



Financial Accounting Standards Board

Board Meeting Handout¹

Proposed FSP FAS 157-e, *Determining Whether A Market Is Not Active and a Transaction Is*

Not Distressed

April 2, 2009

MEETING PURPOSE

1. The Board will discuss the comments received in response to the exposure draft of proposed FSP FAS 157-e, *Determining Whether A Market Is Not Active and a Transaction Is Not Distressed*. The staff also plans to discuss with the Board whether the proposed FSP should be issued as a final FSP and any necessary adjustments to the proposed FSP as a result of the comments received.

BACKGROUND

2. At the February 18, 2009 Board meeting the Chairman announced that he added a project to the Board's agenda to develop additional application guidance to address concerns raised by constituents regarding active and inactive markets and distressed transactions.
3. At the March 16, 2009 Board meeting, the Board approved the issuance of proposed FSP FAS 157-e. The proposed FSP was issued on March 17, 2009 for a 15-day comment period.

¹ The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

COMMENT LETTER RESPONDENT PROFILE

4. The comment period on the proposed FSP ended on April 1, 2009. As of 5:00 p.m. on April 1, 2009, the FASB received over 300 comment letters on this proposed FSP. The pool of respondents includes preparers, individuals, investors and other users of financial statements, regulatory bodies, accounting firms, academics, business associations, and industry organizations. The Board and staff also informally discussed the proposed FSP with a number of users of financial statements that did not provide formal comment letters. Generally, preparers, and business and industry organizations expressed support for additional application guidance on fair value measurements, but many noted specific concerns with the proposed FSP regarding understandability and operability of the Board's intended guidance. Many other respondents were not supportive of the proposed FSP primarily because they thought that the objective of the FSP was not clearly articulated and could have unintended consequences. Additionally, those respondents also expressed concern that the guidance would result in a relaxation of fair value requirements and reduce consistency and comparability in financial statements. Significant issues raised by respondents that warrant consideration by the Board are discussed below.

ISSUE 1 - OBJECTIVE OF THE FSP

5. The most significant comment provided by many constituents was to clarify the objective of the measurement described in the FSP. Specifically, many constituents were confused by the example included in the proposed FSP and questioned whether the Board is changing the objective of a fair value measurement in an inactive market. Based on the

example in the proposed FSP, constituents asked if the objective of a fair value measurement in an inactive market should be:

- a. Fair value in the current inactive market;
 - b. A hypothetical fair value in an **active** market (that is, a “normally active and functioning market”); or
 - c. The midpoint between a. and b.
6. The Staff does not believe the Board’s intent was to change the objective of a fair value measurement. However, the staff believes determining fair value in a market where there has been a significant decrease in the volume and level of activity for the asset at the measurement date is inherently complex, depends on the facts and circumstances and involves significant professional judgment.

STAFF RECOMMENDATION

7. The staff recommends that the Board emphasize that the FSP does not change the objective of a fair value measurement. That is, even when there has been a significant decrease in market activity for the asset, the fair value objective remains the same. Fair value is the price that would be received to sell the asset in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date in the current inactive market. The Staff also recommends that the Board consider highlighting and expanding on the relevant principles in Statement 157 that should be considered in estimating fair value when there has been a significant decrease in market activity for the asset in the final FSP.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommendations?

ISSUE 2 – FACTORS THAT INDICATE THAT THERE HAS BEEN A SIGNIFICANT DECREASE IN THE VOLUME AND LEVEL OF ACTIVITY FOR THE ASSET IN A MARKET THAT IS NOT ACTIVE

8. Constituents were largely in agreement that the factors included in paragraph 11 of the proposed FSP that could indicate that the market for an asset is not active are appropriate. Some respondents requested clarification of some of the factors or suggested additional factors. Some respondents also questioned how the factors should be considered for assets that normally transact in a market that is not active. Those respondents indicated that for those assets, a transaction price occurring in a market that is not active may not require significant adjustment to be considered a relevant observable input to a fair value measurement.
9. Based on those comments, the staff reconsidered how the factors should be applied. To avoid potential unintended consequences, the staff believes that the factors should be used to determine whether there has been a significant decrease in the volume and level of activity for the asset when the market for that asset is not active. The staff has added language to clarify that the factors should be considered in relation to the normal market activity for the asset. The staff has also added additional factors suggested by constituents to the proposed FSP.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommended changes to the application of the factors that indicate a market is not active and the changes to the list of factors?

ISSUE 3 - CHARACTERISTICS OF A TRANSACTION THAT IS NOT ORDERLY

10. Many respondents were concerned by the presumption in the proposed FSP that all transactions in a market that is not active are distressed unless there is evidence a transaction was not distressed (that is, there was sufficient time to market the asset and there were multiple bidders for the asset). Some respondents believe this presumption will enable reporting entities to ignore relevant market data. Other respondents highlighted that there may be unintended consequences because that presumption would potentially force reporting entities to dismiss quoted prices provided by pricing services or to otherwise exclude relevant market data. Some respondents also expressed concerns that the proposed FSP could significantly increase the occurrence of “Day 1 gains” (that is, the difference between transaction prices and the subsequent fair value measurement).
11. Other respondents supported the presumption because those respondents believe that it reduces the emphasis on the so-called “last-transaction-price” when markets are not active. Despite their general support, those same respondents did note that they believe that even in circumstances where there are multiple bidders and sufficient marketing time a transaction could still be distressed. They indicated that when multiple bidders know that the seller is in financial distress the bidders can take advantage of the circumstances.

STAFF RECOMMENDATION

12. The staff recommendation is to remove the presumption that all transactions are distressed unless proven otherwise. The staff believes that it was not the Board's intention to exclude relevant transaction information or preclude the use of pricing services or brokers in a fair value measurement. The staff recommends that the Board require that entities consider whether there are circumstances that indicate that a transaction is not orderly. Circumstances could include:

- a. The seller is in or near bankruptcy or receivership or the seller was required to sell to meet regulatory requirements.
- b. There was a usual and customary marketing period, but the seller marketed the asset to a single market participant.
- c. The transaction price is an outlier relative to other similar transactions.

13. The entity would conclude whether the transaction was orderly based on the weight of the evidence. Quoted prices that are not representative of an orderly transaction are not determinative of fair value nor are they determinative of market participant risk premiums. In estimating fair value, more weight should be placed on transactions that the reporting entity concludes are orderly. Less weight should be placed on transactions that the reporting entity does not have sufficient information to conclude whether the transaction is orderly. Reporting entities do not have to incur undue cost and effort in making these determinations. However, the staff believes reporting entities ordinarily have sufficient information to conclude whether a transaction is orderly when they are party to the transaction.

QUESTIONS FOR THE BOARD

Does the Board agree with the staff's recommendation to remove the presumption that all transactions within a market are distressed unless the reporting entity can provide evidence that a transaction is not distressed?

Does the Board agree with the circumstances that may indicate that the transaction is not orderly and the other changes to the model for considering transaction prices when the volume and level of activity for the asset has significantly decreased?

ISSUE 4 - EXAMPLE

14. As noted in paragraph 5 of this handout, many respondents noted that the example should be clarified to better illustrate the objective of a fair value measurement when there has been a significant decrease in the volume or level of activity for the asset. In addition, respondents indicated that the example should provide additional explanation about how the estimates within the range were derived and how to properly weight the indications.

STAFF RECOMMENDATION

15. The staff recommends that the Board provide additional clarity about how the reporting entity in the example arrived at its estimate of fair value.

QUESTION FOR THE BOARD

Does the Board agree with the Staff's recommendation?

ISSUE 5 - DISCLOSURES

16. All investors indicated that the FSP should require additional disclosures, especially for Level 3 fair value measurements. They indicated that the current level of detail required

by Statement 157 is insufficient. That is, they would like disclosures about the inputs and valuation techniques in more detail and in interim periods. Some suggested using the disaggregation requirements in Statements 115 and 133.

STAFF RECOMMENDATION

17. Consistent with the proposed FSP, at a minimum the staff recommends that the Board require reporting entities to disclose a change in valuation technique (and related inputs) resulting from the application of the FSP, and quantify its effects, if practicable.
18. In addition, the staff recommends that the Board require that reporting entities determine “major categories” (that is, the level of detail of the Statement 157 disclosures) using other applicable accounting standards requiring disclosure of major categories (for example, paragraph 19 of Statement 115 and paragraph 44C of Statement 133). Currently, major category could be interpreted as balance sheet line item and investors have indicated that the categories used in Statement 115, for example, would provide more useful information.

QUESTION FOR THE BOARD

Does the Board agree with the staff’s recommended disclosures?

ISSUE 6 - SCOPE

19. The scope of the proposed FSP applies to financial assets. One respondent suggested that the proposed FSP should apply to liabilities measured at fair value on a recurring basis. It cited that the limited scope would result in a derivative that is in an asset position being measured differently than a derivative in a liability position. Other respondents indicated that the scope should apply to all fair value measurements. Others were concerned by

broadening the scope if the Board's intention is that an exit price is no longer required when the measurement is within the scope of the FSP.

STAFF RECOMMENDATION

20. If the Board affirms the staff's recommendation not to change the fair value measurement objective (that is, the exit price notion), the staff recommends that the Board not limit the scope of the FSP.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommended scope of the FSP?

ISSUE 7 - EFFECTIVE DATE AND TRANSITION

21. The proposed FSP indicated that the FSP would be effective for periods ending after March 15, 2009, applied prospectively.

22. Many preparers indicated that they would like to apply the FSP retrospectively (for example, applied as of December 31, 2008). Investors generally indicated that retrospective application should not be permitted as this causes additional complexity in their analysis. Investors also expressed concern that the benefit of hindsight could result in a bias in any restated fair value measurements.

23. Some preparers suggested that the Board require an effective date of periods ending after June 15, 2009 with early adoption permitted. They noted that depending on the FSP's final requirements, entities may not be ready to apply the FSP for periods ending after March 15, 2009.

STAFF RECOMMENDATION

24. The staff recommends that a final FSP be effective for periods ending after June 15, 2009 with early application permitted for periods ending after March 15, 2009. Retrospective application would not be permitted.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommended effective date and transition?

ISSUE 8 - PERMISSION TO BALLOT

Does the Board approve of proceeding with the issuance of a final FSP?



Financial Accounting Standards Board

Board Meeting Handout¹

Proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*

April 2, 2009

PURPOSE OF MEETING

1. The Board will discuss the comments received in response to the proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b, *Recognition and Presentation of Other-Than-Temporary Impairments*. The staff also plans to discuss with the Board whether the proposed FSP should be issued as a final FSP and any necessary adjustments to the proposed FSP as a result of the comments received.

OVERVIEW

2. The comment period on the proposed FSP ended on April 1, 2009. As of 5:00 pm on April 1, 2009, the FASB received over 250 comment letters on this proposed FSP. The pool of respondents includes preparers, individuals, investors and other users of financial statements, regulatory bodies, accounting firms, business associations, and industry organizations. The staff and individual Board members also informally discussed the proposed FSP with a number of preparers and users of financial statements that did not provide formal comment letters. Though a few respondents did not support the proposed FSP, primarily because of a perceived increase in complexity as a result of the requirement to separate an other-than-temporary impairment into a credit and noncredit component, the majority of respondents (including many users) supported the proposed guidance relating to other-than-temporary impairments. Significant issues raised by respondents that warrant consideration by the Board are discussed below.

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ISSUE 1: OTHER-THAN-TEMPORARY IMPAIRMENT CRITERION

3. The majority of preparers who submitted comment letters supported the replacement of the requirement that management assert that it has both the intent and ability to hold an impaired security for a period of time sufficient to allow for any anticipated recover in fair value with the requirement that management assert that (a) it does not have the intent to sell the security and (b) it is more likely than not that it will not have to sell the security before recovery of its cost basis to avoid considering an impairment to be other than temporary. Those respondents indicated that the proposed requirement would be more operational than the current requirement. However, certain preparers and the majority of auditors, regulators, and users were opposed to changing this requirement for equity securities. Those respondents do not believe the revised requirements would be operational for equity securities because equity securities generally do not have contractual cash flows that would allow an entity to assess when the cost basis of the security will be recovered. Certain respondents, including many users, were also concerned that the revised requirements would allow an entity to delay the recognition of an other-than-temporary impairment on an equity security by asserting that it does not intend to sell the security.
4. Some respondents questioned how the guidance in the proposed FSP would interact with other existing factors used to determine whether a security is other than temporarily impaired (that is, whether an entity need only consider whether it intends to sell a security or whether it is more likely than not that it will have to sell the security before recovery of its cost basis). Those respondents noted that although the background section of the proposed FSP noted that other aspects of determining whether a security is other-than-temporarily impaired remain unchanged, the remainder of the FSP and the amendments to other standards only discuss the intent to sell and the requirement to sell and do not indicate how the other existing factors should be considered. Certain respondents also requested additional guidance on the application of the “intent to sell” criterion, such as over what period the entity would be required to assert that it does not intend to sell the security.

STAFF RECOMMENDATION

5. The staff recommends that the change to existing guidance for determining whether an

impairment is other than temporary be limited to debt securities.

6. For debt securities, the staff recommends that the Board affirm its decision to replace the requirement for management to assert that it has both the intent and ability to hold an impaired security until recovery with the requirement that management assert that (a) it does not have the intent to sell the security and (b) it is more likely than not that it will not have to sell the security before recovery of its cost basis. The staff believes the confusion about the interaction of the guidance in the proposed FSP and other existing factors is that the existing factors are described in SEC Staff Accounting Bulletin (SAB) Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*, and other related literature. The staff recommends that this FSP amend FSP FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, to include the examples of factors that should be considered in determining whether a debt security is other than temporarily impaired from existing literature and how those factors interact with the requirement to assert that the entity does not intend to sell and it is more-likely-than not that the entity will not be required to sell the security before recovery of its cost basis.
7. The staff believes that when evaluating a debt security for other-than-temporary impairment, the entity should first consider whether the entity intends to sell the security (that is, whether the entity has made a decision to sell the security). If the entity intends to sell the security, an other-than-temporary impairment should be considered to have occurred.
8. If the entity does not intend to sell the security, the entity should consider available evidence to estimate the anticipated period over which the cost basis of the security is expected to recover. There are numerous factors to be considered when estimating the anticipated recovery period and their relative significance will vary from case to case. The following are only a few examples of the factors that should be considered:
 - a. The length of time and the extent to which the fair value has been less than amortized cost,
 - b. Adverse conditions specifically related to the security or to specific conditions in an industry or in a geographic area (for example, changes in the financial condition of

- the issuer of the security, including changes in technology or the discontinuance of a segment of the business that may affect the future earnings potential of the issuer of the security),
- c. The historic and implied volatility of the security,
 - d. Failure of the issuer of the security to make scheduled payments,
 - e. Any changes to the rating of the security by a rating agency,
 - f. Recoveries or additional declines in fair value subsequent to the balance sheet date.

If the entity does not anticipate recovery of the entire cost basis of a security (for example, if it is probable that the investor will be unable to collect all amounts due according to the contractual terms of a debt security accounted for in accordance with FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, or it is probable that there has been an adverse change in estimated cash flows of a debt security that is a beneficial interest accounted for in accordance with EITF Issue No. 99-20, “Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets”), an other-than-temporary impairment should be considered to have occurred.

9. Once an anticipated recovery period has been determined, the entity should then determine whether it is more likely than not that it will be required to sell the security prior to its anticipated recovery. If it is more likely than not that an entity will be required to sell the security before its anticipated recovery, an other-than-temporary impairment should be considered to have occurred.

QUESTIONS FOR THE BOARD

Does the Board agree with the staff's recommendation that the change to existing guidance for determining whether an impairment is other than temporary be limited to debt securities?

Does the Board affirm its decision to replace the requirement for management to assert that it has both the intent and ability to hold an impaired security until recovery with the requirement that management assert that (a) it does not have the intent to sell the security and (b) it is more likely than not that it will not have to sell the security before recovery of its cost basis?

Does the Board agree with the staff's recommendation to incorporate the examples of factors that should be considered in determining whether a security is other-than-temporarily impaired from existing literature and how those factors interact with the requirement to assert that the entity does not intend to sell the security and it is more-likely-than not that the entity will not have to sell the security before recovery of its cost basis?

ISSUE 2: PRESENTATION

10. The majority of respondents favored recognizing the noncredit portion of an other-than-temporary impairment of a debt security in other comprehensive income when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security before recovery of its cost basis. However, certain respondents were opposed to this change. Except for preparer respondents, the majority of respondents also favored separately presenting the total other-than-temporary impairment and the amount recognized in other comprehensive income on the face of the statement of earnings.
11. Some users favored separate presentation of the credit and noncredit portions of an other-than-temporary impairment on the face of the income statement. Certain of those users only favored separate presentation of the credit and noncredit portions of an other-than-temporary impairment in the statement of earnings (that is, with the entire amount being recognized in earnings), while others were not opposed to an entity recognizing the noncredit portion of the other-than-temporary impairment in other comprehensive income. Some users opposed the separate presentation of credit and noncredit components of an other-than-temporary impairment, fearing it would make the noncredit portion less relevant.
12. The majority of preparer respondents stated that only the credit portion of an other-than-temporary-impairment, not the gross amount, should be presented on the face of the income statement. These respondents believe that gross presentation of an other-than-temporary impairment would not contribute to the usefulness of the financial statements and would only serve to confuse users. Those respondents further commented that gross amount of an other-than-temporary impairment would be more appropriately disclosed in footnotes to the financial statements.

STAFF RECOMMENDATION

13. The staff recommends that the Board affirm its decision to require that an entity recognize the credit component of an other-than-temporary impairment of a debt security in earnings and the remaining portion in other comprehensive income when the entity does not intend to sell the security and it is more likely than not that the entity will not be required to sell the security prior to the recovery of its cost basis. The staff also recommends that the Board affirm its decision to require that entities present the total other-than-temporary impairment in the statement of earnings with an offset for the amount of the total other-than-temporary impairment that is recognized in other comprehensive income, if any.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommendation?

ISSUE 3: HELD-TO-MATURITY DEBT SECURITIES

14. The majority of preparer respondents disagreed with the requirement in the proposed FSP to include the noncredit portion of an other-than-temporary impairment of a held-to-maturity debt security in other comprehensive income. Those respondents indicated that recording market losses on held-to-maturity debt securities is inconsistent with the notion that such investments are being held to maturity and will not be subject to any market-related losses. Those respondents were concerned such a requirement would confuse readers of the financial statements and add unnecessarily complicated operational procedures for preparers by requiring that the noncredit component be accreted back to the value of the security over the remaining life of the security. Respondents that did not agree with the treatment of held-to-maturity debt securities in the proposed FSP recommended that only credit losses be recognized for held-to-maturity debt securities and that the fair value of those securities be disclosed in the notes to the financial statements.
15. Some respondents were in favor of the requirement to include the noncredit portion of an other-than-temporary impairment of a held-to-maturity debt security in other comprehensive income and to accrete this amount over the remaining life of the security. Those respondents noted that this treatment allows an entity to only recognize credit-related losses in earnings,

while still providing information about the fair value of the security in the balance sheet. In addition, the majority of users that were in favor of separating an other-than-temporary impairment into a credit and noncredit component were in favor of this requirement (that is, they were in favor of writing a held-to-maturity debt security down to fair value).

STAFF RECOMMENDATION

16. The staff recommends that the Board retain the requirement in the proposed FSP to recognize noncredit losses on held-to-maturity debt securities in other comprehensive income and amortize that amount over the remaining life of the security in a prospective manner by offsetting the recorded value of the asset.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommendation regarding other-than-temporary impairments of held-to-maturity debt securities?

ISSUE 4: CREDIT LOSSES

17. The proposed FSP indicates that in determining the amount of the total other-than-temporary impairment related to credit losses, the reporting entity should use its best estimate of the amount of the other-than-temporary impairment that relates to an increase in the credit risk associated with the specific instrument. The FSP refers to FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, and Issue 99-20 as possible methods for estimating that amount.
18. The majority of preparer respondents indicated that the guidance in the proposed FSP for separating credit losses from noncredit losses is operational. Several respondents indicated that additional clarification of the meaning of "credit losses" would be helpful. Those respondents suggested that the FSP clarify that the amount recognized for credit losses should be based on an estimate of the actual credit losses rather than an extraction of the portion of the fair value affected by the change in credit risk. One respondent suggested that this clarification could be accomplished by replacing the phrase "an increase in the credit risk" with "credit deterioration."

19. Certain respondents requested additional detailed guidance on determining the portion of an other-than-temporary impairment that relates to credit for specific types of securities, including corporate bonds and securities accounted for in accordance with Issue 99-20. Several respondents requested that the Board clarify whether an adverse change in cash flows that results from an increase in expected prepayments should be recognized in earnings as a credit loss or in other comprehensive income.
20. Some respondents were concerned that credit losses would represent management's estimate of declines in cash flows and not market participants' expectations about future declines in cash flows.

STAFF RECOMMENDATION

21. The staff believes the Board's intention was to require that credit losses be measured based on an entity's estimate of the decrease in expected cash flows, similar to the model used to measure loan losses in Statement 114. The staff notes that the Statement 114 model was not prescribed in the FSP because comment letters received on proposed FSP FAS 107-a, *Disclosures about Certain Financial Assets*, expressed concerns about applying that model to available-for-sale and held-to-maturity debt securities. The staff believes these concerns primarily related to requiring the same model (the Statement 114 model) for all debt securities, including securities subject to Issue 99-20 and corporate bonds. The staff recommends that the FSP clarify that credit losses should be based on the reporting entity's estimate of the decrease in expected cash flows or the entity's best estimate of the amount of the other-than-temporary impairment that relates to credit deterioration. The staff recommends that the FSP continue to refer Statement 114 as a possible method that could be used to estimate credit losses and to require that investments accounted for in accordance with Issue 99-20 apply the guidance in that Issue. However, the staff does not recommend that the Board prescribe a specific method to be applied for securities that are not subject to Issue 99-20. Also, for some instruments, such as those described in paragraph 14 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, because an increase in prepayments would result in a decrease in expected cash flows, the staff recommends that the Board clarify that a decrease in

expected cash flows that results from an increase in expected prepayments should be accounted for as a credit loss when an entity is determining the amount of an other-than-temporary impairment related to credit losses that should be recognized in earnings.

QUESTIONS FOR THE BOARD

Does the Board agree with the staff's recommendation that credit losses should be based on the reporting entity's estimate of the decrease in expected cash flows?

Does the Board agree with the staff's recommendation that a decrease in expected cash flows that results from an increase in expected prepayments should be accounted for as a credit loss?

ISSUE 5: SUBSEQUENT ACCOUNTING

22. A number of respondents requested the Board provide additional guidance for subsequently accounting for available-for-sale securities when an other-than-temporary impairment is recognized and only the credit portion of the other-than-temporary impairment is recognized in earnings. One respondent suggested that the Board clarify whether the subsequent accounting guidance in FSP FAS 115-1 and FAS 124-1 and Issue 99-20 would continue to apply. Another respondent requested the proposed FSP include detailed examples of the subsequent accounting for debt securities for which an other-than-temporary impairment is recognized.

STAFF RECOMMENDATION

23. The staff recommends that the FSP clarify that existing premiums or discounts and subsequent changes in estimated cash flows or fair value should continue to be accounted for in accordance with existing guidance (for example, a favorable change in estimated cash flows for a security accounted for in accordance with Issue 99-20 would be reflected as an adjustment of the accretable yield). The staff does not believe that additional specific guidance or examples are necessary.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommendation?

ISSUE 6: DISCLOSURE

24. Some respondents recommended the FSP require separate presentation or disclosure of the noncredit portion of an other-than-temporary impairment recorded in accumulated other comprehensive income. Additionally, a number of users indicated that separately recognizing the noncredit portion of an other-than-temporary impairment in other comprehensive income could lead to decreased investor confidence unless additional information is provided to help investors understand the assumptions used in determining the credit component. Those users indicated that it would be useful to have more information by type of security based on the nature and risks of the security (for example, residential mortgage-backed securities, commercial mortgage-backed securities, and collateralized debt obligations) on a quarterly basis, including the cost basis of the security. Users also indicated that some of the inputs they would be interested in for entities that have separated an other-than-temporary impairment between credit and noncredit components would include performance indicators of the underlying assets in the security, such as delinquency rates and percentage of nonperforming assets, loan to collateral value ratios, third party guarantees, levels of subordination, vintage, and credit ratings. Additionally, several users suggested a rollforward of amounts recognized in earnings for debt securities for which an other-than-temporary impairment has been recognized and the noncredit portion of the other-than-temporary impairment has been recognized in other comprehensive income.

STAFF RECOMMENDATION

25. The staff recommends that the Board require entities to separately present in the financial statement where the components of other comprehensive income are reported, amounts recognized in accumulated other comprehensive income related to held-to-maturity and available-for-sale debt securities for which the noncredit portion of an other-than-temporary impairment was recognized in other comprehensive income. The staff also recommends that the Board require the additional disclosures described in separate appendix provided to the Board. The changes to Statement 115 and FSP 115-1 and FAS 124-1 would include:

- a. Requiring that entities provide disaggregate information based on the nature and risks of the security and including additional types of securities in the list of

major security types listed in Statement 115

- b. Requiring that an entity provide the cost basis of available-for-sale and held-to-maturity debt securities by major security type
- c. Requiring that an entity provide information by major security type about the methodology and key inputs used to measure the portion of an other-than-temporary impairment related to credit losses
- d. Providing examples of key inputs that may have been used to measure the portion of an other-than-temporary impairment related to credit losses or in reaching a conclusion that a security is not other-than-temporarily impaired, including performance indicators of the underlying assets in the security, loan to collateral value ratios, third party guarantees, levels of subordination, and vintage
- e. Requiring that an entity provide a rollforward of amounts recognized in earnings for debt securities for which an other-than-temporary impairment has been recognized and the noncredit portion of the other-than-temporary impairment has been recognized in other comprehensive income
- f. Requiring that Statement 115 and FSP FAS 115-1 and FAS 124-1 disclosures be provided for interim periods.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommendation?

ISSUE 7: SCOPE OF SHORT-TERM PROJECT

26. A significant number of respondents that supported issuance of the proposed FSP recommended that the Board take this opportunity to make additional changes to the other-than-temporary impairment guidance that are not within the scope of this project. The suggested changes include:

- a. Modifying the language in paragraph 16 of Statement 115 that indicates that all cash flows be collectable as originally scheduled or estimated by indicating that “an insignificant delay or insignificant shortfall in amount of payments does not automatically result in OTTI (similar to paragraph 8 of Statement 114)
- b. Reconsidering the use of fair value to measure other-than-temporary impairments and instead only requiring that probable credit losses be recognized as an other-than-temporary impairment unless there is an intent to sell or it is more likely than not that the entity will be required to sell prior to

recovery (that is, requiring an impairment model similar to the model for loans and not requiring any amounts to be recognized in other comprehensive income)

- c. Reconsidering the prohibition against reversals of other-than-temporary impairments
- d. Eliminating any remaining differences between the other-than-temporary impairment models in Statement 114 and Issue 99-20
- e. Requiring that all financial instruments be recognized at fair value and that all changes in fair value be recognized in earnings
- f. Addressing equity securities that have characteristics of debt securities, such as asset-backed securities and perpetual preferred securities, including allowing entities that invest in equity securities that hold asset-backed securities to “look through” to the underlying debt securities and apply the guidance for debt securities in the proposed FSP
- g. Giving entities that had not previously elected the fair value option in accordance with FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, the ability to make that election.

STAFF RECOMMENDATION

27. The staff recommends that the Board not expand the scope of the proposed FSP. The staff notes that the FASB and the IASB have a joint project to consider improvements to financial reporting for financial assets and financial liabilities. That project will include a reconsideration of impairments of financial assets (for example, whether there are better alternatives to impairment tests and how the impairment should be measured and presented and/or disclosed). The FASB also has a separate project to consider allowing recoveries of other-than-temporary impairments.

QUESTION FOR THE BOARD

Does the Board agree with the staff's recommendation not to expand the scope of the proposed FSP?

ISSUE 8: EFFECTIVE DATE AND TRANSITION

28. A number of respondents suggested that the effective date of the proposed FSP be revised to

allow entities to apply the FSP to quarters ending December 31, 2008 or earlier periods. Some respondents suggested that the FSP be applied retrospectively or that entities be allowed to record a cumulative effect adjustment for securities owned as of the period of adoption. Those respondents cite inconsistency in the subsequent accounting for securities with other-than-temporary impairments prior to the effective date of the FSP and those with an other-than-temporary impairment after the effective date as a reason for retrospective application. For example, the yield on a held-to-maturity security could be significantly different depending on whether an other-than-temporary impairment was recognized on the security before or after the effective date of the FSP. Additionally, those respondents noted that there could be a lack of comparability among entities holding the same security depending on the timing of the recognition of an other-than-temporary impairment. One preparer respondent also questioned how it would account for additional credit losses when an other-than-temporary impairment that includes credit and noncredit was recognized prior to the effective date of the FSP and cumulative credit losses after the effective date are less than the amount of the original other-than-temporary impairment recognized in earnings.

29. Other respondents expressed support for prospective transition and expressed concerns with an alternative that would require retrospective transition, including concerns about the availability of historical data to support the measurement of credit losses, and questioned whether retrospective treatment would have any benefit to users of financial statements. The majority of users questioned by the staff were not in favor of an earlier effective date or retrospective application.
30. A number of respondents suggested that the effective date of the proposed FSP be revised to be required for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted.

STAFF RECOMMENDATION

31. The staff recommends that the FSP be applied for interim and annual reporting periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. Earlier application for periods ending before March 15, 2009 would not be permitted.

32. The staff recommends that the Board require that entities record a cumulative effect adjustment as of the beginning of the period of adoption to reclassify the noncredit component of a previously recognized other-than-temporary impairment from retained earnings to other comprehensive income if the entity does not intend to sell the security and it is not more likely than not that the entity will be required to sell the security before recovery. The staff acknowledges that this alternative could result in an entity recognizing an other-than-temporary impairment in the statement of earnings more than once (once when the entire amount was recognized in earnings prior to the effective date of this FSP and again if there are credit losses after the effective date of the FSP). However, the staff believes it is more important to have consistency and comparability in the accounting for debt securities subsequent to the recognition of an other-than-temporary impairment.

QUESTIONS FOR THE BOARD

The Board will be asked to decide on the effective date of the FSP after the discussion of FSP FAS 107-b and APB 28-a, Interim Disclosures about Fair Value of Financial Instruments. Does the Board agree with the transition recommended by the staff?

Does the Board approve of proceeding with the issuance of a final FSP?



Board Meeting Handout
REDELIBERATION OF THE PROPOSED FSP FAS 107-B AND APB 28-A,
INTERIM DISCLOSURES ABOUT FAIR VALUE OF FINANCIAL INSTRUMENTS
April 2, 2009

PURPOSE

1. The staff will discuss with the Board comments received in response to the exposure draft of Proposed FSP FAS 107-b and APB 28-a, *Interim Disclosures about Fair Value of Financial Instruments*. The staff also plans to discuss with the Board whether the proposed FSP should be issued as final and any necessary adjustments to the proposed FSP as a result of the comments received as well as other due diligence performed.

Respondent Profile

2. The comment period of the proposed FSP FAS 107-b and APB 28-a ended on March 2, 2009. As of March 15, 2009, 45 comment letters were received, as summarized below.

Type of Respondent	Number	Generally support the proposed FSP	Do not support the proposed FSP	Did not indicate overall position
Accounting Firm	6	4	1	1
Consulting Firm	1	0	1	0
User	1	1	0	0
Individual	2	0	1	1
Professional / Industry Organization	9	1	8	0
Preparer:				
Financial Institution	22	1	21	0
Other	4	2	2	0
Total Preparer	26	3	23	0
TOTAL	45	9	34	2

3. The proposed FSP addressed users' request for more frequent fair value information. Most preparers, the majority of respondents, did not support the proposed FSP. However, many of the respondents who did support the guidance provided comments to improve certain aspects of the proposed FSP. This handout is divided into the following sections to highlight the significant issues raised by respondents:

- (a) Overall Objective of the Proposed FSP
- (b) Scope
- (c) Disclosures
- (d) Other issues
- (e) Effective Date and Transition.

ISSUE 1: OVERALL OBJECTIVE OF THE FSP

4. Constituents have raised concerns about the lack of comparability resulting from the use of different measurement attributes for financial instruments. The Board decided that increasing the frequency of fair value disclosures would improve the transparency and quality of information provided to users of financial statements. Most users indicated that measuring financial instruments at fair value is the most relevant measurement attribute in assessing the effect of current economic events on an entity.

5. Some respondents did not support a short-term response to addressing the complexity of the accounting and financial reporting of financial instruments. They requested that the Board resolve various concerns around fair value measurement prior to requiring more frequent fair value disclosures. Some respondents, mainly users, assert that more frequent fair value information is particularly important due to the current economic environment.

6. Many respondents commented that the cost to prepare the proposed fair value disclosures on an interim basis outweighs the possible incremental benefits provided to users of financial statements. Some respondents noted that in order to provide interim fair value disclosures, preparers must maintain both carrying value and fair value measurements on their systems for financial instruments.

Staff Recommendation

7. The staff notes that the comments regarding the overall objective of the FSP were expected. The majority of those who did not support the FSP were generally community bank preparers in similarly formatted letters. The goal of this short-term disclosure project is to (a) provide additional useful information to users in a timely manner, (b) assist preparers in better explaining the effects of current market conditions on their financial instruments, and (c) execute these changes in a manner that creates the least amount of disruption to financial reporting. The suggestions to include this project within the joint Financial Instruments: Improvements to Recognition and Measurement project would not address the objectives of this project.

8. In addition to the comment letter process, the staff has received informal feedback from users and preparers who are in favor of the FSP as proposed. They noted that additional fair value disclosures will increase the comparability of financial instruments across different measurement attributes as well as provide transparency for users to begin a conversation with the companies that they analyze. Given the unique objectives of this project, the staff recommends that this project be completed.

Question for the Board

Does the Board agree with the staff's recommendation to proceed with this project?

ISSUE 2: SCOPE

All financial instruments within the scope of Statement 107

9. Question 1 of the Notice for Recipients of the proposed FSP requested constituents to provide comments on whether they agreed that the proposed disclosures should apply to all financial instruments currently included within the scope of Statement 107. Most respondents, who agreed with the proposed FSP, agreed that the proposed disclosures should apply to all financial instruments included within the scope of Statement 107.

10. A few respondents did not agree that the FSP should apply to all financial instruments currently within the scope of Statement 107. They were concerned that the costs of requiring

entities to disclose the fair value of financial instruments with a measurement attribute other than fair value on a quarterly basis outweigh the benefits.

All entities within the scope of Statement 107

11. Question 2 of the Notice for Recipients of the proposed FSP requested constituents to provide comments on whether they agreed that the proposed disclosures should be applicable to all entities covered by Statement 107. Most of the respondents commented that the scope of entities for which the proposed FSP should apply should be smaller than the scope of entities for which Statement 107 is applicable. Many respondents, in similarly formatted letters, cited concerns that the FSP would impose a cost burden on entities for which there would be little incremental improvement to financial reporting.

Staff Recommendations

12. ***All financial instruments within the scope of Statement 107:*** The staff agrees with the scope of financial instruments as exposed which included all financial instruments currently within the scope of Statement 107.

13. ***All entities within the scope of Statement 107:*** For interim disclosures required by this FSP, the staff recommends that all nonpublic entities be excluded from the scope of this FSP. The staff notes that users of nonpublic entity financial statements generally have other means of obtaining the fair value information, if relevant, for their analysis. The staff recommends that all public entities be included as the users of public entities financial statements would generally not have access to obtaining such information on a quarterly basis.

Questions for the Board

Does the Board agree with the staff's recommendation to retain the scope of instruments as exposed, more specifically, all financial instruments currently within the scope of Statement 107?

Does the Board agree with the staff's recommendation to require the proposed disclosures for public entities only?

ISSUE 3: DISCLOSURES

Methods and Significant Assumptions

14. In addition to requiring entities to disclose in their interim and annual financial statements the fair value of all financial instruments, the proposed FSP requires entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in those financial statements.

15. Most respondents agreed that the proposed requirement to disclose the method(s) and significant assumptions used to estimate the fair value for all financial instruments for all interim periods is operational. However, many respondents believe such disclosures should only be required for annual financial statements. These respondents commented that the method(s) and assumptions for measuring financial instruments generally do not change from period to period and including such disclosures in interim and annual financial statements may cause interim financial statement to be unduly voluminous. In addition, some respondents highlighted that the disclosure of method(s) and significant assumptions used to estimate fair value are only valuable to users when they relate to financial instruments for which there is little or no market activity causing the fair value to be based on the reporting entity's own assumptions (unobservable inputs).

16. Some respondents commented that there is an inconsistency between the proposed qualitative disclosure requirements for Statement 107 and the qualitative disclosure requirements currently required by Statement 157. These respondents noted that Paragraphs 32 and 33 of Statement 157 require entities to disclose valuation technique(s) used to measure fair value and a discussion of changes in valuation techniques, if any, in annual periods only. Most of the respondents that discussed the inconsistency suggested that the proposed FSP be amended to require qualitative disclosures only in annual financial statements.

Practicability

17. Some respondents commented that entities might use the practicability exception to avoid the proposed interim fair value disclosures. These respondents suggested that the Board clarify its intentions regarding the use of the practicability exception for interim financial statements.

Staff Recommendation

18. ***Methods and significant assumptions:*** The staff recommends that qualitative disclosures, for example, narrative disclosure about the valuation techniques used to measure fair value, should only be required on an annual basis, unless there is a change to the management's valuation methods or techniques on an interim basis.

19. ***Practicability exception:*** The staff notes respondents concerns surrounding the practicability exception as noted in paragraphs 14 and 15 of Statement 107. Determination of what is practicable is based on judgment and the rationale for that judgment is required if the practicability exception is employed by management. Based on the required disclosures and the fact that it is beyond the scope of this project, the staff recommends that additional guidance not be provided.

Questions for the Board

Does the Board agree with the staff's recommendation to require disclosure of methods and significant assumptions in the determination of fair value only for annual periods only unless there is a change in the interim periods?

Does the Board agree with the staff's recommendation to not provide additional guidance related to the practicability exception?

ISSUE 4: OTHER ISSUES

Loan Example Inconsistency with Statement 157

20. One respondent commented that questions have arisen about whether paragraph 31 of Statement 107 is inconsistent with the fair value measurement definition in Statement 157.

Disaggregation

21. One respondent commented that the fair value measurement disclosures made under existing standards do not provide useful information because the information is aggregated at too high a level. They further suggested that the proposed disclosures should further disaggregate

financial instrument categories such as separately presenting major categories of loans or trade receivables either in the balance sheet or in the notes to the financial statements.

Staff Recommendation

30. The staff recommends that the Board not address the questions related to paragraph 31 of Statement 107 and the fair value notion of Statement 157 as part of this FSP because it is beyond the intended scope. The staff recommends consideration of the comment as part of the Financial Instruments: Improvements to Recognition and Measurement project. Additionally, the staff believes that further disaggregation of financial instrument categories is beyond the scope of this FSP.

Questions for the Board

Does the Board agree that the fair value notion related to loans included in paragraph 31 is beyond the scope of this project and should be addressed as part of the Financial Instruments: Improvements to Recognition and Measurement project?

Does the Board agree additional disaggregation of financial instrument categories is beyond the scope of this FSP?

ISSUE 5: EFFECTIVE DATE AND TRANSITION

22. Question 3 of the Notice for Recipients of the proposed FSP requested constituents to provide comments on whether the proposed requirements to disclose fair value information for all interim and annual reporting periods ending after March 15, 2009 is operational. Of the respondents who supported the FSP, several noted that the effective date of interim and annual periods ending after March 15, 2009, is not operational, as it will not provide sufficient time for constituents to adequately consider and implement the proposed changes. A more reasonable effective date of interim and annual periods ending after June 15, 2009, was suggested by several respondents.

Questions for the Board

The Board will be asked to decide on the effective date of the FSP after the discussion of FSP FAS 107-b and APB 28-a, Interim Disclosures about Fair Value of Financial Instruments.

Does the Board authorize the staff to proceed to a draft of the final FSP for vote by written ballot?



Financial Accounting Standards Board

Board Meeting Handout

Insurance Contracts

April 2, 2009

PURPOSE

1. The Board will continue deliberations about accounting for insurance contracts. At this meeting, the Board will discuss three issues pertaining to the guidance on cash flows:
 - a. How should cash flows be determined—that is, based on expected (probability-weighted) cash flows or on the best estimate of the cash flows?
 - b. Should the cash flows be remeasured at each reporting period?
 - c. When (if ever) should market inputs be used in cash flows for a measurement based on a fulfillment value notion?

BACKGROUND

2. At the February 25, 2009, Board meeting, the FASB did not arrive at a conclusion regarding the features of a measurement approach for insurance contracts. Those proposed features (building blocks) included (a) the use of estimates that are as consistent as possible with observable market inputs,¹ (b) the use of explicit current estimates of the expected cash flows, (c) the reflection of the time value of money, and (d) the inclusion of an explicit margin. Conceptually, these building blocks were considered basic features necessary for any measurement for insurance contracts. The FASB cited strong concerns with feature (a), noting that the current wording implies an exit value notion and would not be applicable to other measurement objectives (such as a fulfillment value notion).

¹ At its February 2009 meeting, the IASB decided to narrow this principle to estimates of *financial market variables*.

3. However, the FASB tentatively decided that the measurement objective for insurance contracts should be based on a fulfillment value notion (said differently, the FASB rejected pursuing the measurement of insurance contracts at fair value). The fulfillment value notion has not been defined in terms of its building blocks (cash flows, discounting, and margins). At this meeting, the staff plans to discuss the first of those building blocks—guidance on cash flows.

GUIDANCE ON CASH FLOWS

4. *Fulfillment value* is defined as reflecting “...the insurer’s estimate of the expected present value of the future cash flows that will occur when the entity fulfills the insurance obligations with the policyholder over time.” This definition is broad and requires further description to translate the measurement objective into guidance for measuring insurance contracts at fulfillment value.

Issue 1—Expected Cash Flows versus Best Estimate

Relevant Comments on the IASB Discussion Paper

5. Respondents to the IASB Discussion Paper, *Preliminary Views on Insurance Contracts*, generally supported using expected cash flows (that is, a probability-weighted average) rather than a single best estimate outcome to measure cash flows. Those respondents stated that using a best, single point estimate is outdated and does not reflect how entities make decisions. For certain short-duration contracts in which there are numerous potential loss scenarios, measuring cash flows using expected cash flows is especially appropriate. Some respondents raised concerns about the application of the principle in practice, noting that probability weighting *all* possible cash flows is impracticable and would not result in more reliable estimates of insurance liabilities. Some respondents (U.S. non-life insurance entities) do not believe that probability-weighted cash flows provide a useful representation of the economics of short-duration insurance contracts.

Question for the Board

6. How should the cash flows used in measuring insurance contracts be determined (that is, based on an expected or best estimate of cash flows)?

Staff Recommendation

7. The staff recommends that cash flows for insurance contracts should be measured using the expected cash flows as defined in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*. The significant uncertainty in the amount and timing of cash flows related to an insurance contract is better reflected by expected cash flows. Similar to the thinking for financial guarantee insurance contracts, the staff believes that expected cash flows provide the most meaningful depiction of an insurance contract and its potential numerous outcomes. The staff points out that, in some cases, relatively simple modeling may provide an answer within a tolerable range of precision without the need for a large number of detailed simulations. On the other hand, cash flows may be driven by complex underlying factors and may require sophisticated stochastic modeling.

Issue 2—Remeasurement of Cash Flows

Relevant Comments on the IASB Discussion Paper

8. Respondents generally agreed that, instead of using locked-in estimates, the effects of changes in current estimates of cash flows should be recognized immediately in earnings. These respondents noted that financial reporting can be improved by eliminating the lock-in of assumptions so that significant changes in loss exposure for long-duration insurance contracts have an effect on earnings.

Question for the Board

9. Should cash flows be remeasured at each reporting period?

Staff Recommendation

10. The staff recommends that the cash flows should be remeasured at the end of each reporting period and that estimates of probability should be updated if evidence indicates that those estimates are no longer valid. Due to a significant inherent variability in the cash flows, the staff believes that remeasuring those cash flows at each reporting period provides decision-useful information in a timely manner as conditions change.

Issue 3—Use of Market Inputs in Fulfillment Value Notion

Relevant Comments on the IASB Discussion Paper

11. Respondents supported using market participant cash flows to the extent observable market inputs exist (for variables such as interest rates and equity prices). The IASB Discussion Paper argued that in practice, market participant cash flows relating to underlying insurance claims would not differ from entity-specific cash flows. Most respondents accepted this argument. However, many respondents disagreed with using data related to expenses that a market participant would incur rather than entity-specific expenses. Those respondents were concerned about persuading the auditors and regulators that enough work had been done to confirm that the entity's expenses were in line with a market participant's view of the expenses. In addition, respondents expressed their view that using an entity's expenses is the correct answer.

Question for Board

12. When (if at all) should market inputs be used in cash flows for a measurement based on a fulfillment value notion?

Staff Recommendation

13. The staff recommends that cash flows should be based on all information available to an entity. The staff believes that requiring all available information allows an entity to use entity-specific data as well as market inputs to derive cash flows that represent the economics of the insurance contract. All available information includes, but is not limited to, industry data (such as mortality tables), historical data of an entity's cost (such as an entity's expenses incurred in processing claims), and market inputs (such as interest rates, equity prices, and inflation).

14. However, the staff believes that a presumption exists that if an insurance contract incorporates a (financial) market variable with a market input and that market variable is integral to the fulfillment of the insurance contract, the market input is used. This presumption highlights the fact that market inputs are not excluded from a measurement based on a fulfillment notion and should be used when relevant to the measurement of the insurance contract (that is, for estimating the cash flows that would arise for the entity

that currently holds the liability). For example, a life insurance contract that is explicitly linked to the appreciation (or depreciation) of an equity security or a pool of equity securities (such as a variable universal life insurance contract) should incorporate the market input(s) of the equity security or pool of equity securities since the fair value of the security is integral to the calculation of insurance contract benefits.



Board Meeting Handout

FASB Exposure Draft, *The Objective of Financial Reporting and Qualitative Characteristics and Constraints of Decision-Useful Financial Reporting Information*

Redeliberations of the Objective of Financial Reporting and Drafting the Chapters

April 2, 2009

REDELIBERATIONS OF THE OBJECTIVE OF FINANCIAL REPORTING

1. The Exposure Draft proposed that the objective of financial reporting should encompass all decisions made by capital providers (of a reporting entity) in their capacity as capital providers. Such decisions will include resource allocation decisions and decisions made to protect and enhance their investments.
2. Most respondents agreed with the proposed objective and said that it was a major improvement compared to the Discussion Paper/Preliminary Views.
3. The staff recommends that the Board affirm the following issues:
 - a. The objective should be broad enough to encompass all the decisions that equity investors, lenders, and other creditors make in their capacity as capital providers
 - b. The objective should continue to focus on financial reporting rather than only financial statements, and more specific issues relating to boundaries of financial reporting be dealt at a later phase, as planned.
4. A group of respondents expressed a concern about the Exposure Draft's discussion of economic phenomena and information that depicts economic phenomena. They noted that even though the Boards proposed that the objective applies to financial reporting, the description of what an economic phenomenon is seems to focus on

the financial statements. The concern is that could be misunderstood as excluding or precluding forward-looking or prospective information or management commentary.

5. The staff agrees that the discussion of economic phenomena seems to focus on a narrower scope than what the Boards intended. The staff proposes the following revisions:

QC2. Economic phenomena are economic resources, claims to those resources, and the transactions and other events and circumstances that change them. Financial reporting information depicts economic phenomena ~~(that exist or have already occurred)~~ in words and numbers in financial reports. Financial reporting may also include forward-looking financial information, for example, explanatory material that assists users in understanding the expectations and strategies of the entity.

Questions for the Board

6. Does the Board confirm that the objective should be broad enough to encompass all the decisions that equity investors, lenders, and other creditors make in their capacity as capital providers?
7. Does the Board agree that Chapter 1 should continue to focus on the objectives of financial reporting **and**:
 - a. The scope of Chapter 1 should not be limited to only financial statements at this time?
 - b. A later phase should deal with more specific issues relating to boundaries of financial reporting, including placement of information within particular components of financial reporting?
 - c. The discussion of economic phenomena in Chapter 1 should not suggest or imply that forward-looking information would be excluded or precluded from financial reporting?

8. Does the Board agree with the staff's recommended revisions to improve the discussion of economic phenomenon and its relation to financial information?

DRAFTING THE CHAPTERS

9. The staff believes that all the major issues raised have been redeliberated and addressed by the Boards in response to the Objective and Qualitative Characteristics Exposure Draft. Therefore, the staff recommends proceeding with drafting the final Chapters. However, if during the drafting process, the staff finds issues that require the Boards' attention, we will bring them back as a sweep issue.
10. The staff also believes that the Boards have complied with the due process.

Question for the Board

11. Does the Board agree that the staff should commence drafting the final Chapters?