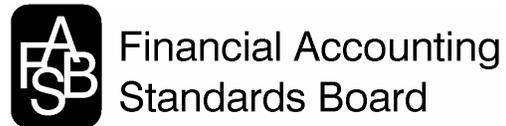


MINUTES



**To:** Board Members

**From:** Derivatives Disclosure—McGrath (ext. 443)

**Subject:** Minutes of the September 6, 2006 Board Meeting (Derivatives Disclosure)      **Date:** September 14, 2006

**cc:** Bielstein, Smith, MacDonald, Leisenring, Polley, Gabriele, Golden, Stoklosa, Wilkins, Brady, Moss, Mayrhofer, Sutay, Carney, Allen, Carnrick, 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 Disclosure: Items Related to the Tables Summarizing an Entity's Use of Derivatives, Financial Statement Presentation and Classification, and Effective Date and Transition

**Basis for Discussion:** Board Memorandum 1 dated August 23, 2006, Board Memorandum 2 dated August 30, 2006, and Supplemental Memorandum to Memorandum 1 dated September 1, 2006

**Length of Discussion:** 9:00 a.m. to 10:15 a.m.

**Attendance:**

**Board members present:** Herz, Batavick, Crooch (by phone), Linsmeier, Seidman, Trott, and Young

**Board members absent:** None

**Staff in charge of topic:** Stoklosa and Brady

**Other staff at Board table:** Smith, Golden, Moss, and McGrath

**Outside participants:** None

Summary of Decisions Reached:

The Board previously decided to require the following disclosures in table format:

- Where and in what amount derivatives and related gains and losses are recorded in the balance sheet and income statement, respectively. Disclosure should be by major underlying, accounting designation, and purpose.
- The notional amount and fair value of derivatives by major underlying, accounting designation, and purpose. Disclose instances in which derivative agreements contain leverage factors and the estimated magnitude of these features.

At this meeting, the Board discussed several issues related to those disclosures. The Board decided that, in the tables summarizing an entity's use of derivatives:

- Derivatives should be presented on a gross basis, even when they are subject to master netting arrangements and qualify for net presentation in the statement of financial position in accordance with FASB Interpretation No. 39, *Offsetting of Amounts Related to Certain Contracts*.
- Cash collateral payables and receivables associated with derivative instruments should be excluded from the disclosure.
- Fair value amounts should be presented as separate asset and liability values. Notional amounts should be presented based on the absolute amount associated with each derivative.

The Board also decided not to address, within the current scope of this project, financial statement presentation and classification of derivative instruments and hedged items falling within the scope of FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*.

Objectives of Meeting:

The objective of this meeting was to discuss the following issues related to derivatives disclosure:

1. Gross versus net presentation in tables summarizing an entity's use of derivatives in instances where an entity has qualified for net presentation in the statement of financial position in accordance with Interpretation 39.
2. The level of aggregation to be required for notional amounts and fair value amounts in the tables summarizing an entity's use of derivatives
3. Whether to include financial statement presentation and classification in the current project scope
4. Whether gains and losses on hedged items should be included in tables summarizing an entity's use of derivatives
5. Effective date and transition

These objectives were partially met. The staff will return to the Board to consider the following issues:

1. Whether the tables summarizing an entity's use of derivatives should include gains and losses on derivatives and related hedged items that existed throughout the period, at the end of the period, or both
2. Whether the disclosure should apply to hedged items related to fair value hedges, hedged transactions related to cash flow hedges, neither, or both
3. Effective date and transition of the proposed standard.

Matters Discussed and Decisions Reached:

1. Mr. Stoklosa opened the meeting by stating that the Board would discuss several issues related to presentation in the tables summarizing an entity's use of derivatives. These issues will clarify the following requirements that were agreed to at the July 19, 2006 Board meeting:
  - a. Disclose where and in what amount derivatives and related gains and losses are recorded in the balance sheet and income statement, respectively. Disclosure should be by major underlying, accounting designation, and purpose.
  - b. Disclose the notional amount and fair value of derivatives by major underlying, accounting designation, and purpose. Disclose instances where derivative agreements contain leverage factors and the estimated magnitude of these features.

**Topic 1: Gross Versus Net Presentation in Tables Summarizing an Entity's Use of Derivatives**

2. Mr. Stoklosa stated that there are two issues within this first topic. He said the first issue deals with whether derivatives subject to master netting arrangements should be displayed in a manner that would ignore netting under a master netting arrangement (i.e., on a gross basis), even in instances where an entity has qualified for net presentation in the statement of financial position in accordance with Interpretation 39. Mr. Stoklosa stated that, if derivatives were presented on a net basis, there would be a lack of transparency around the type of risks being hedged by the derivatives, since Interpretation 39 allows netting of derivatives that have different underlyings. Mr. Stoklosa further stated that, since the disclosures regarding where and in what amount derivatives and related gains and losses are recorded are required to be presented by major underlying, net presentation in the tables summarizing an entity's use of derivatives would require the development of arbitrary criteria to determine in which table the derivatives should be presented. Mr. Stoklosa added that the staff had contacted preparers of financial statements and received feedback that reporting derivatives on a gross basis would not be too burdensome, since those preparers already track derivatives on a gross basis for risk management and for hedge accounting compliance purposes. Mr. Stoklosa stated that the staff recommendation was to require that derivatives be presented on a gross basis in the tables summarizing an entity's use of derivatives.
3. Mr. Trott supported the staff recommendation because the objective of presenting individual tables by underlying is to help users better understand what risks are being hedged by derivatives and how those risks are being hedged. He stated that gross presentation was the only way for the tables to meet this objective. Ms. Seidman also supported the staff recommendation. She stated that her concerns about the operability of this requirement had been satisfied, since the tables present a snapshot of the derivatives' position at the balance sheet date and are not a roll forward of derivative positions that would require dealing with derivatives potentially fluctuating between asset and liability positions.

4. The Board unanimously agreed to require gross presentation in the tables summarizing an entity's use of derivatives, even in instances where an entity has qualified for net presentation in the statement of financial position under Interpretation 39.
5. Mr. Stoklosa stated that the second issue within this topic deals with how to handle cash collateral in situations where collateral is netted against net derivative exposures. He said that the Board is currently working on a separate issue relating to whether a cash collateral payable or receivable can be netted against derivative positions that are already netted under master netting arrangements. Mr. Stoklosa stated that the issue for discussion is whether the cash collateral payable or receivable should be included in the tables summarizing an entity's use of derivatives if the Board decides that netting is appropriate under the offsetting project. Mr. Stoklosa stated that including cash collateral payables and receivables in the disclosure would not be consistent with the scope of this project, which was previously limited to derivatives accounted for under Statement 133 and all hedged items. Mr. Stoklosa added that including the payables or receivables in the disclosure could provide misleading information about what risks are being hedged by derivatives and the related net exposure. Mr. Stoklosa recommended that the Board exclude cash collateral payables and receivables associated with derivative instruments subject to master netting arrangements from disclosures regarding where and in what amount derivatives and related gains and losses are recorded.
6. The Board unanimously decided to exclude cash collateral payables and receivables associated with derivative instruments subject to master netting arrangements from disclosures regarding where and in what amount derivatives and related gains and losses are recorded.

**Topic 2: The Level of Aggregation to be Required for Notional Amounts and Fair Value Amounts in the Tables Summarizing an Entity's Use of Derivatives**

7. Mr. Stoklosa stated the next issue deals with the level of aggregation to be required for notional amounts and fair value amounts within the tables. Mr. Stoklosa stated that the tables summarizing an entity's use of derivatives are separated by major underlying, such as interest rate, credit, foreign exchange, and commodity. Within each table, derivatives

will be required to be presented by accounting designation categories of fair value hedges, cash flow hedges, economic hedges, and other. Within each of these categories, derivatives will be required to be presented by balance sheet classification and/or purpose.

8. Mr. Stoklosa stated that the staff developed three approaches for aggregation of notional amounts and fair value amounts.
  - **Approach 1:** Aggregate the notional amounts and fair value amounts within each accounting designation category. Aggregation of the fair value amounts would be determined by netting, within each category, the derivatives having an asset value and the derivatives having a liability value. Aggregation of the notional amounts would be determined by netting the notional amounts tied to the respective derivatives having asset values and liability values.
  - **Approach 2:** Aggregate the fair value amounts within each accounting designation category. Aggregation of the fair value amounts would be determined by netting the derivatives having an asset value and the derivatives having a liability value. Notional amounts would be presented based on the absolute amount associated with each derivative.
  - **Approach 3:** Require the fair value amounts to be presented as separate asset and liability values. The notional amounts would be presented based on the absolute amount associated with each derivative.
9. Mr. Stoklosa stated that presenting the notional amounts and fair value amounts as shown in Approach 3 provides the best information for users to understand what risks are being hedged by derivatives, how those risks are hedged, and the impact of each risk in relation to one another on the overall financial position and performance of an entity. He added that presenting notional amounts and fair value amounts on a gross basis would provide a better indication of the potential future impact that changes in the underlying would have on the value of the derivative given the current environment for the underlying. Mr. Stoklosa stated that, although the fair value amounts would be presented on a gross basis, an entity would not have to separately report each individual derivative into which the

entity enters. Derivatives would be aggregated within each accounting designation (fair value hedges, cash flow hedges, etc.) and balance sheet classification or purpose based on whether the derivative has an asset value or a liability value. For example, all derivatives having an interest rate underlying that have an asset value and that are used in fair value hedging relationships of investments would be aggregated. Similarly, all derivatives having an interest rate underlying that have a liability value and that are used in fair value hedging relationships of investments would be aggregated.

10. Mr. Herz stated that netting the notional amounts under Approach 1 would provide misleading information about market risk exposure.
11. Mr. Linsmeier preferred Approach 3 because it provides the best information about the degree to which an entity is managing risk with multiple derivatives and the positions of each classification of derivatives. Mr. Linsmeier added that the notional amount has some informational content; presenting the notional amounts by their absolute values and relating them to their respective asset and liability fair value amounts provides information about additional risk that may exist in the derivative position. This connection is not apparent in Approach 2. Mr. Linsmeier also supported Approach 3 because of its potential to tie to the balance sheet.
12. Mr. Herz said that because of Interpretation 39 and the fact that derivatives are often included in the "Other Assets/Liabilities" section of the balance sheet, the tables would not foot easily to the balance sheet. He expressed concern about the value of reporting separate fair value amounts for derivatives in asset positions and derivatives in liability positions without reconciliation to the balance sheet. Mr. Linsmeier said that presenting information in that manner would provide for a sense of the volatility or sensitivity of the derivatives to changes in the underlying. Mr. Herz said that he does not object to presenting separate fair value amounts for derivatives in asset positions and derivatives in liability positions as long as the cost of providing the information does not outweigh the benefits. Mr. Stoklosa said that, based on discussion with preparers, information is maintained on a gross basis for derivatives and it would just be a matter of aggregating the information in the manner prescribed in Approach 3.

13. The Board unanimously decided to require Approach 3 for the level of aggregation to be required in tables summarizing an entity's use of derivatives.

**Topic 3: Whether to Include Financial Statement Presentation and Classification in the Current Project Scope**

14. Ms. Brady stated that the next issue for discussion deals with whether to include financial statement presentation and classification of derivative instruments and related hedged items within the current scope of this project. Ms. Brady recommended financial statement presentation and classification not be added to the project scope because it would delay a final standard that would significantly improve transparency around derivative instruments and related hedged items. Ms. Brady added that financial statement presentation could be addressed as part of a Phase 2 to this project or as part of another concurrent FASB project, such as the Financial Statement Presentation project or the Financial Instruments Disaggregation project. However, the staff did not support addressing financial statement presentation and classification as part of a Phase 2 to this project because it would be difficult to make progress in a separate phase until further issues in those larger projects are deliberated. Ms. Brady stated that since the disclosure framework agreed to by the Board will improve transparency around the impact of derivatives on the financial position, performance, and cash flows of an entity, the staff recommended that the topic of financial statement presentation and classification be addressed as part of another concurrent FASB project.
15. Mr. Young disagreed with the staff recommendation because the Financial Instruments Disaggregation project would take too long and he felt that the Board would be missing an opportunity to explore new ways of presenting information on derivatives. Mr. Young stated that addressing financial statement presentation and classification could add more credibility to the tables by tying them back to the financial statements.
16. Mr. Linsmeier expressed concern that, without addressing certain aspects of financial statement presentation and classification related to the effectiveness and ineffectiveness of hedging relationships, the tables summarizing an entity's use of derivatives might have to be expanded even further to incorporate information about the effective and ineffective

portions of the gains and losses on derivatives and hedged items and their presentation within the financial statements. Mr. Linsmeier added that this concern would be alleviated a bit if the gains or losses on the hedged items were included as part of the tables summarizing an entity's use of derivatives (this topic was addressed later in the meeting), because that would make it easier to ascertain which portion of the gain or loss on the derivative related to the effective and ineffective portions.

17. Mr. Batavick stated that he preferred to stick to the original scope of this project and move on to the exposure draft. Mr. Batavick suggested including some pointed questions about financial statement presentation and classification in the notice to recipients.
18. Mr. Trott agreed with the staff recommendation because he felt the disclosures already agreed upon would provide important information to users of financial statements. He felt it would be better to issue this standard before moving on to bigger issues related to financial statement presentation and classification.
19. Ms. Seidman also supported the staff recommendation because it would be extremely difficult to provide prescriptive guidance on financial statement presentation and classification of derivative instruments covered under Statement 133, which has an underlying elective nature. Ms. Seidman opined that it would be better to develop a framework under the Financial Statement Presentation project and then consider derivatives throughout that project.
20. A majority of the Board supported the staff recommendation that financial statement presentation and classification should not be included as part of this project. Mr. Young disagreed. Additionally, the Board unanimously agreed that the notice to recipients should include some questions about financial statement presentation and classification.

**Topic 4: Whether Gains and Losses on Hedged Items Should Be Included in Tables Summarizing an Entity's Use of Derivatives**

21. Ms. Brady stated that at the July 19, 2005 Board meeting, the Board unanimously decided to require the following disclosure:

Disclose where and in what amount derivatives and related gains and losses are recorded in the balance sheet and income statement, respectively. Disclosure should be by major underlying, accounting designation, and purpose.

22. Ms. Brady stated that in order for users to understand the full effects of a hedging relationship, disclosure of where and in what amount the changes in value of the hedged items are included in the income statement is necessary. She stated that this information would provide transparency and comparability, especially in instances where an entity may be including the effect of the derivative and hedged item in different income statement line items. Resource group members supported this disclosure and believed it would further provide users with information on the impact of derivatives on the risk profile of the entity. Ms. Brady said that the staff recommends that this disclosure be required only in situations in which a designated fair value hedging relationship exists. She said that it is only in fair value hedge situations that changes in fair value of the hedged item occur and impact the income statement. Ms. Brady further stated that the staff initially believed that entities should be encouraged to apply this disclosure to situations where an economic hedge exists but not a Statement 133 hedge. She stated, however, that after further analysis, the staff recommends that entities not be allowed to apply this disclosure to those situations. Ms. Brady stated that the staff believes that entities could potentially provide misleading information about the effectiveness of its economic hedges by picking and choosing the hedging instrument and hedged item to link together for disclosure purposes.
23. Mr. Trott asked whether the tables would report the gain or loss on fair value hedges that remain at year-end or all the fair value hedges that existed throughout the year. Mr. Stoklosa said that the disclosure is currently set up to report the gain or loss on fair value hedges that remain at year-end, but that reporting the gain or loss on all the fair value hedges that existed throughout the year could easily be accomplished in the table.
24. Mr. Linsmeier said that the table should report separately the gains or losses on hedged items for hedging relationships that exist at the end of the period and hedging relationships that were terminated during the period. He also said that the table should present information on the ineffective portion of cash flow hedge relationships that are

reported in earnings separately from the effective portion that is reclassified from other comprehensive income to earnings. Mr. Stoklosa said that the nuances of cash flow hedge accounting results in amounts related to the effective portion being recognized in earnings in time periods different than when the hedging relationship is in place. He said that would result in reporting amounts in the cash flow hedge designation part of the table relating to a hedging relationship that is no longer in place.

25. Ms. Seidman stated that it would be extremely difficult to comply with a tabular format and make the information about gains and losses on hedged items for both fair value and cash flow hedges meaningful. Mr. Stoklosa stated that one possibility to clarify this distinction would be to separate the columns in the table that relate to the income statement impact of the hedged items in fair value hedges from the income statement impact of the hedged items in cash flow hedges.
26. Mr. Herz asked the staff to further consider whether the tables summarizing an entity's use of derivatives should include gains and losses on derivatives and related hedged items that existed throughout the period, at the end of the period, or both. Mr. Herz asked the staff to also research whether the disclosure should apply to hedged items related to fair value hedges, hedged transactions related to cash flow hedges, neither, or both.
27. Mr. Stoklosa stated that the staff would return to the Board at a future meeting to consider those two issues, as well as effective date and transition of the proposed standard.

Follow-up Items:

The staff will return to the Board to consider the following issues:

1. Whether the tables summarizing an entity's use of derivatives should include gains and losses on derivatives and related hedged items that existed throughout the period, at the end of the period, or both
2. Whether the disclosure should apply to hedged items related to fair value hedges, hedged transactions related to cash flow hedges, neither, or both
3. Effective date and transition of the proposed standard.

Additionally, the staff will consider questions about financial statement presentation and classification of derivatives to include in the exposure draft for this project.

General Announcements:

None.