

## In this issue:

Convergence updates:  
Lease accounting and  
financial instruments

On the road to the single  
revenue recognition  
standard

SEC reviews comment  
letters on foreign private  
issuers using IFRS

IAS Plus website gets an  
update

Resources

Contacts

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# IFRS Insights

## Achieving a global standard



### Convergence updates: Lease accounting and financial instruments

The U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (the Boards) continue to work to bring U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS) closer together. Below are updates on the progress related to lease accounting and financial instruments. Please see the separate article in this newsletter for updates about revenue recognition.

#### Lease accounting

The FASB and IASB are proposing to fundamentally change the accounting for lease arrangements for both U.S. GAAP and IFRS. The Boards are attempting to complete their deliberations by the end of June, with a goal of issuing a second exposure draft (ED) by the end of 2012. A final standard is expected to be issued by the end of 2013.

The Boards are proposing a “right-of-use model” for lessees in which all leases are recognized on the balance sheet at lease commencement. A lessee would recognize an asset for the right to use the underlying asset and a liability to make lease payments. The two key factors

in initially measuring the right-of-use asset and lease liability are the lease term and lease payments. The proposed guidance would require the lease term to be the non-cancelable lease period plus any renewal periods for which there is a significant economic incentive for the lessee to exercise the renewal option. The criteria would be generally consistent with the current guidance entities use today to evaluate renewal periods and lease term.

The Boards are also proposing a single lessor accounting model — the “receivable and residual” method — that would apply to all leases except for short-term leases and leases of investment property. This model is similar to the derecognition model proposed in the original ED. Under the receivable and residual method, a lessor would derecognize the underlying asset leased (or portion of the asset leased) and recognize:

- A lease receivable measured as the present value of the future lease payments
- A residual asset measured on an allocated-cost basis

A lessor’s lease of investment property would apply current operating lease accounting; however, this scope exception is still being discussed by the Boards.

And finally, the Boards have tentatively concluded that the initial measurement of lease payments should only include those variable payments either (a) based on an index or rate (e.g., consumer price index) or (b) that are in-substance fixed lease payments. The Boards are currently discussing the lessee's subsequent measurement of the right-of-use asset and obligation to make lease payments. The Boards may also reconsider some of their previous tentative decisions.

### Financial instruments

Regarding the **classification and measurement** phase of the financial instruments project, in November 2011 the IASB tentatively decided to reopen IFRS 9 *Financial Instruments* to address potential application issues in IFRS 9, consider the interaction between IFRS 9 and the tentative decisions made on the insurance project, and the FASB's model on the classification and measurement of financial instruments<sup>1</sup>. In December 2011, the IASB deferred the mandatory effective date of IFRS 9 to annual periods beginning on or after January 1, 2015, because of the delay in the expected timing of completion of the remaining phases of the financial instruments project<sup>2</sup>.

The Boards thus far tentatively decided that:

- An entity assesses both the cash flow characteristics of financial assets and its business model to determine which financial assets should be classified and measured at amortized cost. Financial assets would qualify for amortized cost if the assets are held within a business model whose objective is to hold the assets in order to collect contractual cash flows.
- A financial asset could be eligible for a measurement category other than fair value through profit or loss (FVTPL) (presuming the business model criterion is also met) if the contractual terms of the financial asset result in cash flows that are solely payments of principal and interest on the principal amount outstanding.

### Defining the "buckets"

**Bucket One** would consist of financial assets where there has been no identified credit deterioration since initial recognition. All financial assets would start in Bucket One at initial recognition regardless of their level of credit quality. Financial assets in **Bucket Two** would be evaluated for credit deterioration at a portfolio level, while financial assets in **Bucket Three** would be evaluated for credit deterioration at the individual instrument level (e.g., portfolios would transfer from Bucket One to Two while individual instruments would transfer from Buckets One or Two to Bucket Three).

- The existing requirements under IFRS 9 that precludes the bifurcation of embedded derivatives from financial assets will be retained.

The Boards will continue to discuss aspects of this project over the coming months and expect to publish an ED in the second half of 2012.

Regarding the **impairment** phase of the project, the Boards have tentatively agreed to develop an expected-loss impairment model under which financial assets subject to impairment accounting would be split into three main buckets. (See the February 2012 issue of *IFRS Insights* for additional information about [the three buckets](#).) These buckets would be used to determine the amount and timing of credit losses to be recognized on debt instruments and would reflect different phases of credit deterioration.

The Boards have tentatively decided that:

- Originated and purchased non-credit-impaired assets would be moved back to Bucket 1 when the downward transfer principle is no longer satisfied
- Purchased credit-impaired assets would remain in Bucket 2 or 3 for their lifetime, even if their credit quality improves
- Trade receivables would be subject to an expected-loss model.

A new exposure draft on impairment is expected to be published in the second half of 2012.

The IASB has started deliberations on **macro hedge accounting** and expects to issue an ED or discussion paper in the second half of 2012. A review draft on general hedge accounting is expected to be posted to the IASB's website in the next few months with a final standard expected in the second half of 2012.

The **offsetting** phase of the project is now completed; in December 2011 the Boards issued common disclosure requirements that are intended to help investors and other users to better assess the potential effects of offsetting arrangements on a company's financial position.

*To receive more detailed updates on these convergence projects, please [subscribe](#) to our Heads Up publication.*

<sup>1</sup> For more information, see Deloitte's January 5, 2012, Heads Up publication [Update on FASB's Project on Accounting for Financial Instruments](#).

<sup>2</sup> Before the amendments, IFRS 9 was mandatorily effective for annual periods beginning on or after January 1, 2013.

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## On the road to the single revenue recognition standard

On November 14, 2011, the U.S. Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (the Boards) jointly issued their revised exposure draft (ED) on revenue recognition. The comment period for the revised ED ended on March 13, 2012. The Boards received approximately 350 comment letters on the proposal — significantly fewer than the nearly 1,000 they received on the original ED issued in June 2010.

The respondents were asked to comment on six specific aspects of the ED. An overview of the submitted comments is presented below, in order of the specific areas in which the Boards were seeking comments.

- **The criteria for evaluating when a good or service transfers over time**
  - *Revised ED proposal* — An entity must evaluate whether a performance obligation transfers over time by considering whether certain criteria are met.
  - *Comments overview* — Many respondents supported the ED’s method of determining when a performance obligation is transferred over time and the resulting recognition of revenue over time. However, certain respondents expressed concerns that entities may not interpret or apply the guidance consistently. They, therefore, requested that the Boards clarify certain aspects of the guidance and provide additional examples.
- **The measurement and presentation of a customer’s credit risk**
  - *Revised ED proposal* — An entity would continue to apply the measurement and recognition guidance in ASC 310 *Receivables* to consider if the entity deems amounts uncollectible because of a customer’s credit risk. However, the entity would be required to present initial adjustments for collectability in the income statement as a separate line item next to gross revenue (i.e., as contra revenue).
  - *Comments overview* — Respondents’ feedback on this question was mixed. Some supported the revised ED’s proposals. Others indicated that presenting uncollectible amounts on the face of the income statement would unnecessarily emphasize them.
- **Constraining revenue to the amount that is reasonably assured**
  - *Revised ED proposal* — The cumulative amount of revenue recognized for a satisfied performance obligation is limited to the amount to which the entity is reasonably assured to be entitled.
  - *Comments overview* — While some respondents expressed concerns about certain aspects of the revised ED’s constraint to limit revenue recognition to the amount an entity is reasonably assured to be entitled, many supported the overall concept.
- **The scope of the onerous performance obligations test**
  - *Revised ED proposal* — Entities that satisfy separate performance obligations in a contract over time and over a period greater than one year are required to determine whether those obligations are onerous.
  - *Comments overview* — Most respondents did not agree with the level at which the revised ED’s onerous test would be required to be performed (i.e., the separate performance obligation level rather than the contract level or possibly the overall-customer-relationship level).
- **The proposed interim financial statement disclosure requirements**
  - *Revised ED proposal* — The revised ED proposes a number of new interim disclosures requirements which would amend ASC 270 *Interim Reporting*.
  - *Comments overview* — While many respondents expressed support for the Boards’ objective to improve financial statement disclosures, most believed that the proposed interim disclosures would be overly burdensome and costly to prepare.
- **The application of certain provisions from the revised ED to the transfer of a nonfinancial asset that is not within the proposal’s scope (such as the sale of property, plant, and equipment)**
  - *Revised ED requirement* — An entity should apply the revenue recognition principles for the transfer of control, and the proposed measurement guidance, to the derecognition of (and the determination of gains or losses on) the transfer of nonfinancial assets that are not an output of an entity’s ordinary activities.
  - *Comments overview* — While many constituents generally indicated support for this proposal, some noted that it could be inconsistently applied and that unintended consequences could result.

### Industry-specific comments

Although the feedback from most industries was similar, and generally indicated support for the Boards' efforts to develop a single comprehensive revenue recognition standard, respondents expressed some industry-specific concerns about several aspects of the revised ED. For additional information on those comments, please read our Heads Up publication [Sizing Up the Feedback — Comments on the Revised Exposure Draft on Revenue Recognition](#).

### What's next?

The Boards plan to hold various roundtable discussions, perform additional outreach activities, discuss the comments received and the project plan at an upcoming meeting, and begin their redeliberations in June. They expect to complete the project by the first quarter of 2013. The effective date of the final standard will be determined during the redeliberations.

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## SEC reviews comment letters on foreign private issuers using IFRS

Under the Sarbanes-Oxley Act of 2002, the U.S. Securities and Exchange Commission (SEC) must review every domestic and foreign private issuer's (FPI) disclosures — including financial statements — at least once every three years. The SEC staff's comments on these disclosures, and the issuers' responses to them, are subsequently posted on the SEC's website.

Deloitte recently issued [SEC Comment Letters on Foreign Private Issuers Using IFRSs — A Closer Look \(Third Edition\)](#) to provide insight into the items that the SEC staff focused on while reviewing FPI financial statements over the past two years (see the 'Financial Statement Accounting and Disclosure Topics' and 'Other Disclosure Topics' sections). This updated edition of the publication also features extracts from actual comment letters, analysis, forward-looking considerations, and links to related resources.

Below are key highlights from the publication. This information will be particularly useful for companies that are currently using IFRS and those that are looking to learn more about IFRS. Understanding the SEC staff's comments has become increasingly important as more countries continue to adopt IFRS around the world.

### Financial statement accounting and disclosure topics

The SEC staff has frequently commented on financial instruments; presentation of financial statements; first-time adoption of IFRS; impairment of assets; consolidations; revenue recognition; operating segments; income taxes; property, plant, and equipment; employee benefits; provisions and contingent liabilities; and business combinations.

- In its comments on **financial instruments**, the staff has often asked for clarification of and enhanced disclosures about (1) impairment, (2) eurozone sovereign debt, (3) risk disclosures, (4) fair value, (5) transfers of assets, and (6) classification of financial instruments and their components as financial liabilities or equity.
- The staff has also concentrated on the **presentation of financial statements** and requested expanded disclosures about exclusions of expenses from certain income statement line items (e.g., subtotals), the nature of expenses, disclosure and presentation of equity, statement of cash flows, references to the use of IFRS as issued by the IASB, and the presentation of an opening statement of financial position for retrospective changes in accounting policy or reclassifications.
- In the staff's comments on **first-time adoption**, issuers were asked to provide an opening statement of financial position upon initially adopting IFRS, as well as to clarify adjustments made in adopting IFRS and the use of exemptions in IFRS 1 *First-time Adoption of International Financial Reporting Standards*.
- Regarding asset **impairments**, the staff has commented on issuers' determination of cash-generating units, goodwill allocation, and events and circumstances that led to the recognition of impairment losses.
- The staff has also focused on the appropriateness of issuers' **consolidation** conclusions and issuers' disclosures about investments in associates and interests in joint ventures.
- When commenting on **revenue recognition**, the staff has questioned the completeness and clarity of disclosures about how IAS 18 *Revenue Recognition* criteria were applied, as well as about the accounting for multiple-element arrangements.
- The SEC staff has continued to frequently comment on identification and aggregation of **operating segments** as well as on the completeness of disclosures that issuers provide under IFRS 8 *Operating Segments*.

- The staff's comments on **income taxes** have focused mainly on the completeness and adequacy of disclosures required by IAS 12 *Income Taxes*, particularly the amount of deferred tax assets that were not recognized.
- The staff has also asked about the frequency of issuers' reviews of the residual values, useful lives, and depreciation methods related to their **property, plant, and equipment**.
- In comments on **employee benefits**, the staff has questioned the frequency of actuarial reviews of defined benefit plans and policies for calculating the present value of defined benefit obligations and the fair value of plan assets.
- In its comments about **provisions**, the SEC staff has asked for more information and expanded disclosures about the nature, types, and amounts of provisions that were recognized, as well as about the completeness of disclosures related to **contingent liabilities**.
- In commenting on **business combinations**, the staff has emphasized the need for expanded accounting policy disclosures and clarification of why the purchase accounting method was used in transactions with common-control entities.

#### Other disclosure topics

The SEC staff has frequently commented on the operating and financial review and prospects, particularly in connection with providing a balanced discussion of the risks and opportunities that issuers face. To give investors insight into potential future developments, an issuer should discuss known trends that are reasonably likely to materially affect the issuer's financial position, operations, and liquidity. The staff has also focused on disclosures about risk factors such as the impact of foreign operations, including exposure to sovereign debt and risks related to the political and business climate, currency, and taxation. Regarding risk factors, the staff has reminded issuers to refrain from providing "boilerplate" discussions and instead to disclose specific, known material risks. Issuers should also ensure that disclosure of risk factors is consistent with other disclosures in the filing.

While the staff has generally become more flexible about the use of non-Generally Accepted Accounting Principles financial measures, it has continued to comment when an issuer's use or disclosure of such measures may not have complied with the SEC's regulations and has reminded

issuers that presenting a misleading financial measure is never appropriate. In addition, disclosures about controls and procedures, state sponsors of terrorism, material contracts, and certifications have received staff attention. The staff has also focused on whether guarantees provided by 100 percent owned subsidiaries on registered debt are truly "full and unconditional" and whether the use of condensed consolidating information as outlined in Regulation S-X, Rule 3-10, is appropriate.

In addition to reviewing the FPI financial statements, as part of its SEC Work Plan about the possible incorporation of IFRS into the U.S. financial reporting system, the SEC staff analyzed the financial statements of entities that report under IFRS (as issued by the International Accounting Standards Board) and in November 2011 issued a staff paper titled *An Analysis of IFRS in Practice*. The staff found that the financial statements of the companies included in the analysis "generally appeared to comply with IFRS requirements." However, the staff noted that the disclosures could be more transparent and clear. The staff paper summarized the most common areas of the staff's focus in its reviews of filings of FPIs. In addition, the staff has discussed these top IFRS-related topics at the 2010 and 2011 AICPA National Conferences on Current SEC and PCAOB Developments<sup>3</sup>. We expect that finalizing this work plan will remain a priority of the SEC in 2012<sup>4</sup>.

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### IAS Plus website gets an update

We are pleased to announce that a completely redesigned version of Deloitte's [IAS Plus website](#) has been launched. This global site provides access to up-to-date IFRS-related news and content at no charge, and the new design gives you easier access to the site's information. Also, the site features updated menus, more intuitive navigation, and improved search features.

With the new "My IAS Plus" menu, you can personalize the site and subscribe to various IFRS-related communications and publications that interest you. In addition, for mobile users, IAS Plus now sends news directly to your smart phone.

To make sure the site serves your needs, we invite you to visit the site and click the "Provide your feedback" box (in the group of six boxes on the right side of the front page). Providing feedback is easy and only takes a few minutes.

<sup>3</sup> For additional information about the SEC staff's speeches on key IFRS topics, see Deloitte's December 16, 2010, and December 14, 2011, [Heads Up](#) newsletters.

<sup>4</sup> For additional information about the progress of the SEC's work plan, comments the SEC has received from respondents about incorporating IFRSs into the U.S. financial reporting system, and the SEC staff's observations related to the application of IFRSs in practice, see Deloitte's June 1, 2011, November 8, 2011, and December 2, 2011, [Heads Up](#) newsletters, respectively.

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## Resources

### Upcoming classroom training

If you are looking to learn more about accounting convergence and International Financial Reporting Standards (IFRS), consider attending our upcoming classroom training session in [Chantilly, VA \(Washington DC area\) on June 4-5, 2012](#).

Led by experienced Deloitte IFRS leaders and complemented by industry panelists, this two-day program includes a combination of lectures and real-life case studies for a deeper understanding of the topics. This conference will provide you with an understanding of the IFRS technical accounting changes, tax considerations, valuation issues, and technology/systems requirements. Additional information — including the agenda and cost — can be found on the [registration site](#).

If you are unable to attend a classroom event, please consider our [IFRS e-learning program](#) which also provides CPE credit.

### Highlights from the 2011 IFRS Summit

On October 18, 2011, nearly 170 business executives from around the country gathered in New York City for Deloitte's fourth annual IFRS Summit. An additional 74 people participated via a live simulcast from South America. Attendees got an update on the potential integration of IFRS into the U.S. public company financial reporting framework, heard some real-life experiences from leaders who are managing the IFRS efforts at their companies, and got updates from International Accounting Standards Board (IASB) staff members on key IFRS projects. Visit our [IFRS Summit Center](#) to view video clips which feature commentary and perspectives from IASB Chairman Hans Hoogervorst and U.S. Financial Accounting Standards Board Chairman Leslie Seidman, who were the keynote speakers at the event.

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## Contacts

### Joel Osness

Partner  
Deloitte & Touche LLP  
+1 212 492 3910  
[josness@deloitte.com](mailto:josness@deloitte.com)

### Nick Difazio

Partner  
Deloitte & Touche LLP  
+1 313 396 3208  
[ndifazio@deloitte.com](mailto:ndifazio@deloitte.com)

### Tom Omberg

Partner  
Deloitte & Touche LLP  
+1 212 436 4126  
[tomberg@deloitte.com](mailto:tomberg@deloitte.com)

### Renee Bomchill

Partner  
Deloitte & Touche LLP  
+1 212 436 6836  
[rbomchill@deloitte.com](mailto:rbomchill@deloitte.com)

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