



Accounting Roundup — Special Edition

Wave of Accounting Changes Begins to Crest

Updated May 2011



A Compendium of the FASB's Joint and Individual Projects

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

Introduction

On April 21, 2011, the FASB and IASB gave an [update](#) on their convergence agenda. The boards noted that for a number of joint projects, including fair value measurement and other comprehensive income, they would be issuing final, substantially converged standards in the next few weeks. The boards also indicated that other joint projects for which they had previously committed to issuing final standards (financial instruments, revenue recognition, and leases) or an exposure draft (ED) (insurance) by June 2011 would require further work and consultation with constituents; therefore, they decided to delay the timing of these projects to the second half of 2011.

This update to *Accounting Roundup — Special Edition* contains status summaries of some of the key FASB/IASB joint and FASB-only projects. Thus, it reflects (1) the FASB's and IASB's revisions to their agenda and timeline and (2) developments that have occurred in the joint and FASB-only projects since the last issuance of the publication (in [January 2011](#)). In addition, this publication includes references to Deloitte *Heads Up* newsletters that provide more specifics about these projects.

Note, however, that this publication does not address effective dates for the joint projects because the 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](#) (DP) 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: In their April 21, 2011, convergence agenda update, the boards stressed that their goal is to set effective dates that would give preparers sufficient time to implement the standards. The boards also noted that, before issuing each standard, they plan to assess whether they should expose any revisions made to the proposed standard as previously exposed and whether they should conduct further outreach with constituents to determine whether the proposed standard would be operational and result in improvements to financial reporting.

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 the end of 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.

Editor's Note: 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.

The SEC staff is expected to publish the much-anticipated progress report on its IFRS [work plan](#)¹ soon. In addition, in April 2011, the SEC staff announced that it would host a roundtable on July 7, 2011, inviting investors, smaller public companies, and regulators to discuss the benefits and challenges of potentially adopting IFRSs in the United States.

Not interested in reading the thousands (yes, we said thousands) of pages of new accounting guidance when the final standards are issued? Well, 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. Not a subscriber to our *Heads Up* newsletters? Follow this [link](#) to sign up.

¹ In response to a request by the SEC, the staff of the SEC's Office of the Chief Accountant published in February 2010 a work plan that is intended to help the Commission decide whether, when, and how to transition from U.S. GAAP to IFRSs. In October 2010, the SEC staff reported on the status of this work plan and indicated that it plans to provide further periodic updates on the work plan in the future.

Updated Timeline of FASB's Major Projects

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Joint FASB/IASB Projects

Financial Instruments

Affects: All entities.

Summary: In May 2010, the FASB published an [ED](#) 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. After the ED's comment period, the FASB revised many aspects of the proposed approach to classification and measurement of financial instruments. In addition, the FASB has sought additional input from constituents on impairment and hedge accounting.

Classification and Measurement

Summary: In the ED, the default classification and measurement of financial instruments was fair value, with changes in fair value recognized in net income (FV-NI). Certain exceptions to the default classification and measurement guidance were allowed if specific criteria were met.

During its redeliberations of the project (which began in December 2010), the FASB has revised many of its original proposals on the basis of the feedback received via comment letters and outreach activities conducted by the FASB staff. Highlights of the FASB's tentative decisions to date on its classification and measurement approach include:²

- FV-NI is not the default category for financial instruments. Financial assets and financial liabilities are classified as FV-NI, fair value through other comprehensive income (FV-OCI), or amortized cost on the basis of an evaluation of the criteria that apply to each category. In comparison with the ED, the amortized cost category has been broadened to include loan assets and more issued debt obligations.
- Reclassification of financial instruments between categories (FV-NI, FV-OCI, and amortized cost) is prohibited. Gains and losses from a financial instrument classified as either amortized cost or FV-OCI are recognized in net income when the instrument is (1) sold, expired, or settled or (2) impaired.
- Equity instruments (both marketable and nonmarketable) are classified as FV-NI. However, for nonmarketable equity securities, a practicability exception would be available to nonpublic entities only. Under the practicability exception, a nonmarketable equity security would be measured at cost less any other-than-temporary impairments and would be adjusted for any observable changes in price.
- An entity is required to bifurcate an embedded derivative from a hybrid financial instrument if the embedded derivative meets the bifurcation criteria in ASC 815-15.³ This represents a significant change from the ED, under which an entity would have classified a hybrid instrument as FV-NI if it contained an embedded derivative that the entity would otherwise have been required to bifurcate under ASC 815-15. In other words, under the ED, the embedded derivative feature would not have been separated; instead, the presence of an embedded derivative feature could have caused the entire hybrid instrument to be classified as FV-NI.

Next Steps: Although the FASB continues to make steady progress on its classification and measurement model for financial instruments, the Board still needs to redeliberate many aspects of this model, including the scope of the final standard, financial liabilities, the fair value option for financial assets and financial liabilities, accounting for loan commitments, equity method accounting, presentation and disclosures, and specialized industry accounting guidance. The FASB expects to complete these redeliberations over the next few months, after which it plans to discuss its new model with the IASB. The IASB has indicated that it will issue for public comment a proposal similar to that issued by the FASB. The FASB has indicated that before issuing a final standard in the second half of 2011, it plans to reexpose the new classification and measurement model, as revised during the redeliberations of issues raised by respondents to the FASB's May 2010 ED. ●

² Current through the FASB's April 27, 2011, board meeting.

³ FASB Accounting Standards Codification Subtopic 815-15, *Derivatives and Hedging: Embedded Derivatives*.

Impairment

Summary: On January 31, 2011, the FASB and IASB jointly issued a [supplementary document](#) (SD) for comment as a follow-up to the FASB's ED and the IASB's November 2009 ED on credit impairment.⁴ The SD proposes to replace the incurred loss impairment models under U.S. GAAP and IFRSs with an expected loss impairment model. The document focuses on when and how credit impairment should be recognized and contains the following key provisions:

- The determination of expected losses would be based on all available information, including forward-looking information. This represents a significant change from both the FASB's and IASB's EDs, which required entities to determine expected losses on the basis of information about past and current conditions.
- To determine an impairment allowance, an entity would differentiate financial assets managed in a "bad book" from those managed in a "good book," depending on the degree of uncertainty about the collectibility of the cash flows of the financial assets.
- Immediate recognition of lifetime expected losses would be required for 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-proportional ratio (e.g., weighted-average age to weighted-average life).

After the issuance of the SD, the boards have redeliberated other impairment-related issues. The boards' tentative decisions on some of these issues include the following:⁵

- Expected losses would be estimated on the basis of an expected value approach (i.e., a probability-weighted-average approach) that reflects the effect of discounting. However, the Board indicated that entities would be permitted to use reasonable methods to approximate discounted expected values. The accretion (i.e., unwinding) of the discount in impairment losses would be included in the impairment losses financial statement line item.
- The calculation of amortized cost for a financial asset would not include a reduction for the credit impairment allowance. Entities would recognize revenue on purchased "good book" and "bad book" assets by using an effective interest rate that is determined on the basis of contractual cash flows and expected cash flows, respectively.
- A write-off would be defined as "a direct reduction of the amortized cost of a financial asset resulting from uncollectibility." In addition, an asset would be considered uncollectible if an entity has no reasonable expectation of recovering it. Therefore, an asset would be partially or fully written off in the period in which the entity determines that no reasonable expectation of recovery exists.

Next Steps: The FASB and IASB expect to complete their redeliberations of the issues identified by respondents to the boards' SD and EDs and release a final standard in the second half of 2011 (subject to a determination of whether the revisions to the SD and EDs should first be reexposed). ●

Hedge Accounting

Summary: The FASB's ED also proposed to amend the hedge accounting requirements in ASC 815.⁶ The changes proposed are consistent with the FASB's 2008 [ED](#) on hedge accounting,⁷ except that the May 2010 ED 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 proposed changes to hedge accounting include (1) the elimination of the shortcut and critical-terms-match methods; (2) a change in the threshold for qualifying for hedge accounting 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.

⁴ IASB Exposure Draft, *Financial Instruments: Amortised Cost and Impairment*.

⁵ As of the boards' joint meeting on April 14, 2011.

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

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

Next Steps: The FASB has not yet started redeliberating this aspect of the project. The Board published a [DP](#) in February 2011 to seek feedback on the IASB's December 2010 hedge accounting ED. The FASB will take that feedback into consideration during its redeliberations. The comment period on the FASB's DP ended on April 25, 2011. The FASB has not yet determined when it plans to start redeliberating hedge accounting or when it expects to issue a final hedging standard. ●

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 [ED](#) 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.

The comment period for the ED has since ended. In May 2011, the FASB and IASB held a number of public roundtable meetings in the United States and other parts of the world to obtain feedback on the ED from investors, preparers, auditors, and other constituents.

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 intend to settle the assets and liabilities net or simultaneously.

Next Steps: The boards expect to redeliberate the issues identified by respondents to the ED and participants in the roundtable meetings and aim to issue a final standard in the second half of 2011. ●

Other Resources on Financial Instruments

The following Deloitte publications contain additional information about the boards' project on accounting for financial instruments:

- May 28, 2010, [Heads Up](#) — Summarizes FASB's ED on accounting for financial instruments.
- November 5, 2010, [Heads Up](#) — Gives an overview of feedback on the FASB's financial instruments ED.
- December 22, 2010, [Heads Up](#) — Outlines IASB's proposed new hedge accounting model.
- February 2, 2011, [Heads Up](#) — Discusses FASB's ED on offsetting.
- February 8, 2011, [Heads Up](#) — Presents an overview of the FASB's and IASB's SD on impairment.
- May 10, 2011, [Heads Up](#) — Provides an update on FASB's financial instruments project. ●

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.

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 January 2011, the FASB and IASB began to redeliberate the issues identified in the feedback received on the new revenue recognition principle that the boards exposed for public comment in June 2010. Since then, the boards have tentatively decided to clarify some of the more fundamental aspects of the proposed accounting model, including (1) when a customer has obtained control of a good or service, (2) separating performance obligations, and (3) determining and allocating the transaction price for variable (e.g., contingent) consideration.

Editor's Note: The primary tentative decisions reached for the three fundamental aspects of the proposed accounting model are summarized below. Meeting summaries (including these tentative decisions) from Deloitte observers at the January, February, March, and April meetings are available on Deloitte's [IAS Plus Web site](#) but should not be regarded as official or final.

In addition to the more fundamental changes, the boards have made changes related to other concerns identified in the ED (see Deloitte's December 9, 2010, [Heads Up](#) for more information). Some of the more significant tentative decisions relate to the combining/segmenting of contracts and the accounting for contract modifications, collectibility, onerous performance obligations, warranties, and disclosures. The boards still need to discuss the effective date and transition.

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 redeliberations of the remaining issues by June 2011 and to issue a final standard on revenue recognition in the third quarter of 2011 (subject to a determination of whether the revisions to the SD and EDs should first be reexposed).

Other Resources: The following Deloitte publications contain additional information about the revenue recognition project:

- June 28, 2010, [Heads Up](#) — Summarizes the FASB's June 2010 ED.
- December 9, 2010, [Heads Up](#) — Gives an overview of the feedback on the ED. ●

Leases

Affects: All entities.

Summary: The comment period for the [ED](#) on lease accounting, which ended on December 15, 2010, resulted in over 750 letters. Some of the main themes identified at the roundtables and in comment letters include the overall model for both lessees and lessors (including measurement of lease terms and lease payments), the profit and loss recognition pattern, and the definition of a lease. Over the past several months, the boards have held meetings to discuss these themes and have reached several tentative decisions (discussed in more detail below) that would change the ED. In addition, the boards' staffs have

been conducting field testing and performing extensive outreach to obtain feedback from constituents for the tentative decisions made to date. All such decisions are subject to change before any standard becomes final.

Overall Model

The boards reaffirmed the right-of-use model. A lessee will recognize an asset for the right to use the underlying asset and a liability to make lease payments on the date of the commencement of the lease. Many constituents did not support the ED's lessor accounting proposal. Some even questioned the need to change the current lessor accounting model. The boards will discuss lessor accounting at future meetings.

Key elements that an entity uses in measuring the right-to-use asset and the lease liability are the lease term and lease payments. The lease term is defined as the contractual lease term, including renewal options if there is a significant economic incentive for an entity to exercise these options (e.g., if the lease contains bargain renewal options or a penalty such as loss of leasehold improvements). Lease payments are measured as the present value of contractual minimum lease payments and variable lease payments (e.g., contingent rental payments) that are (1) based on an index or rate and (2) for which the variability lacks commercial substance (e.g., disguised fixed lease payments). A purchase option will also be included in the lease payments if there is a significant economic incentive to exercise the purchase option (i.e., purchase options are evaluated in the same manner as renewal options). All nonlease elements in a multiple-element lease contract should be separated from the lease element and be accounted for in accordance with other applicable GAAP.

Profit and Loss (P&L) Recognition Pattern

At their meetings on May 17 and 19, the boards tentatively decided to reverse an earlier decision that would have resulted in the recognition of lease expense in profit and loss on a straight-line basis. After further deliberating the earlier decision, the boards concluded that they had too many concerns about this approach and decided to revert back to the proposed guidance in the ED. Accordingly, entities will amortize the liability by using the interest method and will typically amortize the right-of-use asset on a straight-line basis.

Definition of a Lease

The ED primarily retained the guidance in Issue 01-8¹⁰ and IFRIC 4¹¹ on distinguishing between a service contract and a lease contract. That guidance requires lease accounting if an arrangement conveys the right to control the use of a specific asset. The boards tentatively decided that a specified asset must be identifiable either implicitly or explicitly (e.g., by a specific serial number). In addition, the boards tentatively decided that the underlying asset can be a physically distinct portion of a larger asset (e.g., a floor of a building) if that portion is explicitly or implicitly specified. A capacity portion of a larger asset that is not physically distinct (e.g., 50 percent of a pipeline) is not a specified asset. The boards also tentatively decided that the concept of control will be similar to that in the proposed revenue recognition project. Consequently, a contract would convey the right to control the use of a specified asset if the customer has the ability to direct the use, and receive benefits from use, of that asset. Such benefits would include economic benefits that arise directly from the use of the asset, such as renewable energy credits and secondary physical output, but would exclude income tax benefits. In addition, the boards tentatively decided that in situations in which a supplier directs the use of an asset used to perform services for a customer, the customer and supplier must assess whether the use of the asset is separable from the services provided to the customer.

Editor's Note: We believe that the Board's revised definition of the right to control the use of an asset represents a significant change from the Issue 01-8 model. The change in definition could significantly reduce the number of take-or-pay and supply contracts subject to lease accounting since it appears to remove the notion that an arrangement contains a lease simply because the purchaser obtains all but an insignificant amount of the output of an asset. The requirement to evaluate whether the asset and service are separable could also result in a significant change related to which arrangements are accounted for as a lease.

¹⁰ EITF Issue No. 01-8, "Determining Whether an Arrangement Contains a Lease."

¹¹ IFRIC Interpretation 4, *Determining Whether an Arrangement Contains a Lease*.

Transition and Short-Term Leases

The proposed transition provisions do not contain a grandfathering clause for outstanding leases. The boards have tentatively allowed lessors and lessees to account for short-term leases (i.e., leases that have a maximum possible lease term, including options to renew, of 12 months or less) in a more simplified way (i.e., much like current operating lease accounting).

Consideration Points: Entities should note that the changes to lease accounting could affect financial ratios and metrics such as the return on assets. 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 continue to redeliberate the issues identified by respondents to the ED and to conduct outreach activities for tentative decisions reached to date. The boards aim to issue a final standard sometime during the second half of 2011.

Editor's Note: The boards continue to meet several times each month to discuss the leases project, and we expect them to keep doing so over the next several months. We think that a final standard will most likely be released by the end of 2011; however, if the boards decide to reexpose the revised standard, the project may not be completed until 2012.

Other Resources: For more information about the FASB's ED on leases, see Deloitte's August 17, 2010, [Heads Up](#) and February 1, 2011, [Heads Up](#). For more information about other recent decisions on the leasing project, see Deloitte's April 15, 2011; March 28, 2011; and February 21, 2011, journal entries (available via subscription to [Deloitte Technical Library](#)). ●

Fair Value Measurement

Affects: All entities.

Summary: On May 12, 2011, the FASB issued an [ASU](#)¹² on fair value measurement. The ASU is the result of joint efforts by the FASB and IASB to develop a single, converged fair value framework — that is, converged guidance on how (not when) to measure fair value and on what disclosures to provide about fair value measurements. Thus, there are few differences between the ASU and its international counterpart, IFRS 13.¹³ The ASU is largely consistent with existing fair value measurement principles in U.S. GAAP (contained in ASC 820¹⁴). The ASU expands ASC 820's existing disclosure requirements for fair value measurements and makes other amendments. The following is a list of some of the ASU's more noteworthy amendments to the fair value measurement guidance as well as some of the new disclosure requirements:

- *Highest-and-best-use and valuation-premise concepts for nonfinancial assets* — The ASU indicates that the highest-and-best-use and valuation-premise concepts only apply to measuring the fair value of nonfinancial assets.
- *Application to financial assets and financial liabilities with offsetting positions in market risks or counterparty credit risk* — The ASU permits an exception to fair value measurement principles for financial assets and financial liabilities (and derivatives) with offsetting positions in market risks or counterparty credit risk when several criteria are met. When the criteria are met, an entity can measure the fair value of the net risk position.
- *Premiums or discounts in fair value measurement* — The ASU states that "[p]remiums or discounts that reflect size as a characteristic of the reporting entity's holding (specifically, a blockage factor that adjusts the quoted price of an asset or a liability because the market's normal daily trading volume is not sufficient to absorb the quantity held by the entity . . .) rather than as a characteristic of the asset or liability (for example, a control premium when measuring the fair value of a controlling interest) are not permitted in a fair value measurement."
- *Fair value of an instrument classified in a reporting entity's shareholders' equity* — The ASU

¹² FASB Accounting Standards Update No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*.

¹³ IFRS 13, *Fair Value Measurement*.

¹⁴ FASB Accounting Standards Codification Topic 820, *Fair Value Measurement*.

prescribes a model for measuring the fair value of an instrument classified in shareholders' equity; this model is consistent with the guidance on measuring the fair value of liabilities.

- *Disclosures about fair value measurements* — The ASU expands ASC 820's disclosure requirements, particularly for Level 3 inputs. Required disclosures include:
 - For fair value measurements categorized in Level 3 of the fair value hierarchy:
 - (1) a quantitative disclosure of the unobservable inputs and assumptions used in the measurement, (2) a description of the valuation processes in place (e.g., how the entity decides its valuation policies and procedures, as well as changes in its analyses of fair value measurements, from period to period), and (3) a narrative description of the sensitivity of the fair value to changes in unobservable inputs and interrelationships between those inputs.
 - 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.

The ASU is effective for interim and annual periods beginning after December 15, 2011, for public entities and for annual periods beginning after December 15, 2011, for nonpublic entities.

Other Resources: Deloitte's May 13, 2011, [Heads Up](#). ●

Insurance

Affects: All entities.

Summary: In September 2010, the FASB published a [DP](#) containing its preliminary views on the IASB's [ED](#) 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 ED 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 certain 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.

Starting in January 2011, the FASB and IASB began redeliberating issues identified (1) during the comment letter period and (2) by preparers, investors, regulators, and others at public roundtable meetings hosted by the two boards. The boards have adopted a set of axioms and assumptions to help them address the feedback from constituents and finalize the new accounting guidance on insurance contracts. On the basis of this set of axioms and assumptions, the boards have tentatively decided to make some changes to the proposals in the IASB's ED and FASB's DP.

Editor's Note: The FASB has posted to its Web site a [summary](#) of decisions the boards have made on the insurance project through May 18, 2011.

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 project. 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 rate of return on assets). Furthermore, entities might have to recognize “day one” losses in net income depending on how they have priced their insurance contracts.

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

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 jointly deliberated the project, they ultimately decided not to converge on all aspects of this topic. While the IASB has continued with a consolidation project that would apply to all entities, the FASB has decided on a narrower project to address whether a decision maker is acting as a principal or as an agent.

VIEs and Voting Interest Entities

The FASB will retain the existing U.S. GAAP guidance on these types of entities (see ASC 810-10¹⁵). However, the Board will provide guidance that would help entities assess whether a decision maker is acting as a principal or as an agent. This guidance would apply to all entities applying the current VIE guidance as well as to partnerships subject to the guidance in ASC 810-20.¹⁶

Editor’s Note: The principal-versus-agent guidance may allow the FASB to eliminate the deferral of Statement 167¹⁷ 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. This qualitative assessment would also allow a general partner to consider its economics when determining whether it should consolidate a partnership.

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. GAAP¹⁸ 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 the assets and liabilities underlying the subsidiary’s investments in the consolidated financial statements.

Consideration Points: U.S. entities should consider any potential impacts of the FASB’s principal-versus-agent guidance on (1) structures involving VIEs, including funds managed by investment managers and (2) partnerships and similar entities applying the guidance in ASC 810-20. 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.

¹⁵ FASB Accounting Standards Codification Subtopic 810-10, *Consolidation: Overall*.

¹⁶ FASB Accounting Standards Codification Subtopic 810-20, *Consolidation: Control of Partnerships and Similar Entities*.

¹⁷ FASB Statement No. 167, *Amendments to FASB Interpretation No. 46(R)*.

¹⁸ FASB Accounting Standards Codification Topic 946, *Financial Services — Investment Companies*.

Next Steps: The IASB issued its consolidation standard¹⁹ in May 2011. The FASB staff plans to issue an ED on the principal-versus-agent guidance in the second quarter of 2011 and a final standard in the second half of 2011. Both boards plan to issue an ED on the investment company guidance in the second quarter of 2011 and aim to finalize this guidance in the second half of 2011. ●

Presentation of Financial Statements

Financial Statement Presentation

Affects: Most entities.²⁰

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 important to understanding the entity's financial position.

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.

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.

¹⁹ In conjunction with the consolidation standard, the IASB issued three IFRSs and amended two IASs. These included IFRS 10, *Consolidated Financial Statements*; IFRS 11, *Joint Arrangements*; IFRS 12, *Disclosure of Interests in Other Entities*; IAS 27, *Separate Financial Statements*; and IAS 28, *Investments in Associates and Joint Ventures*.

²⁰ 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.

Next Steps: The FASB and IASB halted deliberations of their financial statement presentation project, with further consideration not expected before December 2011. The delay in the project will give the boards time to perform and finalize additional outreach, address constituents' concerns, 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 [ED](#) that proposed to amend the criteria for reporting discontinued operations. Since then, the FASB has redeliberated the feedback received from constituents on the ED and has tentatively decided the following:

- To align the scope of ASC 205-20²¹ with that of IFRS 5²² to apply to all recognized noncurrent assets and to all disposal groups of an entity. Thus, a discontinued operation would be either (1) 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 ED in the second quarter of 2011. The Board's goal is to issue a final standard in the second half 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 958-205.²³

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 [ED](#) 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 ED 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 second quarter of 2011.

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

²¹ FASB Accounting Standards Codification Subtopic 205-20, *Presentation of Financial Statements: Discontinued Operations*.

²² IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.

²³ FASB Accounting Standards Codification Subtopic 958-205, *Not-for-Profit Entities: Presentation of Financial Statements*.

FASB-Only Projects

Troubled Debt Restructurings

Affects: All entities.

Summary: In April 2011, the FASB issued an [ASU](#)²⁴ that clarifies 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.

For public entities, the ASU is effective for the first interim or annual period beginning on or after June 15, 2011. For disclosure purposes, public entities must apply the guidance retrospectively to restructurings occurring at or after the beginning of the annual period of adoption. For nonpublic entities, the ASU is effective for annual periods ending on or after December 15, 2012.

Early adoption is permitted for both public and nonpublic entities.

Consideration Points: A public entity must provide the previously deferred (see ASU 2011-01²⁵) disclosures for TDRs required by ASU 2010-20²⁶ in the first interim or annual period beginning on or after June 15, 2011. The TDR provisions of ASU 2010-20 require entities to disclose quantitative and qualitative information about TDRs, including how financing receivables were modified and the financial effects of the modifications. They also require separate disclosures about recurring TDRs (i.e., TDRs that occurred within the previous 12 months for which there has been a payment default during the current period).

For nonpublic entities, the ASU did not amend the effective date of the TDR provisions of ASU 2010-20. Accordingly, the TDR-related disclosures of ASU 2010-20 are required for a nonpublic entity's first annual reporting period ending after December 15, 2011.

Other Resources: Deloitte's April 6, 2011, [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 an [ASU](#) that temporarily defers the effective date in ASU 2010-20 for disclosures about TDRs by creditors until the Board finalizes its project on determining what constitutes a TDR for a creditor. Because of the issuance of ASU 2011-02, the TDR-related disclosures of ASU 2010-20 are no longer deferred (see above).

Other Resources: Deloitte's April 6, 2011, [Heads Up](#). ●

Transfers and Servicing — Repurchase Agreements

Affects: All entities.

Summary: On April 29, 2011, the FASB issued an [ASU](#)²⁷ that eliminates the collateral maintenance requirement under U.S. GAAP for entities to consider 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. The new guidance is effective for an entity's first interim or annual period beginning on or after December 15, 2011 (i.e., a calendar-year-end entity is required to adopt the new guidance as of January 1, 2012). Early adoption is not permitted.

Consideration Points: Although entities must consider all the effective-control criteria under ASC 860,²⁸ the *elimination* of the collateral maintenance requirement may cause more repos to be accounted for as secured borrowings rather than as sales. The ASU also clarifies that the guidance should be applied on a transactional basis

²⁴ FASB Accounting Standards Update No. 2011-02, *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*.

²⁵ FASB Accounting Standards Update No. 2011-01, *Deferral of the Effective Date of Disclosures About Troubled Debt Restructurings in Update No. 2010-20*.

²⁶ FASB Accounting Standards Update No. 2010-20, *Disclosures About the Credit Quality of Financing Receivables and the Allowance for Credit Losses*.

²⁷ FASB Accounting Standards Update No. 2011-03, *Reconsideration of Effective Control for Repurchase Agreements*.

²⁸ FASB Accounting Standards Codification Topic 860, *Transfers and Servicing*.

and not on a broader basis (e.g., a group of transactions executed under a master agreement). Therefore, the new guidance applies only to transfers initiated or modified after the effective date of the final ASU.

Other Resources: Deloitte's November 4, 2010, [Heads Up](#) and May 2, 2011, [Heads Up](#). ●

Investment Properties

Affects: Entities with substantive activities related to investing in real estate that meet certain other conditions.

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 40²⁹) 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.
- An investment property entity, in accounting for a lease for which it is the lessee, would measure right-of-use assets related to investment properties at fair value, with changes in fair value recognized in net income. Right-of-use assets related to non-investment-property assets would be carried at amortized cost in a manner consistent with the leases ED. Non-investment-property assets held by investment property entities would be accounted for under other applicable U.S. GAAP.
- Entities should provide specific disclosures about their investment properties.

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

Editor's Note: The Board has informally indicated that there is a need to finalize the investment property project within a time frame consistent with the leases project. One reason that this is important is that lessors of investment property that are investment property entities would primarily use a fair value accounting model for the investment property and not the lessor accounting model discussed in the leases project.

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 [ED](#) on disclosures about an employer's participation in a multiemployer plan. The objective of the ED is to improve transparency by amending ASC 715-80³⁰ 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.

Consideration Points: Entities that do not currently provide the level of disclosure required by the ED, 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. In November 2010, the FASB decided that the effective date in the ED 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). The Board discussed the comment letter responses during a March 2011 meeting and concluded that the ED should be further redeliberated. The staff is currently conducting additional outreach with financial statement users and preparers in an effort to refine the proposed disclosure requirements.

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

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

²⁹ IAS 40, *Investment Property*.

³⁰ FASB Accounting Standards Codification Subtopic 715-80, *Compensation — Retirement Benefits: Multiemployer Plans*.

Goodwill Impairment Assessments

Affects: All entities.

Summary: In April 2011, the FASB issued an [ED](#) on testing goodwill for impairment. Under the proposal, entities would have the option of performing a qualitative assessment before calculating the fair value of the reporting unit (i.e., step 1 of the goodwill impairment test). If entities determine, on the basis of qualitative factors, that the fair value of the reporting unit is more likely than not greater than the carrying amount, a quantitative calculation would not be needed. The proposal would not change how goodwill is calculated or assigned to reporting units, nor would it revise the requirement to test goodwill annually for impairment. In addition, the proposed guidance does not amend the requirement to test goodwill for impairment between annual tests if events or circumstances warrant; however, it does revise the examples of events and circumstances that an entity should consider.

Next Steps: Comments on the proposal are due by June 6, 2011. The Board expects to issue a final standard in the second half of 2011.

Other Resources: Deloitte's April 25, 2011, [Heads Up](#). ●

Disclosures About Certain Loss Contingencies

Affects: All entities.

Summary: In July 2010, the FASB issued an [ED](#) 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 450-20³¹ and (2) review 2010 Form 10-K filings for calendar-year-end reporting entities and determine whether those efforts resulted in improved disclosures.

Next Steps: In reassessing the project, the FASB has determined it to be lower-priority; further action is not expected before December 2011.

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

³¹ FASB Accounting Standards Codification Subtopic 450-20, *Contingencies: Loss Contingencies*.

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.

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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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