MINUTES

To:	Board Members		
From:	Goodman (ext. 295)		
Subject:	Minutes of September 7, 2005 Board Meeting: Other-Than-Temporary Impairment	**Date:**	September 14, 2005
cc:	L. Smith, Bielstein, Petrone, Project Team, Golden, Polley, Gabriele, Carney, Mahoney, Intranet; IASB: Leisenring		

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<u>Topic</u>: Other-Than-Temporary Impairment

<u>Basis for Discussion</u>: Board Memorandum dated August 30, 2005

<u>Length of Discussion</u>: 9:40 a.m. to 10:15 a.m.

<u>Attendance</u>:

Board members present:	Herz, Batavick, Crooch, Schipper, Seidman, Trott, and Young (via phone)
Board members absent:	None
Staff in charge of topic:	Trench
Other staff at Board table:	L. Smith, Golden, and Goodman
Outside participants:	Leisenring

<u>Summary of Decisions Reached</u>:

The Board discussed whether to provide transition guidance in the final FSP. The Board raised the concern that constituents may interpret the final FSP as eliminating the ability to place securities on nonaccrual once the FSP becomes effective. Some Board members further asserted that the perceived elimination of the nonaccrual approach would not be consistent with other existing GAAP and that not accreting income may be warranted under certain circumstances. The Board directed the staff to research the issue further for discussion before deciding on the issue.

<u>Objective of Meeting</u>:

The objective of the meeting was for the Board to consider whether to provide transition guidance in FSP FAS 115-1, and, if so, what type of transition should be permitted.

<u>Matters Discussed and Decisions Reached</u>:

1. Mr. Trench opened the meeting by stating that the staff believed that transition guidance may be warranted in the proposed FSP for the application of the accounting for debt instruments subsequent to an other-than-temporary impairment. He indicated that during the process of finalizing FSP 115-1, the staff noted that there may be differences in how constituents are accounting for debt securities subsequent to an other-than-temporary impairment. He asked the Board to consider whether it agreed with the staff recommendation that (a) the Board provide transition guidance and (b) the transition be prospective application with no grandfathering permitted.

2. Ms. Schipper noted that the example presented to her to by the staff to illustrate the issue included an entity that recorded an other-than-temporary impairment due to a credit event. The entity then classified the investment as nonaccrual (record no investment income). Prior to this FSP, Ms. Schipper stated that this practice would be acceptable. She stated that this FSP would not allow this practice and would be effectively cleaning up this area of accounting. She further stated that she supported the staff's recommendation because it seemed to be a pragmatic solution for an entity that had designated a security as nonaccrual subsequent to an impairment. However, she

noted that nonaccrual might be an appropriate designation for a debt security that was so deeply defaulted—for example, one valued at 16 cents on the dollar—that the owner may have no expectation of future cash flows from principal or interest. Rather, the owner may anticipate conversion of the debt security into the new equity of the issuer after reorganization.

3. Mr. Leisenring posed the question of whether the need for transition is limited to investments on nonaccrual status and whether this is the only time that this issue arises. Mr. Trott clarified that this applies to any debt instrument that you have had an other-than-temporary impairment and that this FSP would not allow placing an investment on nonaccrual.

4. Ms. Seidman expressed her concern that the proposed FSP, if issued as final, might appear to indicate that under no circumstance could a security be designated as nonaccrual. She stated that she felt it would be inappropriate to accrue interest for a badly defaulted debt security. Ms. Seidman noted that AICPA Statement of Position (SOP) 03-3, *Accounting for Certain Loans or Debt Securities Acquired in a Transfer*, contains a scope qualification which recognizes situations where placing an investment on nonaccrual would be appropriate.

5. Ms. Seidman stated that the Board should note that the proposed FSP does not specify when the designation of a security as nonaccrual would be appropriate. Therefore, she recommended that the staff provide guidance similar to SOP 03-3, such that this FSP does not address when it is appropriate to designate a security as nonaccrual, in which case an entity would not apply the yield guidance when something is on nonaccrual. She suggested that a footnote be included that would indicate that this FSP does not prohibit placing something on nonaccrual. She noted that without the inclusion of this footnote any decisions regarding nonaccrual designation should be exposed for comment and subjected to due process because the reference in the proposed FSP to SOP 03-3—which scopes out securities designated as nonaccrual—had been removed.

6. Mr. Trott indicated that designating a security as nonaccrual reflects an insufficient amount of impairment because the impairment should reflect fair value. Mr. Smith noted that fair value would include the estimated future cash flows.

7. Mr. Trott stated that the fair value of an investment will fluctuate and the carrying value will change though the interest recognition will not change. He noted that the issue to focus on is when there is an other-than-temporary impairment and the cost basis has changed. He noted that here should be a level yield going forward.

8. Messrs. Crooch, Trott, and Leisenring agreed that the fair value of an impaired security, whether calculated using market or internal assumptions, already incorporates the time value of money. As such, income must be accreted for the impaired security. Ms. Schipper added that such securities continue to bear a return on investment despite a change in settlement.

9. Ms. Seidman noted that embedded in GAAP is the notion that sometimes not accreting is appropriate, such as in FASB Statement No. 91, *Accounting for Nonrefundable Fees and Costs Associated with Originating or Acquiring Loans and Initial Direct Costs of Leases*, and the AICPA Audit and Accounting Guide, *Audits of Investment Companies*.

10. Mr. Smith noted that the staff did not design this FSP to specifically address accrual versus nonaccrual and there was no intent on the part of the staff to change this area of accounting. He further noted that the staff was attempting to rely on existing GAAP and that in order to move forward an explanatory paragraph should be added. He agreed with Ms. Seidman that we have not exposed anything relative to this issue.

11. The Board discussed several alternatives, including adding a footnote that would acknowledge that the proposed FSP was not intended to prevent the designation of certain securities as nonaccrual. Questions were raised as to whether this would result in the need for guidance addressing when it is appropriate to designate an investment as nonaccrual. The Board unanimously agreed that it did not wish to address the broad issue of nonaccrual versus accrual status of securities at this time as part of this project.

12. Mr. Trench closed the meeting by acknowledging the Board's request to identify additional alternatives for transition guidance for the Board to consider.

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

The staff will identify additional alternatives for transition guidance for the Board to consider.

<u>General Announcements</u>:

None.