



Liabilities and Equity
Board Meeting Handout
January 3, 2007

BACKGROUND

1. At the September 7, 2006, Emerging Issues Task Force (EITF) meeting, the Task Force requested that the Board undertake a narrow project to make near-term improvements in the accounting by issuers of convertible debt. The suggestion arose because of existing practice problems and the length of the liabilities and equity project.

ALTERNATIVES

2. In response to the Task Force's recommendation, the Board will discuss the following four possible alternatives to address the EITF's request:

- a. **Alternative 1: Amend APB Opinion No. 14, *Accounting for Convertible Debt and Debt Issued with Stock Purchase Warrants*, to separate convertible debt and continue with the modified joint project.**

The Board would develop a limited-scope amendment of Opinion 14 that would require separation of convertible debt into liability and equity components. If the Board decides to proceed with this alternative, the staff would present comprehensive alternatives to the Board in early 2007 regarding scope, recognition, and measurement of convertible instruments.

One staff member supports this alternative. That staff member believes that amending Opinion 14 to require separation of convertible debt would result in a substantial improvement to financial reporting and increased international convergence. Other staff members are concerned that the limited scope of the amendment could lead to structuring opportunities and will not result in a simple, understandable, and decision-useful reporting standard. Certain staff members believe this alternative will have severe implications on the major project.

- a. **Alternative 2: Issue an Exposure Draft of the ownership-settlement approach and continue with the modified joint project.**

The Board would issue an Exposure Draft of the ownership-settlement approach, which would replace the existing fragmented accounting literature. At the same time, the Board would continue to work on developing a long-term solution within the liabilities and equity project and issue a Preliminary Views as originally planned.

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- b. **Alternative 3: Officially disband the modified joint project and issue an Exposure Draft of the Board's preferred approach.**

The Board would continue deliberations in the liabilities and equity project as planned; however, an Exposure Draft would be issued on its preferred approach instead of a Preliminary Views. The Board would issue a final Statement independent of the IASB.

- c. **Alternative 4: Commit both the FASB and the IASB Boards to an aggressive timeline for the modified joint project (do not follow any of the above alternatives).**

The Board would continue its deliberations in the liabilities and equity project as planned and issue a Preliminary Views. Upon issuing the Preliminary Views, the project would become a joint project with the IASB. This approach would commit both Boards to an accelerated timeline for completion of the project.

Some staff members support this alternative because it will result in a comprehensive standard that replaces the current piecemeal literature. This alternative will decrease the structuring of transactions to achieve desired accounting treatment and increase convergence with the IASB.

QUESTIONS FOR THE BOARD

- 3. **Does the Board want to amend Opinion 14 based on the EITF's recommendation? If so, what would be the nature and scope of the amendment (that is, a limited scope of Opinion 14 for convertible instruments only versus the issuance of an Exposure Draft on the ownership-settlement approach)?**



**Board Meeting Handout
Fair Value Option Phase 1
January 3, 2007**

PURPOSE OF THIS MEETING

1. At today's Board meeting, the Board will discuss certain disclosures in Phase 1 of the Fair Value Option (FVO) project that were recommended by users and included in the FVO Cold Review Draft.

CERTAIN FVO DISCLOSURES

Extent to Which Items Are Measured at Fair Value in the Statement of Financial Position

2. The Cold Review Draft requires an entity to disclose, for each line item in the entity's statement of financial position that includes any asset or liability measured at fair value as a result of an election, the following in tabular format:
 - a. The carrying amount as reported in the statement of financial position
 - b. The component of that carrying amount required to be measured at fair value
 - c. The component of that carrying amount not eligible for fair value election
 - d. The component of that carrying amount eligible for the fair value option for which the fair value option was elected
 - e. The component of that carrying amount eligible for the fair value option for which the fair value option was not elected.

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3. Some Board members have suggested various alternatives to the table described above:
- a. **View A₁**—Require separate line items in the statement of financial position for items measured at fair value and amend Statement No. 157's fair value hierarchy table in FASB Statement No. 157, *Fair Value Measurements*, by relating major categories back to line items in the statement of financial position.
 - b. **View A₂**—Continue to permit an entity to report items measured at fair value using either separate line items or parenthetical disclosure on the face of the statement of financial position and amend the fair value hierarchy table by (1) reflecting the total balance sheet carrying amount for each major category and (2) relating major categories back to line items in the statement of financial position.
 - c. **View A₃**—Same as View A₂, except for the following: Add another column to Statement 157's hierarchy table for only annual financial statements to reflect the fair value estimate for the entirety of each major category presented in the fair value hierarchy table to provide FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, disclosure information for those items. (The staff suggests that the additional column would be included in the example provided in the FVO document for presentation purposes only, and this would not require an amendment to either Statement 107 or 157.)
 - d. **View B**—In the example provided in the FVO document, combine the summary table required by Statement 107 and the FVO election table set forth in the Cold Review Draft (which is limited to items measured at fair value through earnings pursuant to a fair value election in Statement 155 or the FVO Statement). View B would not require

separate line items for instruments measured at fair value in the statement of financial position and would not amend Statements 157 or 107.

4. The staff recommends the disclosure set forth in the Cold Review Draft that is described above in paragraph 2, noting that the table is limited to items measured at fair value through earnings pursuant to a fair value election. The staff agrees with the Board's previous decision that trading securities classified under FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*, would be excluded from that table.

How Fair Value Changes Are Reported in the Income Statement

5. The FVO Exposure Draft required an entity to disclose quantitative information by income statement line item indicating where in the income statement gains and losses are reported that arise from changes in the fair value of assets and liabilities for which the fair value option has been elected. Users requested that the quantitative information required in this disclosure be further disaggregated by requiring an entity to disclose for each applicable line item in the statement of financial position where fair value changes for assets and liabilities for which the FVO has been elected are reported in the income statement. The Cold Review Draft was modified to require that an entity disclose "quantitative information by individual line item in the statement of financial position indicating where in the income statement gains and losses are reported that arise from changes in the fair value of assets and liabilities for which the fair value option has been elected." (Statement 157 requires disclosure of where in the income statement gains and losses are reported that arise from changes in the fair value of assets and liabilities but only for the fair value measurements in Level 3 of the fair value hierarchy, regardless whether the use of fair value was required or elective.)

6. The Board will discuss the following views:
- a. **View A**—Reconfirm the disclosure required in the FVO Exposure Draft which (a) is limited to fair value changes for assets and liabilities for which the FVO has been elected and (b) does not require disaggregation of fair value changes by line item in the statement of financial position.
 - b. **View B**—Confirm the disclosure set forth in the Cold Review Draft which (a) is limited to fair value changes for assets and liabilities for which the FVO has been elected and (b) requires disaggregation of fair value changes by line item in the statement of financial position.
 - c. **View C**—Amend Statement 157’s fair value hierarchy table to require an entity to disclose by line item in the statement of financial position where fair value changes for all assets and liabilities measured at fair value (whether elective or required) are reported in the income statement.
7. The staff recommends View B—the disclosure set forth in the Cold Review Draft that is described above in paragraph 5, noting that the table is limited to items measured at fair value through earnings pursuant to a fair value election. The staff recommends that Statement 115 trading securities be excluded from that table.