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Breaking News

Board Approves Three FASB Staff Positions in an Attempt to Clarify Fair Value Accounting

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Earlier this morning, the Board met to discuss over 600 comment letters received on proposed FSP FAS 157-e;[1] proposed FSP FAS 115-a, FAS 124-a, and EITF 99-20-b[2] (FSP FAS 115-a); and proposed FSP FAS 107-b and APB 28-a[3] (FSP FAS 107-b) (collectively, the "proposed FSPs"). The FASB staff received mixed messages from investors, individuals, preparers, regulatory bodies, business associations, and auditors regarding the proposed FSPs. An extensive discussion took place at the Board meeting before consensuses were reached to draft final standards. The final FSPs are expected to be issued late next week. Below is a summary, based on the preliminary and unofficial notes taken by Deloitte observers, of each of the expected final FSPs.

Inactive Markets and Distressed Transactions

The Board discussed several issues related to proposed FSP FAS 157-e. The Board indicated that proposed FSP FAS 157-e was not intended to change the objective of a fair value measurement even when there has been a significant decrease in market activity for the asset being measured. The Board emphasized that fair value is the price that would be received to sell the asset in an orderly transaction between market participants as of the measurement date in the current inactive market (i.e., "an exit price"). Thus, the measurement objective is to determine fair value in the current inactive market and not the value in a hypothetical active market or a midpoint between the two. The example in the proposed FSP will be significantly revised to be consistent with this objective.

A significant change from the proposed FSP FAS 157-e relates to the removal of the presumption that all transactions in an inactive market are distressed unless proven otherwise. Instead, the Board directed the staff to add factors to the final FSP that would require entities to consider whether events and circumstances indicate that the transaction is or is not orderly. Entities would place more weight on observable transactions determined to be orderly and less weight on transactions for which there is insufficient information to determine whether the transaction is orderly (note that entities do not have to incur undue cost and effort in making this determination). In addition, the Board affirmed that it did not intend to preclude entities from using pricing services or broker quotes in determining fair value. Rather, determining fair value in a market in

[1] Proposed FASB Staff Position No. FAS 157-e, "Determining Whether a Market Is Not Active and a Transaction Is Not Distressed."

[2] Proposed FASB Staff Position No. FAS 115-a, FAS 124-a, and EITF 99-20-b, "Recognition and Presentation of Other-Than-Temporary Impairments."

[3] Proposed FASB Staff Position No. FAS 107-b and APB 28-a, "Interim Disclosures About Fair Value of Financial Instruments."

which there has been a significant decrease in activity is complex, depends on facts and circumstances, and involves significant judgment in determining relevance of inputs.

The final FSP will be broadened to include all assets and liabilities (i.e., financial and nonfinancial) subject to fair value measurements and will require enhanced disclosures.

Other-Than-Temporary Impairments

After a thorough discussion regarding other-than-temporary impairment (OTTI), the Board reached a consensus that the scope of the new OTTI model should be limited to debt securities. Therefore, the existing OTTI models for equity securities would continue to apply. Like the Exposure Draft, the new OTTI model for debt securities would shift the focus from an entity's intent to hold until recovery to its intent to sell. An entity would write underwater debt securities that it currently intends to sell (or for which it cannot assert that it is more likely than not that it will not have to sell the securities before recovery), down to fair value through earnings.

If an entity does not intend to sell a debt security (available-for-sale or held-to-maturity), but it is probable that the entity will not collect all amounts due according to the debt's contractual terms, the entity will bifurcate the OTTI. The impairment due to credit, measured as the difference between amortized cost and the present value of expected cash flows discounted at the security's effective rate, would be recognized in earnings. The remaining amount of the impairment (noncredit portion) would be recognized in other comprehensive income (separately from other unrealized gains and losses on available-for-sale securities). The noncredit portion for held-to-maturity securities recorded in other comprehensive income should be amortized prospectively (with the offsetting amount increasing the value of the asset) over the remaining life of the security.

The scope of the new OTTI model should be limited to debt securities.

The Board indicated that it agrees that the final standard of proposed FSP FAS 115-a should illustrate the interaction with other OTTI guidance, such as SAB Topic 5.M[4] and FSP FAS 115-1/124-1,[5] by including examples of factors for an entity to consider in determining whether there is an OTTI for a debt security. In addition, the final FSP will require entities to initially apply the provisions of the final standard to previously other-than-temporarily impaired instruments existing as of the effective date by making a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. The cumulative-effect adjustment reclassifies the noncredit portion of a previously other-than-temporarily impaired instrument held as of the effective date to accumulated other comprehensive income from retained earnings. The final standard will also provide for enhanced disclosures.

Interim Fair Value Disclosures for Financial Instruments

Proposed FSP FAS 107-b expands the **fair value** disclosures required for all financial instruments within the scope of Statement 107[6] to interim periods. The proposed FSP will also require entities to disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments in financial statements on an interim and annual basis and to highlight any changes from prior periods. The disclosure requirements of the proposed FSP will only affect public entities.

Effective Date

The Board voted to delay the effective date for all three proposed FSPs to interim and annual periods ending after June 15, 2009, with early adoption permitted for periods ending after March 15, 2009. However, FSP FAS 157-e and FSP FAS 115-a must be adopted concurrently. Therefore, an entity that wants to early adopt FSP FAS 157-e (for periods ending after March 15, 2009) must also early adopt FSP FAS 115-a, and vice versa. Lastly, an entity that wants to early adopt FSP FAS 107-b (for periods ending after March 15, 2009) must also early adopt the other two FSPs.

[4] SEC Staff Accounting Bulletin Topic 5.M, "Other Than Temporary Impairment of Certain Investments in Debt and Equity Securities."

[5] FASB Staff Position No. FAS 115-1 and 124-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments."

[6] FASB Statement No. 107, *Disclosures About Fair Value of Financial Instruments*.

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