Notice for Recipients of This Proposed FASB Staff Position

This proposed FASB Staff Position (FSP) would amend the disclosure requirements in FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments,* to increase the comparability of information about certain financial assets that have related economic characteristics but have different reporting measurement attributes. The International Accounting Standards Board (IASB) is concurrently proposing a similar set of disclosures for reporting entities that prepare financial statements in accordance with International Financial Reporting Standards (IFRS).

The Board invites individuals and organizations to send written comments on all matters in this proposed FSP. Comments are requested from those who agree with the provisions of this proposed FSP as well as from those who do not. Comments are most helpful if they identify the issues to which they relate and clearly explain the issue or question. Those who disagree with provisions of this proposed FSP are asked to describe their suggested alternatives, supported by specific reasoning.

The Board requests that constituents provide comments on the following:

1. Do you believe that requiring disclosure of different reporting measurement attributes (that is, as reported in the statement of financial position, at fair value, and at the incurred loss amount) for certain financial assets within the scope of this proposed FSP would (a) improve the quality of information provided to users of financial statements and (b) increase the comparability of financial statements under U.S. generally accepted accounting principles (GAAP) and IFRS? Why or why not?

2. Do you agree that the proposed disclosures should not include financial assets measured at fair value in the statement of financial position with changes in fair value recognized through earnings? If not, would you propose including such financial assets within the scope of this proposed FSP? Should financial assets measured at the lower of cost or fair value (such as mortgage loans) be included within the scope of this proposed FSP? Why or why not?

3. Do you believe that requiring disclosures of the pro forma income from continuing operations (before taxes) for financial assets within the scope of this proposed FSP as if those financial assets were carried (a) at fair value with changes in fair value recognized through earnings and (b) at the incurred loss amount with changes recognized through earnings would improve financial reporting? Why or why not? Should the disclosure requirements described in the preceding sentence also be required for net income and shareholders' equity? Why or why not?
4. Would including separate reconciliations of reported income from continuing operations (before taxes) to the proposed pro forma adjusted income from continuing operations (before taxes) under both a fair value basis and an incurred loss basis for financial assets within the scope of this proposed FSP be useful? Why or why not?
5. Do you believe that the provisions of this proposed FSP should be effective for interim and annual reporting periods ending after December 15, 2008? Why or why not? Do you believe that the disclosures in this proposed FSP should be provided on a comparative basis for subsequent periods after initial application of the proposed FSP? Why or why not?
6. Are all of the disclosures in this proposed FSP operational based on the proposed effective date? Why or why not? Please be specific in your response.

Responses must be received in writing by January 15, 2009. Interested parties should submit their comments by email to "director@fasb.org, File Reference: Proposed FSP FAS 107-a." Those without email may send their comments to "Technical Director, FASB, 401 Merritt 7, P.O. Box 5116, Norwalk, CT 06856-5116, File Reference: Proposed FSP FAS 107-a." Responses should not be sent by fax.

All comments received by the FASB are considered public information. Those comments will be posted to the FASB's website and included as part of the public record with other project materials.

PROPOSED FASB STAFF POSITION

No. FAS 107-a

Title: Disclosures about Certain Financial Assets: An Amendment of FASB Statement No. 107

Comment Deadline: January 15, 2009

Objective

1. This FASB Staff Position (FSP) amends the disclosure requirements in FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, to increase the comparability of information about certain financial assets that have related economic characteristics but have different reporting measurement attributes. Those proposed disclosures have been developed jointly with the IASB as an interim step to help users of financial statements better understand and compare the effects of different accounting methods used for various financial assets, both under U.S. GAAP and IFRS. The FASB and IASB share a goal of requiring similar disclosures that would help investors when comparing financial statements of entities holding financial assets within the scope of this guidance.

Background

2. The existing accounting standards for financial assets result in financial assets that have related economic characteristics being measured differently depending on the type and classification of the financial asset. In addition, the impairment models applied to financial assets vary based on when the impairment is required to be recognized and how the impairment is measured. FASB Statements No. 5, *Accounting for Contingencies*, No. 114, *Accounting by Creditors for Impairment of a Loan*, and No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, among other standards, provide guidance for the recognition and measurement of financial assets, including the accounting for impairments.

3. Statement 115 requires that, at acquisition, an entity should classify debt and equity securities (within its scope) into one of three categories: held-to-maturity, available-for-sale, or trading. Securities classified as held-to-maturity are carried at amortized cost (as long as the

entity has the positive intent and ability to hold those securities to maturity). Securities classified as available-for-sale and trading are carried at fair value in the statement of financial position. Unrealized gains and losses for securities classified as available-for-sale are excluded from earnings and reported in other comprehensive income until realized or impaired. Unrealized gains and losses for securities classified as trading are included in earnings as they occur. Receivables and loans are generally measured at amortized cost (except for certain instances such as mortgage loans held for sale, which are accounted for under FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*).

4. Various sources of impairment guidance (described below) exist for most financial assets that are not measured at fair value with changes in fair value recognized through earnings.

a. Under paragraph 8 of Statement 114, a loan[1] is impaired when "it is probable that a creditor will be unable to collect all amounts due according to the contractual terms of the loan agreement." The measurement of impairment is based on the present value of expected future cash flows discounted at the loan's effective interest rate, except when a creditor determines that foreclosure is probable. Statement 114 allows two practical expedients when a creditor may measure impairment based on a loan's observable market price, or the fair value of the collateral if the loan is collateral dependent.

b. Statement 115 requires for individual securities classified as either available-for-sale or held-to-maturity that an entity determine whether a decline in fair value below the amortized cost basis is other than temporary. Paragraph 16 of that Statement provides the following 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 not impaired at acquisition, an other-than-temporary impairment shall be considered to have occurred. If the decline in fair value is judged to be other than temporary, the cost basis of the individual security shall be written down to fair value as a new cost basis and the amount of the write-down shall be included in earnings (that is, accounted for as a realized loss).[Footnote reference omitted.]

c. FASB Staff Position FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*, provides additional guidance for various types of securities about how to determine when an impairment is other than temporary. In addition, both Statement 115 and FSP FAS 115-1 and FAS 124-1 refer to other existing guidance, such as SEC Staff Accounting Bulletin

[1] See paragraph 4 of Statement 114 for the definition of a loan.

Topic 5M, *Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities*.

d. If the impairment guidance in Statements 114 or 115 does not apply, paragraph 8 of Statement 5 requires that an accrual for a loss contingency be recognized when (1) it is probable that an asset has been impaired or a liability incurred and (2) the amount of the loss can be reasonably estimated.

5. The Board received extensive input from constituents (such as financial statement users, preparers, auditors, and regulators) on financial reporting issues related to the measurement and impairment of financial assets. Some constituents (mainly users) indicated that measuring financial assets at fair value is more relevant than other measurements (such as amortized cost) in helping to assess the effect of current economic events on an entity. Other constituents asserted that fair value is not as relevant when financial markets are inactive or distressed. Those constituents stated that recognizing through earnings only the incurred loss component of a fair value decline is more representative of the cash flows that are expected to be collected, especially if the entity has no plans to sell the security. (Various alternatives were suggested for dealing with the difference between fair value and the incurred loss measure, including recording it in other comprehensive income.) Users stated that information about the incurred loss component of an impairment loss is useful information but that the full impairment loss (based on fair value) is still the most appropriate measurement and should be recognized in earnings. Generally, constituents agreed that additional disclosures would be helpful in understanding the different measurement attributes for financial assets applied by an entity and would increase the usefulness of its financial statements.

6. The Board acknowledges that the number and variations of measurement attributes and impairment models for financial assets create complexity. The Board recently added to its agenda a comprehensive joint project with the IASB to address these complexities related to recognition and measurement of financial instruments, including impairment.

7. However, to address on an interim basis the concerns raised about the lack of comparability resulting from the use of different measurement attributes for financial assets, the Board decided that enhancing disclosures about certain financial assets would improve the transparency and quality of information provided to users of financial statements. The Board also decided that the additional disclosures would result in greater understandability and comparability of certain

financial assets under U.S. GAAP and IFRS because, regardless of the differences in the recognition, measurement, and impairment models for financial assets under each set of accounting standards, the disclosure would present in one place comparative financial statement information relating to common measurement attributes required in both sets of accounting standards.

All paragraphs in this FSP have equal authority. Paragraphs in bold set out the main principles.

FASB Staff Position

Scope

8. **This FSP applies to the following financial assets:**

- **a. Debt securities classified as held-to-maturity**
- **b. Debt securities classified as available-for-sale**
- **c. Loans and long-term receivables except those measured at fair value with changes in fair value recognized through earnings.**

Amendment to Disclosure Requirements of Statement 107

9. **An entity shall disclose information that enables users of its financial statements to understand the different measurement attributes used to measure financial assets within the scope of this FSP.**

10. An entity shall provide a comparison of measurement attributes for the financial assets noted in paragraph 8 in a tabular format under the following column headings:

- a. As reported in the statement of financial position
- b. At fair value
- c. At the incurred loss amount.

11. The incurred loss amount represents the reported or pro forma carrying amount of the investment under an incurred loss model. For loans and receivables, an entity shall disclose the reported carrying amount based on their existing accounting policies under Statement 114 and Statement 5. For debt securities classified as held-to-maturity and available-for-sale, an entity

shall measure the incurred loss amount based on the present value of expected future cash flows discounted at the security's effective interest rate (consistent with Statement 114).

12. The line-item presentation of the financial assets in the table required in paragraph 10 shall be consistent with the line-item presentation of those financial assets in the entity's statement of financial position. In addition, debt securities accounted for under Statement 115 shall be presented in a manner consistent with the requirement to disclose information by major security type under Statement 115.

13. An entity also shall provide the following qualitative disclosures:

a. It's accounting policy for each type of financial asset in the table
b. The methodology used to estimate the key inputs used to measure the incurred loss amount (such as estimated cash flows), including any estimates of costs to sell the financial asset
c. To the extent known, a description of the factors causing the differences in measurements for each financial asset presented in the table.

14. For financial assets within the scope of this FSP, an entity shall disclose the pro forma income from continuing operations (before taxes) as if those financial assets were carried:

a. At fair value with changes in fair value recognized through earnings
b. At the incurred loss amount with changes recognized through earnings.

In addition, an entity shall disclose for comparison purposes the amount of income from continuing operations (before taxes) reported in the statement of income related to those financial assets.

15. To the extent possible, the disclosures required by this FSP shall be integrated with disclosures required by other accounting pronouncements to improve the cohesiveness of the disclosures and eliminate duplicate disclosures. For example, disclosures about inputs, assumptions, and methodologies used to estimate fair value that are required by Statement 107 and FASB Statement No. 157, *Fair Value Measurements*, would be most useful if they are presented together with the disclosures required by this FSP.

Effective Date and Transition

16. This FSP shall be effective for interim and annual reporting periods ending after December 15, 2008. This FSP does not require disclosures for earlier periods presented for comparative purposes at initial application or in subsequent periods.

The provisions of this FSP need not be applied to immaterial items.

Appendix

AMENDMENTS TO STATEMENT 107

A1. Statement 107 is amended as follows: [Added text is <u>underlined</u>.]

a. Paragraphs 15E–15I and the heading preceding them are added as follows:

<u>***Disclosures about Certain Financial Assets***</u>

<u>15E. The disclosure requirements of paragraphs 15F–15I apply to the following financial assets:</u>

<u>a. Debt securities classified as held-to-maturity</u>
<u>b. Debt securities classified as available-for-sale</u>
<u>c. Loans and long-term receivables except those measured at fair value with changes in fair value recognized through earnings.</u>

<u>15F. An entity shall disclose in the accompanying notes to the financial statements a comparison of measurement attributes for financial assets in a tabular format under the following column headings:</u>

<u>a. As reported in the statement of financial position</u>
<u>b. At fair value</u>
<u>c. At the incurred loss amount.</u>

<u>For purposes of this disclosure, the incurred loss amount represents the reported or pro forma carrying amount of the investment under an incurred loss model. For loans and receivables, an entity shall disclose the reported carrying amount based on their existing accounting policies under FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*, and FASB Statement No. 5, *Accounting for Contingencies*. For debt securities classified as held-to-maturity and available-for-sale, an entity shall measure the incurred loss amount based on the present value of expected future cash flows discounted at the security's effective interest rate (consistent with FASB Statement No. 114). An entity shall not also estimate an allowance for a pool of similar securities under Statement 5. The line-item presentation of the financial assets disclosed in the tabular format described in the first sentence of this paragraph shall be consistent with the line-item presentation of those financial assets in the entity's statement of financial position. In addition, debt securities accounted for under Statement 115 shall be presented in a manner consistent with the requirement to disclose information by major security type under Statement 115.</u>

<u>15G. An entity also shall provide the following qualitative disclosures:</u>

<u>a. Its accounting policy for each type of financial asset in the table</u>

b. The methodology used to estimate the key inputs used to measure the incurred loss amount (such as estimated cash flows), including any estimates of costs to sell the financial assets
c. To the extent known, a description of the factors causing the differences in measurements for each financial asset presented in the table.

15H. An entity shall also disclose the pro forma income from continuing operations (before taxes) as if the financial assets were carried:

a. At fair value with changes in fair value recognized through earnings
b. At the incurred loss amount with changes recognized through earnings.

In addition, an entity shall disclose for comparison purposes the amount of income from continuing operations (before taxes) reported in the statement of income.

15I. To the extent possible, the disclosures required in the preceding paragraphs shall be integrated with disclosures required by other accounting pronouncements to improve the cohesiveness of the disclosures and eliminate duplicate disclosures. For example, disclosures about inputs, assumptions, and methodologies used to estimate fair value that are required by this Statement and FASB Statement No. 157, *Fair Value Measurements*, would be most useful if they are presented together.

b. Paragraph 33A and the heading preceding it are added as follows:

Example 4—Disclosures about Different Measurement Attributes Relating to Certain Financial Assets

Corporation D might include the following summary tables (the qualitative disclosures required by paragraphs 15G have not been illustrated):

	At December 31, 200X		
	Reported Carrying Amount	**Fair Value**	**Incurred Loss Amount[(a)]**
Held-to-maturity debt securities:			
Corporate debt securities	$11[(b)]	$8	$12
Mortgage-backed securities	10[(b)]	5	11
Available-for-sale debt securities:			
Corporate debt securities	145[(c)]	145	175[(d)]
Mortgage-backed securities	50[(c)]	50	75[(d)]
Loans and lease receivables	150[(e)]	80	150[(g)]
Long-term receivables	80[(f)]	85	80[(g)]
Mortgage loans held for sale	40[(h)]	40	50
Total	$486	$413	$553

(a) For purposes of this disclosure, entities should only estimate the incurred loss amount for each individual security or loan that would be recognized under Statement 114. An entity shall not also estimate an allowance for a pool of similar securities under Statement 5.
(b) At amortized cost, net of other-than-temporary impairments.
(c) At fair value.
(d)At the present value of estimated cash flows, discounted using each financial asset's original effective interest rate.
(e) For loans evaluated individually under Statement 114, at the present value of expected cash flows, discounted using each financial asset's original effective interest rate or a practical expedient. For similar impaired loans evaluated as a pool, pursuant to Statement 5.
(f) Determined pursuant to Statement 5.
(g) The incurred loss amount column is not intended to require a new measurement for loans and long-term receivables. Rather, the incurred loss amount for these financial assets shall be calculated in a manner consistent with an entity's existing accounting policies.
(h)At the lower of cost or fair value.

	For the Year Ended December 31, 200X		
	Reported Income Statement Amount	**Fair Value**	**Incurred Loss Amount**
Income from continuing operations (before taxes) if all debt securities classified as held-to-maturity and available-for-sale, loans, and other long-term receivables were carried at:	$XXX	$XXX	$XXX