only financial statements.

36. Ms. Crook asked the Board to decide the following:

(a) Does the Board think that both parent-only financial statements and consolidated financial statements are capable of providing decision-useful information to external users in the context of general purpose external financial reporting?

i. <u>Conclusion A</u>: Yes, and both should be provided in the GPEFR for a parent entity. This conclusion is consistent with

Approach Three of the Parent = Group View or the Parent ≠ Group View.

ii. Conclusion B: Yes, but it would be a standards-level matter to determine whether, in a given set of circumstances, parent-only financial statements or consolidated financial statements should be prepared to best meet user information needs. This conclusion is consistent with Approach One of the Parent = Group View.

iii. Conclusion C: No, because parent-only financial statements are incomplete and do not faithfully represent the parent-entity's assets, liabilities and activities. This conclusion is consistent with Approach Two of the Parent = Group View.

37. Mr. Trott asked Ms. Crook if the staff had a recommendation for the Board. Ms. Crook responded that she prefers Conclusion A, but she has not asked other staff members for their opinions. Mr. Trott asked if the IASB has indicated a preference regarding the entity and presentation issues. Ms. Crook replied that the IASB meeting on these issues is May 16, 2007, and as such the IASB has not voted on these issues.

38. Mr. Trott stated that he prefers Conclusion A. Mr. Linsmeier stated that he does not find the separation of the entity and presentation issues helpful. He noted that the Board must address whether, in defining the entity, the assets and liabilities of a parent and its subsidiary must be shown in a gross or net presentation. Ms. Seidman disagreed and stated that she thinks the issues for Board consideration are (a) what is included in the group entity, and (b) should both the parent-only and group presentations be provided in the GPEFR.

39. Ms. Seidman referred to the Board's earlier decision to adopt the common control model, and stated that her view that the controlling entity model is the most appropriate control concept corresponds with Conclusion B for the entity and presentation issues. It is potentially misleading to suggest that L has a right to M's assets and vice versa if A is not included.

Conclusion B stipulates that once an entity determines what it has control over, there would be a standards-level decision concerning the best way to present that control. She acknowledged that it would be unlikely that the Board would decide at the standards-level that it would be most appropriate for A to present its control over L and M as "investment in L or M," but there may be circumstances in which such a presentation is appropriate.

40. Mr. Herz stated that he is unsure whether Conclusion B is consistent with Ms. Seidman's description of her preference. He stated that he thinks it would be inappropriate in most cases for an entity to prepare GPEFR using a parent-only presentation in which it presents most or all of its subsidiaries using the equity method or fair value.

41. Ms. Seidman stated that she thinks that in addressing the first issue regarding the control concept, the Board defined the possible circumscribed areas of economic interest that may prepare GPEFR. The second issue concerning the entity and presentation issues requires the Board to decide if a situation will arise in which an investment in a circumscribed area of economic interest is most appropriately presented as "investment in subsidiary." Mr. Linsmeier responded that such a decision was already made by the Board with the investment company guide.

42. Mr. Herz stated that he interprets the entity and presentation issues differently than Ms. Seidman. He explained that he thinks the issue for Board consideration is whether it is acceptable for a company to present parent-only financials with subsidiaries as single line-items and label those financial statements GPEFR. Conclusion A requires a company to report both parent-only and consolidated financial statements in its GPEFR. Mr. Herz stated that he thinks both parent-only and consolidated financial statements **could** be GPEFR, and in a control situation the consolidated financial statements should be required. He stated that he prefers Conclusion A or an approach in which parent-only financial statements are supplementary.

43. Mr. Linsmeier stated that showing parent-only financial statements as GPEFR suggests that the returns to the general purpose external financial reporting users are not dependent on the grossed-up assets of the parent entity's subsidiaries.
44. Ms. Seidman stated that she prefers an approach in which the Board acknowledges it is possible for parent-only financial statements to be GPEFR, and the requirements for presenting parent-only financial statements as GPEFR are determined at the standards-level. She added that she does not want to allow entities the choice of whether parent-only financial statements constitute GPEFR. Mr. Linsmeier stated that he would like the Board to determine the situations in which parent-only financial statements constitute GPEFR instead of simply acknowledging that such situations exist.
45. Mr. Crooch stated that Conclusion A requires an entity to present consolidated **and** parent-only financial statements in its GPEFR. Conclusion B states that it is a standards-level matter to determine circumstances in which parent-only financial statements or consolidated financial statements should be prepared as GPEFR. Conclusion C states that parent-only financial statements are **never** GPEFR. Mr. Crooch stated that he prefers Conclusion A.
46. Mr. Herz stated that he could agree with Conclusion C if parent-only financial statements are supplementary, or he could agree with an approach which requires that consolidated financial statements always be reported and allows entities to prepare parent-only financial statements as GPEFR in certain circumstances. Mr. Herz stated that he does not agree with Conclusion A because he does not think it should be necessary to always show parent-only financial statements. He clarified that parent-only financial statements require that an entity show its controlling interests as single line-items. At the other extreme are consolidated financial statements, in which nothing under the parent entity's control may be shown as a single line-item. He stated that he does not agree with either extreme, and prefers an approach that allows some

combination of aggregation and disaggregation based on the type of control the entity has over its investments.

47. Mr. Bossio asked Mr. Herz how he distinguishes his view from that of Ms. Seidman, who prefers Conclusion B. He noted that Ms. Seidman earlier explained that she would presume that consolidated financial statements are most appropriate, but there may be situations in which a one-line presentation is most appropriate for some investments, and that decision would be made at the standards-level. Mr. Herz stated that he agrees with Ms. Seidman that an entity must show the consolidated financial statements as the primary financial statements. He added that in his view, parent-only financial statements may be supplementary, but they should never constitute GPEFR for a group without also including consolidated financial statements.
48. Mr. Linsmeier summarized that some Board members think parent-only financial statements alone cannot constitute GPEFR. He stated that he prefers Conclusion C, but he does not think that Conclusion C is consistent with the common control model for which the Board voted earlier. Under Conclusion C, if A is an individual, A cannot prepare financial statements for L and M without A. That conclusion does not correspond with the Board's earlier decision that under the common control model, sometimes A should prepare financial statements for L and M without including A's assets and liabilities. Mr. Linsmeier stated that he thinks parent-only financial statements are inconsistent with the Board's earlier discussion about the control concept.
49. Mr. Herz stated that Conclusion C mandates that only consolidated financial statements may be called GPEFR, and parent-only financial statements may be supplementary. The consolidated financial statements would allow entities to list discontinued operations and investment companies as single line-items. Mr. Linsmeier stated that he prefers Conclusion C.
50. Ms. Crook summarized the Board's preferences, and stated that the Board supports a combination of Conclusion B and Conclusion C. That is,

consolidated financial statements constitute GPEFR in general, but there may be circumstances in which it is more appropriate to present a subsidiary as a single line-item. The decision of whether to present a subsidiary gross or as a single line-item would be made on a subsidiary-by-subsidiary basis. The Board agreed with Ms. Crook's summary of its majority view. Mr. Herz added that parent-only financial statements may be presented as supplementary. Mr. Linsmeier asked Ms. Crook to identify factors to consider regarding when a subsidiary is most appropriately shown as gross or a single line-item based on the Board's previous decision to adopt the common control model. He noted that factors will most likely revolve around economic interdependencies and common users.

51. Ms. Seidman stated that the memorandum asked Board members whether it is helpful to divide the entity and presentation issues into two views: (a) parent = group view and (b) parent ≠ group view. She stated that in her opinion, such classification does not help as it did not seem like any Board members referenced the views in choosing Conclusions A, B, or C. Mr. Bossio noted that identification of the two views may prove more helpful when the IASB discusses the entity and presentation issues.
52. Ms. Crook stated that the last question for Board consideration is if the staff should proceed with drafting the Preliminary Views/Discussion Paper on the reporting entity, regardless of whether the IASB comes to similar conclusions as the FASB at its May 16, 2007 meeting. She stated that the staff recommends that even if the IASB reaches different conclusions at its May 2007 meeting, drafting of the PV should proceed as the Boards have sufficiently discussed the issues that will be presented in the PV.
53. Mr. Herz asked if the draft PV would be modified to include the FASB's decisions made at the current meeting. Ms. Crook acknowledged that there will need to be some rewriting to the initial draft to include each Board's most recent decisions at the May meetings.

<u>Follow-up Items</u>:

The staff will proceed with drafting a Discussion Paper/Preliminary Views document on the reporting entity concept that reflects the FASB's and IASB's most recent decisions after the IASB discusses the remaining issues at its meeting on May 16, 2007.

General Announcements:

None.