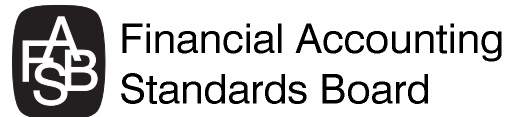


REVISED MINUTES



To: Board Members

From: Fair Value Option Team
(Mike Kramer, ext. 273)

Subject: Revised Minutes of the June 1, 2005 Board Meeting (Fair Value Option) **Date:** July 14, 2005

cc: Bielstein, L. Smith, Golden, Petrone, Leisenring, Project Team, E. Smith, MacDonald, Belcher, Carney, Gabriele, Sutay, Getz, Polley, FASB Intranet

The Board meeting minutes are provided for the information and convenience of constituents who want to follow the Board's deliberations. All of the conclusions reported are tentative and may be changed at future Board meetings. Decisions become final only after a formal written ballot to issue a final Statement or Interpretation.

Topics: Fair Value Option: A Debtor's Recognition of Changes in Its Creditworthiness in Valuing Liabilities

Basis for Discussion: Board memorandum dated May 16, 2005

Length of Discussion: 9:10 a.m. to 10:00 a.m.

Attendance:

Board members present: Herz, Crooch, Schipper, Seidman, Trott, and Young

IASB Board/Staff present: Leisenring

Board members absent: Batavick

Staff in charge of topics: Wilkins

Other Staff at Board table: L. Smith, Golden, MacDonald, Thuener, Lott, Murphy, McBride, E. Smith, Laurenzano, and Kramer

Outside Participants: None

Summary of Decisions Reached:

The Board was unable to reach an agreement on whether it wishes to curtail the debtor's recognizing in earnings the effect of changes in its creditworthiness in reporting liabilities at fair value when the fair value option (FVO) has been elected. The staff has been instructed to do further research on the subject and present that research to the Board at a later date.

Objective of the Meeting:

The objective of the meeting was to decide whether to curtail the debtor's recognizing in earnings the effect of changes in its creditworthiness in reporting liabilities at fair value when the FVO has been elected. The objective of the meeting was not met.

Matters Discussed and Decisions Reached:

1. Mr. Wilkins stated that the discussion will focus initially on whether the Board wishes to curtail the debtor's recognizing in earnings the effect of changes in its creditworthiness in reporting liabilities at fair value when the FVO has been elected. If such curtailment is desired, the staff believed it could be accomplished in one of three ways. Using the OCI approach, the portion of the change in the liability's fair value attributable to changes in the debtor's creditworthiness would be reported in accumulated other comprehensive income (OCI), while the remainder of the change in fair value would be reported in earnings. Using the suspension approach, the fair value measurement attribute would be applied to the debtor's liability until an event or circumstance (such as the debtor's filing for bankruptcy) arose that would preclude the continued use of the fair value measurement attribute to liabilities, at which time another measurement attribute that excluded the effect of changes in the debtor's creditworthiness would need to be applied. Using the dual-attribute option approach, debtors could be prohibited from

electing the fair value measurement attribute for reporting their liabilities under the FVO but would be offered the ability to elect to use a fair value-derived attribute that excluded the effect of changes in the debtor's creditworthiness. The staff recommended that the Board reject all three alternatives and decide not to curtail the debtor's recognizing in earnings the effect of changes in its creditworthiness in reporting liabilities at fair value when the FVO has been elected.

2. The secondary issue would arise if the Board decided not to curtail the debtor's recognizing in earnings the effect of changes in its creditworthiness in reporting liabilities at fair value when the FVO has been elected. If so, the Board would have to consider whether to require additional disclosures regarding the liabilities for which the FVO has been elected. The staff recommended that the Board require at each balance-sheet date the disclosure of the difference between (a) the carrying amount of a liability that is reported at fair value due to election of the FVO and (b) the amount the entity would be contractually required to pay at maturity to the holder of the obligation. The staff recommended that the Board encourage, but not mandate, that debtors provide some quantitative information to users regarding the magnitude of the amounts included in earnings (both currently and cumulatively) for the change in the liability's fair value attributable to changes in the debtor's creditworthiness.
3. Ms. Schipper agreed with the recommendation to not curtail the recognition. With regard to the secondary issue of disclosure, she had no objection to the additional disclosures. Ms. Schipper had considered concerns about bankruptcy, in which an instrument is evaluated outside the terms of the original contract. Any new factors, taking into account all features used by a market participant in evaluating the settlement, could be used to determine the fair value of an instrument if the original contract terms no longer apply because of bankruptcy (the company may be using liquidation accounting or going concern accounting). Considering the Board's objective to reduce

difficulty in financial reporting, all of the approaches have huge conceptual drawbacks, and Ms. Schipper would prefer to not curtail.

4. Mr. Young prefers to curtail recognition in earnings, with a preference for the OCI approach. He feels that it is hard to defend having creditworthiness affect performance reporting. He prefers the OCI approach because it would do so in the least damaging way possible. When challenged that analysts would be interested in the recognition of the timely gain that would be priced into the structure, Mr. Young responded that the issue is created when there is a major stress in the credit structure that creates a swing of 900 basis points, not 100 basis points. At the end of the day, this is not helpful for an investor.
5. Ms. Schipper stated that this situation is similar to impaired purchased goodwill or an impaired fixed asset. When there is diminished earning capability, it is recognized immediately that there will be less cash inflow. This is a very consistent application of the fair value measurement attribute, and it should be done consistently.
6. Mr. Crooch noted that the fair value option is an option and not required. The Board would be allowing preparers to use a process that would make the accounting easier for them. In certain situations, it would reduce the paperwork and complications related to offset accounting using the current hedging literature. With the fair value option, preparers will get the same economic offset without as much complexity as the current literature requires. It is an option that companies should be allowed to use unfettered. Mr. Crooch supported the staff recommendation.
7. Ms. Seidman stated that she is inclined to stop using fair value when the issuer experiences significant economic distress. She is uncertain whether this is a definitional issue about fair value (because one or both counterparties would be acting under duress), or whether there are known triggers in the marketplace that signal distress, such as when the debtor

cannot repurchase its debt. She supports the fair value option in most cases, but when the issuer is in financial distress, she believes that reporting declines in the fair value of liabilities as gains is not necessarily a faithful representation of the overall position of the firm (for example, if there are types of assets that are not recognized or for which impairment has not yet been recognized). She noted that, unlike derivative transactions where credit exposures are actively managed, the FVO will be available to a wide range of issuers; thus, reflecting changes in the issuer's creditworthiness is more likely to have a practical effect.

8. Ms. Seidman expressed concern about the interaction of this issue with the decision reached in the fair value measurement (FVM) project to "consider" the effect of collateral and other contractual arrangements (such as master netting agreements) in the fair value of a liability. She noted that the staff is currently evaluating how cash collateral posted against a derivative transaction should affect the fair value of the related liability (specifically, whether it should be netted). She requested that the Board defer discussion of the issuer-credit issue until a conclusion is reached on that collateral-netting issue. She also asked the staff to obtain more information from constituents about how they identify companies in distress (that is, whether there are observable market triggers) and return to the Board at a later date.
9. Mr. Trott noted that the Board already discussed parts of this issue explicitly and whether it should be included in the scope with the FVO model. He does not like to have the Board deal with decisions that have already been made and are being reversed. He supported no limit. Ms. Seidman recalled that in the FVM project, the Board decided to address the issuer-credit issue on a standard-by-standard basis, the FVO project being one of them.
10. Mr. Batavick prepared a written response that stated that he did not have enough information on whether to curtail. The staff should do more research with constituents, including what disclosures should be used.

11. Mr. Herz was concerned about the distress situation. The creditworthiness of the entity may or may not affect the credit risk of the instruments. He had mentioned to the staff in the past that he would like to get some professional insights from credit agencies, such as Moody's, and see how they would handle these various situations when credit becomes an issue. Mr. Herz wants the staff to do some more work and bring the issue back to the Board at a later date. He expressed that he would also like more information about the suspension approach.
12. Ms. Schipper said that she understands the desire for more research from Moody's, Fitch, and S&P, but they only are concerned about default risk. It might be a good idea to get information from "vulture capitalists" on their valuation techniques. Even that information does not address the ability to realize. The Board needs to separate a few issues. The ability to arrive at a level one or level two fair value measurement for distressed securities is a separable issue from an entity's ability to immediately monetize the fair value. There is no need for research on the second issue, which is dependent on facts and circumstances. The measurability issue is separate from the liquidation issue. If the Board were to use conditions for the suspension approach, it may be missing a credit payment or a certain downgrade from the credit agencies.
13. Ms. Seidman disagreed. In troubled debt accounting, the Board requires that preparers use judgment. The Board may not need a specific rule but can use the guidance in FASB No. Statement 15, *Accounting by Debtors and Creditors for Troubled Debt Restructurings*.
14. Mr. Trott disagreed because the Statement 15 model is why the Board is undergoing the liability extinguishment project, because it does not work well.
15. Mr. Wilkins concluded by noting that no decision was supported by a majority of Board members. Three Board members agreed with the recommendation, one opposed it, one is unable to decide, and two need the staff to do more

work. The staff will do more research on the issues identified by Board members and then present that research to the Board at a later date.

Follow-up Items:

None.

General Announcements:

None.