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Foreword

December 2012

We are pleased to announce our fifth annual accounting and financial reporting update for the asset management sector.

The publication is divided into three sections: (1) “Updates to Guidance,” which highlights changes to accounting and reporting standards that asset management entities need to start preparing for now; (2) “On the Horizon,” which discusses standard-setting topics that will affect asset management entities as they plan for the future; and (3) “Other Topics” that may be of interest to entities in the asset management sector.

The following are links to the publications for each of the other financial services sectors:

- Banking & Securities
- Insurance
- Real Estate

In addition, don’t miss our December 11, 2012, Heads Up, which covers highlights from the 2012 AICPA National Conference on Current SEC and PCAOB Developments.

As always, we encourage you to contact your Deloitte team for additional information and assistance.

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Introduction

During 2012, the financial services industry continued its recovery from the financial crisis. However, lingering economic concerns — coupled with extensive regulatory reform and accounting changes now underway — have contributed to the industry’s challenges. Thorough preparations and unwavering focus will remain a necessity as financial services companies respond and adapt to this volatile business climate.

Economic Concerns

Improvement in the U.S. economy has been slow but steady. Although trends in housing, unemployment, and consumer spending have resulted in recent optimism, these gains have been tempered by new sources of significant uncertainty. Domestically, the long-term implications of a resolution to the year-end “fiscal cliff” remain unknown. And abroad, the weakening of the European economy and a slowdown in China’s growth further jeopardize the recovery’s momentum. Thus, notwithstanding the general improvement in the economy, financial services companies must plan for significant changes and the risks associated with them in the foreseeable future.

Regulatory Reform

In response to mandates under the Dodd-Frank Act,¹ regulators have worked on rulemaking for over two years — a testament, in part, to the Act’s magnitude and complexity. Many of the rules have yet to be finalized, and there is continued uncertainty about the impacts of many of the Act’s major provisions, such as the Volcker Rule.² Needless to say, implementation of the Dodd-Frank Act has proven to be a long journey that has only begun, and many financial services companies are still navigating the long-term implications for their business.

Accounting Changes

The FASB³ and IASB continue to make progress on their development of “converged” standards in several major areas of accounting, yet a decision from the SEC on incorporating IFRSSs into the U.S. financial reporting system for public companies remains to be made. Most financial services companies will be affected by the significant changes expected as a result of projects on the accounting for revenue recognition, financial instruments, and leases. In addition, some financial services companies will be significantly affected by other projects with a narrower focus, such as insurance contracts, investment companies, and consolidation. Because final standards on many of these projects are expected in 2013 or early in 2014, financial services companies will soon need to shift their adoption efforts into high gear.

For additional information about industry issues and trends, see the publications in 2013 Financial Services Sector Outlooks on Deloitte’s Web site.

¹ The Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Act” or the “Dodd-Frank Act”).
² The Volcker Rule (Section 619 of the Dodd-Frank Act) limits the amount of speculative investments that large financial firms are permitted to have on their balance sheets.
³ For a list of abbreviations used in this publication, see Appendix B.
Updates to Guidance
Financial Instruments Project — Offsetting

Background

In December 2011, the FASB issued ASU 2011-11\(^1\) (subsequently codified in ASC 210-20), which established new disclosure requirements regarding the nature of an entity’s rights of setoff and related arrangements associated with its financial instruments and derivative instruments and their potential effect on an entity’s financial position.

This project began as a joint effort between the FASB and the IASB to eliminate significant differences that existed between the U.S. GAAP and IFRSs offsetting models. Because the boards could not agree on a single, converged offsetting presentation model, they ultimately voted to retain their existing offsetting models. However, given (1) constituents’ desire for convergence and improved comparability and (2) a general agreement that both gross and net information is useful for investors and other financial statement users, the boards jointly agreed to require entities to provide more comprehensive disclosure that investors and other financial statement users can use to compare financial statements prepared under U.S. GAAP and IFRSs. The requirements are effective for all entities for fiscal years beginning on or after January 1, 2013, and interim periods within those annual periods.

Scope

The disclosure requirements in ASU 2011-11 apply to recognized financial instruments and derivative instruments that are either:

- “[O]ffset in accordance with [the existing guidance under] either Section 210-20-45 or Section 815-10-45” (i.e., the general offsetting model or the offsetting models for repurchase and reverse repurchase agreements and derivative arrangements and related cash collateral payables or receivables).
- “[S]ubject to an enforceable master netting arrangement [MNA] or similar agreement, irrespective of whether they are offset in accordance with either Section 210-20-45 or Section 815-10-45.”

Recognized financial instruments and transactions within the scope of this guidance typically would (1) include derivatives, repurchase and reverse repurchase agreements, and securities borrowing or lending agreements but (2) exclude loans and customer deposits held at the same institution (unless they are offset in the statement of financial position) and financial instruments that are subject only to a collateral agreement. However, it is important for an entity to carefully analyze those agreements that affect its financial instruments and derivatives to determine whether such agreements are “similar” to an MNA or are otherwise within scope. An entity cannot assume that the disclosure requirements apply only to derivatives, repos, or financial institutions.

Required Disclosure

ASC 210-20-50-3 and 50-4 (added by ASU 2011-11) require that, at a minimum, an entity must disclose the following information “in a tabular format, separately for assets and liabilities, unless another format is more appropriate”:

- The gross amounts of those recognized assets and . . . liabilities
- The amounts offset in accordance with the guidance in Sections 210-20-45 and 815-10-45 to determine the net amounts presented in the statement of financial position
- The net amounts presented in the statement of financial position [i.e., (a)–(b)]
- The amounts subject to an enforceable master netting arrangement or similar agreement not otherwise included in (b) [along with the] amounts related to financial collateral (including cash collateral)
- The net amount after deducting the amounts in (d) from the amounts in (c).

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\(^1\) For the full titles of standards, topics, and regulations, see Appendix A.
Amounts shown for items (a) through (c) should be grouped by type of instrument; however, amounts shown for items (c) through (e) may be shown by type of instrument or by counterparty. Also, the amounts reported for item (c) must be reconciled to amounts presented in the statement of financial position, and the total amount disclosed for item (d) cannot exceed the amount shown for item (c) for a given financial instrument.

An entity also must describe the rights of setoff associated with its recognized financial instruments subject to an enforceable MNA or similar agreement disclosed in item (d) above, including the nature of those rights. The tabular and qualitative disclosures are minimum requirements — an entity may need to supplement such disclosure with additional qualitative disclosure to fully describe the effect of the rights of setoff and related arrangements on the entity’s financial instruments and derivatives and its financial position.


**Transition**

The disclosure guidance must be applied retrospectively for any period presented that begins before an entity’s date of initial adoption of the requirements.

**IFRS Amendments**

Concurrently with the FASB’s issuance of ASU 2011-11, the IASB amended IFRS 7 to require essentially the same disclosures as those required by the ASU. The effective date for those amendments is also for annual periods beginning on or after January 1, 2013, and interim periods therein, with retrospective application required. In addition, although the IASB retained its offsetting model, it changed certain application guidance in IAS 32 to clarify when (1) an entity currently has a legally enforceable right of setoff and (2) the mechanisms of a gross settlement system may be considered equivalent to net settlement. Those amendments will be effective for annual reporting periods beginning on or after January 1, 2014, with retrospective application required. See Deloitte’s December 2011 IFRS in Focus newsletter for more information.

**Other Considerations**

Financial statement preparers should consider whether they have appropriate systems, processes, and internal controls in place to track, gather, and analyze information about rights of setoff for financial instruments and derivative instruments executed under master netting arrangements or similar agreements. This may prove especially challenging for entities that have previously elected not to offset financial instruments under existing offsetting guidance. Preparers also need to analyze the terms of any agreements relating to their financial instruments and derivatives to determine whether such instruments could be in the scope of the ASU 2011-11 disclosure requirements.

**Investment companies** should not assume that the information they currently disclose will satisfy the requirements of ASU 2011-11. Under the standard, companies must disclose items potentially subject to offset to allow financial statements users to assess a company’s financial position from a gross as well as a net exposure. Complying with the standard’s disclosure requirements may be particularly challenging for investment companies because they generally have numerous financial instruments that would fall within the scope of the standard and they may use multiple data-tracking systems, especially if they have multiple service providers or use various subadvisers. Certain investment companies may hold instruments that qualify for offsetting that they elect to present gross in the statement of financial position. Because they would not have done so already, they may need to expend considerable effort gathering information to comply with the new disclosure requirements, particularly those related to collateral not recognized on the balance sheet and that was not previously tracked as part of the financial reporting function.

**Investment companies** should also evaluate their uniform pricing policies because the standard requires disclosure of amounts related to financial collateral. An investment company’s collateral management system may not have been designed to accommodate its financial reporting pricing policies. As a result, there could potentially be a difference in the fair value assigned to a financial instrument held both as an investment and as collateral. Investment companies need to be prepared to address such scenarios and ensure they use the appropriate values in their disclosures.
Proposed Scope Modification

In November 2012, the FASB issued a proposed ASU that clarifies which instruments and transactions are subject to the disclosure requirements under ASU 2011-11 for financial assets and financial liabilities that are offset in the statement of financial position or subject to master netting arrangements or similar agreements. The proposal is intended to address issues about the scope of the disclosure requirements under ASU 2011-11 that were raised by preparers.

In planning to implement the ASU 2011-11 requirements, some preparers became concerned that the scope of the standard was broader than they had originally assumed. In particular, they noted that many of their trade receivable and trade payable agreements contained standard commercial provisions allowing either party to offset in the event of default. They believed that such provisions were similar to an enforceable master netting arrangement and that those receivables and payables would therefore be subject to new disclosure requirements. These preparers asked the FASB to reconsider whether the benefits of including such instruments in the offsetting disclosures justified the costs that preparers would incur to perform a comprehensive review of all of their agreements to determine whether the agreements contained netting provisions similar to a master netting arrangement.

Key Proposed Changes

To respond to these concerns, the FASB proposes to limit the scope of the offsetting disclosures to the following instruments or transactions:

- “Recognized derivative instruments, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are offset in accordance with either [ASC] 210-20-45 or [ASC] 815-10-45.”

- “Recognized derivative instruments, repurchase agreements and reverse repurchase agreements, and securities borrowing and securities lending transactions that are subject to an enforceable master netting arrangement or similar agreement, irrespective of whether they are offset in accordance with either [ASC] 210-20-45 or [ASC] 815-10-45.”

Under the proposal, an entity is also permitted to include in the tabular offsetting disclosures all other recognized derivatives, repurchase and reverse repurchase agreements, and securities borrowing and lending transactions to facilitate reconciliation to line items in the statement of financial position. The proposal would not change the format or content of the offsetting disclosures.

The proposed requirements would be effective for fiscal years beginning on or after January 1, 2013, and interim periods therein. Retrospective application would be required for any period presented that begins before the entity’s initial application of the new requirements. Comments on the proposal are due by December 21, 2012. See Deloitte’s November 29, 2012, Heads Up for further discussion of the proposed scope modification.

Impact on Convergence With IFRSs

At a November 2012 IASB meeting, the IASB staff updated the IASB on the FASB’s decisions regarding the scope of the offsetting disclosures and indicated that it did not recommend that the IASB consider changing the scope of the disclosures under IFRSs. The session was informational, and the IASB was not asked to make any decisions. It is uncertain whether the IASB will revisit this issue in the future. Accordingly, if the FASB’s proposal is finalized, and the IASB does not revisit the scope of the offsetting disclosure requirements in IFRS 7, fewer financial instruments would be subject to the offsetting disclosure requirements under U.S. GAAP than under IFRSs.
Private-Company Standard-Setting Activity

Background

In recent years, the FAF, the parent organization of the FASB, and the FASB issued several reports, studies, and formal recommendations to address the concerns of preparers and users of private-company financial statements. The most notable of these publications is the January 2011 report issued by the Blue-Ribbon Panel (BRP) on Standard Setting for Private Companies. Two significant recommendations in the BRP report are (1) the development of a decision-making framework to identify instances in which exceptions or modifications to U.S. GAAP would be warranted for private companies and (2) the creation, by the FAF, of a separate private-company accounting standards board that would complement this framework. For more information about the BRP report, see Deloitte’s January 31, 2011, Heads Up.

In July 2011, the FASB conducted a comprehensive assessment of (1) the different needs of private-company and public-company financial statement users and (2) the cost-benefit implications for private-company versus public-company reporting. In October 2011, the FAF issued a proposal to create a council that would work toward improving the standard-setting process for private companies. For more information see Deloitte’s October 10, 2011, Heads Up. The result of these efforts was the establishment of the Private Company Council (PCC) in May 2012 (see the FAF’s report) and a proposal by the FASB detailing the decision-making framework. For more information, see Deloitte’s June 5, 2012, Heads Up.

Private Company Council

Overview of the Council

As referenced above, in May 2012, the FAF approved the formation of the PCC, which is tasked with improving the accounting standard-setting process for private companies. The two main responsibilities of the PCC are to (1) determine whether exceptions or modifications to existing nongovernmental U.S. GAAP would benefit end users of private-company financial statements and (2) advise the FASB on how private companies should treat items on the Board’s technical agenda.

PCC Membership and Term Limits

The PCC consists of 10 members and is chaired by Billy Atkinson, former chair of the National Association of State Boards of Accountancy. The other nine council members have significant private-company experience and represent various groups, including users, preparers, and practitioners. Each council member will initially serve a three-year term but can be reappointed for an additional two years.

FASB Liaison and FASB Staff Support

To help support the council and as mandated by the FAF, the FASB assigned member Daryl Buck to work as a PCC liaison. Individuals from the Board’s technical and administrative staff will be assigned to work directly with the new council. When necessary, the FASB will supplement the PCC staff and offer its expertise on particular issues.

Process for Voting for Exceptions/Modifications and FASB Endorsement

The PCC and the FASB will work together to identify suitable criteria through the creation of a private-company decision-making framework that will assist in determining whether and, if so, when exceptions or modifications to U.S. GAAP are warranted for private companies. On the basis of these criteria, the PCC will determine aspects of existing U.S. GAAP for which exceptions or modifications may be necessary. This decision will be made by a two-thirds majority vote after the PCC consults with FASB members and analyzes input from other affected stakeholders.

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2 Separate from the FAF establishment of the PCC, the AICPA issued an ED on November 1, 2012, Proposed Financial Reporting Framework for Small- and Medium-Sized Entities, and is seeking public comment on its proposal for a special purpose framework intended for use by SMEs that are not required to prepare financial statements in accordance with U.S. GAAP. Comments are due by January 30, 2013. See Deloitte’s November 27, 2012, Heads Up for more information.
Any proposed exceptions or modifications are subject to FASB endorsement (a simple majority vote of FASB members), after which they will be exposed for public comment. After the comment period, the PCC will redeliberate the proposed exceptions or modifications and submit them to the FASB for final endorsement, which will generally be within 60 days. If endorsed, the modification or exception will be incorporated into existing U.S. GAAP. When the FASB does not endorse the proposed exception or modification, the FASB chairman must submit a written explanation to the PCC detailing possible revisions that could result in a FASB endorsement.

Next Steps

The PCC held its inaugural meeting on December 6, 2012, at which time it discussed (1) the transition of responsibilities from the Private Company Financial Reporting Committee, (2) the feedback received on the private-company decision-making framework request for comment, and (3) the status of the FASB’s project on the definition of a nonpublic entity, and (4) the FASB’s project on going concern. Further, the PCC discussed four accounting areas\(^3\) for which constituents expressed concerns, instructing the FASB staff to develop a research memorandum to evaluate these areas. The PCC will continue working with the FASB to improve standard setting for private companies going forward.


About the Private-Company Decision-Making Framework

In July 2012, the FASB released a DP requesting comments on a proposed framework that the FASB and the PCC would use to determine whether modifications or exceptions to existing and proposed U.S. GAAP are warranted for private companies. The draft framework addresses five areas in which exceptions or modifications might be considered: (1) recognition and measurement, (2) disclosure, (3) presentation, (4) effective date, and (5) transition guidance.

Within each area covered by the framework, there is a proposed decision tree that considers various factors when determining whether exceptions or modifications would be warranted for private companies. The more significant factors include (1) relevance of the guidance when considering the needs of the financial statement users, (2) costs of implementing the guidance compared with the benefits achieved by the financial statement users, (3) experience level and resource constraints of the preparers, and (4) knowledge that users have about the reporting entity and their ability to obtain information from management on an as-needed basis. The DP also recommends that the FASB and the PCC require private companies to provide the same industry-specific disclosures that is required for public companies since the industry-specific disclosures are generally relevant to financial statement users of both public and private companies operating in those industries.

Definition of a “Private Company”

The DP includes an appendix that presents the FASB’s tentative decisions on the definition of private company, which would help identify companies to be considered under the private-company decision-making framework. One of the key tentative decisions is the identification of entities with certain characteristics that would preclude them from being classified as a private companies, including (1) entities filing or furnishing financial statements with a regulatory agency when issuing securities in a public market or issuing securities that trade in a public market, (2) entities that are for-profit conduit bond obligors for conduit debt securities that are traded in a public market, and (3) employee benefit plans.

Another tentative decision discussed in the DP’s appendix is to exclude from the definition of private company entities that (1) are financial institutions, (2) are consolidated subsidiaries of entities that are public companies, or (3) have controlled and consolidated subsidiaries that are public companies.

As of the date of this publication, the FASB has not completed its deliberations on all the topics to be addressed before it can finalize the definition of a private company.

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\(^3\) The four accounting areas that are of most interest of private company constituents include (1) ASC 810 (formerly Interpretation 46(R) and Statement 167), (2) accounting for plain vanilla interest rate swaps, (3) ASC 740, and (4) recognizing and measuring various intangible assets (other than goodwill). See the FAF’s December 6, 2012, news release for more information.
Consolidated subsidiaries of entities that are public companies could potentially not qualify as private companies under the definition. As a result, private funds such as hedge funds and private equity funds may need to meet the disclosure requirements of public companies when they are consolidated by a public company such as an investment adviser. This development is further complicated by the consolidation and deconsolidation of these types of funds at various reporting periods and by associated constraints on already limited resources in private fund entities.

Next Steps

The comment period on the DP ended on October 31, 2012. The FASB and the PCC will continue to deliberate and consider the feedback received on the DP, with the most recent discussions held at the December 6, 2012, PCC meeting. The final private-company decision-making framework is expected to be issued in early 2013.

Achieving Common Fair Value Measurement and Disclosure Requirements Under U.S. GAAP and IFRSs (ASU 2011-04)

Overview

In May 2011, the FASB issued ASU 2011-04 to conform (1) the definition of fair value and (2) common requirements for measurement and disclosure of fair value under U.S. GAAP and IFRSs. The ASU also clarifies the Board’s intent regarding certain underlying fair value measurement principles, including (1) the definition of a principal market, (2) the use of premiums and discounts, and (3) the applicability of the highest-and-best-use and valuation-premise concepts to financial instruments.

While the ASU largely retains the fair value measurement principles under ASC 820, it significantly expands current disclosure requirements for fair value measurement, particularly those classified in Level 3 of the fair value hierarchy. The ASU affects all entities measuring or disclosing assets, liabilities, or equity instruments measured at fair value.

Effective Date and Transition

The ASU’s measurement and disclosure requirements were effective for public entities for reporting periods (including interim periods) beginning after December 15, 2011, and for nonpublic entities for annual periods beginning after December 15, 2011.

The amendments in the ASU should be applied prospectively (i.e., no cumulative adjustment to opening retained earnings). Entities should disclose the change, if any, in valuation techniques and related inputs resulting from application of the amendments and should quantify and disclose the total effect of the change, if practicable.

Implementation Considerations

Defining of a Public Entity

When implementing ASU 2011-04, it will be important for entities to understand the definition of a public entity as described in ASC 820, as certain disclosure requirements differ for public entities and nonpublic entities. ASC 820 defines a nonpublic entity as:

Any entity that does not meet any of the following conditions:

a. Its debt or equity securities trade in a public market either on a stock exchange (domestic or foreign) or in an over-the-counter market, including securities quoted only locally or regionally.

b. It is a conduit bond obligor for conduit debt securities that are traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local or regional markets).
c. It files with a regulatory agency in preparation for the sale of any class of debt or equity securities in a public market.

d. It is required to file or furnish financial statements with the Securities and Exchange Commission.

e. It is controlled by an entity covered by criteria (a) through (d). [Emphasis added]

The ASC master glossary defines control as the “direct or indirect ability to determine the direction of management and policies through ownership, contract, or otherwise.” This could include nonregistered investments companies that are controlled by a public company (for example, when a public company adviser that is a public entity consolidates a private fund it owns under ASC 810, that private fund’s stand-alone financial statements would be treated as those of a public entity under the current ASC 820 definition of a nonpublic entity).

The FASB staff is working on a separate project to define public and nonpublic entities, which may affect the application of the requirements in the ASU (i.e., ASC 820) for such entities. An ED has been released for comment (comments were due November 9, 2012). Under the ED, certain entities, including a consolidated subsidiary of an entity that is a public company, would not be excluded from the definition of a private company. Readers are encouraged to follow developments regarding this matter on the FASB’s Web site and the Expert Panel meeting minutes.

Financial Services Industry Implementation Analysis

As a result of the new disclosure requirements for fair value measurements, many entities made substantial changes to their financial statement footnotes. To understand how companies interpreted and applied the requirements of ASU 2011-04, the first-quarter Form 10-Q filings of 30 FSI entities from the banking and securities, insurance, real estate, and asset management sectors were examined. Most companies from the sample disclosed that the adoption of the ASU did not materially affect their financial position or results of operations, indicating that the ASU had little effect on measurement practices. However, the ASU’s amendments to the fair value disclosure requirements in U.S. GAAP were more significant. Although some entities applied the new disclosure requirements similarly, there was diversity in practice. See Deloitte’s July 2012 Financial Services Industry Spotlight for the full analysis.

The SEC staff has also frequently requested registrants to provide additional disclosures about valuation methods and assumptions associated with fair value measurements, particularly those that rely on other observable inputs (Level 2) or unobservable data (Level 3). On the basis of the analysis in the July Spotlight, as well as a review of recent SEC comments, it is recommended that companies focus on the following aspects of their fair value disclosure requirements prescribed by ASU 2011-04:

• Quantitative disclosures about significant unobservable inputs (see ASC 820-10-50-2(bbb)), which requires that reporting entities disclose quantitative information about the significant unobservable inputs used in arriving at Level 3 fair value measurements (both recurring and nonrecurring). Previously, entities were required to disclose only qualitative information about valuation technique(s) and inputs used.

• Narrative descriptions of sensitivity to changes in unobservable inputs (see ASC 820-10-50-2(g)), as well as a discussion of the interrelationship between those unobservable inputs. The ASU requires public entities to provide “a narrative description of the sensitivity of [recurring Level 3 fair value measurements] to changes in unobservable inputs if a change in those inputs to a different amount might result in a significantly higher or lower fair value measurement.”

• Valuation processes for Level 3 fair value measurements (see ASC 820-10-50-2(f)), which requires that entities provide a description of the valuation processes they used for both recurring and nonrecurring Level 3 fair value measurements. Valuation process disclosures may be affected by a company’s use of third party valuation specialists.

• Disclosure of the level for each class of assets and liabilities not measured at fair value in the statement of financial position but for which fair value is disclosed.
Thinking Ahead

The ASU has led to a noticeable increase in the amount and type of information that financial services companies have disclosed about fair value measurements. Asset management companies will most likely refine their disclosures to reduce the diversity in practice as well as to bring their disclosures further in line with the letter and intent of the new disclosure requirements.


Technical Corrections and Improvements — Accounting Standards Update (ASU 2012-04)

Background

In October 2012, the FASB issued ASU 2012-04, which makes minor technical corrections and clarifications to the Codification, including a number of “conforming fair value amendments.” When the FASB issued Statement 157 (codified in ASC 820), it conformed the use of the term “fair value” in certain pre-Codification standards but not others. ASU 2012-04 conforms the term’s use throughout the Codification “to fully reflect the fair value measurement and disclosure requirements” of ASC 820.

Changes to Exemption Qualifications

One conforming fair value amendment was to ASC 230-10-15-4, which specifies when an investment company is exempt from preparing a statement of cash flows. The ASU amends the requirements that must be met for an investment company to qualify for the exemption. Specifically, it eliminates the requirements that substantially all of an entity’s investments be carried at “market value” and that the investments be highly liquid. Instead, the ASU requires substantially all of the entity’s investments to be carried at “fair value” and classified as Level 1 or Level 2 measurements under ASC 820. The ASU did not affect the requirements that an entity (1) have little or no debt outstanding during the period relative to average total assets and (2) provide a statement of changes in net assets.

As a result of the ASU’s amendments, investment companies that have not needed to prepare a statement of cash flows in the past could now be required to prepare one. Conversely, investment companies that have been required to prepare a statement of cash flows in the past may now be exempt. Accordingly, investment companies that have not done so need to reassess whether they qualify for the exemption under the amendments, which became effective upon the ASU’s issuance.
On the Horizon
Convergence Update

SEC’s Consideration of IFRSs in the United States

February 2010 Work Plan

In February 2010, after a period of relative inactivity following its 2008 proposed roadmap for the adoption of IFRSs in the United States, the SEC published a work plan for considering the implications of incorporating IFRSs into the U.S. financial reporting system. The SEC confirmed its continued support for a single set of high-quality, globally accepted accounting standards and affirmed that IFRSs are best positioned to be that set of standards for the U.S. markets. The 2010 work plan identified six areas of focus in determining whether, when, and how to incorporate IFRSs into the U.S. financial reporting system. Each area is discussed under 2012 Developments below.

The SEC estimated that by June 2011 it could complete its work plan and determine whether to incorporate IFRSs into the U.S. domestic financial reporting system, coinciding with the anticipated completion date of several convergence projects of the FASB and the IASB, including revenue, leases, and financial instruments (all of which are presently still in progress — see The Road Ahead for the SEC, FASB, and IASB below). For more information about the SEC’s work plan, see Deloitte’s February 26, 2010, Heads Up.

2011 SEC Staff Papers

In May 2011, the SEC issued a staff paper that outlined an approach for U.S. incorporation of IFRSs that combines elements of convergence and endorsement (dubbed “condorsement” by a member of the SEC staff at the 2010 AICPA National Conference on Current SEC and PCAOB Developments). Under this approach, the FASB would endorse and incorporate newly issued IFRSs into U.S. GAAP and follow a convergence approach over a period of transition (possibly five to seven years) for all existing standards. During the transition period, differences between the two sets of standards would be evaluated and any necessary changes would be incorporated into existing U.S. GAAP (thereby retaining the term “U.S. GAAP”) as opposed to a wholesale adoption of IFRSs. Comments received from constituents were varied on the timing and method of transition, although many respondents urged the SEC to reach a decision and put in place a comprehensive transition plan so that adequate preparations could be made. For more information about the staff paper, see Deloitte’s June 1, 2011, Heads Up.

In November 2011, under requirements of its work plan to assess the sufficient development and application of IFRSs, the SEC staff published two papers. The first paper, A Comparison of U.S. GAAP and IFRS, focuses on the significant differences between the two sets of standards and highlights the staff’s concerns related to the convergence process and the ability of the FASB and IASB to reach a consensus on a number of issues. The second paper, Analysis of IFRS in Practice, analyzes a selection of annual IFRS consolidated financial statements of both SEC registrants and nonregistrants and discusses frequent comments by the staff on financial statements prepared by FPIs in accordance with IFRSs. For more information on the two staff papers, see Deloitte’s December 2, 2011, Heads Up.

2012 Developments

In July 2012, the SEC issued its final staff report on the 2010 work plan, summarizing the staff’s findings in relation to each component of the work plan. The report stressed that the SEC has not made “any policy decision as to whether [IFRSs] should be incorporated into the financial reporting system for U.S. issuers, or how any such incorporation, if it were to occur, should be implemented.” Before such a decision can be made, the SEC would need to further analyze and consider “the fundamental question of whether transitioning to IFRS is in the best interests of the U.S. securities market generally and U.S. investors specifically.” In performing its analysis, the staff identified several significant themes:

- Development of IFRSs — The IASB has made significant progress in developing a comprehensive high-quality set of accounting standards; however, many areas including industry specific guidance remain undeveloped, and although U.S. GAAP also contains areas which require improvement “the perception among U.S. constituents is that the ‘gap’ in IFRS is greater.”
• **Interpretive Process** — The IFRS Interpretations Committee, whose role is to consider widespread accounting issues and develop interpretive guidance on those issues (much like the EITF in the United States), should do more to address application issues on a timely basis.

• **IASB’s Use of National Standard Setters** — The IASB should rely more on assistance from national standard setters for their areas of expertise, outreach activities, identifying diversity in practice, and assisting with post-implementation reviews.

• **Global Application and Enforcement** — Differences in the application of IFRSs globally may potentially lead to diversity in practice and a lack of comparability. Regulators in various jurisdictions need to work cooperatively to foster consistent application and enforcement of IFRSs.

• **Governance of the IASB** — The governance structure of the IFRS Foundation (the body that oversees the IASB) appears to be in good standing; however, since the IASB generates standards for a global market and does not cater for jurisdictional differences, mechanisms may need to be put in place to protect U.S. interests and capital markets (e.g., by having the FASB endorse IFRSs in the United States).

• **Status of Funding** — The IFRS Foundation has no ability to require or compel funding for its operations, which is of particular concern to the SEC. Consequently, the IFRS Foundation is currently funded by a small percentage of constituents and has no independent funding mechanism, potentially creating the perception of an influence on its ability to remain neutral.

• **Investor Understanding** — Investors do not have a “uniform” education on accounting issues. Regardless of whether IFRSs are adopted in the United States, the staff plans to further explore how investor engagement and education can be improved.

The SEC has not made a definitive decision about IFRS adoption for U.S. registrants. However, it has continued to express support for a single set of high-quality global accounting standards. Further, the SEC has noted that if an IFRS is significant to U.S. businesses and the investor community, the FASB could incorporate it into U.S. GAAP, and has acknowledged that there are areas of U.S. GAAP that are not addressed by IFRSs — notably, ASC 946, regarding financial services investment companies.

The table below outlines the specific areas of the work plan as well as the SEC staff’s efforts and observations outlined in the final report. For more information about the SEC’s final report, see Deloitte’s July 19, 2012, *Heads Up*.

<table>
<thead>
<tr>
<th>Work Plan Step</th>
<th>Observations</th>
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| Sufficient development and application of IFRSs for the U.S. domestic reporting system | • IFRSs are generally not comprehensive with respect to certain industries or types of common transactions (e.g., utilities, extractive industries).  
• There are concerns about certain fundamental differences between U.S. GAAP and IFRSs as well as differences that remain between standards that are considered “substantially converged.”  
• Notwithstanding the staff’s acknowledgment of the significant progress toward convergence, it expressed reservations about whether the FASB and IASB can achieve convergence on certain issues. |
| Independence of the global standard-setting process for the benefit of investors | • The overall design of the governance structure of the IFRS Foundation provides a reasonable balance between oversight of the IASB and recognizing and supporting its independence.  
• Concerns remain over the low percentage of constituents that provide funding to the IFRS Foundation, including the significant proportion of those funds that are provided by large accounting firms.  
• The IASB has acted in the public interest; however, it needs to continue to develop methods for engaging constituents and improve its ability to issue timely interpretive guidance. |
| Investor understanding and education of IFRSs | • Investors generally support the objective of a single set of high-quality, globally accepted accounting standards; however, many investors do not believe quality should be sacrificed to achieve this.  
• Investor knowledge varies widely.  
• Regardless of the approach to incorporation of IFRSs into the U.S. financial reporting system, sufficient time should be allowed for a successful transition.  
• Most investors favor a retrospective approach to adoption and oppose an option to early adopt in order to ensure comparability of financial statements. |
Incorporation of IFRSs into U.S. GAAP as opposed to its wholesale adoption may eliminate the need to amend all laws, contracts, and other regulatory requirements that currently reference U.S. GAAP. U.S. regulators support the FASB’s continued substantive role in the standard setting process, particularly since some U.S. regulators believe their views on new projects may be diminished on a global scale. Regulators believe the removal of industry-specific guidance may negatively impact them and potentially provide less meaningful information to stakeholders. The introduction of IFRSs may have significant tax implications and potentially increase the number of book-to-tax differences that exist. Accounting policies currently acceptable under U.S. tax laws may no longer be permitted (e.g., IFRSs preclude the use of LIFO for inventory measurement). The SEC’s ultimate decision on IFRSs only covers public entities and questions remain on how this will impact privately held entities, many of which currently report under U.S. GAAP.

Issuers generally support the ultimate objective of a global set of accounting standards, with larger issuers more supportive than smaller issuers that have fewer resources to handle a major transition. The impact to accounting systems, controls, and procedures may be significant in certain cases but is largely dictated by the pervasiveness of differences identified and each entity’s own circumstances. Concerns have been raised over the ability of financial reporting systems to absorb such a change coupled with all the existing convergence projects currently in progress. Issuers generally prefer a managed transition over time as opposed to full adoption at one point in time (“big bang” approach).

The level of IFRS education and training varies widely and the need to improve these levels will depend on the method of transition (i.e., big bang vs. transition over time). The capacity of audit firms to transition to IFRSs depends on the level to which IFRSs have been incorporated into their existing practices; however, there is concern that smaller audit firms may have challenges in adequately equipping themselves given their existing resources.

**The Road Ahead for the SEC, FASB, and IASB**

Following the release of the final staff report, no further statements or actions have been undertaken by the SEC and it has not provided a timetable for an eventual decision. Irrespective of the SEC’s potential decisions on whether, when, and how IFRSs might be incorporated into the U.S. financial reporting system, the FASB and IASB have continued their work on the convergence of U.S. GAAP and IFRSs in “high-priority” accounting areas, including revenue recognition, leases, insurance contracts, and financial instruments. The current timetable for key joint projects is presented in the table below:

<table>
<thead>
<tr>
<th>Topic</th>
<th>2012 Q4</th>
<th>2013 H1</th>
<th>MoU</th>
<th>Joint</th>
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</thead>
<tbody>
<tr>
<td>Financial instruments</td>
<td></td>
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<tr>
<td>Classification and measurement</td>
<td>ED (IASB)</td>
<td>ED (FASB)</td>
<td>X</td>
<td>X</td>
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<tr>
<td>Impairment</td>
<td>ED (FASB)</td>
<td>ED (IASB)</td>
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<td>X</td>
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<tr>
<td>Hedge accounting*</td>
<td>Final (IASB)</td>
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<td>X</td>
</tr>
<tr>
<td>Accounting for macro hedging*</td>
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<td></td>
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<td>X</td>
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<tr>
<td>Leases</td>
<td>ED</td>
<td></td>
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<td>X</td>
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<tr>
<td>Revenue recognition</td>
<td>Final</td>
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<td>X</td>
</tr>
<tr>
<td>Insurance contracts</td>
<td>ED</td>
<td></td>
<td>X</td>
<td>X</td>
</tr>
</tbody>
</table>

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1. See the FASB’s and the IASB’s Web sites for project updates.
2. The estimated timetable for the FASB’s hedging project was unpublished as of the date of this publication.
3. See footnote 2.
Investment Companies

Background

In October 2011, the FASB issued a proposed ASU that would amend the definition of an investment company in ASC 946. The proposed ASU includes six criteria for an entity to qualify as an investment company. A reporting entity that qualifies as an investment company would measure its investments at fair value and provide the current and proposed investment company disclosures. The proposal also requires that in a fund-of-funds structure, an investment company parent would consolidate its controlling interest in another investment company. Finally, the proposal reaffirms the current requirement that a noninvestment company parent would retain the specialized accounting of its investment company subsidiary in its consolidated financial statements. The proposed ASU is the result of a joint project with the IASB to develop converged requirements for an entity to qualify as an investment company. In October 2012, the IASB issued its final guidance on this topic. See Deloitte’s October 21, 2011, Heads Up for more information on the FASB’s proposal.

Comment Letter Feedback Summary

Comments on the FASB’s proposal were due on February 15, 2012. The FASB received 90 comment letters from various respondents, including asset managers, banks, insurance companies, accounting firms, industry associations, and academics. Although many respondents agreed that the proposed criteria to qualify an entity as an investment company were generally appropriate, they expressed concerns that it would be onerous for entities to meet all six criteria. These respondents believed that certain entities that should qualify as investment companies, or that currently apply investment company accounting, could be precluded from qualifying. Further, some respondents suggested that the proposed criteria are too rules-based and recommended a more principles-based model. Respondents also shared their views on each of the proposed qualifying criterion. In addition, a number of REITs expressed concerns about eliminating the REIT scope exception.

Most respondents also did not support the FASB’s proposed requirement that an investment company consolidate its controlling interest in another investment company. They indicated that consolidated information would not be meaningful for financial statement users and would add unnecessary complexity to the financial statements. Instead, these respondents believe that controlling financial interests in other investment companies should be measured at fair value with additional disclosures being required related to the investment. Some respondents suggested that consolidation may be appropriate only in certain situations, such as when controlling interests in other investment companies are specifically formed for tax, legal, or other regulatory purposes (e.g., a blocker fund).

Most respondents agreed with the FASB’s proposed requirement that a noninvestment company parent should retain, in its consolidated financial statements, the specialized accounting applied by its investment company subsidiaries.

For more information about feedback on the proposal, see Deloitte’s April 2012 Asset Management Spotlight.

Redeliberations and Next Steps

The FASB has substantially completed its redeliberations on this project. In response to feedback received from the respondents, the Board has agreed to modify the requirements to qualify an entity as an investment company. Specifically, rather than requiring an entity to meet all six criteria in the proposal, the definition of “investment company” would incorporate only some of these criteria. The FASB has decided that for those entities that are not regulated under the Investment Company Act of 1940 (the “Investment Company Act”) (which would automatically qualify them as investment companies), a reporting entity would need to meet the following revised definition to qualify as an investment company:

1. An investment company is an entity that does both of the following:
   a. Obtains funds from an investor or investors and provides the investor(s) with professional investment management services
   b. Commits to its investor(s) that its business purpose and only substantive activities are investing the funds for returns from capital appreciation, investment income, or both.
2. An investment company and its affiliates do not obtain, or have the objective of obtaining, returns or benefits from their investments that are either of the following:

   a. Other than capital appreciation or investment income

   b. Not available to other noninvestors or are not normally attributable to ownership interests.

The remaining criteria from the proposal would serve as indicators or characteristics typical of an investment company. An entity would need to consider these characteristics in determining whether it meets the revised definition. The FASB decided that an entity would need to consider if it (1) has multiple investments, (2) has multiple and unrelated investors, (3) issues ownership units in the form of equity or partnership interests, and (4) manages its investments on a fair value basis.

Although the concept of an investment company is not new to U.S. GAAP, it is a new concept for IFRS. The IASB’s definition and characteristics of an investment company, included in its final guidance, differ slightly from those agreed to by the FASB.

The FASB has tentatively decided that all REITs should be excluded from the scope of the proposed investment company guidance. The Board has decided to proceed with the investment company project in two phases. During the first phase, the FASB will finalize the revised definition of an investment company. In the second phase, the Board will address issues related to the accounting for real estate investments. The FASB intends to revisit the accounting for REITs as part of the second phase of the project.

The FASB also reversed its decision in the proposed ASU on how an investment company accounts for its controlling financial interests in another investment company. The Board decided against providing any guidance on this topic and will allow current industry practice to continue. The Board also reaffirmed that a noninvestment company parent should retain the specialized accounting of its investment company subsidiary in its consolidated financial statements.

In addition, the FASB amended the disclosure requirements for investment companies to improve transparency about interest in other investment companies, stipulating that investment entities should disclose the following information for each significant interest in an unconsolidated investment company:

   • A description of the investee fund (name and category) and the percentage of the net assets invested in the investee fund.
   • The total assets of the investee fund.
   • The total debt outstanding of the investee fund.
   • The net assets of the investee fund.
   • The expense ratio of the investee fund.
   • The proportionate ownership interest in the investee fund.

This information would only be required for the investment entity’s investees and not for interests in other investment companies held by those investees. Further, reporting entities would disclose the information by including it in the notes to their financial statements or by attaching the investee’s financial statements to theirs.

The FASB decided that the threshold for determining whether to provide these additional disclosures should be based on whether the interest in the other investment company is considered “significant.” The Board acknowledged that views on whether an interest is considered significant may differ depending on whether the investor entity is a regulated or a nonregulated investment company.

The FASB expects to issue final guidance in the first half of 2013. The Board has not yet decided on an effective date or whether early adoption will be permitted.

4 See the FASB’s May 21, 2012, joint board meeting minutes.
Investment Property Entities

Background
In October 2011, the FASB issued a proposed ASU that would require IPEs to measure their investments in real estate properties at fair value, with changes in fair value reflected in net income. The concept of an IPE would be a newly defined type of entity under U.S. GAAP. In order to qualify as an IPE, a reporting entity would have to meet the six criteria outlined in the proposed ASU. See Deloitte’s October 21, 2011, Heads Up for more information on the proposal.

Comment Letter Feedback Summary
Comments on the proposal were due on February 15, 2012, and the Board received 80 comment letters from real estate investors, financial institutions, industry organizations, and others. Most respondents expressed concerns about the proposal’s overall approach and did not believe the proposal should be finalized in its current form. Concerns were raised on the proposed criteria that an entity would have to meet in order to qualify as an IPE. In addition, many respondents noted that creating a new type of entity (i.e., an IPE) under U.S. GAAP, with its own specialized accounting guidance, would be overly complex and unnecessary. Some constituents suggested that instead of creating an IPE concept, the proposed investment company guidance should be clarified to help entities that invest in real estate evaluate whether they qualify as an investment company.

An investment company that invests in a real estate property or properties but does not meet the proposed IPE criteria may still be within the scope of the investment company proposed ASU (also issued in October 2011), in which case it would be required to measure all its investments at fair value, including investments in real estate properties.

Views were also mixed on whether entities that do not qualify as IPEs or investment companies should be required, or given the option, to measure their investment properties at fair value. For more information about comment letter feedback on the proposal, see Deloitte’s April 2012 Real Estate Spotlight.

Redeliberations and Next Steps
Given the concerns expressed by respondents regarding the overall approach in the proposed ASU, the FASB has tentatively decided to discontinue the development of the IPE concept. Rather, the Board may decide to pursue an asset-based approach for measuring investment properties that would be similar to the approach in IAS 40. If the Board pursues such an approach, it would decide whether fair value measurement should be an option or a requirement.

Consolidations Project

Background
In November 2011, the FASB issued a proposed ASU that would provide guidance on assessing whether a decision maker is acting as a principal or an agent when performing a consolidation analysis. The proposal, which would replace the indefinite deferral in ASU 2010-10 for interests in certain entities, would amend the criteria for determining whether an entity is a VIE and, if so, whether a reporting entity is the VIE’s primary beneficiary. The proposal would also revise the definitions of participating and kick-out rights and amend the evaluation of limited partnerships for consolidation. See Deloitte’s November 4, 2011, Heads Up for more information on the proposal.

While the FASB’s consolidation project was initially intended to address interests in entities that qualified for the deferral in ASU 2010-10, the proposed guidance may affect the consolidation conclusions for all entities evaluated under ASC 810-10. Accordingly, all reporting entities will need to reevaluate their assessment of whether (1) an entity is a VIE and (2) the reporting entity is the VIE’s primary beneficiary.
Comment Letter Feedback Summary

Comments on the proposal were due on February 15, 2012, and the Board received 60 comment letters from various respondents — primarily from financial institutions, including asset managers and other entities with investments that currently qualify for the deferral in ASU 2010-10.

While most respondents agreed with the qualitative assessment in the proposed ASU for analyzing whether a decision maker (or a general partner) is a principal or an agent, some were concerned that the proposed qualitative assessment could result in inconsistent and incomparable consolidation conclusions. Respondents also generally agreed with the three factors in the proposal to consider in performing this assessment: (1) rights held by others, (2) fees paid to the decision maker, and (3) the decision maker’s exposure to variability of returns from its other interests. Some respondents did suggest adding more factors to the analysis, including the purpose and design of the entity, the legal or fiduciary responsibilities of the decision maker, the scope of a decision maker’s authority over an entity, and the establishment of a board of directors in accordance with the Investment Company Act. Some respondents also expressed concerns that the proposed ASU’s implementation examples may be considered to create inappropriate “bright lines” for how to weigh each factor in the analysis and the level of economic interest that would result in consolidation.

Many respondents expressed concerns about their expected consolidation conclusion for MMFs under the proposal. As indicated in the proposed ASU, the Board did not intend to require asset managers to consolidate MMFs. However, these respondents indicated that, on the basis of examples in the proposed ASU, it would be difficult to argue that a manager does not have an implicit guarantee to ensure that an MMF operates as designed. This could lead to consolidation of the MMF under the proposed guidance. Some respondents suggested that MMFs be excluded from the scope of the proposal, similar to current U.S. GAAP.

Views were also mixed on how rights held by other parties (participating and kick-out rights) should be considered in the principal-versus-agent analysis. In addition, respondents requested clarification on how interests held by the decision maker’s related parties should be incorporated in the consolidation analysis, particularly in situations in which the related parties are under common control. While most respondents also agreed that a general partner should apply the principal-versus-agent analysis to determine whether it should consolidate a limited partnership or similar entity, some respondents questioned whether the limited partners would be required to consolidate the partnership if the general partner were an agent.

For more information about feedback on the proposal, see Deloitte’s April 2012 Asset Management Spotlight.

Redeliberations and Next Steps

The FASB has started redeliberations related to the consolidations project and expects to issue final guidance in the first half of 2013. To date, the Board has not made any significant decisions related to this project during the redeliberations process.

Financial Instruments Project — Classification and Measurement

In May 2010, the FASB issued a proposed ASU on the accounting for financial instruments, which addresses C&M among other items. Since that time, the FASB has redeliberated and significantly changed its proposed C&M model.

To address constituents’ concerns about the FASB’s original proposals related to C&M and the plan to converge its guidance with the IASB’s, the FASB has redeliberated nearly every aspect of the C&M model in its 2010 proposed ASU. The Board’s tentative decisions to date achieve more limited changes to U.S. GAAP compared with its original proposals.

During 2012, the FASB and the IASB worked to converge key aspects of their respective models, and the FASB redeliberated other components of its model, leaving only the effective date open. A revised exposure draft is expected in the first quarter of 2013.
Recent Tentative Decisions by the FASB

Classification and Measurement of Financial Liabilities

The FASB’s model does not require that financial liabilities pass a cash flows test to qualify for amortized cost. Instead, a financial liability is accounted for at amortized cost unless it is (1) a derivative, (2) a short sale, or (3) a financial liability for which the entity’s business strategy is to subsequently transact at fair value. However, nonrecourse financial liabilities that will be settled using contractually-linked financial assets will be accounted for on the same basis as the related financial assets.

The FASB tentatively decided to retain all specialized investment-company industry guidance in ASC 946, including:

- ASC 946-320-35-1, which requires investment companies to account for investments in debt and equity securities at FV-NI.
- ASC 946-310-45-1, which requires investment companies to separately present and measure certain receivables at net realizable value.

Investment companies would also continue to apply the measurement methods in ASC 946-830 for determining the change in fair value attributable to changes in foreign-currency exchange rates for foreign-currency denominated financial instruments. In addition, investment companies applying the specialized industry guidance in ASC 946 would continue to initially measure instruments at transaction price, despite the FASB’s tentative decision to align initial measurement and subsequent measurement for entities that do not apply specialized industry guidance.

The FASB also made tentative decisions about the specialized industry guidance for depository institutions, mortgage banks, and brokers and dealers.

The Road Ahead

The FASB’s redeliberations on the C&M of financial instruments are nearly complete. The Board is expected to issue an ED in the first quarter of 2013. In November 2012, the IASB proposed limited amendments to IFRS 9 that include reducing key differences between the C&M requirements in IFRS 9 and the FASB’s tentative model. See Deloitte’s December 2012 IFRS in Focus newsletter for more information. The FASB is also expected to issue an ED containing its proposals for the current expected credit loss impairment model toward the end of 2012.

Financial Instruments Project — Liquidity and Interest Rate Risk Disclosures

In June 2012, the FASB issued a proposed ASU that would amend ASC 825 and require all reporting entities to provide new qualitative and quantitative disclosures about liquidity and interest rate risk for interim and annual periods. Under the proposal, the level of disclosure an entity or reporting segment must provide is determined by whether the entity is a “financial institution.” Financial institutions (including reportable segments that meet the definition of a financial institution) must provide significantly more disclosure than nonfinancial institutions.

The proposed ASU attempts to address stakeholder concerns that (1) certain inherent risks of financial instruments and their effect on an entity’s broader risk exposures would not be fully reflected in the measurement model for such instruments and (2) the breadth of such risks could only be communicated through supplemental disclosure. For more information, see Deloitte’s July 3, 2012, Heads Up.

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5 ASC 825-10-50-23A, which would be added by the proposed ASU, defines financial institutions as “entities or reportable segments for which the primary business activity is to do either of the following: (a) Earn, as a primary source of income, the difference between interest income generated by earning assets and interest paid on borrowed funds [or] (b) Provide insurance.”
Disclosures About Liquidity Risk

Under the proposed ASU, a financial institution would provide a tabular liquidity gap maturity analysis that discloses carrying amounts of the various classes of financial assets and financial liabilities, including off-balance-sheet commitments and obligations (e.g., loan commitments, operating lease commitments, and lines of credit). The amounts would be categorized into specified time intervals by the expected maturities⁶ of these instruments, although instruments carried at FV-NI (excluding derivatives) and equity instruments classified as FV-OCI would not need to be allocated.

Reporting entities that are not financial institutions would not have to include a liquidity gap maturity analysis. However, such entities would need to disclose, in tabular format, all undiscounted expected financial cash flow obligations, including off-balance-sheet arrangements, for specified time intervals. The table also should include a column that reconciles amounts shown in the table to the carrying amounts presented in the statement of financial position. Further, entities would be required to disclose (1) any “significant changes related to the timing and amounts of cash flow obligations and available liquid funds in the tabular disclosures from the last reporting period to the current reporting period, including the reasons for the changes and actions taken, if any, during the current period to manage the exposure related to those changes”; and (2) significant assumptions underlying the entity’s estimates of the expected timing of its cash flow obligations if the expected timing differs significantly from the contractual maturities of those obligations.

All reporting entities would also disclose, in a tabular format by asset class, their available liquid funds, which include unencumbered cash and liquid assets (i.e., assets that are of high quality, free from restrictions, and readily convertible to cash) and additional borrowing capability, such as available lines of credit and the amount below the borrowing cap.

Disclosures About Interest Rate Risk

Under the proposed ASU, only financial institutions would be required to provide disclosure about interest rate risk. Those requirements include a repricing gap analysis in a tabular format that would show how the carrying amounts of different classes of their financial assets and financial liabilities reprice over specified time intervals. The tabular disclosure also would include (1) the weighted-average contractual yield of each class for each time interval and a total yield for each class and (2) the total duration of each class of financial assets and financial liabilities. The tabular disclosure should reconcile to the statement of financial position and should be supplemented with a discussion of how instrument durations were estimated.

A financial institution would also provide certain interest rate sensitivity disclosures about the effects on the entity’s net income (for the 12 months after the reporting date) and shareholders’ equity of hypothetical, instantaneous interest rate shifts on the entity’s interest-sensitive financial assets and financial liabilities. The sensitivity analysis would incorporate multiple yield curve shift scenarios (i.e., parallel shifts, and flattening and steepening yield curves) as prescribed by the proposed ASU. Entities would compute changes in net income and shareholders’ equity by using the same measurement attributes (e.g., FV-NI, amortized cost) they used in the statement of financial position. The scenarios would not take into account growth rates, changes in asset mix, or other shifts in business strategy that would otherwise result from these interest rate changes.

An asset manager would most likely not qualify as a financial institution. However, whether certain investment funds meet the definition may not be as clear. For example, if a fund’s strategy was to invest in fixed income instruments while using significant amounts of leverage, it could possibly be considered a financial institution and thus be subject to the additional disclosure requirements.

Supplemental Disclosures

In addition to establishing quantitative disclosure requirements (i.e., tabular disclosures), the proposed ASU emphasizes the importance of discussions that supplement the tabular disclosures. The proposed ASU notes that for each of the broad risk areas (i.e., liquidity risk and interest rate risk), the reporting entity must provide “any additional quantitative and narrative disclosures necessary to provide users of financial statements with an understanding of its exposure” to the various risks included in the proposal’s scope.

⁶ ASC 825-10-50-23E, which would be added by the proposed ASU states, in part, “The term expected maturity relates to the expected settlement of the instrument resulting from contractual terms (for example, call dates, put dates, maturity dates, and prepayment expectations), rather than the entity’s expected timing of the sale or transfer of the instrument.”
Comment Letter Feedback Summary

Almost 200 comment letters were submitted by the September 25, 2012, deadline. Respondents expressed a number of concerns, including whether (1) the disclosures would be meaningful and provide a faithful representation of an entity’s risk exposures, (2) the forward-looking nature of some of the disclosures made them more appropriately suited for MD&A versus audited financial statements, and (3) the proposed disclosures would be redundant and overlap existing SEC disclosure requirements.

Next Steps

The proposed ASU does not include an effective date and specifically asks respondents (1) how much time they thought stakeholders would need to prepare for and implement the proposed amendments and (2) whether the effective date should be delayed for nonpublic entities. The FASB is currently assessing the feedback received during the comment letter process, and has not yet published a timeline for its redeliberations.

Repurchase Agreements

Background

In April 2011, the FASB issued ASU 2011-03, which eliminated from U.S. GAAP the requirement for entities to consider whether a transferor (i.e., seller) has the ability to repurchase financial assets in a repurchase agreement (“repo”). This requirement was one of the criteria under ASC 860 that entities used to determine whether the transferor maintained effective control and thus accounted for the repurchase agreement as a secured borrowing rather than as a sale (and a forward repurchase agreement).

After the amendments in the ASU became effective, the remaining effective-control criteria in ASC 860-10-40-24 are the following:

- “The financial assets to be repurchased or redeemed are the same or substantially the same as those transferred.”
- “The agreement is to repurchase or redeem [the financial assets] before maturity, at a fixed or determinable price.”
- “The agreement is entered into contemporaneously with, or in contemplation of, the transfer.”

During and after the deliberations of the ASU, constituents expressed concerns about the application of the remaining effective-control criteria (in particular, the first and second bullets above). Many constituents view repos as financing transactions even though the accounting literature allows for sale accounting in some cases. They expressed concern that the “substantially the same” and “before maturity” aspects of the first and second bullets above could be interpreted to allow sale accounting in circumstances in which the Board did not intend. Others indicated that more robust disclosures were needed about the (1) nature of the transactions, (2) uses of funds received, and (3) impact of repos on an entity’s credit standing and liquidity. In March 2012, the FASB added a project to its agenda to address these concerns.

Overview of the Latest Changes

The FASB has tentatively decided that a repurchase agreement or similar transaction that has all six of the following characteristics would be accounted for as a secured borrowing:

- “The agreement involves a transfer of existing financial assets at its inception.”
- “The agreement involves both a right and an obligation to repurchase the financial assets.”
- “The initial transfer and forward repurchase agreement involve the same counterparty.”
• “The agreement to repurchase the financial assets is entered into contemporaneously with, or in contemplation of, the initial transfer.”

• “The repurchase price is fixed or readily determinable.”

• “The financial assets specified under the forward repurchase agreement are identical to or substantially the same as the financial assets transferred at inception.”

The FASB also plans to further clarify the term “substantially the same” as used above.

Note that when repurchase agreements and similar transactions do not have one or more of the characteristics above, entities should continue to evaluate the other ASC 860 derecognition conditions (e.g., legal isolation and transferee’s rights to pledge or exchange) in determining whether to account for such transactions as secured borrowings or sales with forward repurchase commitments. The FASB also intends to clarify the application of the legal isolation condition.

The application of the six characteristics above would be limited to the following transactions:

• “[R]epurchase agreements and similar transactions that would be settled through repurchase of financial assets that are the same or substantially the same as those initially transferred.”

• Agreements to transfer a financial asset with a forward contract to repurchase the financial asset when the settlement date of the forward contract coincides with the maturity date of the transferred financial assets, resulting in “an amount of cash equal to the redemption or settlement value of the initially transferred financial assets (or the difference between that value and the fixed repurchase price).”

Other repurchase transactions would only be evaluated on the basis of the other derecognition criteria in ASC 860.

The FASB decided to eliminate the current guidance in ASC 860 for repurchase financing transactions. Instead, repurchase financing transactions would be evaluated by using the six characteristics described above (if they physically settle with delivery of the same or substantially the same asset or cash settled at maturity). The accounting results may differ from the those under the current guidance because ASC 860 indicates that linked repurchase financings are forward contracts that an entity must evaluate under ASC 815 to determine whether they are derivatives.

The Board also decided to require that entities disclose information about (1) the carrying value of the borrowing disaggregated by the type of collateral pledged and (2) the amount of repurchase agreements and similar transactions that did not qualify as a secured borrowing because the transferred assets were not considered substantially the same.

For transition provisions, the FASB decided to require entities to apply the guidance in the ASU in the following manner:

• For repo-to-maturity transactions and repo financings involving repo-to-maturity transactions that are outstanding as of the beginning of the first reporting period in which the guidance is effective, entities should record a cumulative-effect adjustment to beginning retained earnings as of the beginning of that period.

• For all other repo agreements and similar transactions, the ASU should be applied prospectively when those transactions are entered into or modified after the effective date.

• Entities should be required to disclose, as of the beginning of the first reporting period in which the guidance becomes effective, a description of the accounting change and the effect on the balance sheet.

The FASB expects to issue a proposed ASU on repurchase agreements in January 2013 and expose it for public comment, with a comment deadline on or around March 29, 2013. Early adoption of a final ASU will not be permitted.

7 See the FASB’s June 27, 2012, Summary of Board Decisions.
8 See ASC 860-10-40-5.
9 See the FASB’s October 3, 2012, Summary of Board Decisions.
10 See ASC 860-10-40-42 through 40-47.
Revenue Recognition Project

Background

In November 2011, the FASB and the IASB jointly issued a revised ED on revenue recognition, with a 120-day comment period that ended on March 13, 2012. The revised ED outlines a single comprehensive model for accounting for revenue arising from contracts with customers and would supersede substantially all current revenue recognition guidance.

The core principle of the revised ED stipulates that an entity “shall recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.” In applying the revised ED’s provisions to contracts within its scope, an entity would:

- “Identify the contract with a customer.”
- “Identify the separate performance obligations in the contract.”
- “Determine the transaction price.”
- “Allocate the transaction price to the separate performance obligations in the contract.”
- “Recognize revenue when (or as) the entity satisfies a performance obligation.”

See Deloitte’s November 15, 2011, Heads Up for a summary of the key provisions of the revised ED.

The boards received approximately 350 comment letters on the proposal — significantly fewer than the nearly 1,000 they received on the original ED issued in June 2010. Although the feedback from most industries was similar and generally indicated support for the boards’ efforts to develop a single comprehensive revenue recognition standard, respondents expressed concerns about several aspects of the revised ED. Constituents from the asset management industry expressed concerns about accounting for (1) performance-based fees, (2) up-front fees, and (3) third-party fees. See Deloitte’s April 13, 2012, Heads Up for a summary of the responses and general themes of the comment letters.

Comment Letter Feedback Summary

Performance-Based Fees

Comments on the revised ED from a number of asset managers (primarily from entities that manage alternative asset portfolios) were the same concerns they expressed in response to the June 2010 ED — specifically, that the guidance in EITF Topic D-96 (codified in ASC 605-20-S99) would be superseded because of its potential to change the current accounting for performance-based fees. The fee structure for managing separate accounts or other types of investment vehicles offered to customers generally consists of a mix of base management fees and performance-based fees. While the revised revenue ED is not expected to significantly affect the recognition of base management fees, performance-based fees constitute variable consideration under the revised revenue ED and would only qualify for recognition once reasonably assured. Revenue recognition for these fees may therefore need to be deferred.

Up-Front Fees

Asset managers may own a broker that distributes sponsored products for which it receives front-end loaded distribution or up-front fees. The revised revenue ED requires assessment of whether up-front fees qualify as a separate performance obligation. If the up-front fees are determined not to represent a separate performance obligation (i.e., they do not result in the transfer of a promised service), revenue recognition would be deferred and recognized over the service period. This may be a change from current practice.
Third-Party Fees

In some cases, asset managers pay fees to third parties to distribute their products. Entities have asked whether (1) these fees meet the proposed definition of incremental costs incurred in obtaining a contract (which would be deferred as an asset and amortized in a manner consistent with the pattern of transfer of services) or are considered costs for fulfilling the performance obligation under the contract (which would be expensed as incurred) or (2) the fees paid to third parties should be excluded from the scope of the revised revenue ED.

See Deloitte’s April 2012 Asset Management Spotlight for additional information about these issues.

Redeliberations

After significant outreach to constituents, including preparers, users, and others, the boards began redeliberating their revised ED in July 2012. To date, the boards have made a number of important decisions to change the revised ED, including decisions related to the concerns described above.

Next Steps

The boards are expected to complete their deliberations in early 2013 and issue a final standard in the first half of 2013. The revised ED proposes that a final standard would be adopted retrospectively (with certain optional practical expedients) and would not be effective before annual periods beginning on or after January 1, 2015, for public companies, with a minimum of a one-year deferral for nonpublic companies. The final effective date will be set by the boards during redeliberations of the revised ED.

The FASB’s Disclosure Framework

In July 2012, the FASB issued a DP to obtain feedback from stakeholders on its project to develop a framework to make financial statement disclosures “more effective, coordinated, and less redundant.” The DP, which is not a FASB proposal or preliminary views, identifies aspects of the notes to the financial statements that need improvement and explores possible ways to improve them. If implemented, some of the ideas in the DP could significantly change the Board’s process for creating disclosure requirements in future standards and could potentially alter those in existing standards. Comments on the DP were due by November 30, 2012.

In developing the DP, the FASB staff worked with a European team that released a DP of its own concurrently with the FASB’s DP. While the substance of both DPs is similar, there are key differences. See Deloitte’s July 17, 2012, Heads Up for a discussion of these differences.

The Disclosure Framework

The DP is organized into chapters that are discussed below.

Scope and Introduction (Chapter 1)

The DP’s scope is limited to the notes of the financial statements of public and nonpublic entities. When the Board added the disclosure framework project to its agenda in 2009, one of its original objectives was to improve the integration of a company’s public reporting package (e.g., financial statements, MD&A, and other sections). To explore additional ways to accomplish this objective, the FASB plans to work with the SEC and other regulators after completing the project.

1 The European project team consists of the European Financial Reporting Advisory Group (EFRAG), the Autorité des Normes Comptables (French standard setter), and the UK Financial Reporting Council Accounting Committee (UK standard setter).

2 The FASB and the PCC are developing a separate decision-making framework for identifying suitable criteria for determining whether and, if so, when exceptions or modifications to U.S. GAAP are warranted for private companies. Because that framework is in the development stage, it may have an impact on the disclosure framework described in the DP. Also, not-for-profit entities are likely to be covered in a supplemental disclosure framework specific to donor needs.
The Board’s Decision Process (Chapter 2)

In addition to questions for respondents, the DP’s second chapter contains 27 “decision questions” that the Board would potentially use in future standard-setting projects as part of its conceptual framework. The decision questions broadly cover (1) “general information about the reporting entity as a whole,” (2) “information about line items” in the financial statements, and (3) “information about other events and conditions that can affect an entity’s prospects for future cash flows.” The DP also explores an extreme possibility of removing all specific disclosure requirements in the Codification and replacing those requirements with their decision process and a broad disclosure standard that reporting entities would use to determine the relevant footnote disclosures in their financial statements. However, the Board recognizes that given the U.S. legal and regulatory environment, this approach could create challenges including inconsistent application that could affect the comparability of information in the notes to the financial statements.

Making Disclosure Requirements Flexible (Chapter 3)

The Board notes that a main cause of unnecessary volume in the notes to the financial statements is that entities tend to provide each piece of information in a disclosure required by an ASC topic when they have an account balance or transaction related to that topic. The Board identified disclosure selectivity as a possible solution, stating that it “may be the single best way to reduce volume” and increase a user’s ability to find the relevant information needed in the notes to the financial statements. To help achieve disclosure selectivity, the Board identifies various options, which are discussed in the Heads Up referenced above.

As accounting standard setting continues to result in guidance that is more “principles based,” entities must generally increase their use of judgment in applying such guidance. As a result, they may need to add disclosures about their judgments and how the judgments might affect comparability to other entities.

If the FASB decides to remove industry-specific disclosure requirements from the Codification, and particularly from ASC 946, entities may spend more time and resources researching what others in the industry were disclosing. Further, there might still be inconsistencies in application because of different decision-making processes employed throughout the industry.

Reporting Entities’ Decisions About Disclosure Relevance (Chapter 4)

If the Board adopts an approach that offers flexibility in complying with disclosure requirements, reporting entities will need additional guidance to help them determine what information is relevant. Although the DP discusses materiality, it “does not add anything new to existing literature or practice for deciding whether an amount is material.” However, the DP explores an approach under which a disclosure would be relevant “if it would be expected to change users’ assessments of prospects for future cash flows by a material amount.” A reporting entity would consider a list of disclosures for an ASC topic and decide whether to include some, all, or none of the disclosures depending on what it determines to be relevant or material.

The DP uses the term “materiality” as it is described in Concepts Statement 8. The Board acknowledges that the U.S. Supreme Court has interpreted materiality in at least two decisions and that reporting entities must comply with that interpretation. Further, in those decisions, the Supreme Court used the terms “substantial likelihood” and “would” where the Concepts Statement 8 used the term “could.” Accordingly, the Board recognizes that it may need to change its description of materiality. However, the Board believes that reconsideration of the term is beyond the scope of the DP.
Format and Organization (Chapter 5)

The Board has received criticism about the formatting and organization of the notes to the financial statements. The DP suggests that the use of tools such as tables, headings, cross-referencing, and highlighting could potentially enhance a user’s ability to understand the information in the notes to financial statements and the relationship of such information to the financial statements. Other potential alternatives for improving the format and organization of the notes to the financial statements include specifying a standard order for the notes and using a topic-based approach to group related information. Any new requirements related to format or organization would most likely be added to existing guidance on financial statement presentation (rather than becoming part of the disclosure framework).

Disclosures for Interim Financial Statements (Chapter 6)

The issues and potential solutions explored in Chapter 6 of the DP apply only to entities that issue interim financial statements under SEC Form 10-Q.

Other Matters for Discussion, Including Costs and Consequences of Disclosure Requirements (Chapter 7)

The DP notes that the summary of accounting policies potentially contributes to unnecessary volume in the notes to financial statements. This disclosure often includes irrelevant information that users understand or can easily find elsewhere, stays the same from period to period, or addresses immaterial items. Potential solutions highlighted in the DP to reduce this unnecessary volume are outlined in the Heads Up referenced above. Finally, the DP explores the costs and consequences of developing and implementing a disclosure framework.

EITF Issue 12-G “Accounting for the Difference Between the Fair Value of Assets and Liabilities of a Consolidated Collateralized Financing Entity”

Background

Some reporting entities are required to consolidate a CFE, such as CDO and CLO entities. Upon consolidation, such reporting entities must initially measure the CFE’s financial assets and financial liabilities (i.e., beneficial interests) at fair value. In some instances, the aggregate fair value of the CFE’s financial assets exceeds its financial liabilities even though the CFE’s liabilities only have recourse to the assets of the CFE. Some interpret U.S. GAAP as requiring this difference be included in the reporting entity’s earnings despite concerns by financial reporting practitioners that, economically, this excess is attributable to the holders of the CFE’s financial liabilities. Such concerns have led to diversity in entities’ accounting for this difference. In October 2012, the FASB issued a proposed ASU to address this diversity in practice.

Scope

The proposed ASU applies to any entity that consolidates a CFE and is required or has elected to measure the consolidated CFE’s financial assets and financial liabilities at fair value in periods after initial recognition (e.g., if the fair value option in ASC 825 has been elected). The proposed ASU defines a CFE as “[a] variable interest entity that holds debt instruments, issues beneficial interests in those financial assets, and has no equity. All the beneficial interests are financial liabilities that only have recourse to the related financial assets of the collateralized financing entity.”

13 The FASB staff paper states that “[t]he differences between the fair value of the assets and liabilities could result from the following: (a) liquidity discounts that were inherent in the exit price for the CFE’s liabilities and not in the CFE’s assets, (b) differences in the duration of the CFE’s assets and the duration of the CFE’s liabilities, or (c) principal markets for the assets and the liabilities that were not identical.”

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Under the proposed ASU, the fair value measurement of a consolidated CFE’s financial assets and liabilities should be consistent with how market participants would price the reporting entity’s net risk exposure (which might be nil). This approach would be based on the principle in ASC 820 for financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk. Because the measurement is of a net risk exposure, which differs from the unit of account for purposes of presentation (i.e., the financial assets of the CFE separate from the financial liabilities of the CFE), an entity would need to use an appropriate method to allocate fair value amounts to the consolidated financial assets and financial liabilities of the CFE on a reasonable and consistent basis.

The proposed ASU would require that an entity adopt this guidance using a modified retrospective transition approach, with the option to apply it retrospectively to all prior periods. Under the modified retrospective approach, the guidance would only be applied retrospectively to consolidated CFEs that exist as of the adoption date. Early adoption would be permitted. The proposed ASU’s effective date will be determined at a future EITF meeting.

Next Steps

Comments on the proposed ASU were due December 10, 2012. The EITF will consider and discuss the comments and other feedback received on the proposed ASU at its March 2013 meeting.

The Liquidation Basis of Accounting Proposed ASU

Overview

In July 2012, the FASB issued a proposed ASU that would provide guidance on when and how to apply the liquidation basis of accounting. The proposed guidance would be effective for both public and nonpublic entities. Under the proposed ASU, an entity would be required to use the liquidation basis of accounting to present its financial statements when it determines that liquidation is imminent. According to ASC 205-30-25-2 (added by the proposed ASU), liquidation would be considered imminent in either of the following situations:

a. A plan for liquidation has been approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties (for example, those with protective rights).

b. A plan for liquidation is imposed by other forces (for example, involuntary bankruptcy) and the likelihood is remote that the entity will return from liquidation.

Liquidation would also be considered imminent “when significant management decisions about furthering the ongoing operations of the entity have ceased or they are substantially limited to those necessary to carry out a plan for liquidation” that is different from a liquidation plan specified in an entity’s governing documents. The proposed ASU provides indicators for determining whether the liquidation plan changed from what was specified in the governing documents. These indicators include, but are not limited to, the following:

- The expected liquidation date differs from the date specified in the governing documents.
- Assets are disposed of for a value other than fair value or the disposal of the assets is not orderly.
- The entity’s governing documents were amended after their initial creation.

The effects of the proposed ASU on limited life entities could be particularly impactful because limited life funds are able to postpone for a variety of reasons the termination dates in their original governing documents. Under the proposed ASU, such a change in termination date may cause the entity to be considered “in liquidation,” and thus, present its financial statements using the liquidation basis of accounting.
An entity’s financial statements should contain relevant information about the entity’s resources and obligations upon liquidation. When applying the liquidation basis of accounting, the entity would need to initially measure and present the values of its assets and liabilities to reflect the amount the entity expects to receive or to pay in cash or other consideration. The entity would present — separately from the measurement of the assets and liabilities — the expected aggregate liquidation and disposal costs to be incurred during the liquidation process. In addition, the entity would estimate and accrue the expected future costs and income to be incurred or realized during the course of liquidation, such as payroll expense and interest income. These estimates would be remeasured as of each subsequent reporting period.

The current diversity in practice related to the liquidation basis of accounting is further complicated by the sometimes indeterminate period of liquidation when such accruals are made. Concerns have also been raised about estimating income during the course of liquidation because investment income may have already been contemplated when value was assigned to investments.

**Presentation and Disclosures**

At a minimum, the proposed ASU would require entities to present a statement of net assets in liquidation and a statement of changes in net assets in liquidation. An entity would also be required to include expanded disclosures in its financial statements for the reporting period in which the entity determines that liquidation is imminent. ASC 205-30-50-1 (added by the proposed ASU) states that an entity would have to disclose the following:

a. That the financial statements are prepared using the liquidation basis of accounting, including the facts and circumstances surrounding the adoption of the liquidation basis of accounting.

b. A description of the entity’s plan for liquidation, including, at a minimum, a description of the manner by which the entity expects to dispose of its assets and liabilities and the expected duration of the liquidation.

c. The methods and significant assumptions used to measure assets and liabilities, including subsequent changes to those methods and assumptions. Significant methods and assumptions might include, for example, the nature and source of expected future cash flows and discount rates used.

d. The type and amount of costs and income accrued in the statement of changes in net assets in liquidation.

**Effective Date**

The Board will decide on an effective date after further deliberation. The guidance would be adopted as of the beginning of an entity’s first annual reporting period that begins after the effective date and applied prospectively to its interim or annual reporting period after the effective date. Early application would be permitted.

**Next Steps**

The comment period ended October 1, 2012, and the Board will likely begin redeliberations on the proposed ASU in the coming months. In addition, the Board will also revisit its previously tentative decisions regarding the going concern objective of the project.
Other Topics
SEC Comment Letter Trends and Web Site Updates

The SEC continues to focus on enforcing federal legislation and expanding its reviews of company filings. During 2012, the SEC concentrated on the regulatory challenges presented by implementing legislation such as the Dodd-Frank Act and the JOBS Act (see discussion below). For example, in addition to finalizing rules related to the clearing of swaps and derivatives mandated under the Dodd-Frank Act, the SEC proposed a rule to implement the Volcker Rule, which is intended to restrict financial institutions from proprietary trading or trading securities on their own account.

In addition, the SEC staff continued to expand its review of issuers. During each of the last two years, the staff reviewed slightly less than half of all issuers, which is well in excess of the SEC’s mandate to review each issuer at least once every three years. Furthermore, the SEC group responsible for reviewing the largest financial services registrants currently performs continuous reviews of these registrants and has been actively issuing comments to them.

Comments resulting from the SEC staff’s reviews of financial services registrants’ filings have largely centered on MD&A, particularly regarding disclosures of specific material risks such as those associated with operating in foreign countries, state sponsors of terrorism, and early-warning disclosures about potential charges resulting from items such as impairments or contingencies. Other broad comment letter themes have included questions about the qualitative test for goodwill and long-lived asset impairment testing, the determination of reportable segments, and various liquidity-related disclosures. The staff has also asked financial services registrants about their loss contingency disclosures, fair value measurements, valuation of investments (i.e., whether such investments are other-than-temporarily impaired), credit risks, income taxes, revenue recognition, financial instruments, and disclosures about cybersecurity and cyber incidents.

The SEC staff’s comments to asset management registrants have primarily focused on topics such as executive compensation, performance or incentive compensation, fair value disclosures, non-GAAP financial measures, consolidation, and regulatory risk.


SEC Web Site Updates

The SEC’s Division of Investment Management Web site includes an “Issues of Interest” page that highlights issues under the Investment Company Act, Investment Advisers Act, or other federal securities laws that may be of interest to investment companies, advisers, or their counsel. Among the topics are “Funds Using Tender Option Bond (TOB) Financings,” where the staff highlights its position that a TOB financing involves the issuance of a senior security unless securities, other than those deposited into the trust, are segregated and have an at least equal value to the amount of the floaters, plus interest, if any.

No-Action and Interpretive Letters by Topic

The SEC recently added to its Web site a list of compiled no-action letters on securities lending by U.S. open-end and closed-end investment companies. The Web site states the following:

Securities lending by funds implicates a number of provisions of the Investment Company Act of 1940 (the “1940 Act”). For example, the transfer of a fund’s portfolio securities to a borrower implicates section 17(f) of the 1940 Act, which generally requires that a fund’s portfolio securities be held by an eligible custodian. A fund’s obligation to return collateral at the termination of a loan implicates section 18 of the 1940 Act, which governs the extent to which a fund may incur indebtedness. Notwithstanding these (and other) 1940 Act provisions, funds engage in securities lending, in large part in reliance on the following staff no-action letters.
Dodd-Frank Act Updates

Background of the Dodd-Frank Act

The passage of the Dodd-Frank Act in July 2010 brought a number of key reforms to the U.S. financial system. However, many of the statutory changes required the SEC to promulgate rules. Over the last two years, the SEC has acted on a number of provisions in the Dodd-Frank Act by proposing and approving various rules. A summary of recent SEC rulemaking activity that affects the asset management sector is presented below.

Adoption of Clearing Agency Standards

In October 2012, the SEC adopted rules to implement Section 763 of Title VII and Section 805 of Title VIII of the Dodd-Frank Act. Under the final rule, registered clearing agencies that “provide central counterparty services” are required to maintain certain risk management and other standards related to their operations. Specifically, such standards address measurement and management of (1) credit exposures, (2) margin requirements, (3) financial resources, and (4) margin model validation. In addition, the final rule establishes certain recordkeeping and financial disclosure requirements.

SEC Approves Rules and Interpretations on Key Terms for Regulating Derivatives

In July 2012, the SEC and the Commodity Futures Trading Commission (CFTC) jointly adopted final rules under the Commodity Exchange Act (CEA) and the Securities Exchange Act of 1934 (the “Exchange Act”). The final rules implement various provisions of the Dodd-Frank Act and further defines the terms “swap,” “security-based swap,” and “security-based swap agreement.” The final rules also provide interpretations about products that meet these definitions and clarify that certain other products such as security forwards and certain consumer and commercial transactions would not be considered swaps or security-based swaps. In addition, the final rule identifies products that would meet the definitions and include: (1) foreign exchange forwards, (2) foreign exchange swaps, (3) foreign currency options (other than foreign currency options traded on a national securities exchange), (4) non-deliverable forward contracts involving foreign exchange, (5) currency and cross-currency swaps, (6) forward rate agreements, (7) contracts for differences, and (8) certain combinations of or options on swaps and security-based swaps.

CFTC Amendments to Part 4 Regulations

Investment companies should also note that the CFTC issued a final rule amending its part 4 regulations. The amendments increased the need for transparency by commodity pool operators (CPO) and commodity trading advisors (CTA) and revised the definitions of certain derivatives (mainly swaps). The changes include:

- Rescinding the exemption from registration in section 4.13(a)(4).
- Removing relief from the certification requirement for annual reports provided to operators of certain pools offered only to qualified eligible persons under section 4.7.
- Modifying the criteria for claiming relief under section 4.5.
- Requiring the annual filing of notices claiming exemptive relief under several sections of the CFTC’s regulations.
- Adopting amendments that include new risk disclosure requirements for CPOs and CTAs regarding swap transactions.

Because they are regulated by the SEC, registered investment companies have historically been exempt from CFTC oversight and CPO registration. Under the modifications to section 4.5 described above, entities must also meet certain trading and market restrictions to be exempt. An entity that cannot meet these exemptions would be required to register as a CPO with the CFTC and satisfy the part 4 requirements. Entities may still apply for partial exemption under section 4.7, which mitigates certain of the disclosure, reporting, and recordkeeping requirements described below.
The repeal of the exemption in section 4.13(a)(4) (discussed above) will affect private funds since such exemption was commonly used in CPO registration. Further, section 4.13(a)(3) was revised for a caveat under which an exemption is only allowed for CPOs trading a “de minimis” number of commodities. Under the updated regulation, advisers must also meet the trading and market restrictions, which are similar for registered investment companies, and they must believe that participants are accredited or have specific characteristics. Advisers currently claiming exemption under Rule 4.13(a)(4) are not required to register or claim another exemption until the end of the calendar year.

Overall, these modifications may cause more registered investment companies and private funds to register as CPOs because they no longer meet exemption requirements. Entities that are required to register must (1) complete application forms and proficiency exams for certain entity personnel; (2) meet disclosure, reporting and recordkeeping, and filing requirements as described in the final rule; and (3) maintain compliance with NFA rules and bylaws, which includes being subject to examinations.

The CFTC has posted a summary of the changes and a Q&A on its Web site.

In December 2012, the CFTC granted a no-action letter for public and private fund-of-funds managers, which delays compliance of these regulations until the later of June 30, 2013, or six months from the date that the Division of Swap Dealer and Intermediary Oversight issues revised guidance (or the compliance date, if later) on the calculation of the de minimis commodity interest trading tests discussed above in Rules 4.5 and 4.13(a)(3) as long as certain criteria are met. At that later date, a CPO must either be registered with the CFTC or qualify for exemption.

SEC Implements New Procedures for Reviewing Clearing Submissions Implemented

In June 2012, the SEC implemented the requirements of Section 763(a) and Section 806(e) of the Dodd-Frank Act by adopting final rules under the Exchange Act that implement new SEC procedures for reviewing clearing submissions related to security-based swaps. Specifically, the new rules detail the nature and extent of information that clearing agencies would provide to the SEC about security-based swaps that the clearing agencies plan to clear. Such information will assist the SEC in determining whether such security-based swaps require clearance. In addition, the SEC adopted rules that require clearing agencies that meet the designation “systematically important” to submit “notice of changes to their rules, procedures, or operations if the changes could materially affect the nature or level of risk at those clearing agencies.”

SEC Adopts Rule Defining Swaps-Related Terms for Regulating Derivatives

In April 2012, the SEC adopted a final rule that was drafted jointly with the CFTC to implement certain provisions under Title VII of the Dodd-Frank Act, including the requirement to define various over-the-counter swap market terms including: (1) swap dealer, (2) security-based swap dealer, (3) major swap participant, (4) major security-based swap participant, and (5) eligible contract participant. The final rule continues the process under the Dodd-Frank Act to establish a comprehensive framework to regulate derivatives.

Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies

In March 2012, the SEC adopted a final rule that outlines exemptions from mandatory clearing under the Securities Act of 1933 (the “Securities Act”), the Exchange Act, and the Trust Indenture Act of 1939, including security-based swaps that are issued by certain clearing agencies and meet certain conditions. Title VII of the Dodd-Frank Act requires transactions in security-based swaps transactions to undergo a clearing process unless, as outlined in the final rule, “an exception from mandatory clearing applies.”
**SEC Proposes “Volcker Rule” Requirements**

In October 2011, the SEC issued a proposed rule that would implement Section 619 (also known as the “Volcker Rule”) of the Dodd-Frank Act. The proposed rule would prohibit and restrict banking entities1 and nonbank financial companies2 that are supervised by the Federal Reserve (with certain exemptions) from (1) engaging in proprietary trading and (2) having certain interests in, or relationships with, a hedge fund or private equity fund. Affected entities would be required to implement internal programs to monitor and ensure compliance with the prohibitions and restrictions of Section 619. In addition, firms with significant trading operations would be required to report certain quantitative measurements associated with their trading activity to the appropriate federal regulatory agency and banking entities. The purpose of supplying such information is to help these organizations determine which market activities are permissible and which constitute prohibited proprietary trading.

As anticipated, the Volcker Rule has received much attention because of the significant impact it could have on the operations of banks and other financial companies. Although this rule was statutorily required to go into effect in July 2012, over 17,000 comments that resulted in more than 400 constituent questions have delayed the implementation. As a result, the true impact of the proposed rule remains unclear because questions still need to be addressed on topics such as (1) the types of transactions that should be permitted or prohibited in connection with banks’ trading activities, (2) bank investments in covered funds (e.g., relative to private equity and hedge funds), and (3) the nature of the compliance regime required for implementation of the proposed rule.

**SEC Custody Rule Considerations**

As part of the Dodd-Frank Act, the Private Fund Investment Advisers Registration Act of 2010 required all qualified investment advisers to be registered with the SEC by March 31, 2012. Consequently, such advisers are required to satisfy Rule 206(4)-2 (the “custody rule”) of the SEC’s Investment Advisers Act of 1940 (the “Advisers Act”) for all discretionary accounts they manage, including pooled investment vehicles (i.e., private funds).

One way for investment advisers with pooled investment vehicles to satisfy the custody rule is (1) to use the “audit provision,” under which the pooled investment vehicle (fund) (a) has an annual audit performed under auditing standards generally accepted in the United States and (b) receives an unqualified opinion by an independent public accounting firm that is registered with and subject to PCAOB inspection and (2) to distribute such audited financial statements to its investors within 120 days of the fund’s year-end (180 days for a fund of funds). Alternatively, such advisers can undergo an annual “surprise examination” as well as satisfy several additional requirements as described in the custody rule. Many investment advisers choose the audit provision because an annual audit is generally already required as part of the offering documents for funds. Investment advisers should also consider that the audit provision under the custody rule generally requires financial statements to be prepared in accordance with U.S. GAAP, which may be a different basis of accounting than that used in the audited financial statements for the funds’ offering documents.

Questions have arisen about auditor independence as a result of the increase in registration with the SEC by investment advisers in response to the March 31, 2012, deadline. In December 2011, the SEC posted responses on its Web site to frequently asked questions about auditor independence related to the custody rule to help investment advisers understand and apply the requirements. The responses focus on independence-impairing situations as a result of the custody rule, examination periods, timing of examinations, and (for investment advisers that choose not to use the audit provision described above) specific deadlines for examination based on registration dates under the custody rule.

The SEC staff has provided no-action relief to investment advisers to 529 plans, which will relieve them from the surprise inspection requirement of the custody rule. Reliance on this relief requires compliance with certain conditions that are set forth in the no-action letter from the SEC staff.

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1 Footnote 3 of the proposed rule states, in part, “The term ‘banking entity’ is defined in section 13(h)(1) of the BHC Act, as amended by section 619 of the Dodd-Frank Act. See 12 U.S.C. 1851(h)(1). The statutory definition includes any insured depository institution (other than certain limited purpose trust institutions), any company that controls an insured depository institution, any company that is treated as a bank holding company for purposes of section 8 of the International Banking Act of 1978 (12 U.S.C. 3106), and any affiliate or subsidiary of any of the foregoing.”

2 Footnote 4 of the proposed rule states, in part, “A ‘nonbank financial company supervised by the [Federal Reserve] Board’ is a nonbank financial company or other company that the Financial Stability Oversight Council . . . has determined, under section 113 of the Dodd-Frank Act, shall be subject to supervision by the Board and prudential standards.”
SEC Issues Final Rule on Private Fund Reporting

In October 2011, the SEC adopted a final rule implementing Sections 404 and 406 of the Dodd-Frank Act. According to the press release, the final rule requires “registered investment advisers with at least $150 million in private fund assets under management to periodically file a new reporting form (Form PF),” which would assist the Financial Stability Oversight Council (FSOC) in collecting private fund information and monitoring risks to the stability of the U.S. financial system. The investment advisers’ size, which is determined on the basis of the amount of assets under management, will dictate (1) the implementation and compliance deadlines and (2) the amount of information to be reported and the frequency of filing. In addition, unlike the private fund information reported on Form ADV, the information reported on Form PF will remain confidential.

Pursuant to Title IV of the Dodd-Frank Act, the SEC and the CFTC have adopted joint rules under the Advisers Act and the Commodity Exchange Act that require registered private fund advisers to file Form PF, at least annually, with the SEC. The primary purpose of the form is to help the FSOC (1) determine how systemic risk should be assessed and (2) monitor potential systemic risk in the financial system.

First proposed by the SEC on January 25, 2011, and approved on October 26, 2011, Form PF has tiered compliance dates depending on the size (i.e., amount of assets under management) and type of funds managed (i.e., hedge fund adviser, private equity adviser). For example, for large advisers (as defined by the SEC) that manage $5 billion or more of hedge fund assets, private equity fund assets, or combined liquidity and registered money market fund assets (as defined by the SEC), the compliance date was June 15, 2012. For all other large advisers and smaller advisers (as defined by the SEC), the compliance date was December 15, 2012.

Form PF is long and comprehensive and requires advisers to provide legal, compliance, and accounting information from various internal and external sources, including fund administrators and custodians. Compliance with the form’s requirements is less burdensome for fund advisers that adopt a phased and disciplined approach. Most fund advisers have developed a detailed understanding of the form’s requirements and have implemented strategic solutions, which in many cases has involved the use of an automated tool to centralize the filing process.

SEC Approves Final Rule on Security Ratings

In July 2011, the SEC unanimously voted to adopt a final rule implementing Section 939A of the Dodd-Frank Act. The final rule, which is substantially similar to the rule proposed in February 2011, addresses the use of credit ratings in the offering of securities (“security ratings”) and replaces requirements that rely on, or make special accommodations for, security ratings offered on short-form or “shelf” registration statements (e.g., Forms S-3 and F-3) with alternative requirements. Thus, the proposed rule may affect certain registrants’ eligibility to use shelf registration statements.

SEC Issues Rule Amending the Net-Worth Standard for Accredited Investors

In December 2011, the SEC issued a final rule implementing the requirements of Section 413(a) of the Dodd-Frank Act by amending accredited investor standards under the Securities Act. The final rule changes the definition of “accredited investor” to exclude the value of a person’s primary residence for purposes of determining whether the investor qualifies as an “accredited investor” on the basis of having a net worth in excess of $1 million. In addition, the final rule makes conforming technical amendments to Form D and other SEC rules and corrects various cross-references within the Securities Act.
SEC Adopts Rule Requiring Listing Standards for Compensation Committees and Compensation Advisers

In June 2012, the SEC adopted a final rule to implement Section 952 of the Dodd-Frank Act that requires the prohibition of the listing of any issuer’s equity securities that are not in compliance with the amended compensation committee and compensation adviser requirements. In addition, national securities exchanges are required to establish listing standards that address a compensation committee’s:

- Member independence.
- Authority to retain compensation advisers.
- Consideration of any compensation advisers’ independence.
- Responsibility for the (1) appointment, (2) compensation, and (3) oversight of work performed by any compensation adviser.

SEC Review of Funds’ Use of Derivatives

In a speech on December 6, 2012, SEC Director of Investment Management Norm Champ gave an update on the Division’s review of a fund’s use of derivatives. He indicated that the “Division staff will no longer defer consideration of exemptive requests under the Investment Company Act relating to actively-managed ETFs that make use of derivatives provided any such exemptive request includes two specific representations to address some of the concerns that led to the Division’s decision to defer consideration of these types of applications.” These representations are detailed on the SEC’s Web site.

Other Dodd-Frank Activities

In addition to the mandated rulemaking activity associated with the Dodd-Frank Act as detailed above, the SEC has been tasked with establishing various oversight committees and offices. Over the last 12 months, the following have been established:

- **Office of Municipal Securities** (August 2, 2012).
- **Office of Credit Ratings** (June 15, 2012).
- **Investor Advisory Committee** (April 9, 2012).

Further, the SEC has been tasked with completing various studies and reports for Congress, of which the following were issued:

- Second annual report summarizing NRSRO\(^3\) inspections, findings, and responses (November 15, 2012).
- Report on standardization of certain elements of the credit rating process (September 7, 2012).
- Study regarding financial literacy among retail investors (August 30, 2012).
- Jointly prepared a report with the CFTC addressing how swaps are regulated in the United States, Asia, and Europe to identify areas of regulation that are similar and other areas of regulation that could be harmonized (January 31, 2012).
- First annual report summarizing NRSRO inspections, findings, and responses (September 30, 2011).
- Jointly prepared report with the CFTC on improving the common framework for designated clearing entity risk management (July 21, 2011).
- Report summarizing and reviewing existing references to credit ratings in statutes and regulations (July 21, 2011).

\( A \) The NRSRO is an agency, as recognized and approved by the SEC, that provides credit ratings on financial firms that are used by the U.S. government in several regulatory areas. These credit ratings are also often used by investors as a metric to consider when making an investment.
Other Dodd-Frank Rulemaking Yet to Come

In addition to the Dodd-Frank Act accomplishments thus far, there are certain significant areas that the SEC has yet to address, and while some of the areas are not specifically financial reporting related (i.e., more corporate governance), there has been much interest by the various stakeholders. For example, the Dodd-Frank Act directs the SEC to establish rules on executive compensation, including:

- Rules that would require companies to develop a policy on the recovery of incentive compensation (or “clawback”).
- Proxy statement rules that would require companies to disclose (1) a comparison of executive compensation against financial performance (pay versus performance) and (2) median total annual compensation for all employees, excluding CEO compensation, CEO annual compensation, and the ratio of CEO annual compensation to median total annual employee compensation (pay equity disclosure).
- Rules requiring proxy disclosure about whether employees and directors are allowed to hedge the value of any securities granted to them or otherwise owned by them.

In addition, the SEC plans to propose rules to define “other significant matters” related to broker voting on uninstructed shares.

JOBS Act

In April 2012, President Obama signed the Jumpstart Our Business Startups Act (the “JOBS Act” or the “Act”) into law. The primary objective of the Act is to “increase American job creation and economic growth by improving access to the public capital markets for emerging growth companies.” To help reduce the burden smaller companies face in obtaining capital, the JOBS Act limits some of the regulatory requirements introduced by the Sarbanes-Oxley Act of 2002.

Emerging Growth Companies

The most notable provisions of the Act introduce the “emerging growth company” (EGC), a new type of issuer whose less stringent regulatory and reporting requirements are intended to encourage public offerings by small and developing companies. Under Title I of the Act, for a company to be considered an EGC, its total gross revenues cannot exceed $1 billion in its most recently completed fiscal year. EGC status can be held for up to a maximum of five years after an IPO provided (1) the EGC’s total gross revenues do not exceed $1 billion during the five-year period, (2) the EGC’s market capitalization does not exceed $700 million (i.e., the EGC does not meet the definition of a large accelerated filer), or (3) the EGC does not issue more than $1 billion in nonconvertible debt in a three-year period. A company that completed an IPO on or before December 8, 2011, is not be eligible for EGC classification.

Other noteworthy provisions for EGCs include:

- Only two years of audited financial statements are required in registration statements (IPO and other) and periodic filings.
- The periods required for selected financial data in an EGC’s registration statements and periodic filings do not extend to periods before the first year presented in the EGC’s IPO and other registration statements.
- An EGC is exempt from the requirement to obtain an attestation report on ICFR from its auditor.
- An EGC does not need to adopt new accounting standards until they become effective for private companies (i.e., nonissuers).
Title I of the JOBS Act amends the Securities Act to allow an EGC to provide a confidential draft IPO registration statement to the SEC staff for review before its public filing (i.e., the SEC is prohibited from disclosing the information being reviewed). However, an EGC is required to publicly file such draft and any related amendments with the SEC no later than 21 days before its “road show.”

The SEC’s Division of Corporation Finance staff has issued a series of FAQs that address (1) implementation of the Act’s provisions by EGCs, (2) the confidential submission and review process for EGCs, and (3) registration and deregistration thresholds under Sections 12(g) and 15(d) of the Exchange Act.

Communications to Investors

The JOBS Act relaxes certain restrictions on communications among investors, brokers, and analysts involved in an IPO, which may benefit the investment banks underwriting the IPO transaction. The JOBS Act amends the Securities Act to allow oral or written communications that gauge investor interest in a potential offering before or after the filing of a registration statement (commonly referred to as “testing the waters”). Such communications could be made by the EGC or a person authorized to act on its behalf; however, they could only be made to investors that are qualified institutional buyers or accredited investors. The JOBS Act also amends the Securities Act to allow brokers, dealers, or members of a national securities exchange to more freely distribute or publish research reports about an EGC and prohibits the SEC or national securities associations from creating rules that would restrict such flow of information among the parties to an EGC’s IPO transaction. In August 2012, the SEC staff also issued FAQs addressing numerous topics related to research analysts and underwriters, including analyst, test-the-waters, and post-offering communications.

Small Company Capital Formation

Title IV of the JOBS Act increases the limit on filings of exempt offerings currently subject to Regulation A of the Securities Act from $5 million annually to $50 million annually and adds a civil liability provision related to the offering or sale of securities. The Act also requires the issuer to (1) file annual audited financial statements with the SEC, (2) make certain periodic nonfinancial disclosures to investors, and (3) file and distribute an offering statement to prospective investors. In addition, the SEC is required every two years to revisit (and potentially increase) the limits on exempt securities offerings and, if no changes are made, report to Congress its reasons for not increasing the limits.

Access to Capital in Private Offerings

To eliminate the ban on general solicitation and advertising for private offerings, Title II of the JOBS Act directs the SEC to amend Rule 506 of Regulation D and Rule 144A of the Securities Act within 90 days of its enactment. However, the Act limits the general solicitation and advertising to (1) accredited institutional investors in Rule 506 offerings and (2) qualified institutional buyers in offerings under Rule 144A. The Securities Act is also amended to exempt any person selling securities in a Rule 506 offering from broker-dealer registration requirements as long as certain conditions are met regarding compensation and management of the funds exchanged in the offering.

Changes under the JOBS Act to amend Rule 506 and Rule 144A are subject to SEC rulemaking to implement those modifications. In August 2012, the SEC issued a proposed rule with provisions that would reasonably ensure that purchasers of securities under Rule 506 or Rule 144A offerings are accredited institutional investors or qualified institutional buyers, respectively.

Shareholder Thresholds for Reporting

Under the JOBS Act, Section 12(g) of the Exchange Act is amended to increase the shareholder threshold that triggers the requirement for companies to register with the SEC from 500 to 2,000 shareholders of record. For private companies that are not banks or bank holding companies, no more than 499 shareholders of record may be nonaccredited investors. In addition, like securities offered in a crowdfunding transaction, securities offered to employees under an employee compensation arrangement are excluded in the determination of the number of shareholders of record.

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4 An investor “road show” typically consists of presentations to analysts, fund managers, and other potential investors to promote a company’s securities’ offering and to assess interest in the securities being offered.

5 As such terms are defined in Rules 144A and 501(a) of the Securities Act.
Money Market Fund Reform

Background

In response to the financial crisis of 2008, the SEC completed reforms that (1) require money market funds to shorten the maturities and improve the credit quality of investments held by such funds, (2) impose liquidity requirements on money market funds, and (3) expand disclosures about portfolios of such funds' investments and shadow net asset values. Additional reforms were ultimately presented to the SEC as draft proposals.

Development

In August 2012, SEC Chairman Mary Schapiro issued a statement indicating that “[t]hree Commissioners, constituting a majority of the Commission,” would not support the proposed reforms to the structure of money market funds. As such, the proposal has not been published for public comment and cannot be subject to an SEC vote for final approval. The SEC “will not act to issue a money market fund reform proposal,” at least as it was previously proposed, and currently leaves any potential reform in the hands of policymakers.

See the SEC’s Web site for Ms. Schapiro’s full statement.

In November 2012, the FSOC approved proposed recommendations for MMF reform. The FSOC is proposing three alternatives for public comment:

- Floating NAV — Require MMFs to have a floating NAV per share by removing the special exemption that currently allows MMFs to utilize amortized cost accounting and/or penny rounding to maintain a stable NAV of $1.00.

- Stable NAV With NAV Buffer and “Minimum Balance at Risk” — Require MMFs to have an NAV buffer with a tailored amount of assets of up to 1 percent to absorb day-to-day fluctuations in the value of the fund’s portfolio securities and allow the funds to maintain a stable NAV. The NAV buffer would be paired with a requirement that 3 percent of a shareholder’s highest account value in excess of $100,000 during the previous 30 days — a minimum balance at risk — be redeemed on a delayed basis.
Stable NAV With NAV Buffer and Other Measures — Require MMFs to have a risk-based NAV buffer of 3 percent to provide explicit loss-absorption capacity that could be combined with other measures to enhance the effectiveness of the buffer and potentially increase the resiliency of MMFs. Other measures could include more stringent investment diversification requirements, increased minimum liquidity levels, and more robust disclosure requirements. To the extent that it can be adequately demonstrated that more stringent investment diversification requirements, alone or in combination with other measures, complement the NAV buffer and further reduce the vulnerabilities of MMFs, the FSOC could include these measures in its final recommendation and would reduce the size of the NAV buffer required under this alternative accordingly.

### AICPA Working Draft on Private Transactions

**Overview**

The AICPA’s Financial Reporting Executive Committee (FinREC) issued a working draft of a new chapter of the AICPA Accounting and Valuation Guide Valuation of Privately Held Company Equity Securities Issued as Compensation (the Guide) in August 2012. The new chapter — Chapter 8, “Inferring Value From Transactions in a Private Company’s Securities” — provides guidance on evaluating secondary market transactions and their relevance for measuring the fair value of private-entity equity investments. While secondary market transactions generally represent observable inputs, these transactions must be evaluated to determine (1) if the transaction was orderly and (2) what weight should be given to the observed price.

FinREC also released the latest working draft of the Guide to provide context for the draft chapter. The AICPA requested feedback on the draft Chapter 8 and the new Q&As in Chapter 12; comments were due October 1, 2012.
Appendix A — Glossary of Standards and Other Literature

The standards and literature below were cited or linked to in this publication.

**FASB ASC References**

For titles of *FASB Accounting Standards Codification* references, see Deloitte’s “Titles of Topics and Subtopics in the FASB Accounting Standards Codification.”

**FASB Accounting Standards Updates and Other FASB Literature**

See the FASB’s Web site for the titles of:

- Accounting Standards Updates.
- Proposed Accounting Standards Updates.
- Pre-Codification literature (Statements, Staff Positions, EITF Issues, and Topics).
- Concepts Statements.

**SEC Final Rules**

33-9245 and 34-64975, *Security Ratings*

33-9287, *Net Worth Standard for Accredited Investors*

33-9308, 34-66703, and 39-2484, *Exemptions for Security-Based Swaps Issued by Certain Clearing Agencies*

33-9330 and 34-67220, *Listing Standards for Compensation Committees*

33-9338 and 34-67453, *Further Definition of “Swap,” “Security-Based Swap,” and “Security-Based Swap Agreement”; Mixed Swaps, Security-Based Swap Agreement Recordkeeping*

34-65545, *Prohibitions and Restrictions on Proprietary Trading and Certain Interests in, and Relationships With, Hedge Funds and Private Equity Funds*

34-66868, *Further Definition of “Swap Dealer,” “Security-Based Swap Dealer,” “Major Swap Participant,” “Major Security-Based Swap Participant” and “Eligible Contract Participant”*

34-67286, *Process for Submissions for Review of Security-Based Swaps for Mandatory Clearing and Notice Filing Requirements for Clearing Agencies; Technical Amendments to Rule 19b-4 and Form 19b-4 Applicable to All Self-Regulatory Organizations*

34-68080, *Clearing Agency Standards*

IA-3308, *Reporting by Investment Advisers to Private Funds and Certain Commodity Pool Operators and Commodity Trading Advisors on Form PF*

**SEC Proposed Rule**

33-9354, *Eliminating the Prohibition Against General Solicitation and General Advertising in Rule 506 and Rule 144A Offerings*
Commodity Futures Trading Commission Final Rule

RIN 3038-AD30, Commodity Pool Operators and Commodity Trading Advisors: Amendments to Compliance Obligations

International Standards

See Deloitte’s IAS Plus Web site for the titles of:

- International Financial Reporting Standards.
- International Accounting Standards.
## Appendix B — Abbreviations

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<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tbody>
<tr>
<td>AICPA</td>
<td>American Institute of Certified Public Accountants</td>
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<tr>
<td>ASC</td>
<td>FASB Accounting Standards Codification</td>
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<td>ASU</td>
<td>FASB Accounting Standards Update</td>
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<td>BHC Act</td>
<td>Bank Holding Company Act of 1956</td>
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<td>BRP</td>
<td>Blue-Ribbon Panel</td>
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<td>C&amp;M</td>
<td>classification and measurement</td>
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<tr>
<td>CDO</td>
<td>collateralized debt obligation</td>
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<td>CEA</td>
<td>Commodity Exchange Act</td>
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<tr>
<td>CEO</td>
<td>chief executive officer</td>
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<td>CFE</td>
<td>collateralized financing entity</td>
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<td>CFTC</td>
<td>Commodities Futures Trading Commission</td>
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<td>CLO</td>
<td>collateralized loan obligation entity</td>
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<td>CPO</td>
<td>commodity pool operators</td>
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<td>CTA</td>
<td>commodity trade advisor</td>
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<td>DP</td>
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<td>ED</td>
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<td>EFRAG</td>
<td>European Financial Reporting Advisory Group</td>
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<td>EITF</td>
<td>Emerging Issues Task Force</td>
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<td>ETF</td>
<td>exchange-traded fund</td>
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<td>FAF</td>
<td>Financial Accounting Foundation</td>
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<td>FASB</td>
<td>Financial Accounting Standards Board</td>
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<td>FAQ</td>
<td>frequently asked question</td>
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<td>FinREC</td>
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<td>FSOC</td>
<td>Financial Stability Oversight Board</td>
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<tr>
<th>Abbreviation</th>
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<tr>
<td>FV-NI</td>
<td>fair value through net income</td>
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<tr>
<td>FV-OCI</td>
<td>fair value through other comprehensive income</td>
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<td>foreign currency</td>
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<td>generally accepted accounting principles</td>
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<td>internal control over financial reporting</td>
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<td>IFRS</td>
<td>International Financial Reporting Standard</td>
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<td>IPE</td>
<td>investment property entity</td>
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<td>IPO</td>
<td>initial public offering</td>
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<td>JOBS Act</td>
<td>Jumpstart Our Business Startups Act</td>
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<td>LIFO</td>
<td>last in, first out</td>
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<td>MD&amp;A</td>
<td>management’s discussion and analysis</td>
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<tr>
<td>MMF</td>
<td>money market fund</td>
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<tr>
<td>MNA</td>
<td>master netting arrangement</td>
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<tr>
<td>MoU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>NAV</td>
<td>net asset value</td>
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<tr>
<td>NRSRO</td>
<td>nationally recognized statistical rating organization</td>
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<tr>
<td>PCAOB</td>
<td>Public Company Accounting Oversight Board</td>
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<tr>
<td>PCC</td>
<td>Private Company Council</td>
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<td>REIT</td>
<td>real estate investment trust</td>
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<td>REPO</td>
<td>repurchase agreement</td>
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<td>Securities and Exchange Commission</td>
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<td>TOB</td>
<td>tender option bond</td>
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<td>VIE</td>
<td>variable interest entity</td>
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Appendix D — Other Resources

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