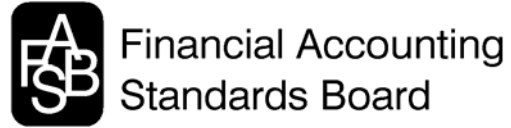


MINUTES



To: Board Members

From: Drum (ext. 296)

Subject: Minutes of the April 9, 2008 Board Meeting – Proposed FSP FAS 157-c

Date: May 14, 2008

cc: Golden, Cosper, MacDonald, Bielstein, Leisenring, Chookaszian, Posta, Lott, McBeth, Gabriele, Allen, Klimek, Maples, Mayer, Stevens, Tully, Wyatt, , C. Smith, Glotzer, Eastman (IASB), 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.

Topic: Measuring Liabilities under FASB Statement No. 157

Basis for Discussion: Board Memorandum 1 dated March 26, 2008

Length of Discussion: 9:45am – 11:30am.

Attendance:

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

Board members absent: None

Staff in charge of topic: Maples

Other staff at Board table: Golden, Drum, Maples, Cosper, Stevens

Outside participants:

Summary of Decisions Reached

1. The Board discussed comments received on proposed FSP FAS 157-c, Measuring Liabilities under FASB Statement No. 157, and directed the staff to make the following changes to the proposed FSP and its related amendments to clarify the Board's intent:
 - a. Modify paragraph 6 of the proposed FSP to clarify that the exceptions to the use of Level 1 inputs in paragraphs 25 and 26 of FASB Statement No. 157, Fair Value Measurements, continue to be available under the guidance in the proposed FSP
 - b. Clarify that when using a quoted price in an active market, an entity should ensure that the item for which the quote pertains is identical to the unit of account for the liability being measured
 - c. Modify paragraph 6 of the proposed FSP to clarify that the best measurement of fair value for an entity's liability is the price at which that liability is traded as an asset
 - d. Maintain paragraph 7 of the proposed FSP as written in the exposure draft without including the staff's revisions related to using entities assumptions about market participant assumptions.
 - e. Clarify that the effect of initially applying the guidance in the proposed FSP should be included as a change in fair value in the period of adoption
 - f. Specify that the final FSP will be effective at the later of (a) the beginning of the first reporting period ending after the issuance date of the FSP or (b) the beginning of the period in which an entity initially applies Statement 157.
2. The Board directed the staff to present a memorandum to the Board to ensure that the staff has captured the Board's views on the FSP. The Board may decide to readdress issues related to this FSP at a future meeting. The Board directed the staff to proceed to a draft of a final FSP for vote by written ballot after it has reviewed the staff memorandum.

Objective of Meeting

3. The objective of the meeting was (a) for the staff to present their summary and analysis of respondents' comment letters received on the proposed FASB Staff Position (FSP) FAS 157-c, *Measuring Liabilities under FASB Statement No. 157*, and (b) for the Board to decide on proposed amendments to the proposed FSP in response to the comment letters.

The objectives were met.

Matters Discussed and Decisions Reached

Issue 1: Realization

4. Mr. Maples stated that many of the respondents indicated that because of transfer restrictions, the best measurement for a liability would be settlement value. In addition, respondents indicated that the measurement of fair value for a liability that ignored the transfer restrictions resulted in a measurement that could not be realized by the reporting entity.
5. The Board has concluded as a part of the Statement 157 deliberations that a reporting entity's intent or ability to settle a liability should not impact the fair value measurement under Statement 157. Furthermore, while a reporting entity may not have the intent or legal ability to transfer the liability, the staff believes that the Board demonstrated that other alternatives are available to a reporting entity to realize changes in fair value. While sympathetic to respondents concerns regarding an inability to realize changes in the fair value of liabilities, the staff does not recommend that the Board reconsider the issue because there is no new information that was not covered during initial deliberations.
6. Mr. Herz stated that in situations where there is a restriction on transfer of a liability, or a lack of marketability for a liability, the only possible exit from the obligation is settlement with the counterparty. Therefore, he believes that for those liabilities the only appropriate fair value under FASB Statement No. 157, *Fair Value*

Measurements, is a settlement value. He noted that in these situations, settlement is the principal market in which the liability transacts. He stated that requiring an entity to consider a hypothetical transaction will result in information that is less reliable and less relevant.

7. Ms. Seidman stated that she is of the view that changing the definition of fair value to include settlement value would constitute a complete overhaul of the provisions of paragraph 15 of statement 157 and other GAAP that requires a fair value measurement of liabilities such as FASB Statement No. 143, *Accounting for Asset Retirement Obligations*.
8. Ms. Seidman questioned whether Mr. Herz believed that when an entity's own debt was trading in the market, the quoted price (as an asset) represented the fair value of the liability. Mr. Herz replied that he viewed the quoted price as a practical expedient. Ms. Seidman countered that the entity could buy back its debt at that amount. Mr. Herz understood that but viewed it as a settlement notion. Ms. Seidman questioned why, in an active market, the quoted price represents an exit price for one party, but not to the other party to the same set of cash flows.
9. Mr. Smith asked whether in a situation where an entity commonly settles a liability with a counterparty prior to maturity, the obligor would be precluded from using this settlement value as an indication of the fair value of the liability. Mr. Maples responded that while settlement value may be indicative of fair value and may be used as a starting point to determine fair value, adjustments would need to be made to reconcile to a transfer notion. Mr. Stevens stated that an entity must consider settlement amount because this is a key term of the liability. He noted that prior to Statement 157 entities may have valued certain derivative liabilities at a settlement value. Under Statement 157 however, they must consider nonperformance risk. Therefore, settlement value may be a good estimate of fair value for a derivative liability, but may not be a good measurement for other liabilities such as bonds or asset retirement obligations.

10. Mr. Batavick stated that the goal of Statement 157 is to establish consistent measurements between entities. He stated that he believes the proposed FSP helps to accomplish this goal.

Issue 2: Consideration of Nonperformance Risk

11. Mr. Maples stated that several respondents indicated that Statement 157 was unclear as to whether a reporting entity is allowed to decide whether its risk of nonperformance (including consideration of the reporting entity's own credit) should or should not be a component of a fair value measurement. Other respondents indicated that because of collateral and netting agreements, the risk of nonperformance (including consideration of the reporting entity's own credit) might be mitigated and they questioned whether a reporting entity should be required in those instances to include the risk of nonperformance in the fair value measurement.

12. Mr. Maples noted that PwC indicates in its comment letter that for a population of transactions it believes certain market participants would look to a contract's settlement value as the primary means for pricing because the contract's settlement value is the primary means for liquidity. The staff believes that the issue of liquidity is a settlement notion and that it is inconsistent with the principles of Statement 157.

13. As to the consideration of the effect of collateral and netting agreements, the staff believes the Board addressed this issue during deliberations of Statement 157 and concluded that an entity should consider the terms of any collateral and other credit enhancements included in the contract when measuring the fair value of a liability.

14. Mr. Maples stated that while sympathetic to the respondents concerns regarding consideration of a reporting entity's own credit, the staff does not recommend that the Board reconsider the issue because the staff does not believe that there is any new information that wasn't previously considered.

15. Ms. Seidman reaffirmed that to the extent that contractual arrangements exist, an entity should consider these in the valuation. Mr. Maples responded that an entity must consider nonperformance risk and any arrangements that alter the

nonperformance risk such as posting collateral. Mr. Stevens clarified that this issue does not answer the question of whether third party guarantees should be considered in the valuation of a liability.

Issue 3: Scope

16. Mr. Maples stated that the staff received several comments questioning whether the guidance in the proposed FSP was intended to apply to all liabilities or just financial instruments. Other respondents questioned whether the scope of the proposed FSP was intended to include derivative instruments, such as swaps, that may be in either an asset or liability position at the measurement date.
17. The staff believes the first principle of the proposed FSP, that is, the use of a quoted price in an active market, would most often be used to measure the fair value of financial instruments. However, it was not the staff's intent to limit the use of a quoted price in an active market strictly to financial instruments.
18. Furthermore, it was not the staff's intent that the second principle of the proposed FSP, that is, the measurement of a liability at the amount that the reporting entity would receive as proceeds if it were to issue that liability at the measurement date, be used in all situations. The staff believes that the use of the second principle of the proposed FSP would be most appropriate to the application of financial instruments. However, the staff felt that it was most appropriate for the reporting entity to consider whether the use of the second principle of the proposed FSP was appropriate in its facts and circumstances.
19. The staff appreciates the fact that derivative instruments are unique from many other liability instruments because the derivative instrument may be in either an asset or liability position at the measurement date. However, the staff is unaware of any justification for excluding a liability derivative from the scoping of the proposed FSP. The staff believes a derivative liability should be included in the scope of the proposed FSP while a derivative asset should not be included in the scope of the proposed FSP.

20. The staff believes the scope of the proposed FSP already incorporates the above notions, and, therefore, believes no further revisions to the scope paragraph are required.

21. The Board agreed that the scope of the proposed FSP should not be revised.

Issue 4: Bid/Ask Spread

22. Mr. Maples stated that the staff received comments from respondents related to whether a reporting entity should use a bid price or an ask price when measuring the fair value of a liability under the guidance of the proposed FSP.

23. The staff believes the fundamental issue of whether a reporting entity should use a bid or ask price in its fair value measurement was addressed in paragraph 31 of Statement 157 which stipulates that “the bid-ask spread that is most representative of fair value in the circumstances shall be used to measure fair value, regardless of where in the fair value hierarchy the input falls (Level 1, 2, or 3).”

24. The staff does not believe it was the intent of the proposed FSP to change how a reporting entity applies the bid/ask spread guidance. The staff believes a reporting entity should continue to apply its policies when applying the guidance in the proposed FSP and to continue to evaluate whether the use of a bid, ask, or other price is most representative of the circumstances.

25. The staff does not recommend any revisions to the proposed FSP as a result of the above comment.

26. The Board agreed that paragraph 31 of Statement 157 provides adequate guidance on the use of bid/ask spreads.

Issue 5: Exceptions to the Use of a Quoted Price in an Active Market

27. Mr. Maples stated that, as drafted, the proposed FSP would not have afforded a reporting entity the exceptions to the use of a quoted price in an active market as specified in paragraphs 25 and 26 of Statement 157. Paragraph 25 of Statement 157

provides an exception to the use of a Level 1 input measurement when the reporting entity does not have ready access to quoted prices for an individual asset or liability. Paragraph 26 of Statement 157 provides an exception to the use of a Level 1 input measurement when the quoted price may not represent fair value at the measurement date because of a significant event that occurs after the close of a market but before the measurement date.

28. The staff believes the exceptions to the use of a Level 1 input should be available under the guidance of the proposed FSP. Accordingly, the staff recommends moving paragraph 15A to paragraph 24A and the changes to paragraph 6 of the proposed FSP as outlined in the Board materials. By moving paragraph 15A to 24A, the paragraph would now be located within the guidance on Level 1 inputs and be subject to the exceptions provided by paragraphs 25 and 26 of Statement 157.
29. The Board agreed that the exceptions to the use of a Level 1 input should be available under the guidance of the proposed FSP and agreed with the staff's proposed changes to the proposed FSP.

Issue 6: Unit of Valuation

30. Mr. Maples stated that some respondents commented that the proposed FSP could cause a reporting entity to replace the consideration of its own nonperformance risk with that of a guarantor when measuring the fair value of the reporting entity's liabilities.
31. Because Statement 157 does not define the unit of account, except as it relates to blockage, the staff understands constituents may face difficulties with the application of Statement 157 to certain liabilities, particularly guaranteed indebtedness. However, the staff believes that the issue of "what is the unit of account" is an issue that is outside of the scope of the proposed FSP and would recommend that the Board not address that issue at this time. However, the staff does recommend that the Board clarify the proposed guidance through the additions as outlined in the Board materials.

32. Mr. Herz stated that the language proposed by the staff was very subtle. Mr. Maples responded that the staff intended to avoid directly answering the question of whether the effect of a third-party guarantee should be included in the value of the liability. He stated that the proposed language is intended to state that the quoted price used should be identical to the unit of account. Mr. Maples stated that if an entity considers the debt by itself to be the unit of account, it would be inappropriate to consider a quoted price that included a guarantee.
33. Ms. Seidman questioned whether the Board plans on answering the question of including the effect of a third-party guarantee in the value of a liability. Mr. Golden responded that the staff is currently researching the diversity in practice to determine whether this question warrants attention from the Board.
34. Ms. Seidman stated that she does not think the addition is helpful, and believes that the staff should answer the question of including the effects of a guarantee directly.
35. Mr. Linsmeier questioned whether the proposed language would be included in the amendments to Statement 157. Mr. Linsmeier also stated that the proposed language should specify that when using an **unadjusted** quoted price in an active market the quote should pertain to an identical liability. Mr. Maples responded that the staff could include that in the amendments if the Board desired. Mr. Smith agreed that the language should be included in the amendments.
36. Messrs. Batavick, Young, Linsmeier, Smith, and Crooch voted in favor of the proposed revision to the proposed FSP. Mr. Herz and Ms. Seidman voted against it.

Issue 7: Blockage

37. Mr. Maples stated that the staff received comments concerning whether a reporting entity should be allowed to apply a discount to the quoted price in an active market (Level 1 input measurement) if it is likely that the reporting entity would receive a lesser amount if it were to transfer its entire liability at one time because the market's normal daily trading volume is insufficient, an issue of blockage.

38. The staff believes paragraph 27 of Statement 157 already precludes the application of a discount when using a quoted price in an active market. The staff understands that blockage has generally been discussed in the context of an asset; however, paragraph 27 of Statement 157 does not limit its application strictly to assets. Accordingly, the staff does not recommend that the Board reconsider this issue.
39. The staff also understands that some constituents have questioned what volume of activity is required before a market is to be considered active as used in Statement 157. However, the staff believes the issue of “what is an active market” is an issue that is outside of the scope of the proposed FSP and the staff would recommend that the Board not address that issue as part of the proposed FSP.
40. Mr. Herz stated that he agrees the Board should not reconsider this issue but he thinks using a quoted price for an asset represents a practical expedient that is inconsistent with the transfer notion in Statement 157.
41. Mr. Maples stated that because parties trading in an asset consider the same attributes that a party transferring the liability would consider, the staff did not consider the guidance a practical expedient.

Issue 8: Identical Liability

42. Mr. Maples stated that the staff understands that there is variance in the ease in which entities have been able to implement Statement 157. While the staff understands that some entities have found it easier to implement than others, the staff continues to believe the proposed guidance would be beneficial to a large number of entities.
43. Furthermore, the staff does not believe it was the Board’s intent that paragraph 6 require an entity to measure the fair value of its liability by using the quoted price of another entity’s *similar* liability that would be a Level 2 input.
44. Based on the above comments, the staff recommends the Board clarify paragraph 6 and 15A as illustrated in the Board materials.
45. The Board agreed with the staff’s revisions to the proposed FSP.

Issue 9: Consistency with the Principles of Statement 157

46. Mr. Maples indicated that the staff appreciates respondents concerns that paragraph 7 of the proposed FSP could be interpreted as an entry price notion and a departure from the principles of Statement 157. However, the staff does not believe it was the Board's intent to amend the principles of Statement 157 but rather simply to provide constituents a mechanism for its application where observable inputs may not exist for the measurement of a liability.
47. Because of the lack of observable inputs available for the fair value measurement of liabilities, the staff understands that some constituents did not have an appreciation as to where to start in determining the fair value of its liabilities. The staff believes it was the intent of paragraph 7 to provide constituents with a possible model for determining that starting point.
48. Because of the unique aspect of liabilities, that is, the need for the risk of nonperformance to be the same before and after the hypothetical transfer, the model presented in paragraph 7 effectively captures the risk of nonperformance. However, the staff recognizes that amounts initially calculated under this proposed model may not be representative of the price market participants would expect to receive in a hypothetical transfer for one or more reasons. Therefore, the staff believes a reporting entity would need to adjust the initially calculated amount for differences in assumptions between the reporting entity and its market participants. The staff believes the reporting entity would still be required to make an assessment of its principal market and market participants as required by Statement 157 in determining whether or not adjustments are necessary to the initially calculated amount.
49. Based on the comments received, the staff recommends the proposed FSP be modified to more clearly communicate the intent of the proposed guidance.
50. Mr. Herz stated that in certain situations, such as with long-dated derivative contracts other market participants may exist. However, there are other situations where no market could exist, for example, where there is a restriction on transfer of a liability,

or a lack of marketability for a liability. Therefore, he believes that for those liabilities the only appropriate fair value under Statement 157 is a settlement value. Mr. Herz stated that he objects to the staff's recommendation and that he would prefer to characterize these interpretations as practical expedients.

51. Mr. Linsmeier stated that there is a difference between estimating a price based on potential transaction and estimating a price based on assumptions of market transaction that could never exist. There are certain situations where the only exit is settlement with the counterparty. He questioned why reporting entities would consider market participant's assumptions when no market participants exist.
52. Ms. Seidman stated that the entry price may not represent an exit price because of transaction costs, different markets, forced sale or liquidation etc. She suggested that instead of directing reporting entities to cross-check with market participants assumptions for Level 3 measurement, the proposed FSP could state that a current transaction price could be representative of fair value as long as none of the conditions in paragraph 17(a-d) of Statement 157 are present. She noted that the purpose of the proposed FSP is to provide simplifying assumptions for measuring a liability within Level 3, that is, where key inputs to the measurements are not observable. The entity will still be required to use any observable inputs that are available. Ms. Seidman said she views this FSP as an interpretation of paragraph 30 for liabilities.
53. Mr. Maples expressed concern over Ms. Seidman's proposal that other issues may cause differences between the price a reporting entity would receive and a transfer notion. He questioned whether the proposed FSP should ignore those possibilities to provide a practical expedient. Ms. Seidman noted that a reporting entity must consider market data in order to estimate what an entity would receive to enter into a liability at the current date. Mr. Maples noted that reporting entities may have different incentives than the market participants. He noted that paragraph 7 of the proposed FSP, as drafted prior to the staff's revisions, does not require an entity to adjust for other assumptions. For example, an insurance company may measure an

insurance contract liability based on assumptions that are dramatically different than market participant's assumptions. Ms. Seidman suggested that Mr. Maples' example would be a subversive implementation of the standard.

54. Mr. Stevens noted that without a requirement to look to assumptions outside of the reporting entity, there is very little discipline surrounding the measurement.

55. Mr. Batavick stated that he believes that Messrs. Herz and Linsmeier's views represent a fundamental change in the principles of Statement 157. He stated that he would be open to contrasting the staff's proposal with Ms. Seidman's proposal. He also noted that because of the urgency he could support the staff's proposal.

56. The Board decided not to redeliberate the measurement of certain liabilities at settlement value. The Board decided against including the staff's revisions to paragraph 7 of the proposed FSP related to using entities assumptions about market participant assumptions. The Board decided not to consider the guidance in paragraph 7 of the proposed FSP a practical expedient. Messrs. Herz and Linsmeier stated that they will dissent to this decision.

Issue 10: Fair Value Hierarchy

57. Mr. Maples stated that, as drafted, the proposed FSP did not specify the level of the input to be used in a fair value measurement calculated under the guidance of paragraph 7. While the staff believed that there would be limited need for a reporting entity to use the guidance in the proposed FSP if observable inputs were available, the staff did not initially consider it necessary to specify that the guidance would only be applicable if significant unobservable inputs were used in the fair value measurement. However, based on the comments received from respondents, the staff believes there are significant advantages to specifying that the guidance from paragraph 7 of the proposed FSP should only be used if significant unobservable inputs are used in the fair value measurement.

Issue 12: Proceeds

58. Several respondents commented that it was unclear as to why the proposed FSP uses the term “proceeds” instead of “price” as used in the definition of fair value in Statement 157. The staff believes the use of the term proceeds was intended to convey the same meaning as the term “price” as used in Statement 157 and recommends replacing proceeds with price in the proposed FSP.

59. The Board agreed that the term “proceeds” should be replaced by “price.”

Issue 13: Examples

60. Mr. Maples stated that the Staff will reassess whether examples are necessary in light of the Board’s discussion.

Issue 14: Transition

61. The Board agreed with the staff’s proposal that the proposed FSP be effective at the later of (a) the beginning of the first reporting period ending after the issuance date of the FSP or (b) the beginning of the period in which an entity initially applies Statement 157.

62. The Board directed the staff to present a memorandum to the Board to ensure that the staff has captured the Board’s views on the FSP. The Board may readdress issues related to this FSP at a future meeting. The Board directed the staff to draft a final FSP for the balloting after it has reviewed the staff memorandum.