

FASB Update

Financial Statement User Edition

May 2011



This summary is meant to update investors on standard-setting activities that may impact the companies they follow. The FASB provides this summarized overview because it recognizes that investors may not have the time to read and respond to detailed technical proposals. For additional information or to provide comment for any of these proposals, contact FASB Senior Investor Liaisons Chandy Smith at ccsmith@fasb.org or Jeff Brickman at jmbrickman@fasb.org.

Below please find an update of accounting standard-setting activities that could be of interest to companies you follow.

All industry sectors:

- The FASB and IASB continue to re-debate issues on how **revenue** should be recognized at companies globally. Changes *could* impact certain industries more than others depending on decisions in the next several months. (See *Revenue Recognition* below.)
- The FASB and IASB continue to re-debate issues about how to account for **leases**. Recent decisions impact how much of the lease liability would be capitalized on the balance sheet for what today are operating leases. (See *Leases* below.)

Financial institutions:

- New disclosures began this year giving further detail and transparency into **loans** and the **allowance for loan losses**. (See *Recently Effective Standard* below.)
- New rules going into effect in the third quarter clarifying the definition of **troubled debt restructurings**. (See *Standard Soon to be Effective* below.)
- The FASB continues to re-debate issues on how financial instruments are classified and measured and is working with the IASB to come to a global answer for how to calculate credit losses at financial institutions. (See *Financial Instruments* below.)
- The FASB and IASB will soon begin to re-debate their proposal on **offsetting**, which could change how derivatives and other instruments are netted

under US GAAP, impacting leverage ratios. (See *Offsetting* below.)

- The FASB has begun researching possible improvements to disclosures at financial institutions about **interest rate risk** and **liquidity risk**. (See *Financial Instrument Risk Disclosures* below.)

Recently Effective Standard

In 2010 annual filings and in recently issued quarterly filings, companies are disclosing more detailed analysis of the **credit quality of financing receivables** and the **allowance for credit losses**. For example, the new rule requires rollforwards of the allowance by portfolio segment, as well as breakouts of nonaccruals, impaired loans, aging information and credit quality information, by class of loan. See the FASB In Focus (click here) for more details.

Standard Soon to Be Effective

A recently issued standard due to become effective in the third quarter will clarify **troubled debt restructurings** (TDR). As loan modifications have surged since the financial crisis, evidence indicated that there was significant diversity in practice as to when those modifications were being disclosed as a TDR. The new rule will hopefully reduce that diversity. Beginning in the third quarter, companies should disclose comparable adjusted TDR figures at that time for the first and second quarters of 2011. For more details and an example on how a financial institution will determine whether a loan modification is a TDR, see our FASB In Focus here.

Update on Timing of Joint Project Activity

Recently Sir David Tweedie, chairman of the IASB, and Leslie F. Seidman, chairman of the FASB, recorded an interview in which they review the achievements of the convergence program so far and the time line for completing the remaining elements of the program. To read a transcript, please click here. Furthermore, a progress report was issued on April 21, with further details on the status and timing of each of the joint projects. Click here to see the progress report.

Effective Dates

The FASB and IASB staff have prepared a short survey to seek the views from users on whether or how to sequence the effective dates for a number of projects that are due to be completed this year, including Revenue Recognition, Leases, Accounting for Financial Instruments, and Insurance Contracts. Click here to access the survey.

Joint discussions continue on a number of projects, including:

Revenue Recognition—Feedback on the Exposure Draft made clear that the Boards needed to better address how to recognize revenue for contracts that contained services or elements of both goods and services. Decisions have been made in recent months in an attempt to address the concerns raised. Additionally, redeliberations have addressed how contract acquisition costs and questionable collectability should be reported. The

Boards still need to re-debate any industry-specific considerations, whether to require retrospective application, and all disclosure requirements.

Leases—The Boards' views on a number of topics have changed during redeliberations. Leases with less than one-year terms will not be capitalized. Variable (contingent) rentals will only be included in the lease liability when they are index-based or in-substance fixed, and renewal options will be included in the lease liability only if there is significant economic incentive that the renewal would be exercised. The Boards have been discussing whether leases with greater than a one-year term should be classified into two types: finance leases and other than finance leases and how the income statement should be presented under each type for both lessees and lessors. The Boards still need to address many issues, including subleases, presentation on the income statement and balance sheet, how to transition existing leases, and all disclosures.

Insurance Contracts—The Boards are re-debating the issues on their respective insurance proposals, with the IASB working towards finalizing a standard and the FASB building towards an Exposure Draft. In recent discussions with investors, analysts have pointed out concerns about any new standard introducing noneconomic volatility as well as strong views about income statement presentation. The Boards have been discussing issues related to the discount rate on the insurance liability, and while several tentative decisions have been made, the Boards still need to make decisions about many significant items, such as whether to include an explicit risk adjustment in the liability, what presentation should be required on the income statement, whether to permit or require a modified approach for shorter-duration contracts, and whether or not to “unlock” the residual or composite margin.

Financial Instruments—The FASB continues to re-deliberate significant portions of its original proposals,

including how financial instruments will be classified and measured. Most notably, the Boards tentatively decided that the classification and measurement of loans not held for sale but which were originated as part of a customer financing activity where credit risk is the primary risk measured from fair value to amortized cost. Many issues remain to be discussed including presentation of the balance sheet and income statement (and whether and how to require highly visible fair value information for items measured at cost), a disclosure package, transition, and other items.

The FASB and IASB have been working jointly on how to calculate credit losses in an impairment model. While the Boards have received very mixed feedback from around the world about how to proceed, there seems to be a majority view among constituents who have weighed in that for all concerned it would be best if the Boards could agree upon a converged solution for impairment. As such, the Boards will continue to explore the best way forward in order to arrive at a converged impairment model in upcoming months.

Offsetting—The FASB and IASB jointly proposed to change the criteria for netting to allow netting of financial assets and liabilities on the face of the balance sheet only when an unconditional right to net exists at all times and when there is an intention to settle contracts net or simultaneously. This would represent a major change for US filers with significant derivatives/repurchase agreement activity. An offsetting roundtable was recently held in Norwalk, CT. **If you would like to provide your thoughts on the proposal, please call Chandy Smith at 203.956.5311.**

We are seeking investor views on the following projects:

Investment Properties—The Board is in the process of issuing a proposed Update (expected by end of June) that would require an investment property entity to measure real estate investment

properties at fair value if criteria are met related to:

- Business activities (must substantively relate to investing in real estate)
- Business purpose (investing in real estate for total return including capital appreciation as opposed to using properties for the production or supply of goods or services, administrative purposes, rental income only, or sale in the ordinary course of business)
- Unit ownership (ownership in the entity is represented by units of investments) and
- Pooling of funds (must have one or more unrelated investors with significant ownership).

The tentative decision would not fully converge with international financial reporting standards, which permit but do not require investment properties to be measured at fair value. **Be on the lookout for this proposed Update. In the interim, please let us know if you have any concerns or questions.**

Financial Instrument Risk Disclosures—We are currently seeking investor views on financial instrument disclosures that would help investors analyze the interest rate and liquidity risk in a company with significant lending activities. Some of the ideas we are considering include:

1. A liquidity gap table based on the expected maturity of assets and liabilities along with excess funding information
2. A repricing gap table that would show the yields for each major asset and liability class
3. A time deposit table showing the weighted-average rate and life of time deposits issued in the past quarter and
4. A sensitivity analysis that would shock net interest income and equity based on a static balance sheet.

Call or email Peter Gustafsson at 203.956.5388 or pgustafsson@fasb.org to hear more about these ideas and to provide your feedback.