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IASB and FASB: Looking Back and
Looking Forward

By Michele B. Amato, CPA

The effort to converge with International Financial Reporting Standards ("IFRS"), while taking longer than expected, has caused the Financial Accounting Standards Board ("FASB") to release new pronouncements and begin new projects. We expect new guidance on financial instruments and leasing, although finalization of such projects may be months away and a decision on convergence has not yet been made.

The FASB and the International Accounting Standards Board ("IASB") still need to reach agreement on some significant projects, such as revenue recognition and fair value, before convergence can be accomplished. While their revenue recognition project is not expected to significantly impact reporting entities in the US, the FASB's proposal on leases and their joint project on fair value of financial instruments have caused numerous discussions among accountants.

Leases

The FASB and the IASB first issued their joint exposure draft on leases on August 17, 2010, and a final standard was expected in 2011. (For detailed discussions on the proposed lease accounting changes, please see *SEC Impact's* December 2010 and January 2011 issues.) While the proposed changes to the definition of a lease could cause arrangements that are considered leases under current accounting to no longer be considered leases under the proposed accounting, the proposed accounting for lease terms and lease payments is generally consistent with current accounting. Several topics arose at December's AICPA National Conference on Current SEC and PCAOB Developments that require further deliberation include the income statement recognition pattern for lessees and the definition of investment property that a lessor uses to determine whether its leases of investment properties are outside

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the scope of the proposed receivable and residual lessor approach.

Following the Conference, the IASB and the FASB discussed non-cancellable leases at their joint board meeting. The Boards discussed the accounting treatment for leases that (1) are cancellable by both the lessee and lessor with minimal termination payments or (2) include renewal options that must be agreed to by both the lessee and the lessor. The Boards tentatively decided that the lease proposals should be applied only to periods for which enforceable rights and obligations arise. Therefore, such cancellable leases would meet the definition of short-term leases if the initial non-cancellable period, together with any notice period, is less than one year. In reaching that decision, the Boards also tentatively decided not to change their previous decisions on the definitions of short-term leases and lease term.

Fair Value

In May 2010, the FASB issued a comprehensive Exposure Draft ("ED") on financial instruments which would require most financial instruments to be measured at fair value. Keep in mind that decisions in an Exposure Draft may be (and often are) changed in redeliberations based on information provided to the Board in comment letters, at public roundtable discussions, and through other communication channels. Through such redeliberations, the FASB tentatively decided that more financial instruments would be measured at amortized cost than under the ED. Trade receivables and loans held for investment would be accounted for at amortized cost. For a debt instrument to qualify for amortized cost, it must have the following characteristics: (1) the debt instrument must not be a derivative instrument; (2) it cannot contractually be prepaid or otherwise settled in such a way that the investor would not recover substantially all of its initial investment, other than through its own choice; and (3) there is an amount transferred to the issuer at inception that will be returned to the investor at maturity or other settlement, which is the principal amount of the contract adjusted by any discount or premium at acquisition. Debt securities classified as held-to-maturity today and most available-for-sale debt securities would be reported at fair value, with unrealized gains and losses passing through other comprehensive income. All trading portfolios, loans held for sale and equity instruments (except equity method investments) would qualify for fair value accounting, with the changes in fair value affecting net income.

Financial instruments would also be classified and measured based on their characteristics and the entity's business strategy. Assets are to be grouped on the basis of "shared risk characteristics."

The FASB and the IASB have different approaches. More financial assets would likely meet amortized cost criteria under IFRS. Fewer financial assets may be measured at fair value through other comprehensive income under IFRS. IFRS would not permit bifurcation and separate accounting for hybrid financial assets, whereas the FASB requires it.

Joint deliberations on impairment began in late 2010 and are ongoing. The Boards are currently developing a "three-bucket approach" to impairment that would reflect the general pattern of deterioration in the credit quality of financial assets. Bucket 1 would

include assets not affected by observable events that provide direct evidence of a probable future default. Bucket 2 would include assets affected by the occurrence of events that indicate a direct relationship to possible future defaults; however, the specific assets in danger of default have not yet been identified. Bucket 3 would include assets for which information is available that specifically identifies that credit losses are expected to occur, or have occurred, on individual assets.

We encourage the FASB and the IASB to make their proposals less complex than current accounting.

If you have any questions about the content of this article, please contact Friedman LLP Partner Michele Amato at [\(212\) 842-7017](tel:2128427017) or mamato@friedmanllp.com, or contact your engagement partner.

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