

THE NEWSLETTER FROM BDO'S NATIONAL ASSURANCE PRACTICE

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2011 ACCOUNTING YEAR IN REVIEW

THE ONLY CONSTANT (IN ACCOUNTING)... IS CHANGE

2011 was another busy year in accounting circles. While the number of standards finalized in 2011 was significantly less than 2010, the FASB continued to busy itself in convergence projects with the IASB. Although the Boards did not meet the June 30, 2011 deadline for completing their major joint projects, they made meaningful progress. We agree with the Boards' decision to take more time to "get it right" in completing the standards for revenue recognition, leases, financial instruments and other topics.

Our year-in-review letter summarizes where the ongoing major projects stand and what constituents can expect in 2012. But first, we recap the new standards that were issued in 2011, some of which will impact year-end financial statements this reporting season. We've also included a comprehensive list of recently issued accounting standards in the appendix.

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► NEW PRONOUNCEMENTS IN 2011

Balance Sheet Offsetting

The FASB issued ASU 2011-11¹ as the result of a joint project with the IASB to enhance and provide converged disclosures about financial and derivative instruments that are either offset on the balance sheet or are subject to an enforceable master netting arrangement. The ASU does not change the conditions for when offsetting is appropriate in US GAAP. However, those conditions differ under IFRS, which results in the single largest financial reporting difference for certain financial institutions. As a result, the FASB and IASB designed the new disclosures to reconcile US GAAP and IFRS primarily through the requirement to present information on both a “gross” and “net” basis in the footnotes.

The ASU is applicable to all companies that have financial instruments and derivative instruments that are either offset in accordance with ASC 210-20-45 or ASC 815-10-45, or are subject to an enforceable master netting arrangement (or similar arrangement). This includes derivatives, sale and repurchase agreements, and securities borrowing and securities lending arrangements. However, assuming a company is not party to a master netting arrangement and does not offset assets and liabilities on the balance sheet, the new disclosures do not apply. Further, loans and customer deposits at the same financial institution² and financial instruments that are only subject to a collateral agreement are also excluded from the disclosure requirements.

The ASU takes effect in 2013. Retrospective application is required for all periods presented.

In general, companies will be required to disclose the effect or potential effect of any rights of setoff associated with recognized assets and liabilities within the scope of the ASU. This information should enable financial statement users to evaluate the impact or potential impact of netting arrangements on the balance sheet. To achieve this objective, the ASU requires the following quantitative disclosures:

- a) The gross amounts of those recognized assets and those recognized liabilities
- b) The amounts offset in accordance with the guidance in ASC 210-20-45 and 815-10-45 to determine the net amounts presented in the statement of financial position
- c) The net amounts presented in the statement of financial position
- d) The amounts subject to an enforceable master netting arrangement or similar agreement not otherwise included in:
 1. The amounts related to recognized financial instruments and other derivative instruments that either:
 - i. Management makes an accounting policy election not to offset.
 - ii. Do not meet some or all of the guidance in either ASC 210-20-45 or ASC 815-10-45.
 2. The amounts related to financial collateral (including cash collateral).
- e) The net amount after deducting the amounts in (d) from the amounts in (c).

The ASU prescribes that the information above be presented separately for assets and liabilities in a tabular format, unless another format is considered to be more appropriate. These disclosures may be grouped by type of instrument or transaction, such as derivatives and repurchase agreements. Alternatively, the disclosures in c) through e) above may be grouped by counterparty.

The ASU provides several illustrations of the quantitative disclosure requirements. Additionally, a company should describe the rights of setoff associated with recognized assets or recognized liabilities subject to d) above. If any of the required disclosures are presented in separate notes to the financial statements, a company should cross-reference between the notes.

Comprehensive Income

The FASB released ASU 2011-5³ in May 2011, and then amended it in December, to narrow the options that are available for reporting financial performance. While the rules for determining net income and earnings per share (EPS) remain unchanged, the items reported below net income that make up other comprehensive income (OCI), including pension adjustments and changes in the fair value of some marketable securities, may no longer be presented in a statement of changes in stockholders' equity. Many companies have used this presentation in the past, but now all companies will be limited to the two remaining options: presenting net income and OCI in a single, continuous statement of comprehensive income, or presenting two separate but consecutive statements of net income, and then comprehensive income.

One of the FASB's primary interests was to emphasize OCI as a performance measure, in part because the FASB expects more activity to be recorded in OCI as a result of its separate project on financial instruments. The FASB concluded the prominence of OCI could be increased by eliminating the option to present OCI in the statement of changes in stockholders' equity. The FASB reasoned that the difference between the remaining two options of one or two statements is minimal and would not significantly impact comparability for financial statement

¹ Disclosures about Offsetting Assets and Liabilities

² This assumes the institution does not offset its loans and customer deposits on the balance sheet.

³ Presentation of Comprehensive Income

users. The FASB also observed the option to choose one or two statements improves convergence with IFRS, which provides the same choice. However, differences continue to exist between US GAAP and IFRS regarding the items to be recorded in OCI and when, or if, they should be reclassified from OCI to net income.

The new standard applies to all companies that provide a full set of financial statements that report financial position, results of operations and cash flows. It also applies to investment companies, defined benefit pension plans and other employee benefit plans that are exempt from the requirements to provide a statement of cash flows. It does not affect companies that have no OCI in any period presented or not-for-profit entities.

Without the option to present OCI in the statement of changes in stockholders' equity, companies must now choose between the one-statement and two-statement approach.

A company that elects the one-statement approach will present:

- Total net income, together with the components that make up net income,
- Total OCI, together with the components that make up OCI, and
- Total comprehensive income, i.e., the sum of net income and OCI.

A company choosing the two-statement approach will present:

- Components of and the total for net income in the statement of net income, and
- Components of and the total for OCI, as well as a total for comprehensive income in the statement of OCI, which must be presented immediately after the statement of net income.

ASU 2011-5 indicates companies that use the two-statement approach will have the option to begin the second statement with or without net income. However, the FASB has already proposed to eliminate that option in a separate "technical corrections" project, such that companies will be required to present net income at the beginning of the second statement.⁴ Therefore as a practical matter, companies using the two-statement approach may wish to include net income on the second statement to avoid having to revise the presentation when the technical corrections project is completed at a later date.

► BDO COMMENT:

At initial adoption, a change in presentation to one of the two acceptable methods would not represent a change in accounting principle and therefore would not impact an auditor's report on the financial statements.

Likewise after adoption, an auditor's report would not need to refer to a change from one method to the other. Rather, the change would be considered a reclassification and should be disclosed in the footnotes. We would generally expect such reclassifications to be rare, consistent with existing practice under ASC 220-10.

Other Provisions

- **Tax effects** – Companies will still have the option to show components of OCI either net of the related tax effects, or before related tax effects with one amount shown for the aggregate tax effect. Accordingly, the tax effect allocated to each component of OCI may be presented in the primary statement in which OCI is reported or disclosed in the footnotes.
- **Accumulated OCI** – Companies will also have an option to present on the face of the financial statements or to disclose in a separate footnote the changes in the accumulated balances of OCI for each component of OCI. While companies have historically reported such accumulated balances of OCI, the requirement to report current period activity (i.e., the changes) in the accumulated balances is new.
- **Noncontrolling interests** – The new standard does not change the requirement to present in the financial statements, if applicable, both net income and comprehensive income attributable to the parent and any noncontrolling interest.
- **Reclassification adjustments** – Also known as "recycling," companies would have been required by ASU 2011-5 to display reclassification adjustments and their effect on net income and OCI in the statement(s) in which the adjustments appear. This provision would have applied to both the one- and two-statement approaches, and it would no longer have been acceptable to show reclassification adjustments in the footnotes. However, after the issuance of ASU 2011-5, constituents raised concerns about the costs of capturing the information necessary to present reclassification adjustments. They also questioned whether the presentation would have confused rather than informed financial statement users, due to the "cluttering effect" of additional line items on the face of the performance statement.

⁴ The technical corrections exposure draft can be accessed [here](#). See paragraphs 65-68.

As such, the FASB issued ASU 2011-12⁵ to defer the new presentation requirements for recycling. Nonetheless, all of the remaining provisions in ASU 2011-5 will take effect in 2012 as planned. In 2012 the FASB plans to consider the operational concerns and the needs of financial statement users for additional information about reclassification adjustments. In the meantime, companies will continue to report recycling adjustments based on existing US GAAP, i.e., prior to ASU 2011-5.

The changes take effect in 2012 for public and private companies, and the new requirements must be applied retrospectively for all periods presented. Early adoption is permitted since the one- and two-statement approaches are both already available under US GAAP.

Derecognition of in Substance Real Estate

Many investors commonly establish a single-purpose legal entity that is capitalized with nonrecourse debt to purchase commercial real estate. The investor will frequently own all of the equity interests of the entity, and therefore consolidate it. The nonrecourse debt may provide the lender with certain protective covenants over the term of the loan and the lender may have additional rights upon an event of default, such as seizing control of the entity. However, the loan may continue to be outstanding during the default period, and the investor may continue to legally own the property. In other words, title doesn't transfer to the lender immediately.

Before ASU 2011-10,⁶ there were different views in practice as to how the investor should account for the loss of control of the real estate entity upon default. Some practitioners believed the investor should apply ASC 810⁷ to determine whether to deconsolidate the real estate entity. Others believed that the real estate literature (ASC 360-20) applied. As such, companies could reach different conclusions regarding if, and when, to remove the underlying real estate from their books.

ASU 2011-10 clarified that companies should apply the real estate literature to determine whether they should remove (i.e., derecognize) the real estate as a result of defaulting on nonrecourse debt and losing control of the real estate entity. The FASB indicated that generally, a company would not satisfy the requirements to derecognize the real estate before transferring title of the real estate to the lender and extinguishing the related nonrecourse loan. Said differently, even if the company loses control of the real estate entity, it would continue to include the real estate, debt and the results of the real estate entity's operations in the investor's consolidated financial statements until title to the real estate is transferred to satisfy the debt.

Public companies must apply the new guidance in 2012, while private companies are not required to adopt until 2013. While early adoption is permitted, the new guidance only applies prospectively.

Fair Value

While Topic 820⁸ has historically provided guidance for fair value measurements under US GAAP, IFRS had no comparable standard until IFRS 13⁹ was issued in May 2011. The FASB issued ASU 2011-4¹⁰ as part of its convergence efforts with the IASB to ensure that fair value has the same meaning in US GAAP and in IFRS and that their respective fair value measurement and disclosure requirements are the same, except for minor stylistic differences. Importantly, the ASU does not change when a fair value measurement is required under US GAAP.

The more notable amendments include:

- **Highest and best use** – Indicates that the concepts of a “valuation premise” and the “highest and best use” for an asset or liability only apply to nonfinancial items.
- **Items reported in stockholders' equity** – Clarifies that a reporting entity should measure its own equity-classified instruments from a market-participant's perspective.
- **Disclosures** – Requires companies to disclose incremental quantitative and qualitative information about unobservable inputs for Level 3 fair value measurements.
- **Instruments in a portfolio** – Permits an exception for groups of assets and liabilities to be measured on a net basis when the entire group (i.e., the portfolio) is managed in response to counterparty or market risks, rather than on an individual asset or liability basis.
- **Block discounts** – Eliminates the ability to apply a block discount to a quoted market price for Level 2 and 3 measurements of groups of assets and liabilities.

The ASU is effective prospectively in 2012 for both public and private companies.

⁵ *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-05*

⁶ *Derecognition of in Substance Real Estate – a Scope Clarification*

⁷ *Consolidation*

⁸ *Fair Value Measurement*

⁹ *Fair Value Measurements*

¹⁰ *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*

On a related matter, the FASB recently started a new project to evaluate whether there is a basis to exempt private companies from providing some disclosures about Level 3 fair value measurements, considering the relevance, costs and benefits of those disclosures. An exposure draft is anticipated during the first half of 2012.

Goodwill Impairment

Under existing US GAAP if the fair value of a reporting unit is more than its carrying amount, then goodwill is not impaired. However, if fair value is less, a second step of analysis is performed to determine the amount of impairment, if any.

In the past, companies have calculated a reporting unit's fair value in the first step of the impairment test. Public companies with only one reporting unit often used market capitalization to estimate fair value. However, private companies would commonly prepare a discounted cash flow projection or obtain a valuation report from a consultant to estimate fair value. Public companies with multiple reporting units faced similar circumstances.

In August 2011, the FASB relaxed its goodwill impairment standard so companies will be able to avoid the cost of developing detailed fair value estimates for their reporting units in some cases.¹¹ The FASB decided to provide companies with a new option to first determine whether it is necessary to apply the traditional two-step impairment test. If a company elects to use the new option, it must decide – on the basis of qualitative information – whether it is more than 50 percent likely that the fair value of a reporting unit is less than its carrying amount. If so, the existing quantitative calculations in steps one and two continue to apply. But if management concludes that fair value exceeds the carrying amount, neither of the two steps in the current goodwill test is required. That is, goodwill is not impaired.

The new option applies to both public and private companies. If early adoption was not elected in 2011, the amendments are effective prospectively in 2012.

► BDO COMMENT:

See our [goodwill impairment newsletter](#) for an in-depth discussion of the new standard and our thoughts on implementation.

Health Insurer Fees

Recent federal healthcare legislation imposes an annual fee on health insurers for each calendar year beginning on or after January 1, 2014. A health insurer's portion of the annual fee is payable no later than September 30 of the applicable calendar year and is not tax deductible.

The annual fee for the health insurance industry will be allocated to individual health insurers based on the ratio of the amount of a company's net premiums written during the preceding calendar year to the amount of health insurance for any US health risk that is written during the preceding calendar year. A health insurer's portion of the annual fee becomes payable to the US Treasury once the entity provides health insurance for any US health risk for each applicable calendar year.

Questions arose as to how a health insurer should account for the fee. ASU 2011-6¹² specifies that the liability for the fee should be estimated and recorded in full once the entity provides qualifying health insurance in the applicable calendar year in which the fee is payable. Companies should also record a corresponding deferred cost that is amortized to expense using a straight-line method, unless another method better allocates the fee over the calendar year that it is payable.

The new guidance takes effect in 2014, when the fee is initially imposed.

Healthcare – Bad Debts Expense

In July 2011, the FASB issued ASU 2011-7¹³ to require certain healthcare companies to reclassify the provision for bad debts associated with patient service revenue from an operating expense to a contra-revenue item on their statement of operations. Also, the ASU requires these healthcare companies to disclose patient service revenue net of contractual allowances and discounts, to provide qualitative and quantitative information about changes in the allowance for doubtful accounts, and to add information about their policies for recognizing revenue and assessing bad debts.

The ASU scopes in healthcare companies that recognize significant amounts of patient service revenue at the time services are rendered even though the companies do not assess a patient's ability to pay at that time. For example, Hospital A is required by law to provide emergency services regardless of a patient's creditworthiness. Accordingly, Hospital A records a significant amount of revenue without

¹¹ While the FASB made its decision in August, ASU No. 2011-8, *Testing Goodwill for Impairment*, was issued on September 15, 2011.

¹² *Fees Paid to the Federal Government by Health Insurers*

¹³ *Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*

concluding that collectibility for services to such patients is reasonably assured, and it must therefore apply the presentation and disclosure requirements of ASU 2011-7.

The ASU takes effect in 2012 for public and private healthcare companies, and the new presentation requirements must be applied retrospectively for all periods presented.

► BDO COMMENT:

See our [healthcare newsletter](#) for an in-depth discussion of the new standard, including examples of the new presentation requirement.

Multiemployer Pension Plan Disclosures

One of the main characteristics of a multiemployer pension plan is that the assets contributed by one employer may be used to pay benefits to the employee of another participating employer. In the past, the disclosures available to a user of an employer's financial statements about multiemployer pension plans were limited to historic contributions. Users expressed concerns about a lack of transparency related to plan participation, particularly the withdrawal liabilities associated with some plans when an employer chooses to stop participating.

In response, the FASB issued ASU 2011-9¹⁴ to enhance the current disclosure requirements. The new ASU does not change the existing accounting guidance, but the new disclosures include the following for individually significant plans in which an employer participates:

- Identifying plan information such as the plan's legal name, EIN and plan number
- The level of an employer's participation in the significant multiemployer plans, including the employer's contributions made to the plans and an indication of whether the employer's contributions represent more than 5 percent of the total contributions made to the plan by all contributing employers
- The financial health of the significant multiemployer plans, including an indication of the funded status (i.e., certified zone status), whether funding improvement plans are pending or implemented, and whether the plan has imposed surcharges on the contributions to the plan
- The nature of the employer commitments to the plan, including when the collective-bargaining agreements that require contributions to the significant plans are set to expire and whether those agreements require minimum contributions to be made to the plans.

The new requirements will enable users to obtain additional information beyond the financial statements, such as from the plan's annual report on Form 5500. Additional footnote disclosures are required for other plans for which users are unable to obtain additional information from public sources. The new provisions take effect in 2011 year-end reports for public companies, while private companies have an additional year. They are also required for all prior years presented.

Transfers and Servicing

In a typical repurchase transaction, a company transfers financial assets to a counterparty in exchange for cash with an agreement for the counterparty to return the assets for a fixed price in the future. Topic 860¹⁵ establishes criteria to determine whether the arrangement represents a single accounting transaction – a collateralized borrowing in which funds are obtained and repaid, or two separate transactions – the sale of assets, and then a repurchase of those same assets at a later date.

The distinction is important because a borrowing treatment reflects the proceeds as debt, while a sale records the proceeds as income. That determination is based, in part, on whether the entity has maintained "effective control" over the transferred financial assets. One criterion for evaluating whether effective control has been maintained is the transferor's ability to repurchase or redeem financial assets before maturity. For this purpose, practitioners must determine whether the amount of collateral in the exchange is sufficient to reasonably assure the contract's completion. That is, in order for the transferor to assert that it maintained effective control over the transferred assets, the transferor must have the ability to repurchase the same or substantially the same assets in the future.

During the recent credit crisis, some constituents criticized the existing provisions in US GAAP that, in effect, established a bright line for measuring the sufficiency of collateral in repurchase transactions. Such quantitative thresholds were susceptible to writing contracts in order to obtain a desired accounting outcome, i.e., sale vs. borrowing treatment.

¹⁴ Disclosures about an Employer's Participation in a Multiemployer Plan

¹⁵ Transfers and Servicing

In response to those criticisms, the FASB concluded in ASU 2011-3¹⁶ that the amount of collateral should not be a determining factor in assessing effective control. Instead, the FASB decided that an assessment should focus on a transferor's contractual rights and obligations with respect to transferred financial assets, not on whether the transferor has the practical ability to honor its rights and obligations. As such, eliminating one of the criteria previously required to demonstrate effective control makes it more likely that repurchase transactions will be reflected as borrowings, rather than sales.

The revised guidance is effective for repurchase arrangements beginning in 2012 for public and private companies.

Troubled Debt Restructurings

When a loan is amended, the creditor must determine whether the modification represents a "troubled debt restructuring (TDR)" for accounting purposes, or if other US GAAP applies to the amendment. In the current economic environment, TDR accounting has become more frequent due to significant increases in the number of residential mortgages and commercial real estate loans that have been restructured.

The FASB recently clarified how *creditors* identify TDRs in ASU 2011-2.¹⁷ The TDR standards for *debtor* accounting were not changed and are provided in ASC 470-60.¹⁸ The new ASU primarily affects financial institutions such as banks that hold loans or other financing receivables. Under ASU 2011-2,¹⁹ if a creditor determines that a loan modification is a TDR, then the creditor may need to perform a different impairment measurement and provide additional disclosures than would otherwise be required.

The new provisions were effective for most public companies in 2011, while private companies are not required to adopt until 2012.

► BDO COMMENT:

For more on the new TDR standard see our [Flash Report](#) on ASU 2011-2. It discusses the new guidance for identifying a creditor's concessions and a debtor's financial difficulties, concepts key to the determination of whether a modification is a TDR. It also summarizes the new TDR disclosure requirements.

► ON THE HORIZON

At this time last year, the FASB and IASB had jointly committed to finishing most of their major convergence projects by June 30, 2011. During 2011, it became apparent more time was needed to ensure the major projects are thoroughly vetted in due process, with the goal of issuing high-quality standards, while minimizing areas in which they differ. In this section, we provide an update on the "Big 3" projects: revenue, leases and financial instruments. Then we summarize three additional exposure drafts with wide applicability: investment company entities, investment property entities and revisions to the consolidation literature. We've also included a brief description of the private company GAAP initiative.

Revenue

On November 14, 2011, the FASB and IASB jointly issued a revised exposure draft, *Revenue from Contracts with Customers*. The proposal revises the initial exposure draft on this topic issued in June 2010 and would supersede the majority of current revenue recognition guidance. The objective of the exposure draft is to clarify existing revenue recognition principles and develop a common standard for US GAAP and IFRS. This includes removing inconsistencies and perceived weaknesses in existing revenue standards, and also improving the comparability of revenue recognition practices across companies, industries and capital markets.

The exposure draft would apply to all companies that enter into contracts with customers unless those contracts are within the scope of other standards.²⁰ The effective date would not be before January 1, 2015 for public companies with a minimum one year deferral period expected for non-public companies. Early adoption would not be permitted by the FASB's proposal; however, the IASB plans to permit early adoption. Retrospective application is required under the exposure draft, although certain transition relief would be available.

The proposed model is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration the vendor receives. To accomplish this objective, the proposed standard would require the application of the following five steps:

¹⁶ *Reconsideration of Effective Control for Repurchase Agreements*

¹⁷ *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*

¹⁸ *Troubled Debt Restructurings by Debtors*

¹⁹ *A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring*

²⁰ For example, lease contracts, insurance contracts, financial instruments and other items are addressed by other standards.

1. Identify the contract with the customer.
2. Identify the separate performance obligations in the contract.
3. Determine the transaction price.
4. Allocate the transaction price to the separate performance obligations in the contract.
5. Recognize revenue when (or as) the company satisfies a performance obligation.

While the five-step model is consistent with the original exposure draft, numerous changes are reflected in the 2011 proposal based on extensive public feedback. Comments are due by March 13, 2012.

► BDO COMMENT:

Refer to our [Revenue Flash Report](#) for a discussion of the 2011 exposure draft, which includes an appendix summarizing how it compares with the 2010 version.

In addition, BDO will be hosting a one hour webcast for clients and contacts summarizing the revised revenue proposal on January 18, 2012. Details and registration instructions are available [here](#).

Leases

While not as far along as revenue, the Boards have made significant progress on the leasing project. During the first part of 2011, the Boards focused on lessee accounting. Most importantly, the Boards affirmed the basic "right-of-use" model that requires leases to be presented on the balance sheet, eliminating operating-lease treatment. In addition, many decisions were reached that will simplify the original proposal and make it more practical to implement. For instance, the Boards decided that contingent rents in the original estimate of the right to use asset and lease payment liability should be included using a best estimate approach, rather than the more sophisticated (and complex) probability-weighted approach.

In the latter part of 2011, the Boards have spent significant time deliberating lessor accounting. They have focused on a "receivable and residual" approach that would cause lessors to recognize profit on Day 1, rather than periodically over the life of the lease. In broad terms, it more closely resembles the "derecognition" model than the "performance obligation" model in the original exposure draft. Specifically, under the receivable and residual approach:

- Lessors would derecognize the underlying asset, recognize a receivable for the right to receive lease payments and a residual asset for the asset that will be returned to the lessor at the end of the lease term.
- The receivable would be measured at the present value of the lease payments, while the residual asset would equal i) the present value of the estimated residual asset at the end of the term plus ii) deferred profit, which is the difference between the gross residual asset and the carrying amount of the underlying asset.
- Day 1 profit would equal the sum of the lease payment receivable and the residual asset, less the underlying asset that was derecognized.
- Subsequently, the lease receivable would be accreted using the effective interest method, while the residual asset would be accreted to its estimated value at the end of the lease term. Profit would not be recognized until the underlying asset is subsequently sold or re-leased.

However, an important scoping issue still needs to be resolved regarding the interaction of this project with the Investment Property Entity (IPE) exposure draft that we discuss below. The Boards are currently exploring two different patterns for profit recognition over time, rather than on Day 1, for lessors outside of the receivable and residual approach. One approach would record rental income on a straight-line basis, while another approach would record profit as amounts are earned under the contract. Therefore, at the time of this newsletter, there are three different profit recognition models being considered for lessors. As such, the FASB's final definitions of an IPE and investment property will be key considerations for lessors of real estate as both projects move forward.²¹

The Boards have publicly committed to re-exposing an updated draft of leasing standard during the first half of 2012. Project details are available [here](#).

Financial Instruments

Of the "Big 3" projects, accounting for financial instruments has proven to be the most difficult. Consistent with the original exposure draft, the project addresses classification, measurement, impairment and hedge accounting and would result in comprehensive changes to the current accounting for many instruments including investments in debt and equity securities, nonmarketable equity securities, loans, loan

²¹ By definition, an IPE is an entity-based notion, whereas the concept of "investment property" is asset-based.

commitments, debt liabilities and derivatives. The proposal would have the greatest effect on banks and other financial institutions, but all enterprises that engage in financial instrument transactions would be affected.

The Boards have spent considerable effort obtaining additional public feedback after the initial exposure period, much of which has focused on an impairment model for instruments that are not carried at fair value with changes recognized in earnings. While there was a broad consensus that existing US GAAP resulted in impairment losses being recorded "too little, too late," there has been scant agreement on how much sooner losses should be recorded, and in what amount. Just recently, the FASB and IASB reached a tentative agreement on a "three bucket" impairment approach where expected losses would be recorded differently based upon the "bucket" or category in which an instrument is classified. Instruments in Bucket 1 would reflect expected losses for the next 12 months. Buckets 2 and 3 would reflect expected lifetime losses; Bucket 2 would be based on a portfolio of instruments, while Bucket 3 would represent individually evaluated instruments. Moreover, instruments would be moved from one bucket to another based on credit deterioration (or improvement). Additional work is anticipated on the impairment model, and the Boards have publicly committed to at least re-exposing this element of the larger financial instruments project, although no date for re-exposure has been established yet.

Many observers expect the entire project to be re-exposed, similar to revenue and leases. However, the FASB has not progressed significantly on its hedge accounting model, another key element of the project. The FASB's financial instruments project page is available [here](#).

Investment Company Entities

The definition of an "investment company" has varied in practice under US GAAP because the scope of current standards is open to significant judgment. Several years ago, the AICPA issued SOP 07-1²² in response to the existing diversity. However, soon after its issuance, the FASB deferred SOP 07-1 indefinitely to address a number of implementation issues. In October 2011, the FASB issued an exposure draft to establish a consistent definition and resolve the implementation issues. In addition to scope, the amendments would affect the measurement, presentation and disclosure requirements for investment companies. Specifically, they would:

- Amend the investment company definition in Topic 946²³ and provide comprehensive guidance for assessing whether an entity is an investment company.
- Require an investment company to consolidate another investment company or an IPE if it holds a controlling financial interest in the entity in a fund-of-funds structure. The investment company parent would retain the specialized guidance when consolidating another investment company or an IPE.
- Amend the financial statements and financial highlights presentation requirements for situations in which an investment company consolidates a less-than-wholly owned investment company or a less-than-wholly owned IPE.
- Prohibit an investment company that is able to exercise significant influence over another investment company or an IPE from accounting for its interest using the equity method of accounting. Rather, those investments would be measured at fair value.
- Require additional disclosures including changes in a company's status as an investment company, whether the investment company has provided support to any of its investees, and any significant restrictions on an investee's ability to transfer funds to the investment company.

The proposed scope of investment company accounting would be narrower than in the past, in part because companies capitalized with debt (rather than equity) would be excluded. Comments are due by February 15, 2012.

Investment Property Entities

In a joint project with the IASB,²⁴ the FASB issued this proposed ASU to establish the notion of an IPE in US GAAP. As such, it would provide accounting guidance to determine whether a company meets the criteria to be an IPE, which are similar (but not identical) to the scoping criteria proposed in the investment company project. The proposed amendments would also introduce additional presentation and disclosure requirements for an IPE.

Investment properties acquired by an IPE would initially be measured at the transaction price, including transaction costs, and subsequently measured at fair value with all changes in fair value recognized in net income. Real estate properties other than investment properties would be measured in accordance with other relevant US GAAP. In addition, an IPE would be required to follow applicable guidance in other Topics for assets (and liabilities) other than real estate.

²² Clarification of the Scope of the Audit and Accounting Guide Investment Companies and Accounting by Parent Companies and Equity Method Investors for Investments in Investment Companies

²³ Financial Services – Investment Companies

²⁴ Under IFRS, an option (rather than a requirement) exists to carry investment property at fair value with changes recognized in earnings pursuant to IAS 40, *Investment Property*.

The proposed amendments would also require an IPE to account for a controlling financial interest in another IPE, an investment company entity and certain service-providing entities in accordance with Topic 810. An IPE would measure a controlling financial interest in any other entity at fair value with all changes in fair value recognized in net income. The IPE would retain the specialized guidance when consolidating another IPE or an investment company.

The exposure draft would require an IPE to account for an investment in an operating company that provides services to the IPE in accordance with Topic 323²⁵ if it can exercise significant influence over the operating company. An IPE would measure all other investments that would otherwise qualify for the equity method of accounting at fair value with all changes in fair value recognized in net income, including investments in another IPE or an investment company.

Investments in companies in which the IPE does not have a controlling financial interest or cannot exercise significant influence would be measured in accordance with other relevant US GAAP. For example, an IPE would account for a debt security issued by another IPE in accordance with Topic 320.²⁶

Lastly, if an investment in a company holding real estate does not qualify as an IPE, practitioners would be required to evaluate whether the investment is considered an investment company entity, as defined by the companion exposure draft discussed above. Comments on the IPE proposal are also due by February 15, 2012.

Consolidation: Principal vs. Agent

In 2009, the FASB issued Statement No. 167²⁷ which requires a reporting entity to perform a qualitative evaluation of its power and economics to determine whether it should consolidate a variable interest entity (VIE). This would have led many investment managers and other similar companies to consolidate certain funds that they manage, an outcome to which many constituents objected. At the same time, the IASB was developing a consolidation standard that was expected to yield similar consolidation conclusions as Statement 167 for most VIEs but that yielded different conclusions for investment funds that are VIEs. In light of these two developments, the FASB deferred the effective date of the consolidation requirements in Statement 167 for certain entities, allowing it to work with the IASB to develop converged guidance for evaluating whether a decision maker is using its decision-making authority (power) as a principal or an agent and whether it should consolidate another entity.

The FASB released the principal vs. agent exposure draft in November 2011. It would rescind the indefinite deferral and would require all VIEs to be evaluated for consolidation under the revised guidance. The proposed amendments would also establish a framework for determining whether a decision maker is using its power as a principal or an agent, which affects whether the entity is a VIE and, if so, whether it should be consolidated. In addition, the proposal would resolve an inconsistency in the way that kickout and similar rights would be evaluated for VIEs and all other entities.

Specifically, the evaluation to assess whether a decision maker is using its power as a principal or an agent would focus on:

- the rights held by other parties
- the compensation to which the decision maker is entitled in accordance with its compensation agreement(s), and
- the decision maker's exposure to variability of returns from other interests that it holds in the entity, including through related parties.

In addition, the same provisions would be used to evaluate whether a general partner controls a limited partnership (or similar entity), consistent with the principal versus agent analysis for evaluating VIEs.

The exposure draft would also change the assessment as to whether the participating rights of a noncontrolling shareholder would overcome the presumption of control by the majority shareholder. Instead of a rebuttable presumption, it would focus on whether such rights allow the noncontrolling shareholders to participate in the activities that most significantly impact the investee's economic performance.

Comments on the principal vs. agent proposal are due by February 15, 2012.

Other Current FASB Projects

A complete list of the FASB's technical agenda and the timeline for each project can be accessed on the FASB's [website](#).

²⁵ *Investments – Equity Method and Joint Ventures*

²⁶ *Investments – Debt and Equity Securities*

²⁷ *Amendments to FASB Interpretation No. 46(R)* (subsequently codified by Accounting Standards Update No. 2009-17, *Consolidation [Topic 810]: Improvements to Financial Reporting by Enterprises Involved with Variable Interest Entities*)

Private Company GAAP

A Blue Ribbon Panel charged with making recommendations on the future of standard setting for private companies was launched by the AICPA and the Financial Accounting Foundation (FAF) in 2009 and in January 2011 it issued a report to the FAF Board of Trustees (the oversight body for the FASB). The report calls for fundamental changes to the system of standard setting, including the creation of a new board, to be overseen by the FAF, that would focus on making exceptions and modifications to US GAAP for private companies that better respond to the needs of the private company sector. The report also recommends the creation of a differential framework – a set of decision criteria – to facilitate a standard setter's ability to make appropriate, justifiable exceptions and modifications.

After studying the Blue Ribbon Panel's report, the FAF issued its [Plan to Establish the Private Company Standards Improvement Council](#). The plan calls for the establishment of a new council with the authority to identify, propose and vote on specific improvements to US accounting standards for private companies. Changes would be subject to ratification by the FASB. The provision to require FASB ratification has been a point of contention, as the AICPA and the Blue Ribbon Panel have advocated for a body independent of the FASB, but still subject to FAF oversight.

► BDO COMMENT:

We believe the FAF's proposal reflects a reasoned and practical path forward in light of the significant concerns expressed by some constituents about the FASB's engagement with private company stakeholders. As such, we support establishing a new Council that is subject to FASB oversight. However, we believe the FAF's plan can be improved, and have provided our recommendations in a comment letter to the FAF, which can be accessed [here](#).

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► EFFECTIVE DATES OF U.S. ACCOUNTING PRONOUNCEMENTS

This appendix was prepared with a calendar year-end company in mind. Therefore standards issued in 2010 have been included since many companies applied them for the first time in 2011, e.g., the first interim or annual period beginning on or after December 15, 2010. Standards that do not require adoption before 2012 are highlighted in gray.

PRONOUNCEMENT	EFFECTIVE DATE
ASC 210, Balance Sheet	
ASU 2011-11, <i>Disclosures about Offsetting Assets and Liabilities</i>	An entity is required to apply the amendments for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by those amendments retrospectively for all comparative periods presented.
ASC 220, Comprehensive Income	
ASU 2011-12, <i>Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income in Accounting Standards Update No. 2011-5</i>	For public entities, effective for interim and annual periods beginning after 12/15/2011. For nonpublic entities, effective for fiscal years ending after 12/15/2012, and interim and annual periods thereafter. Retrospective adoption is required. The amendments in ASU 2011-12 are effective simultaneous with ASU 2011-5.
ASU 2011-5, <i>Presentation of Comprehensive Income</i>	For public entities, effective for interim and annual periods beginning after 12/15/2011. For nonpublic entities, effective for fiscal years ending after 12/15/2012, and interim and annual periods thereafter. Retrospective adoption is required. Early adoption is permitted, because compliance with the amendments is already permitted. The amendments do not require any transition disclosures.
ASU 2011-2, <i>A Creditor's Determination of Whether a Restructuring Is a Troubled Debt Restructuring</i>	Effective for public entities for the first interim or annual period beginning on or after 6/15/2011, and should be applied retrospectively to modifications occurring on or after the beginning of the annual period of adoption. Effective for nonpublic entities for annual periods ending on or after 12/15/2012, including interim periods within those annual periods. Early adoption is permitted for public and nonpublic entities, with certain stipulations for nonpublic entities.
ASU 2011-1, <i>Deferral of the Effective Date of Disclosures about Troubled Debt Restructurings in Update No. 2010-20</i>	ASU 2011-01 temporarily delayed the effective date of ASU 2010-20 for public companies, while the Board completed its deliberations on what constitutes a TDR for a creditor. See ASU 2011-02 for current effective date requirements.
ASU 2010-20, <i>Disclosures about the Credit Quality of Financing Receivables and the Allowance for Credit Losses</i>	For public entities, disclosures at period end are effective for interim and annual reporting periods ending on or after 12/15/10. Disclosures about activity that occurs during a reporting period are effective for interim and annual reporting periods beginning on or after 12/15/10. For nonpublic entities, the disclosures required by ASU 2010-20 are effective for annual reporting periods ending on or after 12/15/2011.
ASC 350, Intangibles – Goodwill and Other	
ASU 2011-8, <i>Intangibles – Goodwill and Other (Topic 350): Testing Goodwill for Impairment</i>	Effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date before September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued or, for nonpublic entities, have not yet been made available for issuance.
ASU 2010-28, <i>When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts</i>	Effective for public entities for fiscal years, and interim periods within those years, beginning after 12/15/2010. Early adoption is not permitted. Effective for nonpublic entities for fiscal years, and interim periods within those years, beginning after 12/15/2011. Nonpublic entities may elect early adoption using the same effective date as public entities.

► **EFFECTIVE DATES OF U.S. ACCOUNTING PRONOUNCEMENTS** *(continued)*

PRONOUNCEMENT	EFFECTIVE DATE
ASC 360, Property, Plant, and Equipment	
ASU 2011-10 , <i>Derecognition of in Substance Real Estate – a Scope Clarification (a consensus of the FASB Emerging Issues Task Force)</i>	<p>The amendments in this Update should be applied on a prospective basis to deconsolidation events occurring after the effective date. Prior periods should not be adjusted even if the reporting entity has continuing involvement with previously derecognized in substance real estate entities.</p> <p>For public entities, the amendments in this Update are effective for fiscal years, and interim periods within those years, beginning on or after June 15, 2012. For nonpublic entities, the amendments are effective for fiscal years ending after December 15, 2013, and interim and annual periods thereafter. Early adoption is permitted.</p>
ASC 605-25, Revenue Recognition, Multiple-Element Arrangements	
ASU 2010-17 , <i>Milestone Method of Revenue Recognition</i>	<p>Effective prospectively for milestones achieved in fiscal years, and interim periods within those years, beginning on or after 6/15/2010. Early adoption is permitted. If a vendor elects early adoption and the period of adoption is not the beginning of the entity's fiscal year, the entity should apply the amendments retrospectively from the beginning of the year of adoption.</p> <p>Additionally, a vendor electing early adoption should disclose certain information specified in the ASU for all previously reported interim periods in the fiscal year of adoption.</p> <p>A vendor may elect, but is not required, to adopt the amendments in the ASU retrospectively for all prior periods.</p>
ASU 2009-13 , <i>Multiple-Deliverable Revenue Arrangements</i>	Effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after 6/15/2010. Early application is permitted.
ASC 715, Compensation	
ASU 2011-9 , <i>Compensation – Retirement Benefits – Multiemployer Plans (Subtopic 715-80): Disclosures about an Employer's Participation in a Multiemployer Plan</i>	For public entities, effective for annual periods for fiscal years ending after December 15, 2011, with early adoption permitted. For nonpublic entities, effective for annual periods for fiscal years ending after December 15, 2012, with early adoption permitted. The amendments should be applied retrospectively for all prior periods presented.
ASC 718, Stock Compensation	
ASU 2010-13 , <i>Effect of Denominating the Exercise Price of a Share-Based Payment Award in the Currency of the Market in Which the Underlying Equity Security Trades</i>	Effective for fiscal years, and interim periods within those fiscal years, beginning on or after 12/15/2010. The amendments should be applied by recording a cumulative-effect adjustment to the opening balance of retained earnings for all awards outstanding as of the beginning of the annual period in which the Update is adopted. Early application is permitted.
ASC 720, Other Expenses	
ASU 2011-6 , <i>Fees Paid to the Federal Government by Health Insurers (a consensus of the FASB Emerging Issues Task Force)</i>	Effective for calendar years beginning after December 31, 2013, when the fee initially becomes effective.
ASU 2010-27 , <i>Fees Paid to the Federal Government by Pharmaceutical Manufacturers</i>	Effective for calendar years beginning after 12/31/2010, when the fee initially becomes effective.
ASC 740, Income Taxes	
ASU 2010-12 , <i>Accounting for Certain Tax Effects of the 2010 Health Care Reform Acts</i>	Effective immediately upon issuance on 4/14/2010.
ASC 805, Business Combinations	
ASU 2010-29 , <i>Disclosure of Supplementary Pro Forma Information for Business Combinations</i>	Effective for public entities prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after 12/15/2010. Early application is permitted.

▶ **EFFECTIVE DATES OF U.S. ACCOUNTING PRONOUNCEMENTS** *(continued)*

PRONOUNCEMENT	EFFECTIVE DATE
ASC 815, Derivatives and Hedging	
ASU 2010-11, <i>Scope Exception Related to Embedded Credit Derivatives</i>	Effective for interim periods beginning after 6/15/2010. Early application permitted for the first interim period after 3/5/2010.
ASC 820, Fair Value Measurements and Disclosures	
ASU 2011-4, <i>Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs</i>	The amendments in this Update are to be applied prospectively. For public entities, the amendments are effective during interim and annual periods beginning after 12/15/2011; early application is not permitted. For nonpublic entities, the amendments are effective for annual periods beginning after 12/15/2011. Nonpublic entities may apply the amendments in this Update early, but no earlier than for interim periods beginning after 12/15/2011.
ASU 2010-6, <i>Improving Disclosures about Fair Value Measurements</i>	Effective for interim and annual periods beginning after 12/15/2009; except for the requirement to separately disclose amounts in the Level 3 rollforward on a gross basis, which is effective for interim and annual periods beginning after 12/15/2010. Early application is permitted.
ASC 860, Transfers and Servicing	
ASU 2011-3, <i>Reconsideration of Effective Control for Repurchase Agreements</i>	Effective for all entities, both public and nonpublic, for the first interim or annual period beginning on or after 12/15/2011. The guidance should be applied prospectively to transactions or modifications of existing transactions that occur on or after the effective date. Early adoption is not permitted.
ASC 924-605, Casinos-Revenue Recognition	
ASU 2010-16, <i>Accruals for Casino Jackpot Liabilities</i>	Effective for fiscal years, and interim periods within those fiscal years, beginning on or after 12/15/2010. The amendments should be applied prospectively with a cumulative-effect adjustment reflected in retained earnings. Early application is permitted. If an entity elects early adoption and the period of adoption is not the beginning of the entity's fiscal year, the entity should apply the amendments retrospectively from the beginning of the year of adoption.
ASC 932, Extractive Activities – Oil and Gas	
ASU 2010-14, <i>Accounting for Extractive Activities – Oil & Gas</i>	Effective upon issuance on 4/20/2010.
ASC 944, Financial Services – Insurance	
ASU 2010-26, <i>Accounting for Costs Associated with Acquiring or Renewing Insurance Contracts</i>	Effective for fiscal years, and interim periods within those fiscal years, beginning after 12/15/2011 through prospective adoption. Retrospective application for all periods presented is permitted. Early adoption is permitted, but only at the beginning of an entity's annual reporting period.
ASU 2010-15, <i>How Investments Held through Separate Accounts Affect an Insurer's Consolidation Analysis of Those Investments</i>	Effective for fiscal years, and interim periods within those fiscal years, beginning after 12/15/2010. The amendments should be applied retrospectively to all prior periods upon the date of adoption. Early application is permitted.
ASC 954, Health Care Entities	
ASU 2011-7, <i>Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities (a consensus of the FASB Emerging Issues Task Force)</i>	Effective for public entities for fiscal years beginning after December 15, 2011, and interim periods within those fiscal years. For nonpublic entities, the Issue will be effective for fiscal years ending after December 15, 2012, and interim and annual periods thereafter. Early adoption is permitted. Entities must apply the presentation requirements retrospectively; however, the qualitative and quantitative disclosures are only required to be provided prospectively.
ASU 2010-24, <i>Presentation of Insurance Claims and Related Insurance Recoveries</i>	Effective for fiscal years, and interim periods within those years, beginning after 12/15/2010. A cumulative-effect adjustment should be recognized in opening retained earnings in the period of adoption if a difference exists between any liabilities and insurance receivables recorded as a result of applying the amendments. Early adoption and retrospective application are permitted.

► EFFECTIVE DATES OF U.S. ACCOUNTING PRONOUNCEMENTS *(continued)*

PRONOUNCEMENT	EFFECTIVE DATE
ASU 2010-23 , <i>Measuring Charity Care for Disclosure</i>	Effective for fiscal years beginning after 12/15/2010. The amendments should be applied retrospectively to all prior periods presented. Early application is permitted.
ASC 985-605 , <i>Software, Revenue Recognition</i>	
ASU 2009-14 , <i>Certain Revenue Arrangements That Include Software Elements</i>	Effective prospectively for revenue arrangements entered into or materially modified in fiscal years beginning on or after 6/15/2010. Early application is permitted.