Statement of
Financial Accounting
Standards No. 105

Note: This Statement has been completely superseded

FAS105 Status Page
FAS105 Summary

Disclosure of Information about Financial
Instruments with Off-Balance-Sheet
Risk and Financial Instruments with
Concentrations of Credit Risks

March 1990

Financial Accounting Standards Board
of the Financial Accounting Foundation
401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116
Statement of Financial Accounting Standards No. 105

Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk

March 1990

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FAS 105: Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk

FAS 105 Summary

This Statement establishes requirements for all entities to disclose information principally about financial instruments with off-balance-sheet risk of accounting loss. It is the product of the first phase on disclosure of information about financial instruments. This first phase focuses on information about the extent, nature, and terms of financial instruments with off-balance-sheet credit or market risk and about concentrations of credit risk for all financial instruments. Subsequent phases will consider disclosure of other information about financial instruments. The disclosure phases are interim steps in the Board's project on financial instruments and off-balance-sheet financing. Recognition and measurement issues are currently being considered in other phases of the project.

This Statement extends present disclosure practices of some entities for some financial instruments by requiring all entities to disclose the following information about financial instruments with off-balance-sheet risk of accounting loss:

- The face, contract, or notional principal amount
- The nature and terms of the instruments and a discussion of their credit and market risk, cash requirements, and related accounting policies
- The accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity
- The entity's policy for requiring collateral or other security on financial instruments it accepts and a description of collateral on instruments presently held.

This Statement also requires disclosure of information about significant concentrations of credit risk from an individual counterparty or groups of counterparties for all financial instruments.

This Statement is effective for financial statements issued for fiscal years ending after June 15, 1990.
INTRODUCTION

1. The FASB added a project on financial instruments and off-balance-sheet financing to its agenda in May 1986. The project is expected to develop broad standards to aid in resolving existing financial accounting and reporting issues and other issues likely to arise in the future about various financial instruments and related transactions. Issues to be considered include whether assets or liabilities should be recognized in financial statements of an entity as a result of certain transactions involving financial instruments; when assets should be considered sold and when liabilities should be considered settled; how to account for financial instruments that seek to transfer market and credit risks and for the underlying assets and liabilities to which the risk-transferring items are related; how financial instruments should be initially and subsequently measured; how entities that issue financial instruments with both liability and equity characteristics should account for them; and how best to disclose the potential favorable or unfavorable effects of financial instruments.

2. Because of the complexity of the issues on how financial instruments and transactions should be recognized and measured, Statements covering those issues will be developed only after extensive Board deliberations and after issuance of initial discussion documents, public hearings, and Exposure Drafts. The Board decided that as an interim step, pending completion of the recognition and measurement phases of the financial instruments project, improved disclosure of information about financial instruments is necessary. This Statement is the initial response to that need for improved disclosure of information.

3. Some disclosure of information about financial instruments has been required previously by generally accepted accounting principles. Some entities previously have disclosed additional information about financial instruments in their financial statements or elsewhere in annual reports to stockholders or regulators, either because of requirements of the Securities and Exchange Commission (SEC) or because of requirements of the regulators of particular industries or institutions. Moreover, some entities previously have disclosed additional information beyond that required by generally accepted accounting principles because they believe the information disclosed might be useful to investors, creditors, and other users in better understanding financial instruments and their effects on the entity. For many financial instruments, however, the information disclosed in financial statements has been inadequate.

4. Many new financial instruments have been and will be created as responses to market volatility, deregulation, tax law changes, and other stimuli. The dynamic state of financial markets suggests the need to develop broad, general disclosure requirements about financial instruments. Generally accepted accounting principles and regulatory accounting requirements for financial instruments seem to have developed on an ad hoc basis, and only certain types of
financial instruments or entities have been included within their scope. For example, FASB Statement No. 80, *Accounting for Futures Contracts*, applies primarily to only one type of financial instrument—futures contracts.

5. The Board initially concluded that the disclosure phase of the financial instruments project should take a broad approach to disclosure of information about financial instruments. However, after public comment on an initial Exposure Draft, *Disclosures about Financial Instruments*, issued November 30, 1987, the Board decided that the disclosure issues should be considered in separate phases. The first phase, which resulted in this Statement, includes financial instruments with off-balance-sheet credit or market risk and all financial instruments with concentrations of credit risk—areas many perceive as most in need of improvement. This Statement applies to all financial instruments with off-balance-sheet risk of accounting loss and all financial instruments with concentrations of credit risk except those specifically excluded by paragraphs 14 and 15. It applies to all entities. Subsequent phases will consider disclosure of other information about financial instruments.

**STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING**

**Definitions and Scope**

6. A financial instrument is cash, evidence of an ownership interest in an entity, or a contract that both:

   a. Imposes on one entity a contractual obligation 1 (1) to deliver cash or another financial instrument 2 to a second entity or (2) to exchange financial instruments on potentially unfavorable terms with the second entity

   b. Conveys to that second entity a contractual right 3 (1) to receive cash or another financial instrument from the first entity or (2) to exchange other financial instruments on potentially favorable terms with the first entity.

7. The risk of accounting loss 4 from a financial instrument includes (a) the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract (credit risk), (b) the possibility that future changes in market prices may make a financial instrument less valuable or more onerous (market risk), 5 and (c) the risk of theft or physical loss. This Statement addresses credit and market risk only.

8. Some financial instruments are recognized as assets, and the amount recognized reflects the risk of accounting loss to the entity. A receivable that is recognized and measured at the present value of future cash inflows, discounted at the historical interest rate (often termed *amortized cost*), is an example: the accounting loss that might arise from that account receivable cannot
exceed the amount recognized as an asset in the statement of financial position. 6

9. Some financial instruments that are recognized as assets entail conditional rights and obligations that expose the entity to a risk of accounting loss that may exceed the amount recognized in the statement of financial position; for example, an interest rate swap contract providing for net settlement of cash receipts and payments that conveys a right to receive cash at current interest rates may impose an obligation to deliver cash if interest rates change in the future. Those financial instruments have off-balance-sheet risk. 7

10. Some financial instruments are recognized as liabilities, and the possible sacrifice needed to settle the obligation under the terms of the financial instrument cannot exceed the amount recognized in the statement of financial position. However, other financial instruments that are recognized as liabilities expose the entity to a risk of accounting loss because the ultimate obligation may exceed the amount that is recognized in the statement of financial position; for example, the ultimate obligation under a financial guarantee may exceed the amount that has been recognized as a liability. Those financial instruments have off-balance-sheet risk.

11. Still other financial instruments may not be recognized either as assets or as liabilities, yet may expose the entity to a risk of accounting loss; for example, a forward interest rate agreement that, unless a loss has been incurred, is not recognized until settlement. Those financial instruments also have off-balance-sheet risk.

12. This Statement requires disclosure of information about financial instruments that have off-balance-sheet risk and about financial instruments with concentrations of credit risk except as specifically modified by paragraphs 14 and 15. It does not change any requirements for recognition, measurement, or classification of financial instruments in financial statements.

13. Examples of financial instruments with off-balance-sheet risk that are included within the scope of this Statement are outstanding loan commitments written, 8 standby and commercial letters of credit written, financial guarantees written, options written, interest rate caps and floors written, recourse obligations on receivables sold, obligations to repurchase securities sold, outstanding commitments to purchase or sell financial instruments at predetermined prices, futures contracts, interest rate and foreign currency swaps, and obligations arising from financial instruments sold short. Appendix B provides additional examples of financial instruments that have and do not have off-balance-sheet risk.

14. The requirements of paragraphs 17, 18, and 20 do not apply to the following financial instruments, whether written or held:

a. Insurance contracts, other than financial guarantees and investment contracts, as discussed in FASB Statements No. 60, Accounting and Reporting by Insurance Enterprises, and No. 97, Accounting and Reporting by Insurance Enterprises for Certain Long-Duration Contracts and for Realized Gains and Losses from the Sale of Investments
b. Unconditional purchase obligations subject to the disclosure requirements of FASB Statement No. 47, *Disclosure of Long-Term Obligations*  


d. Financial instruments of a pension plan, including plan assets, when subject to the accounting and reporting requirements of Statement 87  

e. Substantively extinguished debt subject to the disclosure requirements of FASB Statement No. 76, *Extinguishment of Debt*, and any assets held in trust in connection with an in-substance defeasance of that debt.

15. The requirements of paragraphs 17 and 18 do not apply to the following instruments:

a. Lease contracts as defined in FASB Statement No. 13, *Accounting for Leases*

b. Accounts and notes payable and other financial instrument obligations that result in accruals or other amounts that are denominated in foreign currencies and are included at translated or remeasured amounts in the statement of financial position in accordance with FASB Statement No. 52, *Foreign Currency Translation*, except (1) obligations under financial instruments that have off-balance-sheet risk from other risks in addition to foreign exchange risk and (2) obligations under foreign currency exchange contracts. Examples of the first exception include a commitment to lend foreign currency and an option written to exchange foreign currency for a bond (whether or not denominated in a foreign currency). Examples of the second exception include a forward exchange contract, a currency swap, a foreign currency futures contract, and an option to exchange currencies.

The requirements of paragraph 20 of this Statement do apply to the items described in subparagraphs (a) and (b) above.

16. Generally accepted accounting principles contain specific requirements to disclose information about the financial instruments noted in paragraphs 14 and 15, and this Statement does not change those requirements. For all other financial instruments, the requirements in this Statement are in addition to other disclosure requirements prescribed by generally accepted accounting principles.


17. For financial instruments with off-balance-sheet risk, except as noted in paragraphs 14 and 15, an entity shall disclose either in the body of the financial statements or in the accompanying
notes the following information by class of financial instrument: 12

a. The face or contract amount (or notional principal amount if there is no face or contract amount)
b. The nature and terms, including, at a minimum, a discussion of (1) the credit and market risk of those instruments, (2) the cash requirements of those instruments, and (3) the related accounting policy pursuant to the requirements of APB Opinion No. 22, Disclosure of Accounting Policies. 13

Disclosure of Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk

18. For financial instruments with off-balance-sheet credit risk, except as noted in paragraphs 14 and 15, an entity shall disclose either in the body of the financial statements or in the accompanying notes the following information by class of financial instrument:

a. The amount of accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity
b. The entity's policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

19. An entity may find that disclosing additional information about the extent of collateral or other security for the underlying instrument indicates better the extent of credit risk. Disclosure of that additional information in those circumstances is encouraged.

Disclosure of Concentrations of Credit Risk of All Financial Instruments

20. Except as noted in paragraph 14, an entity shall disclose all significant concentrations of credit risk arising from all financial instruments, whether from an individual counterparty or groups of counterparties. Group concentrations of credit risk exist if a number of counterparties are engaged in similar activities and have similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions. The following shall be disclosed about each significant concentration:

a. Information about the (shared) activity, region, or economic characteristic that identifies the concentration
b. The amount of the accounting loss due to credit risk the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity
c. The entity's policy of requiring collateral or other security to support financial instruments
subject to credit risk, information about the entity's access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments.

Amendment to Statement 77

21. This Statement amends FASB Statement No. 77, Reporting by Transferors for Transfers of Receivables with Recourse. In paragraph 9 of that Statement, the phrase (b), if the information is available, the balance of the receivables transferred that remain uncollected at the date of each balance sheet presented is superseded by (b) information required by paragraphs 17, 18, and 20 of FASB Statement No. 105, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk.

Effective Date and Transition

22. This Statement shall be effective for financial statements issued for fiscal years ending after June 15, 1990. Earlier application is encouraged. Disclosure in the year of transition of information required by paragraphs 17, 18, and 20 that previously has not been required to be reported need not be included in financial statements that are being provided for comparative purposes for fiscal years ending before the effective date of this Statement. For all subsequent fiscal years, the information required to be disclosed by this Statement shall be included for each year for which a statement of financial position is presented for comparative purposes.

| The provisions of this Statement need not be applied to immaterial items. |

This Statement was adopted by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Dennis R. Beresford, Chairman
Victor H. Brown
Raymond C. Lauver
James J. Leisenring
C. Arthur Northrop
A. Clarence Sampson
Robert J. Swieringa
Appendix A

ILLUSTRATIONS APPLYING THE DEFINITION OF A FINANCIAL INSTRUMENT

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Appendix A: ILLUSTRATIONS APPLYING THE DEFINITION OF A FINANCIAL INSTRUMENT

Introduction

23. This appendix provides a definition of a financial instrument and examples of instruments that are included in and excluded from the definition.

24. A financial instrument is cash, evidence of an ownership interest in an entity, or a contract that both:

   a. Imposes on one entity a contractual obligation (1) to deliver cash or another financial instrument to a second entity or (2) to exchange financial instruments on potentially unfavorable terms with the second entity
   b. Conveys to that second entity a contractual right (1) to receive cash or another financial instrument from the first entity or (2) to exchange other financial instruments on potentially favorable terms with the first entity.

Example 1—Cash

25. Currency \textsuperscript{14} is a financial instrument even though generally the only contractual obligation placed on the issuing government is that it accept the currency as legal tender for payments due to it.

26. Demand deposits in banks are financial instruments of both the depositors and the banks. The depositors have a contractual right to receive currency on demand, and the banks have a contractual obligation to deliver currency on demand. The term cash as used in the definition includes both U.S. dollars and the currencies of other nations.

Example 2—Evidence of an Ownership Interest in an Entity

27. Common stock is a financial instrument that is evidence of an ownership interest in an entity, but others include preferred stock, partnership agreements, certificates of interest or participation, or warrants or options to subscribe to or purchase stock from the issuing entity.

Example 3—Contractual Right or Obligation to Receive or Deliver Cash

28. A contractual right to receive cash in the future is a financial instrument. Trade accounts, notes, loans, and bonds receivable all have that characteristic. An entity can have a contractual
right to receive cash only if another entity has a contractual obligation to pay cash.

29. A contractual obligation to deliver cash in the future is also a financial instrument. Trade accounts, notes, loans, and bonds payable all have that characteristic. An entity can have a contractual obligation to pay cash only if another entity has the contractual right to receive cash.

30. Physical assets such as inventory, property, plant, and equipment, and leased assets including their unguaranteed residuals, as well as intangibles such as patents, trademarks, and goodwill, do not meet the definition of a financial instrument. Each of those assets could eventually lead to the receipt of cash; however, because no other entity has a present obligation to deliver cash, the entity has no present right to receive cash.

Example 4—Contractual Right or Obligation to Receive or Deliver Goods or Services

31. The definition of a financial instrument excludes many assets that contain contractual rights, such as prepaid expenses and advances to suppliers, because their probable future economic benefit is receipt of goods or services instead of a right to receive cash or an ownership interest in another entity. It also excludes many liabilities that contain contractual obligations, such as deferred revenue, advances from suppliers, and most warranty obligations, because their probable economic sacrifice is delivery of goods or services instead of an obligation to deliver cash or an ownership interest in another entity.

32. The definition excludes contracts that either require or permit settlement by the delivery of commodities. Those contracts are excluded because the future economic benefit is receipt of goods or services instead of a right to receive cash or an ownership interest in an entity and the economic sacrifice is delivery of goods or services instead of an obligation to deliver cash or an ownership interest in an entity. For example, bonds to be settled in ounces of gold or barrels of oil rather than in cash are not financial instruments under the definition. Similarly, contracts that entitle the holder to receive from the issuer either a financial instrument (such as the face value of a bond) or a physical asset (such as a specified amount of gold or oil) do not meet the definition of a financial instrument (regardless of the probability of settlement in cash rather than in goods or services).

Example 5—Contractual Right or Obligation to Receive or Deliver Another Financial Instrument

33. Another financial instrument is one whose future economic benefit or sacrifice is receipt or delivery of a financial instrument other than cash. For example, a note that is payable in U.S. Treasury bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver bonds, not cash. But the bonds are financial instruments because they represent obligations of the U.S. Treasury to pay cash. Therefore, the note is also a financial instrument of the note holder and the note issuer.
Example 6—Contractual Right or Obligation to Exchange Other Financial Instruments

34. Another financial instrument is one that gives an entity the contractual right or obligation to exchange other financial instruments on potentially favorable or unfavorable terms. An example is a call option to purchase a U.S. Treasury note for $100,000 in 6 months. The holder of the option has a contractual right to exchange the financial instruments on potentially favorable terms; if the market value of the note exceeds $100,000 six months later, the terms will be favorable to the holder who will exercise the option. The writer of the call option has a contractual obligation because the writer has an obligation to exchange financial instruments on potentially unfavorable terms if the holder exercises the option. The writer is normally compensated by the holder for undertaking that obligation. A put option to sell a Treasury note has similar but opposite effects. A bank's commitment to lend $100,000 to a customer at a fixed rate of 10 percent any time during the next 6 months at the customer's option is also a financial instrument.

35. A more complex example is a forward contract in which the purchasing entity promises to exchange $100,000 cash for a U.S. Treasury note and the selling entity promises to exchange a U.S. Treasury note for $100,000 cash 6 months later. During the six-month period, both the purchaser and the seller have a contractual right and obligation to exchange financial instruments. The market price for the Treasury note might rise above $100,000, which would make the terms favorable to the purchaser and unfavorable to the seller, or fall below $100,000, which would have the opposite effect. Therefore, the purchaser has both a contractual right (a financial instrument) similar to a call option held and a contractual obligation (a financial instrument) similar to a put option written; the seller has a contractual right (a financial instrument) similar to a put option held and a contractual obligation (a financial instrument) similar to a call option written.

36. An interest rate swap can be viewed as a series of forward contracts to exchange, for example, fixed cash payments for variable cash receipts computed by multiplying a specified floating-rate market index by a notional amount. Those terms are potentially favorable or unfavorable depending on subsequent movements in the index, and an interest rate swap is both a contractual right and a contractual obligation to both parties.

37. Options and contracts that contain the right or obligation to exchange a financial instrument for a physical asset are not financial instruments. For example, 2 entities may enter into sale-purchase contracts in which the purchaser agrees to take delivery of gold or wheat 6 months later and pay the seller $100,000 on delivery. Because the sale-purchase contracts require the delivery of gold or wheat, which are not financial instruments, the sale-purchase contracts are not financial instruments.
Example 7—Contingent Rights or Obligations

38. Contingent items can be financial instruments under the definition. For example, in a typical financial guarantee, a borrower who borrows money from a lender simultaneously pays a fee to a guarantor; in return the guarantor agrees to pay the lender if the borrower defaults on the loan. The guarantee is a financial instrument of the guarantor (the contractual obligation to pay the lender if the borrower defaults) and a financial instrument of the lender (the contractual right to receive cash from the guarantor if the borrower defaults—normally reported together with the guaranteed loan).

39. Other contingent items that ultimately may require the payment of cash but do not as yet arise from contracts, such as contingent liabilities for tort judgments payable, are not financial instruments. However, when those obligations become enforceable by government or courts of law and are thereby contractually reduced to fixed payment schedules, the items would be financial instruments under the definition.

Appendix B: ILLUSTRATION APPLYING THE DEFINITION OF A FINANCIAL INSTRUMENT WITH OFF-BALANCE-SHEET RISK

40. A financial instrument has off-balance-sheet risk of accounting loss if the risk of accounting loss to the entity may exceed the amount recognized as an asset, if any, or if the ultimate obligation may exceed the amount that is recognized as a liability in the statement of financial position.

41. The risk of accounting loss from a financial instrument includes (a) the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract (credit risk), (b) the possibility that future changes in market prices may make a financial instrument less valuable or more onerous (market risk), and (c) the risk of theft or physical loss. This Statement addresses credit and market risk only.

42. The following illustration presents some financial instruments that have and that do not have off-balance-sheet risk of accounting loss; it does not illustrate all financial instruments that are included in the scope of this Statement. Off-balance-sheet risk of accounting loss for similar financial instruments may differ among entities using different methods of accounting.
**Illustration**

<table>
<thead>
<tr>
<th>Financial Instrument</th>
<th>Holder a</th>
<th>Type of OBS Risk c</th>
<th>Issuer b</th>
<th>Type of OBS Risk c</th>
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<td></td>
<td>OBS Risk d</td>
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<td>CR</td>
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<td>CR</td>
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<td>Foreign currency</td>
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<td>MR</td>
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<tr>
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<td>Refundable (margin) deposits</td>
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<td>Cash dividends declared</td>
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<td>Innovative items:</td>
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<td>Increasing rate debt</td>
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<td>Variable coupon redeemable notes</td>
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<td>Collateralized mortgage obligations (CMOs):</td>
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<tr>
<td>CMO accounted for as a borrowing by issuer</td>
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<td></td>
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<tr>
<td>CMO accounted for as a sale by issuer</td>
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<td></td>
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<tr>
<td>Transfer of receivables:</td>
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<tr>
<td>Investor has recourse to the issuer at or below the receivable carrying amount—accounted for as a borrowing by issuer</td>
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<td></td>
<td></td>
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<tr>
<td>Investor has recourse to the issuer—accounted for as a sale by issuer</td>
<td>No</td>
<td>Yes</td>
<td>X</td>
<td></td>
</tr>
<tr>
<td>Investor has recourse to the issuer and the agreement includes a floating interest rate provision—accounted for as a sale by issuer</td>
<td>No</td>
<td>Yes</td>
<td>X</td>
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<tr>
<td>Investor has no recourse to the issuer—accounted for as a sale by issuer</td>
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<td></td>
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<tr>
<td>Securitized receivables</td>
<td>Same as transfer of receivables</td>
<td></td>
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<td></td>
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<tr>
<td>(Reverse) Repurchase agreements:</td>
<td>No</td>
<td></td>
<td></td>
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<tr>
<td>Accounted for as a borrowing by issuer</td>
<td>No</td>
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<td></td>
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<tr>
<td>Accounted for as a sale by issuer</td>
<td>No</td>
<td>Yes</td>
<td>X</td>
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<tr>
<td>Put option on stock (premium paid up front):</td>
<td>No</td>
<td>Yes</td>
<td>X</td>
<td></td>
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<tr>
<td>Covered option</td>
<td>No</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
| Instrument                              | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | Naked | Covered | 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## Off-Balance-Sheet (OBS) Risk of Accounting Loss

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<th>Financial Instrument</th>
<th>Type of OBS Risk</th>
<th>CR</th>
<th>MR</th>
</tr>
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<tbody>
<tr>
<td><strong>Interest rate swaps</strong>&lt;br&gt;Note: accrual basis:</td>
<td>Both Counterparties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In a gain position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>In a loss position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Gain or loss position netted: right of setoff exists</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td><strong>Interest rate swaps</strong>&lt;br&gt;Note: marked to market:</td>
<td>Both Counterparties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In a gain position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>In a loss position</td>
<td>Yes</td>
<td></td>
<td>X</td>
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<tr>
<td>Gain or loss position netted: right of setoff exists</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td><strong>Currency swaps</strong></td>
<td>Same as interest rate swaps</td>
<td></td>
<td></td>
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<tr>
<td><strong>Financial futures contracts</strong>—hedges (marked to market and gain or loss deferred—Statement 52 or 80 accounting):</td>
<td>Both Counterparties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In a gain position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>In a loss position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Multiple contracts settled net</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td><strong>Financial futures contracts</strong>—nonhedges (marked to market—Statement 52 or 80 accounting):</td>
<td>Both Counterparties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In a gain position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>In a loss position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>Multiple contracts settled net</td>
<td>Yes</td>
<td></td>
<td>X</td>
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<tr>
<td><strong>Forward contracts</strong>—hedges (marked to market and gain or loss deferred):</td>
<td>Both Counterparties</td>
<td></td>
<td></td>
</tr>
<tr>
<td>In a gain position</td>
<td>Yes</td>
<td></td>
<td>X</td>
</tr>
<tr>
<td>In a loss position</td>
<td>Yes</td>
<td></td>
<td>X</td>
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<tr>
<td>Gain or loss position netted: right of setoff exists</td>
<td>Yes</td>
<td></td>
<td>X</td>
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</table>
Forward contracts--nonhedges (marked to market and gain or loss recognized):

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<th></th>
<th>Yes</th>
<th>X</th>
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</thead>
<tbody>
<tr>
<td>In a gain position</td>
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<td></td>
</tr>
<tr>
<td>In a loss position</td>
<td></td>
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<tr>
<td>Gain or loss position netted: right of setoff exists</td>
<td>Yes</td>
<td>X</td>
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Forward contracts—not marked to market

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Appendix C: ILLUSTRATIONS APPLYING THE DISCLOSURE REQUIREMENTS ABOUT FINANCIAL INSTRUMENTS WITH OFF-BALANCE-SHEET RISK AND CONCENTRATIONS OF CREDIT RISK

43. The examples that follow are guides to implementation of the disclosure requirements of this Statement. Entities are not required to display the information contained herein in the specific manner or in the degree of detail illustrated. Alternative ways of disclosing the information are permissible as long as they satisfy the disclosure requirements of this Statement.

Example 1—Nonfinancial Entity

44. This example illustrates the information that might be disclosed by CDA Corporation, a nonfinancial entity that has entered into interest rate swap agreements and foreign exchange contracts. CDA Corporation has no significant concentrations of credit risk with any individual counterparty or groups of counterparties.

45. CDA Corporation might disclose the following:

Note U: Summary of Accounting Policies

[The accounting policies note to the financial statements might include the following.]

Interest Rate Swap Agreements

The differential to be paid or received is accrued as interest rates change and is recognized over the life of the agreements.

Foreign Exchange Contracts

The Corporation enters into foreign exchange contracts as a hedge against foreign accounts payable. Market value gains and losses are recognized, and the resulting credit or debit offsets foreign exchange gains or losses on those payables.

Note V: Interest Rate Swap Agreements

The Corporation has entered into interest rate swap agreements to reduce the impact of changes in interest rates on its floating rate long-term debt. At December 31, 19XX, the Corporation had outstanding 2 interest rate swap agreements with commercial banks, having a total notional principal amount of $85 million. Those agreements effectively change the Corporation's interest
rate exposure on its $35 million floating rate notes due 1993 to a fixed 12 percent and its $50 million floating rate notes due 1998 to a fixed 12.5 percent. The interest rate swap agreements mature at the time the related notes mature. The Corporation is exposed to credit loss in the event of nonperformance by the other parties to the interest rate swap agreements. However, the Corporation does not anticipate nonperformance by the counterparties.

**Note W: Foreign Exchange Contracts**

At December 31, 19XX, the Corporation had contracts maturing June 30, 19X1 to purchase $12.9 million in foreign currency (18 million deutsche marks and 5 million Swiss francs at the spot rate on that date).

**Example 2—Financial Entity**

46. This example illustrates the information that might be disclosed by Bank of SLA, which has entered into the following financial instruments with off-balance-sheet risk: commitments to extend credit, standby letters of credit and financial guarantees written, interest rate swap agreements, forward and futures contracts, and options and interest rate caps and floors written. Bank of SLA has (a) significant concentrations of credit risk in the semiconductor industry in its home state and (b) loans to companies with unusually high debt to equity ratios as a result of buyout transactions.

47. Bank of SLA might disclose the following:

**Note X: Summary of Accounting Policies**

[The accounting policies note to the financial statements might include the following.]

**Interest Rate Futures, Options, Caps and Floors, and Forward Contracts**

The Corporation is party to a variety of interest rate futures, options, caps and floors, and forward contracts in its trading activities and in the management of its interest rate exposure.

Interest rate futures, options, caps and floors, and forward contracts used in trading activities are carried at market value. Realized and unrealized gains and losses are included in trading account profits.

Realized and unrealized gains and losses on interest rate futures, options, caps and floors, and forward contracts designated and effective as hedges of interest rate exposure are deferred and recognized as interest income or interest expense over the lives of the hedged assets or liabilities.
Interest Rate Swap Agreements

The Corporation is an intermediary in the interest rate swap market. It also enters into interest rate swap agreements both as trading instruments and as a means of managing its interest rate exposure.

As an intermediary, the Corporation maintains a portfolio of generally matched offsetting swap agreements. These swaps are carried at market value, with changes in value reflected in noninterest income. At inception of the swap agreements, the portion of the compensation related to credit risk and ongoing servicing is deferred and taken into income over the term of the swap agreements.

Interest rate swap agreements used in trading activities are valued at market. Realized and unrealized gains and losses are included in trading account profits. Unrealized gains are reported as assets and unrealized losses are reported as liabilities.

The differential to be paid or received on interest rate swap agreements entered into to reduce the impact of changes in interest rates is recognized over the life of the agreements.

Note Y: Financial Instruments with Off-Balance-Sheet Risk

The Corporation is a party to financial instruments with off-balance-sheet risk in the normal course of business to meet the financing needs of its customers and to reduce its own exposure to fluctuations in interest rates. These financial instruments include commitments to extend credit, options written, standby letters of credit and financial guarantees, interest rate caps and floors written, interest rate swaps, and forward and futures contracts. Those instruments involve, to varying degrees, elements of credit and interest rate risk in excess of the amount recognized in the statement of financial position. The contract or notional amounts of those instruments reflect the extent of involvement the Corporation has in particular classes of financial instruments.

The Corporation's exposure to credit loss in the event of nonperformance by the other party to the financial instrument for commitments to extend credit and standby letters of credit and financial guarantees written is represented by the contractual notional amount of those instruments. The Corporation uses the same credit policies in making commitments and conditional obligations as it does for on-balance-sheet instruments. For interest rate caps, floors, and swap transactions, forward and futures contracts, and options written, the contract or notional amounts do not represent exposure to credit loss. The Corporation controls the credit risk of its interest rate swap agreements and forward and futures contracts through credit approvals, limits, and monitoring procedures.
Unless noted otherwise, the Corporation does not require collateral or other security to support financial instruments with credit risk.

<table>
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<tr>
<th>Contract or Notional Amount (in millions)</th>
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### Financial instruments whose contract amounts represent credit risk:
- Commitments to extend credit: $2,780
- Standby letters of credit and financial guarantees written: 862

### Financial instruments whose notional or contract amounts exceed the amount of credit risk:
- Forward and futures contracts: 815
- Interest rate swap agreements: 10,520
- Options written and interest rate caps and floors written: 950

Commitments to extend credit are agreements to lend to a customer as long as there is no violation of any condition established in the contract. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without being drawn upon, the total commitment amounts do not necessarily represent future cash requirements. The Corporation evaluates each customer's creditworthiness on a case-by-case basis. The amount of collateral obtained if deemed necessary by the Corporation upon extension of credit is based on management's credit evaluation of the counterparty. Collateral held varies but may include accounts receivable, inventory, property, plant, and equipment, and income-producing commercial properties.

Standby letters of credit and financial guarantees written are conditional commitments issued by the Corporation to guarantee the performance of a customer to a third party. Those guarantees are primarily issued to support public and private borrowing arrangements, including commercial paper, bond financing, and similar transactions. Except for short-term guarantees of $158 million, most guarantees extend for more than 5 years and expire in decreasing amounts through 20XX. The credit risk involved in issuing letters of credit is essentially the same as that involved in extending loan facilities to customers. The Corporation holds marketable securities as collateral supporting those commitments for which collateral is deemed necessary. The extent of collateral held for those commitments at December 31, 19XX varies from 2 percent to 45 percent; the average amount collateralized is 24 percent.

Forward and futures contracts are contracts for delayed delivery of securities or money market instruments in which the seller agrees to make delivery at a specified future date of a specified instrument, at a specified price or yield. Risks arise from the possible inability of counterparties to meet the terms of their contracts and from movements in securities values and interest rates.
The Corporation enters into a variety of interest rate contracts—including interest rate caps and floors written, interest rate options written, and interest rate swap agreements—in its trading activities and in managing its interest rate exposure. Interest rate caps and floors written by the Corporation enable customers to transfer, modify, or reduce their interest rate risk. Interest rate options are contracts that allow the holder of the option to purchase or sell a financial instrument at a specified price and within a specified period of time from the seller or "writer" of the option. As a writer of options, the Corporation receives a premium at the outset and then bears the risk of an unfavorable change in the price of the financial instrument underlying the option.

Interest rate swap transactions generally involve the exchange of fixed and floating rate interest payment obligations without the exchange of the underlying principal amounts. Though swaps are also used as part of asset and liability management, most of the interest rate swap activity arises when the Corporation acts as an intermediary in arranging interest rate swap transactions for customers. The Corporation typically becomes a principal in the exchange of interest payments between the parties and, therefore, is exposed to loss should one of the parties default. The Corporation minimizes this risk by performing normal credit reviews on its swap customers and minimizes its exposure to the interest rate risk inherent in intermediated swaps by entering into offsetting swap positions that essentially counterbalance each other.

Entering into interest rate swap agreements involves not only the risk of dealing with counterparties and their ability to meet the terms of the contracts but also the interest rate risk associated with unmatched positions. Notional principal amounts often are used to express the volume of these transactions, but the amounts potentially subject to credit risk are much smaller.

Note Z: Significant Group Concentrations of Credit Risk

Most of the Corporation's business activity is with customers located within the state. As of December 31, 19XX, the Corporation's receivables from and guarantees of obligations of companies in the semiconductor industry were $XX million.

As of December 31, 19XX, the Corporation was also creditor for $XX of domestic loans and other receivables from companies with high debt to equity ratios as a result of buyout transactions. The portfolio is well diversified, consisting of XX industries. Generally, the loans are secured by assets or stock. The loans are expected to be repaid from cash flow or proceeds from the sale of selected assets of the borrowers. Credit losses arising from lending transactions with highly leveraged entities compare favorably with the Corporation's credit loss experience on its loan portfolio as a whole. The Corporation's policy for requiring collateral is [state policy, along with information about the entity's access to that collateral or other security and a description of collateral].

Example 3—Concentration of Credit Risk for Certain Entities

48. For certain entities, industry or regional concentrations of credit risk may be disclosed.
adequately by a description of the business. For example:

a. *A Retailer*—XYZ Corporation is a retailer of family clothing with three stores, all of which are located in Littletown. The Corporation grants credit to customers, substantially all of whom are local residents.

b. *A Bank*—ABC Bank grants agribusiness, commercial, and residential loans to customers throughout the state. Although the Bank has a diversified loan portfolio, a substantial portion of its debtors' ability to honor their contracts is dependent upon the agribusiness economic sector.
Appendix D

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

CONTENTS

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<th>Section</th>
<th>Paragraph Numbers</th>
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Appendix D: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

49. This appendix summarizes considerations that were deemed significant by Board members in reaching the conclusions in this Statement. It includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.

Background Information

50. The Board added a project on financial instruments and off-balance-sheet financing to its agenda in May 1986. Some of the financial reporting issues that prompted the project were not new, but financial innovation had created many new problems and given a new sense of urgency to settling some older ones.

51. Deregulation, foreign exchange and interest rate volatility, and tax law changes are major causes of the creation of new financial instruments. Deregulation and competition have increasingly clouded once relatively distinct lines between various financial and predominantly nonfinancial entities and have resulted in the expansion of financial services and products. Many financial instruments have been developed to reduce an entity's interest rate and foreign exchange rate risk resulting from volatile markets by transferring risk to other entities; other instruments have been created to provide tax advantages. Many of the innovative financial instruments are a result of breaking apart or combining traditional instruments. In addition to the important economic incentives, some financial instruments have been favored because of their accounting implications.

52. Some financial reporting issues related to financial instruments have been resolved by the Board or its predecessors. The FASB Emerging Issues Task Force has reached consensuses on other issues. However, those decisions have often dealt narrowly with specific financial reporting issues. Consequently, the specific guidance often does not clearly apply to new financial instruments, or the guidance developed to resolve various specific issues may appear to be inconsistent if applied to similar, but not identical, financial reporting problems.

53. Innovative financial instruments, which gave rise to inconsistent accounting and solutions developed on an ad hoc basis, caused many, including the accounting profession, the SEC, bank regulators, and some providers of financial statements, to urge the Board to add to its agenda a major project dealing with financial instruments and off-balance-sheet financing.
54. The Board decided that recognition and measurement problems dealing with financial instruments should be considered as several separate, though related, issues, including:

a. Whether assets should be considered sold if there is recourse or other continuing involvement with them; whether liabilities should be considered settled when assets are dedicated to settle them; and other questions of derecognition, nonrecognition, and offsetting of related assets and liabilities
b. How to account for financial instruments and transactions that seek to transfer market and credit risks—for example, futures contracts, interest rate swaps, options, forward commitments, nonrecourse arrangements, and financial guarantees—and for the underlying assets or liabilities to which the risk-transferring items are related
c. How financial instruments should be measured—for example, at market value, amortized original cost, or the lower of cost or market
d. How issuers should account for financial instruments that have both debt and equity characteristics
e. Whether the creation of separate legal entities or trusts affects the recognition and measurement of financial instruments (which may not need to be included in the financial instruments project because it is already being addressed in the Board's project on the reporting entity).

55. Because of the complexity of those issues, Statements dealing with them will be issued only after extensive Board deliberation, including discussion documents, public hearings, and Exposure Drafts. As an interim measure, pending completion of the recognition and measurement phases of the financial instruments project, the Board decided that improved disclosure of information about financial instruments is necessary to provide better information about those instruments and to increase comparability of financial statements.

56. On November 30, 1987, the Board issued the Exposure Draft, *Disclosures about Financial Instruments*. That Exposure Draft defined financial instruments broadly to include both instruments for which the risk of loss is recognized in the statement of financial position (for example, bonds, loans, and trade receivables and payables) and instruments with potential risk of accounting loss that may substantially exceed the amount recognized, if any, in the statement of financial position (for example, interest rate swaps, forward contracts to buy or sell government bonds, and loan commitments). The latter instruments are often referred to as "off-balance-sheet"; however, that is an inaccurate description of the instruments as a class because many are recognized in the statement of financial position to some extent.

57. The 1987 Exposure Draft proposed to require for all financial instruments (both with and without off-balance-sheet risk) disclosure of information about their credit risk (maximum credit risk, probable and reasonably possible credit losses, and individual, industry, or geographic concentrations); market risk, including interest rate and foreign exchange risks (effective interest rates and contractual repricing or maturity dates); liquidity risk (contractual future cash receipts
and payments); and current market values if they could be determined or estimated.

58. After issuing the 1987 Exposure Draft, the Board (a) worked with a group of companies and accounting firms that participated in a test application of the Exposure Draft's provisions, (b) met with financial analysts, accounting and other professional groups, and representatives of agencies that regulate financial institutions, and (c) analyzed approximately 450 letters of comment received on the Exposure Draft to obtain a better understanding of the feasibility of implementing the proposed disclosure requirements, the potential implementation costs, and the usefulness of the resulting information.

59. Overall, the Board found that most respondents agreed that improving disclosure of information about financial instruments, especially financial instruments with off-balance-sheet risk, is a useful interim step pending completion of the recognition and measurement phases of the financial instruments project. Respondents also agreed in general with the purposes of disclosure set forth in the 1987 Exposure Draft: to describe both recognized and unrecognized items, to provide a useful measure of unrecognized items and other relevant measures of recognized items, and to provide information to help investors and creditors assess risks and potentials of both recognized and unrecognized items. Most respondents also agreed that the areas of risk identified in the Exposure Draft—market, credit, and liquidity risk—need more comparable disclosure of information.

60. However, many respondents also asserted that the proposed disclosure requirements were too extensive and that the cost of implementing them would be excessive. Many respondents suggested that the proposed requirements were overly quantitative and that more emphasis should be placed on supplementing or even replacing some proposed required quantitative information with narrative or qualitative descriptions of the nature, terms, and purposes of an entity's financial instruments.

61. Many respondents expressed concern that off-balance-sheet issues were not sufficiently considered in the Exposure Draft. They noted that many of the proposed requirements (for example, future contractual receipts and payments and information about interest rates and foreign exchange rates) could not be applied to some financial instruments with off-balance-sheet risk because of the contingent or conditional nature of those instruments. Some recommended that the Board concentrate on those off-balance-sheet issues as the area of most immediate concern.

62. After considering those responses, the Board concluded that the most expeditious way to deal with what many respondents perceive as the area most in need of improvement was to consider the disclosure issues discussed in the 1987 Exposure Draft in phases. The first phase, covered by this Statement, considers principally financial instruments with off-balance-sheet risk, focusing on disclosing information about the extent, nature, and terms of those instruments and about the credit risks associated with them. The first phase also addresses concentrations of credit risk for all financial instruments. Subsequent phases will consider disclosure of other information about financial instruments.
63. An advisory group was formed in October 1986 to advise the Board during the initial deliberations on the disclosure phase of the project. That group was subsequently replaced by a task force on the financial instruments project that was appointed in January 1989 to assist the Board in all aspects of the project. The need to improve the information disclosed, the purposes of disclosures, and possible disclosure of information about financial instruments were discussed at public meetings of those groups and at several public Board meetings.

64. On July 21, 1989, the Board issued the revised Exposure Draft, Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk. One hundred and eighty-eight comment letters were received. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing.

**Need to Improve Information Disclosed about Financial Instruments**

65. Financial statements and notes to those statements provide considerable descriptive information about financial instruments and the risks involved with them in addition to the information provided by the recognition of many financial instruments in statements of financial position. However, the Board concluded that not all relevant information about financial instruments has been adequately disclosed and not all information disclosed has been comparable.

66. Some entities have disclosed information not required by generally accepted accounting principles; others have disclosed information to comply with requirements of the SEC, or in reports required by those that regulate bank, savings and loan, insurance, and other industries or entities. But disclosure rules of the SEC apply only to public companies—some apply only to large banks and savings and loan holding companies—and the rules of other regulatory agencies apply only to specific regulated industries and only in special reports that, even if publicly available, are not distributed as widely as general-purpose financial statements.

67. Voluntary disclosures about financial instruments with off-balance-sheet risk and other information about recognized financial instruments differ, as might be expected, from entity to entity. Disclosure requirements of regulators tend to produce comparability within an industry, but different requirements for similar but separately regulated industries often do not. Comparability problems result from different time intervals used for disclosing information about future cash flows and interest rates, different principles in dealing with optional features of particular financial instruments, different measurement approaches, and other causes.

68. Each existing disclosure practice or rule may have responded to a particular perceived need when it was adopted. But the inadequacy of information disclosed about financial instruments and the lack of comparability are inevitable consequences of the ad hoc way in which disclosure practices and requirements have evolved.
69. In response to those problems, the Board decided to seek improvements in information disclosed about financial instruments as the initial, interim step in its broad project on financial instruments and off-balance-sheet financing.

**Approach Taken in Developing This Statement**

70. The Board decided to improve information disclosed about financial instruments by extending and expanding practices presently existing within generally accepted accounting principles. The Board first considered the objectives of financial reporting, then the objectives or purposes of disclosures, and finally areas for improvement. The particular improvements identified in this Statement focus principally on financial instruments with off-balance-sheet risk.

**Purposes of Disclosure**

**Objectives of Financial Reporting**

71. The purposes of disclosure in financial reporting derive from the objectives of financial reporting. The objectives of financial reporting by business enterprises are based on the need to provide information that is useful to present and potential investors and creditors and other users in making rational investment, credit, and similar decisions about a particular enterprise. Since investors, creditors, and other users are interested in receiving cash from the enterprise, financial reporting should provide information to help them assess the amounts, timing, and uncertainty of prospective net cash flows of the enterprise because their prospects for receiving cash from investments in, loans to, or other participation in the enterprise depend significantly on its cash flow prospects. Financial reporting should respond to those user needs by providing information about the economic resources of an enterprise, the claims to those resources (its obligations to transfer resources to other entities and owners' equity), and the effects of transactions, other events, and circumstances that change resources and claims to those resources (FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, paragraphs 34-40).

72. Similarly, the objectives of financial reporting by not-for-profit organizations are based on the need to provide information that is useful to present and potential resource providers and other users in making decisions about the allocations of resources to those organizations. Since resource providers and other users are interested in the success of the organization in carrying out its service objectives, financial statements should provide information to help them assess the services that a not-for-profit organization provides and its ability to continue to provide those services. Moreover, managers of a not-for-profit organization are accountable to resource providers and other users, not only for the custody and safekeeping of organization resources, but also for their efficient and effective use. Therefore, financial reporting should provide information useful in assessing how managers have discharged those responsibilities. Financial reporting should respond to those user needs by providing information about the economic
resources, obligations, and net resources of a not-for-profit organization and the effects of
transactions, events, and circumstances that change resources and interests in those resources
(FASB Concepts Statement No. 4, Objectives of Financial Reporting by Nonbusiness
Organizations, paragraphs 35-43).

Role of Financial Statements

73. Financial statements are a central feature of financial reporting. A full set of financial
statements provides considerable information about an entity's economic resources (assets) and
claims to those resources (liabilities and equity) and about the changes in those resources and
claims. A full set of financial statements is necessary to satisfy the objectives of financial
reporting. Further, a full set of financial statements requires notes or parenthetical disclosures to
satisfy the objectives of financial reporting because of the practical limits on the information that
can be conveyed in the body of financial statements.

Roles of Recognition and Disclosure

74. FASB Concepts Statement No. 5, Recognition and Measurement in Financial Statements
of Business Enterprises, paragraph 6, says:

Recognition is the process of formally recording or incorporating an item into
the financial statements of an entity as an asset, liability, revenue, expense, or the
like. Recognition includes depiction of an item in both words and numbers, with
the amount included in the totals of the financial statements.

The words that describe a recognized item, or the category of like items that includes it, convey
important information.

75. But recognition of an asset or liability, or of the effects of a transaction or other event,
often does not disclose all the information financial reporting can and should provide for
investors, creditors, and other users. Disclosure of additional information often is necessary and
commonly provided about recognized items. Moreover, many important items are not
recognized as assets and liabilities in financial statements, and many transactions and other
events are not recognized when they occur but only later when uncertainty about them is reduced
sufficiently so that their effects are clear.

76. Concepts Statement 5, paragraph 7, develops the idea from Concepts Statement 1,
paragraph 5, and Concepts Statement 4, paragraph 11:

. . . some useful information . . . is better provided, or can only be provided,
by notes to financial statements or by supplementary information or other means
of financial reporting:

a. Information disclosed in notes or parenthetically on the face of financial
statements, such as significant accounting policies or alternative measures for assets or liabilities, amplifies or explains information recognized in the financial statements.\(^4\) That sort of information is essential to understanding the information recognized in financial statements and has long been viewed as an integral part of financial statements prepared in accordance with generally accepted accounting principles.

\(^4\)For example, notes provide essential descriptive information for long-term obligations, including when amounts are due, what interest they bear, and whether important restrictions are imposed by related covenants.

77. The major purposes of disclosure identified by the Board based on the concepts summarized in the preceding paragraphs and its observations of present practices are (a) to describe both recognized and unrecognized items, (b) to provide a useful measure of unrecognized items and relevant measures of recognized items other than the measure recognized in the statement of financial position, and (c) to provide information to help investors and creditors assess risks and potentials of both recognized and unrecognized items. Those purposes are of primary importance for general-purpose external financial reporting, and they underlie most existing disclosure practices as well as the requirements of this Statement.

78. Another purpose underlying some disclosure requirements is to provide important information in the interim while other accounting issues are being studied in more depth. That purpose underlies, for example, FASB Statements No. 36, *Disclosure of Pension Information*, No. 47, *Disclosure of Long-Term Obligations*, and No. 81, *Disclosure of Postretirement Health Care and Life Insurance Benefits*. It also underlies the requirements of this Statement.

**Information Disclosed Provides Descriptions**

79. One purpose of disclosure identified by the Board is to describe items recognized in the financial statements. The information conveyed by the brief description and the related amount recognized may suffice for a straightforward item like cash. However, additional descriptive information beyond that on the face of financial statements may need to be disclosed in notes or parenthetically for more complex items and for heterogeneous categories. For example, an explanatory disclosure about bonds payable might include a description of interest rates, maturity dates, and call provisions. For heterogeneous categories, such as portfolios of loans or common stocks, disclosure may include descriptions of the items or major subcategories of items combined in the category.

80. Information disclosed about financial instruments with off-balance-sheet risk describes characteristics that are not described in the statement of financial position. For example, disclosure of information about interest rate swaps might include the notional principal amounts, maturity dates, interest rates, dates on which interest rates change (if different from maturity), and perhaps other key features of the instruments or might illustrate the anticipated effects of
those features. For conditional items, such as options written and financial guarantees, information disclosed might include the contract amounts or describe the reasons the entity engaged in those transactions and the conditions that would cause the entity to have an advantageous or disadvantageous result.

81. Information disclosed also commonly describes to some extent an entity's organizational structure, its accounting policies, events not recognized in its financial statements because they occurred after the financial statement date, and numerous other pertinent facts about the entity that may not be directly related to particular assets and liabilities or changes in them.

Information Disclosed May Provide Measures

82. For some financial instruments, the amount recognized, if any, in the entity's financial statements does not provide a measure of the instrument's risk of accounting loss. For example, an entity might recognize an asset or liability in connection with an interest rate swap contract. The risk of accounting loss could exceed the amount recognized as an asset in the statement of financial position, or the ultimate obligation could exceed the amount recognized as a liability in the statement of financial position. Unquantified descriptive information may be useful in helping investors and creditors to better understand the nature and terms of financial instruments with off-balance-sheet risk. However, it is also generally necessary to quantify in some way the entity's extent of involvement with financial instruments with off-balance-sheet risk and the entity's risk of accounting loss to give investors, creditors, and other users an idea of the relative importance of those instruments and their possible effects on the entity.

Information Disclosed Helps in Assessing Risks and Potentials

83. Whichever attribute of an asset or liability is measured in the financial statements, the amount recognized represents only a single point estimate of the future benefits or future sacrifices expected from the asset or liability. The amount recognized in the financial statements is determined with due care and regard to accounting standards, whose principal purpose is to guide or direct the determination of those amounts. However, a point estimate and a brief description can communicate only some of the information that investors, creditors, and other users need about future benefits embodied in assets or about future sacrifices embodied in liabilities. Additional information is generally necessary to help users assess the uncertainties that are present and the potential effects on the entity of the different possible outcomes. That need has been accepted in longstanding general practices of disclosure about loss and gain contingencies (codified in FASB Statement No. 5, Accounting for Contingencies, paragraphs 10 and 17(b)) and underlies many other present disclosure requirements and practices.

84. Benefit and sacrifice are not certain for most assets and many liabilities. For example, common stocks owned may go down, or up, in price before they are sold. Options written may require major outlays of cash or may expire unexercised depending principally on movements in the price of the underlying item. Investors, creditors, and other users trying to assess risks and potentials usually need information about all financial instruments to help them understand an entity's risk position.
85. Downside risk is perhaps of greater concern to investors and creditors than upside potential. While upside potential may increase profits, perhaps substantially, downside risk can eliminate profits, imperil creditors' likelihood of collection, or even destroy the entity. Financial instruments such as futures, forwards, swaps, options, and collars have the upside potential of producing gains and, through hedging, stabilizing an entity's financial position in an unstable market environment. But they also carry with them risks of sudden loss or failure if speculative positions are taken or if designated hedges prove not to be effective.

**Consideration of Costs**

86. While disclosures can produce benefits by providing descriptions and measures and can help in assessing risks and potentials, costs also must be considered in establishing standards that require disclosures. FASB Concepts Statement No. 2, *Qualitative Characteristics of Accounting Information*, paragraph 137, says:

> The costs of providing information are of several kinds, including costs of collecting and processing the information, costs of audit if it is subject to audit, costs of disseminating it to those who must receive it, costs associated with the dangers of litigation, and in some instances costs of disclosure in the form of a loss of competitive advantages vis-a-vis trade competitors, labor unions (with a consequent effect on wage demands), or foreign enterprises. The costs to the users of information, over and above those costs that preparers pass on to them, are mainly the costs of analysis and interpretation and may include costs of rejecting information that is redundant, for the diagnosis of redundancy is not without its cost.

Accordingly, disclosures should only be required if, in the Board's judgment, the benefits of the disclosures justify the related costs.

**Disclosure of Information about Financial Instruments with Off-Balance-Sheet Risk and Financial Instruments with Concentrations of Credit Risk**

87. When the Board decided to consider first the disclosure of information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk, a primary objective was to improve the information disclosed about those instruments and to promote disclosure of comparable information in financial statements as quickly as possible. The Board also concluded that another primary objective of phase one was to bring the level of disclosure of information about financial instruments with off-balance-sheet risk at least up to that of existing disclosure requirements for on-balance-sheet financial instruments.

88. Consideration of the purposes of disclosure and observations of current practice and
requirements led the Board to conclude that information about financial instruments with off-balance-sheet credit or market risk should disclose the extent, nature, and terms of an entity's financial instruments with off-balance-sheet risk, the cash requirements of those instruments, and the related credit risk of those instruments. The Board further concluded that financial statements should include information about financial instruments with concentrations of credit risk that would disclose the entity's exposure to credit risk due to changes in economic or other conditions. Paragraphs 89-112 provide the basis for the Board's conclusions about the specific information required to be disclosed by this Statement and about possible disclosures of information considered by the Board but not required. Areas to be considered in subsequent phases include disclosure of information about interest rates, future cash receipts and payments, and market value.

**Extent, Nature, and Terms of an Entity's Financial Instruments with Off-Balance-Sheet Risk**

89. The Board concluded that disclosing information about the face or contract amount (or notional principal amount) of financial instruments with off-balance-sheet risk provides a useful basis for assessing the extent to which an entity has open or outstanding contracts. The disclosure of that amount is intended to apprise investors, creditors, and other users that the entity is engaged in certain activities whose off-balance-sheet risk is beyond what is currently recognized in the statement of financial position. The face or contract amount gives investors and creditors an idea of the extent of involvement in transactions that have off-balance-sheet risk. That information conveys some of the same information provided by amounts recognized for on-balance-sheet instruments.

90. The July 1989 revised Exposure Draft included a requirement to disclose the amount recognized, if any, in the statement of financial position for instruments with off-balance-sheet risk. The Board asked for disclosure of amounts recognized in the statement of financial position because those amounts reduce the exposure to off-balance-sheet risk. Also, the Board was concerned that failure to disclose amounts already recognized for losses from risks may lead users to overestimate the risk of further losses that might be recognized.

91. Some respondents stated that to disclose the amount recognized in the statement of financial position applicable to financial instruments with off-balance-sheet risk is difficult if that amount is commingled with the allowance for loan losses and the entity assesses and recognizes the allowance for the losses either on an overall basis or by counterparty rather than by class of financial instrument. For example, liabilities for losses on financial instruments with off-balance-sheet risk, such as standby commitments and guarantees, may be included in the allowance for loan losses rather than recognized as liabilities. After considering concerns of respondents about the practicability of identifying appropriate amounts in some cases, the Board decided not to require the disclosure of the amount recognized in the statement of financial position for instruments with off-balance-sheet risk. The Board continues to believe that disclosure of the amount recognized is often helpful to investors, creditors, and other users and therefore encourages entities to disclose those amounts.
92. Notwithstanding the above respondents' views about commingling of accounts in practice, the Board believes that probable credit losses, however assessed, either can be associated with or can be allocated for particular instruments. The Board believes that generally accepted accounting principles proscribe inclusion of an accrual for credit loss on a financial instrument with off-balance-sheet risk in a valuation account (allowance for loan losses) related to a recognized financial instrument.

93. The Board concluded that narrative descriptions of an entity's financial instruments with off-balance-sheet risk would help investors, creditors, and other users to understand better the effect that those instruments have on the entity. The Board concluded that a discussion of the credit and market risk and the cash requirements of those instruments and the entity's accounting policy for recognizing and measuring those instruments should be required for that purpose.

94. Some respondents previously had suggested requiring disclosure of information about the entity's purpose for holding or contracting financial instruments with off-balance-sheet risk, for example, whether a contract was intended to be a hedge or an investment. The Board concluded that the purpose of entering into a financial instrument may, in some cases, be self-evident from (a) the class of the instrument (for example, financial guarantees written or loan commitments or letters of credit written) or (b) the accounting policy (for example, the accounting policy may differ for those instruments designated as hedges and for those instruments designated as investment contracts). The Board concluded that a requirement to disclose the purpose of entering into certain financial instruments is not necessary because reporting entities are likely to disclose that information to explain more adequately the nature of risks of those instruments.

95. Some respondents suggested requiring disclosure of how an entity controls and monitors its off-balance-sheet risk. In part because it questioned whether the benefit of requiring that disclosure would justify the costs involved, the Board decided that that disclosure should not be required. The Board also was concerned that disclosure of that information might become "boilerplate" and thus of questionable relevance.

Credit Risk of Financial Instruments with Off-Balance-Sheet Credit Risk

96. The Board concluded that disclosure of information about amounts of credit risk and about collateral or other security should be required to help investors, creditors, and other users assess the credit risks of the entity.

Amounts of Credit Risk

97. Respondents to the revised Exposure Draft expressed concern about the requirement to disclose the amount that portrays the accounting loss the entity would incur if any party to the financial instrument failed completely to perform according to the terms of the contract and the collateral or other security, if any, for the amount due proved to be of no value to the entity. They stated that when the risk of loss is remote, disclosure is not required under Statement 5.
Other respondents concurred with the Board's view that the amount to be disclosed should be conceptually the total amount that would be recognized (as an asset) if the instrument were an on-balance-sheet financial instrument. Collateral, if any, would not be considered, although it would be included in measuring any actual loss.

98. The Board concluded that disclosing the accounting credit risk exposure—the amount of accounting loss the entity would incur if the counterparty defaulted and the collateral or other security, if any, proved to be valueless—provides useful information for quantifying credit risk and should be required. That amount of exposure may not be a likely loss, but it delimits the total risk and provides a base point for analytical comparisons. Moreover, the amount of credit risk for financial instruments for which credit risk is not "off-balance-sheet" is recognized in the statement of financial position. For those instruments, the carrying amount in the statement of financial position defines the accounting loss the entity would incur due to complete counterparty failure. The Board concluded that the equivalent amount should be disclosed for financial instruments with off-balance-sheet risk.

Collateral

99. The Board concluded that disclosure of information about collateral or other security supporting financial instruments with off-balance-sheet risk is useful because collateral or other security generally reduces credit risk. The Board concluded that disclosing an entity's policy of requiring collateral or other security, and the entity's access to that collateral or security, along with a description of either the collateral or the security, would aid investors, creditors, and other users in assessing an entity's collateral policy and adequacy of the collateral in the event of default. The Board concluded also that while general information about collateral and other security may be useful and should be required, detailed information about the extent of coverage of potential loss may be difficult to quantify and should not be required. The Board decided to encourage disclosure of that information.

Concentrations of Credit Risk of All Financial Instruments

100. The Board concluded that disclosure of information about concentrations of credit risk resulting from exposures with an individual counterparty or groups of counterparties in the same industry or region or having similar economic characteristics should be required. Depending on the risks associated with an individual counterparty or groups of counterparties, a concentration of credit risk can be perceived as favorable or unfavorable, that is, as indicative of more or less credit risk. However, lack of diversification in a portfolio is generally considered—other factors being equal—to indicate greater exposure to credit risk. Concentration information also allows investors, creditors, and other users to make their own assessments of the credit risk associated with the area of concentration.

101. The Board considered specifying quantitative thresholds for determining reportable concentrations of credit risk with an individual counterparty or groups of counterparties. The Board concluded, however, that an entity should review its portfolio of financial instruments
subjecting the entity to credit risk to determine if any significant concentrations of credit risk with an individual counterparty or groups of counterparties exist. Group concentrations of credit risk exist if a number of counterparties are engaged in similar activities or activities in the same region or have other similar economic characteristics that would cause their ability to meet contractual obligations to be similarly affected by changes in economic or other conditions, for example, concentrations of credit risk resulting from loans to highly leveraged entities. The Board chose not to specify a threshold because "significance" depends, to a great extent, on individual circumstances.

102. In commenting on the revised Exposure Draft, some respondents suggested that additional guidance should be provided to define further group concentrations in similar activities, activities in the same region, or those having other similar economic characteristics. Others suggested that the Board should quantify significant. One reason given by some respondents was concern that the absence of more specific guidance allows room for "second-guessing" the conclusions reached by management after events have taken their course. While the Board understands those concerns, it finds persuasive the view that management judgment about concentrations and significance is in and of itself useful information. Therefore, the Board chose not to define further those terms.

103. Industry or regional concentrations often may be disclosed adequately by a description of the entity's principal activities, which may greatly reduce the cost of determining whether significant concentrations exist and of reporting their existence. For example, a local retail store may be able to disclose concentrations of credit risk adequately by describing its business, location, and the related granting of credit to local customers. In a similar manner, an entity whose principal activity consists of supplying parts to the computer industry may adequately disclose concentrations of credit risk by describing its principal activity and the related granting of credit to computer manufacturers. However, in other cases, a description of the principal activities may not provide sufficient information about concentrations of credit risk.

104. The Board considered requiring disclosure of concentrations of credit risk only for financial instruments with off-balance-sheet risk. However, the Board concluded that information about concentrations of credit risk is relevant only as related to an entity's entire credit risk portfolio. A judgment that a concentration exists is, in part, a judgment about significance and one that can be made only in the context of the total financial position of the entity. A judgment about concentrations within off-balance-sheet credit risk alone could result in disclosing information that is not significant in the context of the entity as a whole or in disclosing only a part of a concentration of the entity's credit risk thereby implying that no further risk of that kind exists. Therefore, the Board concluded that this Statement should require information about concentrations of credit risk for all financial instruments.

105. Some respondents to the revised Exposure Draft suggested that information about lease receivables should be included in the disclosure of concentration information, primarily because leases constitute a significant element of credit risk for many entities. The Board decided to adopt that suggestion.
Exclusion of Certain Financial Instruments

106. The Board concluded that insurance contracts, other than financial guarantees and investment contracts, as discussed in Statements 60 and 97, should be excluded from this Statement's requirements because the significant business risks involved are generally other than credit and market risk. The risks associated with insurance contracts relate to cash surrender values, lapses, mortality, morbidity, and casualty risks.

107. The Board also excluded from this Statement's requirements (a) employers' and plans' obligations for pension benefits, 18 employers' and plans' obligations for postretirement health care and life insurance benefits, employer stock option and stock purchase plans for employees, employers' obligations for compensated absences, and other forms of deferred compensation, (b) financial instruments of a pension plan, including plan assets, when subject to the accounting and reporting requirements of Statement 87, (c) lease contracts (except for information about concentrations of credit risk), (d) unconditional purchase obligations subject to the disclosure requirements of Statement 47, and (e) extinguished debt subject to the disclosure requirements of Statement 76 and any assets held in trust in connection with an in-substance defeasance of that debt.

108. The Board or its predecessors previously have deliberated the information to be reported about those financial instruments with the exception of employers' accounting for postretirement health care and life insurance benefits, and adequate disclosure requirements exist. This Statement does not change the specific disclosure requirements for those financial instruments. As part of the Board's project on employers' accounting for postretirement health care and life insurance benefits, Statement 81 on disclosure of information was issued and should continue to be followed pending completion of the project.

109. Financial instruments of a pension plan, including plan assets, when subject to the accounting and reporting requirements of Statement 87, are excluded from this Statement's requirements because of the financial reporting burden that would likely ensue. The Board was concerned that the information that otherwise would be required to be disclosed would not be easily determinable by employers and that the costs of compliance would be excessive. The Board considered but decided not to exclude from this Statement's requirements financial instruments of a pension plan, other than obligations for pension benefits, when the plan is subject to the accounting and reporting requirements of Statement 35. Concerns were not expressed about the cost and feasibility of compliance by employers for pension plans.

110. The Board developed the definition of financial instruments with off-balance-sheet risk of accounting loss to establish a scope that would include instruments that are generally considered to be off-balance-sheet instruments. The Board is aware that some instruments that may be considered to be on-balance-sheet have off-balance-sheet risk as defined by this Statement.
Appendix B of the revised Exposure Draft included a list of financial instruments that have and do not have off-balance-sheet risk. The list of "traditional items" included "obligations receivable/payable in foreign currency" and indicated that those obligations do not result in off-balance-sheet risk to either the holder or the issuer. One respondent to the revised Exposure Draft observed that obligations payable denominated in foreign currency meet the definition of financial instruments with off-balance-sheet risk. The Board acknowledges that those obligations have off-balance-sheet risk of accounting loss as defined by this Statement.

111. In determining whether those instruments should be included in the disclosure requirements of this Statement for instruments with off-balance-sheet risk, the Board acknowledged that it had not previously contemplated that those instruments would be covered by this Statement. The Board noted that present practice generally includes disclosures about long-term debt denominated in foreign currency. Therefore, for practical reasons, the Board decided to exclude certain financial instrument obligations denominated in foreign currencies from the disclosure requirements for instruments with off-balance-sheet risk as described in paragraph 15(b) of this Statement.

112. The Board also noted that Appendix B of the revised Exposure Draft did not include the obligation arising when financial instruments are sold short as an example of an instrument with off-balance-sheet risk. The Board observed that those instruments do have off-balance-sheet market risk and are subject to the disclosure requirements of this Statement.

Need for Judgment

113. Judgment will be needed in developing some of the information required to be disclosed by this Statement. The degree of judgment needed, for example, to identify significant industry or regional concentrations is similar to that needed to comply with other longstanding accounting and reporting requirements, such as determining allowances for losses on loans, inventory obsolescence, and litigation.

Application in Comparative Financial Statements

114. The Board decided that in the initial transitional year of applying the provisions of this Statement, disclosure of information beyond that already provided should be required only for the financial statements for the year of initial application. To obtain information retroactively that was not required for prior years might be difficult and costly for some entities, and the Board believes the benefits would not justify the costs.

115. The Board concluded that comparative disclosure of information about the extent, nature, and terms of financial instruments with off-balance-sheet risk would help investors, creditors, and other users assess any pertinent trends and the extent to which an entity is involved in investments with off-balance-sheet risk.
116. The Board also concluded that disclosure of information about the accounting loss an entity would incur if any party failed completely to perform according to a contract and information about collateral should be required on a comparative basis because that information is basically an extension of what is already generally provided about recognized financial instruments for each period included in comparative financial statements. Although no specific disclosure of information about collateral for recognized financial instruments is presently called for, the balance sheet description of certain financial instruments, for example, "real estate loans," "consumer loans," and "commercial loans," often gives a user an indication of whether the instrument is secured or collateralized. The Board concluded that the disclosure of comparative information also should extend to concentrations of credit risk so that an investor, creditor, or other user would have an indication of changes in that involvement.

117. The Board concluded that the requirement in this Statement to disclose that information on a comparative basis is consistent with ARB No. 43, Chapter 2, "Form of Statements," and Concepts Statement 2:

   In any one year it is ordinarily desirable that the balance sheet, the income statement, and the surplus statement be given for one or more preceding years as well as for the current year. Footnotes, explanations, and accountants' qualifications which appeared on the statements for the preceding years should be repeated, or at least referred to, in the comparative statements to the extent that they continue to be of significance. [Chapter 2, Section A, paragraph 2, emphasis added.]

   Information about an enterprise gains greatly in usefulness if it can be compared with similar information about other enterprises and with similar information about the same enterprise for some other period or some other point in time. The significance of information, especially quantitative information, depends to a great extent on the user's ability to relate it to some benchmark. The comparative use of information is often intuitive, as when told that an enterprise has sales revenue of $1,000,000 a year, one forms a judgment of its size by ranking it with other enterprises that one knows. Investing and lending decisions essentially involve evaluations of alternative opportunities, and they cannot be made rationally if comparative information is not available.

   . . . the purpose of comparison is to detect and explain similarities and differences. Comparability should not be confused with identity, and sometimes more can be learned from differences than from similarities if the differences can be explained. The ability to explain phenomena often depends on the diagnosis of the underlying causes of differences or the discovery that apparent differences are without significance. [Concepts Statement 2, paragraphs 111 and 119, emphasis added.]
Applicability to Small, Nonpublic, or Nonfinancial Entities

118. The Board considered whether certain entities should be excluded from the scope of this Statement and concluded that the Statement should apply to all entities. In particular, the Board considered the usefulness of the disclosure of information for small, nonpublic, or predominantly nonfinancial entities. After considering the costs and benefits of the disclosure of information about financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk required by this Statement, the Board concluded that the disclosures are important for small and nonpublic entities and should be required. To the extent that a small or nonpublic entity has those instruments, some respondents have suggested that the disclosures required by this Statement may have a greater effect because, while many larger, public entities have disclosed information about financial instruments with off-balance-sheet risk voluntarily, few of the smaller or nonpublic entities have done so. The Board also observed that many small entities may have few, if any, financial instruments with off-balance-sheet risk.

119. The Board also considered whether the provisions of this Statement should apply to predominantly nonfinancial entities. The Board concluded that while this Statement likely would have its greatest effect on the financial reporting of entities whose assets and liabilities are primarily financial instruments, financial instruments with off-balance-sheet risk and financial instruments with concentrations of credit risk may constitute a significant part of the assets and liabilities of predominantly nonfinancial entities and disclosure of information about them is useful and should be required. Furthermore, in today's environment, distinguishing between financial entities and nonfinancial entities is often difficult.

Location of Information within Financial Reports

120. The Board considered whether the disclosure of information required by this Statement should be part of basic financial statements or should be provided as supplementary information. Concepts Statement 5 distinguishes between information that should be part of the basic financial statements and that which should be provided as supplementary information. Paragraph 7 of that concepts Statement emphasizes that information disclosed as part of the basic financial statements amplifies or explains information recognized in financial statements and is essential to understanding that information.

121. The disclosures required by this Statement build on the disclosures already included in basic financial statements and, like them, serve the major purposes of disclosure summarized in paragraph 77. In the past, requiring information as supplementary has also been a way of excluding certain entities from the scope of the requirements; however, as discussed in paragraphs 118 and 119, the Board concluded that the disclosures called for in this Statement should be provided by all entities. The Board concluded that there were no persuasive reasons for the disclosures about financial instruments to be outside the basic financial statements.
122. In responding to the revised Exposure Draft, certain investment companies observed that they already make extensive disclosure of information about financial instruments, including financial instruments subject to the disclosure requirements of this Statement. They observed further that those disclosures may appear in proxy materials or other materials outside the financial statements or in other documents separate from the financial statements. They asked that the Board consider permitting incorporation in the financial statements by reference in the notes to the financial statements. The Board does not object to incorporation of information by reference as long as that information is included elsewhere in the document containing the financial statements.

**Effective Date**

123. Prior to the release of the revised Exposure Draft, many constituents noted that completion of this phase of the disclosure project would be desirable as soon as practicable so that the Board could proceed to address remaining disclosure issues. Others commented that investors, creditors, and other users would be better prepared to respond to issues about financial instruments—both those about disclosure of information and those about recognition and measurement—with the benefit of the information about financial instruments required by this Statement.

124. Some had expressed concern, however, that some entities may not currently accumulate some of the required information. After consideration of those comments, the Board concluded that the effective date for all disclosure requirements of this Statement should be for financial statements issued for fiscal years ending after June 15, 1990. The Board, however, encourages entities to apply the disclosure requirements for financial statements issued for fiscal years ending on or before that date.
Footnotes

FAS105, Footnote 1--Contractual obligations encompass both those that are conditioned on the occurrence of a specified event and those that are not. All contractual obligations that are financial instruments meet the definition of liability set forth in FASB Concepts Statement No. 6, Elements of Financial Statements, although some may not be recognized as liabilities in financial statements--may be "off-balance-sheet"--because they fail to meet some other criterion for recognition. For some financial instruments, the obligation is owed to or by a group of entities rather than a single entity.

FAS105, Footnote 2--The use of the term financial instrument in this definition is recursive (because the term financial instrument is included in it), but it is not circular. It requires a chain of contractual obligations that ends with the delivery of cash or an ownership interest in an entity. Any number of obligations to deliver financial instruments can be links in a chain that qualifies a particular contract as a financial instrument.

FAS105, Footnote 3--Contractual rights encompass both those that are conditioned on the occurrence of a specified event and those that are not. All contractual rights that are financial instruments meet the definition of asset set forth in Concepts Statement 6, although some may not be recognized as assets in financial statements--may be "off-balance-sheet"--because they fail to meet some other criterion for recognition. For some financial instruments, the obligation is held by or due from a group of entities rather than a single entity.

FAS105, Footnote 4--Accounting loss refers to the loss that may have to be recognized due to credit and market risk as a direct result of the rights and obligations of a financial instrument.

FAS105, Footnote 5--A change in market price may occur (for example, for interest-bearing financial instruments) because of changes in general interest rates (interest rate risk), changes in the relationship between general and specific market interest rates (an aspect of credit risk), or changes in the rates of exchange between currencies (foreign exchange risk).

FAS105, Footnote 6--It is possible that an economic loss could exceed that amount if, for example, the current market value of an asset was higher than the amount recognized in the statement of financial position. This Statement, however, does not address that economic loss.

FAS105, Footnote 7--In this Statement, off-balance-sheet risk is used to refer to off-balance-sheet risk of accounting loss.

FAS105, Footnote 8--The off-balance-sheet risk from a commitment to lend cash at a floating interest rate is the exposure to credit loss arising from the obligation to fund a loan in accordance with the terms of the commitment.

FAS105, Footnote 9--Unconditional purchase obligations not subject to the requirements of
Statement 47 are included in the scope of this Statement. That is, unconditional purchase obligations that require the purchaser to make payment without regard to delivery of the goods or receipt of benefit of the services specified by the contract and are not within the scope of Statement 47 (because they were not negotiated as part of a financing arrangement, for example) are included in the scope of this Statement.

FAS105, Footnote 10--Financial instruments of a pension plan, other than the obligations for pension benefits, when subject to the accounting and reporting requirements of Statement 35 are included in the scope of this Statement.

FAS105, Footnote 11--A contingent obligation arising out of a cancelled lease contract and a guarantee of a third-party lease obligation are not lease contracts and are included in the scope of this Statement.

FAS105, Footnote 12--Practices for grouping and separately identifying--classifying--similar financial instruments in statements of financial position, in notes to financial statements, and in various regulatory reports have developed and become generally accepted, largely without being codified in authoritative literature. In this Statement, class of financial instrument refers to those classifications.

FAS105, Footnote 13--Paragraph 12 of Opinion 22 as amended by FASB Statement No. 95, Statement of Cash Flows, says:

Disclosure of accounting policies should identify and describe the accounting principles followed by the reporting entity and the methods of applying those principles that materially affect the determination of financial position, statement of cash flows, or results of operations. In general, the disclosure should encompass important judgments as to appropriateness of principles relating to recognition of revenue and allocation of asset costs to current and future periods; in particular, it should encompass those accounting principles and methods that involve any of the following:

a. A selection from existing acceptable alternatives;
b. Principles and methods peculiar to the industry in which the reporting entity operates, even if such principles and methods are predominantly followed in that industry;
c. Unusual or innovative applications of generally accepted accounting principles (and, as applicable, of principles and methods peculiar to the industry in which the reporting entity operates).

FAS105, Appendix A, Footnote 14--The definition of a financial instrument could be written to exclude currency but include other forms of cash (for example, cash deposits) since currency does not generally represent a promise to pay. The definition includes currency in cash primarily as a matter of convenience.
FAS105, Appendix B, Footnote a--Holder includes buyer and investor.

FAS105, Appendix B, Footnote b--Issuer includes seller, borrower, and writer.

FAS105, Appendix B, Footnote c--An "X" in any of the columns (CR or MR) denotes the presence of the respective off-balance-sheet risk of accounting loss. The types of risk included are:

1. Credit risk (CR)--the possibility that a loss may occur from the failure of another party to perform according to the terms of a contract
2. Market risk (MR)--the possibility that future changes in market prices may make a financial instrument less valuable or more onerous.

FAS105, Appendix B, Footnote d--A "Yes" in this column denotes the presence of off-balance-sheet risk of accounting loss; a "No" denotes no off-balance-sheet risk of accounting loss.

FAS105, Appendix B, Footnote e--Many joint ventures or other equity method investments are accompanied by guarantees of the debt of the investee. Debt guarantees of this nature present off-balance-sheet risk of accounting loss due to credit risk and should be evaluated with other financial guarantees.

FAS105, Appendix B, Footnote f--Issuer refers to both the trust and the sponsor.

FAS105, Appendix B, Footnote g--Put options on interest rate contracts have credit risk if the underlying instrument that might be put (a particular bond, for example) is subject to credit risk

FAS105, Appendix B, Footnote h--Swaps, forwards, and futures are two-sided transactions; therefore, the holder and issuer categories are not applicable. Risks are assessed in terms of the position held by the entity.

FAS105, Appendix B, Footnote i--Netting of receivable and payable amounts when right of setoff does not exist is in contravention of APB Opinion No. 10, Omnibus Opinion--1966, paragraph 7, and FASB Technical Bulletin No. 88-2, Definition of a Right of Setoff.

FAS105, Appendix C, Footnote 15--This example might apply also to a financial entity that has a limited number of financial instruments with off-balance-sheet risk.
FAS105, Appendix C, Footnote 16--Placement within financial statements of the information that describes the extent of involvement an entity has in financial instruments with off-balance-sheet risk and the related nature, terms, and credit risk of those instruments is at the discretion of management. The example illustrates information that would be provided in a note "Interest Rate Swap Agreements." As an alternative, this same information could be included in the entity's note about long-term financing arrangements.

FAS105, Appendix C, Footnote 17--Placement within financial statements of the information that describes the extent of involvement an entity has in financial instruments with off-balance-sheet risk and the related nature, terms, and credit risk of those instruments is at the discretion of management. The example illustrates information that would be provided in a note "Financial Instruments with Off-Balance-Sheet Risk." An entity may decide, however, to disclose this information in several separate notes.

FAS105, Appendix D, Footnote 18--Contractual obligations other than those for pension benefits are not, however, excluded from this Statement's requirements.