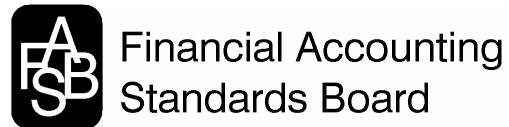


MINUTES



**To:** Board Members

**From:** Derivatives Disclosures—Hoyt (ext. 298)

**Subject:** Minutes of the July 25, 2007 Board Meeting (Derivatives Disclosures)

**Date:** August 10, 2007

**cc:** L. Smith, Bielstein, MacDonald, Leisenring, Lott, Polley, Gabriele, Golden, Stoklosa, Bhave, Drum, Hoyt, Wilkins, Sutay, Allen, Carnrick, Finden, 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.*

**Topic:** Derivatives Disclosures: Redeliberation on Scope

**Basis for Discussion:** Board Memorandum 2 dated July 3, 2007

**Length of Discussion:** 11:10 a.m. to 11:50 a.m.

**Attendance:**

**Board members present:** Herz, Batavick, Crooch, Linsmeier, Smith and Young

**Board members absent:** Seidman

**Staff in charge of topic:** Stoklosa

**Other staff at Board table:** Golden, Bhave, McGrath, Hoyt, and Drum

**Outside participants:** None

Summary of Decisions Reached:

The Board began redeliberations of issues raised by respondents to the Exposure Draft, Disclosures about Derivative Instruments and Hedging Activities. The Board decided to retain the project scope as proposed in the Exposure Draft; that is, the disclosures will apply to all derivatives (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 37 and 42 of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities) and related hedged items accounted for under Statement 133 and its related interpretations.

The Board also directed the staff to further research a possible scope exception for the trading activities of an entity.

Objectives of Meeting:

The objective of this meeting was to decide whether to limit the scope of the project to derivative instruments and hedged items in designated and qualifying hedging relationships (as proposed). The objective was met.

Matters Discussed and Decisions Reached:

**PURPOSE**

1. Mr. McGrath began the meeting by stating that the purpose of the meeting was to determine whether the scope of the derivatives disclosures project should be limited to derivative instruments and hedged items in designated and qualifying hedging relationships under Statement 133 (as proposed in the ED).
2. Mr. McGrath stated that, consistent with the Board's decision on July 19, 2006 to limit the scope of the project to derivative instruments and hedged items in designated and qualifying hedging relationships under Statement 133, the Board decided that the projects objectives are to provide an enhanced understanding of:
  - a. How and why an entity uses derivative instruments

- b. How derivative instruments and related hedged items are accounted for under Statement 133 and its related interpretations
  - c. How derivative instruments affect an entity's financial position, results of operations, and cash flows.
3. Mr. McGrath stated that the staff also presented the Board, at that time, with a fourth disclosure objective, that the disclosures should provide an understanding of an entity's risk exposures and the strategy for mitigating those risks. The Board rejected that objective because it focuses more on an entity's overall risk management strategies that encompass all financial instruments, which is beyond the scope that the Board decided on for the project.

#### **CONSTITUENT CONCERNS**

4. Mr. McGrath stated that the majority of respondents to the ED agreed with the Board's decision to limit the scope of the project. While many of those respondents acknowledged that disclosures about all financial instruments are important, they stated that the Board should consider those disclosures in a separate project.
5. Other respondents, mainly large financial institutions, did not agree with the Board's decision to limit the scope of the project. They stated that disclosures about derivatives and related hedged items would provide misleading information to users about an entity's overall risk management activities and profile, especially when considered in the context of financial institutions that engage in heavy derivative use and have elaborate and dynamic risk management strategies that entail entering into derivatives, in addition to many other types of financial instruments.
6. Mr. McGrath also stated that throughout the project users have provided input on the project scope and objectives and expressed general support for a limited derivatives only scope in the near term. They indicated that a project encompassing a broader scope to include all financial instruments and overall risk management strategies would take a longer period of time and they do not want important disclosures on derivatives to be delayed.

## **STAFF RECOMMENDATION**

7. Mr. McGrath stated that in order to address constituent concerns about the project scope and objectives while satisfying user needs, the staff developed three alternatives for the Board to consider:
  - a. Alternative 1 – Expand the project scope to include all financial instruments and expand the objectives to include information on an entity’s overall risk management activities and profile.
  - b. Alternative 2 – Retain the project scope as proposed in the ED and add an objective to provide an enhanced understanding of how derivatives are used in the context of an entity’s risk management profile.
  - c. Alternative 3 – Retain the project scope and objectives as proposed in the ED.
  
8. Mr. McGrath stated that the staff recommends that the scope and objectives of the project be based on Alternative 3 because it represents a significant short-term improvement to financial reporting. The staff believes that Alternative 3 would provide information in a timely manner about derivatives that is desired by users of financial statements. While information about all financial instruments and an entity’s overall risk management activities is important, the staff believes that the Board should consider those disclosures in a separate project and not delay the issuance of a final standard on derivative disclosures. The staff also believes that the tabular disclosures proposed in the ED require information beyond the stated objectives of the project. The staff believes that the tabular disclosures could be revised to require information that would be more consistent with the project’s objectives and satisfy constituent concerns without expanding the scope of the project. In fact, the staff is developing revised tables that would accommodate both Alternatives 2 and 3. The added objective in Alternative 2 could be achieved without impacting the revised tables and by requiring the added disclosures in paragraph 44 of Statement 133. However, the staff still recommends Alternative 3 over Alternative 2 because Alternative 2 still does not resolve constituent concerns about providing

misleading information since it still only requires information about derivative instruments.

9. Mr. Linsmeier suggested adding, within Alternative 3, an option for the preparer to include nonderivative hedging instruments and/or all items subject to a specific risk in the ED's tables in order to comprehensively report upon the overall risk profile of the entity. Mr. Linsmeier stated that, as he understood it, the ED *precluded* scoping into the tables instruments outside of the scope of the ED. He stated that one way to be responsive to the constituents' concerns without having to reexpose the proposal is to allow for the voluntary disclosure option within the final standard. However, the option, if chosen, would require that the entity include all nonderivative hedging instruments within the disclosure. In other words, the option would have "fences around it" such that an entity would be unable to "cherry-pick" those instruments that it wanted to provide in the disclosure—also termed as "all or nothing" approach.
10. Mr. Linsmeier also stated that he does not see how Alternative 3 is consistent with the three objectives that are specified in the ED. He stated that, in order to achieve the first objective, an entity would need to disclose that it is using derivatives to manage risk and further disclose the risk that is being managed by those derivatives. Further, the second objective would have to require the disclosure of hedged items as well. He stated that it would appear that the staff's proposals to revise the tabular disclosures would actually remove risk from the tabular disclosure and provide less information than that proposed in the ED.
11. Mr. Stoklosa responded to Mr. Linsmeier's suggestion by stating that an option such as the one described by Mr. Linsmeier would effectively be expanding the scope of the project such that it resulted in an outcome similar to Alternative 1. Further, Mr. Stoklosa stated that he is concerned that a disclosure prescribed under GAAP that also allowed an entity the option to essentially add whatever else the entity wanted within the disclosure, whether or not it met the objective of the disclosure, would lead to misleading information. Moreover, the objective behind the staff's recommendation of Alternative 3 was to refocus the tabular disclosures from risk to the location and the fair value amount and change in fair value amount of derivatives in the financial statements—where and how much is the fair value of derivatives on

the balance sheet, and where and how much are the changes in fair value of those derivatives in the income statement.

12. In response to Mr. Linsmeier's statement regarding the objectives of this project, Mr. Stoklosa stated that the first objective, concerning how and why an entity uses derivatives, would be achieved through the ED's qualitative amendments made to paragraph 44 of Statement 133.
13. Mr. Stoklosa also stated that although some constituents argued for a scope that would require providing information on all financial instruments and an entity's overall risk management profile and activities, those constituents were not in favor of the tabular disclosures as proposed in the ED. They stated that the tabular requirements in the ED would result in the need to complete numerous tables that would provide an overwhelming amount of information in a disjointed format that would not reflect how an entity manages risk.
14. Mr. Linsmeier stated that if we require a risk perspective disclosure only on a qualitative basis and do not require a quantitative disclosure, then, in his opinion, the disclosure provides no useful information. If that is what is being recommended by the staff, then he is opposed to Alternative 3.
15. Mr. Herz stated that the genesis of this project was to enhance disclosures about the derivative activities of entities not engaged in derivative trading activities. In other words, the project was principally established to expand derivative disclosures with respect to derivative activities of corporate treasuries. He stated that he does not think that disclosing information about derivative instruments for the larger financial institutions with significant trading activities is a good idea. Consequently, he would consider a scope exception for the derivative trading activities of an entity.
16. Mr. Linsmeier stated that he would also be in favor of exploring with users and preparers a scope exception for the derivative trading activities of an entity, as suggested by Mr. Herz.
17. Mr. Golden stated that the staff does not yet have a clear definition of trading activities, and that defining the scope exception could potentially delay the project.
18. Mr. Batavick stated that he was not in favor of expanding the scope of the project and that he supports the staff's recommendation of Alternative 3. He also stated that he

would be willing to explore a scope exception for the trading activities of an entity bearing in mind that it may be problematic to define trading activities. He stated that he is also concerned from a comparability standpoint with the option to include nonderivative hedging instruments as suggested by Mr. Linsmeier.

19. Mr. Smith stated that he supports the staff's recommendation of Alternative 3. He also stated that he is in favor of exploring a scope exception for the trading activities of an entity and agrees with Mr. Herz that the focus on corporate use of derivatives was initially what brought about this project. However, he stated that, unless a definition of trading activities can be incorporated from the research being performed in another project, the scope exception would require another exposure draft which could potentially delay the project.
20. Mr. Crooch stated that he supports the staff recommendation of Alternative 3. He stated that he believes that this is a first step toward improving derivative disclosures. He stated that he was concerned that establishing a scope exception for trading activities of an entity may be difficult and potentially delay the project.
21. Mr. Young stated that he would support Alternative 2 at this point; however, he would like to hear the input from the Investors Technical Advisory Committee (ITAC) and other users on the revised tabular disclosures. He stated that revisions made to the tabular disclosures within the ED may change his decision going forward.
22. Mr. Linsmeier stated that, ultimately, he was not in favor of any of the alternatives presented by the staff and was concerned that Alternative 3 would mean a revision of the tabular disclosures to something that was less useful than what was proposed initially in the ED.
23. Mr. Herz stated that he was in favor of Alternative 3 and for exploring a scope exception for the trading activities of an entity, if such an exception could be efficiently and effectively implemented into the standard. If that can't be done, he stated that he wasn't particularly concerned since these large financial institutions were already providing some of this information in their MD&A disclosures. Further, the scope exception would make it clear that the focus of the project is to mandate disclosures that reveal information about the use of derivatives from a corporate treasury perspective.

24. Overall, a majority of Board members supported the staff's recommendation of Alternative 3, which is to retain the project scope as proposed in the ED. The Board would also like the staff to further research a possible scope exception for the derivative trading activities of an entity.

Follow-up Items:

None.

General Announcements:

None.