



Financial Accounting Standards Board

**Board Meeting Handout  
Proposed FSP FAS 157-a**

**February 6, 2008**

At today’s meeting, the Board will discuss comments received on the proposed FSP FAS 157-a, *Application of FASB Statement No. 157 to FASB Statement No. 13 and Its Related Interpretative Accounting Pronouncements that Address Leasing Transactions*, and the staff’s analysis and recommendation regarding one significant issue raised by respondents. The Board will also discuss whether to proceed to drafting a final FSP.

**COMMENT LETTER SUMMARY**

The comment period for the proposed FSP ended on January 4, 2008. As of January 16, 2008, the staff received comment letters from 10 respondents, which are summarized below.

**Respondent Profile by Occupation/Role**

<b>Type of Respondent</b>	<b>Number</b>
<b>Public Accounting</b>	
Big Four Accounting Firm	1
Non-Big Four Accounting Firm	1
<b>Total Public Accounting</b>	<b>2</b>
<b>Preparer</b>	
Financial Institution	1
Corporation	2
Private	0
Other	0
<b>Total Preparer</b>	<b>3</b>
<b>User</b>	
Rating Agency	0
Other	0
<b>Total User</b>	<b>0</b>
<b>Other</b>	
Industry Organization	3
Consulting	0
Other	2
<b>Total Other</b>	<b>5</b>
<b>Total Respondents</b>	<b>10</b>

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The staff prepares 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.

Three of the ten respondents are industry organizations, which represent multiple preparer constituents. All ten respondents supported the proposed FSP; however, three respondents raised questions regarding the scope of the proposed FSP.

## **SIGNIFICANT ISSUE RAISED BY RESPONDENTS - SCOPE**

### **Comments Received**

The proposed FSP states that “this FSP amends FASB Statement No. 157 to exclude FASB Statement No. 13 and its related interpretive accounting pronouncements that address leasing transactions.” Comments from three respondents indicated a need for the staff to clarify the breadth of the scope exception. The comments regarding the scope of the FSP were as follows:

- Ernst & Young (CL #5) stated that “it may be unclear to some whether the FASB intended to exclude the application of Statement 157 when accounting for lease transactions that fall under other pronouncements within the scope of Statement 157. Examples include, but are not limited to: (1) Lessee accounting for assets under capital lease pursuant to FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, (2) Lessee accounting for an operating lease pursuant to FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*, and (3) Accounting for acquired leases in a business combination pursuant to FASB Statement No. 141(R), *Business Combinations*.”
- Institute of Management Accountants (CL#10) stated, “We are aware that some respondents to the proposed FSP have raised questions related to the breadth of the scope exception. We believe that the scope exception should apply broadly to all leasing transactions, including situations in which fair value is determined for leases under other pronouncements, such as FIN 21, FAS 141(R), FAS 144 and FAS 146. There is nothing about application of fair value to leases in the context of those standards that warrants a market participant approach. We believe the implementation problems will be the same and that there would be a high risk of inadvertent non-compliance as preparers assume that FAS 157 does not apply to leases at all. We also believe it would be counterintuitive to have different measurement approaches for leases originated or acquired individually versus those acquired in a business combination. We therefore urge the Board to clarify that the scope of FAS 157 does not apply to fair value measurements of leases that fall within these standards.”

The staff received an additional comment indicating the need for clarification of the how the proposed FSP would apply to FASB Interpretation No. 21, *Accounting for Leases in a Business Combination*, (and, by extension, FAS 141 and 141(R)):

- The Equipment Leasing and Finance Association (CL#8) stated, “The proposed changes in the provisions of Statement 157 address our shared concern that Statement 157 may have had unforeseen impacts on lease accounting, notably in lease classification, estimating residual values, and *the accounting for acquired leases under FIN 21.*” [Emphasis added]

In summary, the proposed FSP (as revised) will limit the Statement 157 scope exception to Statement 13 and other accounting pronouncements that address fair value measurements for purposes of lease classification or measurement under Statement 13. The scope exception would not be expanded to include fair value measurements required by Statement 144, Statement 146, and Interpretation 21 (and, by extension, Statements 141 and 141(R)).

#### ***Statement 146***

Statement 146 requires that a liability for costs to terminate a contract (including an operating lease), or costs that will continue to be incurred under a contract without economic benefit to the entity, shall be recognized and measured at its fair value. For operating leases, the fair value of a liability at the cease-use date is determined based on the remaining lease rentals reduced by estimated sublease rentals. Statement 146 (as amended by Statement 157) indicates an expected present value technique is often the best available valuation technique with which to estimate the fair value of a liability for costs to terminate an operating lease.

#### ***Statement 144***

Statement 144 addresses financial accounting and reporting for the impairment of long-lived assets, including capital leases of lessees and long-lived assets of lessors subject to operating leases. The staff notes that preparers and others have observed difficulties in resolving Statement 157 implementation issues related to the determination of impairment for nonfinancial assets because those measurements rely on unobservable inputs. The partial deferral of the effective date of Statement 157 for nonfinancial assets and nonfinancial liabilities will allow preparers additional time to resolve these issues.

### ***FIN 21 and Statement 141(R)***

The challenges in applying the Statement 157 fair value measurement objective to a lessor's measurement of unguaranteed residual values could be the same in a business combination as they are for a newly originated lease accounted for under Statement 13. The following approaches are designed to address concerns regarding the measurement of a lessor's unguaranteed residual value under FIN 21 (and by extension 141(R)). All other measurements required for leases under FIN 21/141(R) should be within the scope of Statement 157. Based on further staff research and discussion with constituents, the staff will determine whether to ask the Board to add a project to its agenda related to acquired leases measured in accordance with Statement 141(R). The staff does not believe potential issues related to Statement 141(R) should delay the issuance of the proposed FSP.

The staff notes several of the measurements currently required for leases under Statement 141 either represent practicability exceptions to a fair value measurement or would be addressed by the partial deferral of the effective date of Statement 157 for nonfinancial assets and nonfinancial liabilities.

**Approach A:** A lessor's determination (measurement) of the amount to assign to an unguaranteed residual value in a sales-type, direct financing, or leveraged lease under the provisions of FIN 21 (and by extension, Statement 141(R)) should be excluded from Statement 157. This approach would require lessors to assign an amount to the unguaranteed residual value in an acquired sales-type, direct financing, or leveraged lease in accordance with Statement No. 13 and would essentially scope out a nonfinancial asset of lessors (the unguaranteed residual value) from measurement under Statement 157.

**Analysis of Approach A:** This approach results in presenting one component of the lease receivable (the minimum lease payments receivable) at fair value and another component (the unguaranteed residual value) at a present value that would not necessarily represent fair value.

**Approach B:** All leases acquired in a business combination (including leases where a lessor is required to measure an unguaranteed residual value) should be recorded at fair value.

**Analysis of Approach B:** In a business combination, an acquiring lessor would measure the entire investment in the lease at fair value; however, the estimated residual value would be recorded at an amount that reflects the lessor's assumptions regarding the eventual disposition of the asset, as required by Statement 13. Because the lessor would still accrete the initial fair value to the residual value as determined in accordance with Statement 13, there would not be a gain or loss if the property was disposed of at the entity's expected residual value at the end of the lease term.

#### ***Leveraged Leases Acquired in a Business Combination***

One respondent was concerned about the use of entity specific (not market participant) assumptions related to income taxes when measuring acquired leveraged leases. The accounting for income taxes related to leveraged leases is not within the scope of FASB Statement No. 109, *Accounting for Income Taxes*; however, Statement 13 states that "tax positions shall be reflected in the lessor's initial calculation and/or subsequent recalculation [of a leveraged lease] based on the recognition, derecognition, and measurement criteria in Interpretation 48." Income taxes are an exception to the recognition and measurement provisions of Statement 141(R). Some constituents believe this exception should also apply to the accounting for income taxes related to a leveraged lease because of difficulties with the subsequent accounting for the leveraged lease if a fair value determination was made based on assumptions about income tax cash flows that are inconsistent with Interpretation 48.

Based on further staff research and discussion with constituents, the staff will determine whether to propose to the Board a project to address income tax assumptions associated with the measurement of a leveraged lease in a business combination accounted for under Statement 141(R).

***Does the Board agree with the recommended modifications to the proposed FSP?***



**Proposed FSP FAS 157-b**  
**Effective Date of Statement 157**  
**Board Meeting Handout**  
**February 6, 2008**

**BACKGROUND**

On November 14, 2007, the Board approved a one-year deferral of the effective date of FASB Statement No. 157, *Fair Value Measurements*, for all nonfinancial assets and nonrecurring liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

The comment period for the proposed FSP began on December 14, 2007, and ended on January 16, 2008. As of January 28, 2008, the staff received comment letters from 20 respondents. Of the 20 comment letters, 17 respondents supported the proposed FSP, while 3 did not. Further, 10 respondents specifically indicated that they would have preferred a full deferral. Two respondents indicated that a partial deferral adds unnecessary complexity. Of the comments received, the staff believes that there are two substantive issues that require further Board deliberation.

**SUBSTANTIVE ISSUES**

**Issue 1—Application to Private Issuers**

Two comment letters were received that expressed their position that Statement 157's effective date should be fully deferred for private or small issuers.

**Issue 2—Effect of Proposed FSP on Impaired Loans Measured Using the Practical Expedient Allowed Pursuant to Statement 114**

Question: Are collateral dependent loans measured for impairment using the practical expedient in Statement 114 financial assets excluded from the scope of the deferral?

- VIEW A (financial asset)—Proponents of View A believe that the impaired loan is a financial asset. Paragraph 6 of Statement 159 defines a *financial asset* as one which includes a contract that conveys to one entity a right to receive cash or another financial instrument from a second entity. Proponents believe that this right to receive cash also includes the right to receive cash from the sale of collateral in a defaulted loan. Further, they believe that in the current credit environment, the consistency, comparability, and transparency that Statement 157 provides to users is important and would encourage more items to be excluded from the deferral.
- VIEW B (nonfinancial asset)—Proponents of View B believe that while the asset being recognized is the loan, the recognition of that impaired loan is based entirely on the fair

value of a nonfinancial asset. Further, they believe that the Statement 157 implementation issues that are causing most concern are nonfinancial measurements, and accordingly, believe that to exclude this item from the deferral would be contrary to the proposed FSP's principle.

### **Issue 2a—Applicability of Statement 157 Disclosure Requirements to Loans Measured Using the Practical Expedient allowed Pursuant to Statement 114**

Question: Are the disclosures pursuant to Statement 157 required, in particular, the nonrecurring disclosure requirements described in paragraph 33?

The comment letter respondent that raised this question believes that it is clear that the collateral for an impaired loan under Statement 114 should be measured according to the guidance in Statement 157. However, they believe that Statement 157's disclosure requirements do not apply. They believe that the Statement 157 disclosures are for assets and liabilities that are measured at fair value, and that while the fair value of the collateral may be an important factor in the fair value of the loan, it is not the fair value of the loan itself. Therefore, the asset (that is, the loan) is not measured at fair value and would not be required to follow the nonrecurring disclosure requirements of Statement 157. Opponents of this view disagree and believe that the nonrecurring disclosure requirements of Statement 157 apply.

### **Questions for Board**

*Question 1 (Issue 1)—The staff recommends that private companies should have the same deferral requirements as public entities. Does the Board agree?*

*Question 2 (Issue 2)—The staff recommends that impaired loans measured at fair value based on the underlying collateral pursuant to the guidance in Statement 114 are not subject to the deferral. Does the Board agree?*

*Question 3 (Issue 2a)—The staff believes that providing guidance on the applicability of Statement 157's disclosures to impaired loans measured using the Statement 114 practical expedient is outside the scope of this project and recommends that guidance should not be provided within the proposed FSP. Does the Board agree?*

*Question 4—The staff has made various suggested nonsubstantive drafting changes to the proposed FSP (attached to Board Memorandum 6). Does the Board agree with the proposed changes, and if so, should the staff prepare a final draft of the FSP for vote by written ballot?*



## Board Meeting Handout

February 6, 2008  
Proposed FSP SOP 07-1-a

### BACKGROUND

Proposed FSP SOP 07-1-a, *Effective Date of AICPA Statement of Position 07-1*, defers indefinitely the effective date of AICPA Statement of Position 07-1, *Clarification of the Scope of the Audit and Accounting Guide, Investment Companies, and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies* (the SOP). There were 14 comment letters received on the proposed FSP. The majority of respondents indicated that they supported the issuance of a final FSP without substantive change.

### PURPOSE

Respondents suggested clarification of the proposed FSP's early adoption provisions and its effective date. The Board will discuss the following items:

- (1) Whether early adoption of SOP 07-1 should be permitted
- (2) Whether the effective date of the FSP should be modified
- (3) If early adoption is permitted and a parent entity elects to continue to apply the SOP's provisions in consolidation, whether the FSP should permit or require any newly formed or newly consolidated entity within that parent's consolidated group to also apply the SOP's provisions
- (4) If early adoption is permitted and a parent entity elects to continue to apply the SOP's provisions, whether the FSP should clarify that a parent entity must account for all of its consolidated entities in accordance with the provisions of the SOP in consolidation
- (5) If early adoption is permitted, whether the FSP should permit or require an equity method investor to apply the SOP's provisions to future economically similar equity method investments
- (6) If early adoption is permitted, whether the FSP should define "adoption."

### ISSUE 1

The proposed FSP permits entities that early adopt the SOP prior to the issuance of a final FSP to continue to apply the SOP's provisions. However, constituents have raised concerns that limiting the ability to adopt the SOP only to those entities that early adopt may result in economically similar entities being reported using different methods.

The staff observes that few companies have early adopted SOP 07-1. By permitting an entity to continue to apply the SOP's provisions, lack of comparability may result because two different versions of the Investment Company guide will be in use.

## **QUESTION FOR THE BOARD**

***Q1: Does the Board want to modify the proposed FSP to prohibit all entities from applying the provisions of SOP 07-1 and require any entity that early adopted the SOP to rescind its adoption?***

## **ISSUE 2**

The proposed FSP indicates that the effective date of the final FSP would be its issuance date. One respondent recommended that the effective date should be changed to December 15, 2007 to coincide with the original effective date of SOP 07-1. They observed that if the FSP is issued after December 15, 2007, the deferral of the SOP could not be enacted except retroactively after the required initial adoption of the SOP. The staff believes that the Board did not intend to require a company to (a) initially adopt the SOP for fiscal years beginning on or after December 15, 2007 (the original effective date), and (b) subsequently be required to rescind that adoption once the final FSP is issued. In other words, a calendar year company was not expected to adopt the SOP's provisions on January 1, 2008, and then unwind that adoption upon issuance of the final FSP.

In addition to keeping the proposed effective date, the following sentence could be added to the FSP: "If an entity adopted SOP 07-1 pursuant to its original effective date, that entity must rescind its adoption of the SOP as of the day that the entity was required to initially adopt the SOP." The staff believes that the sentence above clarifies that a calendar year company that did not early adopt the SOP may not reflect the application of the SOP in its 2008 financial statements.

## **QUESTION FOR THE BOARD**

***Q2: Does the Board want to add the following sentence to the FSP: "If an entity adopted SOP 07-1 pursuant to its original effective date, that entity must rescind its adoption of the SOP as of the day that the entity was required to initially adopt the SOP"?***

## **ISSUE 3**

If the Board answers "yes" to Q1, this issue is no longer applicable.

The proposed FSP would not permit an entity formed after the FSP's effective date to apply the SOP's provisions. If a new subsidiary is formed subsequent to the FSP's effective date, that subsidiary would not be able to apply the SOP's provisions in its standalone financial statements. If the parent entity had early adopted the SOP and continued to apply its provisions, as permitted by the proposed FSP, the staff believes that the parent entity would apply the SOP's provisions to the new subsidiary in consolidation but the subsidiary would not be permitted to apply the SOP in its standalone financial statements.

## QUESTION FOR THE BOARD

***Q3: If early adoption of SOP 07-1 is permitted, does the Board want to add an election or a requirement for subsidiaries formed or acquired after the parent's adoption of the SOP to apply the provisions of the SOP in their standalone financial statements? For example, does the Board want to add one of the following exceptions:***

- a. "If a parent that early adopted the SOP chooses not to rescind its early adoption, an entity consolidated by that parent that is formed or acquired after the parent's adoption of the SOP may elect to apply the provisions of the SOP in its standalone financial statements."***
- b. "If a parent that early adopted the SOP chooses not to rescind its early adoption, an entity consolidated by that parent that is formed or acquired after the parent's adoption of the SOP must apply the provisions of the SOP in its standalone financial statements."***

## ISSUE 4

If the Board answers "yes" to Q1 or Q3b, this issue is no longer applicable.

Two respondents expressed concern that a parent entity that early adopted SOP 07-1 and chose to continue to apply its provisions following the effective date of the FSP would not be permitted to apply the provisions of the SOP to a newly-formed, economically similar subsidiary in consolidation. As previously noted, the proposed FSP prohibits an entity from adopting SOP 07-1 unless the entity early adopted the SOP prior to issuance of the final FSP. The staff believes that if a parent entity early adopted SOP 07-1, it would apply the SOP's provisions to all entities within the consolidated group, regardless of when a subsidiary is formed or acquired.

## QUESTION FOR THE BOARD

***Q4: If early adoption of SOP 07-1 is permitted, does the Board want to modify the FSP regarding a parent entity's application of the provisions of the SOP to a newly formed subsidiary in consolidation? For example, does the Board want to add the following:***

***"A parent entity that chooses not to rescind its early adoption of the SOP must apply the provisions of the SOP to all current and future entities within its consolidated group in consolidation."***

## ISSUE 5

If the Board answers "yes" to Q1, this issue is no longer applicable.

One respondent expressed concern that an equity method investor may account for newly-formed investees differently from similar equity method investments due to the proposed FSP's prohibition that entities may not adopt SOP 07-1 after the FSP's effective date. The staff notes that the risk an entity accounts for economically similar entities or investments using different methods exists today and was one of the risks that the SOP was attempting to address. The staff

believes that adding a provision to allow a newly-formed equity method investee to apply the SOP is not practical because equity method investees may have two or more equity method investors—one that follows investment company accounting and one that does not.

#### **QUESTION FOR THE BOARD**

***Q5: If early adoption of SOP 07-1 is permitted, does the Board want to modify the FSP to permit or require an equity method investor that chooses not to rescind its early adoption to apply the provisions of the SOP to any future economically similar equity method investments?***

#### **ISSUE 6**

If the Board answers “yes” to Q1, this issue is no longer applicable.

One respondent suggested that the Board provide a definition of “adoption” because some entities intended to early adopt the SOP, their books and records reflect the adoption of the SOP, but they may not have issued quarterly, semi-annual, or annual financial statements evidencing adoption to shareholders and/or to a governing regulatory authority. The staff believes that, if an entity early-adopted the SOP, that entity likely was excluded from the scope of the Investment Company Guide prior to its adoption of the SOP. (That is, adoption would likely result in some investments being reported at fair value through earnings for the first time.) If the Board believes that additional clarification is needed and/or adoption must be evidenced by distributing financial information reflecting that adoption to third parties, the following sentence could be added to the FSP: “The provisions of the SOP have been adopted if an entity has issued to third parties financial information prepared in accordance with U.S. GAAP that reflects the application of the SOP’s provisions.”

#### **QUESTION FOR THE BOARD**

***Q6: If early adoption of SOP 07-1 is permitted, does the Board want to add a definition of “adoption” to the FSP? For example, does the Board want to add the following statement:***

***“The provisions of the SOP have been adopted if an entity has issued to third parties financial information prepared in accordance with U.S. GAAP that reflects the application of the SOP’s provisions.”***