

**Board Meeting Handout
Derivatives Disclosures
September 26, 2007**

At today's meeting, the Board will continue redeliberations of the Exposure Draft of the proposed Statement, *Disclosures about Derivative Instruments and Hedging Activities* (ED). The issue for redeliberation at this meeting is the disclosure requirements for a tabular presentation of information about fair values of derivatives, gains and losses on derivatives, and gains and losses on hedged items in designated and qualifying hedging relationships.

Background Information

In the ED, the Board decided that information about fair values of derivatives, gains and losses on derivatives, and gains and losses on hedged items in designated and qualifying hedging relationships should be disclosed using a tabular format. The ED requires that individual tables be presented for each primary underlying risk, including interest rate risk, credit risk, foreign exchange rate risk, and overall price risk. Individual tables would also be presented for situations in which derivatives contain multiple underlying risks (for example, interest rate risk and credit risk, interest rate risk and foreign exchange rate risk, and credit risk and foreign exchange rate risk). An entity therefore could potentially disclose seven individual tables.

Within each individual table, information on derivatives and related hedged items, where appropriate, would be presented by accounting designation and purpose for entering into the derivative. Accordingly, information in each individual table would be presented separately for (a) fair value hedges, (b) cash flow hedges, (c) net investment hedges, and (d) derivatives not designated as hedging instruments. Within the purpose category, information on derivatives and related hedged items would be further disaggregated by those open at period end and those no longer open at period end. For those derivatives

open at period end, derivatives in asset positions would be presented separately from derivatives in liability positions, thus resulting in a gross presentation. Information on derivatives that are no longer open at period end would be disclosed in the aggregate.

Constituent Comments

A number of respondents believe that the tabular disclosure would be too voluminous and not provide useful information to users of financial statements. They noted that displaying information about derivatives and related hedged items under numerous levels of disaggregation is not necessary to meet the objectives of how derivatives are accounted for in the financial statements and how they affect an entity's financial position, results of operations, and cash flows.

User Needs

One of the main criticisms of the current disclosure requirements of Statement 133 is that they provide little transparency into the overall impact derivatives have on the financial statements. For example, it is often difficult to ascertain where and in what amounts derivatives and their related gains and losses are recorded in the statement of financial position and in the statement of financial performance, respectively. Analysts have indicated to the staff that this often makes it difficult to assess the performance of an entity's operations to the extent operating results have been impacted by derivatives.

Revised Tables

To address constituent concerns, meet user needs, and to meet the objectives of the project, the staff developed the attached new tables that would replace those proposed in the ED:

Table 1 – Disclosure of fair values of derivative instruments in the statement of financial position.

Table 2 – Disclosure of gains and losses on derivative instruments in the statement of financial performance.

The staff presented the tables to various preparer and user constituents for input. Preparers generally commented that the tables are much more operational and less complex than the tables required in the ED. Users generally commented that the tables meet their needs as it relates to providing information on the amount of derivatives reported in the financial statements and where in the financial statements derivatives are located. However, they reiterated that the usefulness of the information in the tables is limited without requiring disclosure about the various risks that are managed by derivatives and how the use of derivatives correspond with an entity's broader asset/liability risk management practices.

With regards to Table 2, which focuses on disclosing the location and amount of derivative gains and losses reported in the statement of financial performance, preparers favored the version that excludes and users favored the version that includes hedged item information related to fair value hedges. Preparers indicated that hedged item information (a) is not useful since gains and losses on the derivatives and hedged items within Statement 133 hedging relationships largely offset each other as a result of the highly effectiveness criteria in Statement 133, and (b) could be misleading without providing hedged item information relating to economic hedging relationships not designated under Statement 133. Users indicated that hedged item information is useful because (a) it provides a more complete picture of an entity's derivative activity, (b) it may encourage an entity to more clearly articulate in qualitative disclosures the various risks the entity is intending to manage with its derivative positions, (c) it provides more information about the effect of derivatives on an entity's financial position, results of operations, and cash flows, and (d) it provides more information about how and why an entity is using derivatives.

Staff Recommendation

The staff recommends that the revised tabular disclosure be a required disclosure in a final statement. The revised tables would replace the tables required in the ED. The staff believes that the revised tabular disclosures when combined with the qualitative disclosures required by paragraph 44 of Statement 133, as amended, would effectively achieve the project's objectives.

The staff is split, however, on the two alternative versions of Table 2 (the income statement table). Some staff members believe that hedged item information associated with fair value hedging relationships should be included in Table 2 (alternative 1) because such a disclosure would provide more information to users in assessing the effectiveness of hedging relationships designated under FAS 133. Other staff members believe that the usefulness of the hedged item information is limited given that Statement 133 requires hedging relationships to be highly effective. Those staff members also believe that information about how and why an entity uses derivatives is limited because information about the type of hedged item (loan, investment security) is not provided. Consequently, the staff does not have a specific recommendation for the Board on this issue.

Questions for the Board

Does the Board agree that the revised tabular disclosures, when combined with the qualitative disclosures required by paragraph 44 of Statement 133, as amended, would effectively achieve the project's objectives? If yes, in addition to Table 1, which alternative version of Table 2 should be required to be included as part of the tabular disclosures?

Table 1

Fair Values of Derivative Instruments

<i>In millions of dollars</i>									
As of December 31	Asset Derivatives				Liability Derivatives				
	2009		2008		2009		2008		
	Bal. Sheet Classification	Fair Value	Bal. Sheet Classification	Fair Value	Bal. Sheet Classification	Fair Value	Bal. Sheet Classification	Fair Value	
Derivatives Designated as Hedging Instruments under Statement 133									
Interest rate contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Foreign exchange contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Equity contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Commodity contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Credit contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Other contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Total Derivatives Designated as Hedging Instruments under Statement 133		XX,XXX		XX,XXX		XX,XXX		XX,XXX	
Derivatives Not Designated as Hedging Instruments under Statement 133(1)									
Interest rate contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Foreign exchange contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Equity contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Commodity contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Credit contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Other contracts	Other Assets	XX,XXX	Other Assets	XX,XXX	Other Liab.	XX,XXX	Other Liab.	XX,XXX	
Total Derivatives Not Designated as Hedging Instruments under Statement 133		XX,XXX		XX,XXX		XX,XXX		XX,XXX	
Total Derivatives		XX,XXX		XX,XXX		XX,XXX		XX,XXX	
(1) See footnote XX for additional information on the ABC Company's purpose for entering into derivatives <u>not</u> designated as hedging instruments and its overall risk management strategies.									

The staff prepares meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

**Derivative Instruments' Impact on the Statement of Financial Performance
for the year ended December 31, 2009**

Derivatives in Statement 133 Fair Value Hedging Relationships	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative		I/S Classification of Gain or (Loss) on Hedged Item	Amt of G/(L) on Hedged Item Recognized in Income Attributable to the Risk Being Hedged			
		2009	2008		2009	2008		
Interest rate contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX		
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX		
Equity contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX		
Commodity contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX		
Credit derivatives	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX		
Other contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX		
Total		XX,XXX	XX,XXX		XX,XXX	XX,XXX		
Derivatives in Statement 133 Cash Flow Hedging Relationships	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative (Ineffective Portion)		I/S Classification of Gain or (Loss) Reclassed from OCI into Income	Amt of Gain or (Loss) Reclassified from OCI into Income (Effective Portion)		Amt of G/(L) Recognized in OCI on Derivative (Effective Portion)	
		2009	2008		2009	2008	2009	2008
Interest rate contracts	Other income/(expense)	XX,XXX	XX,XXX	Interest income(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX	Sales/Revenue	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Equity contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commodity contracts	Other income/(expense)	XX,XXX	XX,XXX	Cost of sales	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Credit derivatives	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Other contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total		XX,XXX	XX,XXX		XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives in Statement 133 Net Investment Hedging Relationships	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative (Ineffective Portion)		I/S Classification of Gain or (Loss) Reclassed from OCI into Income	Amt of Gain or (Loss) Reclassified from OCI into Income (Effective Portion)		Amt of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	
		2009	2008		2009	2008	2009	2008
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX	G/(L) on sale of subsidiay	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives not designated as hedging instruments under Statement 133(1)	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative						
		2009	2008					
Interest rate contracts	Other income/(expense)	XX,XXX	XX,XXX					
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX					
Equity contracts	Other income/(expense)	XX,XXX	XX,XXX					
Commodity contracts	Other income/(expense)	XX,XXX	XX,XXX					
Credit derivatives	Other income/(expense)	XX,XXX	XX,XXX					
Other contracts	Other income/(expense)	XX,XXX	XX,XXX					
Total		XX,XXX	XX,XXX					
(1) See footnote XX for additional information on the ABC Company's purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategies.								

**Derivative Instruments' Impact on the Statement of Financial Performance
for the year ended December 31, 2009**

Derivatives in Statement 133 Fair Value Hedging Relationships	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative						
		2009	2008					
Interest rate contracts	Other income/(expense)	XX,XXX	XX,XXX					
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX					
Equity contracts	Other income/(expense)	XX,XXX	XX,XXX					
Commodity contracts	Other income/(expense)	XX,XXX	XX,XXX					
Credit derivatives	Other income/(expense)	XX,XXX	XX,XXX					
Other contracts	Other income/(expense)	XX,XXX	XX,XXX					
Total		XX,XXX	XX,XXX					
Derivatives in Statement 133 Cash Flow Hedging Relationships	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative (Ineffective Portion)		I/S Classification of Gain or (Loss) Reclassed from OCI into Income	Amt of Gain or (Loss) Reclassified from OCI into Income (Effective Portion)		Amt of G/(L) Recognized in OCI on Derivative (Effective Portion)	
		2009	2008		2009	2008	2009	2008
Interest rate contracts	Other income/(expense)	XX,XXX	XX,XXX	Interest income(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX	Sales/Revenue	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Equity contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Commodity contracts	Other income/(expense)	XX,XXX	XX,XXX	Cost of sales	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Credit derivatives	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Other contracts	Other income/(expense)	XX,XXX	XX,XXX	Other income/(expense)	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Total		XX,XXX	XX,XXX		XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives in Statement 133 Net Investment Hedging Relationships	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative (Ineffective Portion)		I/S Classification of Gain or (Loss) Reclassed from OCI into Income	Amt of Gain or (Loss) Reclassified from OCI into Income (Effective Portion)		Amt of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion)	
		2009	2008		2009	2008	2009	2008
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX	G/(L) on sale of subsidiay	XX,XXX	XX,XXX	XX,XXX	XX,XXX
Derivatives not designated as hedging instruments under Statement 133(1)	I/S Classification of Gain or (Loss) on Derivative	Amt of G/(L) Recognized in Income on Derivative						
		2009	2008					
Interest rate contracts	Other income/(expense)	XX,XXX	XX,XXX					
Foreign exchange contracts	Other income/(expense)	XX,XXX	XX,XXX					
Equity contracts	Other income/(expense)	XX,XXX	XX,XXX					
Commodity contracts	Other income/(expense)	XX,XXX	XX,XXX					
Credit derivatives	Other income/(expense)	XX,XXX	XX,XXX					
Other contracts	Other income/(expense)	XX,XXX	XX,XXX					
Total		XX,XXX	XX,XXX					
(1) See footnote XX for additional information on the ABC Company's purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategies.								



**Board Meeting Handout
Interaction between Statement 13 (Leasing) and
Statement 157 (Fair Value Measurements)**

September 26, 2007

PURPOSE

At today's meeting, the Board will discuss whether to add to its technical agenda a project to address issues related to the interaction between FASB Statement No. 13, *Accounting for Leases*, and FASB Statement No. 157, *Fair Value Measurements*. The staff will provide the approaches it recommends to address the issues. The staff will also ask if the Board agrees with the staff's recommendations.

BACKGROUND

The Exposure Draft preceding Statement 157 proposed a scope exception for Statement 13 and other accounting pronouncements that require fair value measurements for leasing transactions. At that time, the Board was concerned that applying the fair value measurement objective in the Exposure Draft to leasing transactions could have unintended consequences, requiring reconsideration of aspects of lease accounting that were beyond the scope of the Exposure Draft. However, respondents to the Exposure Draft indicated the fair value measurement objective for leasing transactions is generally consistent with the fair value measurement objective in Statement 157. Others in the leasing industry subsequently affirmed that view. Based on that input, the Board decided to include lease accounting pronouncements in the scope of Statement 157.

Paragraph E4 of Statement 157 amended the Statement 13 definition of fair value in paragraph 5(c) of Statement 13 as follows:

Fair value of the leased property. ~~The price for which the property could be sold in an arm's length transaction between unrelated parties.~~ The price that would be received to sell the property in an orderly transaction between market participants at the measurement date. Market participants are buyers and sellers that are independent of the reporting entity, that is, they are not related parties at the measurement date. (See definition of related parties in leasing transactions in paragraph 5(a).) The following are examples of the determination of fair value...

Statement 157, however, did not amend the related examples included in subparagraphs (i) and (ii) of paragraph 5(c), which state:

- i. When the lessor is a manufacturer or dealer, the fair value of the property at the inception of the lease...will ordinarily be its normal selling price, reflecting any volume or trade discounts that may be applicable....
- ii. When the lessor is not a manufacturer or dealer, the fair value of the property at the inception of the lease will ordinarily be its cost, reflecting any volume or trade discounts that may be applicable

Paragraphs 6(b)(i) and 6(b)(ii) of Statement 13 indicate that a lease cannot be classified as a direct financing lease by the lessor if, at lease inception, the fair value of the leased asset and the cost of the leased asset are not equal. Paragraphs 12 and 14 of FASB Technical Bulletin No. 88-1, *Issues Relating to Accounting for Leases*, clarify that for purposes of determining whether to classify a lease as a direct financing lease, the requirement in paragraph 6(b)(ii) is to be applied literally.

Subsequent to the issuance of Statement 157, leasing constituents have raised issues about the interaction of the fair value measurement objective in Statement 13, as amended, and the fair value measurement objective in Statement 157. Those issues focus principally on the following:

- Initial fair value measurements for lease classification when the lessor is not a manufacturer or dealer (Issue 1).
- Applying the fair value measurement objective in Statement 157 to estimated residual values (Issue 2).

ISSUES FOR BOARD CONSIDERATION

ISSUE 1—Initial Fair Value Measurements for Lease Classification When the Lessor is not a Manufacturer or Dealer

1. Statement 13 requires initial fair value measurements for purposes of lease classification. Issues relating to those initial fair value measurements involve third-party lessors. A third-party lessor is not a manufacturer or dealer (examples include banks and independent finance companies). In practice, third-party lessors typically include as part of the cost basis of the leased asset costs such as installation of the leased asset, freight charges associated with the leased asset, sales taxes, and transaction costs associated with the leased asset (broker commissions, third-party legal fees, real estate transfer taxes, and so

forth), as well as volume discounts that it receives from a vendor, regardless of whether it passes those discounts along to the lessee through lease payments.

2. For purposes of lease classification, the initial fair value of the leased asset determined under Statement 157 might not be its cost because paragraph 17 of Statement 157 excludes transaction costs from a fair value measurement. The initial fair value of the leased asset determined under Statement 157 also might not be its cost if the market in which the third-party lessor acquires the leased asset is not the exit market (principal market) for the asset. In either case, the lease would not qualify for classification as a direct financing (or leveraged) lease under Statement 13. Instead, the lease generally would be classified as a sales-type lease (if criteria for a sales type lease in paragraphs 7 and 8 of Statement 13 are met). However, the lease could also be classified as an operating lease if the leased asset is real estate or integral equipment as defined in FASB Interpretation No. 43, *Real Estate Sales*.
3. Third-party lessors now question whether a lease will ever qualify for classification as a direct financing (or leveraged) lease. Classification of the lease as other than a direct financing lease would represent a significant change to practice. Among other things, a change in classification raises issues about the timing of revenue recognition. Statement 157 also could result in a change to practice for lessees; specifically, the fair value measurements used for purposes of lease classification and initial measurement of the leased asset (determined based on a comparison of the present value of the minimum lease payments to the fair value of the leased asset to the lessor).

Approaches for Issue 1

Approach A—Scope out Statement 13 and its related interpretive accounting pronouncements from Statement 157

Amend Statement 157 to scope out Statement 13 and its related interpretive accounting pronouncements that address leasing transactions. The potential conflicts between the guidance for initial fair value measurements in Statement 13 and the guidance in Statement 157 create confusion as to whether and, if so, how to apply the transaction price presumption in paragraph 5(c)(ii) of Statement 13 (that is, whether it represents a practical expedient). Absent further amendments, one could also view a fair value measurement from the perspective of the entity (as required by Statement 157) as being in direct conflict with Statement 13's requirement for a fair value measurement for a lessee from the perspective of the lessor. Based on the

Board's deliberations of Statement 157, it clearly was not the Board's intent to change lease accounting, supporting a scope-out for fair value measurements for leasing transactions.

Approach B—Provide Implementation Guidance

Address the issues raised and provide implementation guidance for initial fair value measurements used for lease classification under Statement 13. Such guidance would specify that for purposes of Statement 13's lease classification requirements, the initial fair value of the leased asset should be based on its cost—as a practical expedient. That would be consistent with the Board's approach to FASB Interpretation No. 45, *Grantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*, in finalizing Statement 157 (discussed in paragraph C21 of Statement 157).

Approach C—Provide No Guidance

Provide no guidance, pending deliberations in the leasing project. Therefore, Statement 157 would apply to fair value measurements for leasing transactions. Paragraph 5(c)(ii) of Statement 13 does not indicate that cost will represent fair value in all cases. Similarly, Statement 157 does not indicate that cost (transaction price) will not represent fair value in any cases.

Staff Recommendation

The staff recommends Approach A. It is consistent with the Board's approach in its deliberations of Statement 157 and is appropriate based on the new information that is now available since the issuance of Statement 157. A scope out for Statement 13 and its related interpretive accounting pronouncements that address leasing transactions would also resolve Issue 2 (discussed below).

ISSUE 2—Applying the fair value measurement objective in Statement 157 to estimated residual values

1. The lessor's gross investment in both a direct financing lease and a sales-type lease is equal to the minimum lease payments plus the unguaranteed residual value accruing to the benefit of the lessor.
2. Paragraph 5(h) of Statement 13 defines the estimated residual value of leased property as, "the estimated fair value of the leased property at the *end* of the lease term" (emphasis added). Paragraph 5(i) of Statement 13 defines the unguaranteed residual value as "the

estimated residual value of the leased property...exclusive of any portion guaranteed by the lessee or by a third-party unrelated to the lessor.” Statement 13 requires that the lessor review residual value at least annually. If a decline in the residual value is other than temporary, the resulting reduction in the net investment should be recognized as a loss in the period of change. An upward adjustment is not permitted.

3. In practice, lessors, particularly those engaged in high volume leases of smaller ticket assets (for example, copiers, computers, and telecommunications equipment) with multiple means of disposing the leased asset at the end of the lease term (for example, lessee purchase, retail market, and wholesale market), generally utilize a weighted-average expected cash-flow valuation model to determine estimated residual values. The model incorporates various assumptions regarding sales proceeds from different exit markets and the probabilities of selling to those markets.
4. The fair value definition in Statement 157 assumes an exit transaction in the entity’s principal market (paragraph 8). When there are multiple markets for a leased asset, the Statement 157 principal market approach will require lessors to use the pricing information in just one of the markets (not a weighted average) to determine the residual value (that is, the estimated fair value of the leased asset at the end of the lease term). In that situation, a price in a single market would not reflect the reality of multiple markets which are available and utilized to dispose of off-lease assets.
5. Moreover, in situations in which the Statement 157 principal market approach results in a higher residual value than the weighted-average approach, the result would be higher income recognized over the term of the lease and a higher implicit rate in the lease. This additional income could be offset by a loss (impairment) upon the eventual disposition of the leased asset. In situations in which the reverse occurs, (that is, a lower residual value), the result would be lower income recognized over the term of the lease and a lower implicit rate in the lease.
6. In either situation, the result would be a change to the longstanding valuation practices that are now common in the leasing industry (and, for national banks, a departure from residual-value-setting guidelines as established by the Office of the Comptroller of the Currency).

Approaches for Issue 2

Approach A—Scope out Statement 13 and its related interpretive accounting pronouncements from Statement 157

Amend Statement 157 to scope out Statement 13 and its related interpretive accounting pronouncements that address leasing transactions. Absent a scope out, the resulting change to practice for lessors as it relates to residual values would represent an example of an "unintended consequence" that the Board was seeking to avoid when it initially proposed to exclude the leasing pronouncements from the scope of the Statement 157 project.

Approach B—Provide Implementation Guidance

Provide implementation guidance regarding the application of Statement 157 to leasing transactions. Questions relating to the Statement 157 principal market definition could exist in other industries. Absent additional guidance, there could be diversity in practice.

Approach C—Clarify that Residual Value is Not a Fair Value Measurement

Clarify that residual value measurements are not in the scope of Statement 157 because they are measurements that are similar to fair value, but that are not fair value. The objective of a residual value measurement is to estimate a future "market" price (the price in an exit transaction at the end of the lease term). In contrast, the objective of a fair value measurement is to estimate a current "market" price (the price in an exit transaction at the measurement date).

Approach D—Provide No Guidance

Provide no guidance, pending deliberations in the leasing project. Whether or not Statement 157 would apply would depend on whether the Board believes a residual value measurement is a fair value measurement under Statement 157.

Staff Recommendation

The staff recommends Approach A, consistent with its recommendation for Issue 1. Approach A is consistent with the Board's approach in its deliberations of Statement 157 and is appropriate based on the new information that is now available since the issuance of Statement 157.

Questions for the Board

Does the Board want to add a project to its technical agenda to address issues related to the interaction between Statements 13 and 157?

Does the Board agree with the staff's recommendations for Issues 1 and 2?



Board Meeting Handout*
Ratification of EITF Consensuses-for-Exposure¹
September 26, 2007

At today's meeting, the staff will request that the Board consider ratifying the consensuses-for-exposure that were reached at the September 11, 2007 EITF meeting.

Task Force Consensuses-for-Exposure:

1. Issue No. 07-1, "Accounting for Collaborative Arrangements"—The Task Force reached a consensus-for-exposure on Issue 1 that a collaborative arrangement is a contractual arrangement in which the parties are active participants to the arrangement and are exposed to significant risks and rewards that are dependent on the ultimate commercial success of the endeavor. An entity should consider all relevant facts and circumstances when evaluating whether an arrangement is a collaborative arrangement.

The Task Force reached a consensus-for-exposure on Issue 2 that transactions with third parties (that is, revenue generated and costs incurred by participants with parties outside the collaborative arrangement) should be reported gross or net on the appropriate line item in each entity's respective financial statements pursuant to the guidance in Issue 99-19. In reaching that consensus-for-exposure, the Task Force also concluded that the equity method of accounting under Opinion 18 should not be applied to collaborative arrangements.

The Task Force reached a consensus-for-exposure on Issue 3 that the income statement classification of payments among participants pursuant to a collaborative arrangement be evaluated based on the nature of the arrangement, the nature of each entity's business operations, and the contractual terms of the arrangement. Task Force members observed that the payments between participants pursuant to a collaborative arrangement that are within the scope of other authoritative literature regarding income statement classification should apply the relevant provisions of that literature. If the payments are not within the scope of other authoritative accounting literature, the income statement classification for the payments should be based on an analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy.

The Task Force reached a consensus-for-exposure on Issue 4 that a participant in a collaborative arrangement should disclose annually:

- a. Information about the nature and purpose of its collaborative arrangements
- b. Its rights and obligations under the collaborative arrangements

* The staff prepares Board meeting handouts to facilitate the audience's understanding of the issues to be addressed at the Board meeting. This material is presented for discussion purposes only; it is not intended to reflect the views of the FASB or its staff. Official positions of the FASB are determined only after extensive due process and deliberations.

¹ Consensuses-for-exposure refers to a conclusion reached by the Task Force on an Issue indicating that the Issue has been approved for release as an exposure draft subject to Board ratification.

- c. The stage of the underlying endeavor's life cycle
- d. The accounting policy for collaborative arrangements in accordance with Opinion 22
- e. The income statement classification and amounts attributable to transactions among other participants to the collaborative arrangement
- f. Amounts due from or owed to other participants under the collaborative arrangements.

Additionally, the Task Force reached a consensus-for-exposure that this Issue should be effective for fiscal years beginning after December 15, 2007. Entities should report the effects of applying this Issue as a change in accounting principle through retrospective application to all periods. If it is impracticable to apply the effects of a change in accounting principle retrospectively, disclosure should be made of both the reasons why reclassification was not made and the effect of the reclassification on the current period pursuant to the guidelines in paragraph 9 of Statement 154. The evaluation of whether transition through retrospective application is practicable should be made on an arrangement-by-arrangement basis.

- 2. Issue No. 07-4, "Application of the Two-Class Method under FASB Statement No. 128, *Earnings per Share*, to Master Limited Partnerships"**—The Task Force reached a consensus-for-exposure that the scope of this Issue apply only to master limited partnerships (MLPs) that have concluded that the incentive distribution is an equity distribution (as opposed to compensation expense). The Task Force also reached a consensus-for-exposure that this Issue should apply to all MLP arrangements regardless of whether the incentive distribution rights (IDRs) are a separate interest or embedded in the general partnership (GP) interest. When the IDRs are a separate interest, the Task Force concluded that the IDRs represent a participating security and therefore the MLP would allocate current period earnings to the GP, LP, and IDR holder using the two-class method. In contrast, when the IDR is embedded in the GP interest, the IDR would not be considered a participating security; however, the MLP would still apply the two-class method to the interests of the GP and LPs (although the GP's earnings allocation would include the rights of the IDRs).

The Task Force reached a consensus-for-exposure that when applying the two class method, and current period earnings are in excess of cash distributions and the IDRs are a separate LP interest, undistributed earnings should be allocated to the GP, LPs, and IDR holder as if the undistributed earnings were available cash. That is, undistributed earnings would be allocated to the GP, LPs, and IDR holder utilizing the distribution waterfall for available cash specified in the partnership agreement. Similarly, when an IDR is embedded in the GP interest, undistributed earnings should be allocated to the GP (including the distribution rights of the embedded IDR) and LPs as if the undistributed earnings were available cash. In reaching its consensus-for-exposure, the Task Force observed that the distribution waterfall for available cash would not be considered a specified threshold as described in Example F in paragraph 16 of Issue 03-6.

The Task Force also reached a consensus-for-exposure that when cash distributions are in excess of current period earnings and the IDRs are a separate LP interest, net income (or loss) should be reduced (or increased) by distributions to the GP, LPs, and IDR holder. The resulting negative undistributed earnings amount after deducting cash distributions would be

allocated to the GP and LPs based on their respective sharing of losses specified in the partnership agreement. If the IDR holder does not share in losses, no allocation of the negative undistributed earnings amount is made to the IDR holder. . If the IDR holder has a contractual obligation to share in the losses of the MLP on a basis that is objectively determinable, then the hypothetical loss would be allocated to the GP, LPs, and IDR holder based on their respective sharing of losses specified in the partnership agreement. Similarly, when the IDR is embedded in the GP interest, net income (or loss) should be reduced (or increased) by distributions to the GP (including the distribution rights of the embedded IDR) and LPs. The resulting negative undistributed earnings amount would be allocated to the GP and LPs based on their respective sharing of losses specified in the partnership agreement.

Additionally, the Task Force reached a consensus-for-exposure that this Issue should be effective for financial statements issued for fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted. The guidance in this Issue should be applied retrospectively for all financial statements presented.

- 3. Issue No. 07-6, "Accounting for the Sale of Real Estate When the Agreement Includes a Buy-Sell Clause"**—The Task Force reached a consensus-for-exposure that the buy-sell clause should be evaluated based on all relevant facts and circumstances to determine whether the clause constitutes an option or other prohibited form of continuing involvement. A buy-sell clause, in and of itself, does not constitute a prohibited form of continuing involvement that would preclude partial sales treatment under Statement 66. However, a buy-sell clause may constitute a prohibited form of continuing involvement that precludes partial sales treatment if the buyer cannot act independently from the seller or if the seller is economically compelled to reacquire the real estate. The Task Force considered factors that would result in the buyer compelling a seller or where, based on the facts, it may indicate that the seller has substantial continuing involvement in the real estate. The Task Force did not consider any one factor to be presumptive or determinative but agreed that all factors must be considered. The factors discussed included the following:

Factors that may indicate that the seller has substantial continuing involvement in the real estate:

- a. The price specified in a buy-sell clause may indicate that the parties have already negotiated for the seller to acquire the buyer's interest. For example, a fixed price is specified in the buy-sell clause.
- b. The seller may have a strategic necessity or an investment strategy that indicates that it cannot give up its ownership rights to the buyer and therefore the buyer's exercise of the buy-sell clause would compel the seller to reacquire full ownership of the real estate.
- c. The seller may have arrangements with the jointly owned entity, such as management or third-party leasing arrangements, that may economically compel the seller to reacquire the real estate in order to retain the economic benefits (for example, leasing commissions from lessees) or escape the negative economic consequences (for example, below-market contract with the entity) of such arrangements.

- d. Tax implications economically compel the seller to buy the other interest in the entity (thereby reacquiring the real estate) from the buyer.

Factors that may indicate the buyer can compel the seller to repurchase the property:

- e. Tax implications may economically compel the buyer to sell its interest in the entity to the seller.
- f. The buyer is financially unable to acquire the seller's interest. A requirement for an appraisal or for the offer price to be at fair value may provide protection to the buyer in such circumstances and provide evidence that the buyer is financially unable to acquire the seller's interest. However, a requirement for an appraisal may not be evidence of compulsion in other situations.
- g. The buy-sell clause stipulates a specified rate of return to the buyer (or seller), indicating that the buyer may not fully participate in the rewards of ownership from the real estate.
- h. The buyer may have a strategic necessity or an investment strategy that requires that it sell its interest to the seller.
- i. The buyer may be legally restricted from acquiring the seller's interest.
- j. If the real estate is integrated into the seller's business, the buyer may not have alternative means available, such as sale to an independent third party, to realize its economic interest.

The Task Force reached a consensus-for-exposure that this Issue should be effective for new arrangements entered into in fiscal years beginning after December 15, 2007, and interim periods within those fiscal years. Earlier application is not permitted.