

## In this issue:

Highlights of the 2011 AICPA National Conference on Current SEC and PCAOB Developments

New offsetting disclosure requirements issued

The “three-bucket” impairment model

IFRS resources

IFRS contacts

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# IFRS Insights

## Achieving a global standard



### Highlights of the 2011 AICPA National Conference on Current SEC and PCAOB Developments

The AICPA National Conference on Current SEC and PCAOB Developments (the Conference) was held December 5–7, 2011, in Washington, DC. Although the conference provided valuable input on a number of important topics, the method or timing of incorporating International Financial Reporting Standards (IFRS) into the United States financial reporting system was not definitively clarified.

#### The SEC makes progress in evaluating IFRS

Securities and Exchange Commission (SEC) Chief Accountant James Kroeker noted<sup>1</sup> that the SEC has not yet made a final determination related to the incorporation of IFRS in the United States. However, Mr. Kroeker did point out that the SEC staff has completed the majority of its field work and is working toward finalizing a comprehensive report on its work plan. Mr. Kroeker said that he remains positive about the prospect of IFRS incorporation, but wants to ensure that a strong and lasting framework is established. He also indicated that the feedback received on the [SEC's May 2011 staff paper](#)<sup>2</sup> on convergence approaches is encouraging and that the framework for incorporating IFRS should:

- Provide clear U.S. authority over standards applicable in the U.S. capital markets
- Facilitate a strong U.S. voice in establishing global accounting standards
- Be responsive to economic and other impacts of change

#### The boards' views of the path toward IFRS in the U.S.

U.S. Financial Accounting Standards Board (FASB) Chairman Leslie Seidman and International Accounting Standards Board (IASB) Chairman Hans Hoogervorst expressed support for the approach described in the SEC's May 2011 staff paper. Ms. Seidman described<sup>3</sup> a “modified incorporation” approach that the FASB's parent organization, the Financial Accounting Foundation (FAF), had proposed to the SEC.

Under the approach proposed by the FAF, the FASB and IASB (the boards) would complete their priority convergence projects and the IASB would subsequently issue new accounting standards. The FASB would later incorporate the standards into U.S. Generally Accepted Accounting Principles (U.S. GAAP). In addition, the FASB would retain the ability to set U.S. standards if there are significant topics that are not on the IASB's active agenda.

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<sup>1</sup> Transcript of James Kroeker's remarks

<sup>2</sup> Read Deloitte's [Heads Up: SEC Staff Paper Explores Method of Incorporating IFRS into the U.S. Reporting System](#) for additional information about the staff paper

<sup>3</sup> Transcript of Leslie Seidman's remarks

Regarding the approach proposed by the FAF, Mr. Hoogervorst stated<sup>4</sup> that there should be a clear timeline for the completion of the initial endorsement process and that there should be a very high threshold for non-endorsement. Further, he expressed his view that deviations from standards issued by the IASB should be “extremely rare.”

Mr. Hoogervorst also suggested that before making a final decision about the incorporation of IFRS, the SEC should seriously consider giving a limited number of U.S. companies the option to early adopt IFRS for their consolidated financial reporting in SEC filings. He argued that this would be a good test of whether IFRS would work in the U.S. financial system and would signal the U.S. commitment to adopt IFRS. However, Mr. Kroeker and Ms. Seidman questioned the notion of permitting the optional use of IFRS domestically. Ms. Seidman noted that rule makers and financial statement users have cited investors’ concerns that allowing such an option would result in a lack of comparability in financial reporting.

#### **Convergence state of affairs**

Throughout the conference, senior representatives from the SEC, FASB, and IASB gave updates on numerous standard-setting projects for converging and jointly improving accounting standards, including those on financial instruments, revenue, and leasing. They all stressed the importance of high-quality financial reporting standards. Mr. Kroeker recognized the progress the FASB and IASB have made in converging international accounting standards and noted that although many of the projects have taken longer than originally expected, largely because of ongoing deliberations, he believed that “success should be, and ultimately will be, measured by the quality of the resulting output.” Mr. Kroeker admitted that at this time, many of the projects are still months or more away from finalization; however, he believes that the additional time is warranted.

#### **What’s next?**

The SEC is expected to announce their decision on incorporation of IFRS in the U.S. in the first half of 2012.

Please read Deloitte’s [Heads Up: Highlights of the 2011 AICPA National Conference on Current SEC and PCAOB Developments](#) for additional information about the event.

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## **New offsetting disclosure requirements issued**

The U.S. Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) wrapped up 2011 with a culmination of their efforts on the joint offsetting project. The progress made resulted in the issuance of the Accounting Standards Update 2011-11, *Disclosures About Offsetting Assets and Liabilities* (ASU 2011-11) and amendments to IFRS 7, *Financial Instruments: Disclosures*, both related to the offsetting of financial assets and financial liabilities and issued by the FASB and IASB, respectively. The IASB also published amendments to IAS 32 *Financial Instruments: Presentation* to clarify certain aspects of their offsetting rules.

Although the related guidance is now more comparable between the two sets of standards, since the FASB and IASB (the boards) could not agree on a single, converged offsetting presentation model, they ultimately voted to retain their existing offsetting models. Nonetheless, given constituents’ desire for convergence and improved comparability (and a general agreement that both gross and net information was useful for investors and other financial statement users), the boards found some common ground in developing these new, expanded disclosure requirements.

The amendments are effective for annual periods beginning on or after January 1, 2014, and are required to be applied retrospectively. The new disclosures are designed to make financial statements that are prepared under U.S. Generally Accepted Accounting Principles (U.S. GAAP) more comparable to those prepared under International Financial Reporting Standards (IFRS).

Generally, it is more difficult to qualify for offsetting under IFRS than U.S. GAAP because under U.S. GAAP certain derivative and repurchase agreement arrangements are granted exceptions from the general offsetting model. As a result, entities with significant financial instrument and derivative portfolios that report under IFRS typically present positions on their balance sheets that are significantly larger than those of entities with similarly sized portfolios whose financial statements are prepared in accordance with U.S. GAAP. To better facilitate comparison between financial statements prepared under U.S. GAAP and IFRS, the new disclosures will give financial statement users information about both gross and net exposures.

<sup>4</sup> Transcript of Hans Hoogervorst’s remarks

Under U.S. GAAP, offsetting qualifying financial instruments on the balance sheet is elective (as an accounting policy choice). However, an entity that has any financial instruments or derivatives within the scope of ASU 2011-11 must provide the new disclosures, regardless of whether it has elected to offset those instruments on the balance sheet. Therefore, the ASU's new disclosure requirements may have a greater impact on entities that have not previously elected to offset because such entities may not separately track information for instruments with rights of setoff under enforceable master netting arrangements (or similar agreements).

#### Implementation considerations

The revised guidance requires more extensive disclosures under both sets of standards and could raise issues when implementing some of the changes.

- **Operational challenges** — Some entities currently may not closely track information with respect to rights of setoff for financial instruments and derivative instruments executed under master netting arrangements or similar agreements. For example, such entities may (1) not have a significant volume of instruments that qualify for offsetting or (2) hold instruments that may qualify for offsetting but that elect to present those instruments gross in the statement of financial position. When preparing to implement the standard, such entities should consider whether they have appropriate processes and internal controls in place to track, gather, and analyze the information they need to comply with new disclosure requirements.
- **Interaction with other U.S. GAAP standards** — Under current U.S. GAAP, entities are already required to disclose information about certain amounts offset in the statement of financial position as well as information about related collateral (pledged or received) and other information about exposures to credit risk. However, entities should not assume that certain requirements of ASU 2011-11 are already met through disclosures they already provide to meet the guidance in place before the issuance of the ASU 2011-11.

Please read Deloitte's [Heads Up: FASB and IASB Issue New Balance Sheet Offsetting Disclosure Requirements](#) for further details.

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## The “three-bucket” impairment model

During the October 2011 U.S. Financial Accounting Standards Board (FASB) and International Accounting Standards Board (IASB) meetings, the FASB and IASB staff was asked to develop a principle for the measurement attribute of the credit allowance balance of financial assets included in a so-called “Bucket One” and develop a principal and indicators for when it is appropriate to transfer financial assets from “Bucket One” to “Bucket Two.” Subsequently, the FASB and IASB (the Boards) spent time discussing a variety of topics in the continued development of a “three-bucket” impairment model. (See call-out on next page for the definitions of the buckets.)

The Boards reached tentative decisions on several key topics related to the three-bucket approach, including the following:

- **The measurement of the Bucket One allowance** — The Bucket One allowance comprises lifetime expected losses on the portion of financial assets for which a loss event is expected over the next 12 months.
- **The principle of transferring out of Bucket One** — The tentative decision suggests that entities should recognize lifetime losses (i.e., transfer assets out of Bucket One) when there has been a more-than-insignificant deterioration in credit quality since initial recognition and it is at least reasonably possible that the contractual cash flows may not be fully recoverable. The proposed guidance will include examples illustrating that the transfer should occur when the risk of default starts to substantially accelerate. Probability of default should be the primary factor that entities consider in determining when to transfer financial assets between buckets. However, entities should not ignore information indicating the potential for loss (e.g., “loss given default” information). Further, the guidance will include potential indicators of when the credit quality of a financial asset may have deteriorated.
- **The application of the model to debt securities and loans** — To date, the discussions of the three-bucket expected-loss impairment model have focused on loans; however, the impairment model will also apply to debt securities. Under the impairment model, there will be no bright lines for evaluating a debt security for credit deterioration when its fair value is less than its cost basis; rather, it is sufficient for an entity to consider indicators when applying the impairment model to debt securities.

Further, with respect to commercial and consumer loans, the impairment model will not include a bright line indicating that meaningful credit deterioration has occurred on the basis of predetermined factors (e.g., days delinquent, achieving a particular credit risk rating).

#### Other important issues

The impairment model will include guidance on determining the level of aggregation for evaluating credit impairment, particularly in the context of transferring portfolios from Bucket One to Bucket Two. This guidance will emphasize the shared risk characteristics that currently exist in U.S. Generally Accepted Accounting Principles and International Financial Reporting Standards.

#### Defining the “buckets”

**Bucket One** would consist of financial assets where there has been no identified credit deterioration since initial recognition. All financial assets would start in Bucket One at initial recognition regardless of their level of credit quality. Financial assets in **Bucket Two** would be evaluated for credit deterioration at a portfolio level, while financial assets in **Bucket Three** would be evaluated for credit deterioration at the individual instrument level (e.g., portfolios would transfer from Bucket One to Two while individual instruments would transfer from Buckets One or Two to Bucket Three).

#### IFRS resources

If you are looking to learn more about accounting convergence and International Financial Reporting Standards (IFRS), consider attending one of our upcoming classroom training sessions: **IFRS Conference: Practical and Strategic Implications**.

Led by experienced Deloitte IFRS leaders and complemented by industry panelists, this two-day program includes a combination of lectures and real-life case studies for a deeper understanding of the topics. This conference will provide you with an understanding of the IFRS

technical accounting changes, tax considerations, valuation issues, and technology/systems requirements. Additional information — including the agenda and cost — can be found on the registration sites.

- [March 22–23 in Santa Clara, CA \(San Jose area\)](#)
- [June 4–5 in Chantilly, VA \(Washington DC area\)](#)

If you are unable to attend a classroom event, please consider our [IFRS e-learning program](#) which also provides CPE credit.

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