



Chapter 1

The Financial Reporting Environment

Learning objectives

- Identify the roles of the Financial Accounting Foundation (FAF), Financial Accounting Standards Board (FASB), the Emerging Issues Task Force (EITF), and the Private Company Council (PCC) in establishing accounting standards.
 - Identify major characteristics of the FASB *Accounting Standards Codification*[®] (ASC) and how this resource is used.
-

Introduction

This chapter provides an overview of the roles played by FASB, the EITF, and the PCC in establishing accounting standards for nongovernmental entities. The chapter also includes discussion of FASB ASC as well as International Financial Reporting Standards and the move toward the globalization of accounting standards.

Facts about FASB

Financial accounting standards board

FASB, established in 1973, is the designated accounting standard setter for establishing private sector financial accounting and reporting standards for nongovernmental entities. FASB is subject to the oversight of the FAF's board of trustees.

The FASB board is composed of seven independent members. Each individual board member has a diversified background, is appointed to a five-year term, and is then eligible for reappointment for one additional five-year term. To ensure board independence, each board member is required to sever ties with any entities or firms prior to joining the board.

The Securities and Exchange Commission (SEC) has the statutory authority to establish financial accounting and reporting standards for publicly held companies. However, the SEC policy has historically been to rely on FASB for this function to the extent that their standards demonstrate the ability to fulfill the SEC's responsibility to the public interest. FASB and SEC have a working protocol in which SEC staff first refer issues it identifies that may have accounting standard setting implications to FASB for consideration; the SEC staff reserves the right to exercise its legislative authority to deal with any issues it identifies.

FASB maintains FASB ASC, which represents the only source of authoritative nongovernmental accounting and reporting standards, other than those issued by the SEC.

Emerging issues task force

The EITF was formed in 1984. Their mission is to assist FASB in improving financial reporting by timely addressing and reducing diversity in practice. The EITF addresses narrow emerging issues, and implementation or application issues, arising from existing generally accepted accounting principles (GAAP). Involvement by the EITF in the standard setting process minimizes the need for FASB to address narrow items and thereby provides FASB with additional time to devote to the larger and more complete items on their technical agenda.

The EITF is composed of volunteer members that are drawn from a cross section of constituencies, such as preparers, auditors, and users of financial statements. The chief accountant or the deputy chief accountant of the SEC regularly attends the EITF meetings in the capacity of an observer with the privilege of speaking on the floor.

Private company council

The board of the FAF established the PCC in May 2012 to address the needs of private company financial statement users. The PCC serves to advise FASB regarding the proper treatment of private company accounting as it relates to active items on FASB's technical agenda. FASB and the PCC work closely together, based upon mutually agreed-upon criteria, to determine alternatives to GAAP for private companies.

The PCC is composed of volunteer members, and the PCC chair works closely with the FASB liaison member, FASB chairman, and the FASB technical director. The FASB board and liaison member are expected to attend and participate in all PCC meeting deliberations.

Knowledge check

1. FASB is subject to the oversight of
 - a. The PCC.
 - b. The FAF.
 - c. The SEC.
 - d. The EITF.

 2. The PCC is the primary private company accounting advisory body to
 - a. The FAF.
 - b. FASB.
 - c. The EITF.
 - d. The SEC.
-

FASB ASC

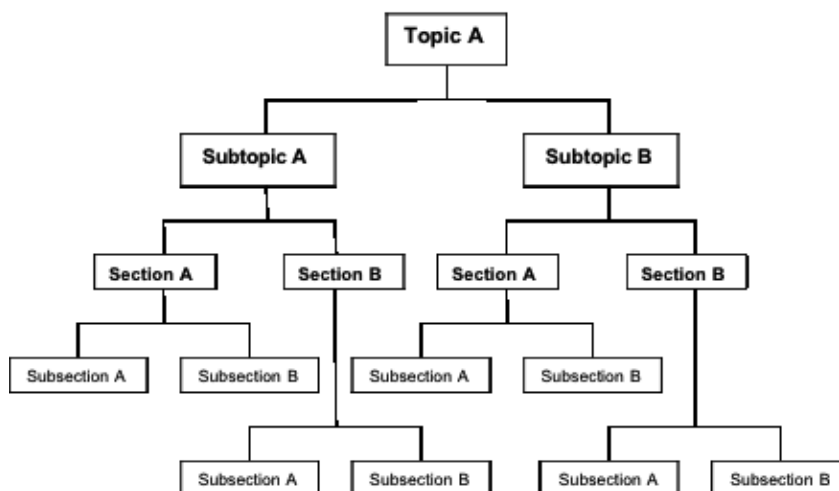
On September 15, 2009, FASB ASC became effective as the only source of authoritative nongovernmental GAAP. FASB ASC has only one level of authority; accounting guidance residing inside FASB ASC is considered authoritative, although other accounting literature residing outside FASB ASC is considered nonauthoritative (for example, the FASB Concept Statements).

The content in FASB ASC is arranged topically and updated by the issuance of Accounting Standards Updates (ASUs). FASB ASUs communicate changes to FASB ASC, but are not considered standalone authoritative standards. Upon the issuance of a final FASB ASU, its content is added to FASB ASC. If the FASB ASU adds a new paragraph, that new paragraph is inserted in the appropriate place in FASB ASC. If an existing paragraph is amended or deleted, the amended or deleted paragraph is placed immediately after the existing paragraph. The new, amended, or deleted paragraphs are labeled “Pending Content” and their effective dates and transition provisions are described.

To increase the utility of FASB ASC for public companies, relevant portions of authoritative content issued by the SEC and selected SEC staff interpretations and administrative guidance are included for reference in FASB ASC such as Regulation S-X (SX), FASB ASC of Financial Reporting Releases (FRRs), Interpretive Releases (IRs), and Staff Accounting Bulletins (SABs). The SEC sections *do not contain* the entire population of SEC rules and regulations. FASB ASC does not replace or affect guidance issued by the SEC or its staff for public companies in their filings with the SEC.

Topical structure

When using FASB ASC, it is important to understand its structure. FASB ASC utilizes an organizational structure as reflected in the following chart.



In FASB ASC, *topics* represent a collection of related guidance. Following the topic level, FASB ASC further refines topics into subtopics, sections, and subsections. Note that subsections are a further disaggregation of a section and, except for the general section, occur in a limited number of cases. Unlike a section, a subsection is not numbered.

The following originates from FASB ASC available on FASB's website at www.fasb.org.

In FASB ASC the topics reside in six main areas, as illustrated in the following chart.

The six main areas of FASB ASC	
General Principles FASB ASC 105-199	This area contains one topic, FASB ASC 105, <i>Generally Accepted Accounting Principles</i>
Presentation FASB ASC 205–299 These topics relate only to presentation matters and do not address recognition, measurement, and derecognition.	<ul style="list-style-type: none"> ▪ 205, <i>Presentation of Financial Statements</i> ▪ 210, <i>Balance Sheet</i> ▪ 215, <i>Statement of Shareholder Equity</i> ▪ 220, <i>Income Statement – Reporting Comprehensive Income</i> ▪ 230, <i>Statement of Cash Flows</i> ▪ 235, <i>Notes to Financial Statements</i> ▪ 250, <i>Accounting Changes & Error Corrections</i> ▪ 255, <i>Changing Prices</i> ▪ 260, <i>Earnings per Share</i> ▪ 270, <i>Interim Reporting</i>

The six main areas of FASB ASC (continued)

	<ul style="list-style-type: none"> ▪ 272, <i>Limited Liability Entities</i> ▪ 274, <i>Personal Financial Statements</i> ▪ 275, <i>Risks and Uncertainties</i> ▪ 280, <i>Segment Reporting</i>
<p>Assets, Liabilities, and Equity FASB ASC 305–599</p> <p>This topic area contains guidance on balance sheet accounts.</p>	<ul style="list-style-type: none"> ▪ 305, <i>Cash and Cash Equivalents</i> ▪ 310, <i>Receivables</i> ▪ 320, <i>Investments – Debt and Equity Securities</i> ▪ 321, <i>Investments – Equity Securities</i> ▪ 323, <i>Investments – Equity Method and Joint Ventures</i> ▪ 325, <i>Investments – Other</i> ▪ 326, <i>Financial Instruments – Credit Losses</i> ▪ 330, <i>Inventory</i> ▪ 340, <i>Other Assets and Deferred Costs</i> ▪ 350, <i>Intangibles – Goodwill and Other</i> ▪ 360, <i>Property, Plant, and Equipment</i> ▪ 405, <i>Liabilities</i> ▪ 410, <i>Asset Retirement & Environmental Obligations</i> ▪ 420, <i>Exit or Disposal Cost Obligations</i> ▪ 430, <i>Deferred Revenue</i> ▪ 440, <i>Commitments</i> ▪ 450, <i>Contingencies</i> ▪ 460, <i>Guarantees</i> ▪ 470, <i>Debt</i> ▪ 480, <i>Distinguishing Liabilities from Equity</i> ▪ 505, <i>Equity</i>
<p>Revenue and Expenses FASB ASC 605–799</p> <p>This topic contains guidance on specific income statement accounts.</p>	<ul style="list-style-type: none"> ▪ 605, <i>Revenue Recognition</i> ▪ 606, <i>Revenue from Contracts with Customers</i> ▪ 610, <i>Other Income</i> ▪ 705, <i>Cost of Sales and Services</i> ▪ 710, <i>Compensation – General</i> ▪ 712, <i>Compensation – Nonretirement Postemployment Benefits</i> ▪ 715, <i>Compensation – Retirement Benefits</i> ▪ 718, <i>Compensation – Stock Compensation</i> ▪ 720, <i>Other Expenses</i> ▪ 730, <i>Research and Development</i> ▪ 740, <i>Income Taxes</i>

The six main areas of FASB ASC (continued)

<p>Broad Transactions FASB ASC 805–899</p> <p>These topics relate to multiple financial statement accounts and are generally transaction-oriented.</p>	<ul style="list-style-type: none">▪ 805, <i>Business Combinations</i>▪ 808, <i>Collaborative Arrangements</i>▪ 810, <i>Consolidation</i>▪ 815, <i>Derivatives and Hedging</i>▪ 820, <i>Fair Value Measurement</i>▪ 825, <i>Financial Instruments</i>▪ 830, <i>Foreign Currency Matters</i>▪ 835, <i>Interest</i>▪ 840, <i>Leases</i>▪ 842, <i>Leases</i>▪ 845, <i>Nonmonetary Transactions</i>▪ 850, <i>Related Party Disclosures</i>▪ 852, <i>Reorganizations</i>▪ 853, <i>Service Concession Arrangements</i>▪ 855, <i>Subsequent Events</i>▪ 860, <i>Transfers and Servicing</i>
<p>Industries FASB ASC 905–999</p> <p>These topics relate to accounting that is unique to an industry or type of activity.</p>	<ul style="list-style-type: none">▪ 905, <i>Agriculture</i>▪ 908, <i>Airlines</i>▪ 910, <i>Contractors – Construction</i>▪ 912, <i>Contractors – Federal Government</i>▪ 920, <i>Entertainment – Broadcasters</i>▪ 922, <i>Entertainment – Cable Television</i>▪ 924, <i>Entertainment – Casinos</i>▪ 926, <i>Entertainment – Films</i>▪ 928, <i>Entertainment – Music</i>▪ 930, <i>Extractive Activities – Mining</i>▪ 932, <i>Extractive Activities – Oil and Gas</i>▪ 940, <i>Financial Services – Brokers and Dealers</i>▪ 942, <i>Financial Services – Depository and Lending</i>▪ 944, <i>Financial Services – Insurance</i>▪ 946, <i>Financial Services – Investment Companies</i>▪ 948, <i>Financial Services – Mortgage Banking</i>▪ 950, <i>Financial Services – Title Plant</i>▪ 952, <i>Franchisors</i>▪ 954, <i>Health Care Entities</i>▪ 958, <i>Not-for-Profit Entities</i>▪ 960, <i>Plan Accounting – Defined Benefit Pension Plans</i>▪ 962, <i>Plan Accounting – Defined Contribution Pension Plans</i>▪ 965, <i>Plan Accounting – Health and Welfare Benefit Plans</i>▪ 970, <i>Real Estate – General</i>▪ 972, <i>Real Estate – Common Interest Realty Associations</i>

The six main areas of FASB ASC (continued)

- 974, *Real Estate – Real Estate Investment Trusts*
- 976, *Real Estate – Retail Land*
- 978, *Real Estate – Time Sharing Activities*
- 980, *Regulated Operations*
- 985, *Software*
- 995, *U.S. Steamship Entities*

Note. FASB ASC also contains a master glossary that includes links to the topics, subtopics, sections, and paragraphs where the terminology is used in FASB ASC.

Sections

The following excerpts originated from FASB ASC, *About the Codification* (v4.10), the full text of which is available on FASB ASC's website at www.fasb.org.

Sections represent the nature of the content in a subtopic such as recognition, measurement, disclosure, and so forth. Every subtopic uses the same sections. If there is no content for a section, then the section will not display.

Similar to topics, sections correlate very closely with sections of individual International Financial Reporting Standards. The sections of each subtopic include the following:

XXX-YY-ZZ where XXX = topic, YY = subtopic, ZZ = section

- XXX-YY-00 Status
- XXX-YY-05 Overview and Background
- XXX-YY-10 Objectives
- XXX-YY-15 Scope and Scope Exceptions
- XXX-YY-20 Glossary
- XXX-YY-25 Recognition
- XXX-YY-30 Initial Measurement
- XXX-YY-35 Subsequent Measurement
- XXX-YY-40 Derecognition
- XXX-YY-45 Other Presentation Matters
- XXX-YY-50 Disclosure
- XXX-YY-55 Implementation Guidance and Illustrations
- XXX-YY-60 Relationships
- XXX-YY-65 Transition and Open Effective Date Information
- XXX-YY-70 Grandfathered Guidance
- XXX-YY-75 XBRL Elements

Accessibility

Three views of FASB ASC are available online: the professional view, the academic view, and the basic view. The professional and academic views are available for an annual subscription fee and provide full functionality and advanced navigation. The basic view is available free of charge; and although it does allow browsing by topic, printing is limited.

Knowledge check

3. How many levels of authority does FASB ASC include?
- a. Five.
 - b. Three
 - c. Two.
 - d. One.

Globalization of accounting standards

The following information provides a brief overview of the ongoing globalization of accounting standards, International Financial Reporting Standards (IFRSs) as a body of accounting literature, the status of convergence with IFRSs in the United States, and the related issues that accounting professionals need to consider today.

As the business world becomes more globally connected, regulators, investors, audit firms, and public and private companies of all sizes are expressing an increased interest in having common accounting standards among participants in capital markets and trading partners around the world. Proponents of convergence with or adoption of IFRSs for financial reporting in the United States believe that one set of financial reporting standards would improve the quality and comparability of investor information and promote fair, orderly, and efficient markets.

Many critics, however, believe that accounting principles generally accepted in the United States of America (GAAP) are the superior standards and question whether the use of IFRSs will result in more useful financial statements in the long term and whether the cost of implementing IFRSs will outweigh the benefits. Implementing IFRSs will require a staggering effort by management, auditors, and financial statement users, not to mention educators.

The increasing pressure to globalize accounting standards, both in the United States and around the world, means that now is the time to become knowledgeable about these changes. The discussion that follows explains the underpinnings of the international support for a common set of high quality global standards and many of the challenges and potential opportunities associated with such a fundamental shift in financial accounting and reporting.

History

The international standard setting process began several decades ago as an effort by industrialized nations to create standards that could be used by developing and smaller nations. However, as cross-border transactions and globalization increased, other nations began to take interest, and the global reach of IFRSs expanded. More than 100 nations and reporting jurisdictions permit or require IFRSs for domestic listed companies and most have fully conformed to IFRSs as promulgated by the International Accounting Standards Board (IASB) and include a statement acknowledging such conformity in audit reports. Several countries, including Argentina and Canada, adopted IFRSs on January 1, 2011, and many other countries have plans to converge (or eliminate significant differences between) their national standards and IFRSs.

For many years, the United States has been a strong leader in international efforts to develop globally accepted standards. Among other actions in support of IFRSs, the U.S. SEC removed the requirement for foreign private issuers registered in the United States to reconcile their financial reports with U.S. GAAP if their accounts complied with IFRSs as issued by IASB. In addition, the SEC continues to analyze and evaluate appropriate steps toward, and challenges related to, incorporating IFRSs into the U.S. financial reporting system, as subsequently described.

In addition to the support received from certain U.S.-based entities, financial and economic leaders from various organizations have announced their support for global accounting standards. Most notably, in 2009, the Group of Twenty Finance Ministers and Central Bank Governors (G20), a group from 20 of the world's industrialized and developing economies (with the 20th member being the European Union, collectively), called for standard setters to redouble their efforts to complete convergence in global accounting standards.

Costs versus benefits

Acceptance of a single set of high quality accounting standards may present many significant opportunities, including the improvement in financial reporting to global investors, the facilitation of cross-border investments, and the integration of capital markets. Further, U.S. entities with international operations could realize significant cost savings from the use of a single set of financial reporting standards. For example, U.S. issuers raising capital outside the United States are required to comply with the domestic reporting standards of the foreign country *and* U.S. GAAP. As a result, additional costs arise from the duplication and translation of financial reporting information.

Many multinational companies support the use of common accounting standards to increase comparability of financial results among reporting entities from different countries. They believe common standards will help investors better understand the entities' business activities and financial position. Large public companies with subsidiaries in multiple jurisdictions would be able to use one accounting language company-wide and present their financial statements in the same language as their competitors. In addition, some believe that in a truly global economy, financial professionals, including CPAs, will be more mobile, and companies will more easily be able to respond to the human capital needs of their subsidiaries around the world.

Although certain cost reductions are expected, the initial cost of convergence with IFRSs is expected to be one of the largest obstacles for many entities, including accounting firms and educational institutions. Substantial internal costs for U.S. corporations in the areas of employee training, IT conversions, and general ledger software have been predicted. In addition, the time and effort required from various external functions, including the education of auditors, investors, lenders, and other financial statement users, will be significant factors for consideration.

Although the likelihood of acceptance of IFRSs may lack clarity for the time being, U.S. companies should consider preparing for the costly transition to new or converged standards, which likely will include higher costs in the areas of training and software compliance.

IASB

The IASB is the independent standard setting body of the IFRS Foundation, formerly the International Accounting Standards Committee Foundation. As a private sector organization, the IFRS Foundation has no authority to impose funding regimes on countries. However, a levy system and national contributions through regulatory and standard setting authorities or stock exchanges have been introduced in a number of countries to fund the organization. Although the AICPA was a founding member of the International Accounting Standards Committee, IASB's predecessor organization, it is not affiliated with IASB.

IASB, founded on April 1, 2001, in London, England, is responsible for developing IFRSs and promoting the use and application of these standards. In pursuit of this objective, IASB cooperates with national accounting standard setters to achieve convergence in accounting standards around the world.

The structure includes the following primary groups: (a) the IFRS Foundation, an independent organization having two main bodies: the IFRS Foundation trustees and IASB; (b) the IFRS Advisory Council; and (c) the IFRS Interpretations Committee, formerly the International Financial Reporting Interpretations Committee (IFRIC). The trustees appoint the IASB members, exercise oversight, and raise the funds needed, but IASB itself has responsibility for establishing IFRSs.

The IFRS Foundation is linked to a monitoring board of public authorities, including committees of the International Organization of Securities Commissions, the European Commission, and the SEC. The monitoring board's main responsibilities are to ensure that the trustees continue to discharge their duties as defined by the IFRS Foundation Constitution, as well as approving the appointment or reappointment of trustees. In addition, through the monitoring board, capital markets authorities that allow or require the use of IFRSs in their jurisdictions will be able to more effectively carry out their mandates regarding investor protection, market integrity, and capital formation.

The IASB board members are selected chiefly upon their professional competence and practical experience. The trustees are required to select members so that IASB will comprise the best available combination of technical expertise and international business and market experience and to ensure that IASB is not dominated by any particular geographical interest or constituency. IASB has members from several different countries, including the United States. The members are responsible for the development and publication of IFRSs, including International Financial Reporting Standard for Small-

and Medium-sized Entities (IFRS for SMEs), and for approving the interpretations of IFRSs as developed by the IFRS Interpretations Committee.

The IFRS Interpretations Committee, founded in March 2002, is the successor of the previous interpretations committee, the Standing Interpretations Committee (SIC), and is the interpretative body of IASB. The role of the IFRS Interpretations Committee is to provide timely guidance on newly identified financial reporting issues not specifically addressed in IFRSs or issues in which interpretations are not sufficient.

IFRSs are developed through a formal system of due process and broad international consultation, similar to the development of U.S. GAAP.

In May 2008, the AICPA Governing Council voted to recognize IASB as the designated accounting body for purposes of establishing international financial accounting and reporting principles. Accordingly, IFRSs are not considered to be another comprehensive basis of accounting, but rather a source of generally accepted accounting principles.

IFRSs

The term *IFRSs* has both a narrow and broad meaning. Narrowly, IFRSs refer to the numbered series of pronouncements issued by IASB, collectively called standards. More broadly, however, IFRSs refer to the entire body of authoritative IASB literature, including the following:

1. Standards, whether labeled IFRSs or International Accounting Standards (IASs)
2. Interpretations, whether labeled IFRIC (the former name of the interpretive body) or SIC (the predecessor to IFRIC)

IFRSs are not designed to apply to not-for-profit entities or those in the public sector, but these entities may find IFRSs appropriate in accounting for their activities.

IASB's Conceptual Framework for Financial Reporting (conceptual framework) establishes the concepts that underlie the preparation and presentation of financial statements for external users. IASB is guided by the conceptual framework in the development of future standards and in its review of existing standards. The conceptual framework is not an IFRS, and when there is a conflict between the conceptual framework and any IFRS, the standard will prevail.

IFRS for SMEs

IFRS for SMEs is a modification and simplification of full IFRSs aimed at meeting the needs of private company financial reporting users and easing the financial reporting burden on private companies through a cost-benefit approach. IFRS for SMEs is a self-contained global accounting and financial reporting standard applicable to the general purpose financial statements of entities that, in many countries, are known as small- and medium-sized entities (SMEs). Full IFRSs and IFRS for SMEs are promulgated by IASB.

The AICPA has developed a resource that compares IFRS for SMEs with corresponding requirements of U.S. GAAP. To learn more about the resource, visit www.ifrs.com.

FASB and IASB convergence efforts

To address significant differences between IFRSs and U.S. GAAP, the FASB and IASB agreed to a "Memorandum of Understanding" (MoU), which was originally issued in 2006 and subsequently updated. FASB and IASB have converged several topics, such as Revenue Recognition (ASU No. 2014-09 & IFRS 15) and Fair Value Measurements (ASU No. 2011-04 and IFRS 13). Consider monitoring the FASB and IASB websites for additional developments regarding the convergence efforts, such as discussion papers, exposure drafts, and requests for comments.

SEC work plan

The SEC continues to affirm its support for a single set of high quality, globally accepted accounting standards; however, no decision has been made on whether or not to adopt IFRSs. In May 2011, the SEC staff produced a work plan outlining how such a possible transition might happen.

In November 2011, the SEC released a staff paper that summarizes the current status of convergence projects, which are grouped by both short term and long term, as well as by level of priority (greater priority versus lower priority). Currently, the three projects that are of greater priority are financial instruments, revenue recognition, and leases.

In July 2012, the SEC published its final staff report on the work plan, which focuses on the arguments for and against various forms of adoption of global accounting standards. When assessing the implications of incorporating IFRSs in the U.S. financial reporting system, the SEC concluded that although international standards have improved in comprehensiveness, there are still some gaps, especially in the areas of insurance, extractive industries, and rate-regulated industries. The report also states that the costs of full IFRS adoption remain among the most significant costs required from an accounting perspective and that companies questioned whether the benefits would justify such a full-scale transition. Although the report does not contain information leading to any decision the SEC has made regarding incorporation of IFRSs, the staff expects that the SEC and others in the United States will remain involved with the development and application of IFRS.

Refer to www.sec.gov for the full version of the staff paper.

Knowledge check

4. Which statement is accurate regarding IFRSs?
 - a. IFRSs have both a narrow and broad meaning.
 - b. IFRSs merely refers to the numbered series of pronouncements issued by IASB.
 - c. IFRSs are designed to apply to not-for-profit entities.
 - d. IFRSs are designed to apply to entities in the public sector.

Practice questions

1. What is the EITF's role in the standard setting process?
2. Why does FASB ASC contain authoritative content issued by the SEC?
3. What is your view on the globalization of accounting standards? Are you for or against it?

