

Heads Up

In This Issue:

- Contents
- Summary
- Appendixes

The proposed ASU contains a comprehensive, new model of accounting for financial assets and financial liabilities that addresses (1) recognition and measurement, (2) impairment, and (3) hedge accounting.

America's Next Top (FI) Model? FASB Issues Proposed ASU on Accounting for Financial Instruments

by Magnus Orrell, Shahid Shah, and Stephen McKinney, Deloitte & Touche LLP

On May 26, 2010, the FASB issued a proposed Accounting Standards Update (ASU), *Accounting for Financial Instruments and Revisions to the Accounting for Derivative Instruments and Hedging Activities*. The proposed ASU contains a comprehensive, new model of accounting for financial assets and financial liabilities that addresses (1) recognition and measurement, (2) impairment, and (3) hedge accounting. The proposal would significantly affect the accounting for a broad range of financial instruments, including investments in debt and equity securities, nonmarketable equity investments, loans, loan commitments, deposit liabilities, trade payables, trade receivables, derivative financial instruments, and debt liabilities. Comments on the proposed ASU are due by September 30, 2010.

In response to the global financial crisis and the existing complexity in accounting for financial instruments, the FASB and IASB are reconsidering their current accounting requirements for financial instruments. However, the two boards' project plans for developing new accounting requirements for financial instruments differ. In November 2009, the IASB finalized its new classification and measurement requirements for financial assets (included in IFRS 9, *Financial Instruments*). In addition, the IASB has issued exposure drafts on impairment of financial assets and the use of the fair value option for financial liabilities. The IASB expects to issue an exposure draft on hedge accounting later this year. For more information about international convergence and the project timeline, see the [International Convergence and Project Timeline](#) section below.

Currently, the two boards' approaches differ in important respects. For instance, under the FASB's proposed ASU, more financial instruments would be measured at fair value than under current U.S. GAAP and IFRSs. The IASB, however, is retaining a mixed-measurement attribute model that is more similar to the requirements under current U.S. GAAP and IFRSs; this model would require that some items be measured at fair value and others at amortized cost, but would contain revised criteria for amortized cost measurement. In addition, the two boards' approaches for recognizing and measuring credit impairment losses differ. The FASB's proposed ASU addresses hedge accounting by incorporating most of the proposed guidance that was initially included in its 2008 proposed Statement, *Accounting for Hedging Activities*. The IASB is currently deliberating its hedge accounting model and expects to issue an exposure draft on hedge accounting in the second half of 2010.

This *Heads Up* provides an overview and analysis of the key provisions of the proposed ASU. [Appendix A](#) lists financial instruments that are outside the scope of the FASB's proposed ASU. [Appendix B](#) includes a decision tree illustrating the proposed classification and measurement model. [Appendix C](#) includes a table comparing the classification and measurement provisions of the proposed ASU with the key provisions in IFRS 9 and the IASB's tentative decisions to date regarding the accounting for financial liabilities. [Appendix D](#) contains a tabular comparison of the FASB's proposed impairment model and the IASB's exposure draft on impairments (issued in November 2009). Finally, [Appendix E](#) gives an overview of the FASB's proposed approach to hedge accounting. While this is a significant amount of reading, it's all relative; it's condensed from the FASB's 214-page exposure draft.

FASB/IASB: A Convergence Update and a Deeper Dive Into the FASB's Financial Instruments Proposals

Deloitte will host a 90-minute webcast on Friday, July 16, at 2:00 p.m. (EDT) on the FASB's proposed ASU on financial instruments. This special webcast will also provide an update of (1) projects included in the Memorandum of Understanding between the FASB and the IASB and (2) the FASB's various exposure drafts. Registration for this webcast will be available shortly on Deloitte's [Dbriefs](#) Web site.

Contents

Summary	4
Scope	4
Classification of Financial Instruments	4
Classification Criteria: FV-OCI	5
Classification Criteria: Amortized Cost	6
Loan Commitments and Standby Letters of Credit	7
Specialized Industry Guidance	7
Initial Recognition and Measurement	7
Initial Measurement	7
Treatment of Transaction Costs and Fees	7
Subsequent Measurement	8
Investments Redeemable at a Specified Amount	8
Demand Deposit Liabilities	8
Income Recognition	9
Financial Statement Presentation	9
Statement of Financial Position	9
Statement of Comprehensive Income	9
Credit Impairment	10
Assessment of Credit Impairments	10
Measurement of Credit Impairments	10
Collective (Pool) Basis	11
Individual Basis	11
Direct Write-Off of Financial Assets	12
Interest Income Recognition	12
Hedge Accounting	12
Effectiveness Assessment	12
Measuring and Reporting Ineffectiveness in Cash Flow Hedges	13
Ability to Dedesignate a Hedging Relationship	13
Effective Date and Transition	13
International Convergence and Project Timeline	14
Appendixes	15
Appendix A: Scope Exceptions	15
Appendix B: Decision Tree Illustrating the Proposed ASU's Classification and Measurement Model	17
Appendix C: Classification and Measurement	18
Appendix D: Impairment Model	20
Appendix E: Hedge Accounting	21

Summary

Scope

The proposed ASU applies to all entities and to all financial assets and financial liabilities that are not specifically outside its scope.

Editor's Note: The proposed ASU's scope includes, for example:

- Investments in debt securities, such as government and corporate bonds.
- Investments in equity instruments, such as publicly traded equity securities and nonmarketable equity investments, when the investor does not have significant influence over the investee.
- Investments in equity securities, when the investor has significant influence over the investee but the operations of the investee are unrelated to the investor's consolidated operations.
- Mutual fund investments.
- Beneficial interests in securitized financial assets.
- Loans, such as consumer loans, commercial loans, and mortgage loans.
- Trade receivables and trade payables.
- Deposit liabilities.
- An entity's own debt.
- Derivative financial instruments, such as options, forwards, futures, and swap contracts.

There are a few scope exceptions, such as employee stock options, interests in consolidated subsidiaries (including equity investments and noncontrolling interests), instruments classified in stockholders' equity, pension obligations, most insurance contracts, and lease assets and lease liabilities. For a more complete list of financial instruments that are outside the scope of the proposed ASU, see [Appendix A](#).

The proposed ASU eliminates the cost method of accounting for nonmarketable equity investments in ASC 325.¹ Instead, all equity investments that are currently accounted for under the cost method would be subject to the proposed ASU. In addition, the proposed ASU narrows the scope of equity method accounting under ASC 323 by limiting its application to equity investments in which the (1) entity has significant influence over the investee and (2) operations of the investee are considered related to the investor's consolidated operations. Equity investments that meet both of these criteria would be accounted for under the equity method, while other investments that are currently accounted for under the equity method would be subject to the proposed ASU and would be accounted for at fair value, with changes in fair value recognized in net income. The proposed ASU lists qualitative factors that an investor should consider in determining whether the investee's operations are considered related to the investor's consolidated operations (e.g., similar operations and common employees).

Editor's Note: The proposed ASU eliminates the fair value option for equity investments in ASC 825-10. Therefore, an entity could no longer elect to account for equity investments that meet the proposed criteria for equity method accounting at fair value through net income.

Classification of Financial Instruments

Upon initial recognition, an entity would classify a financial instrument into one of the categories of financial assets and financial liabilities identified in the proposed ASU. Reclassification after initial recognition would be prohibited. The proposed ASU identifies the following principal categories of financial assets and financial liabilities:

- Fair value, with changes in fair value recognized in net income (FV-NI).
- Fair value, with certain changes in fair value recognized in other comprehensive income (FV-OCI).
- Amortized cost.

Editor's Note: These classification categories would replace the classification categories for financial instruments under current U.S. GAAP, such as securities held for trading, available for sale, or held to maturity and loans held for sale or held for investment.

¹ For titles of FASB Accounting Standards Codification (ASC) references, see Deloitte's "Titles of Topics and Subtopics in the FASB Accounting Standards Codification."

The default category for financial assets and financial liabilities within the scope of the proposed ASU (other than core demand deposit liabilities and certain redeemable investments) is FV-NI (i.e., measured at fair value, with changes in fair value recognized in net income). However, an entity is permitted to instead classify an asset or liability as FV-OCI or amortized cost provided that it meets certain qualifying criteria, discussed below. If classified as FV-OCI, the instrument is measured at fair value but certain specified changes in fair value are recognized in OCI rather than in net income (see the [Income Recognition](#) section below).

The proposed ASU provides special accounting guidance on core demand deposit liabilities and certain redeemable investments (see the [Subsequent Measurement](#) section below).

Classification Criteria: FV-OCI

A financial asset or financial liability that is a debt instrument² can be classified as FV-OCI if it meets **all** of the following three criteria:

1. Cash Flow Characteristics

- An amount is transferred to the debtor (issuer) at inception that will be returned to the creditor (investor) at maturity or other settlement. This amount is the principal amount of the contract, adjusted by any original issue discount or premium.
- The contractual terms of the debt instrument identify any additional contractual cash flows to be paid to the creditor (investor) either periodically or at the end of the instrument's term.
- The debt instrument cannot contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its initially recorded investment, other than through its own choice.

Editor's Note: Whether it is probable that the holder will not recover substantially all of its recorded investment is not relevant to the assessment of whether the contractual cash flow characteristics criterion is met. If there is any possibility, however remote, that the investor might not recover substantially all of its initial recorded investment under the contractual terms, the instrument is not eligible for FV-OCI classification. However, a financial instrument could meet the cash flow characteristics criterion even if the investor might lose some or all of its recorded investment, provided that such a loss would be due to reasons outside the contractual terms (e.g., borrower default or changes in the functional-currency-equivalent amount of a foreign-currency-denominated debt instrument).

Examples of financial instruments that would not meet the cash flow characteristics criterion include:

- Derivative financial instruments (e.g., options, forwards, and swaps).
- Equity securities.
- Prepayable debt securities purchased at a substantial premium to par.
- Beneficial interests in securitized financial assets that, because of prepayment risk, contractually expose the investor to the risk that it may not recover substantially all of its initially recorded investment.
- Subordinated, non-pro rata beneficial interests in securitized financial assets that, because of the credit protection provided to more senior tranches, expose the investor to the risk that it may not recover substantially all of its initially recorded investment.
- Interest-only strips that have no principal balance and for which payments are derived from prepayable financial assets.

2. Business Strategy

- The entity's business strategy for the instrument is to collect or pay the related contractual cash flows rather than to sell the financial asset or to settle the financial liability with a third party. The possibility that a debt instrument may be settled with the counterparty before the stated maturity date because of exercise of an embedded call or put option would not prevent an entity from having a business strategy to collect or pay the instrument's contractual cash flows.

² The proposed ASU defines a debt instrument as "[a] receivable or payable that represents a contractual right to receive cash (or other consideration) or a contractual obligation to pay cash (or other consideration) on fixed or determinable dates, whether or not there is any stated provision for interest."

Editor's Note: In determining whether the business strategy criterion is met, an entity would assess how it manages its financial instruments on a portfolio basis rather than its intent for individual financial instruments. The business strategy criterion is met if the instrument is held as part of a longer-term business activity in which sales are infrequent. Thus, financial instruments that are held for trading or otherwise for sale would not meet this criterion. However, occasional sales or settlements within a portfolio would be permitted.

Consider a financial institution that has a (1) trading portfolio of actively traded debt and equity securities and (2) retail banking business with long-term loans to customers that are typically not sold or securitized before maturity. In this case, the financial instruments in the trading portfolio would not meet the business strategy criterion but the financial instruments in the retail banking business would.

3. No Embedded Derivative Is Required to Be Separated

- It is not a hybrid instrument for which the guidance on derivatives and hedging in ASC 815-15 would otherwise have required that the embedded derivative be accounted for separately from the host contract.

Editor's Note: The proposed ASU eliminates the current bifurcation requirements for **financial** host contracts that are within its scope. A hybrid financial instrument containing an embedded derivative that under ASC 815-15 would currently be bifurcated and accounted for separately as a derivative cannot be classified as FV-OCI under the proposed ASU; rather, such an instrument must be classified as FV-NI and measured in its entirety at fair value, with changes in fair value immediately recognized in earnings. Said differently, the embedded derivative feature would no longer be separated.

The determination of whether this criterion is met is based on an assessment of whether (1) the economic characteristics and risks of the embedded feature are clearly and closely related to the economic characteristics and risks of the host contract and (2) a stand-alone contract with the same terms as the embedded derivative feature would meet the definition of a derivative and not be outside the scope of derivative accounting under ASC 815. An entity must perform this assessment at initial recognition.

The proposed ASU does not change the bifurcation requirements for **nonfinancial** host contracts or for financial host contracts that are outside its scope. Such contracts continue to be bifurcated in accordance with the existing requirements in ASC 815-15.

Classification Criteria: Amortized Cost

An entity is permitted to classify short-term receivables and payables as amortized cost if they (1) arise in the normal course of business, (2) are due in customary terms not exceeding one year, (3) meet the FV-OCI classification criteria (see the [Classification Criteria: FV-OCI](#) section above), and (4) are not short-term lending arrangements (e.g., credit card receivables or short-term debt securities).

Financial assets other than short-term receivables cannot be classified as amortized cost. An entity may elect to classify **financial liabilities** other than deposit liabilities as amortized cost if both of the following criteria are met:

- The financial liability meets the criteria for FV-OCI classification (see the [Classification Criteria: FV-OCI](#) section above).
- Measurement of the financial liability at fair value would create or exacerbate an accounting mismatch of recognized assets and liabilities.

Measuring a financial liability at fair value is considered to create or exacerbate an accounting mismatch only if at least one of the following criteria is met:

- The financial liability is contractually linked to an asset measured at amortized cost (e.g., a liability is collateralized by an asset measured at amortized cost or is contractually required to be settled upon the derecognition of such an asset).
- The financial liability is issued by and recorded in, or evaluated by the chief operating decision maker as part of, an operating segment that subsequently measures less than 50 percent of the segment's recognized assets at fair value.
- The financial liability does not meet the above criteria but is a liability of a consolidated entity for which less than 50 percent of consolidated recognized assets are subsequently measured at fair value.

In assessing the quantitative criteria described above, an entity would consider only recognized assets as of the last reporting period plus any new recognized assets acquired through the proceeds received from issuing the financial liability (assets contractually linked to a financial liability would be excluded). When assessing these criteria, the entity would not consider cash balances to be measured at fair value.

Loan Commitments and Standby Letters of Credit

The proposed ASU includes special classification guidance on loan commitments and standby letters of credit. An entity that provides a loan commitment or financial standby letter of credit ("commitment") must classify the commitment in the same way as it will classify the loan that would be extended under the commitment. Thus, the commitment would be classified as FV-OCI if the resulting loan would be classified as FV-OCI and as FV-NI if the loan would be classified as FV-NI.

Editor's Note: Loan commitments and financial standby letters of credit held by a potential borrower are outside the scope of the proposed ASU.

Specialized Industry Guidance

The proposed ASU includes specialized industry guidance for broker-dealers and investment companies. More specifically, broker-dealers subject to ASC 940 and investment companies subject to ASC 946 are required to classify all of their financial assets as FV-NI. Broker-dealers are permitted to use the FV-OCI or amortized cost categories for their financial liabilities provided that those liabilities meet the qualifying criteria discussed above. Investment companies, on the other hand, must classify all of their financial liabilities as FV-NI. Accordingly, an investment company would measure all of its financial assets and financial liabilities at fair value and would recognize changes in fair value in the increase (or decrease) in net assets for the period.

The proposed ASU provides application guidance for not-for-profit health care entities that are within the scope of ASC 954. Under the proposed ASU, entities within the scope of ASC 954 that report a performance indicator must report amounts recognized for instruments classified as FV-NI as part of the performance indicator and amounts recognized for instruments classified as FV-OCI outside the performance indicator, since such entities do not report net income and other comprehensive income. Similarly, an entity that does not report a performance indicator would recognize total changes in fair value of a financial instrument (either FV-NI or FV-OCI) as "a change in the appropriate net asset class in its statement of activities."

Initial Recognition and Measurement

Initial Measurement

A financial instrument classified as FV-NI is initially measured at fair value. Any difference between the transaction price and the fair value is immediately recognized as a gain or loss in net income. Other financial instruments within the scope of the proposed ASU are initially measured at their transaction price.

For a financial instrument classified as FV-OCI, any difference between the transaction price and fair value upon the first remeasurement after initial recognition is recognized in OCI. However, the proposed ASU requires that if, on the basis of "reliable evidence," an entity determines that there is a "significant" difference between the transaction price and fair value at initial recognition for such an instrument, the entity must determine whether the transaction includes "other elements" in accordance with ASC 820-10-30-3(c) and must account for those elements (e.g., unstated rights and privileges) under other U.S. GAAP. If so, the entity would initially measure the financial instrument at fair value and would recognize the "other elements" of the transaction in accordance with other U.S. GAAP (e.g., as an asset, liability, gain, or loss). However, the proposed ASU includes an exception that would allow an entity to record the entire "significant" difference between the transaction price and fair value in earnings upon initial recognition if the entity is unable to identify or cannot determine the value of the other elements in the transaction.

Editor's Note: The proposed ASU clarifies that differences between transaction price and fair value should not be considered "significant" if they are due to (1) transaction fees and costs, as discussed in ASC 820-10-30-3(c), or (2) a difference in the market in which the transaction occurs compared with the market in which the entity would sell the asset or transfer the liability, as discussed in ASC 820-10-30-3(d).

Treatment of Transaction Costs and Fees

For a financial instrument classified as FV-NI, any initial transaction costs and fees (e.g., loan origination fees and costs) are recognized in net income immediately as incurred.

For a financial instrument classified as FV-OCI or amortized cost, certain transaction costs and fees are deferred and recognized in earnings as a yield adjustment over the life of the instrument in a manner broadly consistent with current U.S. GAAP. In other words, the interest method is used to amortize such transaction costs and fees to earnings over the life of the instrument.

Subsequent Measurement

In the statement of financial position, all financial assets and financial liabilities are subsequently measured at fair value, except for:

- Qualifying short-term receivables and payables that the entity elects to measure at amortized cost (see the [Classification Criteria: Amortized Cost](#) section above).
- Qualifying financial liabilities that the entity elects to measure at amortized cost (see the [Classification Criteria: Amortized Cost](#) section above).
- Certain redeemable investments, which are measured at their redemption value (further discussed below).
- Core demand deposit liabilities, which the entity measures by using a remeasurement attribute other than fair value (further discussed below).

Editor's Note: The proposed ASU would significantly expand the use of fair value measurements in the financial statements. Financial instruments that are measured at amortized cost under current U.S. GAAP, such as held-to-maturity securities, loans held for investment, and certain financial liabilities, would instead be measured at fair value in the statement of financial position. Fair value accounting would also apply to nonmarketable equity securities that are currently subject to the cost method of accounting and some that are currently subject to the equity method of accounting.

Investments Redeemable at a Specified Amount

Any investment that has **all** of the following characteristics is exempt from the fair value measurement guidance in the proposed ASU:

- It does not have a readily determinable fair value, because ownership is restricted and it lacks a market.
- It cannot be redeemed for an amount greater than the entity's initial investment.
- It is held, not for capital appreciation, but to obtain other benefits, such as access to liquidity or assistance with operations.
- It must be held for the holder to engage in transactions or participate in activities with the issuing entity.

Such an investment must be measured at its redemption value rather than at fair value. Examples of such investments include stock of the Federal Home Loan Bank (FHLB) System that a financial institution must hold to qualify to borrow from an FHLB or stock in Federal Reserve banks that a financial institution must hold as a condition for membership. Another example could be an investment in certain agricultural and other cooperative entities.

Demand Deposit Liabilities

The proposed ASU specifies a new remeasurement attribute for core demand deposit liabilities. The proposed ASU defines core deposit liabilities as "[d]eposits without a contractual maturity that management considers to be a stable source of funds, which excludes transient and surge balances." Such core deposit liabilities would, if they are due on demand, be measured "at the present value of the average core deposit amount . . . over the implied maturity of the deposits." This amount would be determined separately for each major type of deposit (e.g., non-interest-bearing checking accounts, savings accounts, and money market accounts). In discounting the core deposit amount, an entity would use a discount rate equal to the difference between the alternative funds rate (i.e., the rate of the next available source of funds) and the all-in-cost-to-service rate (i.e., a rate that includes the net direct costs to service core deposits, such as interest paid and fee income on core deposits as well as expenses of maintaining a branch network).

Changes in the remeasurement attribute for core demand deposit liabilities are recognized in net income unless the criteria for FV-OCI classification are met and the entity elects to recognize such changes in OCI.

Under the proposed ASU, noncore demand deposit liabilities must be measured at fair value. The document notes, however, that the face amount may approximate fair value if the maturity is short. Deposits with a maturity (i.e., term deposits that are not repayable on demand) are accounted for in accordance with the proposed ASU's guidance that applies to other liabilities.

Editor's Note: Two important reasons underlying the FASB's decision to propose a remeasurement attribute for core demand deposit liabilities are (1) the fact that core deposits are a key source of value for a financial institution and (2) the Board's belief that a remeasurement attribute would provide investors with useful information about assessing asset-liability mismatches.

Income Recognition

For a financial instrument classified as FV-NI, all changes in fair value during the period are recognized in net income.

For a financial instrument classified as FV-OCI, a portion of the change in fair value during the period is recognized in OCI. That portion is the total change in fair value, excluding (1) current-period interest accruals (including amortization or accretion of any premium or discount and certain deferred loan origination fees and costs), (2) current-period credit losses (or reversals), and (3) changes in fair value that are attributable to the hedged risk in a qualifying fair value hedge, which are recognized in net income. In addition, changes in fair value that were previously recognized in OCI are recognized in net income when they are realized through sale or settlement.

Editor's Note: Under the proposed ASU, foreign currency gains and losses on financial assets and financial liabilities classified as FV-OCI are not recognized in net income until realized.

Financial Statement Presentation

Statement of Financial Position

Financial instruments classified as FV-NI and FV-OCI are displayed separately on the face of the balance sheet.

For financial assets and financial liabilities classified as FV-NI, an entity must present the fair value amount on the face of the statement of financial position but is not required to present the amortized cost amount unless an entity's own outstanding debt is classified as FV-NI, in which case the entity must present the amortized cost amount in addition to the fair value amount for that debt.

For financial assets and financial liabilities classified as FV-OCI, an entity must present the following amounts in separate line items on the face of the statement of financial position:

- Amortized cost.
- Allowance for credit losses on financial assets.
- Accumulated amount needed to reconcile amortized cost less allowance for credit losses to fair value.
- Fair value.

For core demand deposit liabilities, an entity must present the following amounts in separate line items on the face of the statement of financial position:

- The amount due on demand.
- The amount needed to adjust that amount under the remeasurement method in the proposed ASU.
- The remeasured amount of the deposit.

An entity is also required to separately present, on the face of the statement of financial position, amounts included in accumulated OCI that relate to changes in fair value or the remeasurement amount (related to core deposit liabilities) that has been recognized in OCI.

Statement of Comprehensive Income

In conjunction with its proposed changes to the accounting for financial instruments under U.S. GAAP, the FASB is proposing to require entities to present a single statement of comprehensive income as part of the basic financial statements in each reporting period. That statement would include a total for comprehensive income and a subtotal for net income. Entities would continue to report basic and diluted earnings per share on the basis of net income only. (See Deloitte's [May 27, 2010, Heads Up](#) for more information about the proposed ASU on this single statement of comprehensive income.)

For financial instruments classified as FV-NI, an entity must present one aggregate amount for realized and unrealized gains and losses on the face of the statement of comprehensive income.

For financial instruments classified as FV-OCI, an entity must present the following amounts recognized in net income separately on the face of the statement of comprehensive income:

- Current-period interest income and expense, including amortization (or accretion) of any premium (or discount) at inception.
- Credit impairment for the period.
- Realized gains or losses (by means of an offsetting entry to OCI to the extent that prior-period unrealized gains or losses on the instrument were reported in OCI).

For financial instruments denominated in a foreign currency and classified as FV-OCI, foreign currency transaction gains and losses are included in OCI unless realized and are not separately recorded in net income.

For financial liabilities measured at amortized cost (other than short-term payables), an entity must present separately the following amounts within net income:

- Current-period interest expense, including amortization (or accretion) of any premium (or discount) upon incurrence.
- Realized gains or losses on settlement of liabilities.

For financial liabilities measured at fair value, an entity must separately present, on the face of the statement of comprehensive income, significant changes in fair value that are related to an entity's own credit standing (excluding changes related to fluctuations in the price of credit) for financial liabilities classified as (1) FV-NI and (2) FV-OCI.

For core demand deposit liabilities for which changes in the remeasurement amount are recorded in net income, an entity must separately present an aggregate amount for unrealized gains and losses on the face of the statement of comprehensive income.

For core demand deposit liabilities for which changes in the remeasurement amount are recorded in OCI, an entity must separately present current-period interest expense in net income on the face of the statement of comprehensive income.

Credit Impairment

The proposed ASU also includes new guidance on how entities should recognize and measure credit impairments. This guidance applies to the following financial assets that are subject to credit-risk-related losses: (1) financial assets classified as FV-OCI, (2) short-term receivables measured at amortized cost (plus or minus any fair value hedging adjustments), and (3) financial assets that can be redeemed only for a specified amount and measured at their redemption value.

Editor's Note: Unlike existing U.S. GAAP, the proposed ASU indicates that the same impairment approach would apply to loan assets, debt securities, beneficial interests in securitized financial assets, and purchased loan assets with evidence of credit deterioration. For instance, the proposed ASU's impairment guidance would replace the current U.S. GAAP approach to assessing other-than-temporary impairments that applies to debt securities.

Assessment of Credit Impairments

Under the proposed ASU, an entity would recognize a credit impairment when the entity "does not expect to collect all contractual amounts due for originated financial asset(s) and all amounts originally expected to be collected upon acquisition for purchased financial asset(s)." That is, the entity recognizes a credit impairment if it expects that there will be either a shortfall or delay in the cash flows. However, the entity does not recognize a credit impairment during the period of delay if it expects to collect all contractual amounts due, including accrued interest during the period of delay.

The proposed ASU indicates that in determining whether a credit loss exists, the entity should not apply any probability threshold. That is, in assessing credit impairment, the entity would not wait until a loss is probable before recognizing an impairment. Although the entity would not forecast future events or economic conditions that do not exist as of the reporting date in assessing a financial asset for credit impairment, the entity would consider the impact of past events and existing conditions on the current and future collectibility of the cash flows associated with the financial asset.

Editor's Note: In assessing credit impairments, an entity would consider remaining payment terms, the financial condition of the borrower or issuer, failure to make scheduled payments, expectations (based on past events and existing conditions) about potential default, credit rating, and collateral value. The entity would also consider existing environmental factors, such as industry, geographical, economic, and political data; the existing business climate in a particular industry; the level of delinquencies, bankruptcies, charge-offs, and recoveries; national, regional, or local economic conditions; and effects of credit concentrations.

Measurement of Credit Impairments

According to the proposed ASU, an entity "shall recognize . . . at the end of each financial reporting period the amount of credit impairment related to all contractual amounts due for originated financial asset(s) that the entity does not expect to collect and all amounts originally expected to be collected for purchased financial asset(s) that the entity does not expect to collect." The credit loss is recognized in net income, with an equal offset to the allowance account for credit losses related to the financial asset (i.e., Dr. Credit loss; Cr. Allowance for credit loss). The allowance is presented as a contra-asset account in the statement of financial position.

Editor’s Note: Unlike existing U.S. GAAP, the proposed ASU requires entities to use an allowance account to record credit losses for investments in debt securities classified as FV-OCI, not just for loan assets. Another difference from existing U.S. GAAP is that the proposed ASU permits entities to evaluate not only loans, but also investments in debt securities, for impairment on a pool or portfolio basis.

The proposed ASU permits an entity to assess and measure impairment either on an asset-by-asset basis or in relation to groups (pools) of assets with similar risk characteristics.

Collective (Pool) Basis

When measuring impairment on a pool basis under the proposed ASU, an entity aggregates financial assets that share common risk characteristics (e.g., collateral type, interest rate, term, industry, geographic location, risk ratings or classification, and financial asset type). In determining the amount of impairment, an entity must apply a “loss-rate” approach by using historical loss rates that apply to the relevant pool of similar financial assets, adjusted for information about collectibility, including the effect of past events and existing economic factors and conditions. Those loss rates should “reflect cash flows that the entity does not expect to collect over the life of the financial assets in the pool.” If an entity does not have any historical loss experience with similar financial assets, reference to the historical loss experience of other entities may be appropriate (i.e., when the financial assets held by the other entities have attributes similar to those of the financial assets held by the entity). The proposed ASU does not prescribe a specific method for determining historical loss rates. Rather, it states that this method “may vary depending on the size of the entity, the range of the entity’s activities, the nature of the entity’s pools of financial assets, and other factors.”

Editor’s Note: Unlike existing U.S. GAAP, the proposed ASU permits entities to measure impairment for investments in debt securities classified as FV-OCI on a group basis. Note also that the proposed ASU does not require entities to estimate future cash flows or discount them by using a present value technique in measuring impairment for a group of financial assets that are not individually identified as impaired. Instead, a historical loss rate technique is used to measure impairment in such a group. However, if an entity aggregates assets with similar risk characteristics that are individually identified as impaired, it must use a present value technique in measuring the amount of impairment in the group.

Individual Basis

For financial assets that have been individually identified as impaired, except for collateral-dependent assets for which the entity may elect to use a practical expedient, the entity must use a present value technique to measure credit impairment. In measuring the present value of the cash flows expected to be collected, the entity would discount these cash flows by using the asset’s effective interest rate (see the [Interest Income Recognition](#) section below). However, if the entity elects the practical expedient for a collateral-dependent financial asset, it would estimate impairment on the basis of the fair value of the collateral instead.

If the present value of the cash flows expected to be collected changes after the initial recognition of impairment, an additional impairment or recovery of impairment is recognized in net income (except for an increase in estimated cash flows related to certain assets acquired at a discount due to credit and for which no allowance exists; see the [Interest Income Recognition](#) section below).

For a financial asset that has been individually evaluated for impairment, but for which no impairment has been identified, an entity must assess whether, for a group of similar financial assets (i.e., assets with similar risk characteristics), a loss would have existed if the financial asset were assessed as part of a pool. If the entity determines that a loss would have existed if the financial asset were assessed as part of a pool, the entity must recognize a credit impairment for the financial asset. In such cases, the credit impairment is measured “by applying the historical loss rate (adjusted for existing economic factors and conditions) applicable to the group of similar financial assets” referenced by the entity in its assessment.

Editor’s Note: The proposed approach to measuring impairment for a financial asset that is not individually identified as impaired is different from that under existing U.S. GAAP. Under existing U.S. GAAP, debt securities typically are not assessed for impairment on a group or pool basis. While a loan asset that is not individually identified as impaired under current U.S. GAAP may be grouped with similar loan assets held by the entity to determine whether there is an incurred loss in a group of loans with similar characteristics, the entity would perform a pool assessment of impairment for such an asset under the proposed ASU even if it does not hold similar assets. Under the proposed ASU, the pool of similar assets that the entity uses to determine whether an impairment exists for a financial asset that is not individually identified as impaired could instead be a “hypothetical” pool of similar assets that the entity does not actually hold. The FASB noted that financial assets often are priced by assuming a certain amount of losses on a pool basis even though the entity initially expects to collect on each individual asset.

Direct Write-Off of Financial Assets

An entity is required to write off a financial asset (or part of a financial asset) if and when the entity has “no reasonable expectation of recovery” (i.e., the asset is uncollectible). The write-off is accomplished by a reduction of the allowance for credit losses (i.e., Dr. Allowance; Cr. Financial asset). If cash is subsequently received on a financial asset that was previously written off, this recovery is recognized in net income (i.e., Dr. Cash; Cr. Recovery).

Interest Income Recognition

The proposed ASU includes guidance on how entities should recognize interest income for financial assets that are classified as FV-OCI. Under the proposed ASU, an entity calculates interest income by applying the effective interest rate (EIR) of the financial asset to its amortized cost balance (rather than its fair value carrying amount), net of any related allowance for credit impairments.

The determination of the EIR depends on whether a financial asset was purchased at a discount related to credit quality. For originated financial assets and financial assets purchased at a discount that does not relate to credit quality, the EIR “is the rate that equates the contractual cash flows (adjusted for any [initial] net deferred loan fees or costs, premium, or discount) . . . , with the initial cash outflow.” For purchased financial assets that were acquired at a discount that relates, at least in part, to the asset’s credit quality, the EIR “is the rate that equates the entity’s estimate of cash flows expected to be collected with the purchase price of the financial asset.” The EIR is typically not adjusted for subsequent changes in expected cash flows. However, there are exceptions:

- For a financial asset with a contractual interest rate that varies on the basis of subsequent changes in an interest rate or interest rate index (e.g., LIBOR), the EIR is adjusted on the basis of the appropriate interest rate or index as it changes over the life of the asset.
- If there is an increase in the entity’s estimate of expected cash flows for a purchased financial asset acquired at a discount due to credit quality and no allowance for credit losses has been established since acquisition, the EIR is adjusted prospectively to reflect the new estimate.
- An entity’s consideration of anticipated prepayments under ASC 310-20 in determining the EIR.

The approach of recognizing interest income on the basis of an asset’s amortized cost balance, net of any allowance for credit losses, will often result in a difference between the amount of interest income accrued and the amount of interest income contractually due, since the amount contractually due does not take the allowance into account. For example, for an originated fixed-rate loan with no net deferred fees or costs, premium, or discount, the amount of cash interest received will exceed interest income accrued if there is an allowance related to the loan. When an entity receives cash in excess of accrued interest income, the entity must recognize the difference as an increase to the account for the allowance for credit losses. To the extent that the allowance account exceeds the entity’s estimate of expected credit losses, the difference would be recognized in income as a recovery of impairment, with an offsetting reduction of the allowance account (i.e., Dr. Allowance; Cr. Recovery).

Under the proposed interest income model, the current practice of placing loans on nonaccrual status would no longer apply unless the financial asset has a negative yield (e.g., if the gross undiscounted cash inflows expected to be collected are less than the original cash outflow). The proposed ASU indicates that in such cases, a cost recovery method should be used.

Hedge Accounting

The proposed ASU also includes changes to the hedge accounting requirements in ASC 815. These changes apply to all hedging relationships and are in most respects consistent with the FASB’s exposure draft of a proposed Statement, *Accounting for Hedging Activities*, which was issued in June 2008. In contrast to the 2008 exposure draft, however, the proposed ASU retains ASC 815’s provision that allows an entity to designate hedging relationships by risk (i.e., benchmark interest rate risk, foreign currency exchange rate risk, and credit risk) for financial hedged items.

The following paragraphs summarize key changes proposed to the hedge accounting requirements in ASC 815:

Effectiveness Assessment

In an attempt to reduce some of the complexities many preparers face in complying with the current hedge effectiveness requirements in ASC 815, the proposed ASU lowers the minimum threshold to qualify for hedge accounting from “highly effective” to “reasonably effective.” Because the term “reasonably effective” is not defined, the proposed ASU suggests that preparers must use judgment in determining whether the hedging relationship is reasonably effective. The FASB notes that “judgment should include a holistic consideration of all the facts and circumstances that led an entity to enter into a hedging relationship.”

Also eliminated is the requirement to always assess hedge effectiveness quantitatively. Instead, for most hedging relationships, a qualitative assessment demonstrating that an economic relationship exists between the hedging instrument and the hedged item is sufficient to show that the hedging instrument will be reasonably effective at achieving offset. However, an entity would need to perform a quantitative analysis if a qualitative assessment cannot establish that the hedge will be reasonably effective. After hedge inception, an entity would not need to perform any assessments of hedge effectiveness unless changes in circumstances indicate that the hedging relationship may no longer be reasonably effective.

Editor's Note: While an entity generally would not need to quantitatively assess hedge effectiveness to qualify for hedge accounting either at inception or on an ongoing basis, an entity would continue to be required to perform a quantitative measurement when recording the hedging relationship in the financial statements and recognizing any actual ineffectiveness in net income.

The proposed ASU eliminates the shortcut and critical-terms-match methods of hedge accounting under ASC 815. Thus, an entity could not assume that such a hedging relationship is perfectly effective or that no ineffectiveness needs to be recognized in earnings.

Measuring and Reporting Ineffectiveness in Cash Flow Hedges

Under the proposed ASU, cash flow hedge ineffectiveness is measured by comparing the change in fair value of the actual hedging instrument with the present value of the cumulative change in expected future cash flows of the hedged transaction. Unlike existing U.S. GAAP, the proposed ASU would also require entities to record ineffectiveness for underhedges in earnings. The proposed ASU suggests that an entity could use a hypothetical derivative to measure the cumulative change in expected future cash flows of the hedged transaction. That hypothetical derivative would (1) be priced at market, (2) mature on the date of the hedged transaction, and (3) exactly offset the hedged cash flows. An entity would be permitted, when constructing a hypothetical derivative, to use the same credit risk adjustment it used to calculate the fair value of the actual hedging derivative.

The proposed ASU also provides guidance on effectiveness assessments and measurements for cash flow hedges of a group of forecasted transactions within a specific period. Under the proposed ASU, an entity is allowed to assess and measure effectiveness by using a hypothetical "derivative that would settle within a reasonable period of time of the cash flows related to the hedged transactions." The entity may consider the period reasonable if the "difference is minimal between the forward rate on that derivative and the forward rate on a derivative or derivatives that would exactly offset the changes in cash flows of the forecasted transactions."

Ability to Dedesignate a Hedging Relationship

Unlike existing U.S. GAAP, the proposed ASU prohibits an entity from electively removing a hedge designation. A hedging relationship can be discontinued only if it no longer meets one of the required hedging criteria in ASC 815 or if the hedging instrument expires or is sold, terminated, or exercised. The FASB is proposing this change because it believes that an entity should only be permitted to discontinue hedge accounting if the economic relationship between the hedging instrument and the hedged item has changed. The Board does not believe that entities should be able to use dedesignations that do not involve actual economic transactions as a tool to change measurement attributes or the classification of transactions reported in net income.

The proposed ASU suggests that "a hedging derivative instrument may be considered to be effectively terminated when an offsetting derivative instrument is entered into; however, concurrent documentation of this effective termination is required." Once a hedging derivative instrument is considered "effectively terminated," the entity would be prohibited from later designating the hedging instrument or the offsetting derivative instrument in a new hedging relationship.

Effective Date and Transition

The proposed ASU does not currently have an effective date. The FASB plans to decide on the effective date when it considers the comments received on the proposed standard. Early adoption would be prohibited. The transition would be applied via a cumulative-effect adjustment to the statement of financial position for the reporting period that immediately precedes the effective date. For example, if the proposed ASU were to be effective for periods beginning after December 15, 20X3, a calendar-year entity would be required to restate its statement of financial position as of December 31, 20X3, in its financial report for the first quarter of 20X4.

For nonpublic entities with less than \$1 billion in total consolidated assets, the FASB is proposing that the effective date of certain provisions of the proposed ASU be deferred for four years after the original effective date of the final standard. The deferral applies to loans, loan commitments, and core deposit liabilities to allow the entities concerned to develop infrastructure to effectively remeasure core deposit liabilities under the proposed ASU and gain experience in estimating the fair value of loans and loan commitments. However, these entities would be required to adopt the other provisions of the proposed ASU.

International Convergence and Project Timeline

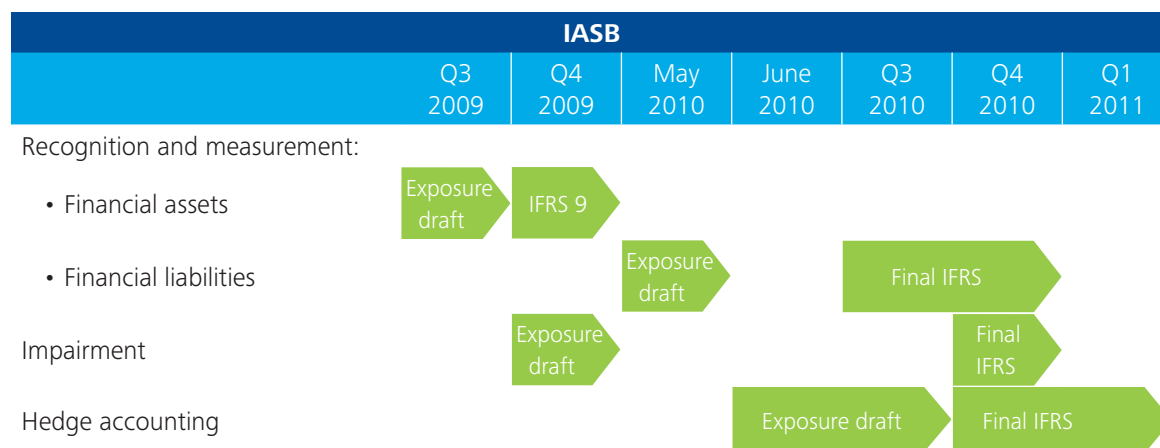
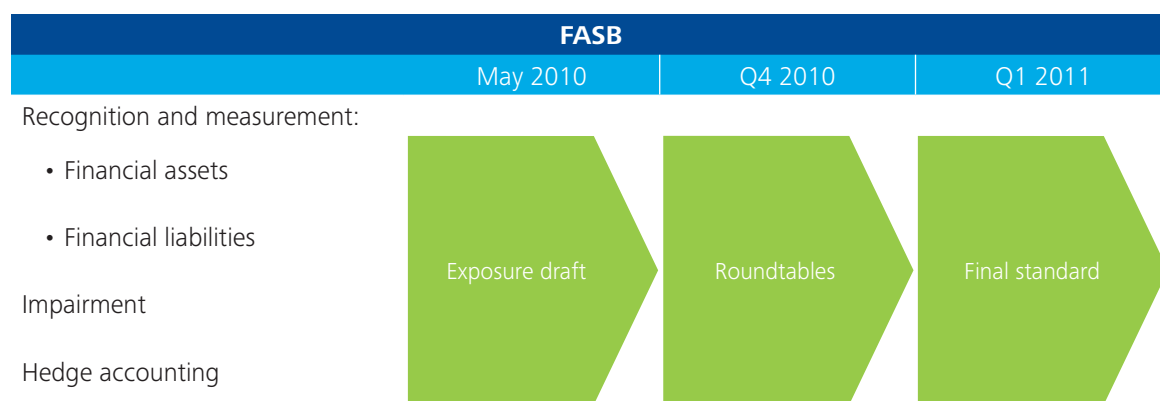
As noted earlier, the FASB's and IASB's project plans and accounting approaches for financial instruments differ in important respects. In a [joint status report](#) issued on April 14, 2010, the two boards acknowledged these differences and identified a strategy for moving forward with convergence in this area:

[Each] board has faced different imperatives that pushed our development timetables out of alignment. In particular, the IASB has been replacing its financial instrument requirements in a phased approach, whereas the FASB has been developing a comprehensive proposal. Those differing development timetables and other factors have contributed to the boards reaching differing conclusions on a number of important technical issues . . .

Our strategy for addressing those differences calls for each board to publish its proposals and that of the other board, as a way of giving interested parties the opportunity to compare and assess the relative merits of both boards' proposals. . . .

Our strategy also calls for us to consider together the comment letters and other feedback we receive in an effort to reconcile our differences in ways that foster convergence. We expect to begin those joint discussions in the third quarter of 2010. Although our recent experiences with joint meetings show that we have been able to resolve differences on several projects, **there is no guarantee we will be able to resolve all, or any, of our differences on this project.** [Emphasis added]

The tables below gives an overview of each board's progress in the project on accounting for financial instruments:



Appendixes

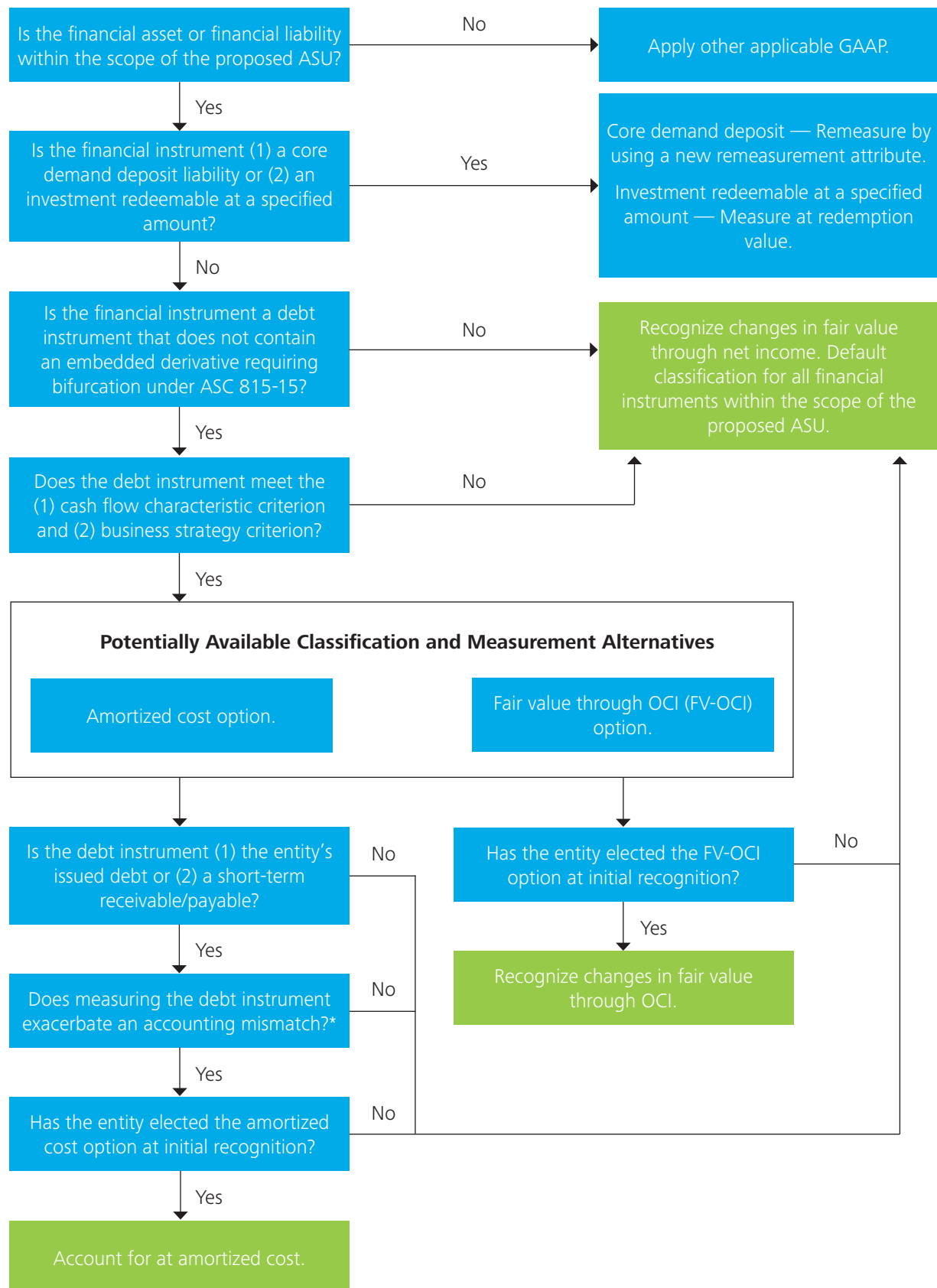
Appendix A: Scope Exceptions

This appendix identifies financial instruments that are outside the scope of the proposed ASU:

1. An equity instrument classified in stockholders' equity in its entirety (e.g., equity-classified common or preferred shares and equity-classified warrants, options, or forward contracts on an entity's own shares).
2. An equity component that has been bifurcated from a hybrid instrument and classified in shareholders' equity in accordance with U.S. GAAP (e.g., an equity-classified component of convertible debt).
3. An employer's or plan's obligation for pension benefits; other retirement benefits, including health care and life insurance benefits; postemployment benefits; employee stock options and stock purchase plans; and other forms of deferred compensation arrangements (see ASC 710-10-15-3, ASC 712-10-15-3, ASC 715-10-15-3, ASC 718-10-15-3, ASC 960, ASC 962, and ASC 965).
4. A contract within the scope of ASC 944 on insurance, except for deposit-type and investment contracts issued by insurance entities.
5. An investment in another entity's equity instrument that qualifies for equity method accounting under ASC 323.
6. An equity investment in a consolidated subsidiary (see ASC 810-10).
7. A noncontrolling interest in a consolidated subsidiary (see ASC 810-10).
8. An interest in a variable interest entity that the entity is required to consolidate (see ASC 810-10).
9. A financial asset or financial liability pertaining to a lease that is accounted for under ASC 840.
10. From the holder's (potential borrower's) perspective, loan commitments or financial standby letters of credit, including revolving lines of credit issued under a credit card arrangement.
11. A conditional obligation to make future payments or otherwise transfer consideration under a registration payment agreement (see ASC 825-20). Debt instruments that are subject to a registration payment arrangement would not be outside the scope of the proposed ASU under this provision.
12. A contingent consideration arrangement based on a nonfinancial variable (e.g., a specified volume of sales).
13. A not-for-profit entity's receivable or payable that arises from voluntary nonreciprocal transfers.
14. Any of the following financial guarantee contracts:
 - a. A contract that provides for payments that constitute a vendor rebate.
 - b. A guarantee or an indemnification whose existence prevents the guarantor from being able to either account for a transaction as the sale of an asset that is related to the guarantee's underlying or recognize in earnings the profit from the sale transaction.
 - c. A guarantee or an indemnification of an entity's own future performance.
 - d. A product warranty or other guarantee for which the underlying is related to the functional performance of a nonfinancial asset owned by the guaranteed party.
 - e. A guarantee issued between a parent and its subsidiary or between entities under common control.
 - f. A parent's guarantee of its subsidiary's debt to a third party.
 - g. A subsidiary's guarantee of the debt owed to a third party by either its parent or another subsidiary of that parent.
15. Forward contracts that require physical settlement by repurchase of a fixed number of the issuer's equity shares in exchange for cash accounted for in accordance with ASC 480-10-35-3.
16. Any of the following instruments that are outside the scope of ASC 815 on derivatives and hedging:
 - a. A forward contract related to a regular-way securities trade.
 - b. A derivative that is an impediment to sale accounting under ASC 860.

- c. An investment contract accounted for under ASC 960 on plan accounting for certain benefit plans.
- d. A contract that is not exchange-traded and for which the underlying is any of the following:
 - i. A climatic or geological variable.
 - ii. The price or value of a nonfinancial asset or liability of one of the parties to the contract, provided that the asset is not readily convertible to cash.
 - iii. Specified volumes of sales or service revenues of one of the parties to the contract.
- e. A policyholder's investment in a life insurance contract accounted for under ASC 325-30.
- f. A contract between a potential acquirer and seller to enter into a business combination on a future date.

Appendix B: Decision Tree Illustrating the Proposed ASU's Classification and Measurement Model



* Criterion not applicable to a short-term receivable/payable.

Appendix C: Classification and Measurement

The following table summarizes similarities and differences between the FASB's and the IASB's approaches to classification and measurement of financial assets and financial liabilities. The FASB's approach is described in the proposed ASU on accounting for financial instruments. The IASB's approach to financial assets is covered in IFRS 9, *Financial Instruments*, which was published in November 2009, while its approach to financial liabilities is described in its exposure draft *Fair Value Option for Financial Liabilities*, published in May 2010.

Subject	FASB's Proposed ASU	IASB's Approach
Categories of financial assets and financial liabilities	<p>Effectively, six categories of financial assets and financial liabilities:</p> <ol style="list-style-type: none"> 1. Fair value through net income (FV-NI; default category). 2. Fair value through other comprehensive income (FV-OCI; elective for qualifying debt instruments). 3. Amortized cost (elective for qualifying liabilities and short-term payables and receivables). 4. Redemption value (required for certain redeemable investments). 5. Remeasurement approach for core deposits through net income (default category for core demand deposit liabilities). 6. Remeasurement approach for core deposits through other comprehensive income (elective for qualifying core demand deposit liabilities). 	<p>Effectively, three categories of financial assets:</p> <ol style="list-style-type: none"> 1. Fair value through profit or loss (FVTPL). 2. Amortized cost (required for certain debt instruments). 3. Fair value through other comprehensive income (FV-OCI; elective for equity investments). <p>Effectively, three categories of financial liabilities:</p> <ol style="list-style-type: none"> 1. FVTPL (required for trading and derivative liabilities). 2. Fair value, with changes attributable to an entity's own credit risk recognized in other comprehensive income and other changes recognized in profit or loss (required for financial liabilities elected under the fair value option). 3. Amortized cost (required for certain debt instruments).
Criteria for amortized cost measurement	<p>An entity has the option to elect to carry the following financial instruments at amortized cost:</p> <ol style="list-style-type: none"> 1. Short-term receivables and payables (other than short-term lending arrangements, such as credit card receivables) arising in the normal course of business and due in customary terms not exceeding one year that meet the criteria for classification as FV-OCI (see below). 2. Financial liabilities that meet the criteria for classification as FV-OCI (see below), provided that measuring the financial liability at fair value would create or exacerbate an accounting mismatch. 	<p>A financial asset must be carried at amortized cost if it meets both of the following criteria:</p> <ol style="list-style-type: none"> 1. <i>Business model</i>— The objective of the entity's business model is to hold assets to collect the contractual cash flows. 2. <i>Cash flow characteristics</i>— The asset's contractual cash flows represent payment of principal and interest. <p>A financial liability must be carried at amortized cost if it is not held for trading and the entity has not elected the fair value option.</p>
Criteria for FV-OCI classification	<p>An entity has the option to classify a financial asset or financial liability as FV-OCI if it meets all of the following criteria:</p> <ol style="list-style-type: none"> 1. <i>Cash flow characteristics</i>— A debt instrument that cannot contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its initially recorded investment, other than through its own choice. 2. <i>Business strategy</i>— Business strategy for the instrument is to collect or pay the related contractual cash flows. 3. <i>No embedded derivative required to be separated</i>— It is not a hybrid instrument for which an embedded derivative is required to be separated under existing U.S. GAAP. <p>For instruments in this category, current-period interest accruals, credit losses, and realized gains or losses are recognized in earnings.</p>	<p>Upon initial recognition, an entity has the option to irrevocably elect to classify an equity investment as FV-OCI. For this category, both unrealized and realized gains and losses are recorded in OCI, while dividend income is recorded in profit or loss unless the dividend clearly represents a recovery of part of the cost of the investment.</p>
Reclassification of accumulated OCI to net income	Amounts in accumulated OCI are recycled to net income upon sale, settlement, or impairment.	Amounts in accumulated OCI are permanently deferred in equity.
Equity investments	Carried at fair value, with changes in fair value recognized in earnings, except for certain redeemable investments that are carried at redemption value, with changes in the redemption value recognized in earnings.	Carried at fair value, with changes in fair value recognized in profit or loss, except for investments that an entity irrevocably elects to classify as FV-OCI on initial recognition.

Subject	FASB's Proposed ASU	IASB's Approach
Embedded derivatives in hybrid financial contracts	<p>Hybrid financial contracts with an embedded derivative, which currently must be bifurcated under ASC 815 (formerly FASB Statement No. 133, <i>Accounting for Derivative Instruments and Hedging Activities</i>), would instead be measured in their entirety at fair value, with changes in fair value recognized in earnings. No embedded derivative would be bifurcated from a hybrid financial asset or liability (except for hybrid financial instruments that are outside the proposed ASU's scope).</p> <p>An entity is permitted to classify as FV-OCI hybrid financial contracts that meet the FV-OCI classification criteria and that contain an embedded derivative that does not require bifurcation under ASC 815.</p>	<p>The embedded derivative guidance is eliminated for hybrid financial assets (except for hybrid financial assets that are outside the proposal's scope). That is, embedded derivatives would never be bifurcated from such assets.</p> <p>The embedded derivative guidance is retained for hybrid financial liabilities. That is, embedded derivatives would continue to be bifurcated from such liabilities if they meet the criteria for bifurcation.</p>
Fair value option	No explicit fair value option.	<p>Retained for financial assets but only available when a fair value designation eliminates or significantly reduces an accounting mismatch; irrevocable election at initial recognition.</p> <p>Retained for financial liabilities and available when a fair value designation eliminates or significantly reduces an accounting mismatch or an entity manages and evaluates a group of instruments on a fair value basis or the liability contains certain types of embedded derivatives. Changes in total fair value are recognized in profit or loss, with an entry to reclassify changes attributable to changes in an entity's own credit from earnings to OCI. Recycling of amounts initially recognized in OCI is prohibited.</p>
Reclassification	Not permitted.	Required for a financial asset if the business model changes; however, changes in the business model are expected to be infrequent.

Appendix D: Impairment Model

The following table summarizes similarities and differences between the FASB's and the IASB's approaches to recognition and measurement of impairment of financial assets. The FASB's approach is described in the proposed ASU on accounting for financial instruments. The IASB's approach is described in its exposure draft *Amortised Cost and Impairment*, published in November 2009.

Subject	FASB's Proposed ASU	IASB's Exposure Draft, November 2009
Scope	Financial assets classified as FV-OCI and short-term receivables accounted for at amortized cost.	Financial assets accounted for at amortized cost.
Probability threshold for recognition of impairment	No. All information related to past events and existing conditions is considered.	No.
Measurement of impairment	An entity measures impairment of financial assets that are individually identified as impaired by using the present value of expected future cash flows, except that the fair value of collateral may be used as a practical expedient to measure impairment of collateral-dependent assets. An entity measures impairment of financial assets that are assessed as a group by using a historical loss rate that is adjusted for current conditions.	An entity measures impairment of financial assets by using the present value of expected future cash flows.
Effective interest rate (EIR)	At initial recognition, the EIR is not adjusted for initially expected future credit losses, except in the case of purchased financial assets for which credit losses are expected at the time of purchase.	At initial recognition, the EIR is adjusted to exclude a margin for initially expected future credit losses over the life of the financial asset. This adjustment has the effect of reducing reported interest income and gradually building up an allowance for credit losses over the life of an asset before actual losses occur.
Interest recognition	Interest income is calculated by applying the EIR to the amortized cost basis, net of any related allowance for credit impairments.	Interest income is calculated by applying the EIR to the amortized cost basis, net of any related allowance for credit impairments.
Ongoing reassessment	Yes. Changes in expected cash flows typically result in recoveries (gains) or losses.	Yes. Changes in expected cash flows result in recoveries (gains) or losses.

Appendix E: Hedge Accounting

The following table summarizes the FASB's approach to hedge accounting, as described in the proposed ASU on accounting for financial instruments. The IASB has not yet finalized its proposed approach to hedge accounting.

Subject	FASB's Proposed ASU
Hedgeable risks	The proposed ASU retains the provision under current U.S. GAAP (ASC 815) that allows an entity to designate hedges of financial items for certain risks (e.g., benchmark interest rate risk, foreign currency risk, credit risk).
Threshold for hedge accounting	Reasonably effective.
Means of assessing effectiveness	Typically, only a qualitative assessment is required; however, a quantitative assessment may be necessary if the qualitative assessment is not conclusive.
Frequency of hedge effectiveness assessments	Inception only, unless reassessment is warranted because of a change in circumstances.
Assumption that a hedge is perfectly effective	Neither the shortcut method nor the critical-terms-match method is permitted.
Determination of amounts recorded in OCI for cash flow hedges	Recorded at the amount necessary to offset the present value of the cumulative change in expected future cash flows on the hedged transaction since hedge inception.
Dedesignating a hedging relationship	An entity cannot remove hedge designation after it has been established; however, the entity may enter into an offsetting derivative to effectively terminate the hedge.

Subscriptions

If you wish to receive *Heads Up* and other accounting publications issued by Deloitte's Accounting Standards and Communications Group, please [register](http://www.deloitte.com/us/subscriptions) at www.deloitte.com/us/subscriptions.

Dbriefs for Financial Executives

We invite you to participate in *Dbriefs*, Deloitte's webcast series that delivers practical strategies you need to stay on top of important issues. Gain access to valuable ideas and critical information from webcasts in the "Financial Executives" series on the following topics:

- Corporate governance.
- Financial reporting.
- Risk intelligence.
- Driving enterprise value.
- Financial reporting for taxes.
- Transactions and business events.

Dbriefs also provides a convenient and flexible way to earn CPE credit — right at your desk. [Join *Dbriefs*](#) to receive notifications about future webcasts at www.deloitte.com/us/dbriefs.

Registration is available for this upcoming *Dbriefs* webcast. Use the link below to register:

- [Compensation Update: Redefining the Norm](#) (June 2, 2 p.m. (EDT)).

Technical Library: The Deloitte Accounting Research Tool

Deloitte makes available, on a subscription basis, access to its online library of accounting and financial disclosure literature. Called Technical Library: The Deloitte Accounting Research Tool, the library includes material from the FASB, the EITF, the AICPA, the PCAOB, the IASB, and the SEC, in addition to Deloitte's own accounting and SEC manuals and other interpretive accounting and SEC guidance.

Updated every business day, Technical Library has an intuitive design and navigation system that, together with its powerful search features, enable users to quickly locate information anytime, from any computer. In addition, Technical Library subscribers receive *Technically Speaking*, the weekly publication that highlights recent additions to the library.

For more information, including subscription details and an online demonstration, visit www.deloitte.com/us/techlibrary.

Heads Up is prepared by the National Office Accounting Standards and Communications Group of Deloitte as developments warrant. This publication contains general information only and Deloitte is not, by means of this publication, rendering accounting, business, financial, investment, legal, tax, or other professional advice or services. This publication is not a substitute for such professional advice or services, nor should it be used as a basis for any decision or action that may affect your business. Before making any decision or taking any action that may affect your business, you should consult a qualified professional advisor.

Deloitte shall not be responsible for any loss sustained by any person who relies on this publication.

As used in this document, "Deloitte" means Deloitte & Touche LLP, a subsidiary of Deloitte LLP. Please see deloitte.com/us/about for a detailed description of the legal structure of Deloitte LLP and its subsidiaries.

Copyright © 2010 Deloitte Development LLC. All rights reserved.