



## Board Meeting Handout

### Accounting for Financial Instruments: Classification and Measurement January 9, 2013

#### PURPOSE OF THIS MEETING

1. The purpose of this meeting is to address the following two issues:
  - a. *Issue 1:* Whether the practicability exception for equity securities without a readily determinable fair value should be extended to investments in other types of ownership interests in an entity that are not equity securities (for example, partnership interests)
  - b. *Issue 2:* Whether a scope exception should be provided for measuring certain *other investments* held by not-for-profit entities.

#### ISSUE 1—PRACTICABILITY EXCEPTION FOR EQUITY SECURITIES WITHOUT A READILY DETERMINABLE FAIR VALUE

2. Under the Board's tentative decisions, equity securities without a readily determinable fair value can be measured at cost minus impairment, if any, plus or minus changes in fair value resulting from observable price changes in orderly transactions for the identical security or a similar security of the same issuer.
3. Other investments in ownership interests in an entity that are not securities but meet the definition of financial instruments (such as partnership interests) would not be subject to the practicability exception.

#### Question 1 for the Board

- 1) Does the Board wish to expand the practicability exception to all investments in ownership interests in an entity?

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## ISSUE 2—OTHER INVESTMENTS HELD BY NOT-FOR-PROFIT ENTITIES

4. Currently, not-for-profit entities are allowed to carry all *other investments* within the scope of Section 958-325-35, Not-for-Profit Entities—Investments—Other—Subsequent Measurement, at fair value or cost/equity method under an explicit portfolio-wide election to use fair value. *Other investments* in the scope of Section 958-325-35 include both financial instruments (such as ownership interests in an entity without readily determinable fair values) and nonfinancial instruments (such as real estate).
5. If Section 958-325-35 is not retained, other investments that qualify for the equity method under Topic 323, Investments—Equity Method and Joint Ventures, would no longer be eligible to be measured at fair value even when managed at fair value as part of a portfolio of investments because of the Board’s tentative decisions to retain the equity method and eliminate the fair value option under Subtopic 825-10, Financial Instruments—Overall.

### Question 2 for the Board

- 2) Does the Board wish to retain the portfolio-wide election for not-for-profit entities to measure equity method investments at fair value or the equity method?



## Board Meeting Handout

### Balance Sheet Offsetting

January 9, 2013

#### Introduction

1. On November 26, 2012, the Board issued proposed Accounting Standards Update, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*. The comment period on the proposed Update closed on December 21, 2012. At the January 9, 2013, Board meeting the staff plans to discuss the feedback received and deliberate the issues raised by the comment letters. The staff will also ask the Board for permission to ballot a final Update to be issued in the first quarter.
2. Twenty-eight comment letters were received and posted to the FASB's website as of January 2, 2013. The table below provides information on the types of comment letter respondents.

Type of Respondent	Number
Preparers	15
Professional Organizations	6
Public Accounting Firms	5
Others	2
<b>Total</b>	<b>28</b>

3. All respondents supported the proposed scope clarification. They noted that the scope clarification included in the proposed Update cures significant operability and auditing concerns that were present with the scope wording included in paragraph 210-20-50-1 of Update 2011-11. In the proposed Update, the Board had asked whether there are other instruments that should be included within the scope that would provide useful information to users of financial statements as it

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relates to reconciling differences as a result of offsetting between financial statements prepared in accordance with U.S. GAAP and those financial statements prepared in accordance with IFRS. Respondents noted that the instruments included in the proposed scope would provide information to the users of financial statements on offsetting in relation to the product areas that they have indicated are of most interest to them, including information that allows users to reconcile financial statements prepared in accordance with U.S. GAAP to those financial statements prepared in accordance with IFRS.

4. The comment letters identified two issues that the staff will summarize for the Board in deliberations, as identified below:
  - (a) Definition of derivative instrument
  - (b) Definition of repurchase agreement.
5. Additionally, the staff would like to confirm the following with the Board:
  - (a) Effective date and transition
  - (b) Issuance timing and permission to ballot.

### **Definition of Derivative Instrument**

6. The scope paragraph of the proposed Update, namely paragraph 210-20-50-1(c), links to the derivative instrument definition in the Master Glossary of the Codification which is defined by linking to paragraphs 815-10-15-83 through 15-139 of the Codification. This definition would include both derivatives accounted for as derivatives in accordance with Topic 815 as well as the scope exceptions included in paragraphs 815-10-15-13 through 815-10-15-82. In addition, this definition would include both embedded and freestanding derivatives.

### ***Scope Exceptions from Topic 815***

7. Certain recognized derivative instruments which are scoped out of the derivative accounting of Topic 815 are included in the linked definition of derivative

instrument included in the proposed Update. For instance, this would include financial guarantees, regular way trades, insurance, etc. Similarly, these instruments were scoped out of the disclosures required by FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities*. The staff notes, however, that the provisions of Section 210-20, Balance Sheet: Offsetting, are applicable to all derivative instruments, regardless of whether they qualify for a scope exception to Topic 815. The staff recommends only including derivatives subject to the accounting of Topic 815 within the scope of the final Update as the staff believes that these were the instruments on which investors were focused. Derivative instruments which are scoped out of Topic 815 would have separate accounting and disclosures requirements which would be relevant based on the specifics of the instrument.

8. In summary, the staff recommends clarifying that the scope of derivatives subject to the disclosures contained in the amendments in Update 2011-11 would be “recognized derivatives instruments (linked) that are contracts accounted for in accordance with Topic 815.”

**Question- Derivative instrument definition**

Does the Board agree with the staff’s recommendation to include only derivative instruments that are accounted for in accordance with Topic 815?

***Embedded vs. Freestanding***

9. As noted above, the definition included in the proposed Update would include both freestanding and embedded derivatives. A hybrid instrument would not meet the definition of derivative instrument contained in paragraphs 815-10-15-83 through 15-139 and, therefore, would not be included in the scope of the Update. Separated embedded derivatives are accounted for at fair value, but, are classified

with the related host contract (for example, debt). In addition, respondents noted that bifurcated embedded derivatives are (in their experience) not presented net, even when executed under an enforceable master netting arrangement. The staff did note that bifurcated embedded derivatives were included in the scope of Statement 161. The staff, however, has a split recommendation.

### **Other Comments**

10. Two other comments were identified which the staff believes are clear in the proposed Update and does not intend to clarify. The first comment relates to one-sided master netting arrangements, where a master netting arrangement exists granting a right of offset to the counterparty other than the reporting entity (and the reporting entity does not have a mirror right of offset). Because the reporting entity does not have a master netting arrangement from their perspective, the staff does not believe that these instruments would be in scope for the reporting entity. Additionally, a respondent noted that some have interpreted the proposed scope to include all activity related to derivatives including receivables and payables which arise from settlement, and are not accounted for as a derivative. Again, the staff does not believe that these receivables and payables are in scope as they would not meet the definition of a derivative instrument as defined in the Master Glossary of the Codification.
11. Other comments noted included updating examples and other implementation guidance related to “similar agreements.” The staff believes professional judgment must be applied when applying the disclosures requirements. Furthermore, the staff noted that the examples are intended to be for informational purposes only and are not required templates.

<b>Question- Derivative instrument definition</b>
Does the Board want to include both freestanding and bifurcated embedded within the scope of the disclosures?

## Effective Date and Transition

12. The Board included a proposed effective date and transition, identical to Update 2011-11 in the proposed Update. This would require that:
  - (a) An entity apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity would provide the disclosures required by those amendments retrospectively for all comparative periods presented.
13. Respondents noted that the proposed clarification will significantly reduce costs and time associated with applying the requirements of Update 2011-11.

### Question- Effective Date and Transition

Does the Board agree with the staff's recommendation to retain the effective date and transition from Update 2011-11?

### Questions- Ballot & Comment Period

Does the Board direct the staff to draft a final Update for ballot?