

# **Ernst & Young's On Call Advisory Services**

## **Accounting Alert**

Tuesday, December 26, 2006

### **FASB Board Meeting Summary December 20, 2006**

#### ***Fair Value Option Phase 1***



At the December 20, FASB meeting, the Board discussed certain disclosures in Phase 1 of the Fair Value Option (FVO) project and scope exception for convertible debts. The Board agreed that the scope exception should not be provided to conventional convertible debt. The scope exception would still be provided for convertible debt with beneficial conversion features. The next Board meeting on FVO will be January 3, 2007.

#### Background – Scope Exception:

At its October 18, 2006 meeting, the Board unanimously agreed to add a scope exception that would apply to contracts issued or held by the reporting entity that contain an embedded derivative that both (a) is indexed to its own stock and (b) would, on a standalone basis, be classified in shareholder's equity in its statement of financial position.

The scope exception is inconsistent with Statement 155, under which an election to use fair value is available for most of the conventional convertible debt issued today (which instruments are structured to maximize their tax benefits for the issuer by including an embedded derivative that warrants bifurcation).

The staff recommended that the scope exception in paragraph 4(d) of the Cold Review Draft be deleted.

The issuer's accounting for convertible debt with beneficial conversion features under current GAAP (i.e., EITF 98-5) results in separate accounting in additional paid-in capital for the intrinsic value of the embedded beneficial conversion features. A critical issue is whether the issuer should be permitted to elect the FVO for either (a) the entire convertible debt with beneficial conversion features (with no separate accounting in additional paid-in capital) or (b) the remaining liability (which would represent the convertible debt with an at-the-money conversion option).

# Ernst & Young's On Call Advisory Services

## Accounting Alert

Tuesday, December 26, 2006

The staff recommended that a scope exception be added to the FVO for Phase 1 to prohibit the issuer of convertible debt with beneficial conversion features from electing the FVO for that contract. The staff opposed giving reporting entities the free choice whether to disregard the requirement in EITF 98-5 that the intrinsic value for an in-the-money conversion option in convertible debt should be reported in additional paid-in capital. Although the staff believed that the issuer's accounting for the issuance of convertible debt with an in-the-money conversion option would best be addressed in a separate project, the Board could decide in the discussions for Phase 2 of the FVO project whether the issuer's accounting should be addressed in that phase or in another project.

### Conclusion Reached Related to FVO Disclosures Requirements:

#### *Unamortized Balances and Allowances Written Off upon Initial Adoption*

The Board agreed with the staff's recommendation to add a requirement to disclose, by individual line item in the statement of financial position, the amounts of unamortized deferred costs, fees, premiums, and discounts as well as any allowance for loan losses that have been removed from the statement of financial position and included in the cumulative-effect adjustment in conjunction with the initial adoption of the FVO.

#### *Gross Unrealized Gains and Losses Presented Separately*

The Board did not approve the staff's recommendation to disclose separately unrealized gross gains and gross losses by line item in the statement of financial position. The Board agreed that net gains and losses by line item is appropriate disclosure.

#### *Reasons for Electing or Partially Electing the FVO at Transition*

The Board agreed with the staff's recommendation to add disclosure requirement for the date of adoption.

#### *Fair Value Methods and Significant Assumptions*

The Board disagreed with the staff's recommendation that no modification to its previous decision to require an entity to disclose its methods and significant assumptions used to estimate the fair value of assets or liabilities for which the FVO has been elected if the fair value measurement of that asset or liability represents a Level 3 measurement within the fair value hierarchy.

# **Ernst & Young's On Call Advisory Services**

## **Accounting Alert**

Tuesday, December 26, 2006

The Board did not think that it is appropriate to treat FVO election that happens to be Level 3 differently from other Level 3 required fair value amount, therefore the disclosure requirements should follow Statement 157.

### *Drivers of Changes in Fair Values*

The Board agreed with the staff's recommendation that no modification to provide additional information about drivers of changes in fair values for items for which the FVO has been elected.

### *Debt Issuances*

The Board approved the staff's recommendation not to require an entity to disclose the proceeds received and the date of issuance if the entity has issued debt securities or other notes payable during the period. This information is already disclosed in the cash flow statement and footnote disclosure.

### *Application of the FVO Disclosure Requirements to Statement 115*

The staff recommended that investments in securities that are classified as trading under Statement 115 be excluded from the scope of the FVO disclosure requirements.

The Board did not approve the staff's recommendation at the meeting and asked the staff to look at disclosure requirements already in Statement 115 and Statement 157 to evaluate what incremental disclosures are needed.

### *Changes in Instrument-Specific Credit Risk*

The Board did not approve the staff's recommendation to include a statement in the Basis for Conclusions that clarifies instrument-specific credit risk should exclude the risk of changes in the credit spread over the risk-free or benchmark rate.

### *Difference between Fair Value Carrying Amounts and Aggregate Principal Amounts for Assets and Liabilities*

The Board agreed to specify the disclosure requirements for the difference between fair value carrying amounts and principal amounts with respect to financial assets and financial liabilities for which the FVO has been elected and that such disclosure be presented by line item in the statement of financial position.

# Ernst & Young's On Call Advisory Services Accounting Alert

Tuesday, December 26, 2006

If you have any questions please call your On-Call team or

*Lisa Filomia-Aktas*  
*On-Call Practice Leader*  
*tel: (212) 773-2833*  
*e: [lisa.filomia@ey.com](mailto:lisa.filomia@ey.com)*

## ***On-Call Advisory Services Group:***

*Kobi Assaraf (212) 773-7064, Michael Brosnan (212) 773-1797, Betty Davis, (202) 327-5631, Peter Hornecker (212) 773-0227, Karla Johnsen (212) 773-5510, Tim Kane (212) 773-3648, Hee Lee (212) 773-8605, Jung Lee (212) 773-2196, James Medeiros, (212) 773-1884, Kirk Robinson (212) 773-2713, Deha Rozanes (212) 773-0731, Mandy Sagar (212) 773-6425, Paul Sheahen (212) 773-5578, Erik Swanson (212) 773-0532, David Thrope (212) 773-0930, Jonathan Tkach (212) 773-8756 Ken Wilchfort (212) 773-3414*

## ***On-Call Advisory Services:***

Ernst & Young's On-Call Advisory Services Group assist clients with accounting, tax and regulatory aspects of securitization, derivative, M&A, compensation, leasing and structured transactions. This experienced group is available 24/7 via phone, fax, email, or in person. In addition to our On-Call Advisory, we provide related services such as operational reviews, due diligence, and training sessions.

This alert is correct to the best of our knowledge and belief as at the date of this alert. It is, however, written in general terms and professional advice must always be obtained before any action is taken.