Financial Accounting Standards Board

Proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*

Frequently Asked Questions

September 2010

The Board issued proposed Accounting Standards Update, *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities—Financial Instruments (Topic 825) and Derivatives and Hedging (Topic 815)*, on May 26, 2010. The comment period for the proposed Accounting Standards Update ends on September 30, 2010.

The Board and staff continue to educate constituents about the proposal through webcasts, podcasts, focused newsletters, participation in various conferences, and by holding numerous meetings with investors, preparers, auditors, and regulators. Through these efforts, the Board and staff have received questions about various aspects of the proposal. This document clarifies the proposal by answering common questions received about the proposed guidance.

The Board has implemented an extensive outreach plan to obtain feedback on this comprehensive proposal from all constituents, including investors, preparers, auditors, and regulators. Constituents can provide feedback on this proposal through the following channels:

a. *Public Comment Letters*—Comment letters can be submitted by email to director@fasb.org, File Reference No. 1810-100. Those without email should send their comments to "Technical Director, File Reference No. 1810-100, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116." Do not send responses by fax. The comment letter deadline is September 30, 2010.

b. *Investor Questionnaire*—Investors can provide confidential feedback by completing and submitting the Investor Questionnaire in the Investors section of the FASB's website.

c. *Field Visits*—The Board and staff will be visiting various entities, on a confidential basis, to discuss the operationality and the costs and benefits of the proposal.

d. *Public Roundtables*—The Board plans to hold public roundtable meetings in October. Any individual or organization desiring to participate notified the FASB by sending an email to director@fasb.org and submitted its comments on the proposal in writing by September 1, 2010. Roundtable meetings can accommodate a limited number of participants. Depending on the number of responses received, the Board may not be able to accommodate all requests to participate.

The Board and staff will analyze all feedback received through these activities as part of the Board's redeliberations process. The Board intends to work jointly with the IASB to issue a final Accounting Standards Update on accounting for financial instruments.

Questions and Answers

General

1. **What are some of the most significant changes to current U.S. generally accepted accounting principles (GAAP) arising from the proposal?**

   The proposal would require a new classification and measurement model for all financial assets and liabilities within its scope. This proposed model would replace classification and measurement models currently in U.S. GAAP for various types of financial instruments. In addition, the proposed guidance would establish a single credit impairment model for all financial assets as well as a uniform interest income recognition model for all interest-earning financial assets, replacing the multiple impairment and interest income recognition models in current U.S. GAAP.

   Appendix C of the proposed Accounting Standards Update summarizes significant changes to current U.S. GAAP. Major areas of current U.S. GAAP that would be superseded by the proposal are the following:

   a. The guidance on classification and measurement of debt and equity securities in Subtopic 320-10 (originally issued as FASB Statement No. 115, *Accounting for Certain Investments in Debt and Equity Securities*)

   b. The guidance on subsequent measurement of loan impairments in Section 310-10-35 (originally issued as FASB Statement No. 114, *Accounting by Creditors for Impairment of a Loan*)

   c. The guidance on impairment and interest income recognition of loans and debt securities acquired with deteriorated credit quality in Subtopic 310-30 (originally issued as AICPA Statement of Position 03-3, *Accounting for Certain Loans and Debt Securities in a Transfer*)

   d. The guidance on subsequent measurement of debt and equity securities in Section 320-10-35 and the guidance on subsequent measurement of a not-for-profit entity's investments in Section 958-325-35 (originally issued as FASB Staff Position FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*).

e. The guidance on cost method investments in Subtopic 325-20 (originally issued as APB Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*)

f. The guidance on beneficial interests in securitized financial assets in Subtopic 325-40 (originally issued as EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased Beneficial Interests and Beneficial Interests That Continue to Be Held by a Transferor in Securitized Financial Assets")

g. The guidance on shortcut method and critical terms match method in Topic 815 (originally issued as FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*).

Classification and Measurement

2. How will the proposal affect the existing classification categories for financial assets in current U.S. GAAP, for example, the trading, available-for-sale and held-to-maturity classifications for investments in debt and equity securities under Topic 320?

The proposal creates two categories for classifying all types of financial assets. Financial assets that are debt instruments (loans, receivables, and debt investment securities) that meet certain criteria, including the entity having a business strategy to hold those debt instruments for collection or payment of cash flows, may measure those financial assets at fair value with qualifying changes in fair value recognized in other comprehensive income. If those criteria are not met, the financial asset would be required to be measured at fair value with all changes in fair value recognized in net income. See Question 3 for a discussion about the proposed changes to accounting for equity investments. See Question 13 for a discussion about how the proposal retains amortized cost information.

The proposal would eliminate the current classification categories for debt investment securities under Topic 320. The three categories in current U.S. GAAP (trading, available-for-sale, and held-to-maturity) would be replaced by the two categories. Amortized cost measurement of financial assets classified as held-to-maturity would no longer be permitted. Similarly, the proposal would eliminate the current classification and measurement guidance for loans. The proposal would eliminate the guidance in current U.S. GAAP for loans held for sale, which are required to be measured at the lower of cost or fair value under current U.S. GAAP.

3. **How will the proposal affect the accounting for equity investments? Will the proposed changes to the equity method of accounting affect the accounting for investments in limited partnerships that are considered to be more than minor (that is, more than 3 to 5 percent as defined in current U.S. GAAP)?**

   The proposal would require all investments in equity securities, including those that do not meet the proposed criteria for equity method of accounting and those that do not have a readily determinable fair value as defined in current U.S. GAAP, to be measured at fair value with all changes in fair value recognized in net income. Therefore, investments in equity securities that were previously permitted to be classified as available-for-sale with changes in fair value recognized in other comprehensive income under Subtopic 320-10 would be measured at fair value with all changes in fair value recognized in net income.

   Equity investments in entities in which the investor has significant influence may be eligible for application of the equity method of accounting. However, the proposal would change the criteria that must be met to apply the equity method of accounting. The proposal would not change the level of influence (significant influence) required to apply the equity method of accounting. However, the proposal also would require that an equity investment be in an entity with operations related to the investor's business to qualify for equity method accounting. If either criterion is not met, the equity method of accounting would be prohibited and the investor would account for the equity investment at fair value with all changes in fair value recognized in net income. In addition, the fair value option would no longer be available for equity method investments.

   SEC staff guidance for public entities in Subtopic 323-30 (originally issued as EITF Topic No. D-46, "Accounting for Limited Partnership Investments") requires that investments in limited partnerships that are considered to be more than minor (that is, more than 3 to 5 percent) be accounted for under the equity method of accounting. The Board understands that the SEC staff will evaluate whether its position in Topic D-46 should be revised to be consistent with the final Accounting Standards Update.

4. **How should an entity evaluate the business strategy criterion for recognizing qualifying changes in fair value in other comprehensive income? Are there any qualitative or quantitative guidelines (such as a threshold for acceptable portfolio turnover)?**

   The Board decided not to provide detailed guidelines about an entity's assertions of intent and holding periods for financial instruments. Rather, the Board decided on a principle that financial instruments held as part of a longer term business activity in which sales are infrequent should be eligible to have certain changes in fair value recognized in other comprehensive income. The Board eliminated the current tainting notion but decided that an entity should evaluate its business strategy for financial instruments on the basis of how the entity manages its financial instruments on a portfolio basis rather than the entity's intent for an individual financial instrument.

5. **In analyzing an entity's business strategy to hold financial instruments for collection or payment of contractual cash flows, will an entity be required to consider the *actual* contractual term of the financial instrument in all cases (as suggested by paragraph IG37 of the proposed Accounting Standards Update) or can the *effective* maturity of financial instruments be considered, for example, for loans and securities with prepayment options?**

   An entity should consider the *effective* maturity of financial instruments for the purposes of applying the business strategy criterion. Therefore, for financial instruments such as mortgage-backed securities and other prepayable instruments, an entity should consider the *effective* maturity in order to evaluate if the financial instrument meets the criteria to recognize qualifying changes in fair value in other comprehensive income.

6. **Is reclassification of a financial instrument ever permitted? For example, consider the following:**

   a. **A debt instrument is modified (for which extinguishment accounting is not triggered), and the terms of the modified instrument would have required a different classification had those terms been present at inception.**

   b. **A hybrid instrument contains a debt host and an embedded derivative that, at initial recognition, did not require bifurcation but would require bifurcation in a later period (for example, if the embedded feature subsequently met the net settlement characteristic of a derivative).**

   No. The proposal would not permit reclassifications. The proposal would require that at the time an entity initially recognizes a financial asset or issues/incurs a financial liability, it must determine the classification and measurement of that financial instrument. Once a financial instrument is classified upon initial recognition, the proposal would not permit the entity to subsequently change its initial classification and would not provide an exception for any scenario, including the two specific examples in the question above.

7. **Is it fair to assume that fair value information currently disclosed in the notes to the financial statements for loans under the guidance on financial instruments in Topic 825 (originally issued as FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments)* reflects the amounts that would be recorded on the balance sheet?**

   No. Paragraph 825-10-55-3 provides implementation guidance that permits an entity to estimate the fair value amounts for certain loans by discounting the future cash flows using the current rates at which similar loans would be made to borrowers with similar credit ratings and for the same remaining maturities for fair value disclosure purposes. That approach is not consistent with an exit price notion for fair value measurement as defined in Topic 820 (originally issued as FASB Statement No. 157, *Fair Value Measurements*). The proposal would require loans to be measured at fair value using an exit price notion.

8. **How will the proposal affect fair value option elections made under Topic 825 (originally issued as FASB Statement No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*)?**

   The proposal would eliminate the need for a fair value option for financial instruments within the scope of the proposal because the proposal would allow an entity to elect to measure any financial instrument at fair value with all changes in fair value recognized in net income, including those financial instruments that meet the criteria to recognize qualifying changes in fair value in other comprehensive income. The proposal also would eliminate the fair value option for equity method investments. However, any other assets or liabilities that are currently eligible for the fair value option under Topic 825 that are excluded from the scope of the proposal would continue to be eligible for the fair value option.

9. **Could the discount rate for remeasuring core deposits be negative? How should an entity measure the core deposit liability in that situation?**

   In certain economic conditions, the all-in-cost-to-service rate could exceed the alternative funds rate. In this situation, an entity should measure the core deposit liability at face amount and would not apply the guidance in paragraph 31 of the proposed Accounting Standards Update.

10. **How will the proposal affect the current accounting models for convertible debt (and similar) financial instruments?**

    The current guidance on debt with conversion and other options in Subtopic 470-20 requires that certain debt-equity hybrid instruments be separated into a liability component and an equity component upon initial recognition. Paragraph 4(b) of the proposed Accounting Standards Update excludes the equity component from the proposed guidance but does not exclude the liability component. Therefore, the proposal would require application of the proposed classification and measurement model for financial instruments to the liability component. Specialized models in current U.S. GAAP require issuers of certain debt-equity hybrid instruments to allocate proceeds from issuance using a certain methodology.

The separation approaches required for debt-equity hybrid instruments differ depending on the type of the instrument as follows:

a. Debt with detachable stock purchase warrants is separated using a relative fair value method.

b. Convertible debt that may be settled in cash upon conversion is separated using an approach that first determines the fair value of the liability component, which is based on a comparable debt instrument without the conversion feature, with the remaining proceeds allocated to the equity component.

c. Debt with nondetachable beneficial conversion features is separated using an approach that first determines the intrinsic value of the beneficial conversion feature, which is the amount allocated to equity, with the difference between total proceeds and the intrinsic value of the beneficial conversion feature allocated to the liability component.

For debt-equity hybrid instruments requiring allocation of proceeds to an equity component and a liability component, the proposal would require initial measurement of the liability component at fair value or transaction price, if applicable. With respect to initial measurement, only the approach for convertible debt that may be settled in cash upon conversion is consistent with the guidance in the proposal. Therefore, the other existing models that result in the debt component not being initially measured at fair value would be affected by the proposal. Effectively, the proposal would require all allocations to be performed by first determining the fair value of the liability component (based on a comparable debt instrument without the conversion feature) with the remaining proceeds allocated to the equity component. In addition, unlike the existing models, the proposal would require the subsequent measurement of the liability component at fair value.

11. Would the proposal require the liability component of convertible debt instruments to be measured at fair value with all changes in fair value recognized in net income by the issuer in all cases?

As discussed in Example 10 (paragraphs IG64 and IG65) in the implementation guidance section of the proposed Accounting Standards Update, generally, a convertible debt instrument from an issuer's perspective would not meet the criterion in paragraph 21(a)(1) of the proposed Accounting Standards Update for qualifying changes in fair value to be recognized in other comprehensive income because there is no required return of principal to the holder of the instrument. Instead, there is the potential, at the holder's option, to issue equity shares upon conversion to satisfy the obligation.

However, a convertible debt instrument for which, upon conversion, the issuer must satisfy the accreted value of the obligation in cash and may satisfy the conversion spread in either cash or stock (commonly referred to as “Instrument C”) may meet the criteria to recognize qualifying changes in fair value in other comprehensive income in the issuer’s financial statements. A convertible debt instrument with these characteristics would meet the criterion in paragraph 21(a)(1) of the proposed Accounting Standards Update because the issuer is required to return the principal amount in cash to the holder at maturity. Therefore, from an issuer’s perspective, such an instrument could qualify for certain changes in fair value to be recognized in other comprehensive income as long as it meets the other required criteria for that classification (such as the business strategy criterion).

Presentation

12. How will the proposal affect net income?

The proposal does not change the *components* of total net income as it is reported today. Interest accruals, dividend accruals, credit losses, and realized gains/losses on sales or settlements would continue to be recognized in net income for all financial instruments. For financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income, interest accruals and credit losses (for financial assets) are required to be separately presented in net income with the remaining portion of the fair value change presented in other comprehensive income on the face of the statement of comprehensive income. In addition, realized gains and losses on sales and settlements would be required to be separately presented on the face of the statement of comprehensive income as a component of net income for those financial instruments.

However, it is important to note that the proposal would affect the determination of the amounts included in specific presentation line items (for example, interest income and credit impairment to be recognized).

13. Will fair value measurement eliminate amortized cost information?

No. For those financial instruments for which an entity’s business strategy is to hold the instruments for collection or payment of cash flows and meet the criteria to be measured at fair value with qualifying changes in fair value recognized in other comprehensive income, amortized cost information would continue to be presented on the statement of financial position. Also, the statement of comprehensive income would present components of net income in a manner that is consistent with the current amortized cost measurement approach for those financial instruments.

In addition, the proposal permits amortized cost measurement of certain financial instruments. Specifically, the proposal provides an amortized cost option for certain financial liabilities for which measurement at fair value would create or exacerbate a measurement attribute mismatch. The proposal also permits amortized cost measurement of certain receivables and payables arising in the normal course of business that are due in customary terms not exceeding one year.

Statement of Financial Position
The proposal would require amortized cost to be presented on the statement of financial position for financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income. Below is an example of the proposed presentation of the statement of financial position for these financial instruments:

Financial Assets	
Cost/Amortized Cost	XXX
Accumulated Credit Losses	(XX)
Fair Value Adjustment	(XX)
Fair Value	XXX

Financial Liabilities	
Amortized Cost	XXX
Fair Value Adjustment	(XX)
Fair Value	XXX

In addition, the proposal would require amortized cost to be presented on the statement of financial position for an entity's own debt measured at fair value with all changes in fair value recognized in net income. The proposal would also require an entity to present separately period-end fair value changes recognized in accumulated other comprehensive income for financial instruments.

Statement of Comprehensive Income
For financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income, an entity would be required to separately present components of net income in a manner that is consistent with the current amortized cost measurement approach. That is, net income would reflect credit losses for financial assets and interest income/expense, but would not reflect other components of fair value changes (which instead would be recognized in other comprehensive income). Realized gains/losses upon sales or settlements of financial instruments also would be reflected in net income.

14. Will shareholders' equity reflect fair value changes? Will the proposal change regulatory capital requirements?

Total shareholders' equity would reflect fair value changes for all financial instruments except those permitted to be measured at amortized cost, as discussed in the previous question. However, the proposal would require an entity to present separately fair value changes recognized in accumulated other comprehensive income for financial instruments for which qualifying changes in fair value are recognized in other comprehensive income. This would allow users to evaluate the impact of fair value measurement on equity for those financial instruments.

The Board has kept regulators informed of decisions reached throughout the deliberations process of this proposal. However, the Board has no information about changes to regulatory capital calculations that may arise as a result of this proposal. Regulators have the ability and authority to determine how regulatory capital is calculated.

Credit Impairment and Interest Income

15. Why did the Board eliminate the requirement in current U.S. GAAP that an impairment loss must be probable of occurring in order to recognize the loss? Will the proposal require an entity to recognize a credit impairment if it believes there is a remote chance of the loss occurring?

The Board decided to eliminate the requirement in current U.S. GAAP that an impairment loss must be probable of occurring in order to qualify for recognition because that requirement limits an entity from recognizing impairment losses in certain reporting periods simply because of the inability to demonstrate whether the losses are probable of occurring. The Board expects that the elimination of the threshold would result in more timely recognition of impairment losses.

The proposal does not contain any particular threshold that would trigger recognition of impairment losses. The principle for recognition of impairment losses focuses on management's expectations regarding the collectibility of cash flows that it originally expected to collect, whether upon origination of a loan or upon purchase of a loan or other receivable. The Board decided that eliminating the threshold would enable management to exercise greater judgment in determining when a loan (or other receivable) is impaired and an impairment loss should be recognized.

16. Can past trends, historical experience, or announced events be used to forecast future events or economic conditions to be included in calculation of a loss rate?

The proposal would not permit an entity to forecast future events or macroeconomic conditions, such as future economic downturns, when determining if a financial asset is impaired.

An entity should consider all available information relating to past events and existing conditions in assessing financial assets for impairment. Impairment would be recognized for cash flows (both principal and interest) not expected to be collected. When an event has occurred that triggers the recognition of a credit impairment, an entity also should consider the implications of that event on the collectibility of cash flows over the remaining expected or contractual life of the financial instrument.

Historical information is important for developing loss rates applicable to the current economic environment. Specifically, assuming that the pool consists of financial assets with similar characteristics (including risk profile) and that sufficiently reliable loss data is available, historical loss experience from past economic environments allows an entity to determine the magnitude of losses that it may experience in the current economic environment. However, the proposal does not provide a specific methodology for determining historical loss rates. An entity must apply judgment to determine the historical information that is most relevant for developing a historical loss rate that best represents the portfolio of loans in question in the current economic environment.

17. Will expected lifetime credit losses be immediately recognized for financial assets?

For both originated and purchased loans (as well as purchased debt securities), the assessment and measurement of impairment that occurs at the end of the first reporting period after origination or purchase would result in reflecting a lifetime credit impairment loss. The credit impairment loss would be recognized at the end of the reporting period. The loss recognized represents all cash flows associated with the financial asset or pool of financial assets that the entity does not expect to collect over the remaining estimated or contractual life of the assets. For financial assets that an entity evaluates on a pool basis, the entity would apply a loss rate that would capture cash flows (principal and interest) not expected to be collected over the estimated or contractual life of the pool of financial assets based on its expectation of cash flows expected to be collected. For financial assets evaluated for impairment on an individual basis, credit impairment would be measured based on the present value of cash flows not expected to be collected if the financial asset is determined to be impaired. If the financial asset evaluated for impairment on an individual basis is determined to be performing, the entity must consider a pool of similar financial assets to determine an appropriate historical loss rate to be applied. The assessment of credit losses will change as current economic events and conditions change and as management's expectations about cash flows expected to be collected changes. Therefore, for both loans evaluated on a pool basis and on an individual basis, the allowance for credit losses would likely require adjustment at the end of each reporting period.

18. **For a loan evaluated on an individual basis that an entity determines is not individually impaired and the application of paragraph 65 of the proposed Accounting Standards Update would require consideration of a pool of loans in determining a loss rate to be applied to that loan, should the loan be evaluated as part of that pool in subsequent periods rather than on an individual basis?**

    If an entity determines that the loan is performing in accordance with its expectations and is therefore not individually impaired, the entity is then required by paragraph 65 of the proposed Accounting Standards Update to consider a pool of similar loans to determine an appropriate historical loss rate for determining an allowance for credit losses for that pool of loans. The entity would continue to apply this approach until the entity determines based on an individual assessment of the loan that it has become impaired. In that reporting period, the entity would measure credit impairment of that loan using a net present value technique. Once a loan is evaluated for impairment on an individual basis, the loan would continue to be evaluated on an individual basis in subsequent periods.

19. **Will the FASB's proposal result in higher or lower reserves versus the IASB's proposal? Will the FASB's proposed changes to impairment and interest income recognition result in more or less volatility in net income?**

    The IASB's proposal would require an entity to forecast credit losses upon acquisition of a financial asset and allocate a portion of the initially expected credit losses to each reporting period as a reduction in interest income by using an effective interest rate method, which would result in the recognition of the expected losses over the life of the financial asset. The FASB's proposal would require the entire shortfall in cash flows expected to be collected to be recorded in the period in which the shortfall is estimated. Thus, in situations in which credit impairment is recognized early in the life of a financial asset, the FASB's proposal would result in the recognition in net income of a credit impairment for the entire expected shortfall in cash flows expected to be collected. In this situation, the FASB's proposal would result in higher recognized losses earlier in the life of a financial instrument than would be recognized under the IASB's proposal. However, this result could vary based on different facts and circumstances. Neither proposal was designed to increase or decrease volatility in net income but to depict more accurately the timing and amounts of credit impairment losses.

    With respect to interest income recognition, the IASB's proposal recognizes interest at a rate that represents the expected yield of the instrument at the inception or acquisition of the financial asset. The FASB's proposal recognizes credit losses (whether at inception, acquisition, or ongoing) when information indicates that cash flows expected to be collected by an entity may not be collectible. The FASB's proposal would require that the impairment allowance for credit losses be factored into the interest yield at the time that an impairment is recognized, thereby resulting in a potentially different effective yield recognized each period.

Depending on the fact pattern, both proposals could increase volatility in reported net income when compared to the current impairment and interest income recognition models.

20. How will the proposal affect interest income recognition guidance for debt instruments? Will net interest margins reflect a current market rate of interest?

For debt instruments that meet the criteria to recognize qualifying changes in fair value in other comprehensive income, the proposal requires separate recognition of interest income and expense. The proposal preserves the interest method discussed in the guidance on the imputation of interest in Subtopic 835-30 (originally issued as APB Opinion No. 21, *Interest on Receivables and Payables*). Under this method, a debt discount or premium is amortized as interest expense or income over the life of the debt instrument so as to result in a constant rate of interest when applied to the amount outstanding at the beginning of the reporting period. For financial assets that meet the criteria to recognize qualifying changes in fair value in other comprehensive income, the proposal also preserves the adjustment of yield for loan origination fees and costs as defined in Subtopic 320-10. A significant change from current U.S. GAAP is the requirement that would decrease interest income recognized for interest-bearing receivables, loans, and debt investment securities as a result of applying the instrument's effective interest rate to its amortized cost balance less the amount of the allowance for credit losses attributable to those financial instruments.

Net interest margins would not reflect a current market rate of interest. The proposal would require interest income on financial assets measured at fair value with qualifying changes recognized in other comprehensive income to be calculated by applying the effective interest rate associated with the financial instrument to its amortized cost balance, net of the allowance for credit losses.

Additionally, an entity would cease accruing interest income on a financial asset if the entity's expectations about cash flows expected to be collected indicate that the overall yield on the financial asset will be negative. In all other scenarios, an entity would account for decreases in cash flows expected to be collected as a credit impairment and would not cease accruing interest income.

The proposal would eliminate various specialized income recognition models in current U.S. GAAP. Specifically, it would supersede the interest income recognition models in the following areas of the Accounting Standards Codification:

a. The guidance on the retrospective method of interest for certain structured notes in Section 310-10-35 (originally issued as EITF Issue No. 96-12, "Recognition of Interest Income and Balance Sheet Classification of Structured Notes")

b. The guidance on impairment and interest income recognition of loans and debt securities acquired with deteriorated credit quality in Subtopic 310-30 (originally issued as SOP 03-3)

c. The guidance on beneficial interests in securitized financial assets in Subtopic 325-40 (originally issued as Issue 99-20).

Hedge Accounting

21. Are there any qualitative or quantitative guidelines for applying the "reasonably effective" criterion for risk assessment?

The Board decided not to define the term *reasonably effective* for purposes of determining when hedge accounting could or could not be applied. The Board believes that judgment must be used to determine whether a hedging relationship is reasonably effective. That judgment should include a holistic consideration of all the facts and circumstances that led an entity to enter into a hedging relationship. That would include, for example, consideration of whether the objective of applying hedge accounting was to compensate for accounting anomalies or to achieve a fair value measurement option for items not currently eligible for fair value measurement. The Board does not believe that applying a bright line to determine hedge effectiveness as is currently being used accurately reflects an entity's hedging activities or results in the most useful information for investors.

Disclosures

22. Will there be additional disclosures to help investors understand measurement subjectivity and uncertainty in a "fair value" balance sheet?

All fair value disclosures currently required by U.S. GAAP would continue to apply to financial instruments measured at fair value. The proposal also would require an entity to comply with proposed measurement uncertainty disclosures relating to the potential effects on net income for changing unobservable inputs by a reasonably expected amount on fair value measurement for annual reporting periods for all financial instruments measured at fair value and classified as Level 3 in the fair value hierarchy, except investments in unquoted equity instruments. (The guidance for disclosing measurement uncertainty is included in proposed Accounting Standards Update, *Fair Value Measurements and Disclosures (Topic 820): Amendments for Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*.) For interim periods, if the unobservable inputs (Level 3) used to measure fair value have changed significantly from the last reporting period, an entity would be required to provide this disclosure. If the unobservable inputs (Level 3) used to measure fair value have not changed significantly from the last reporting period, an entity would be required to disclose that fact and would not be required to provide this disclosure in that interim period.

In addition, Accounting Standards Update No. 2010-20, *Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses,* requires increased credit risk disclosures for financing receivables and loan losses. The proposal would extend many of the disclosure requirements in that Accounting Standards Update to financial instruments measured at fair value with qualifying changes in fair value recognized in other comprehensive income.

23. The proposed Accounting Standards Update on Topic 820 also would require measurement uncertainty disclosures for unquoted equity instruments. That requirement is inconsistent with this proposal. Will measurement uncertainty disclosures be required for unquoted equity instruments?

The Board is aware of the inconsistency between this proposal and the fair value measurement proposal. The Board plans to resolve this inconsistency during the redeliberations process.