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US GAAP Update for Funds

December 2010

Steve Stormonth



Agenda

- **US GAAP codification**
- **Topic 820 – Fair values (previously FAS 157)**
- **Topic 815 – Derivative instruments (previously FAS 161)**
- **Topic 740 – Uncertain tax positions (previously FIN 48)**
- **Topic 855 – Subsequent events (previously FAS 165)**
- **Questions**



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Codification

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What is the codification of GAAP?

- ◆ Creation of a single source for authoritative reference for non governmental U.S. GAAP
- ◆ SEC rules and interpretive releases will continue to add to authoritative GAAP for SEC Registrants
- ◆ Benefit is to eliminate multiple sources of authoritative GAAP and the potential of not citing all relevant guidance when considering a reporting issue.

Effective for Financial Statements issued for interim and annual periods ending after September 15, 2009

How is US GAAP organised post codification?

Brings together in one place all authoritative GAAP previously issued

FASB Statements

FASB Interpretations

EITF Abstracts

FASB Staff Positions

AICPA Statements of Positions

AICPA Audit and Accounting Guides

US GAAP now organized by

Topic

Subtopic

Sections

Paragraph

Subparagraph

General topic structure

Topic 105 – General Principles

Topic 200's – Presentation

Topic 300's – Assets

Topic 400's – Liabilities

Topic 500's – Equity

Topic 605 – Revenue Recognition

Topic 700's – Expenses

Topic 800's – Broad Transactions (e.g. Topic 820 Fair Values, Topic 825 Financial Instruments)

Topic 900's – Industry audit and accounting guides (e.g. Topic 946 Investment Companies)

Structure of a topic – Example from Leases Topic 840

Topic 840

Subtopics

10 - Overall

20 - Operating Leases

30 - Capital Leases

40 - Sale-Leaseback Transactions

958 - Not-for-Profit Entities

974 - Real Estate—Real Estate Investment Trusts

978 - Real Estate—Time-Sharing Activities

980 - Regulated Operations

Subtopic structure

Example Subtopic – 840 -10

00 - Status

05 - Overview and Background

10 - Objectives

15 - Scope and Scope Exceptions

20 - Glossary

25 - Recognition

30 - Initial Measurement

35 - Subsequent Measurement

40 - Derecognition

45 - Other Presentation Matters

50 - Disclosure

55 - Implementation Guidance and Illustrations

60 - Relationships

65 - Transition and Open Effective Date Information

75 - XBRL Elements

How will GAAP be amended and updated

- ◆ **New pronouncements issued by the FASB will be called Accounting Standards Updates and will be added to appropriate topics and subtopics in the Codification**
- ◆ **FASB Statements, Interpretations, Staff Positions, EITFs will no longer be issued in this format**
- ◆ **Example:**
 - Accounting standards update 2009-12 Investment in Certain Entities that calculate NAV per Share (or its equivalent) provides amendments to subtopic 820-10-50-6A Fair Value Measurements and Disclosures - Overall

Disclosure in accounts

Intention of the FASB is to see a common reference structure in accounts, articles and guidance
Structure is suggested as follows:

General format

ASC XXX-YY-ZZ-PP

XXX = Topic

YY = Subtopic

ZZ = Section

PP = Paragraph

Example

ASC 820 (Topic 820, "Fair value measurements and disclosures")

ASC 820-10 (Subtopic 10, "Overall," of Topic 820)

ASC 820-10-50 (Section 50, "Disclosures," of Subtopic 820-10-50)

ASC 820-10-50-2 (Paragraph 50-2 of Section 820-10-50 (fair value hierarchy))

Codification online

The screenshot displays the FASB Accounting Standards Codification website. The browser address bar shows the URL: http://asc.fasb.org/section&trid=2155961%26analyticsAssetName=subtopic_page_subsection%26nav_type=subtopic_page#d3e19186-110258. The page title is "820-10-50 Disclosure". The breadcrumb trail is: Home > Broad Transactions > 820 Fair Value Measurements and Disclosures > 10 Overall > 50 Disclosure. The left sidebar contains a navigation menu with categories like "CODIFICATION" and "OTHER SOURCES". The main content area shows the "820 Fair Value Measurements and Disclosures" section, including a "Table of Contents" and a "General Note". The "General" section is expanded, showing "Recurring Measurements" and "50-1" which details reporting requirements for fair value measurements. A "Pending Content" section is also visible, detailing transition guidance for December 15, 2009.

Reference sources for codification

The following resources are available on the FASB website (<http://asc.fasb.org/>)

Registration is required to use the codification materials (free or subscription based on required functionality).

- Up to date codification incorporating all issued ASU's
- Cross reference tool between pre-codification and codification references
- Join sections tool to create documents containing multiple topics

The codification is also available to order via the website in a four volume book set. This will only remain up to date for a limited time period.



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Topic 820 – Fair Value measurements

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TOPIC 820 (formerly FAS 157) and IAS 39 – a summary

FAS 157 – Fair value measurements – Now incorporated as part of Topic 820-10

- Initially effective for periods commencing after 1 November 2007.
- Primarily this is a disclosure standard but also defined fair value.
- Subsequent improvements increasing the level of disclosures have been made on an annual basis.

IAS 39 – Defines fair value under International financial reporting standards

IFRS 7 - Provides disclosure requirements for Financial instruments

- IFRS 7 was updated in March 2009 (effective for periods commencing on 1 January 2009) to bring disclosures on fair value broadly in line with FAS 157.

Fair value defined – US GAAP versus IFRS

US GAAP

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

IFRS

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Both US GAAP and IFRS use the same fair value hierarchy to disclose the significance of and thereby the reliability of inputs in to the determination of fair value.

- quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
- inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (ie as prices) or indirectly (ie derived from prices) (Level 2); and
- inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The level in the fair value hierarchy within which the fair value measurement is categorised in its entirety shall be determined on the basis of the lowest level input.

Disclosures Topic 820 and IFRS 7 compared

Issue	Topic 820	IFRS 7
Disclosure fair value by level and by category of instrument.	Yes	Yes
Disclose by class of instrument within each category (see example disclosures)	Yes (from ASU 2010-06)	No
Reconciliation of level 3	Yes (from ASU 2010-06 all movements are on a gross basis)	Yes (transfers in and out are on a net basis unless significant)
Discussion of approaches to valuing different categories of instruments	Yes	Yes
Disclosure of details on level 2 and 3 valuation techniques and inputs	Yes	No
Disclose the effect of changing key assumptions to possible alternatives (level 3)	No	Yes
Disclose transfers in and out of all levels	Yes (from ASU 2010-06)	Yes (only significant transfers for level 1 and 2)
Disclose reasons for the transfers	Yes (from ASU 2010-06)	Yes (Level 3 transfers in and out only)

Level 2 and 3 measurements

- Provide description of the valuation technique (or multiple valuation techniques) used such as market approach, income approach or cost approach and the INPUTS used in the determining the fair value of each class of assets and liabilities
- Changes in valuation techniques must be disclosed and the reason for changing the valuation technique must also be disclosed

Example – Disclosure by class of asset and liability

Description	12/31/XX	Fair Value at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable inputs (Level 3)
(\$ in millions)				
Trading securities				
Equity securities—real estate industry	\$ 93	\$ 70	\$ 23	
Equity securities—oil and gas industry	45	45		
Equity securities—other	15	15		
Total trading securities	\$ 153	\$ 130	\$ 23	
Available-for-sale debt securities				
Residential-mortgage-backed securities	\$ 149		\$ 24	\$ 125
Commercial-mortgage-backed securities	50			50
Collateralized debt obligations	35			35
U.S. Treasury securities	85	\$ 85		
Corporate bonds	93	9	84	
Total available-for-sale debt securities	\$ 412	\$ 94	\$ 108	\$ 210
Available-for-sale equity securities				
Financial services industry	\$ 150	\$ 150		
Healthcare industry	110	110		
Other	15	15		
Total available-for-sale equity securities	\$ 275	\$ 275		
Total available-for-sale securities	\$ 687	\$ 369	\$ 108	\$ 210
Hedge fund investments				
Equity long/short	\$ 55	\$ 55		
Global opportunities	35	35		
Distressed debt	90			\$ 90
Total hedge fund investments	\$ 180	\$ 90		\$ 90
Private equity investments ^(a)	\$ 25			\$ 25
Venture capital investments ^(a)	10			10
Derivatives				
Interest rate contracts	57		\$ 57	
Foreign exchange contracts	43		43	
Credit contracts	38			38
Commodity futures contracts	78	\$ 78		
Commodity forward contracts	20		20	
Total derivatives	\$ 236	\$ 78	\$ 120	\$ 38
Total	\$ 1,291	\$ 667	\$ 251	\$ 373

(a) Based on its analysis of the nature and risks of these investments, the reporting entity has determined that presenting them as a single class is appropriate.

(Note: For liabilities, a similar table should be presented.)

Example – Disclosure transfers in and out

Roll forward
(\$ in millions)

	Fair Value Measurements Using Significant Unobservable Inputs (Level 3)							Total
	Available-for-Sale Debt Securities			Other Fund Investments				
	Residential Mortgage-Backed Securities	Commercial Mortgage-Backed Securities	Collateralized Debt Obligations	Hedge Fund Distressed Debt	Private Equity	Venture Capital	Derivatives Credit Contracts	
Beginning balance	\$ 100	\$ 39	\$ 25	\$ 145	\$ 20	\$ 11	\$ 30	\$ 370
Transfers into Level 3	60 ^(a) ^(b)							60
Transfers out of Level 3								
Total gains or losses								
Included in earnings (or changes in net assets)	(8)			7	5	(3)	5	6
Included in other comprehensive income	(15)	(5)	(7)				(5)	(32)
Purchases, issuances, sales, and settlements								
Purchases		16	17			2	18	53
Issuances								
Sales	(12)			(62)				(74)
Settlements							(10)	(10)
Ending balance	\$ 125	\$ 50	\$ 35	\$ 90	\$ 25	\$ 10	\$ 38	\$ 373
The amount of total gains or losses for the period included in earnings (or changes in net assets) attributable to the change in unrealized gains or losses relating to assets still held at the reporting date				\$ (5)	\$ 5	\$ (3)	\$ 2	\$ (1)

(a) Transferred from Level 2 to Level 3 because of lack of observable market data due to decrease in market activity for these securities.

(b) The company's policy is to recognize transfers in and transfers out as of the actual date of the event or change in circumstances that caused the transfer.

(Note: For liabilities, a similar table should be presented.)

FSP 157-4 Guidance for applying FSA 157

FSP 157-4 addressed concerns that FASB Statement No. 157, *Fair Value Measurements*:

Did not provide sufficient guidance on how to measure fair value when markets were no longer active

Placed too much emphasis on the last transaction price or quoted price as the only determinant of fair value, even if the transaction was not orderly

Provides guidance on:

Determining when volume and level of activity has decreased significantly

Identifying circumstances when transaction is not orderly

How significant decrease in volume and trading activity or existence of non-orderly transactions affect fair value measurement

The practical expedient for investments in alternative investments

What is it?

- When FAS 157 (Topic 820) was released it posed questions as to whether NAV per share represented fair value or whether other adjustments were required from NAV to reach a fair value.
- In practice NAV per share continued to be used as fair value.

ASU 2009-12 (effective 15 December 2009) amended topic 820 to clarify that NAV per share (or its equivalent) could be used as fair value in the following situation:

- the investees have the attributes of investment companies and the net asset values, or their equivalents, are calculated consistent with the AICPA Audit and Accounting Guide, *Investment Companies* which generally require investments to be measured at fair value.

When the practical expedient is not appropriate

Adjustments are required to NAV in the following situations:

- If Investee's date is different from investors, use latest NAV reported adjusted for significant market events that have occurred since date investee calculated NAV
- If NAV not prepared in accordance with the Investment Companies Guide, then make adjustments to reported NAV necessary to arrive at adjusted NAV calculated consistent with the Investment Companies Guide.
- all or a portion of the investment will be sold at an amount other than net asset value

Level in the hierarchy

When issued FAS 157 investments in investment funds were as a matter of common practice classified as level 3 .

ASU 2009-12 amended as follows:

- If investment can be redeemed at measurement date at NAV, classify as Level 2
- Investments that cannot be redeemed at NAV classify as Level 3
- Investment not redeemable on measurement date but will be at a future date, the length of time until the investment is redeemable should be considered in determining classification as Level 2 or Level 3

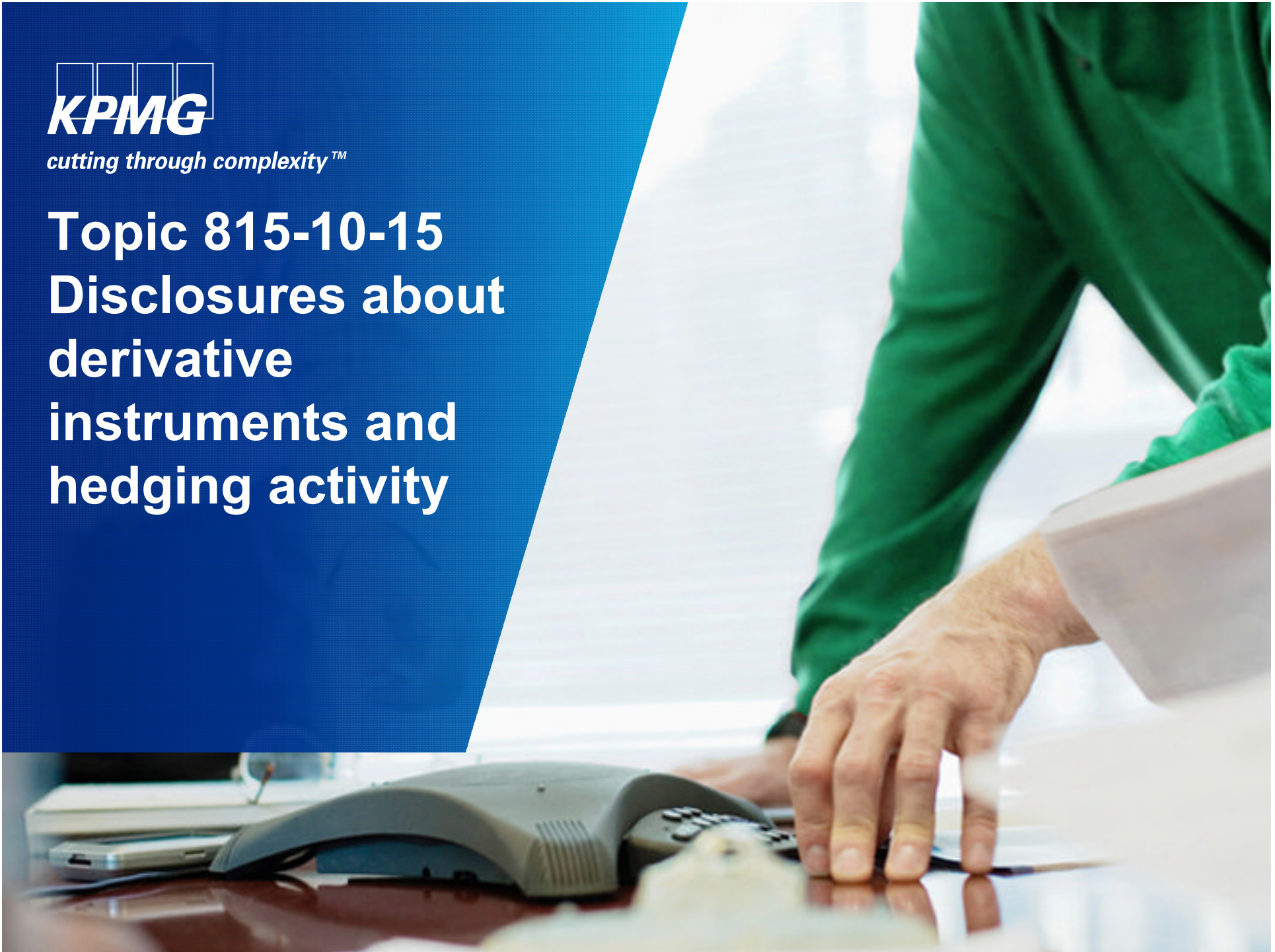
Disclosure requirements for each major category of investment:

- (i) Fair value of the investments and description of the significant investment strategies of the investee funds
- (ii) Investments that provide distributions on liquidation of investees' underlying assets (can't redeem investment) disclose the estimated time period over which underlying assets are expected to be liquidated
- (iii) Amount of unfunded commitments to the investee funds
- (iv) Description of terms/conditions under which investor can redeem (i.e. quarterly redemption with 60 days' notice)
- (v) Circumstances of an investment or portion thereof that might not be redeemable (lockup or gate) and disclose best estimate of when restriction might lapse. If estimate cannot be made, disclose that fact and how long restriction has been in effect
- (vi) Any significant restriction on ability to sell an investment
- (vii) Total fair value of investments probable of being sold at reporting date for an amount other than NAV
- (viii) Plans to sell and any remaining actions required to complete the sale



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Topic 815-10-15 Disclosures about derivative instruments and hedging activity



Disclosures about derivatives

(Formerly FAS 161)

Objective – to provide users of financial statements with an enhanced understanding of:

- How and why an entity uses derivative instruments
- How derivative instruments and related hedged items are accounted for under FAS 133
- How derivative instruments and related hedged items affect an entity's financial position, financial performance and cash flows

Requirements of Topic 815-10-15

To meet those objectives, the Statement requires:

- Qualitative disclosures about objectives and strategies for using derivatives
- Quantitative disclosures about fair value amounts of gains and losses on derivative instruments
- Disclosures about credit-risk-related contingent features in derivative agreements

Qualitative disclosures

- Entities objectives for holding or issuing the instruments. Information about those instruments shall be disclosed in the context of each instrument's primary underlying risk exposure (e.g. interest rate, credit, foreign exchange)
- Distinguish between those used for risk management purposes and those used for other
- Include information that would enable users of its financial statements to understand the volume of its derivative activity.

Quantitative disclosures

- Asset and liability location and amount on a gross basis split by designated qualifying hedges and not designated and sub categorized by type of instrument.
- Realized and unrealized gains and losses reported in the statement of financial performance (and OCI when applicable) disclosed by location split by designated qualifying hedges (including effective/ ineffective portions) and non designated and sub categorized by type of instrument.
 - Key issue in meeting disclosure requirements is that computer systems may not be set up to track the realised gains and losses on different categories of derivatives during the period.
 - Disclosures in the notes should be capable of being reconciled back to numbers in the statement of financial position, statement of financial performance and schedule of investments.

Example Table Disclosing the Fair Values of Derivative Instruments – Statement of Financial Position

<i>In millions of dollars</i>	Asset Derivatives				Liability Derivatives			
	2010		2009		2010		2009	
As of December 31	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
	Derivatives Not Designated as Hedging Instruments (1)							
	Interest rate contracts	Unrealized gain on Swap contracts XX	Unrealized gain on Swap contracts XX	XX	Unrealized loss on Swap contracts XX	XX	Unrealized loss on Swap contracts XX	XX
	Foreign exchange contracts	Unrealized gain on foreign currency contracts XX	Unrealized gain on foreign currency contracts XX	XX	Unrealized loss on foreign currency contracts XX	XX	Unrealized loss on foreign currency contracts XX	XX
	Equity contracts	Call options written XX	Call options written XX	XX	Call options written XX	XX	Call options written XX	XX
	Commodity contracts	Unrealized gain on future contracts XX	Unrealized gain on future contracts XX	XX	Unrealized loss on future contracts XX	XX	Unrealized loss on future contracts XX	XX
	Credit contracts	Unrealized gain on Swap contracts XX	Unrealized gain on Swap contracts XX	XX	Unrealized loss on Swap contracts XX	XX	Unrealized loss on Swap contracts XX	XX
	Other contracts	XX	XX	XX	XX	XX	XX	XX
	Total Derivatives not Designated as Hedging instruments	XX	XX	XX	XX	XX	XX	XX
	Total Derivatives	XX	XX	XX	XX	XX	XX	XX

(1) See note XX for additional information on ABC Company's purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategies.

Example Table Disclosing the Fair Values of Derivative Instruments – Statement of Financial Performance

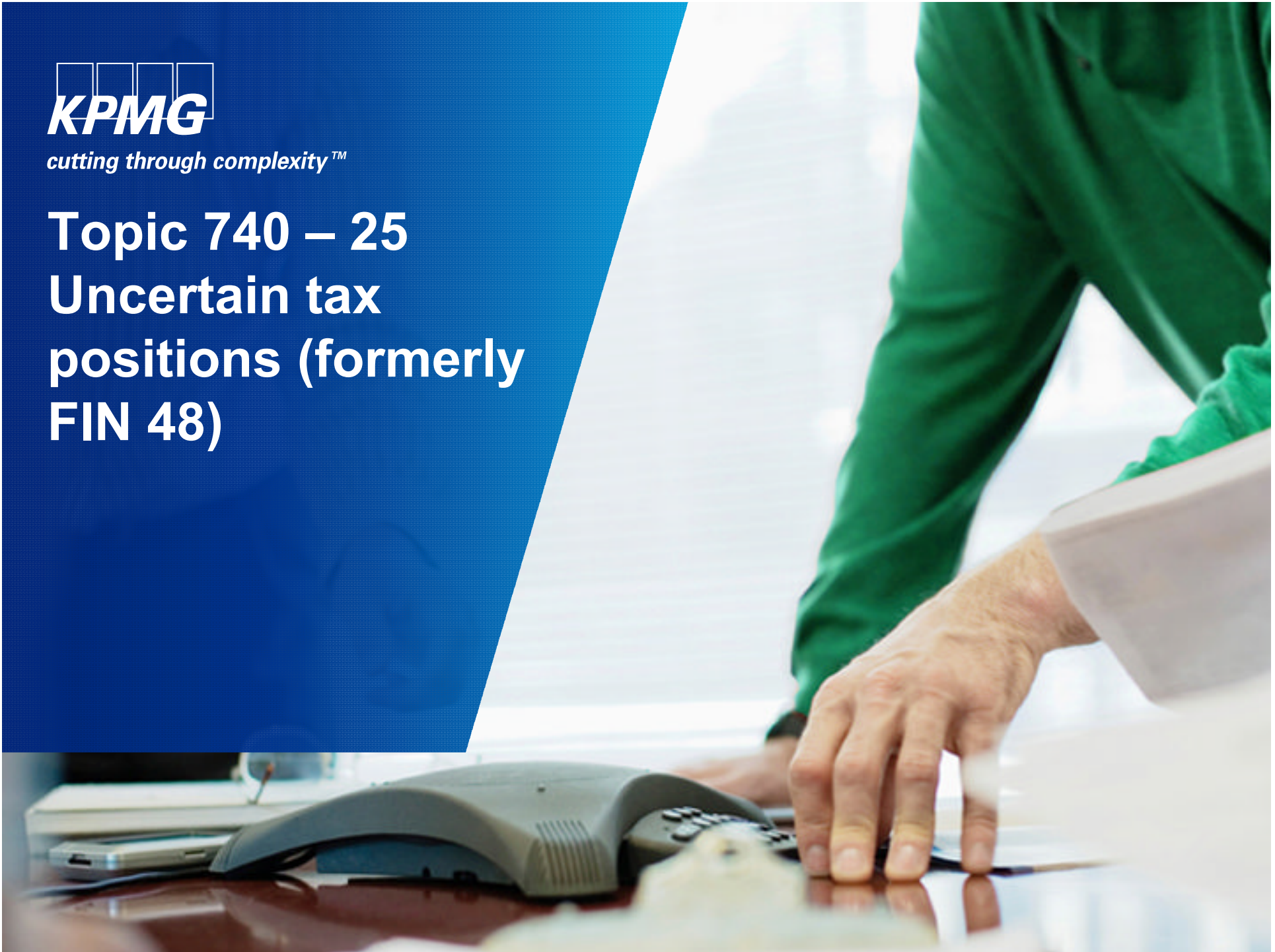
	Location	Realized gain/ loss	Location	Unrealized Gain / Loss
Derivatives Not Designated as Hedging Instruments				
Interest rate contracts	Realized gain/ loss – investments	XX	Unrealized gain/ loss – investments	XX
FX contracts	Realized gain/ loss – foreign currency transactions	XX	Unrealized gain/ loss foreign currency transactions	XX
Equity contracts	Realized gain/ loss - investments	XX	Unrealized gain/ loss – investments	XX
Commodity contracts	Realized gain/ loss - investments	XX	Unrealized gain/ loss – investments	XX
Credit derivatives	Realized gain/ loss - investments	XX	Unrealized gain/ loss – investments	XX
Other contracts				
Total		XX	XX	XX

(1) See note XX for additional information on ABC Company's purpose for entering into derivatives not designated as hedging instruments and its overall risk management strategies.



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Topic 740 – 25 Uncertain tax positions (formerly FIN 48)



What is required for recognition of a tax position.

740-10-25-6

An entity shall initially recognize the financial statement effects of a tax position when it is more likely than not, based on the technical merits, that the position will be sustained upon examination. The term more likely than not means a likelihood of more than 50 percent; the terms examined and upon examination also include resolution of the related appeals or litigation processes, if any.

For example, if an entity determines that it is certain that the entire cost of an acquired asset is fully deductible, the more-likely-than-not recognition threshold has been met. The more-likely-than-not recognition threshold is a positive assertion that an entity believes it is entitled to the economic benefits associated with a tax position.

The determination of whether or not a tax position has met the more-likely-than-not recognition threshold shall consider the facts, circumstances, and information available at the reporting date. The level of evidence that is necessary and appropriate to support an entity's assessment of the technical merits of a tax position is a matter of judgment that depends on all available information.

How to identify and measure an uncertain tax position

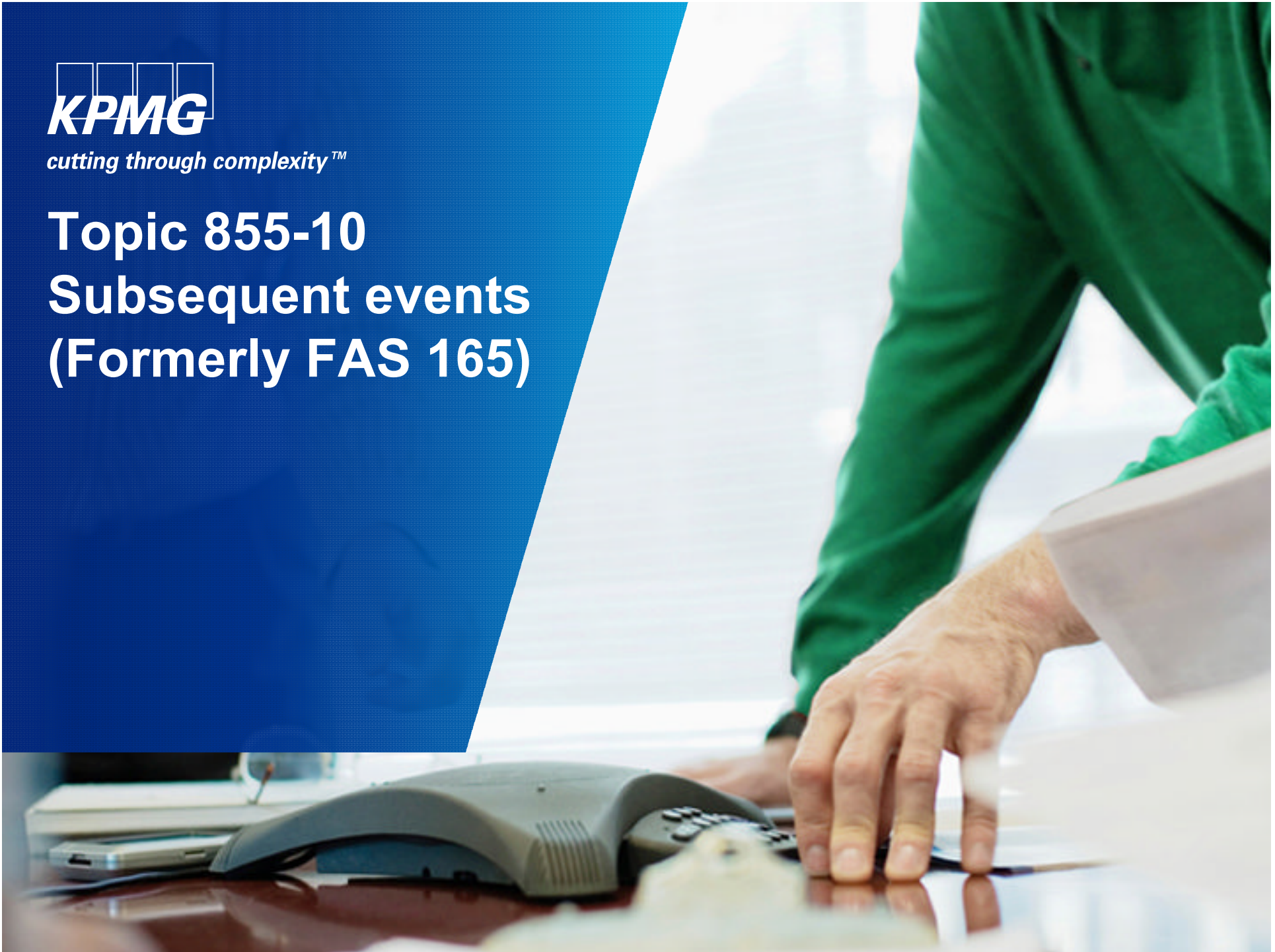
Process to be applied in assessing uncertain tax positions:

- 1) **Identify all tax positions taken (e.g. depreciation rates, deduction of WHT, enacted legislation not applied, residency or elections taken)**
- 2) **Assess on a position by position basis whether the position taken has a potential to be challenged**
- 3) **If challenged what is the maximum potential effect of the alternative position on the accounts (i.e. is the difference potentially material)**
- 4) **Assess for each material position with a potential to be challenged whether on examination the position has will more than likely be sustained. If not recognise in the accounts**



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Topic 855-10 Subsequent events (Formerly FAS 165)



Subsequent events

Objective – to establish principles and requirements for subsequent events recognition/ disclosure covering:

- The period after the balance sheet date during which management shall evaluate events for recognition/ disclosure.
- Circumstances under which the entity shall recognize events or transactions.
- The disclosures that an entity shall make about events or transactions.

Changes to established practice

Does not result in significant changes in the subsequent events that an entity reports either through recognition or disclosure.

Statement does introduce the concept of financial statements being available for issue and requires a clear statement of the date to which management has evaluated subsequent events.

- Available for issue is the date that the accounts are able to be distributed to third parties. Approval date is the date that management approve the accounts (frequently will be the same date).

Disclosures

- Explicit statement disclosing the date through which subsequent events have been evaluated by management, as well as whether that date is the date the financial statements were issued or the date the financial statements were available to be issued.
- Explicit statement that no subsequent events have been identified if this is the case
- A non-recognized subsequent event may be so significant that it must be disclosed to prevent the financial statements from being misleading. In such circumstances disclosure of the nature and an estimate of financial effect shall be made.

Questions?