



Accounting Roundup — Special Edition

First Wave of Accounting Changes Coming

Updated January 2011



A Compendium of the FASB's Joint and Individual Projects

by Deloitte & Touche LLP's Accounting Standards and Communications Group

January 2011 Update

On November 29, 2010, the FASB and IASB gave an [update](#) on their convergence agenda. The boards decided to delay the timing of (1) several convergence projects, including financial statement presentation, financial instruments with characteristics of equity, and investment company accounting (a phase of the consolidations project), and (2) a number of independent standard-setting projects, such as the FASB's project on disclosures about certain loss contingencies. The boards reasoned that the delay of these projects would allow them to focus on high-priority projects for which the boards remain committed to issue final standards by June 2011. These high-priority projects include financial instruments, leases, revenue recognition, fair value measurement, and presentation of other comprehensive income.

This update to *Accounting Roundup — Special Edition* reflects (1) the FASB's and IASB's revisions to their agenda and timeline (discussed in the Next Steps sections of the project updates in this publication) and (2) developments that have occurred in the joint and FASB-only projects since the original issuance of this publication. In addition, this special edition focuses on the projects with the broadest applicability and potential impact on financial reporting. It is not intended to be a "deep dive" into each of those projects; rather, it is meant to highlight some of the key changes the projects would make.

This publication does not address effective dates because the two boards have yet to decide whether they should set (1) the same effective date for all joint projects (an approach that some have termed the "Big Bang") or (2) separate effective dates for each respective project. In October 2010, the FASB and IASB issued a [discussion paper](#) that lays out these two alternatives and proposes different transition methods for different projects. For further details, see Deloitte's October 21, 2010, [Heads Up](#).

Editor's Note: During a January 25, 2010, webcast, FASB Chairman Leslie Seidman noted that most respondents to the discussion paper to date "seem to support adopting the standards all at once," which she found surprising. She further stated that "most people seem to support a limited form of retrospective application — that is, go back as far as you practically can and provide some disclosure to provide a bridge for investors about trend information . . . for at least some period of time."

Much of the recent debate in the financial reporting community has focused on whether and, if so, when U.S.-based public entities should be permitted or required to adopt IFRSs as a basis of financial reporting. The SEC is expected to decide on the use of IFRSs for U.S. public entities later this year. In the meantime, the FASB and IASB have been working both individually and jointly on a number of projects that, if finalized, would bring about a seismic shift in the accounting and financial reporting landscape.

Regardless of whether the SEC adopts IFRSs in the United States, U.S.-based public entities should expect, and prepare for, significant changes to existing U.S. GAAP as a result of the FASB's and IASB's convergence efforts.

While the FASB and IASB have been working together for over a decade, their more recent collaborative efforts have been under the auspices of a "Memorandum of Understanding" (originally the Norwalk Agreement that was signed in 2002). Recently, the two boards committed to expediting many of the joint projects in an effort to complete them by mid-2011. So, regardless of whether the SEC adopts IFRSs in the United States, U.S.-based public entities should expect, and prepare for, significant changes to existing U.S. GAAP as a result of the FASB's and IASB's convergence efforts.

While the FASB and IASB are working jointly on a number of projects, the focus of this special edition of *Accounting Roundup* is on the FASB's activities and the decisions that it has reached to date. These activities and the resulting changes to U.S. GAAP will affect U.S.-based entities the most in the short term.

Not interested in reading the thousands (yes, we said thousands) of pages of new accounting guidance when the final standards are issued? Well, in our customary fashion, we will issue a *Heads Up* newsletter on each of these projects as they are exposed for public comment and again as they become final standards. The *Heads Up* newsletters provide that deeper dive into each of the proposed standards. Not a subscriber to our *Heads Up* newsletters? Follow this [link](#) to sign up.

Updated Timeline of FASB's Major Projects

	Expected Date				Page Number
	1Q	2Q	3Q	4Q	
Joint FASB/IASB Projects					1
Presentation of Financial Statements					1
Financial Statement Presentation					1
Discontinued Operations		E		F	1
Other Comprehensive Income	F				2
Financial Instruments					2
Accounting for Financial Instruments	D	F			2
Offsetting	E, R	F			5
Financial Instruments With Characteristics of Equity					5
Leases		F			6
Revenue Recognition		F			7
Consolidation	E	E		F	8
Fair Value Measurement	F				9
Insurance					10
FASB-Only Projects					11
Troubled Debt Restructurings	F				11
Deferral of Effective Date of Disclosures About Troubled Debt Restructurings in ASU 2010-20	F				11
Transfers and Servicing — Repurchase Agreements	F				11
Investment Properties		E		F	11
Risks and Uncertainties (Formerly Going Concern)					12
Disclosures About Certain Loss Contingencies					12
Disclosures About an Employer's Participation in a Multiemployer Plan		F			13
Key Takeaways					13

* If necessary.

D Discussion Paper

E Exposure Draft

F Final Document

R Roundtable Discussion

Joint FASB/IASB Projects

Presentation of Financial Statements

Financial Statement Presentation

Affects: Most entities.¹

Summary: In this project, the boards are taking a "fresh look" at the manner in which entities present financial information in their statement of financial position, statement of comprehensive income, and statement of cash flows. The boards expect the revised financial statement format to be more cohesive and split between business (i.e., operating and investing) and financing activities. This format would largely resemble the current presentation in the statement of cash flows. The intent of requiring a single financial statement presentation is to enhance the usefulness of financial information and increase the comparability and consistency of financial statements within and across entities. Specific changes would include the following:

- *Statement of financial position* — Requiring presentation of assets and liabilities by major activity within operating, investing, and financing categories.
- *Statement of comprehensive income* — Requiring a single statement of comprehensive income grouped by using the same categories as those in the statement of financial position; further disaggregation of line items in the statement would be required.
- *Statement of cash flows* — Requiring separate presentation of the main categories of cash receipts and cash payments for operating activities (i.e., direct method) rather than a reconciliation of net income to net operating cash flows (i.e., indirect method). However, a reconciliation of operating income to net operating cash flows would be required in the notes to the financial statements.
- *Notes to the financial statements* — Requiring disclosure of the rationale used to classify assets and liabilities into categories and sections in the statement of financial position. In addition, an entity would be required to provide a reconciliation of beginning to ending balances of select assets and liabilities that management deems to be important to understanding the entity's financial position.

Consideration Points: As a result of the revised financial statement presentation, entities may need to reassess their financial reporting processes to evaluate the manner in which they will adhere to these new requirements, particularly the shift to the direct method of presenting cash flows. This assessment could include an evaluation of the information technology systems or other processes used to gather financial statement information, the internal controls over the financial reporting process, and the resources within the financial reporting function for implementing necessary changes. Further, the proposed standard would most likely require entities to disaggregate their financial information and provide disclosures beyond what they currently present in their financial statements. Thus, entities may need to evaluate (1) the effect of having to provide this additional financial information (e.g., the time it takes to identify, gather, and prepare the financial statements) and (2) how financial statement users analyze the information.

Next Steps: The FASB and IASB halted deliberations of their financial statement presentation project until after June 2011, at which point we would expect the boards to provide additional information about the direction of this project. The delay in the project will give the boards time to perform and finalize additional outreach, address concerns of constituents, and further develop other convergence priorities.

Other Resources: Deloitte's July 8, 2010, [Heads Up](#). ●

Discontinued Operations

Affects: All entities.

Summary: In September 2008, the FASB published an [exposure draft](#) that proposed to amend the criteria for reporting discontinued operations. Since then, the FASB has redeliberated the feedback received from constituents on the exposure draft and has tentatively decided the following:

- To align the scope of ASC 205-20² with that of IFRS 5³ to apply to all recognized noncurrent assets and to all disposal groups of an entity. Thus, a discontinued operation would be either (1)

¹ The proposed standard would not apply to the structure and content of general-purpose financial statements prepared by a not-for-profit entity or benefit plan within the scope of FASB Accounting Standards Codification Topics 960, *Plan Accounting — Defined Benefit Pension Plans*; 962, *Plan Accounting — Defined Contribution Pension Plans*; and 965, *Plan Accounting — Health and Welfare Benefit Plans*. Further, certain provisions would not apply to nonpublic entities, certain investment companies, common trust funds, variable annuity accounts, or similar funds that meet specific requirements.

² FASB Accounting Standards Codification Subtopic 205-20, *Presentation of Financial Statements: Discontinued Operations*.

³ IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.

a component of an entity that either has been disposed of or is classified as held for sale and that represents (or is part of a single coordinated plan to dispose of) a separate major line of business or geographical area of operations, or (2) a business that, on acquisition, meets the criteria for classification as held for sale.

Editor's Note: The FASB expects the changes in scope to have a limited impact on entities, except for disposals of certain equity method investments, which now might qualify as discontinued operations.

- To require specific disclosures for (1) disposals of components that meet, and disposals of significant components that do not meet, the revised criteria for classification as a discontinued operation; (2) disposals of long-lived assets that are not components of an entity; and (3) continuing involvement with discontinued operations and continuing cash flows between discontinued operations and the entities that remain after the disposal date.

Next Steps: The FASB expects to issue an exposure draft in the second quarter of 2011. The Board's goal is to issue a final standard in the fourth quarter of 2011. ●

Other Comprehensive Income

Affects: All entities, except those that have no other comprehensive income in any period presented or not-for-profit entities that are required to follow the guidance in ASC 958-205.⁴

Summary: Under current U.S. GAAP, entities can choose between several alternatives for displaying other comprehensive income and its components in the financial statements. In May 2010, the FASB issued an [exposure draft](#) that proposes to eliminate those choices and to require entities to present comprehensive income in one continuous statement that displays net income and the components of other comprehensive income.

The FASB has since redeliberated the feedback received on the exposure draft and tentatively decided:

- To require "entities to present net income and other comprehensive income either in a single continuous statement or in two separate, but consecutive, statements."
- To require presentation of reclassification adjustments in both other comprehensive income and net income.
- To permit entities to present other comprehensive income items "either net of tax with details in the notes or gross of tax with each item's tax effect displayed parenthetically."
- To retain the current calculation of earnings per share on the basis of net income available to common shareholders.

Next Steps: The Board's goal is to issue a final standard in the first quarter of 2011.

Other Resources: Deloitte's May 27, 2010, [Heads Up](#). ●

Financial Instruments

Accounting for Financial Instruments

Affects: All entities.

Summary: In May 2010, the FASB published an [exposure draft](#) that would affect the accounting for a broad range of financial instruments, including investments in debt and equity securities, investments in nonmarketable equity securities, loans, loan commitments, deposit liabilities, trade payables, trade receivables, derivative financial instruments, and debt liabilities. The changes contemplated would affect (1) classification and measurement of financial instruments, (2) accounting for impairment of financial assets, and (3) hedge accounting.

⁴ FASB Accounting Standards Codification Subtopic 958-205, *Not-for-Profit Entities: Presentation of Financial Statements*.

The default classification and measurement of financial instruments within the scope of the exposure draft would be fair value, with changes in fair value recognized in net income (FV-NI). However, the exposure draft contains exceptions to the default classification and measurement guidance. Entities could elect to recognize and measure financial assets that are debt instruments at fair value, with certain unrealized changes in fair value recognized in other comprehensive income (FV-OCI), if (1) the asset has qualifying cash flow characteristics, (2) is held as part of a business strategy to collect the contractual cash flows, and (3) is not a hybrid financial instrument that contains an embedded derivative for which ASC 815-15⁵ would otherwise have required bifurcation. Entities would also have the option to measure certain financial liabilities at amortized cost if (1) the liability meets the FV-OCI criteria and (2) measuring the financial liability at fair value creates or exacerbates an accounting mismatch. An accounting mismatch may occur, for example, when the financial liability is contractually linked to an asset that is measured at amortized cost. Note that entities would classify financial liabilities (other than core deposit liabilities) that do not qualify for amortized cost as FV-NI (or as FV-OCI if the conditions discussed above for measuring financial assets at FV-OCI were met). Lastly, hybrid financial instruments would be recognized and measured at either FV-NI or FV-OCI (if the conditions discussed above are met) and the requirement to bifurcate the embedded feature from the host contract would be eliminated. The exposure draft also would require that once entities determine the classification of financial instruments at initial recognition, they cannot subsequently change it. If the FASB finalizes the exposure draft as currently drafted, the existing classification categories, such as available for sale and held to maturity, would be eliminated. The proposed classification guidance would also apply to all trade payables and receivables with maturities greater than one year.

Editor's Note: In the feedback the FASB received on its exposure draft, many respondents expressed their belief that amortized cost is the most relevant measurement attribute for loans, core deposits, and an entity's own debt. Many respondents cited the subjectivity of fair value measurements and a potentially inappropriate negative impact on regulatory capital as reasons why fair value was not appropriate for these instruments. In addition, most nonusers recommended a mixed-attribute model based on an entity's business strategy. For example, (1) financial instruments held for collection or payment of cash flows could be measured at amortized cost and (2) financial instruments held for trading could be measured at FV-NI.

During its redeliberations, the Board tentatively agreed to significantly revise its proposed classification and measurement model for financial assets. Under the revised model, the FV-NI category would encompass an entity's trading or held-for-sale activities. The FV-OCI category would apply to financial assets that are being managed in accordance with an investing activity, with a focus on managing risk exposures (interest rate risk and liquidity risk) and maximizing total return. The amortized cost category would apply to financial assets for which an entity's business strategy is managing the assets for the collection of the contractual cash flows through a lending or customer financing activity.

The Board also tentatively agreed to prohibit reclassification between categories and reaffirmed its previous conclusion that gains and losses on financial assets classified as FV-OCI would be recognized in net income, when such gains and losses are realized from sales or settlements.

According to the exposure draft, entities would not consider a probability threshold in determining whether a credit loss exists and in quantifying such a loss; rather, they would consider all past and current events and existing conditions. Entities would be required to assess credit impairment in each reporting period and to recognize the credit impairment in earnings. Other unrealized changes in the fair value of the instrument (e.g., changes in the fair value as a result of changes in market interest rates) would be recognized in OCI. The proposed impairment model would also prescribe a revised approach for measuring interest income to be accrued and recognized in net income. Entities using this approach would calculate the amount of interest income by applying the effective interest rate to the amortized cost of the financial asset, reduced by any related allowance for credit impairment.

⁵ FASB Accounting Standards Codification Subtopic 815-15, *Derivatives and Hedging: Embedded Derivatives*.

Editor’s Note: Many respondents to the FASB’s exposure draft expressed concern about limiting management’s expectations regarding losses to current conditions. Many recommended that the FASB permit forecasting for the foreseeable future, but some constituents expressed concerns about the subjectivity involved when the measurement requires a forecast for the entire life of the instrument. In addition, many respondents did not support the proposal related to interest income recognition. They believed that interest income recognition should be separated from credit impairment and calculated on the basis of amortized cost without any adjustment for allowances.

During joint redeliberations, the boards tentatively agreed that determination of expected losses should be based on all available information, including forward-looking information. This represents a significant change from the FASB’s exposure draft, which required entities to determine expected losses on the basis of information about past and current conditions. In addition, the boards agreed to seek feedback on revisions they tentatively made during their redeliberations of the impairment recognition models proposed in their respective exposure drafts. In January 2011, the boards proposed, in the form of a supplementary document to their exposure drafts, two impairment recognition approaches. These approaches are (1) immediate recognition of the amount of credit losses expected to emerge in a period that can be reliably estimated (this period could represent a portion of the asset’s life or its full life) and (2) a “bad book/good book” approach. This approach would require immediate recognition of lifetime expected losses for the assets in the “bad book.” For assets in the “good book,” an entity would recognize the higher of (1) a loss estimate based on the amount of credit losses expected to occur within a period that can be reliably estimated (no less than 12 months) or (2) the expected lifetime loss estimate apportioned to the period passed, calculated by using a time-proportionate ratio (i.e., weighted-average age to weighted-average life).

The exposure draft would also amend the hedge accounting requirements in ASC 815.⁶ The changes proposed are consistent with the FASB’s 2008 [exposure draft](#) on hedge accounting,⁷ except that the current exposure draft would retain the existing provision in ASC 815 that gives entities the ability to achieve hedge accounting for risk components of financial items. Some of the significant changes to hedge accounting would include (1) the elimination of the shortcut and critical-terms-match methods; (2) a change in the quantitative assessment of the hedge effectiveness criteria from highly effective to reasonably effective; and (3) the inability to voluntarily terminate a hedging relationship simply by removing the hedge designation, unless the criteria for hedge accounting are no longer met or the hedging instrument is sold, is terminated, expires, or is exercised.

Editor’s Note: Respondents to the FASB’s exposure draft generally supported the proposed changes to the hedge accounting model in ASC 815. However, many noted a need for additional guidance on certain aspects of the proposal, such as the meaning of the term “reasonably effective.” One aspect of the project that respondents expressed significant concern about was the elimination of the ability to voluntarily dedesignate a hedging relationship, which they believed would negatively affect many hedging strategies in practice.

The FASB has not yet begun redeliberating its hedge accounting proposal.

Consideration Points: In light of its comprehensive nature, the exposure draft, if adopted as a final standard in its current form, would have broad implications for how the underlying information for financial instruments is developed and maintained by an entity’s other departments, such as treasury, risk management, and information technology. Entities may need to reconfigure their risk management and accounting systems to meet the requirements for the (1) increased use of fair value, (2) proposed credit impairment measurement model, (3) proposed interest income recognition model, and (4) proposed hedge accounting model. To comply with the increased fair value requirements, entities would need to assess whether they have sufficient internal personnel who are well versed in financial instruments and fair value measurements.

Next Steps: In December 2010, the FASB began redeliberations of its exposure draft. The Board has organized these redeliberations as follows:

- *Classification and measurement* — After the Board has made significant tentative decisions on this aspect of the project, it plans to jointly discuss these decisions with the IASB to determine whether convergence can be achieved.

⁶ FASB Accounting Standards Codification Topic 815, *Derivatives and Hedging*.

⁷ Proposed FASB Statement, *Accounting for Hedging Activities* — an amendment of FASB Statement No. 133.

- *Impairments* — In January 2011, the FASB and IASB published proposals on two different impairment recognition models for financial assets (see above for a brief description of these models). Comments on the proposals are due by April 1, 2011.
- *Hedge accounting* — The FASB has not yet started redeliberating this aspect of the project. The Board plans to publish a discussion paper in the first quarter of 2011 to seek feedback on the IASB's hedge accounting exposure draft issued in December 2010. The FASB will take that feedback into consideration when redeliberating hedge accounting.

The FASB expects to issue a final standard during the second quarter of 2011.

Other Resources: For more information about the FASB's exposure draft on accounting for financial instruments, see Deloitte's May 28, 2010, [Heads Up](#). In addition, see Deloitte's November 5, 2010, [Heads Up](#) for further details on the feedback the FASB has received on its financial instruments project and December 22, 2010, [Heads Up](#) for insights into the IASB's proposed new hedge accounting model. ●

Offsetting

Affects: All entities.

Summary: In 2010, the FASB added a joint project to its agenda to reconsider the guidance on balance sheet offsetting in ASC 210-20.⁸ The Board added this project to its agenda in response to requests from constituents to permit offsetting of securities-lending transactions cleared through a regulated central counterparty.

At their June 16, 2010, meeting, the FASB and IASB agreed to work together on the issue of balance sheet offsetting to achieve greater convergence of IFRSs and U.S. GAAP. In January 2011, the boards published an [exposure draft](#) proposing the following:

- The scope of the new offsetting guidance would be all recognized financial assets and financial liabilities, including derivative instruments (financial and nonfinancial).
- Entities would be required to present, in the statement of financial position, financial assets and liabilities on a net basis if they (1) have a legally enforceable, unconditional right to offset these assets and liabilities and (2) intend to settle them net or simultaneously.
- Entities would be required to apply the new offsetting guidance retrospectively.
- Entities would have to provide expanded disclosures about rights of setoff and similar arrangements (e.g., collateral agreements) associated with their financial assets and liabilities.

Consideration Points: According to the proposed offsetting guidance, entities would most likely no longer be able to present, on a net basis⁹ in their statement of financial position, derivative assets and liabilities, and related rights to reclaim or obligations to return cash collateral, that are subject to master netting arrangements. These arrangements generally only provide entities with a right of offset in the event of the counterparty's default; thus, the right is not unconditional. Furthermore, the underlying assets and liabilities often settle on different dates, thus making it difficult for entities to assert that they have the intention of settling the assets and liabilities net or simultaneously.

Next Steps: Comments on the exposure draft are due by April 28, 2011. The FASB and IASB plan to conduct public roundtable meetings by the end of March or after the comment period. The Board's goal is to issue a final standard by the end of the second quarter of 2011.

Other Resources: Deloitte's February 2, 2011, [Heads Up](#). ●

Financial Instruments With Characteristics of Equity

Affects: All entities.

Summary: Many entities finance their business by issuing hybrid financial instruments that have characteristics of both liabilities and equity. The current accounting requirements governing the classification of financial instruments as liabilities or equity under both IFRSs and U.S. GAAP have been criticized for lacking a clear and consistently applied set of principles and for not distinguishing between equity and liabilities in a manner that best reflects the economics of those instruments. In response to those concerns, the FASB

⁸ FASB Accounting Standards Codification Subtopic 210-20, *Balance Sheet: Offsetting*.

⁹ According to ASC 815-10-45-5, entities are currently permitted to present derivative assets and liabilities, and related rights to reclaim or obligations to return cash collateral, that are subject to master netting arrangements on a net basis.

and IASB have agreed to undertake a joint project to improve and simplify the financial reporting for financial instruments with characteristics of equity.

The FASB initially planned to expose the new classification model for comment by the end of June 2010. However, in light of both negative feedback from constituents on an informal draft of the new classification model and prioritization of other convergence projects, the FASB decided in November 2010 to delay this project until after June 2011.

Consideration Points: Regardless of the classification model that is eventually developed, entities would need to assess any impact of the new approach on their debt and equity levels, financial leverage ratios (e.g., debt-to-equity and interest coverage ratios), return on equity and other financial ratios, earnings, and compliance with debt covenants. In addition, entities in the financial services industry would want to consider any effects of the new approach on their regulatory capital levels.

Next Steps: The FASB expects to start deliberations after June 2011. ●

Leases

Affects: All entities.

Summary: For a few years now, the FASB and IASB have been working on revising the lease accounting model to effectively rid financial reporting of the operating lease classification and its off-balance-sheet treatment. The boards' joint efforts culminated in the issuance of an [exposure draft](#) on lease accounting in August 2010. The proposed lease model would focus on an entity's right to use an asset. Lessees would record a right-of-use asset and a corresponding obligation to pay rentals. Lessors would apply a hybrid model. If the lessor is significantly exposed to risks associated with the underlying asset, it would apply a performance obligation approach. The partial derecognition approach would apply to all other leases. Under the performance obligation approach, the underlying asset would remain on the lessor's books and the lessor would recognize a (1) receivable and (2) performance obligation liability. Under the partial derecognition approach, the lessor would recognize a receivable and derecognize a portion of the underlying asset and would recognize (1) sales for the present value of the lease payments and (2) cost of sales for the portion of the asset derecognized.

The lease term (for both lessees and lessors) would be defined as the longest possible lease term that is more likely than not to occur, which may be longer than the lease term under current U.S. GAAP (e.g., the proposed lease term may include additional lease renewal options). In addition, the measurement of lease payments would include expected payments for contingent rentals and residual value guarantees, which would represent a significant change from the current lease accounting model.

The scope of the proposed standard would be generally consistent with current U.S. GAAP; however, contracts that represent the purchase (lessee) or sale (lessor) of the underlying asset would be excluded from the new guidance. The new guidance would indicate that a contract is a purchase or sale if, at the end of the contract, the contract transfers (1) control of the underlying asset and (2) all but a trivial amount of the risks and benefits associated with the underlying asset. In addition, the proposed standard would allow for a simplified form of lease accounting for leases with a maximum possible term of less than 12 months.

The new guidance would also affect the accounting for sale and leaseback transactions. Under the proposed model, these transactions would be accounted for as a sale and leaseback (rather than as a financing) if it is determined that the underlying asset has been sold (see discussion above).

The proposed transition provisions do not contain a grandfathering clause for outstanding leases. A lessee would apply the proposed requirements for leases by recognizing and measuring an obligation to pay rentals and a right-of-use asset for all outstanding leases as of the date of initial application. For simple leases (leases that do not have options, contingent rentals, or residual value guarantees) that are currently classified by lessees as capital leases, the measurement of the assets and liabilities most likely would not be changed on transition or subsequently.

Editor's Note: The FASB and IASB received mixed feedback on the exposure draft. Generally, respondents agreed with the proposal to recognize lease contracts in the balance sheet. However, respondents were concerned that the proposed scope of lease accounting was unclear and asked the boards to provide clearer guidance on distinguishing (1) lease contracts from service contracts and, (2) within a contract, lease components from service components. Respondents also raised operational concerns about the (1) proposed definition of the lease term, including the proposed consideration of renewal options, and (2) inclusion of contingent payments, on a probability-weighted expected-outcome basis, in the measurement of the asset and liability related to the lease contract. Further, respondents expressed their belief that the proposed accounting for lessors would not significantly enhance the existing accounting and asked the boards to focus on improving lessee accounting. Finally, most respondents did not agree on how a lease should be reflected in a lessee's income statement (or a lessor's income statement under the performance obligation approach). Several respondents disagreed with the income statement recognition pattern proposed in the exposure draft, arguing that it would result in (1) higher expenses in the earlier periods of the lease and (2) further divergence from the cash payments made in lease contracts.

Consideration Points: Entities should be mindful of the fact that the elimination of operating leases would affect financial ratios and metrics such as debt-to-equity, debt-to-EBITDA,¹⁰ interest coverage, and tangible net worth. For lessees, the new model could also affect certain debt covenants and EBITDA would generally increase as a result of the elimination of rent expense (replaced by amortization and interest expense). The treasury departments of lessee entities would need to consider these factors in their "lease vs. buy" analysis and when negotiating debt covenants. Moreover, the sales forces of lessor entities would need to be cognizant of how the potential accounting affects their clients. The bottom line is that both lessee and lessor entities would need to have a handle on their lease portfolios before these changes take effect.

Next Steps: The FASB and IASB have started to redeliberate the issues identified by respondents to the exposure draft and aim to issue a final standard in the second quarter of 2011.

Other Resources: For more information about the FASB's exposure draft on leases, see Deloitte's August 17, 2010, [Heads Up](#). In addition, see Deloitte's February 1, 2011, [Heads Up](#), which summarizes the feedback received from the comment letters on the exposure draft and other FASB outreach activities. ●

Revenue Recognition

Affects: All entities.

Summary: This project represents a broad reconsideration of the manner in which an entity recognizes and reports information about revenue resulting from contracts with customers. It would supersede most of the current guidance on revenue recognition in U.S. GAAP, with certain exceptions, doing away with the volumes of industry-specific guidance that many have been using for years. In its place, entities would apply a broad principle when recognizing revenue for contracts under which goods or services are provided to customers. That broad principle would require an entity to (1) identify the contract with a customer, (2) identify the distinct performance obligations, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations, and (5) recognize revenue when the performance obligations are satisfied.

In December 2010, the FASB and IASB discussed some of the common themes identified in the feedback received on the new revenue recognition principle that the boards exposed for comment in June 2010. The boards also agreed on a plan to try to finalize redeliberations by June 2011.

Editor's Note: Most respondents indicated support for the boards' efforts to develop a single comprehensive revenue recognition standard. However, respondents were concerned that the concepts as proposed in the exposure draft, such as transfer of control (in particular for construction and other service contracts) and separation of performance obligations, were not clear enough to be applied in practice. Respondents raised similar operational concerns about other aspects of the exposure draft, including the combining or segmenting of contracts, the accounting for contract modifications, variable (contingent) consideration, collectibility, onerous performance obligations, warranties, required disclosures, and retrospective application. Further, respondents encouraged the boards to perform additional field testing of the proposals and to include specific implementation guidance to support the concepts in the exposure draft.

¹⁰ Earnings before interest, taxes, depreciation, and amortization.

In January 2011, the boards started redeliberations by discussing two fundamental issues raised by constituents: (1) determining when a customer has obtained control of a good or service and (2) separating performance obligations. The boards plan to focus on the remaining issues at future meetings.

Editor's Note: Many respondents were significantly concerned about whether the exposure draft's guidance on applying the control principle to service contracts would be operational in practice. At their January 2011 joint meeting, the boards tentatively decided that for service contracts, an entity should recognize revenue for the entity's performance of tasks that are contractually agreed upon if any of the following criteria are met:

- The work-in-process is under the customer's control.
- The task would not need to be reperformed by another entity if that entity is required to fulfill the remaining obligation to the customer.
- The "entity has a right to payment for the performed task and the entity's performance to date could not be put to an alternative use by the entity (i.e., the performance to date has not created an asset that could be transferred to another customer)."

Further, the boards decided that "an entity would recognize revenue for a service only if the entity can reasonably measure its progress toward successful completion of the service."

Consideration Points: As a result of this project, entities may need to (1) assess their information technology systems, specifically those related to sales, and whether those systems need to be reconfigured; (2) evaluate the existing terms of their contracts and determine how they may affect revenue recognition; (3) educate their sales force on the key aspects of recognizing revenue; and (4) reconsider the timing or the manner in which the sales force is compensated as a result of the changes, if any, in the manner in which revenue is recognized. In addition, because the application of the principles in the proposed standard would most likely require significant judgment, entities may also need to evaluate their accounting policies to ensure consistent application of the principles throughout the entity. Lastly, certain entities may experience significant changes in the amount and timing of revenue recognition and may need to evaluate how and when to disclose such changes to external financial statement users.

Next Steps: The FASB and IASB plan to finalize redeliberation of the remaining issues by June 2011 and issue a final standard on revenue recognition shortly thereafter.

Other Resources: Deloitte's June 28, 2010, [Heads Up](#), which summarizes the FASB's June 2010 [exposure draft](#), and December 9, 2010, [Heads Up](#), which summarizes the feedback received from the comment letters on the exposure draft and other FASB outreach activities. ●

Consolidation

Affects: All entities.

Summary: The objective of the consolidations project is the development of an improved, converged consolidations standard that would apply to all entities (i.e., variable interest entities (VIEs), voting interest entities, and investment companies). Although the FASB and IASB have had a number of joint meetings on this project, they have not been able to agree, and in fact recently decided not to converge, on all aspects of this topic.

- *VIEs and voting interest entities* — The FASB will retain the existing U.S. GAAP guidance on these types of entities (see ASC 810-10¹¹). However, the Board will provide guidance that would help entities applying the current VIE guidance determine whether an entity is acting as an agent or as a principal.

Editor's Note: The principal-versus-agent guidance may allow the FASB to eliminate the deferral of Statement 167¹² for certain investment funds, since entities would be allowed to use a more qualitative approach in determining whether a decision maker (e.g., an investment manager) is acting as a principal or as an agent. The changes would also allow for the consideration of removal rights, even when those rights require the agreement of multiple parties. Under the current VIE model, removal rights are not considered in the consolidation analysis unless a single entity has the unilateral ability to exercise those rights.

¹¹ FASB Accounting Standards Codification Subtopic 810-10, *Consolidation: Overall*.

¹² FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*.

Under the IASB model, entities holding less than 50 percent of the outstanding shares of another entity may be compelled to consolidate that investee; the IASB describes this concept as “effective” or “de facto” control. The FASB decided not to import this concept into U.S. GAAP. Thus, this aspect of the guidance on voting interest entities in U.S. GAAP will not be converged with that in IFRSs.

- *Investment companies* — The FASB and IASB have tentatively concluded that investment companies should recognize and measure their investments in entities they control at fair value through net income (FV-NI). The boards have used the guidance on investment companies in U.S. GAAP¹³ as the basis for developing the attributes of an investment company. A point of disagreement between the FASB and IASB is on whether the parent of an investment company subsidiary would retain, in the consolidated financial statements, the accounting that applies in the subsidiary’s stand-alone financial statements. The FASB believes that the parent of an investment company subsidiary should recognize and measure that subsidiary’s investments at FV-NI in the consolidated financial statements. However, the IASB would agree with that accounting only if the parent itself qualified as an investment company; otherwise, the IASB would want the parent to reflect, in the consolidated financial statements, the assets and liabilities underlying the subsidiary’s investments.

Consideration Points: U.S. entities should consider any potential impacts of the FASB’s principal-versus-agent guidance on structures involving VIEs, including funds managed by investment managers. In addition, U.S. entities should monitor any changes that the FASB makes to the definition of an investment company, since such changes could cause a change in the number of companies that qualify for investment company accounting.

Next Steps: The IASB expects to finalize and publish its consolidation standard during the first quarter of 2011. The FASB staff plans to issue an exposure draft on the principal-versus-agent guidance in the first quarter of 2011. Both boards plan to issue an exposure draft on the investment company guidance in the second quarter of 2011 and aim to finalize this guidance in the fourth quarter of 2011. ●

Fair Value Measurement

Affects: All entities.

Summary: In June 2010, the FASB issued an [exposure draft](#) that would amend the fair value measurement and disclosure requirements in U.S. GAAP. The exposure draft is the result of a joint project between the FASB and IASB to develop a single, converged fair value framework.

During the fourth quarter of 2010, the FASB and IASB jointly redeliberated a number of issues identified by respondents. The boards tentatively decided:

- To affirm the proposed clarifications to the measurement principles in current U.S. GAAP (see ASC 820¹⁴).

Editor’s Note: We do not expect these proposed clarifications to affect many entities. However, entities should carefully consider the guidance in the final standard if they have (1) employed an “in-use” valuation premise to measure groups of financial assets that do not have offsetting positions in a particular market risk or counterparty credit risk or (2) applied a premium or discount to a Level 2 or Level 3 fair value measurement because of the quantity held by the entity (i.e., not because of the unit of account specified in U.S. GAAP).

- To affirm the proposed requirement to disclose (1) the entity’s use of a nonfinancial asset if this use differs from the asset’s highest and best use and (2) the level, in the fair value hierarchy, of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed.
- To require the following disclosures for Level 3 fair value measurements (which would be additional for U.S. entities): (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation control processes in place, and (3) a qualitative discussion of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.

¹³ FASB Accounting Standards Codification Topic 946, *Financial Services — Investment Companies*.

¹⁴ FASB Accounting Standards Codification Topic 820, *Fair Value Measurements and Disclosures*.

The FASB decided not to include in the final standard the proposal that would have required entities to provide, for all Level 3 recurring fair value measurements, a quantitative measurement uncertainty disclosure. This disclosure would have been in the form of a sensitivity analysis of unobservable inputs to reasonable alternative amounts. The proposed disclosure requirement would have also compelled entities to take into account the effect of correlation between unobservable inputs if such correlation was relevant to estimating the effect on fair value measurement. The FASB decided to further assess this disclosure requirement as part of a separate project.

The FASB also decided not to exempt nonpublic entities from the fair value measurement principles in the final standard. However, nonpublic entities will be exempt from certain disclosure requirements. For example, they will not be required to categorize, within the fair value hierarchy, items whose fair value is disclosed but not recognized in the financial statements. In addition, such entities will not be required to qualitatively discuss the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.

Next Steps: The FASB expects to issue a final standard before the end of the first quarter of 2011. However, the Board has not yet decided on the final standard's transition and effective date.

Other Resources: Deloitte's June 30, 2010, [Heads Up](#), which summarizes the FASB's exposure draft. ●

Insurance

Affects: All entities.

Summary: In September 2010, the FASB published a [discussion paper](#) containing its preliminary views on the IASB's [exposure draft](#) on insurance contracts. If adopted in the United States, the IASB's new approach would result in sweeping changes to the existing U.S. insurance accounting model. The proposed guidance would apply to all writers of insurance contracts, regardless of the type of entity issuing the contract. The IASB's exposure draft proposes a new measurement approach that would apply to all types of insurance contracts, with a modified measurement approach for some short-duration contracts. Under the IASB's new approach, entities would measure insurance contracts on the basis of the present value of probability-weighted fulfillment cash flows (which incorporate incremental acquisition costs) and would include an adjustment for the uncertainty about the amounts and timing of those cash flows (i.e., a "risk adjustment margin") and a residual margin to eliminate any gain at initial recognition. The present value of probability-weighted cash flows is also the foundation of the FASB's model; however, in contrast to the IASB's "two-margin" measurement approach, the FASB's approach would include a single composite margin that eliminates profit at inception and implicitly reflects the uncertainty in the amounts and timing of the fulfillment cash flows.

Consideration Points: Entities that have not traditionally viewed themselves as insurers may need to examine the characteristics of contracts they issue to determine whether such contracts meet the definition of insurance and are therefore within the scope of the standard. The measurement approaches proposed by the IASB and FASB are different from the approaches used by U.S. insurers today and would most likely require insurers to develop new methods of estimating each of the building blocks (i.e., an explicit, unbiased, and probability-weighted estimate of future cash flows; a discount rate that adjusts those cash flows for the time value of money; and a risk adjustment and residual margin (IASB's preference) or composite margin (FASB's preference) to reflect uncertainty and future profits). Entities also may have to develop new data systems to obtain relevant information about making such estimates. In addition, the new measurement approaches could generate increased earnings volatility arising from differences between the measurement basis of the insurance liabilities (fulfillment value, which generally does not incorporate credit risk) and that of the related assets, which could be measured at fair value or amortized cost (e.g., the discount rate used to measure the insurance liabilities may differ from the expected return on assets). Furthermore, entities might have to recognize "day one" losses in net income depending on how they have priced their insurance contracts.

Next Steps: At their January 2011 joint meeting, the FASB and IASB began deliberating the issues identified during the comment letter period. The boards plan to finalize these deliberations in the second quarter of 2011. The IASB plans to issue a final standard in June 2011. The FASB has not yet decided whether it will expose the same standard for public comment in the United States.

Other Resources: Deloitte's October 8, 2010, [Heads Up](#). ●

FASB-Only Projects

Troubled Debt Restructurings

Affects: All entities.

Summary: In October 2010, the FASB published an [exposure draft](#) that proposes to clarify when a loan modification or restructuring is considered a troubled debt restructuring (TDR). Under U.S. GAAP, when a loan's terms have been modified, the creditor (i.e., the lender) must evaluate whether the modification represents a TDR. Possible effects of a conclusion that a modification is a TDR include the following:

- A lender may need to perform a different impairment measurement analysis.
- A lender may have to provide additional financial statement disclosures.

Next Steps: The FASB has begun deliberating comments received on the exposure draft and intends to issue a final standard during the first quarter of 2011.

Other Resources: Deloitte's October 15, 2010, [Heads Up](#). ●

Deferral of the Effective Date of Disclosures About Troubled Debt Restructurings in ASU 2010-20

Affects: All entities.

Summary: In January 2011, the FASB issued a [final standard](#)¹⁵ that temporarily defers the effective date in ASU 2010-20¹⁶ for disclosures about TDRs by creditors until the Board finalizes its project on determining what constitutes a TDR for a creditor.

Other Resources: Deloitte's January 21, 2011, [Heads Up](#). ●

Transfers and Servicing — Repurchase Agreements

Affects: All entities.

Summary: In November 2010, the FASB published an [exposure draft](#) that proposes to eliminate the collateral maintenance requirement that entities must consider under U.S. GAAP in determining whether a transfer of financial assets subject to a repurchase arrangement ("repo") is accounted for as a sale or as a secured borrowing.

Consideration Points: The proposal, if issued as a final standard in its current form, may cause more repos to be accounted for as secured borrowings rather than as sales.

Next Steps: The FASB intends to deliberate comments received on the proposal and to issue a final standard in the first quarter of 2011.

Other Resources: Deloitte's November 4, 2010, [Heads Up](#). ●

Investment Properties

Affects: All entities.

Summary: The objective of this project is to determine what constitutes an investment property and how an investment property should be measured (e.g., at fair value through earnings as of each reporting date).

In this project, the FASB has tentatively decided that:

- Entities that meet definitional criteria similar to those for investment companies must measure investment properties (generally, as defined in IAS 40¹⁷) at fair value.
- Entities that sell properties in the ordinary course of business must continue to measure previously recognized investment properties at fair value when these entities commence development of the properties with a view to sale.
- Entities should provide specific disclosures about their investment properties.

Next Steps: The FASB expects to publish an exposure draft in the second quarter of 2011 and a final standard in the fourth quarter of 2011. ●

¹⁵ FASB Accounting Standards Update No. 2011-01, *Deferral of the Effective Date of Disclosures About Troubled Debt Restructurings in Update No. 2010-20*.

¹⁶ FASB Accounting Standards Update No. 2010-20, *Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*.

¹⁷ IAS 40, *Investment Properties*.

Risks and Uncertainties (Formerly Going Concern)

Affects: All entities.

Summary: The objective of this project is to provide guidance on (1) required disclosures about risks and uncertainties that may interfere with an entity's ability to continue as a going concern and meet its obligations when they become due and (2) the application of the liquidation basis of accounting.

In this project, the FASB has tentatively decided that an entity would be required:

- To provide specific disclosures when it is reasonably foreseeable that it "may not be able to meet its obligations as they become due without making substantial changes to its operating or capital structure" (e.g., a substantial disposition of assets outside the ordinary course of business, a restructuring of debt, the issuance of equity, or externally or internally forced revisions of the entity's operations). The entity would be required to take into account available information about the foreseeable future, which would be generally, but not necessarily, 12 months from the end of the reporting period.
- To use the liquidation basis of accounting in preparing its financial statements if liquidation appears to be imminent. This accounting basis would require the entity to measure financial statement items to reflect the amount of cash expected to be collected or paid during the course of liquidation.
- To update the assessment of its ability to meet its obligations as they become due if, before the entity had issued its financial statements, a subsequent event occurs that significantly affects the entity's assessment. The entity would use the updated assessment to determine whether it would be required to provide the related disclosures (see first bullet point). However, the entity would still have to apply the guidance in ASC 855¹⁸ to recognition and disclosure of specified subsequent events.

Next Steps: At its December 2010 meeting, the FASB discussed key issues raised by external reviewers regarding a preliminary staff draft of an exposure draft for this project. Because this project may overlap with rules and standards of other agencies, the Board asked the staff to obtain input from the SEC, AICPA, and PCAOB staffs on (1) the revised draft and (2) any conflict with existing or pending guidance on this topic. ●

Disclosures About Certain Loss Contingencies

Affects: All entities.

Summary: In July 2010, the FASB issued an [exposure draft](#) proposing:

- To expand the scope of loss contingencies subject to disclosure to include certain remote contingencies.
- To increase the quantitative and qualitative disclosures entities must provide to enable users to assess the nature, potential magnitude, and potential timing (if known) of loss contingencies.
- For public entities, to require a tabular reconciliation for changes in amounts recognized for loss contingencies.

Constituents expressed concerns regarding many of the proposed disclosure requirements. Before beginning redeliberations, the FASB has directed its staff to (1) understand efforts made by the SEC and PCAOB to improve compliance with existing disclosure requirements in ASC 450-20¹⁹ and (2) review 2010 Form 10-K filings for calendar-year-end reporting entities and determine whether those efforts resulted in improved disclosures about loss contingencies.

Next Steps: The FASB will perform additional outreach during the first half of 2011 and plans to begin redeliberations during the second half of 2011.

Other Resources: Deloitte's July 20, 2010, [Heads Up](#). ●

¹⁸ FASB Accounting Standards Codification Topic 855, *Subsequent Events*.

¹⁹ FASB Accounting Standards Codification Subtopic 450-20, *Contingencies: Loss Contingencies*.

Disclosures About an Employer’s Participation in a Multiemployer Plan

Affects: All nongovernmental entities that participate in multiemployer plans.

Summary: In September 2010, the FASB issued an [exposure draft](#) on disclosures about an employer’s participation in a multiemployer plan. The objective of the exposure draft is to improve transparency by amending ASC 715-80²⁰ to significantly increase the level of quantitative and qualitative disclosures an employer would be required to provide about its participation in multiemployer plans, including the effect on its cash flows.

In November 2010, the FASB decided that the effective date included in the exposure draft was not practicable (the effective date for public entities was proposed to be the fiscal year ending after December 15, 2010, with a one-year deferral for nonpublic entities).

Consideration Points: Entities that do not currently provide the level of disclosure required by the exposure draft, or that do not have such information readily available, may need to plan and coordinate preparation of the proposed disclosures with the trustees and administrators of the plan. Entities should also consider the effect that the increased disclosure requirements will have on their internal controls over financial reporting.

Next Steps: The Board expects to issue a final standard in the second quarter of 2011.

Other Resources: Deloitte’s September 2, 2010, [Heads Up](#). ●

Key Takeaways

So what should management and others in the financial reporting community think about now as this tidal wave of accounting and financial reporting changes crests? Management should ensure that plans are in place to address each of these projects that are under way at the FASB. Having thoughtful and regular discussions with the affected parties regarding the impact of each of these projects will help ease the transition, turning the tidal wave into a manageable swell in the water. To get those discussions going, we have included a list of questions for entities to consider:

1. Are all necessary groups engaged in the discussions regarding these changes?
2. What are the key differences between current accounting policies and proposed changes to U.S. GAAP? How will these accounting changes affect critical accounting policies and management’s estimates?
3. How will the proposed changes affect the financial statements, capital ratios, debt covenants, and internal controls over financial reporting?
4. Are sufficient and knowledgeable resources available to address these accounting changes?
5. Are information technology systems able to integrate the proposed changes?
6. Will these accounting changes require the increased use of external specialists?
7. What educational needs and goals do the board and audit committee have? How will the changes affect the financial expert designation?
8. How will the changes affect the duties and responsibilities of the audit committee with respect to internal control and financial statement disclosure?
9. What information, if any, will need to be communicated to external financial statement users?

Still uneasy about the significance of these changes? Stay tuned for further communications regarding each of these projects (e.g., [Heads Up](#) newsletters and [Dbriefs](#) webcasts). In addition, feel free to reach out to a Deloitte representative to have more detailed discussions regarding these projects, the accounting changes they represent, or the business impact they may pose.

²⁰ FASB Accounting Standards Codification Subtopic 715-80, *Compensation — Retirement Benefits: Multiemployer Plans*.

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Conclusions of the FASB, GASB, IASB, and IFRIC are subject to change at future meetings and generally do not affect current accounting requirements until an official position (e.g., Accounting Standards Update or IFRS) is issued. Official positions are determined only after extensive deliberation and due process, including a formal vote.

Further information about the standard setters can be found on their respective Web sites as follows: www.fasb.org (FASB); www.fasb.org/eitf/agenda.shtml (EITF); www.aicpa.org (AICPA); www.sec.gov (SEC); www.fasab.gov (FASAB); www.gasb.org (GASB); and www.iasb.org — or on www.iasplus.com/index.htm (IASB and IFRIC).

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