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American Association of Port Authorities Finance Seminar

FASB Update
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Agenda

- Recently Issued Accounting Standards Updates

- Ongoing Standard-Setting Activities

Recently Issued Accounting Standards Updates

Recently Issued Accounting Standards Updates

- **ASU 2010-06**, *Improving Disclosures about Fair Value Measurements*
  - Significant new disclosures of fair-value by class and transfers in and out of Level 1 and Level 2 was effective for interim and annual periods beginning after December 15, 2009
  - Additional disclosures of purchase, sale, issuance and settlement in rollforward activity of Level-3 fair-value measurement effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years
- **ASU 2010-28**, *When to Perform Step 2 of the Goodwill Impairment Test for Reporting Units with Zero or Negative Carrying Amounts* (EITF 10-A)
  - Requires step 2 test if reporting unit has zero or negative carrying amount and qualitative factors exist that indicate it is more likely than not that a goodwill impairment exists
  - Effective for fiscal years beginning after December 15, 2010 for public companies and December 15, 2011 for nonpublic companies

Recently Issued Accounting Standards Updates

- **ASU 2010-29**, *Disclosure of Supplementary Pro Forma Information for Business Combinations* (EITF 10-G)
  - Pro forma information should be prepared assuming acquisition occurred at the beginning of the prior annual reporting period for both the current and prior reporting periods
  - Pro forma disclosures should be accompanied by a narrative description of material, nonrecurring pro forma adjustments
  - Effective for business combinations with acquisition dates on or after the beginning of the first annual reporting period beginning on or after December 15, 2010
- **ASU 2011-03**, *Reconsideration of Effective Control for Repurchase Agreements*
  - Eliminates the requirement within ASC paragraph 860-10-40-24(b) for the transferor in a repo agreement to obtain cash or other collateral that is sufficient to fund substantially all of the cost of purchasing a replacement financial asset during the contract term as one of the conditions necessary to conclude that a transferor has effective control
  - Effective for interim and annual periods beginning on or after December 15, 2011, with early adoption prohibited
  - Prospective application for both transfers and modification

Recently Issued Accounting Standards Updates

- **ASU 2011-04**, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*
  - Ensures that fair value has the same meaning in GAAP and IFRS and improves the comparability of the fair value measurement and disclosure requirements in GAAP and IFRS
  - Applies to all entities that measure assets, liabilities or instruments classified in shareholder's equity at fair value, or provide fair value disclosures for items not recorded at fair value
  - Effective prospectively for public entities in interim and annual periods beginning after December 15, 2011 and for nonpublic entities in annual periods beginning after December 15, 2011
- **ASU 2011-05**, *Presentation of Comprehensive Income*
  - Eliminates the option to report other comprehensive income and its components in the statement of changes in stockholder's equity
  - Component of net income and other comprehensive income cab be presented either in Single Continuous Statement or Two Separate but Consecutive Statements
  - Effective retrospectively for public entities annual periods, and interim periods within those years beginning, after December 15, 2011 and for nonpublic entities in annual periods beginning after December 15, 2012, and interim and annual periods thereafter
  - Certain reclassification adjustments deferred by ASU 2011-12, *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*

Recently Issued Accounting Standards Updates

- **ASU 2011-08**, *Testing Goodwill for Impairment*
  - The option to first assess qualitative factors before applying the two-step impairment test
  - If it is not more likely than not that the fair value of a reporting unit is less than its carrying amount, the two-step impairment test is not necessary
  - Effective for annual and interim goodwill impairment tests performed in fiscal years beginning after December 15, 2011
- **ASU 2011-11**, *Disclosures about Offsetting Assets and Liabilities*
  - Result of a joint project between the FASB and the IASB to address a significant financial statement presentation difference between U.S. GAAP and IFRS
    - Boards could not agree on a converged offsetting model and decided to retain their existing offsetting models
    - Instead, Boards developed converged disclosure requirements
  - Improves current disclosure requirements and allows comparability of balance sheets prepared under U.S GAAP (where more netting is permitted) versus IFRS
  - Scope limited to recognized financial instruments (and derivatives) subject to master netting arrangements or similar agreements
  - Disclosures are applicable for annual periods beginning on or after January 1, 2013 (and interim periods within those annual periods) with retrospective application required

Recently Issued Accounting Standards Updates

- **ASU 2011-12**, *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*
  - Defers the effective date of the requirement to present separate line items on the income statement for reclassification adjustments of items out of accumulated other comprehensive income into net income
  - Effective retrospectively for public entities annual periods, and interim periods within those years beginning, after December 15, 2011 and for nonpublic entities in annual periods beginning after December 15, 2012, and interim and annual periods thereafter
  - Does not defer requirement to present comprehensive income in a single statement or two consecutive statements as of the effective date above

Ongoing Standard-Setting Activities

FASB/IASB Joint Projects – Scheduled Publication Dates

Joint Projects	Due Process Document and Targeted Timing
Revenue Recognition	ED published, comment period ends March 2012
Leases	Revised ED 1H 2012
Consolidations – Policy and Procedures	ED published, comment periods ends February 2012
Consolidations – Investment Companies	ED published, comment period ended January 5, 2012 **
Insurance Contracts	Review Draft or Revised ED 1H 2012
Emissions Trading Schemes	Not Determined
Reporting Discontinued Operations	DELAYED
Financial Statement Presentation	DELAYED
Financial Instruments with Characteristics of Equity	DELAYED

** IASB issued exposure draft August 2011. FASB issued proposed ASU October 2011.

FASB Projects – Scheduled Publication Dates (continued)

FASB Only Projects	Due Process Document and Targeted Timing
Investment Property Entities	ED published, comment period ends February 2012
Disclosure of Certain Loss Contingencies	Not Determined
Disclosures about Risk and Uncertainties and the Liquidation Basis of Accounting (Formerly Going Concern)	ED 1H 2012
Disclosure Framework	Discussion Paper 1H 2012
Nonpublic Entity Fair Value Measurement Disclosures	ED 1H 2012

FASB/IASB Financial Instruments Project Timeline

- FASB issued one comprehensive ASU that addresses each phase in 2010. It is expected that final standards on classification and measurement and impairment will be issued in 2012.

IASB Project Phase	Exposure Draft	Finalization
Classification and measurement (Phase 1)	July 2009	IFRS 9 issued November 2009. Addressed financial assets only** Financial Liabilities added to IFRS 9 – Oct 2010
Amortized Cost and Impairment of Financial Assets (Phase 2)	Nov 2009 (original) Jan 2011 (supplement) Re-exposure Q2 2012	TBD
Hedge accounting (Phase 3)	General hedge accounting: Review Draft Q1 2012 Macro hedge accounting: Q3 2012	General hedge accounting: Q2 2012 Macro hedge accounting: TBD

** Potential amendments to financial asset classification and measurement

Financial Instruments Joint Project

Objective

- Significantly improve decision usefulness of financial instrument reporting for users of financial statements

Goals

- Develop a comprehensive model for accounting for financial instruments that addresses:
  - Classification and measurement
  - Impairment
  - Hedge accounting

FASB Exposure Draft

- Issued May 26, 2010; more than 2,800 comment letters received
- Redeliberations on technical decisions reached are ongoing

Joint project of the FASB and IASB

- Timing of deliberations and issuance of Exposure Drafts not synchronized
- Different approaches to Exposure Drafts (individual vs. all project components)

Financial Instruments Project Update

Classification and Measurement

- Measurement categories: amortized cost, FV-OCI, FV-NI
  - More financial assets and liabilities would be measured at amortized cost than under the ED
  - Financial instruments would be classified based on their characteristics and the business activity the entity uses to manage those financial instruments, rather than the entity's intent for an individual financial instrument
- Expect re-exposure and final ASU in 2012

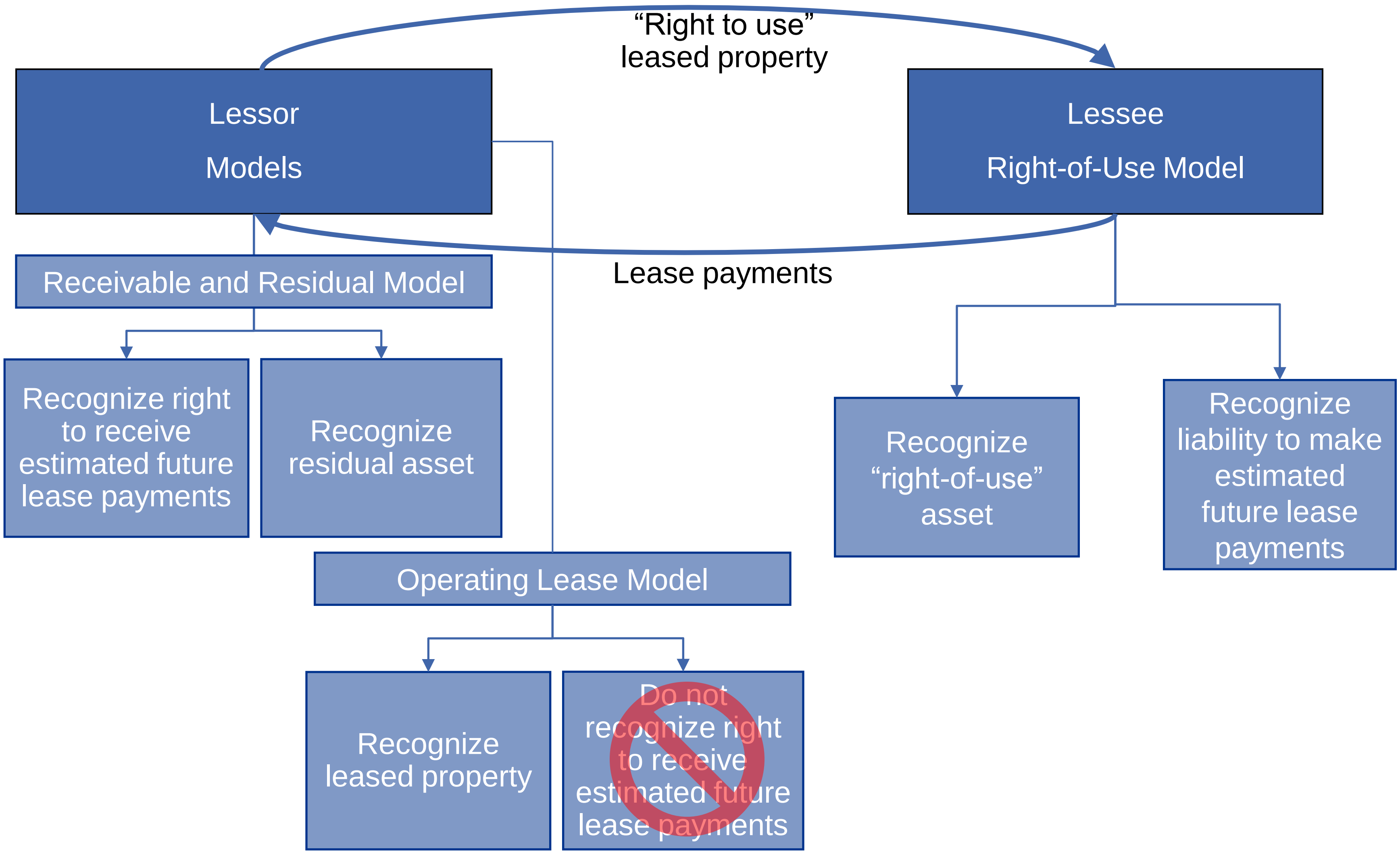
Impairment

- Boards developing a "three-bucket" approach to impairment which would reflect the general pattern of deterioration of credit quality of financial assets
- Expect re-exposure in the first half of 2012

Hedging Activities

- IASB proposed model would allow for much broader use of hedge accounting
- FASB received feedback on IASB hedge accounting model for its consideration
- Redeliberations have not yet begun and timing of a final standard on hedge accounting is unclear

Overview of Proposed Accounting Models – Lessor and Lessee



Proposals' Key Impacts

Lessees

Leases "on balance sheet"

- All leases other than some short-term leases
- Increases in assets and liabilities
- Impact on key ratios and covenants

Impact on net income

- All leases other than some short-term leases have financing impact
- Front-loading of expenses vs. increase in EBITDA for most leases

New liability measurement basis

- E.g., residual value guarantees
- Reassessment → volatility

Lessors

Balance sheet impact

- Lease receivables and residual assets recognized, underlying asset derecognized, for all leases except leases of investment property and some short-term leases
- Residual asset measured on allocated cost basis

Impact on net income

- Leases other than leases of investment property and some short-term leases have financing impact
- Up-front profit recognition on lease receivable
- Deferred profit on residual asset
- Residual asset accretion

New asset measurement basis

- Reassessment → volatility

Lease Definition

Definition of a lease similar to existing GAAP (FASB ASC 840 (FAS 13/EITF 01-8) and IAS 17/IFRIC 4)

- A contract that conveys the right to control the use of a specified asset or assets for a period of time in exchange for consideration
  - Fulfillment of the contract depends on the use of a specified asset or assets, and
  - Customer controls the use of the specified asset(s) throughout the term of the arrangement
    - Ability to direct the use of the specified asset(s), <u>and</u>
    - Receive substantially all of the potential economic benefits from use, of the specified asset(s) throughout the term of the arrangement

Assets inseparable from a service

- Assess whether the supplier directs the use of the asset and the asset is an inseparable part of a service
- Customer does not control the use of the asset if it is inseparable from the service (e.g., cable TV boxes)
  - The customer cannot use the asset on its own or together with other readily available resources,
  - The asset is not sold or leased separately by the supplier, and
  - The right to use the asset and the services were not negotiated separately

Portion of a larger asset

- Non distinct portion would generally not be a lease (e.g., specified percentage of the capacity of a pipeline)
- Physically distinct portions may be specified assets and subject to lease accounting (e.g., specifically identified strands within a fiber optic cable, floors of an office building, airport terminals, etc.)

Agreements with Lease and Non-Lease Components

	Lessee	Lessor
When the purchase price (PP) or selling price (SP) of each component is observable	Separate the lease and non-lease components Allocate the payments based on a *relative purchase price basis*	Always separate the lease and non-lease components Allocate payments using the revenue recognition standard's guidance (i.e., on a *relative selling price basis*).
When the PP/SP of one or more, but not all, components is observable	Separate the lease and non-lease components Allocate the payments using the *residual method*	
When no observable PP/SP for any of the components in the arrangement is available	Account for the entire arrangement as a lease	

Future considerations

FASB to consider providing private company lessees an option not to separate lease and non-lease components.

Lessee Accounting Model

Right-of-Use Model

- Lessee recognizes right-of-use asset and liability to make future lease payments at lease commencement
- Lease liability initially measured at the present value of estimated future lease payments and subsequently amortized on the effective interest method
  - Reassess lease liability only if facts and circumstances indicate there is a significant change, for example, changes in:
    - Expectations about the exercise of purchase and lease term options, and
    - Estimated payments under residual value guarantees
  - Re-measure lease liability each reporting period to reflect changes in estimated lease payments based on an index or rate
- Right-of-use asset initially measure at an amount equal to the lease liability plus any initial direct costs and prepaid rent, less any lease incentives and subsequently amortized generally on a straight-line basis
  - Re-measure the right-of-use asset when there are changes to lease liability due to reassessment that relate to future periods

Lessor Accounting Models

Receivable and Residual (R&R) Model

- Lessor derecognizes the underlying asset and recognizes a lease receivable and residual asset at lease commencement
- Lease receivable initially measured as the present value of estimated lease payments discounted using the rate the lessor charges the lessee plus initial direct costs
- Residual asset initially measured as an allocation of the carrying amount of the underlying asset
- Profit recognition
  - Gain or loss on transfer of right-of-use asset recognized at lease commencement
  - Interest income and profit from the accretion of the residual asset recognized over the lease term
- Would not apply to leases of investment property and some short-term leases

Operating Lease Model

- Would apply to leases of investment property and some short-term leases
  - For investment property not measured at fair value and short-term leases, rental income recognized over the lease term generally on a straight-line basis
  - For investment property measured at fair value by investment property entities and investment companies, rental income recognized when due under the contract

Leveraged leases

- No longer retain specialized accounting

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