MINUTES

To:	Board Members
From:	FVM Team (Goetsch, ext. 447)
Subject:	Minutes of the January 25, 2006, FVM Board Meeting — **Date:** February 1, 2006
cc:	Bielstein, L. Smith, Fair Value Team, Revenue Recognition Team, Business Combinations Team, McBeth, Polley, Gabriele, Carney, Mahoney, Sutay, Leisenring (IASB), Nelson (IASB) P. Martin (CICA), 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.

<u>Topic</u>:	Proposed FASB Statement, *Fair Value Measurements*: External reviewer comments (fair value hierarchy, disclosures, effective date, transition disclosures, and timing)
<u>Basis for Discussion</u>:	Memorandums dated December 6, 2005, and January 11, 2006, and audience handout (attached)
<u>Length of Discussion</u>:	8:40 a.m. to 9:40 a.m.

<u>Attendance</u>:

Board members present:	<u>FASB:</u> Batavick, Crooch, Herz, Schipper, Seidman, Trott, and Young
Board members absent:	None
Staff in charge of topic:	MacDonald
Other staff at Board table:	Belcher, Bielstein, Gerard, Goetsch, Lott, Thuener, and Todorova
Outside participants:	None

Summary of Decisions Reached

The Board discussed issues raised by external reviewers on the October 21, 2005, working draft of a final FASB Statement, *Fair Value Measurements,* (FVM Statement) relating to the fair value hierarchy, disclosures, and effective date and transition.

The Board clarified the fair value hierarchy as follows:

1. The Board affirmed the guidance within Levels 2–4 but decided to combine those levels, thereby establishing a 3-level hierarchy for both measurement and disclosure purposes.

2. The Board decided to incorporate guidance clarifying that where within the fair value hierarchy the fair value measurement in its entirety falls should be based on the lowest level significant input.

3. The Board affirmed its previous decision to allow the use of an alternative pricing method (for example, matrix pricing) as a practical expedient to the requirement to use quoted prices for identical assets or liabilities within Level 1, but clarified that the resulting measurement should not be disclosed as a Level 1 measurement (it is a Level 2 measurement).

4. The Board affirmed its previous decision that the cost and/or effort associated with obtaining or otherwise deriving market inputs is not sufficient basis for determining whether to use those inputs to measure fair value. The Board acknowledged that, in some cases, market inputs might not be available. In those cases, entity inputs (inputs reflecting the entity's internally developed assumptions of market inputs) should be used to measure fair value within Level 5 (new Level 3). However, the fair value measurement objective remains the same. Therefore, entity inputs should be adjusted if information is available that indicates that market participants would use different assumptions.

The Board reconsidered its previous decision to require disclosure of the percentage of total assets (liabilities) that are remeasured at fair value on a recurring basis. The Board decided not to require that disclosure. The Board plans to discuss other fair value disclosures at a future Board meeting.

The Board reconsidered its previous decisions relating to effective date and transition. Specifically:

1. The Board decided that the FVM Statement should be effective for financial statements issued for fiscal years beginning after November 15, 2006, and interim periods within those fiscal years, subject to the timing of a final FVM Statement. However, the Board decided that all of the disclosure requirements of the FVM Statement should apply in the first interim period in which the FVM Statement is initially applied.

2. The Board affirmed its previous decision that the effect of the change in accounting principle on income before extraordinary items and any affected per-share amounts should be initially applied retrospectively (full retrospective transition approach). However, the Board decided not to require disclosure of the effect of that change in the fiscal year in which the FVM Statement is initially applied, as previously discussed.

The Board decided not to issue a final FVM Statement until after it substantially completes redeliberations of related issues raised by respondents to the proposed FSP FAS 133-a, "Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value under Statement 133".

Objective of Meeting

The purpose of the meeting was for the Board to discuss issues raised by external reviewers on the October 21, 2005, working draft of the FVM Statement.

Matters Discussed and Decisions Reached

Fair Value Hierarchy

Levels

1. Ms. MacDonald explained that in commenting on the fair value hierarchy, some reviewers questioned the ordering of the inputs within Levels 2–4. She explained that Levels 2–4 were added to clarify the types of market inputs that should be used to measure fair value without prescribing the ordering of those inputs because the market inputs used to measure fair value will vary depending on the circumstances. She stated that in response, the staff proposes that the Board either (a) retain the guidance within Levels 2–4 but combine those levels, thereby establishing a 3-level hierarchy for purposes of measurement and disclosure or (b) retain the levels but clarify the related guidance to emphasize that there is no prescribed ordering of the inputs within those levels.

2. All Board members agreed to combine Levels 2–4, emphasizing the need to retain the related guidance.

Designation of Fair Value Measurements

3. Ms. MacDonald stated that the FVM Statement clarifies that where within the fair value hierarchy the fair value measurement in its entirety falls depends on where within the fair value hierarchy the input that is significant to the fair value measurement falls. She explained that some reviewers asked how that guidance would apply if multiple inputs within different levels of the fair value hierarchy are significant to the fair value measurement. She stated that, in response, the staff recommends that the Board incorporate additional guidance specifying that where within the fair value hierarchy the fair value measurement in its entirety falls should be based on the *lowest level significant input*, as suggested by some reviewers.

4. All Board members agreed with that staff recommendation.

Level 1

5. Ms. MacDonald explained that the FVM Statement specifies that within Level 1, the fair value measurement should be determined using a quoted price for an identical asset or liability in an active market whenever it is available, except as follows. In the limited situations in which an entity holds a large number of similar assets and liabilities that are required to be measured at fair value and individual price quotes in an active market are available but not readily accessible for each of those assets and liabilities (for example, from pricing services or individual broker-dealers), the FVM Statement allows for the use of an alternative pricing method (for example, matrix pricing) as a practical expedient. She stated that some reviewers agreed with the practical expedient in the limited situations referred to, but stated that the resulting measurement should not be disclosed as a Level 1 measurement (it is a Level 2 measurement). She stated that the staff agrees and recommends that the Board clarify the related guidance within Level 1 accordingly.

6. All Board members agreed with that staff recommendation.

Level 5

7. Ms. MacDonald explained that the FASB Exposure Draft, *Fair Value Measurements,* (FVM ED) specified that entity inputs should be used to measure fair value if market inputs are not available without *undue cost and effort*. In that context, the undue cost and effort criterion in the FVM ED was not intended to allow an exception to the requirement of other accounting pronouncements to measure fair value. Rather, it was intended to allow for the use of entity inputs to meet the fair value measurement objective in cases where market inputs within higher levels of the fair value hierarchy are not readily available (without undue cost and effort). In other words, the fair value measurement objective (an exchange price in a transaction between market participants) remains the same. Therefore, entity inputs should be adjusted if there are contrary data indicating that market participants would use different assumptions. She noted that similar guidance is included in FASB Concepts Statement No. 7, *Using Cash Flow Information and Present Value in Accounting Measurements*, and, to varying degrees, incorporated in other existing accounting pronouncements, including FASB Statements No. 141, *Business Combinations*, No. 142, *Goodwill and Other Intangible Assets*, No. 143, *Accounting for Asset Retirement Obligations*, No. 144*, Accounting for the Impairment or Disposal of Long-Lived Assets*, and No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

8. Ms. MacDonald explained that in its redeliberations of the FVM ED, the Board decided to remove the undue cost and effort criterion within Level 5. That change was made to convey the requirement to fully consider market inputs when measuring fair value, largely in response to comments that cost and effort alone are not sufficient basis on which to ignore market inputs that are otherwise available. She stated that some reviewers noted that the guidance in Level 5, as revised, could be viewed as excessive and impose undue cost and burden. Other reviewers noted that for some entities, the requirement to more fully consider market inputs could result in a significant change to practice under other existing accounting pronouncements where entity inputs are used to measure fair value. Largely for that reason, they stated that the FVM ED should be re-

exposed. In response, she stated that the staff seeks the Board's view on (a) whether to reinstate the undue cost and effort criterion within Level 5 and (b) how to clarify the ongoing fair value measurement requirements under other existing accounting requirements where entity inputs are used to measure fair value.

9. All Board members agreed that the undue cost and effort criterion should not be reinstated. Instead, the related guidance within Level 5 should be clarified to emphasize that:

a. The fair value measurement objective applies whether using market and/or entity inputs

b. Cost and effort alone are not sufficient basis on which to ignore market inputs that are otherwise available

c. Entity inputs used to measure fair value should be adjusted if information is available that indicates that market participants would use different assumptions (consistent with the related guidance in Concepts Statement 7).

10. Mr. Young asked about the related transition requirements. Ms. MacDonald explained that in its earlier discussions, the Board acknowledged a change to practice resulting from a change in the methods used to measure fair value and decided that the change should be initially applied prospectively. She added that a prospective transition approach would continue to be required. Retrospective application in all (or some) prior periods presented would not be allowed.

Disclosures

11. Ms. MacDonald explained that the FVM Statement requires disclosure of assets and liabilities that are remeasured at fair value on a recurring basis, in total and as a percentage of total assets and liabilities. That disclosure was initially required to provide context, indicating the extent to which assets and liabilities that are recognized in the statement of financial position are remeasured at fair value. However, a few reviewers indicated that the

percentage disclosure would not necessarily provide incremental information useful to users of financial statements. She stated that the staff seeks the Board's view of whether to retain that disclosure.

12. All Board members agreed to remove the percentage disclosure requirement.

Effective Date(s)

13. Ms. MacDonald explained that the FVM Statement is currently effective for financial statements issued for fiscal years *beginning* after December 15, 2006, and interim periods within those fiscal years, except for the disclosure requirements that are effective for financial statements issued for fiscal years *ending* after December 15, 2006. She stated that several reviewers expressed concerns about the accelerated effective date for disclosures, noting that the disclosures convey information resulting from the application of the measurement provisions of the FVM Statement, which, in some cases, will require systems and operational changes. They stated that the FVM Statement should be effective in its entirety at the same time. Further, because some financial institutions have November 30 year-ends, some of those reviewers suggested that the Board revise the effective date so that it is effective for financial statements issued for fiscal years beginning after November 15, 2006, and interim periods within those fiscal years. She stated that the staff agrees and, therefore, recommends that the FVM Statement be effective in its entirety for financial statements issued for fiscal years beginning after November 15, 2006, and interim periods within those fiscal years.

14. All Board members agreed with that staff recommendation, subject to the timing of a final FVM Statement. In addition, Mr. Trott stated that all of the disclosures required by the FVM Statement should be required in the first interim reporting period of the fiscal year in which the FVM Statement is initially applied, effectively incorporating the related SEC reporting requirements. All Board members agreed with those expanded disclosure requirements, noting that they would apply only for SEC registrants.

Transition Disclosures (Blocks)

15. Ms. MacDonald explained that for blocks of financial instruments, the change in method for measuring fair value should be applied retrospectively to all prior periods. Further, in the fiscal year in which the Statement is initially applied, and in all interim periods within that fiscal year, an entity should disclose the effect of that change on income before extraordinary items and any affected per-share amounts, if applicable (in accordance with FASB Statement No. 154, *Accounting Changes and Error Corrections*). She stated that some reviewers said that those disclosures, in combination with a full retrospective transition approach, would not be cost beneficial. She stated that the staff agrees and, therefore, recommends that the Board remove those transition disclosures.

16. All Board members agreed with that staff recommendation.

Timing

17. Ms. MacDonald stated that the staff seeks the Board's preliminary view on the timing of issuance of a final FVM Statement relative to proposed FSP FAS 133-a. She explained that there are some significant issues relating to the FVM Statement (reference market principle and transaction price presumption) that are significant under proposed FSP FAS 133-a. Largely for that reason, the staff recommends that (a) the Board defer issuance of a final FVM Statement until after those issues have been resolved in the FVM and FSP FAS 133-a projects and (b) at that time, consider the need for additional constituent input. She stated that currently, the staff expects to substantially complete redeliberations of proposed FSP FAS 133-a in the second quarter of 2006.

18. All Board members agreed with that staff recommendation.

<u>Follow-up Items:</u>

14. None.

<u>General Announcements:</u>

15. None.

Board Meeting Handout
FAIR VALUE MEASUREMENT PROJECT
January 25, 2006 Board Meeting

The Board will discuss issues raised by external reviewers on the October 21, 2005 working draft of FASB Statement No. 15X, *Fair Value Measurements* (FVM Statement), including issues relating to the fair value hierarchy, disclosures, and effective date and transition.

1. FAIR VALUE HIERARCHY

Levels

Levels 1–4 of the fair value hierarchy set out broad categories of market inputs used to measure fair value. Some reviewers indicated a need to clarify the ordering of the market inputs included within Levels 2–4. In response, the Board will consider whether to:

a. Combine Levels 2–4, thereby establishing a 3-level hierarchy

b. Retain Levels 2–4, but clarify that the fair value hierarchy allows for judgment in selecting the market inputs within those levels, considering the relative reliability of the inputs in the circumstances.

Designation of Fair Value Measurements

The FVM Statement clarifies that where within the fair value hierarchy the fair value measurement in its entirety falls depends on where within the fair value hierarchy the input that is significant to the fair value measurement falls. Some reviewers pointed out that in some cases, multiple inputs within different levels of the fair value hierarchy might be significant to the fair value measurement. In response, the Board will consider whether to incorporate additional guidance specifying that where within the fair value hierarchy the fair value measurement in its entirety falls should be based on the *lowest level significant input*.

Alternative Pricing Methods within Level 1

The FVM Statement specifies that within Level 1, the fair value measurement should be determined using a quoted price for an identical asset or liability in an active market whenever it is available, except as follows. In the limited situations in which an entity holds a large number of similar assets and liabilities that are required to be measured at fair value and individual price quotes in an active market are available but not readily accessible for each of those assets and liabilities (for example, from pricing services or individual broker-dealers), the FVM Statement allows for the use of an alternative pricing method (for example, matrix pricing) as a practical expedient.

In response to related comments, the Board will discuss whether to clarify that within Level 1, the use of an alternative pricing method is a practical expedient to the requirement to measure fair value using a quoted price for an identical asset or liability in an active market in the limited situations referred to, but that the use of an alternative pricing technique renders the fair value measurement a lower level measurement.

Level 5 "Undue Cost and Effort" Criterion

In its redeliberations of the FASB Exposure Draft, *Fair Value Measurements*, (FVM ED) the Board decided to remove the undue cost and effort criterion within Level 5, specifying that entity inputs should be used to measure fair value if market inputs are not available. Some external reviewers indicated that as revised, the requirement to use market inputs could be viewed as excessive, and potentially impose excessive cost and effort. In response, the Board will discuss whether to reinstate the undue cost and effort criterion within Level 5, specifying that entity inputs should be used to measure fair value if market inputs are not available without undue cost and effort (as in the FVM ED).

2. DISCLOSURES

Total Assets/Liabilities Remeasured at Fair Value

The FVM Statement requires disclosure of assets and liabilities that are remeasured at fair value on a recurring basis in total and as a percentage of total assets and liabilities. Some reviewers stated that the percentage disclosure would not necessarily provide incremental information useful to users of financial statements. In response, the Board will consider whether to remove the percentage disclosure.

3. EFFECTIVE DATE(S)

The FVM Statement is effective for financial statements issued for fiscal years *beginning* after December 15, 2006, and interim periods within those fiscal years, except for the disclosure requirements, which are effective for financial statements issued for fiscal years *ending* after December 15, 2006. In response to related comments, the Board will consider whether to:

a. Revise the FVM Statement so that it is effective in its entirety at the same time, thereby eliminating the accelerated effective date for the disclosure requirements

b. Revise the effective date so that it is effective for financial statements issued for fiscal years beginning after November 15, 2006, and interim periods within those fiscal years, to encompass all financial institutions (which have November 30 and December 31 fiscal years), considering the timing of issuance of a final FVM Statement.

4. TRANSITION DISCLOSURES (BLOCKS)

The FVM Statement specifies that the change in method for measuring the fair value of blocks of financial instruments should be applied retrospectively to all prior periods. In the fiscal year in which the Statement is initially applied, and in all interim periods within that fiscal year, an entity shall disclose the effect of that change in accounting principle on income before extraordinary items and any affected per-share amounts, if applicable (in accordance with FASB Statement No. 154, *Accounting Changes and Error Corrections*).

In response to related comments, the Board will discuss whether to retain the requirement for transition disclosures relating to blocks or, alternatively, whether to eliminate the requirement for transition disclosures relating to blocks (1) in interim periods within the fiscal year within which the Statement is initially applied or (2) in their entirety.

5. TIMING

The Board will discuss the timing of issuance of a final FVM Statement, considering the interaction of the FVM Statement and the proposed FSP FAS 133-a, *Accounting for Unrealized Gains (Losses) Relating to Derivative Instruments Measured at Fair Value under Statement 133*. Specifically, the Board will consider whether to defer issuance of a final FVM Statement until after it substantially completes redeliberations of the proposed FSP FAS 133-a.