

Hot Topic

Update on major accounting
and auditing activities

FASB/IASB MoU projects update

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Overview

The Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) (collectively, the Boards) have been working closely together since 2002, when the two standard-setters entered into the Norwalk Agreement that formalized their commitment to convergence. This commitment was renewed in a Memorandum of Understanding (MoU) in 2006, which was updated in 2008 and reaffirmed in November 2009. The Boards committed to complete a number of major MoU projects in 2010 or 2011, and in addition, have committed to several other joint projects. The number of matters on the Boards' agenda is unprecedented. The completion timetable is extremely ambitious, and will require extraordinary efforts to complete on schedule (final standards on all projects issued by June 2011). However, both Boards continue to state that they are committed to meet these deadlines.

The deadlines were established in contemplation of the fact that several major countries are adopting IFRS in 2011 and that the decision of some countries to convert to IFRS is at least partially dependent on continued improvement of IFRS and continued convergence with US GAAP. On 24 February 2010, the US Securities and Exchange Commission (SEC) voted unanimously to publish a statement reaffirming its longstanding commitment to the goal of a single set of high-quality global accounting standards and expressing its continued support for the convergence of US GAAP and IFRS. The SEC Commissioners generally agreed that timely completion of these convergence efforts, among other things, would best position IFRS to serve as the single set of global accounting standards.

Regardless of any future decision to require IFRS reporting in the US, the projects underway are expected to ultimately result in substantial changes to US GAAP in many areas. The issuance of so many new standards in so short a time will represent a significant challenge for preparers, auditors, regulators and financial statement users. The FASB has noted that it plans to consider the effective dates and transition for standards to be completed by 30 June 2011 collectively, so as to consider the overall impact on constituents. For example, the Board will consider whether it is best to have the effective dates of all of these standards coincide (i.e., a "big bang" on 1 January 2013 or 2014) or provide for staggered effective dates over a period of potentially several years. Constituents are encouraged to evaluate carefully the exposure drafts when issued and provide thoughtful comment letters to the Boards. An unprecedented number of significant exposure drafts will be issued in a short

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period beginning in a matter of weeks. Analyzing the proposals and determining their effect on your company will require significant effort. Accordingly, we encourage you to begin planning for this effort now.

Joint FASB/IASB standards projects

The following is the expected timetable for the joint FASB/IASB standards projects as estimated by the FASB, as well as the comment periods anticipated for each of the exposure drafts.¹ This timetable is based on information on the FASB’s website or public comments by FASB members or FASB staff members. Note that the timing on all projects is subject to change by the Boards.

The timetable indicates the quarter in which the exposure draft (ED) is expected to be issued, along with an indication of the length of the expected comment period (if known). The timetable also indicates when the Boards expect to hold roundtables with constituents. While these roundtables likely will be held in various locations around the world, we expect at least one roundtable for each major project to be held at the FASB’s offices in Norwalk, CT, or in a nearby location. The timetable also indicates when a final standard is expected to be issued. The Boards currently intend to issue all final standards by 30 June 2011. Note that the discussion of individual projects that follows is based on decisions made through 19 March 2010. The Boards are meeting frequently and new decisions are made almost daily. For new and revised decisions, please see the FASB’s Action Alerts available on the FASB’s website and announced in Week in Review, which is included in EY AccountingLink. We will update this publication periodically.

FASB/IASB joint standards projects timetable

	2010			2011
	Q2	Q3	Q4	
Financial Instruments	ED (TBD, likely 3-4 months)	Roundtable	Final	
Balance Sheet – Offsetting		ED (TBD)		Final
Revenue Recognition	ED (TBD, likely 4 months)	Roundtable		Final
Financial Statement Presentation	ED (TBD, likely 5 months)	Roundtable		Final
Statement of Comprehensive Income	ED (TBD)	Final		
Reporting Discontinued Operations	ED (TBD)	Final		
Leases	ED (4 months)	Roundtable		Final
Financial Instruments with Characteristics of Equity	ED (4 months)	Roundtable		Final
Consolidation	ED (TBD)	Roundtable	Final	
Insurance Contracts		ED (4 months)	Roundtable	Final
Fair Value Measurement	ED (TBD, likely 1.5-2 months)	Roundtable	Final	
Emissions Trading Schemes		ED (TBD)		Final

¹ While the Boards have a joint project on their agenda to reconsider the derecognition model for financial assets, the FASB has not begun deliberations on this issue and the project is described as in the “research stage” on the FASB’s website.

Financial Instruments

Although this is a joint project, the Boards have diverged on both the timetable and several key components of the new financial instruments model. The scope of the Boards' financial instruments projects encompasses classification and measurement, impairment and hedging for all financial assets and financial liabilities, with limited exceptions. In November 2009, the IASB issued several chapters of IFRS 9, *Financial Instruments*, addressing classification and measurement of financial assets, as well as an ED, *Financial Instruments: Amortised Cost and Impairment*, addressing impairment. The IASB continues to consider the classification and measurement of financial liabilities as well as hedge accounting, and will issue its finalized guidance in the form of additional chapters to IFRS 9. The FASB chose to address the project in its entirety and plans to issue a single comprehensive exposure draft addressing all aspects of this project. The following discussion focuses on the FASB's tentative decisions on this project.

The scope of the project includes all financial instruments, with limited exceptions for obligations for pension benefits, leases and insurance contracts. In addition, the FASB plans to provide a four-year scope deferral, limited to loans and core deposit liabilities, for nonpublic entities with less than \$1 billion in consolidated total assets. The equity method of accounting would continue to be applied to equity investments in which the investor has significant influence over the investee, but only if the investment is related to the investor's consolidated businesses. All other equity investments would be measured at fair value with changes in fair value recognized in net income, as described further below.

The FASB's default category for the recognition and measurement of financial instruments is fair value with changes recognized through net income (FVTNI). An entity may elect to recognize changes in fair value of certain loans and debt securities through other comprehensive income (FVTOCI) if its business strategy is to hold the instruments for collection or payment of contractual cash flows rather than to sell or settle the financial instruments with a third party. An amortized cost election would be available for an entity's own debt only if certain criteria are met. Financial institutions' core deposit liabilities would be measured at a present value amount rather than fair value or cost. Once the initial classification decision is made for a specific financial instrument, reclassifications are not permitted.

An entity would be required to present separately financial instruments accounted for at FVTNI and FVTOCI on the face of the balance sheet. In addition, an entity would be required to present separately significant changes in the fair value of its own debt resulting from changes in its creditworthiness if the debt instrument is not measured at amortized cost. Numerous other disclosure requirements have been proposed, including disclosure of amortized cost amounts on the face of the balance sheet.

The FASB has decided that for those assets classified as FVTOCI, including both loans and debt securities, an entity would apply an incurred loss model for the recognition of impairments (which will be charged to income). Interest income for these assets would be calculated by multiplying their amortized cost (less cumulative credit impairments) by the effective interest rate.

The FASB also has decided to modify the existing hedge accounting model based largely on changes proposed in its 2008 ED, *Accounting for Hedging Activities*, with one notable exception. The new model would retain the existing provisions that allow hedging of certain risk components (i.e., bifurcation-by-risk) for hedged financial items. Note that the 2008 ED proposed, among other changes, to eliminate the "short-cut" method of assessing hedge effectiveness, and the new model carries forward that elimination.

Implications for US GAAP:

The FASB's proposed model will result in dramatic changes in the accounting for loans, debt securities currently measured at amortized cost, equity securities (both those currently measured at cost and those classified as available-for-sale) and core deposit liabilities.

Convergence implications:

In contrast to the FASB's proposed financial instruments model, the IASB model requires an amortized cost measurement when certain criteria are met (the criteria are generally consistent with those proposed by the FASB for its FVTOCI category). All other financial assets will be measured at fair value, with changes in fair value reported in net income or other comprehensive income. A fair value option is available. For those financial assets measured at amortized cost, the IASB has proposed to recognize impairment under an 'expected loss' model that, unlike the FASB's incurred loss model, will include estimated future credit losses in the determination of the original effective interest rate.

The IASB has indicated that it plans to expose the FASB's proposal for public comment to the IASB's constituents and consider whether it should change any aspects of IFRS 9. However, it remains unclear whether the IASB would ultimately make significant changes to its model that would require greater use of fair value. While we strongly believe that a converged standard on financial instruments is critical to convergence efforts, the prospects for a converged standard at this point remain uncertain.

Next steps:

The FASB plans to issue a comprehensive ED in the second quarter of 2010 with a final standard in the fourth quarter of 2010.

FASB's Offsetting Project

As a result of a constituent request to permit offsetting of amounts related to certain stock lending and stock borrowing transactions (which is not permitted under current US GAAP), the FASB added a project to its agenda to reconsider broadly when offsetting financial assets and financial liabilities in the balance sheet is appropriate. To date, no decisions have been made.

Implications for US GAAP:

Too soon to say.

Convergence implications:

The requirements for offsetting under IFRS effectively are more stringent than US GAAP because of the manner in which master netting agreements are considered. At this point, the IASB has not proposed changes to its requirements for offsetting.

Next steps:

The FASB plans to issue an exposure draft in the third quarter of 2010.

Revenue Recognition

Currently, US GAAP for revenue recognition includes industry specific guidance that requires very different accounting depending on the applicable guidance for a transaction (e.g., ASC 985-605, *Software – Revenue Recognition* and ASC 605-35, *Revenue Recognition – Construction-Type and Production-Type Contracts*). The Boards' objective is to develop a single revenue recognition model that would be applied consistently to most transactions, although it likely will not apply to financial instruments, insurance and leasing contracts as well as certain nonmonetary exchanges.

The proposed model would require an entity to identify their contracts with customers – written, verbal or implied – and then to identify the performance obligations within the contract. After determining the transaction price, consideration would be allocated to the identified performance obligations based on relative standalone selling prices. Revenue is recognized as the performance obligations are satisfied by the transfer of control of the goods or services to the customer. The Boards have expanded the guidance on the notion of transfer of control, providing a list of indicators to help with this determination. Further, if a performance obligation is onerous (i.e., a loss is expected on satisfying the performance obligation), the entity would recognize a liability and corresponding loss. Upon transition to the new standard, the Boards tentatively have decided to require full retrospective application.

Implications for US GAAP:

Aspects of the proposed revenue recognition model are similar to the recently issued multiple-element arrangements guidance. For example, the identification of performance obligations under the proposed revenue recognition model is relatively consistent with the current requirements within the multiple-element guidance. Further, the allocation of transaction price is also similar to that guidance, although significant differences exist in the determination of transaction price; specifically the treatment of contingent consideration.

Under current GAAP, contingent consideration must be excluded from the transaction consideration until the contingency is resolved (both for single- and multiple-element transactions). Under the proposed model, the expected amount of contingent consideration, based on a probability weighted calculation, is included in the transaction consideration if it can be reasonably estimated. Therefore, in many cases contingent revenue will be recognized earlier under the proposed model.

Convergence implications:

At the date of this publication the Boards were in agreement on all substantive recognition and measurement conclusions. However, the FASB recently decided to address the accounting for contract costs within the scope of its revenue recognition project, while the IASB has decided to leave the accounting for such costs to other accounting literature.

Next steps:

The Boards expect to issue an ED by the end of the second quarter of 2010, with a final standard in 2011.

Financial Statement Presentation

In October 2008, the FASB and the IASB issued a joint Discussion Paper, *Preliminary Views on Financial Statement Presentation*. The objective of the Boards' joint project is to create a standard that requires entities to organize financial statements in a manner that clearly communicates an integrated financial picture of the entity. The new presentation model would represent a significant change for all reporting entities and likely will require significant changes to entities' information systems.

The Boards have decided that there will be two core presentation principles: cohesiveness (presenting information in a manner that portrays a cohesive picture of an entity's activities) and disaggregation (presenting information in a manner that makes it useful in assessing the amount, timing and uncertainty of an entity's future cash flows). The financial statements would contain defined sections, categories and subcategories. An entity would present information about the way it creates value (its business activities) separately from information about the way it funds those business activities (its financing

activities). Information about an entity's business activities would be further separated into operating activities and investing activities. Financing activities would be separated into debt and equity categories. In addition, an entity would present separate sections for discontinued operations and income taxes.

The new presentation model would require increased disaggregation by function, nature and measurement basis in the statements of financial position, comprehensive income and cash flows. In addition, disclosure of remeasurement information would be required in the notes. In line with the core disaggregation principle, an entity would be required to present all cash flows directly (a gross cash flow presentation), including operating cash flows. In addition, presentation of a reconciliation of operating income to operating cash flows would be required in the notes. An entity would also disclose an analysis of the changes in balances of all significant asset and liability line items, with each line item analysis distinguishing six specific components – cash transactions, accruals, noncash transactions, accounting allocations (e.g., depreciation), accounting provisions or reserves and remeasurements (e.g., adjustments to balances carried at fair value).

The FASB has decided that an entity would be required to disclose additional information related to its reportable segments. An entity would provide, for each reportable segment, a measure of operating cash flow, reconciling the sum to the operating cash flow in the statement of cash flows, and a measure of operating assets and operating liabilities. In addition, a measure of liabilities for each reportable segment would be required if that information is used by the chief operating decision maker. Note that the IASB would not require any incremental segment disclosures to those already required by IFRS.

Implications for US GAAP:

The proposed changes would represent a fundamental change in how financial information is presented. In particular, the requirements to (a) disaggregate information by nature as well as function, (b) present the statement of cash flows using the direct method and (c) to roll forward all significant balance sheet accounts, likely will require significant systems changes and changes to internal controls for most companies.

Convergence implications:

The Boards have reached agreement on all significant presentation matters, although differences may continue to exist for certain disclosure requirements.

Next steps:

The Boards have completed their deliberations and expect to issue an ED in the second quarter of 2010. A final standard is expected in 2011.

Discontinued Operations

The joint project on Discontinued Operations is related to the Financial Statements Presentation project. The Boards issued a joint ED in September 2008 that proposed to evaluate discontinued operations at the operating segment level. The Boards now are planning to expose a revised ED that proposes to adopt the current IFRS definition of a discontinued operation, supplemented with enhanced disclosures, although disclosures would be required for many dispositions that would not qualify as discontinued operations.

Implications for US GAAP:

Under US GAAP, the proposed guidance would change the level at which discontinued operations are evaluated. Rather than evaluating at the component level (operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity), the proposed model would require an evaluation at the level of a major line of business or geographic area. In another significant change, the proposed model would not consider the continuing involvement and continuing cash flows criteria that currently exist in US GAAP. This approach likely will result in fewer items being reported as discontinued operations under US GAAP, although the elimination of the prohibition on significant continuing involvement may result in some items being reported as a discontinued operation that would not be reported as such under current US GAAP.

Convergence implications:

Based on the decisions to date the accounting for discontinued operations under US GAAP and IFRS would be converged.

Next steps:

The Boards plan to issue an ED in the second quarter of 2010 with final guidance issued in the third quarter of 2010.

Other Comprehensive Income

As a result of decisions made in deliberations on other projects, the Boards decided to develop converged guidance on the presentation of comprehensive income that would be issued separately by the IASB and the FASB. The guidance will be independent of the Financial Statement Presentations project, with an exposure draft that will coincide, for the FASB, with the proposed guidance on the Financial Instruments project.

The Boards tentatively have decided that an entity would be required to display total comprehensive income and its components in a continuous statement of comprehensive income. The continuous statement would be displayed with two sections: net income and other comprehensive income. The components of each section must be reported consistently. Earnings per share would continue to be calculated based on net income.

The Boards are not changing existing requirements related to the income tax effects of items reported in other comprehensive income or the guidance on determining the items that must be presented in other comprehensive income. The primary effect of the Boards' decisions to date would be to remove the presentation alternatives that currently exist in both US GAAP and IFRS. The FASB has affirmed that reclassifications between other comprehensive income and net income should be displayed in the same level of detail in which the items originally were reported.

Implications for US GAAP:

While this project would not change any of the amounts reported by reporting entities following US GAAP, it would significantly change their presentation. Most reporting entities present amounts of other comprehensive income within the statement of changes in stockholders' equity. That alternative would no longer be permitted, and all such amounts would be required to be presented on the face of a single statement of comprehensive income, along with all items included in the traditional income statement.

Convergence implications:

While the *presentation* of other comprehensive income would be converged, differences will remain in how items of other comprehensive income are measured and under what circumstances those items are "recycled" into net income.

Next steps:

The FASB expects to issue an ED in the second quarter of 2010 simultaneously with the proposed guidance on financial instruments. Final guidance is expected in the third quarter of 2010.

Leases

The Boards' project on leases will have broad implications for almost all companies by eliminating the practice of distinguishing between operating and capital (finance) leases. The Boards tentatively have decided that the lease model would apply only to leases of tangible assets and would not apply to those that are in substance sales/purchases. All leases would be recorded on the balance sheet with assets and liabilities measured at the present value of expected payments under the lease (although the Boards have decided on a simplified measurement method for leases with a maximum term of 12 months). As the Boards have tentatively decided that existing lease arrangements will not be grandfathered, an assessment of all existing leases would be required upon adoption.

The new model would require initial assessment, and then periodic reassessment, of the expected payments, including consideration of optional renewal periods, contingent rents and residual value guarantees. Lessees would record an intangible asset for the right to use the leased item and a liability for the obligation to pay rentals – a right-of-use model.

Historically, the accounting for certain leases and executory contracts were similar (e.g., operating leases and service contracts). However, with the proposed changes, the accounting for leases will change significantly and the differences between lease accounting and accounting for executory contracts will be greater (e.g., the "gross-up" of the right of use asset and the obligation to pay for a lease, while executory contracts generally are not grossed-up). It will therefore become increasingly important to distinguish between a lease and a non-lease executory arrangement.

The Boards tentatively have decided that lessors would be required to record an asset for the right to receive payments and a liability for the performance obligation to the lessee. The underlying asset would also remain on the lessor's balance sheet.

Implications for US GAAP:

The proposed model would represent a fundamental change to the leasing model, as lessees will recognize an asset and liability for substantially all leases, not just capital leases as is the case today. The proposed model also could have a significant effect on the balance sheets of lessors, depending on the presentation requirements for the leased asset and the asset for the right to receive lease payments.

Convergence implications:

While the Boards reached different conclusions on several issues in the Discussion Paper issued in 2009, most of those differences have since been reconciled. The remaining significant differences relate primarily to issues that are addressed by other authoritative literature (e.g., the accounting for investment properties and impairment of intangible assets). The FASB has added a project to its agenda to consider whether investment properties should be permitted or required to be accounted for at fair value.

Next steps:

The Boards expect to issue an ED in the second quarter of 2010 with a final standard in 2011.

Financial Instruments with Characteristics of Equity

This joint project started in earnest with the November 2007 issuance of the FASB's Preliminary Views, *Financial Instruments with Characteristics of Equity*. Shortly thereafter, in February 2008, the IASB issued a Discussion Paper. The Boards essentially have rejected all the approaches proposed in those discussion documents and are now considering an approach that would be based largely on the principles outlined in IAS 32, *Financial Instruments: Presentation*, but with several key amendments. The proposed requirements would apply to all financial instruments unless specifically excluded from the standard's scope. Exceptions include share-based payment awards accounted for under ASC 718, *Compensation-Stock Compensation*, as well as insurance contracts.

The Boards have decided that all perpetual instruments would be classified as equity. These are defined as instruments not required to be redeemed unless the entity decides or is forced to liquidate its assets and settle claims against the entity, and would include both ordinary and preferred shares. Certain mandatorily redeemable and puttable instruments also would be classified as equity under certain circumstances, generally if the redemption (or potential redemption) relates to the holder's withdrawal as an owner or cessation of transactions or participation with the entity. Other mandatorily redeemable instruments would be classified as liabilities, while other puttable instruments would be separated into their liability (written put option) and equity components.

Contracts that require or may require an entity to issue a specified number of equity-classified instruments in exchange for a specified price (e.g., call options, forward contracts to issue shares) also would be classified as equity. Likewise, instruments that require an entity to issue a specified number of its own equity-classified instruments for no further compensation (e.g., prepaid forward contract to issue shares) would be classified as equity.

Contracts that require the repurchase of an entity's own shares (e.g., physically-settled forward contracts and similar instruments) would be "grossed up" and separated into a liability representing the amount to be paid, with an offset to equity. On the other hand, a freestanding written put option would be presented "net" as a liability in its entirety.

Convertible debt would be separated into liability and equity components if the conversion option meets certain criteria; otherwise convertible debt instruments would be classified as liabilities in their entirety and remeasured at fair value.

Implications for US GAAP:

While the proposed changes are not as significant as those that had been proposed in the discussion documents, the changes will nonetheless have a significant effect on many entities. For example, many instruments currently classified as "mezzanine equity" by SEC registrants will be accounted for as liabilities or will be bifurcated into liability and equity components. Additionally, certain convertible debt instruments that are classified entirely as liabilities measured at amortized cost today would be bifurcated into liability and equity components or, in some cases, classified as liabilities and remeasured at fair value. Additionally, the accounting for many freestanding equity derivatives will change significantly.

Convergence implications:

The Boards are in agreement on all significant decisions to date so, absent any future differences, this project would result in a converged standard.

Next steps:

The Boards are preparing to issue an ED in the second quarter of 2010 with a final standard expected in 2011.

Consolidation

The Boards' objective is to develop one consolidation model that can be applied to both voting interest and variable interest entities. The model will build on the power and benefits principles in ASC 810-10, *Consolidation – Overall*, and the IASB's ED 10, *Consolidated Financial Statements*, which the Boards concluded contain fundamentally consistent objectives for assessing control of entities.

The Boards tentatively have decided that there should be an exception to consolidation whereby an investment company would measure investments in entities that it controls at fair value. The guidance currently in ASC 946, *Financial Services – Investment Companies*, would be used as the basis for developing the attributes of an investment company.

The Boards still have many issues to deliberate, including kick-out rights, determining whether a party with power is acting as a principal or an agent and related party considerations. In addition, the Boards must determine whether specific consolidation guidance should be provided for structured or special-purpose entities. Also, the Boards have not yet addressed disclosures related to the new model.

Implications for US GAAP:

Certain tentative decisions made to date could significantly change US GAAP. One of the key tentative decisions provides that a reporting entity with less than half of the voting rights (say 40%) in an entity may consolidate that entity if, for example, the reporting entity holds significantly more voting rights than any other party or organized group of shareholders, and in which the other shareholders are widely dispersed (no other individual shareholder has more than 5%). This is sometimes termed "de facto control." The Boards also have tentatively decided that a reporting entity should consider options and convertible instruments when assessing whether it has the power through voting rights. Based on decisions to date, the new model would likely result in more entities being consolidated.

Convergence implications:

While the Boards generally have reached the same decisions to date, their conclusions on when a reporting entity would consolidate based on de facto control currently differ. The FASB currently believes that a party must have demonstrated the ability to exert de facto control before it could consolidate an entity when it has less than 50% of the outstanding voting interests. The IASB would not require that the reporting entity demonstrate the ability to exert de facto control before consolidating an entity. However, the Boards are currently reconsidering this issue, among others.

Next steps:

The FASB plans to issue an ED in the second quarter of 2010 while the IASB plans to re-expose some or all of ED 10 at that time. Both Boards expect to issue a final standard in the fourth quarter of 2010.

Insurance Contracts

The joint IASB/FASB insurance contracts project addresses recognition, measurement, presentation and disclosure requirements for insurance contracts. In February 2009, the Boards commenced discussions on the development of an exposure draft, with several tentative decisions made to date. Included in these decisions is a proposed approach for the measurement of insurance contracts that is based on four building blocks:

- ▶ The unbiased, probability-weighted average of future cash flows expected to arise as the insurer fulfills the obligation
- ▶ The time value of money
- ▶ A risk adjustment
- ▶ A residual margin (to eliminate any gain at inception of the contract)

These building blocks would be used to measure the combination of rights and obligations under the contract, with measurement updated each reporting period for all elements, except for the residual margin. The Boards have acknowledged that additional guidance will be necessary for several elements of the building blocks in the proposed measurement approach and are expected to provide that guidance in the exposure draft for insurance contracts.

The Boards also have asked the staff to develop guidance on accounting for the various components of an insurance contract as if they were separate contracts (i.e., unbundling). The Boards tentatively have decided that the combination of rights and obligations of an insurance contract would be presented net on the statement of financial position but are still deliberating presentation on the statement of comprehensive income. The Boards also are continuing deliberations on the accounting for reinsurance contracts.

Although the FASB tentatively affirmed its previous decision that an insurer should recognize all acquisition costs as an expense when incurred and should not recognize revenue to offset those costs, the IASB tentatively decided to exclude from the initial measurement of the residual margin an amount equal to the incremental acquisition costs. The Boards noted that in some circumstances acquisition costs may be recoverable from the policyholder or from third parties. The Boards have asked the staff to consider whether investigating those circumstances would make it easier for the Boards to reach a common approach to acquisition costs.

Implications for US GAAP:

The proposals to date would represent a fundamental change in the recognition and measurement of insurance contracts and the related costs of issuing insurance policies.

Convergence implications:

The Boards are struggling to reach common decisions on a number of issues, including the unbundling of insurance contract obligations (under what circumstances investment and derivative features should be unbundled from insurance features and accounted for separately) and the accounting for acquisition costs, among others. It is too early to say whether the ultimate standard on insurance contracts will be fully converged.

Next steps:

The Boards will continue discussions and work toward an ambitious goal of issuing a joint ED in the second quarter of 2010 with final guidance expected to be issued in 2011.

Fair Value Measurement

In 2006, the FASB issued its comprehensive fair value guidance codified in ASC 820, *Fair Value Measurements and Disclosures*, while the IASB issued its ED, *Fair Value Measurement*, in 2009. This joint project is intended to eliminate differences between the IASB's proposed guidance and ASC 820. The Boards have jointly deliberated and reached tentative conclusions on a number of issues related to the fair value measurement framework.

Implications for US GAAP:

Most of the tentative decisions reached to date are consistent with the guidance in ASC 820, although clarification is provided on certain matters. In some cases, although the specific guidance may be altered, practice under US GAAP is expected to remain largely unchanged. For example, while the Boards determined that the concepts of "highest and best use" and "valuation premise" do not apply to financial instruments, they also tentatively decided to clarify that entities are permitted to consider offsetting counterparty credit risk positions when measuring the fair value of financial instruments when there is a legally enforceable right of offset with the counterparty in the event of default (e.g., a master netting agreement). While not explicit under current US GAAP, we believe this clarification is largely consistent with current practice regarding the assessment of credit risk when measuring the fair value of derivatives. To date, one of the most significant changes to the measurement guidance in ASC 820 would be the Boards' tentative decision to prohibit the application of a "blockage factor" at any level of the fair value hierarchy. Currently, use of a blockage factor is prohibited for Level 1 fair value measurements (i.e., those based on trading prices), but not for measurements under Levels 2 and 3 of

the fair value hierarchy. In addition, certain tentative decisions reached in this project will result in additional disclosures under US GAAP. For example, the Boards decided to require disclosure of classification in the fair value hierarchy for assets and liabilities whose fair value is disclosed (e.g., financial instruments under ASC 825), even though these measurements are not presented on the statement of financial position. The Boards also tentatively agreed to move forward with converged guidance on sensitivity disclosures related to Level 3 fair value measurements, but continue to debate what fair value measurements would be subject to such requirements.

Convergence implications:

It appears that the IASB's decision not to address the recognition of day one gains or losses for financial instruments in this project could result in a continued difference between IFRS and US GAAP. The recognition of day one gains and losses is currently limited under IFRS to those instances in which fair value can be evidenced by observable market data, while no such threshold exists in US GAAP. The IASB may choose to address this issue as part of its Financial Instruments project.

Next steps:

An ED with amendments to ASC 820 is expected in the second quarter of 2010, with a final standard to be issued by both Boards in the third quarter of 2010.

Emissions Trading Schemes

The objective of this project is to provide guidance on the accounting issues that arise related to emissions trading schemes. These schemes to reduce greenhouse gas emissions have expanded rapidly in recent years at the state, national and international levels. The joint project will address issues including asset recognition, measurement and impairment, liability recognition and measurement, as well as timing of profit/loss recognition and presentation and disclosure issues. The project is expected to cover both cap-and-trade and baseline-and-credit schemes (both government mandated and voluntary), as well as project-based certificates and renewable energy certificates. The guidance is expected to apply to participants in a scheme and non-participants that buy and sell tradable rights.

To date, there has been little discussion by the Boards on this project with no decisions yet made by the FASB.

Next steps:

Although the FASB's project timeline indicates that an ED will be issued in the third quarter of 2010 with final guidance in 2011, there are many significant decisions yet to be made.

FASB projects

In addition to the numerous joint projects that are being deliberated and drafted with the IASB, the FASB has several standards projects in process on its own agenda. The table below indicates the FASB's expected timing on some of these projects that may be effective for calendar year 2010 reporting, as well as a brief overview of each project's objective.

Project	Objective	Status
Disclosures about Credit Quality and the Allowance for Credit Losses	Improve disclosures a creditor provides about the allowance for credit losses and the credit risks inherent in its loan and lease portfolio	Final guidance expected in the second quarter of 2010.
Disclosure of Certain Loss Contingencies	Enhance the disclosure requirements for loss contingencies under ASC 450-20, <i>Contingencies – Loss Contingencies</i>	Final guidance expected in the second quarter of 2010.
Going Concern	Incorporate going concern guidance in FASB literature, provide definitions and clarifications of certain guidance and enhance certain disclosures	ED expected in the second quarter of 2010 with final guidance in the third quarter of 2010.

EY resources

- ▶ Hot Topic, SEC reaffirms its commitment to IFRS (SCORE No. CC0294)
- ▶ Hot Topic, Update on status of FASB/IASB joint projects (SCORE No. BB1899)
- ▶ Technical Line, Status update – Joint revenue recognition project (SCORE No. BB1885)
- ▶ Hot Topic, Accounting for financial instruments – a changing landscape (SCORE No. BB1861)
- ▶ Technical Line, Revenue recognition project preliminary views (SCORE No. BB1750)
- ▶ Hot Topic, Leases project preliminary views (SCORE No. BB1719)
- ▶ Hot Topic, Revenue recognition project preliminary views (SCORE No. BB1660)
- ▶ Hot Topic, FASB issues preliminary views on financial statement presentation (SCORE No. BB1607)
- ▶ Hot Topic, FASB proposes new definition of a discontinued operation (SCORE No. BB1588)

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AccountingLink at ey.com/us/accountinglink offers easy access to many of the publications produced by our US Professional Practice Group. AccountingLink is available free of charge.

Our **Global IFRS website** at ey.com/ifrs offers online resources that provide more detail about IFRS, as well as issues to consider as you research the potential impact of IFRS on your company.

GAAIT-Client Edition contains Ernst & Young's comprehensive proprietary technical guidance, as well as all standard-setter content. GAAIT-Client Edition is available through a paid subscription.

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