



**Board Meeting Handout  
Disclosures about Credit Derivatives  
April 30, 2008**

**PURPOSE OF THIS MEETING**

1. The purpose of this meeting is to discuss (a) the project's scope, (b) the proposed disclosures, (c) the effective date and transition, and (d) the comment period.

**BACKGROUND**

2. In March 2008, a short-term project was added to the Board's agenda to amend Statement 133, *Accounting for Derivative Instruments and Hedging Activities*, to improve disclosures about credit-indexed derivative instruments (credit derivatives). Examples of credit derivatives include credit default swaps (CDS), credit spread options, and credit index products.
3. The volume of credit default swaps has increased substantially over the last few years. In view of the current turmoil in the credit markets, some have expressed concerns that Statement 133's current disclosure requirements do not adequately address potential adverse effects of changes in credit risk on the financial position and performance of the sellers of credit derivatives.

**ISSUE 1—SCOPE**

4. FASB Interpretation No. 45, *Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, requires disclosures by guarantors for instruments within its scope. Those disclosures apply to some, but not all, credit derivatives. However, many credit derivatives that are not subject to Interpretation 45's disclosure requirements are substantially similar to financial guarantees in terms of the risks and rewards involved. Since similar instruments should have similar disclosures, the staff believes that the disclosures in Interpretation 45 should apply to all credit derivatives.

5. Accordingly, the staff recommends that the Board amend Statement 133 to require disclosures that are similar to those in Interpretation 45 for credit derivatives accounted for under Statement 133. Further, in order to have all recognition, measurement, and disclosure requirements for derivatives in one place (that is, in Statement 133), the staff recommends that the Board amend Interpretation 45 to exclude all Statement 133 derivatives from its scope.

***Question: Does the Board agree with the proposed scope of the project?***

## **ISSUE 2—PROPOSED DISCLOSURES**

6. Based on disclosures in Interpretation 45, the staff recommends the following disclosures for the sellers of credit protection:
  - a. The nature of the credit derivative, the events or circumstances that would require the seller to perform under the credit derivative, the approximate term of the credit derivative, and the current credit risk of the referenced entity or obligation (based on either internal or external credit ratings, depending on how the seller manages its risk).
  - b. The maximum potential amount of future payments (undiscounted) the seller could be required to make under the credit derivative. That maximum potential amount of future payments shall not be reduced by the effect of any amounts that may possibly be recovered under recourse or collateralization provisions in the credit derivative (which are addressed under (d) below). If the terms of the credit derivative provide for no limitation to the maximum potential future payments under the contract, that fact shall be disclosed. If the seller is unable to develop an estimate of the maximum potential amount of future payments under the credit derivative, the seller shall disclose the reasons why it cannot estimate the maximum potential amount.
  - c. The fair value of the credit derivative.
  - d. The nature of (1) any recourse provisions that would enable the seller to recover from third parties any of the amounts paid under the credit derivative and (2) any

assets held either as collateral or by third parties that, upon the occurrence of any specified pre-agreed event or condition under the credit derivative, the seller can obtain and liquidate to recover all or a portion of the amounts paid under the credit derivative. The seller shall indicate, if estimable, the extent to which the proceeds from liquidation of those assets would be expected to cover the maximum potential amount of future payments under the credit derivative. In its estimate of potential recoveries, the seller of credit protection should consider the effect of any purchased credit protection with an identical underlying(s).

***Question: Does the Board agree with the staff’s recommended disclosures for sellers of credit protection?***

### **ISSUE 3—EFFECTIVE DATE AND TRANSITION**

7. The staff recommends that the proposed disclosures be effective for all fiscal years and interim periods beginning after November 15, 2008. The staff also recommends that the proposed disclosures be applied prospectively with earlier application encouraged.
8. The staff believes the recommended effective date is appropriate because:
  - a. The proposed disclosures are similar to those already being provided for guarantees subject to Interpretation 45; therefore, entities should require a relatively short period to implement the proposed FSP.
  - b. The proposed effective date would coincide with the effective date of Statement 161 and, thus, help preparers implement the necessary system changes for both pronouncements at the same time.

***Question: Does the Board agree with the staff’s recommended effective date and transition provisions?***

### **ISSUE 4—COMMENT PERIOD**

9. The staff recommends a 30-day comment period for the proposed FSP.

***Question: Does the Board agree with the staff that a 30-day comment period is appropriate?***



**Board Meeting Handout**  
**STATEMENT 133 HEDGING**

**April 30, 2008**

**PURPOSE**

The purpose of this meeting is to discuss the following technical issues that arose while drafting the Exposure Draft of the proposed Statement to amend the hedging guidance in FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*:

1. Determining the credit risk adjustment for calculating the fair value of the perfect derivative for cash flow hedges
2. Assessing effectiveness and measuring ineffectiveness in cash flow hedges for a forecasted group of sales or purchases that are expected to occur within a specific time
3. Measuring ineffectiveness for a purchased option used in a cash flow hedge to provide only one-sided offset against the hedged risk.

The purpose of this meeting is also to discuss the effective date for the proposed Statement and comment period for the Exposure Draft.

**ISSUE 1—CREDIT RISK ADJUSTMENT FOR CALCULATING THE FAIR VALUE OF THE PERFECT DERIVATIVE FOR CASH FLOW HEDGES**

FASB Statement No. 157, *Fair Value Measurements*, requires consideration of nonperformance risk, including credit risk, when calculating the fair value of financial assets and liabilities, including derivatives. Therefore, the discount rate for calculating the fair value of the actual derivative designated as the hedging instrument in a cash flow hedge would reflect the credit rating of the party in a liability position to the derivative. However, since the perfect derivative's cash flows would be expected to occur and, therefore, be riskless, the conceptually appropriate credit adjustment or discount rate for calculating the fair value of the perfect derivative would reflect a risk-free credit rating. The staff believes that, if it is probable that default under the actual derivative would not occur, the ineffectiveness resulting from the differences in the credit adjustment or discount rate does not provide information useful for determining the degree to which the forecasted hedged cash flows will be offset.

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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.

### **Issue 1–Staff Recommendation**

The staff recommends that the credit risk adjustment related to nonperformance of the party in a liability position to the derivative used for calculating the fair value of the actual derivative hedging instrument be permitted to be used for calculating the fair value of the perfect derivative when it is probable that default under the derivative would not occur. If it is not probable that default under the derivative would not occur, an entity should be required to use a credit risk adjustment that would reflect risk-free credit rating in calculating the fair value of the perfect derivative.

### **Issue 1–Question for the Board**

Does the Board agree that the credit risk adjustment related to nonperformance of the party in a liability position to the derivative used for calculating the fair value of the actual derivative should be permitted to be used for calculating the fair value of the perfect derivative when it is probable that default under the derivative would not occur?

## **ISSUE 2—ASSESSING EFFECTIVENESS AND MEASURING INEFFECTIVENESS IN CASH FLOW HEDGES FOR A FORECASTED GROUP OF TRANSACTIONS WITHIN A SPECIFIC TIME FRAME**

The Board decided in this project to retain the ability currently permitted in Statement 133 to designate a group of individual transactions as the hedged transaction if those individual transactions share the same risk exposure for which they are designated as being hedged. Just as it could be difficult to predict the exact date on which the individual hedged transactions within a group could occur, the staff acknowledges that determining the derivative that would be expected to perfectly offset the individual hedged transactions within the group would also be difficult. Additionally, while requiring that the individual transactions share the same risk exposure for which they are designated as being hedged could help ensure that a single derivative could be reasonably effective as a hedge of the aggregated transactions, it would not eliminate the difficulties in determining the perfect derivative.

### **Issue 2–Staff Recommendation**

The staff recommends that the proposed Statement permit the perfect derivative for cash flow hedges of a group of transactions within a specific time period to be one that is expected to

perfectly offset the hedged cash flows and settle within one month of the cash flows related to the hedged transactions.

### **Issue 2—Question for the Board**

Does the Board agree that the perfect derivative for a forecasted group of transactions within a specific time period can be one that is expected to perfectly offset the hedged cash flow and settle within one month of the cash flows related to the hedged transactions?

### **ISSUE 3—MEASURING INEFFECTIVENESS FOR A PURCHASED OPTION USED IN A CASH FLOW HEDGE TO PROVIDE ONLY ONE-SIDED OFFSET**

At the June 27, 2001 meeting, the Board cleared Statement 133 Implementation Issue No. G20, “Assessing and Measuring the Effectiveness of an Option Used in a Cash Flow Hedge,” which addresses the implications of an entity designating a purchased option contract as the hedging instrument in a hedging relationship and documents that the assessment of hedge effectiveness will be based on total changes in the purchased option’s cash flows. Implementation Issue G20 allows an entity to defer the time value component of a purchased option used in a cash flow hedge to other comprehensive income and record no ineffectiveness in earnings related to the time value component if certain criteria are met, including critical terms matching of the hedging instrument and hedged forecasted transaction. If those certain criteria are not met, the entity is still permitted to assess hedge effectiveness based on total changes in the option’s cash flows, but it must determine whether ineffectiveness must be recognized in earnings. Since the Board previously decided that the proposed Statement should not permit the notion of critical terms matching in assessing hedge effectiveness, a main portion of Implementation Issue G20 would be superseded.

The staff believes that, conceptually, the time value component of an option represents ineffectiveness and should be recorded currently in earnings. However, many constituents have been utilizing the guidance in Implementation Issue G20 to measure and record ineffectiveness for cash flow hedges using a purchased option. In addition, Statement 133 effectively permits the deferral of the time value (initial spot-forward difference) in a forward contract for a cash flow hedge by permitting effectiveness to be assessed and ineffectiveness to be measured using forward rates. In this case, the spot-forward difference is reflected in the financial statements in the same period that the forecasted transaction affects earnings, rather than as ineffectiveness during the hedge period.

### **Issue 3–Staff Recommendation**

The staff recommends that, for simplicity and ease of implementation, if an entity uses a purchased option contract as the hedging instrument in a cash flow hedge to provide only one-sided offset against the hedged risk, the perfect derivative to be used for determining ineffectiveness to be reported in earnings can include total changes in the option’s cash flows.

### **Issue 3–Question for the Board**

Does the Board agree that if a purchased option contract is used as the hedging instrument in a cash flow hedge to provide only one-sided offset against the hedged risk, the perfect derivative to be used for determining ineffectiveness to be reported in earnings can include total changes in the option’s cash flows?

### **EFFECTIVE DATE**

The staff previously expected the Exposure Draft to be issued in the first quarter of 2008. Allowing for a comment period and subsequent revisions, the Board decided that the proposed Statement should be effective for fiscal years beginning after November 15, 2008 and that earlier application would not be permitted. The staff now expects the Exposure Draft to be issued in the second quarter of 2008, which would not give entities adequate time to meet a November 15, 2008 effective date.

### **Staff Recommendation**

The staff recommends that the proposed Statement be effective for fiscal years beginning after November 15, 2009, and that earlier application not be permitted.

### **Question for the Board**

Does the Board agree that the proposed Statement should be effective for fiscal years beginning after November 15, 2009, and that earlier application should not be permitted?

### **COMMENT PERIOD**

The staff previously recommended a 45-day comment period for the Exposure Draft. However, some Board members believed that such a short comment period would not be sufficient due process and suggested at least a 60-day comment period. At that time, the Board agreed to wait until the Exposure Draft is ready to be issued to determine the comment period.

**Staff Recommendation**

Given the later effective date proposed above, the extent of changes proposed in the Exposure Draft, and an expected issuance of the Exposure Draft by June 1, 2008, the staff recommends a comment period of approximately 75 days, through August 15, 2008.

**Question for the Board**

Does the Board agree with the August 15, 2008, comment period deadline?



**Board Meeting Handout  
Not-for-Profit Mergers and Acquisitions  
April 30, 2008**

**PURPOSE OF THIS MEETING**

1. The purpose of this meeting is for the Board to discuss and approve a project plan and steps for completing this project. Those steps include redeliberations that are expected to focus on the significant concerns raised by respondents to the following October 2006 Exposure Drafts, which include the proposals for the recognition of donor-related intangible assets and for goodwill or contribution received in an acquisition, and the subsequent accounting for goodwill.

- a. *Not-for-Profit Organizations: Mergers and Acquisitions*
- b. *Not-for-Profit Organizations: Goodwill and Other Intangible Assets Acquired in a Merger or Acquisition*

**BACKGROUND**

2. At its September 19, 2007 meeting, the Board (a) affirmed that the acquisition method should be required for acquisitions by not-for-profit organizations, (b) tentatively decided that the carryover method of accounting should be retained for mergers between not-for-profit organizations and that the feature that distinguishes a merger from an acquisition is the governing bodies of two or more not-for-profit organizations ceding control of those organizations to create a new organization, (c) directed the staff to draft a limited revision of the NFP M&A Exposure Draft to distinguish between a merger and an acquisition by a not-for-profit organization, and (d) considered but rejected suggestions that it also permit use of the carryover method of accounting for acquisitions by smaller not-for-profit organizations.

3. As a result of lapsed time and reassignments, the staff has updated their thinking about how the project might best proceed with a goal of completion by December 31, 2008. The staff will ask that the Board to discuss that plan, including its identification of the remaining steps and issues for redeliberations, use of resources, and projected timeline, and approve or modify that plan consistent with the Board's overall goals and priorities.

## **ISSUE 1—OVERALL OBJECTIVE AND GOAL**

### **Key Questions:**

**Q1—Does the Board agree with the overall objective and goal of completing the project by the end of 2008?**

**Q2—Is that goal compatible (not conflict) with other goals, priorities, and available resources?**

4. To aid the discussion of those key questions the staff will ask the Board to consider the below specifics of its current plan for achieving the goal of completing the Board's redeliberations and issuance of a final Statement by the end of 2008.

## **ISSUE 2—PLAN FOR ACHIEVING THE GOAL**

**Q3—Does the Board agree with the project plan for completing the project, including its strategies, issues for redeliberations, steps, resources, and timetable?**

## **DISCUSSION MATERIAL**

5. As part of the plan to complete the project by the end of this year, the staff proposes the following:

- a. Continue with the existing plan of limiting the Board's substantive redeliberations to significant issues for which new information has arisen. Those issues include (1) differing accounting methods for mergers and acquisitions, (2) donor-related intangible assets (for example, donor lists and relationships), (3) initial recognition of goodwill or contribution received, and (4) subsequent impairment testing of goodwill.
- b. Adhere to the scope and do not stray into requests for more guidance or concerns about other GAAP that are outside the scope of the project.
- c. Rely on consolidation guidance and do not try to fix deficiencies in consolidation guidance through this project.
- d. Adhere to the difference-based approach and affirm that the Statement 141(R) post-Exposure Draft changes are to apply to not-for-profit organizations acquisitions.
- e. Solicit additional information about the workability of the "ceding control" notion. However, rather than using a formal revised Exposure Draft the staff suggests other more efficient means be used, which could include:

- (1) A staff paper to invite further comments from all respondent to the Exposure Draft
  - (2) A web-based invitation to comment
  - (3) Further discussions with resource group members
  - (4) Field visits with preparers and auditors
  - (5) If subsequently desired, a limited-scope revised Exposure Draft remains a possibility.
- f. Utilize limited staff resources over the next six months for the Board's remaining redeliberations, constituent outreach, and an outside consultant for document drafting.
- g. Assuming agreement with the above strategies, list of significant issues, steps to completion, commitment of resources, and the Board's priorities and ability to reach decisions, the proposed timetable projects issuance of final Statements by the end of 2008, if not earlier.