



**Board Meeting Handout**

**Accounting for Financial Instruments**

**November 17, 2009**

**INTRODUCTION**

1. In the project on accounting for financial instruments, the Board has reached the following decisions regarding presentation of amortized cost amounts on the face of the balance sheet:
  - a. At the July 15, 2009 Board meeting, the Board decided that for financial assets and financial liabilities that are measured at fair value with fair value changes partially recognized in other comprehensive income, the *amortized cost* of those financial assets and liabilities must be displayed on the face of the balance sheet in addition to a fair value adjustment to arrive at fair value.
  - b. At the August 13, 2009 Board meeting, the Board decided that amortized cost must be presented (parenthetically) for an entity's own debt that is measured at fair value with changes in fair value recognized in net income.
2. It is necessary to clarify the definition of *amortized cost* because of those decisions and the continued use of the term in existing U.S. generally accepted accounting principles (GAAP). This clarification would also be useful for the potential amortized cost election for certain financial liabilities that may meet the eligibility criteria.

**Existing Definitions of *Amortized Cost***

3. The following definitions of *amortized cost* are currently used in U.S. GAAP:
  - a. The Master Glossary in the FASB *Accounting Standards Codification*<sup>TM</sup> (as originally defined in paragraph 23 of AICPA Statement of Position 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*) defines *amortized cost* as:

The sum of the initial investment less cash collected less write-downs plus yield accreted to date.

- b. The Master Glossary (as originally defined in paragraph 19 of FASB Staff Position FAS 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments*) defines *amortized cost basis* as:

The amount at which an investment is acquired, adjusted for accretion, amortization, collection of cash, previous other-than-temporary impairments recognized in earnings (less any cumulative-effect adjustments), foreign exchange, and fair value hedge accounting adjustments.

4. The staff is presenting two alternatives for the Board's consideration. The difference between the two alternatives is that the allowance for credit losses would be a reduction in the calculation for determining the amortized cost amount under the second alternative but not under the first alternative.

#### **Alternative 1**

5. Alternative 1 defines *amortized cost* as follows:

Amortized cost of a financial asset or financial liability is a cost-based subsequent measurement that adjusts the historical cost for amortization or other allocations. Amortized cost is calculated as the historical cost amount of the financial asset or financial liability adjusted over time as follows:

- a. Minus principal repayments
- b. Plus or minus the cumulative amortization or accretion of any difference between that initial amount and the maturity amount
- c. Plus or minus foreign exchange adjustments
- d. Minus *direct write-offs* of the principal amount.

#### **Alternative 2**

6. Alternative 2 defines *amortized cost* as follows:

Amortized cost of a financial asset or financial liability is a cost-based subsequent measurement that adjusts the historical cost for amortization or other allocations. Amortized cost is calculated as the historical cost amount of the financial asset or financial liability adjusted over time as follows:

- a. Minus principal repayments
- b. Plus or minus the cumulative amortization or accretion of any difference between that initial amount and the maturity amount

- c. Plus or minus foreign exchange adjustments
- d. Minus *any reduction for credit impairment* (that is, direct write-off of the principal amount and *allowances for credit impairments*).

**Question for the Board**

Should the definition of amortized cost be based on Alternative 1 or Alternative 2? If neither, how should amortized cost be defined?