Financial Statement Reporting Developments: Convergence Efforts

DELOITTE & TOUCHE LLP PANEL DISCUSSION
August 3, 2010

Margaret Mulley- Moderator-
*Partner of Strategy & Communications and Chief Learning Officer, Deloitte & Touche LLP*
Introduction:

- Memorandum of Understanding (MoU) established in 2006 between FASB and IASB to improve and converge global accounting standards
- The 2008 update established the goal of completing major joint projects by 2011
- MoU updated again in June 2010, responding to constituents need for adequate time to develop quality comments on the many proposed accounting changes
- This panel presentation will discuss several of the most important joint accounting projects that are discussed in that MoU
Agenda

- **Overview of Joint FASB & IASB Convergence Projects:** Patrick Casabona, Senior manager, Deloitte & Touche LLP, pcasabona@deloitte.com & Professor, St. Johns University (10 minutes)

- **Accounting for Financial Instruments:** Adrian E. Mills, Deloitte & Touche LLP, Recent Practice Fellow, Financial Accounting Standards Board, amills@deloitte.com (20 minutes)

- **Revenue Recognition:** Ignacio Perez Zaldivar, Partner, Deloitte & Touche LLP, igperez@deloitte.com, (20 minutes)
Agenda

- **Lease Accounting:** Christine Murphy, MDP Audit Manager, Deloitte & Touche LLP, christinemurphy@deloitte.com (15 minutes)
- **Financial Statement Presentation:** Christine Ng, MDP Audit Manager, Deloitte & Touche LLP, chrng@deloitte.com (15 minutes)
- **Other Joint Projects—Liabilities & Equity, Other Comprehensive Income, Fair Value Measurement, Consolidations:** Adrian Mills (10 minutes)
- Questions & Answers (10 minutes)
The views expressed in this presentation are those of the Presenters and do not represent positions of Deloitte & Touche LLP
Joint FASB/IASB Developments—Overview

Pat Casabona
FASB’s & IASB’s Updated MoU for improving and achieving convergence of US GAAP & IFRS, issued June 2, 2010

**Announces their intention to modify the strategy to improve and converge IFRSs and U.S. GAAP accounting standards**

- **Prioritize the major projects**
  - Concern about agenda being too aggressive for boards and constituents
  - Prioritizes the projects and focuses on those most in need of global improvement and which boards can complete by June 2010, such as: financial instruments, revenue recognition, lease accounting, fair value measurement and offsetting.

- **Stagger the publication of Exposure Drafts (EDs)**
  - Decided not to publish more than four EDs per quarter. This is a reflection of not wanting to overload constituents and of focusing more on quality and effective stakeholder participation in due process.

- **Issue a separate consultation document**
  - Seek stakeholder input about effective dates and transition methods. Decided to publish a discussion paper this quarter to seek input from constituents as to what the best implementation approach for all these convergence projects should be.
SEC’s Statement on Convergence – June 2, 2010

Mary L. Schapiro

- Boards believe that the modified plan will increase the quality of the standards as it provides additional time for stakeholders to give quality feedback on the proposals. “I view this as time that is well invested”.

- Boards’ decision to delay some projects would not impact the SEC’s decision in 2011 on whether and, if so when, to adopt IFRSs into the US capital markets.

- The SEC is on schedule to determine in 2011 whether to incorporate IFRS into the financial reporting system for U.S. issuers.
## Revised Timeline for MoU and Other Joint Projects

<table>
<thead>
<tr>
<th>Projects</th>
<th>2010</th>
<th>2011</th>
</tr>
</thead>
<tbody>
<tr>
<td>Expected date</td>
<td>Q2</td>
<td>Q3</td>
</tr>
<tr>
<td>Financial instruments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Classification and measurement</td>
<td>FASB ED</td>
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<tr>
<td>Impairment</td>
<td></td>
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<tr>
<td>Hedge accounting</td>
<td>IASB ED</td>
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<tr>
<td>Offsetting</td>
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<tr>
<td>Revenue recognition</td>
<td>ED</td>
<td></td>
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<tr>
<td>Fair value measurement</td>
<td>ED</td>
<td></td>
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<tr>
<td>Leases</td>
<td></td>
<td>ED</td>
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<tr>
<td>Financial statement presentation:</td>
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<tr>
<td>Statement of OCI</td>
<td>ED</td>
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<tr>
<td>Discontinued operations</td>
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<tr>
<td>Main project</td>
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</tbody>
</table>

**Abbreviations:**
- ED – Exposure Draft
- RT – Roundtable
- F – Final Standard
### Revised Timeline for MoU and Other Joint Projects (cont.)

<table>
<thead>
<tr>
<th>Projects</th>
<th>Expected date</th>
<th>2010</th>
<th>2011</th>
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<tbody>
<tr>
<td></td>
<td></td>
<td>Q2</td>
<td>Q3</td>
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<tr>
<td>Derecognition — Disclosures</td>
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<tr>
<td></td>
<td>IASB F</td>
<td></td>
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<tr>
<td>Consolidations:</td>
<td></td>
<td></td>
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</tr>
<tr>
<td>• Voting interest entities</td>
<td>FASB RT</td>
<td></td>
<td></td>
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<tr>
<td>• Investment companies</td>
<td>IASB F</td>
<td></td>
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<tr>
<td></td>
<td>IASB ED</td>
<td></td>
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<tr>
<td>Postemployment benefits</td>
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<tr>
<td>Financial instruments with characteristics of equity</td>
<td>IASB ED</td>
<td></td>
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<tr>
<td></td>
<td>ED</td>
<td></td>
<td></td>
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<tr>
<td>Insurance</td>
<td></td>
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<tr>
<td></td>
<td>IASB ED</td>
<td></td>
<td></td>
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<tr>
<td>Emissions trading schemes</td>
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<td></td>
<td>ED</td>
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</tbody>
</table>

**ED** – Exposure Draft    **RT** – Roundtable    **F** – Final Standard
Outline

- Problems with Existing Standards
- Scope
- Classification & Measurement
- Presentation
- Credit Impairment
- Hedge Accounting
- Effective Date & Transition
- Project Timeline
Problems with Existing Standards

- Complexities and inconsistencies within and between U.S. GAAP and IFRS, on:
  - Classification and measurement,
  - Impairment
  - Hedge accounting
- In U.S., different impairment approaches for debt securities and loans especially problematic
- Financial Crisis pointed to untimely recognition of credit impairment of loans held for collection by financial institutions.
Scope

All financial instruments (as defined), except:

- Employee benefits including pensions, share-based payments and other compensation contracts
- Insurance contracts
- Lease contracts
- Equity investments in consolidated subsidiaries
- Variable interest entities
- Noncontrolling interests in consolidated entities
- Certain financial guarantees
- Contingent consideration arrangements not based on an observable market
- Certain financial instruments excluded from the scope of ASC 815
## Classification and Measurement

### Default category:
- **All financial instruments**

#### Classification
- Fair value through earnings

#### Measurement
- Initial: Fair value
- Subsequent: Fair Value

### Option to record:
- **Debt instruments:** Business strategy (to hold a debt instrument for collection or payment of contractual cash flows rather than selling or settling)

#### Classification
- Portion of the change in fair value through OCI

#### Measurement
- Initial: Transaction price (exception apply)
- Subsequent: Fair Value

### Option to record:
- **Own Debt:** Business strategy + measurement attribute mismatch

#### Classification
- Amortized cost

#### Measurement
- Amortized cost

- All equities
- All derivatives
- Many hybrids

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Note: The information is derived from the image and the text extracted from it. The original source is not referenced directly.
Classification and Measurement: FV-OCI Criteria

Option to measure a debt instrument at FV-OCI, if:

- The debt instrument is held or issued with all of the following:
  - There is amount transferred to a debtor at inception that will be returned to the creditor at maturity or other settlement
  - The contractual terms identify any additional contractual cash flows to be paid to the creditor either periodically or at maturity
  - The debt instrument cannot be contractually prepaid or otherwise settled in such a way that the investor would not recover substantially all of its initial investment, other than through its own choice

- The entity’s business strategy is to hold the debt instrument for collection or payment of contractual cash flows rather than to sell or settle with a third party; and

- It is not a hybrid instrument for which guidance in ASC 815-15 would have required the embedded derivative to be accounted for separately from the host contract
Classification and Measurement: Amortized Cost Criteria

Option to measure a financial liability at amortized cost, if:

- The financial liability qualifies for FV-OCI classification; and
- Measuring the financial liability at fair value would create or exacerbate a measurement attribute mismatch of recognized assets and liabilities

Criteria applicable to measurement attribute mismatch (must meet at least one criteria):

- The financial liability is **contractually linked** to an asset not measured at fair value
- The financial liability is issued by and recorded in an operating segment for which less than 50 percent of the segment’s recognized assets are subsequently measured at fair value
- The financial liability is the liability of a consolidated entity for which less than 50 percent of the consolidated recognized assets are subsequently measured at fair value
Classification and Measurement – Impact on Certain Instruments

Hybrid Financial Instruments
- Measured at fair value (no bifurcation of embedded derivative)
- Classification category dependent on:
  - Whether the embedded feature meets the bifurcation requirements in ASC 815-15
  - FV-OCI classification criteria

Loan Commitments
- Based on how the underlying loan is classified and measured
- Exception for potential borrower

Equity Method Accounting
- Applicable only if the entity has (1) significant influence over investee and (2) the investee’s operations are related to those of the entity’s consolidated operations
Classification and Measurement – Exceptions to Subsequent Measurement Principle

- Core deposit liabilities
  - Measured at the present value of the average core deposit amount discounted at the difference between the alternative funds rate and the all-in-cost-to-service rate over implied maturity
  - Noncore deposit liabilities at fair value

- Short-term receivables and payables
  - Receivables and payables arising in the normal course of business that are due in customary terms not exceeding one year and meet the FV-OCI classification criteria
  - Measured at amortized cost less allowance for credit impairment

- Instruments redeemable for specified amounts
  - Redemption value
  - E.g., investments in stocks of FHLB, FRB, etc
## PRESENTATION*

<table>
<thead>
<tr>
<th>Category</th>
<th>Balance Sheet</th>
<th>Statement of Comprehensive Income**</th>
</tr>
</thead>
<tbody>
<tr>
<td>Fair value through P&amp;L</td>
<td>• Fair value</td>
<td>• Realized and unrealized gains and losses (in the aggregate)</td>
</tr>
<tr>
<td></td>
<td>• Amortized cost (only for own debt measured at fair value)</td>
<td>• Changes in fair value related to own credit standing (financial liabilities)</td>
</tr>
<tr>
<td>Fair value through OCI</td>
<td>• Amortized cost</td>
<td>• Interest income &amp; interest expense (including amortization/accretions of premium/discount)</td>
</tr>
<tr>
<td></td>
<td>• Allowance for credit losses on financial assets</td>
<td>• Credit impairments</td>
</tr>
<tr>
<td></td>
<td>• Amount needed to reconcile amortized cost less allowance for credit losses to fair value</td>
<td>• Realized gains and losses</td>
</tr>
<tr>
<td></td>
<td>• Fair value</td>
<td>• Changes in fair value related to own credit standing (financial liabilities)</td>
</tr>
<tr>
<td>Amortized cost</td>
<td>• Amortized cost only</td>
<td>• Interest expense (including amortization/accretions of premium/discount)</td>
</tr>
<tr>
<td></td>
<td></td>
<td>• Realized gains and losses</td>
</tr>
</tbody>
</table>

*Refer to exposure draft for complete presentation requirements

**One statement of financial performance with a total for comprehensive income, including a subtotal for net income.
## CREDIT IMPAIRMENT

<table>
<thead>
<tr>
<th>Topic</th>
<th>Proposed ASU</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Scope</strong></td>
<td>Financial assets at FV-OCI and short-term receivables</td>
</tr>
<tr>
<td><strong>Trigger for impairment</strong></td>
<td>No trigger</td>
</tr>
<tr>
<td><strong>Impairment recognition</strong></td>
<td>Based on expected future cash flows; all available information relating to past events and existing conditions is considered.</td>
</tr>
<tr>
<td></td>
<td>An entity measures impairment of financial assets that are <strong>individually identified</strong> as impaired by using the present value of expected future cash flows, except that the fair value of collateral may be used as a practical expedient.</td>
</tr>
<tr>
<td></td>
<td>An entity measures impairment of financial assets that are assessed as a <strong>group</strong> by using a historical loss rate that is adjusted for current conditions.</td>
</tr>
<tr>
<td><strong>Initial recognition of a loss</strong></td>
<td>When impairment is assessed (individual asset or group basis), a loss may be recognized as of the first reporting date (e.g., by applying a loss rate)</td>
</tr>
</tbody>
</table>
## CREDIT IMPAIRMENT (CONTINUED)

<table>
<thead>
<tr>
<th>Topic</th>
<th>Proposed ASU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective Interest Rate (EIR): <strong>Originated &amp; purchased w/no discount to par for credit quality</strong></td>
<td>Rate that equates the present value of the contractual cash flows (adjusted for any net deferred loan fees or costs, or discounts) to the amount paid.</td>
</tr>
<tr>
<td>EIR: <strong>Purchased w/discount to par for credit quality</strong></td>
<td>Rate that equates the present value of the entity’s estimate of cash flows expected to be collected with the purchase price of the financial asset</td>
</tr>
<tr>
<td>Interest recognition</td>
<td>Apply the EIR to the amortized cost basis adjusted by any related allowance for credit impairments. If cash received in excess of interest accrued, difference is recognized as an increase in allowance. If allowance exceeds entity’s estimate of expected losses, the difference is recognized as recovery in income</td>
</tr>
</tbody>
</table>
## HEDGE ACCOUNTING

<table>
<thead>
<tr>
<th>Topic</th>
<th>Proposed ASU</th>
</tr>
</thead>
<tbody>
<tr>
<td>Hedgeable risks</td>
<td>Similar to current U.S. GAAP (ASC 815)</td>
</tr>
<tr>
<td>Determination of amounts recorded in other comprehensive income for cash flow hedges</td>
<td>Recorded at the amount necessary to offset the present value of the cumulative change in expected future cash flows on the hedged transaction since hedge inception</td>
</tr>
<tr>
<td>Assumption that hedge is perfectly effective</td>
<td><strong>Neither shortcut nor critical terms matching method is permitted</strong></td>
</tr>
<tr>
<td>Frequency of hedge effectiveness assessments</td>
<td>Inception only, unless a change in circumstances warrants reassessment</td>
</tr>
<tr>
<td>Threshold for hedge accounting</td>
<td><strong>Reasonably effective</strong></td>
</tr>
<tr>
<td>Means of assessing effectiveness</td>
<td>Qualitative assessment is required at the inception of the hedging relationship; however, a quantitative assessment may be necessary in certain situations</td>
</tr>
<tr>
<td>Designating a hedging relationship</td>
<td><strong>Entity cannot remove hedge designation</strong> after it has been established; however, an entity may enter into an offsetting derivative to effectively terminate the hedge</td>
</tr>
</tbody>
</table>
EFFECTIVE DATE & TRANSITION

Effective Date

- TBD (during final deliberations)
- Special 4-year deferral for non-public entities with less than $1 billion in total consolidated assets. Only applicable to following financial assets and financial liabilities provided they qualify for the FV-OCI category:
  - Loans
  - Loan commitments
  - Core deposit liabilities

Transition

- Cumulative effect adjustment in the reporting period that immediately precedes the effective date
PROJECT TIMELINE

Exposure Draft
☐ May 26, 2010

Comment period ends
☐ September 1, 2010 (for roundtable participants)
☐ September 20, 2010 (all others)

Roundtables
☐ October 12, 2010
☐ October 21, 2010

Final ASU
☐ First half of 2011
# Accounting for Financial Instruments

## FASB vs IASB

<table>
<thead>
<tr>
<th>Area</th>
<th>FASB</th>
<th>IASB</th>
</tr>
</thead>
<tbody>
<tr>
<td>Main Classification</td>
<td>Fair value through net income</td>
<td>Fair value through net income</td>
</tr>
<tr>
<td>Categories</td>
<td>Fair value through other comprehensive income (FV-OCI)</td>
<td>Amortized cost</td>
</tr>
<tr>
<td>Credit Impairment</td>
<td>Based on past events and existing conditions and their implications for the collectibility of the financial asset(s)</td>
<td>Impairment recognized based on expected credit losses over the life of the financial asset</td>
</tr>
<tr>
<td></td>
<td>Recognized in net income</td>
<td>Recognized in net income</td>
</tr>
<tr>
<td>Hedge Accounting</td>
<td>Bifurcation by risk allowed for financial items</td>
<td>Currently deliberating issues with a plan to issue and exposure draft in the second half of 2010</td>
</tr>
<tr>
<td></td>
<td>Qualitative assessments required at inception (quantitative may be necessary)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Reasonably effective threshold</td>
<td></td>
</tr>
</tbody>
</table>
The Revenue Project: Summary of Key Provisions

Ignacio Perez Zaldivar
Revenue Recognition Project
Summary of the Proposed Revenue Recognition Model

This summary is organized as it would appear in the Accounting Standards Codification as follows:

- Overview and Background (objective)
- Scope (and scope exceptions)
- Glossary
- Recognition
- Initial Measurement
- Subsequent Measurement
- Presentation
- Disclosure
- Implementation Guidance
Revenue Project - Summary of Key Provisions

Overview and Background

Definition of Revenue...

**FASB Concepts Statement No. 6 Elements of Financial Statements (paragraph 78)**

“Revenues are inflows or other enhancements of assets of an entity or settlements of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations.”

**IAS No. 18 Revenue (paragraph 7)**

“Revenue is the gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.”
Key Concepts in the Exposure Draft Overview and Background

Transfer of Control

Performance Obligations

One Size Fits All

Can a “one size fits all model” for revenue recognition work?
Revenue Project - Summary of Key Provisions
Overview and Background

Steps in applying the model...

a) Identify the contract with the customer,
b) Identify the separate performance obligations in the contract,
c) Determine the transaction price
d) Allocate the transaction price to the separate performance obligations
e) Recognize revenue when performance obligations are satisfied.

SOUNDS SIMPLE...RIGHT?
Revenue Project - Summary of Key Provisions
Scope (and scope exceptions)

- Applies to an entity’s contracts with customers
- Does not apply to:
  a) Leasing contracts (ASC 840),
  b) Insurance contracts (ASC 944),
  c) Financial instrument contracts,
  d) Guarantees (other than product warranties (ASC 460)) and
  e) Nonmonetary exchanges in the same line of business entered into for the purpose of facilitating sales to customers other than the parties to the exchange
- Model should be applied consistently
Revenue Project - Summary of Key Provisions
Scope (and scope exceptions)

Performance obligations in scope of other standards separated based on the initial measurement of the other standard and accounted for accordingly

Contract includes performance obligations in scope of another standard

Allocate Transaction Price

Obligation in Another Standard
Separated based on the initial measurement in accordance with the other standard

Remaining Obligations
Remainder of transaction price allocated to performance obligations in revenue model

Another Standard

Revenue model
Contract partially in the scope of this proposed Update and partially in the scope of other Topics

<table>
<thead>
<tr>
<th>Apply other standard</th>
<th>• Other standard address both separation and measurement of a component of a contract</th>
</tr>
</thead>
<tbody>
<tr>
<td>Apply other standard followed by revenue model</td>
<td>• Other standard addresses separation only</td>
</tr>
<tr>
<td>Apply revenue model</td>
<td>• Other standard does not address separation or measurement</td>
</tr>
</tbody>
</table>
Revenue Project - Summary of Key Provisions
Scope (and scope exceptions)

- A contract can be *written, verbal, or implied*
- Revenue model to be applied to each contract only if:
  a) The contract has commercial substance,
  b) The parties to the contract have approved the contract and are committed to satisfying their respective obligations
  c) The entity can identify each party’s enforceable rights regarding the goods or services transferred; and
  d) The entity can identify the terms and manner of payment for those goods or services
- If either party can terminate without penalty then contract does not exist
Revenue Project - Summary of Key Provisions
Scope (and scope exceptions)
Combination and Segmentation of Contracts

Combine

Contracts combined

Contract A

Contract B

Segment

Contracts Separated

Contract A

Contract B

Pricing for contract A and B are considered *interdependent*

Pricing for goods/services in contract A are *independent* of pricing in contract B
Revenue Project - Summary of Key Provisions
Scope (and scope exceptions)

Contract Modification

• Account for a contract modification...
• A change in scope or price of a contract
• Account for a contract modification...
  - as a separate contract if it is priced *independently* of the original contract,
  - together with the original contract, recognizing the cumulative effect of the modification in the period in which it occurs, if the prices are *interdependent*
Revenue Project - Summary of Key Provisions

Glossary

- Transaction price
- Custom
- Performance
- Control
- Contract
- Contract Asset
- Contract liability
- Stand-Alone Selling Price
- Obligation
Customer—a party that has contracted with an entity to obtain goods or services that are an output of the entity’s ordinary activities.

Contract—an agreement between two or more parties that creates enforceable rights and obligations.

Contract asset—an entity’s right to consideration from a customer in exchange for goods or services transferred to the customer.

Contract liability—an entity’s obligation to transfer goods or services to a customer for which the entity has received consideration from the customer.

Transaction price—the amount of consideration that an entity receives, or expects to receive, from a customer in exchange for transferring goods or services, excluding amounts collected on behalf of third parties (for example, taxes).

Performance obligation—an enforceable promise (whether explicit or implicit) in a contract with a customer to transfer a good or service to the customer.

Standalone selling price (of a good or service)—the price at which the entity would sell a good or service separately to the customer.

Control (of a good or service)—an entity’s ability to direct the use of, and receive the benefit from, a good or service.
Revenue Project - Summary of Key Provisions

Recognition

**Identifying performance obligations...**

- Identify all promised goods or services and determine whether to account for them as separate performance obligations.
- Goods or services include (per paragraph 21 of ED):
  - goods produced for sale (e.g. inventory);
  - goods purchased for resale;
  - arranging for another party to transfer goods or services (i.e. agent);
  - standing ready to provide a good or service (e.g. when-and-if available software products);
  - constructing or developing an asset on behalf of a customer
  - granting of licenses, rights to use, and options; and
  - Performing a contractually agreed task (or tasks).
- Account for each promised good or service as a separate performance obligation only if it is distinct (otherwise combine with other goods or services until the bundle is distinct)
Revenue Project - Summary of Key Provisions Recognition

Identifying performance obligations

1. Do the promised goods or services transfer at the same time?
   - Yes: Treat as a single performance obligation and recognize revenue when control transfers
   - No: Is the promised good/service sold separately and therefore distinct?

2. Is the promised good/service sold separately and therefore distinct?
   - Yes: Account for each distinct performance obligation(s) separately
   - No: Could the promised good/service be sold separately because it’s distinct?

3. Could the promised good/service be sold separately because it’s distinct?
   - Yes: Combine performance obligations until two or more performance obligations are distinct
   - No: No
Revenue Project - Summary of Key Provisions

Recognition

Satisfaction of performance obligations...

• Recognize revenue when a promised good or service is transferred to the customer which occurs when the customer obtains control of that good or service
• Indicators of control – the customer...
  - has an unconditional obligation to pay
  - has legal title
  - has physical possession
  - specifies the design or function of the good or service
• Continuous delivery of goods or services – select one revenue recognition method for each separate performance obligation
Determine the transaction price...

- **Transaction Price** – the probability-weighted amount of consideration expected to be received from the customer.

- **Collectibility** – transaction price adjusted to reflect customer’s credit risk (adjustments to subsequent assessments shall be recognized separately from revenue).

- **Time Value of Money** – transaction price adjusted for the time value of money if contract includes a material financing component (rate reflects a separate financing transaction).

- **Noncash Consideration** – measure at fair value or indirectly by reference to the selling price of goods or services transferred.
Revenue Project - Summary of Key Provisions
Initial Measurement

**Determine the transaction price—Variable Consideration**

- Consideration often varies due to discounts, rebates, refunds, credits, incentives, performance bonus/penalty, contingencies, price concessions, customer’s credit risk, or similar items
- Entities shall recognize revenue from satisfying performance obligations only if the transaction price is reasonably estimable.
  - If not…transaction price limited to non-variable portion

**Consideration Paid to a Customer**

- Determine if the consideration paid is a...
  (a) reduction of the transaction price (hence revenue), or
  (b) payment for a distinct goods and services, or
  (c) combination of (a) and (b)
- Recognize reductions of revenue when goods or services are transferred to the customer and an obligation is incurred
Revenue Project - Summary of Key Provisions
Initial Measurement

Allocate transaction price to performance obligations...

- Allocate transaction price on a relative stand-alone selling price basis (estimate standalone selling price if not observable)
  - expected cost-plus margin and adjusted market assessment approaches acceptable

- After contract inception, allocate any changes in the transaction price to all performance obligations (based on initial allocation)
  - recognize amounts allocated to satisfied obligations

- Do not reallocate transaction price for changes in standalone selling prices
Revenue Project - Summary of Key Provisions

Subsequent Measurement

**Onerous performance obligations...**

- Recognize a separate liability and a corresponding expense for any expected loss on satisfying remaining obligations

- Measure such liability at the amount of direct costs (costs related directly to the contract) to satisfy the performance obligation less the allocated transaction price

- Update the measurement of the liability at each subsequent financial statement date (changes recognized as a reduction of expense)
Revenue Project - Summary of Key Provisions

Contract Costs

• Recognize assets in accordance with other Topics (inventory, PP&E, software, etc), otherwise only if the costs:
  - relate directly to the contract (or specific contract under negotiation);
  - relate to future performance (generate/enhance a resource used to satisfy obligations in the future); and
  - are expected to be recovered

• Recognize the following costs as expense when incurred:
  - costs of obtaining a contract (e.g. selling and marketing)
  - costs related to satisfied performance obligations
  - costs of abnormal amounts of wasted material, labor or other resources to fulfill the contract

• Assets amortized on a systematic basis consistent with the transfer of the related goods or services
Recognize either a contract asset or liability depending on relationship between entity’s and customer’s performance.

A contract asset or liability does not include unconditional rights to consideration from the customer.
- Right is unconditional if only the passage of time is required
- Unconditional rights accounted for under ASC 310

Contract asset or liability does not include capitalized contract costs or onerous performance obligation liabilities.
Revenue Project - Summary of Key Provisions

Disclosure

Objective...

• Disclosure qualitative and quantitative information about...
  
  a) Contracts with customers; and
  b) Significant judgments, of changes to such, in applying the revenue recognition guidance

• Information shall be aggregated or disaggregated...

  “so that useful information is not obscured by either the inclusion of a large amount of insignificant detail or the aggregation of items that have different characteristics.”
Revenue Project - Summary of Key Provisions Disclosure

Contracts with customers...disclosure information to help users understand the amount, timing, and uncertainty of revenue and cash flows, including:

• Disaggregation of revenue...into categories that best depict how its affected by economic factors (such as type product or contract, geography, or market)

• Reconciliation of contract balances...from the opening to the closing contract asset/liability positions and to the statement of financial position including changes from:
  - amounts recognized in comprehensive income
  - cash received
  - amounts transferred to receivables
  - noncash consideration received
  - contracts acquired (business combinations) or disposed
Revenue Project - Summary of Key Provisions Disclosure

Contracts with customers... (continued)

- Performance obligations... a description of the obligations and information about the expected timing of their satisfaction:
  - A description of:
    - a) goods or services promised to be transferred,
    - b) when performance obligations are typically satisfied,
    - c) significant payment terms (variable consideration/financing)
    - d) provisions for returns or refunds or similar obligations
    - e) types of warranty or related obligations

  - The amount of obligations expected to be satisfied:
    - a) within one year;
    - b) between one and two years;
    - c) between two and three years; and
    - d) later than three years.
Revenue Project - Summary of Key Provisions
Disclosure

Characteristics of contracts with customers

• **Onerous contracts**—disclose amount of any additional liability recognized, including:
  a) nature and amount of the performance obligations for which the liability has been recognized
  b) reason why performance obligations have become onerous
  c) When the entity expects to satisfy the liability

• Rollforward of liability recognized for onerous performance obligation
Revenue Project - Summary of Key Provisions Disclosure

- **Significant judgments**...and changes in judgments, that affect the determination of the amount and timing of revenue

- *Continuous Transfer* ... methods used to recognize revenue and why methods faithfully depict the transfer of goods/services

- *Determining and allocating the transaction price*... information about estimates, inputs and assumptions used to allocate consideration, including those used:
  a) to determine the transaction prices
  b) to estimate standalone selling prices
  c) to measure returns, refunds, and other similar obligations
  d) to measure any liability for onerous performance obligations
Revenue Project - Summary of Key Provisions

Effective Date and Transition

**Effective Date**...to be determined after exposure

(2012, 2013, or 2014?)

**Transition**...apply retrospectively by applying Topic 250.

(3 years of information – start in 2009, 2010, or 2011?)
Identifying performance obligations...

- **Principal versus agent considerations**—determine whether obligation is to actually provide goods or services (gross) or arrange for another party to provide (net) goods or services.

- **Options to acquire additional goods or services**—represents a performance obligation only if it provides a material right to a customer that would not otherwise have been received.

- **Licenses and rights to use**...
  - if customer obtains control of an entire licensed intellectual property treated as a sale.
  - grant of an exclusive license (without obtaining control of the entire license) recognized over time.
  - non-exclusive license recognized when customer can use and benefit from license (consider other obligations).
Revenue Project - Summary of Key Provisions
Implementation Guidance

Identifying performance obligations...

• **Right of Return**—not a separate performance obligation but do not recognize revenue for goods expected to be returned.

• **Product Warranties**...

<table>
<thead>
<tr>
<th>Coverage for</th>
<th>Accounting</th>
</tr>
</thead>
<tbody>
<tr>
<td>Latent defects (faults that exist when transferred to customer) (assurance)</td>
<td>Not a separate performance obligation – do not recognize revenue for assets or components expected to be returned or replaced</td>
</tr>
<tr>
<td>Faults that arise after product is transferred</td>
<td>Separate performance obligation - allocate part of transaction price to warranty</td>
</tr>
</tbody>
</table>

• **Product Liabilities**—account for in accordance with ASC 450-20, *Loss Contingencies*
ACCOUNTING FOR LEASES: JOINT PROJECT OF THE IASB AND FASB
CHRISTINE MURPHY
Overview

Why Are We Here?
• Current lease accounting model - bright lines
• SEC - 2005 report on off-balance-sheet arrangements
• 2006 – MOU between IASB/FASB

How Did We Get Here?
• March 2009 – Joint Discussion Paper on leases
• Continued discussion at July joint meeting
• Exposure Draft – Late August 2010, final standard in 2011
• Effective Date – Not discussed yet
Why Should I Care Right Now?

• Operating lease treatment is gone (details later – think capital lease – but more complicated)
• Transition – No grandfathering – Will apply to all outstanding leases
• Differences from current capital lease treatment
  • Contingent rents and RVGs booked up front
  • Reassessment of lease term and contingent rents
  • Greater pressure to identify non-lease components
• Impact on ratios and debt covenants
• Lease/Buy Analysis – Structuring costs – Customer considerations
• Resources/Planning for implementation
Scope

• Overall – Similar to current US GAAP
  • A lease is a contract in which the right to use a specified asset is conveyed, for a period of time, in exchange for consideration

• Lease if contract conveys:
  • The right to use a specified asset, and
  • The right to control the use of the underlying asset

• Similar principles as current GAAP to determine if arrangement is a lease (as opposed to a service contract)
  • Current guidance will be “rewritten to help clarify it’s meaning”

• Identification of other services in a lease contract
  • Fuel, maintenance, etc.
  • This distinction becomes much more important
  • Tie to revenue recognition project – distinct components
Scope

• Exclude:
  o Leases of intangible assets
  o Leases to explore for or use natural resources (minerals, oil, natural gas, etc.)
  o Leases of biological assets

• Include:
  o Long term leases of land
  o “Non-core” leases

• Short-term leases
  o Maximum possible lease term < 12 months
  o Lessee: Simplified accounting, still record asset and liability (no discounting)
  o Lessor: Accrual accounting
Scope (Purchase or Sale Exclusion)

Purchases or sales are scoped out

What is a purchase or sale as compared to a lease?

Isn’t that question what got us here in the first place?

• Contract is purchase or sale if, at the end, it transfers:
  o Control of the underlying asset, and
  o All but a trivial amount of risks and benefits of underlying asset

• When has control been transferred/obtained?
  o Title of underlying asset transfers to lessee automatically
  o Bargain purchase option that is reasonably certain to be exercised
  o Lessor receives a fixed return
  o Reasonably certain that lease will cover expected life of asset, and risks/benefits retained by lessor at end of contract not expected to be more than trivial

• Very long leases of land are not purchases or sales

NOTE: These decisions may be revisited by the Boards depending on lessor accounting decisions
The New Model in a Nutshell....

<table>
<thead>
<tr>
<th><strong>Lessee</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Right of use approach</strong></td>
</tr>
<tr>
<td>• Asset: right-of-use asset</td>
</tr>
<tr>
<td>• Liability: obligation to pay rent</td>
</tr>
<tr>
<td>• Amortization expense and interest expense</td>
</tr>
<tr>
<td>• No rent expense!</td>
</tr>
<tr>
<td>• No operating leases</td>
</tr>
<tr>
<td>• Right-of-use asset accounted for like an intangible asset</td>
</tr>
</tbody>
</table>
Lessor Accounting – Hybrid Model

Is the lessor exposed to significant risks associated with underlying asset?

Yes: Performance Obligation
No: Partial Derecognition

Criteria for “significant risks” assessment is still being developed
The New Hybrid Model in a Nutshell....

<table>
<thead>
<tr>
<th>Lessor Performance Obligation Approach</th>
<th>Lessor Partial Derecognition Approach</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Asset – right to receive rents (lease receivable)</td>
<td>• Asset – right to receive rents (lease receivable)</td>
</tr>
<tr>
<td>• Liability – performance obligation to permit lessee to use leased item</td>
<td>• Asset – right to the asset at the end of the term (Residual asset)</td>
</tr>
<tr>
<td>• Recognize revenue over lease term as performance obligation is satisfied</td>
<td>• Sales (pv of rents) and cost of sales (portion of asset derecognized) recognized on day 1</td>
</tr>
<tr>
<td>• No lease classification</td>
<td>• Possible net presentation of P&amp;L for certain lessors</td>
</tr>
<tr>
<td><strong>Leased asset is not derecognized</strong></td>
<td><strong>Portion of leased asset is derecognized</strong></td>
</tr>
</tbody>
</table>
Timing of Initial Recognition

• When a contract is signed (lease inception)
  o Lessee and lessor measure assets and liabilities
  o Initial measurement of asset would generally equal liability
  o Lessee and lessor present assets and liabilities net
  o Disclose assets and liabilities

• When right of use asset is delivered
  o Lessee and lessor present assets and liabilities gross

• Current lease accounting model requires classification and measurement at lease inception -- recognition occurs upon delivery
## Initial Measurement

<table>
<thead>
<tr>
<th>Lessee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>“Right-of-use” asset</strong></td>
</tr>
<tr>
<td>• Cost = Present value of lease payments plus initial direct costs incurred by the lessee</td>
</tr>
<tr>
<td><strong>“Obligation to pay rent” liability</strong></td>
</tr>
<tr>
<td>• Present value of lease payments</td>
</tr>
</tbody>
</table>

**Discount rate** = Incremental borrowing rate (rate implicit in lease if readily determinable)

**Initial direct costs** = Incremental costs directly attributable to negotiating and arranging a lease
## Initial Measurement

<table>
<thead>
<tr>
<th>Lessor – Performance Obligation</th>
<th>Lessor – Partial Derecognition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>“Right to receive rent payments” asset</strong>&lt;br&gt;• PV of lease payments plus initial direct costs incurred by the lessor</td>
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</tr>
<tr>
<td><strong>“Performance obligation” liability</strong>&lt;br&gt;• Transaction price (PV of lease payments)</td>
<td><strong>Residual asset</strong>&lt;br&gt;• Allocation of the previous carrying amount of the underlying asset</td>
</tr>
<tr>
<td><strong>Discount rate</strong> = Rate implicit in the lease</td>
<td><strong>Discount rate</strong> = Rate implicit in the lease</td>
</tr>
<tr>
<td><strong>Initial direct costs</strong> = Incremental costs directly attributable to negotiating and arranging a lease</td>
<td></td>
</tr>
</tbody>
</table>
## Subsequent Measurement

<table>
<thead>
<tr>
<th>Lessee</th>
</tr>
</thead>
</table>
| **Right-of-use asset**  
  • Amortized cost  
  • Impairment – refer to existing standards (ASC 350, IAS 36)  
  • Revaluation (IFRS only) – refer to existing standards (IAS 38) |
| **“Obligation to pay rent” liability**  
  • Amortized cost (effective interest rate method)  
  • No remeasurement at fair value  
  • Generally, no revision of incremental borrowing rate |
### Subsequent Measurement

<table>
<thead>
<tr>
<th>Lessor – Performance Obligation</th>
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</tr>
<tr>
<td>• Generally, no revision of rate implicit in lease</td>
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</tr>
<tr>
<td>• No consensus on impairment model</td>
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</tr>
<tr>
<td><strong>“Performance obligation” liability</strong></td>
<td><strong>Residual asset</strong></td>
</tr>
<tr>
<td>• Reflects decrease in obligation to permit lessee to use leased item</td>
<td>• Not remeasured</td>
</tr>
<tr>
<td></td>
<td>• Assess for impairment</td>
</tr>
</tbody>
</table>
## Leases with renewals or purchase options

<table>
<thead>
<tr>
<th>Subject</th>
<th>Lessee</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Lease Term</strong></td>
<td>• Recognize obligation to pay rent for the <strong>longest possible lease term that is more likely than not to occur</strong>&lt;br&gt;• Consider all relevant factors</td>
</tr>
<tr>
<td><strong>Reassessment of lease term</strong></td>
<td>• Reassess term at each reporting date&lt;br&gt;• No requirement to examine every lease contract in detail unless there is a change in facts and circumstances&lt;br&gt;• Change to obligation to pay rentals is recorded as an adjustment to the right-of-use asset</td>
</tr>
<tr>
<td><strong>Purchase Options</strong></td>
<td>• Recognize only upon exercise</td>
</tr>
</tbody>
</table>
## Leases with renewals or purchase options

<table>
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<th>Lessor – Partial Derecognition</th>
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<td>• No requirement to examine every lease contract in detail unless there is a change in facts and circumstances</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Change to lease receivable is recorded as an adjustment to the performance obligation</td>
<td>• Derecognize or reinstate a portion of the residual asset</td>
</tr>
<tr>
<td><strong>Purchase options</strong></td>
<td>• Recognize only upon exercise</td>
<td></td>
</tr>
</tbody>
</table>
### Contingent Rents and Residual Value Guarantees

<table>
<thead>
<tr>
<th>Subject</th>
<th>Lessee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Initial recognition and measurement</td>
<td>• Recognize as part of obligation to pay rents</td>
</tr>
<tr>
<td></td>
<td>• Measure using expected outcome technique</td>
</tr>
<tr>
<td></td>
<td>• Contingent rentals based on index or rate measured using forward rates if readily available. If not readily available, use rate at inception of lease.</td>
</tr>
<tr>
<td></td>
<td>• Do not revise discount rate unless rents based on variable reference interest rates</td>
</tr>
<tr>
<td>Subsequent measurement</td>
<td>• Reassess at each reporting date</td>
</tr>
<tr>
<td></td>
<td>• Recognize change in obligation:</td>
</tr>
<tr>
<td></td>
<td>– If arising from current or prior periods, in profit or loss</td>
</tr>
<tr>
<td></td>
<td>– All other changes as adjustment to right-of-use asset</td>
</tr>
</tbody>
</table>
# Contingent Rents and Residual Value Guarantees

<table>
<thead>
<tr>
<th>Subject</th>
<th>Lessor – Performance Obligation</th>
<th>Lessor – Partial Derecognition</th>
</tr>
</thead>
</table>
| Initial recognition and measurement         | • Recognize as part of lease receivable, to the extent can be measured reliably  
  • Measure using expected outcome technique  
  • Contingent rentals based on index or rate measured using forward rates if readily available. If not readily available, use rate at inception of lease.  
  • Do not revise discount rate unless rents based on variable reference interest rates                                                                                                                                  |                             |
| Subsequent measurement                       | • Reassess at each reporting date                                                                                                                                                                                                 |                             |
|                                              | • Recognize change in receivable as adjustment to performance obligation:  
  – If allocation to **satisfied** performance obligation, recognize in revenue  
  – If allocation to **unsatisfied** performance obligation, adjust performance obligation                                                                                                                               | • Recognize all changes in profit and loss                                                                                                                   |
Subleases

- Recognition and measurement:
  - Intermediate lessor (lessee in head lease) should account for head lease under lessee model
  - Intermediate lessor (lessor in sublease) should account for sublease under lessor model

- Disclosure
  - Nature and amount of significant subleases
Sale and leaseback transactions

• Account for as sale and leaseback (rather than as financing) if the underlying asset has been sold

• Underlying asset has been sold if, at end of the term, contract transfers to buyer/lessor:
  o Control of underlying asset, AND
  o All but a trivial amount of risks and benefits of underlying asset

• If transaction qualifies for sale and leaseback and:
  o if both sale and leaseback are established at FV, recognize any gains or losses in profit or loss
  o if sale or leaseback are not established at FV, adjust asset, liabilities, gains and losses to reflect current market rentals
## Presentation - Lessee

<table>
<thead>
<tr>
<th>Statement</th>
<th>Presentation</th>
</tr>
</thead>
</table>
| **Statement of Financial Position**      | • Right-of-use asset: Present with PP&E, but separately from assets that are owned but not leased  
• Performance obligation: Present separately from other financial liabilities |
| **Statement of Comprehensive Income**    | Amortization expense and interest expense:  
• Present separately from other amortization/interest expense, or disclose in footnotes |
| **Statement of Cash Flows**              | Cash repayments of amounts borrowed and interest payments:  
• Classify as financing activities  
• Present separately from other cash repayments and interest payments |
# Presentation - Lessor

<table>
<thead>
<tr>
<th>Statement</th>
<th>Lessor – Performance Obligation</th>
<th>Lessor – Partial Derecognition</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Statement of Financial Position</strong></td>
<td>• Lease receivable, leased asset, and performance obligation: Present total as a net lease asset or net lease liability</td>
<td>• Lease receivables separate from other receivables • Residual separately within PP&amp;E</td>
</tr>
<tr>
<td><strong>Statement of Comprehensive Income</strong></td>
<td>• Lease income, interest income, and depreciation expense • <strong>FASB</strong>: present total as net lease income or expense • <strong>IASB</strong>: present separately from other similar items</td>
<td>• Revenue and cost of sales based on lessor business model • Certain lessors would present net</td>
</tr>
<tr>
<td><strong>Statement of Cash Flows</strong></td>
<td>Repayments of lease receivable and interest income: • Classify as operating activities</td>
<td></td>
</tr>
</tbody>
</table>
Disclosures

<table>
<thead>
<tr>
<th>Lessee</th>
<th>Lessor</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Principles: Disclose Quantitative and Qualitative Information That:</strong>&lt;br&gt;• Identifies and explains amounts recognized in f/s from lease contracts, and&lt;br&gt;• Helps users evaluate nature and extent of amount, timing and uncertainty of future CFs from lease contracts, plus disclose how lessee manages these uncertainties</td>
<td></td>
</tr>
</tbody>
</table>

**General description of leasing activities (disaggregated by nature or function)**<br>• Reconciliation of opening and closing balances for assets and liabilities from lease contracts
FINANCIAL STATEMENT PRESENTATION – JOINT PROJECT OF THE IASB AND FASB
CHRISTINE NG
PRIMARY PROJECT OBJECTIVE

- Purpose to establish a standard that will guide the organization and presentation of information in financial statements.
  - Goal: to improve usefulness of information provided in financial statements to help users make decisions

- Affects how entity management communications financial statement information.
WHO WOULD BE AFFECTED?

- All business entities that prepare financial statements in accordance with IFRS or GAAP except a benefit plan within the scope of:
  - IAS 26 Accounting and Reporting by Retirement Benefit Plans
  - FASB ASC 960, Plan Accounting – Defined Benefit Pension Plans
  - FASB ASC 962, Plan Accounting – Defined Contribution Pension Plans
  - FASB ASC 965, Plan Accounting – Health and Welfare Benefit Plans
CORE PRINCIPLES

- Flaws with the current presentation model
  - Multiple presentation alternatives permitted
  - Financial information is inconsistently presented on an entity’s financial statements

Core Principle #1: A reporting entity presents a **cohesive** set of financial statements.

- Insufficient guidance regarding the legal of aggregation of financial information exists

Core Principle #2: A reporting entity **disaggregates** financial information of an item based on the item’s function, nature, and measurement basis.
OUTREACH ACTIVITIES

The Staff plans to...

- ask users of financial statements to evaluate how the proposed changes to the organization of and information presented in financial statements would benefit their analysis and resource allocation decisions.

- ask preparers of financial statements to evaluate the effort and cost involved in adopting these proposed changes in their unique circumstances.

- meet preparers and users of financial statements of financial services entities to discuss the proposed changes.

- gather additional information about benefits and costs by doing more fieldwork on the proposals in the staff draft, including additional field testing and/or experimental research.
INCONSISTENT PRESENTATIONS

- Transactions/events recognized in financial statements are not described/classified in the same way in each of the statements.

- IFRS and GAAP allow alternatives for how an entity presents information in its financial statements.

- Presentation requirements
  - IFRS: includes minimum presentation requirements
  - US GAAP
    - statement-by-statement basis
    - presentation and disclosure requirements under Regulation S-X
## CONSOLIDATED FINANCIAL STATEMENTS

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business Section</strong></td>
<td><strong>Business Section</strong></td>
<td><strong>Business Section</strong></td>
</tr>
<tr>
<td>- Operating Category</td>
<td>- Operating Category</td>
<td>- Operating Category</td>
</tr>
<tr>
<td>- Operating Finance Subcategory</td>
<td>- Operating Finance Subcategory</td>
<td>- Investing Category</td>
</tr>
<tr>
<td>- Investing Category</td>
<td>- Investing Category</td>
<td></td>
</tr>
<tr>
<td><strong>Financing Section</strong></td>
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<td><strong>Financing Section</strong></td>
</tr>
<tr>
<td>- Debt Category</td>
<td>- Debt Category</td>
<td></td>
</tr>
<tr>
<td>- Equity Category</td>
<td>- Equity Category</td>
<td></td>
</tr>
<tr>
<td><strong>Income Tax Section</strong></td>
<td><strong>Income Tax Section</strong></td>
<td><strong>Income Tax Section</strong></td>
</tr>
<tr>
<td><strong>Discontinued Operation Section</strong></td>
<td><strong>Discontinued Operation Section</strong></td>
<td><strong>Discontinued Operation Section</strong></td>
</tr>
<tr>
<td></td>
<td><strong>Multi-category Transaction Section</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Other Comprehensive Income, net of tax</strong></td>
<td></td>
</tr>
<tr>
<td></td>
<td><strong>Other Comprehensive Income, net of tax</strong></td>
<td></td>
</tr>
</tbody>
</table>

---
CONSOLIDATED FINANCIAL STATEMENTS

Statement of Financial Position
- presentation of assets and liabilities by major activity/function within operating, investing and financing categories
- assets, liabilities and equity would not be presented in groups

Statement of Comprehensive Income
- single statement of comprehensive income grouped by the same categories as those used in the Statement of Financial Position
- additional disaggregation of the line items in the statement would be required
CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)

Statement of Cash Flows

- separate presentation of the main categories of cash receipts and cash payments for operating activities (direct method) vs. reconciliation of net income to net operating cash flows (indirect method)

Notes to the Financial Statements

- disclosure of the rationale used to classify assets and liabilities into categories and sections in the Statement of Financial Position
- reconciliation of beginning to ending balances of select assets and liabilities which management determines to be important to understanding the entity’s financial position
## BUSINESS SECTION

<table>
<thead>
<tr>
<th>Assets and Liabilities</th>
<th>Income and Expenses</th>
<th>Cash Flows</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Operating</strong></td>
<td></td>
<td><strong>Operating</strong></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>Cash from customers</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>Revenue</td>
<td>Cash paid to suppliers</td>
</tr>
<tr>
<td>Inventory</td>
<td>Cost of goods sold</td>
<td>Cash paid to employees</td>
</tr>
<tr>
<td>Property, plant, and equipment</td>
<td>Depreciation</td>
<td>Purchase of property, plant,</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>Operating expenses</td>
<td>and equipment</td>
</tr>
<tr>
<td><strong>Operating finance</strong></td>
<td></td>
<td>Cash paid for operating</td>
</tr>
<tr>
<td>Net pension liability</td>
<td>Expected return on plan assets</td>
<td>expenses</td>
</tr>
<tr>
<td>Lease liability</td>
<td>Postemployment benefit service cost</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest expense on leases</td>
<td></td>
</tr>
</tbody>
</table>

**Operating**

- Revenue
- Cost of goods sold
- Depreciation
- Operating expenses
- Postemployment benefit service cost
- Interest expense on leases
- Expected return on plan assets
- Postemployment benefit interest costs
<table>
<thead>
<tr>
<th>Assets and Liabilities</th>
<th>Income and Expenses</th>
<th>Cash Flows</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investing</strong></td>
<td></td>
<td><strong>Investing</strong></td>
</tr>
<tr>
<td>Short-term investments</td>
<td><strong>Investing</strong></td>
<td>Interest received</td>
</tr>
<tr>
<td>Investment in securities</td>
<td>Interest income</td>
<td>Net cash from short-term investments</td>
</tr>
<tr>
<td>Equity method investment</td>
<td>Interest and dividends</td>
<td>Purchase of securities</td>
</tr>
<tr>
<td></td>
<td>Gains/losses</td>
<td>Sale of securities</td>
</tr>
<tr>
<td></td>
<td>Equity income</td>
<td>Interest and dividends received</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Cash invested in equity method investment</td>
</tr>
</tbody>
</table>
# FINANCING SECTION

<table>
<thead>
<tr>
<th>Assets and Liabilities</th>
<th>Expenses</th>
<th>Cash Flows</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Debt</strong></td>
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<td><strong>Debt</strong></td>
</tr>
<tr>
<td>Short-term debt</td>
<td>Interest expense</td>
<td>Proceeds from issuance of debt</td>
</tr>
<tr>
<td>Long-term debt</td>
<td></td>
<td>Repayment of debt</td>
</tr>
<tr>
<td>Interest payable</td>
<td></td>
<td>Interest paid</td>
</tr>
<tr>
<td>Dividends payable</td>
<td></td>
<td>Dividends paid</td>
</tr>
<tr>
<td><strong>Equity</strong></td>
<td></td>
<td><strong>Equity</strong></td>
</tr>
<tr>
<td>Common stock</td>
<td></td>
<td>Cash received from issuance of shares</td>
</tr>
</tbody>
</table>
FINANCIAL STATEMENT PRESENTATION

Discussion Points:

- Systems needed to do the direct method of cash flows
  - Complexity and cost exponentially increase for larger, decentralized organizations
- Changes in mapping from the GL to financial reports and other financial reporting system changes
  - Can be sleeper issue/could be intensive
- Affect on controls over financial reporting
- Instituting process to reconcile beginning and ending balances of select asset and liability accounts
  - More complex for decentralized entities
- Educating users of financial statements how new requirements will specifically affect the entity
FINANCIAL STATEMENT PRESENTATION

Presentation of Other Comprehensive Income

- Improve transparency of reported items of other comprehensive income
- Improve transparency of reported items of other comprehensive income
- Ease comparison of income statements prepared using IFRS or US GAAP

Discontinued Operations

- Eliminate differences between definitions and related disclosures surrounding discontinued operations
OTHER JOINT PROJECTS OF THE IASB AND FASB: ADRIAN MILLS
Financial Instruments with Characteristics of Equity

- Objective – principle-based model to distinguish between financial liabilities and equity that matches underlying economics and reduces complexity
- Classify as equity those instruments that either:
  - The entity relies on as the foundation of its capital structure (the owners of the entity), or
  - Both expose the counterparty to value changes like those of owners AND eventually will result in the counterparty becoming an owner
- Eliminate mezzanine equity
Financial Instruments with Characteristics of Equity (cont.)

- **Equity**
  - Perpetual instruments (that lack a settlement requirement)
  - Instruments that are only redeemable if the entity liquidates or the holder ceases to participate in the activities of the entity (e.g. GP interest)
  - Instruments where holder may withdraw but existing holders still maintain control (e.g. LP interest)
  - Instruments settled by exchanging specified shares for specified price
  - Derivatives on puttable instruments deemed equity and settled by exchanging specified equity shares for specified price
  - Preferred stock that is convertible into a specified number of equity shares
Financial Instruments with Characteristics of Equity (cont.)

- **Liability classification**
  - All other mandatorily redeemable instruments
  - Convertible instruments not convertible into a specified number of shares

- **Bifurcation**
  - Puttable instruments not deemed equity in entirety – written put option is accounted for as a derivative and share component is equity
  - Convertible debt instruments that are convertible at holder’s option into a specified number of equity instruments

- **Project status**
Statement of Comprehensive Income

Current GAAP provides three presentation alternatives:
- Below the components of net income in a statement of comprehensive income
- In a separate statement of other comprehensive income that begins with total net income
- In a statement of changes in equity

Proposed ASU would require:
- Report comprehensive income in a continuous financial statement in two sections: (a) net income and (b) other comprehensive income
- The proposed ASU would not change the items that must be reported in other comprehensive income

Next Steps:
- Comments are due by September 30, 2010
- Expected issuance of final ASU in first half of 2011
Fair Value Measurement

Objective: To create converged fair value measurement guidance

Proposal out for comment:

- Fair value will continue to be defined as exit price from market participant perspective maximizing the use of observable inputs
- The highest and best use concept is relevant only for nonfinancial assets and is not relevant for liabilities or financial assets (offsetting risk exception)
- Extends blockage prohibition to level 3; discusses control premiums
- New disclosure – Uncertainty analysis for level 3 fair value measurements unless another standard exempts such a disclosure
Consolidations

- Similar to recent changes that impact variable interest entities (VIE) but would apply to all entities
- Focus is on the entity that has the "power to direct" (this power might not be with the entity that has greater than 50% of the voting rights)
- An investment company would continue to measure their investments in entities they control at fair value through earnings. Maybe some refinement to what constitutes an investment company
Questions?