Impact of Updates to 4 Areas of FASB Codification

Katelyn Woten

Black Hills State University

Author Note

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Abstract

Laws and regulation standards need to be updated regularly to match social, economic, and political movements and trends. Another reason for change in laws and regulations is the identification of an issue. Since the inception of financial accounting, many issues have arisen and been addressed, though new problems regularly emerge. The organization that currently regulates financial accounting is the Financial Accounting Standards Board (FASB) under a codification system. One of the primary goals of the Codification is to accurately represent authoritative United States Generally Accepted Accounting Principles (GAAP) and this can only be achieved through updates as a result of identification of issues presented by the users of GAAP and other stakeholders. The purpose of this project was to examine the updates to four areas of the FASB Codification and how these updates will impact business entities and American accountants. The four areas that were studied were revenue recognition, leases, pension, and fair value measurement. The information presented was collected from the original, amended, and new standards. In addition, supplemental facts were retrieved from journals, surveys, and books. Through this research, the following conclusions are made. Revenue recognition now follows a compiled standard in the asset-liability approach. American businesses will now be required to recognize over a trillion dollars from assets and liabilities associated with leases on their balance sheets. For defined benefit pension plans, service costs and net benefit costs must now be reported separately. The notes to financial statements relating to fair value measurement will now be streamlined. Combined, these updates will help users of financial statements better understand and asses the financial position of a company.

Impact of Updates to 4 Areas of FASB Codification

As a part of humanity, a majority of the population strives to improve the current state of any aspect of daily life. When an issue is identified, those that have the ability to change the situation often feel obligated to make that change. In certain situations, changes do not improve the state or completely address the faults of the situation. Since the inception of financial accounting, many issues have arisen and been addressed, though new problems regularly emerge. The organization that currently regulates financial accounting is the Financial Accounting Standards Board (FASB) under a codification system. Updates to the FASB Codification effectively change financial accounting standards. Four areas of the Codification that are currently being updated are revenue recognition, leases, pensions, and fair value measurement. The original principle, current practice, and proposed update of each of these areas will be addressed followed by an explanation of how the updates will affect the status quo. One of the primary goals of the Codification is to accurately represent authoritative United States Generally Accepted Accounting Principles (GAAP) and this can only be achieved through updates as a result of identification of issues presented by the users of GAAP and other stakeholders.

History and Background of FASB

Beginning in 1938, the American Institute of Accountants (AIA) created the Committee on Accounting Procedure (CAP) in response to the Securities and Exchange Commission's (SEC) issuance of Accounting Series Release No. 4, which established that accounting principles filed with the SEC had to have "substantial authoritative support" to be generally accepted. Over the next 21 years CAP issued 51 Accounting Research Bulletins (ARB). During 1953, ARB 43 was issued as codification and, though CAP lacked official authority, is still widely respected today. Two years before CAP dissolved, in 1957, the AIA became the AICPA, American Institute of Certified Public Accountants. (Redding, 1986)

Later in the year CAP disbanded (1959) the Accounting Principles Board (APB) was created to promulgate accounting standards. The APB existed until 1973 with the intent to continue CAP's work hoping to have fewer of the weaknesses CAP had shown including little research assistance, shared staff, lack of authority, and inconsistency. The APB consisted of six full-time research staff and a Director of Research. Initially, they were tasked with the creation of a set of basic concepts, referred to as "postulates," as guidance for resolving issues; however, the attempts at this project failed. While it was functioning the APB was able to issue 31 "Opinions" that were later used by FASB as a part of GAAP. The most significant reasons for the demise of the APB were the lack of an endorsement by the SEC that would have validated their authority and the structural problem of having too many members, 18 on a general basis.

Created in 1973, a few months before the APB dissolved, FASB is a non-governmental, privately funded agency that is endorsed by the SEC and state-level regulatory agencies. FASB is comprised of three separate components the Financial Accounting Foundation, the Financial Accounting Standards Board, and the Financial Accounting Standards Advisory Committee.

The Financial Accounting Foundation is considered the “parent” organization of the three with most of the responsibility of the nonprofit corporation allocated to the 16 member Board of Trustees. They must fundraise to finance the operation of all three organizations, appoint the members of the other two groups, and review the performance of the FASB. Thirteen of the trustees are elected, in specified quantities, from eight sponsoring organizations. Two of the other trustees are elected by these 13 from the commercial banking industry and the general business community; the last trustee is a senior elected official of the AICPA.

Second of the three parts, the Financial Accounting Standards Board is the “action arm” of the group. It is tasked with being the primary researching organization, communicating with outside parties, and resolving issues. The board consists of seven members that have severed all relationships with past employers and are employed by the Foundation. Board members serve a five-year term and may be reappointed for one more term. A Special Review Committee outlined seven qualifications members should possess but recognize that it is beneficial to maintain a wide variety of backgrounds.

Finally, the Financial Accounting Standards Advisory Council (FASAC) advises the Board and the Staff. Primarily, they give council on how to prioritize current and upcoming projects and note concerns with preliminary positions taken on projects. There are 35-40 members, with a specific number of people representing certain backgrounds, of the FASAC that are appointed by the Board of Trustees for up to four consecutive one-year terms. Council members, apart from the Chairman, are not paid for their services though primary employers are expected to compensate for travel and related expenses. Before meetings, Council members are asked to fill out questionnaires about the Board’s potential and occurring activities.

In addition to these three organizations, there are also Research and Technical Activities (RTA) Staff, Project Managers, and fellows. The RTA is made of 40-50 full-time employees similar to Board members. They have many specific tasks that make the work of FASB and its members possible. Project Managers direct project teams and are assisted by a Senior Technical Advisor, an Assistant Project Manager, a Technical Associate, and a Project Administrative Assistant. They are considered the workhorses of the FASB staff because they are the go-betweens for the Board Members and Staff, the business community, and occasionally the press. The most difficult job Project Managers must complete is finding a consensus among Board Members on issues. Fellows participate in a program, similar to an internship, to grain expertise; participants can be categorized as practice, industry, or faculty, which distinguishes the job they are putting on hold to participate in the experience.

When it began, FASB created a procedure, still used today, to develop standards involving five goals stated as: discovery of the problem, description of the underlying issues, alternative positions on those issues, evaluation of the alternatives, and selection of the most beneficial alternative. Steps for accomplishing these goals are: preliminary evaluation, feature on meeting agenda, initial deliberations, possible resolution, further deliberations, and final resolution. A group called the Emerging Issues Task Force helps with the first three steps and occasionally is able to resolve an issue in the preliminary evaluation. When an issue makes it to the meeting agenda up to 59 members of the general public are able to sit in on the meeting, after which there is a comment period to express concerns through written communication. While deliberating, a Task Force of 10-30 members may be created to help with larger projects. An Advisory Group of 6-10 people may also be formed for Implementation and Practice Problems projects. For the tentative resolution phase, an Exposure Draft must be published for projects that

lead to Statement of Financial Accounting Standards or a Statement of Financial Accounting Concepts. Following the return and analysis of responses to the Exposure Draft, further deliberations commence with three outcomes possible: termination of the project, issuance of another Exposure Draft, or movement to final pronouncement. To resolve an issue, a “Ballot Draft” of the pronouncement is distributed to members of the Board and passed by majority approval. A Technical Bulletin or an Interpretation may be issued in response to a minor issue after final publication. All of these documents are used in the creation, establishment, and amendment of GAAP.

One of the first and most important projects FASB undertook was creation of a Conceptual Framework. The reasons this Framework was created were to describe existing practices, prescribe future practices, and define common terms. By describing existing practices FASB was trying to make it easier for non-accounting persons to understand what accountants do. At the same time, they were trying to establish general rules to follow for existing similar transactions and make it easier for standard setters to solve new problems in the future. Defining common terms made standard setting more efficient and consistent. Between 2004 and 2010, FASB worked on a joint project with the International Accounting Standards Board (IASB) to build an improved Conceptual Framework; however, the project was abandoned to focus on other pressing issues. Since 2014, FASB has been performing research to review the Framework for updates to improve the usefulness in relation to present concerns and to address any notable issues, though the project is no longer in jointly active with the IASB (FASB-Concepts Team, personal communication, June 23, 2014).

Revenue Recognition

The original revenue principle recognized that revenue "should be recorded as earned when (*a*) there has been an exchange transaction involving a transfer of goods or services and (*b*) the earning process is essentially complete." [1] Thus revenue was recognized at point of sale or when services were rendered. This method was referred to as the sales method and required accrual basis accounting. The sales method was used when "(*a*) the ultimate collection of the sales or service price in full is reasonably certain; and (*b*) the expenses related to the particular transaction appear to be reasonably determinable, with reasonable accuracy, in the period of sale or service."

Though this definition seems simple and easy to follow, this was only the general basis that was complicated by certain occurrences. Four exceptions to this application were the cash, percentage-of-completion, production, and cost recovery approaches. Each exception had a set of circumstances as justification for use. The cash approach, or installment method, was used when there was doubt that the ultimate collection would be made or related costs could not be accurately determined. In other words, the earning process was not complete at point of sale. Percentage of completion approach was used for certain long-term construction contracts. Progress of the project was used for recognizing revenue earned. Similarly, the production approach used production progress for recognition purposes in cost-plus-fixed-fee contracts. Finally, the cost recovery approach, also called sunk cost approach, was used for very uncertain transactions. When the final outcome was highly speculative, interest was not recognized as a gain until the original investment was recovered.

Many changes have been implemented since this principle was created. Generally, revenue that does not have specific guidance for recognition should be recognized when it is

[1] Hendriksen, Eldon S. (1970). *Accounting Theory* (pp.161), Homewood, IL: R.D. Irwin.

realized or realizable and earned.[2] Revenues are earned "when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues." Installment and cost recovery are the primary methods used, though the milestone method is applicable in certain situations. The milestone method applies to research and development deliverables wherein milestones, vendor's performance or a specific outcome, constitute payment.[3] The technical procedures for recognizing revenue have been narrowed down specifically to certain situations; however, recent updates have simplified the process and created a more complete standardized method for similar transactions.

Revenue comes in many forms including sales, fees, rent, interest, royalties, and service revenue. As basis for the current principle, revenue should be recognized when it is either realized, realizable, or earned. By definition, when the entity receives cash for goods or services the revenue is realized; when the entity can convert an asset received into cash, revenue is realizable; when the company has accomplished the task that entitles them to the revenue it has been earned. This primarily leads to four transactions that result from different circumstances. *(1)* Products sold are recognized on the date of the sale or date of delivery to the customers; similarly, *(2)* earnings from sale of assets (that are not products of the company) are also recorded on the sale date. *(3)* Revenues from services provided are recorded when the services have been performed; *(4)* receipts from use of assets (rent, interest, or royalties) are recognized when used. A focusing concept of this principle states: during an operating period, inflows of assets and settlements of liabilities sale of goods, providing services, and other activities that create earnings constitute revenue.

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[2] FASB (1984). Recognition and Measurement in Financial Statements of Business Enterprises. *Statement of Financial Accounting Concepts No. 5* (par. 83) Stamford, CT.
[3] FASB ASC 605-28-25-2 (2010). Revenue Recognition-Milestone Method. *Accounting Standards Update 2010-17.* Norwalk, CT.

Many similar transactions are reported differently under this principle, which is one of the biggest issues and reasons for the change. When discussing this topic at the BNA Bloomberg Conference, Deputy Chief Accountant for the SEC Wesley Bricker, stated, "The transition from a reporting model that currently consists of industry specific and at times disparate models, to a single comprehensive model grounded in core concepts and clear principles and converged with International Financial Reporting Standards (IFRS) is a shift that has the potential to benefit investors with more decision useful information."[4]

A hypothetical example that illustrates issues with the current standard is as follows: a lawn care service mows a business's grass lot for the set fee of $50. Revenue may be recorded as soon as the act is complete. However, if the company pays the lawn care service $500 in early spring for mowing service that will be completed over 5 months, the service would recognize portions of the payments equally over the service period. The amount recognized would the same each month even though the lawn may be mowed 3 times the first month and 5 times the next month.

The most recent set of updates came from FASB Topic 606. Measuring revenue as a result of changes in assets and liabilities is known as the asset-liability approach which is the basis of the new revenue recognition standard. Depicting the transfer of goods and services to customers at the amount the company expects to receive or will receive is the main objective of the principle. This update outlines a five step procedure as follows: "*(1)* Identify the contract(s) with a customer. *(2)* Identify the performance obligations in the contract. *(3)* Determine the transaction price. *(4)* Allocate the transaction price to the performance obligations in the

[4] (2015, Sep 17). Remarks at the Bloomberg BNA conference on revenue recognition. *Targeted News Service* Retrieved from http://search.proquest.com/docview/1713766437?accountid=9609

contract. *(5)* Recognize revenue when (or as) the entity satisfies a performance obligation." The final step of the procedure also acts as the basis of the new principle.[5]

As defined in FASB Topic 606, a contract is "an agreement between two or more parties that creates enforceable rights and obligations." The contract must be approved of by both parties, identify the rights of the parties and payment terms, and have commercial substance. One last requirement associated with the contract is, it must be probable that the entity will collect consideration in the exchange for goods or services transferred to the customer. The promise associated with this exchange is called a performance obligation. If the contract indicates that more than one good or service will be transferred to the customer, the goods or services must be accounted for as separate obligations only if the goods or services are both distinct and substantially the same, including the same pattern of transfer. Transaction price is the amount of consideration given to the seller by the buyer. A few things to be kept in mind when determining transaction price are: if the consideration is variable; any constraints that should be exerted on estimates of variable consideration; any significant financing components; noncash consideration; and consideration payable to the customer. When a contract has more than one performance obligation, the entity should use a standalone selling price or an estimate to determine a reasonable amount to allocate to each obligation while also recognizing any discounts specific to individual obligations. Revenue is then recognized as performance obligations are satisfied; in other words, when the customer obtains control of the good or service.

To determine if the performance obligation is satisfied over time, the entity must consider if the customer will consume benefit as it receives it from the entity, if the entity is creating an

[5] FASB ASC 606 (2014, May). Revenue from Contracts with Customers. *Accounting Standards Update 2014-09.* Norwalk, CT.

asset with alternative uses to the entity, and if there is a right to payment for performance completed to date. However, if the performance obligation is not satisfied over time, the entity must indicate it is completed at one point in time. This is achieved by proving that the entity has right to payment at the present time, the customer has title to the asset, physical possession has been transferred from the entity, the customer is responsible for risks and rewards of ownership, or the customer has accepted the asset. The method for measuring progress of performance obligations should be consistent over time but adapt as circumstances arise. An entity should recognize any cost to create the contract that it expects to recover as an asset, though, if the amortization is less than one year, the amount may be expensed as incurred.

In regards to how this affects accountants in the United Sates, these changes unify IFRS and GAAP standards allowing a more standardized and comparable analysis of the revenue of companies across industries and internationally. In preparation of financial statements, the number of requirements has been reduced. This update has provided a framework for dealing with revenue recognition issues completely and with less room for individual interpretation. Also, this framework reduces the number of requirements an entity must consider as opposed to previously required industry specific transactions. Now financial statements should be more user friendly in terms of understanding timing, nature, amount, and uncertainty of revenue. Lastly, nonpublic entities now have more extensive guidance. At the previously mentioned conference, Bricker also said, “I believe that the new model-when applied with appropriate professional judgment-will consistently report revenue, one of the single most important measures used by investors, regardless of a company's industry or the capital markets accessed.”

Some issues were reported by companies in 2014 as they examined the new standard. The issues included determining if an arrangement meets the criteria required to be considered a

contract, retrospective modification of contracts currently in progress, distinguishing components as separate performance obligations, estimating the selling price, how goods and consideration will be transferred over time, and new disclosures that will be required.[6] In response, in May of 2015 FASB reworked the update to clarify separation of performance obligations. The board also made the modification of ongoing contracts simpler by using the original selling price(s). Other new disclosures regarding intellectual property licenses, presentation of sales tax, noncash consideration, and the collectability threshold were integrated as well, due to concerns expressed by business owners and American accounting professionals.[7]

Another major issue that has been expressed, by multiple stakeholder groups, suggests that the principles-based guidance opens the door to greater susceptibility to fraud. To address this contention, the AICPA has suggested that the benefits of comparable and more transparent financial statements outweigh the associated risks. Accounting for expenses and liabilities, in terms of timing, is one of the most prevalent areas associated with accounting fraud. However, there is little to no evidence to suggest that use of an asset-liability approach for revenue recognition will make committing fraud any easier.[8]

Though being specific about financial information is necessary, too much information may be confusing and costly. Current standards for revenue recognition are extremely industry and transaction specific. The new standard will generally guide recognition based on a set of principles. Effective dates for this standard are December 15, 2016 for public entities, and

[6] Tysiac, K. (2014). Seven revenue recognition considerations. *Journal of Accountancy, 217*(3), pp. 24-26. Retrieved from http://search.proquest.com/docview/1505315881?accountid=9609
[7] Tysiac, K. (2015). Revenue recognition revisited. *Journal of Accountancy, 219*(4), pp. 20-20. Retrieved from http://search.proquest.com/docview/1675635424?accountid=9609
[8] Williams, B. J. (2016). *The New Frontiers of Accounting Fraud: The Impact of Accounting Standards Convergence on Fair and Accurate Financial Reporting*. Available from ProQuest Dissertations & Theses Global. Retrieved from http://search.proquest.com/docview/1754639699?accountid=9609

December 15, 2017 or December 15, 2018 for all other entities, depending upon the timeline of reporting.

Leases:

In 1976, a lease was defined as "a contract between an owner (the lessor) and another party (the lessee) which conveys to the lessee the right to use the lessor's property in return for a consideration, usually periodic rental payments."[9] The two types of leases were operating and financing. In an operating lease, the lessor maintained all risks and rewards associated with ownership for a short duration. Typical examples included apartment rentals, shopping center spaces, and vehicles. Financing leases were most often long term and non-cancellable with ownership risks and rewards transferred to the lessee. The lessee usually paid taxes, insurance, and maintenance on the property. When the lease expired, the lessee often had the option to buy the property for a nominal sum.

Since the original standard was set, the procedures have undergone changes to make the principle more complete and specific. Currently, organizations use a classification test to determine if the lease is a capital lease, originally called a financing lease, that is recognized on the balance sheet or an operating lease which is not recognized on the balance sheet.

For lessees, the classification test sets forth four criteria to be considered a capital lease; if the lease fulfills one or more of these criteria, it is considered an operating lease. The four criteria are *(1)* transfer of ownership of the property to the lessee, *(2)* presence of a bargain purchase option in the contract, *(3)* the lease term is at least 75 percent of the estimated useful economic life of the asset, and *(4)* the present value of the minimum payments is equal to or

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[9] FASB (1976, November). Statement on Lease Accounting. *Statement of Financial Accounting Standards No. 13.* Norwalk, CT.

greater than 90 percent of the current fair value of the asset.[10] On the balance sheet, the asset and liability are recorded at the lower of the present value of minimum lease payments or the fair value of the leased asset at beginning of the contract. For an operating lease, the present value of the minimum lease payments is expensed evenly over the duration of the contract. By comparison, a capital lease reports a greater amount of short-term and long-term debt, a larger sum for total assets, and a lower value for income and retained earnings than an operating lease.

In contrast, cash flow of the business is not affected by this choice. With a capital lease, the interest from the capital lease expense will be included in cash flow from operations and the principle payment will be part of cash outflows from financing activities. In other words, cash flows from operating activities will be overstated and cash flows from financing activities will be understated. By comparison, the total lease payment is included as an outflow from operating activities for an operating lease.[11] Thus, the affect is relatively equal. Ultimately, the charges to operations are the same over the entirety of the lease term.

On the contrary, there are two additional criteria leases must fulfill for capitalization under the lessor accounting model. The first stipulation is collectability of the payments from the lessee must be reasonably predictable. Secondly, there must be no significant uncertainties about costs that will not be reimbursed which means the lessor has considerably completed all performance obligations or future costs are easily predictable. If all of the criteria are met, the lessor may classify a lease with a related manufacturer's or dealer's profit as a sales-type lease and all others as direct-financing leases. Just as with the lessee accounting model, if any of the

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[10] FASB ASC 840-10-25-1. (1980, May). Accounting for Leases. *FASB Statement No. 13 as amended and interpreted.* (par. 6-8) Stamford, CT.

[11] Guinan, J. (2009). Liabilities - Effects Of Capital Vs. Operating Leases. In The (I) investopedia guide to Wall speak: The terms you need to know to talk like Cramer, think like Soros, and buy like Buffett. New York: McGraw-Hill. Retrieved from http://www.investopedia.com/exam-guide/cfa-level-1/liabilities/capital-operating-leases-effects.asp

criteria are not met the lease is considered operating. With a direct-financing lease, a lease receivable is recorded at the present value of the minimum lease payments under "Net Investment in Capital Leases" on the balance sheet. For an operating lease, the lessor should distribute depreciation in a normal manner and the related expense should be matched to rent revenue each period. Fees, such as appraisal, finder's, and credit checks, are amortized over the life of the lease.

Relating to the Enron scandal, in 2005 the SEC named leasing as a form of off-balance sheet accounting that needed to be changed. At that time, FASB began to look into the extensive use and misuse of leasing for obtaining assets and financing while reducing the risk associated with ownership. Often, companies would manipulate one aspect of the contract to ensure the lease would be considered operating rather than capital to avoid the impact it would have on the balance sheet.[12] As a result, after the effective date all capital leases will be included on the balance sheet as assets and liabilities. Though this is not a deviation from the original standard substantially fewer leases will be considered operating. This means throughout the United States, over a trillion dollars that were not previously featured on the balance sheet will be reported.[13]

With the latest updates to the Codification the accounting for capital leases will not change considerably for the lessor (owner of the asset) or the lessee (user of the asset). The two proposed updates are Topic 840 Leasing: Amendments to Financial Accounting Standards Board Codification and Topic 842 Leasing. The lessee accounting model for financing leases, currently called capital leases, recognizes amortization of the right-of-use (ROU) asset separate from the interest on the lease liability; on the other hand, operating leases will be recognized as one total

[12] Abdel-khalik, Rashad. (1981). The Economic Effects on Lessees of FASB Statement No. 13, Accounting for Leases. *Research Report.* Stamford, CT.
[13] Fioravante, Janice. (2014, October). 5 Ways to Prepare for New Lease Accounting Rules. Retrieved from http://www.accountingweb.com/aa/standards/5-ways-to-prepare-for-new-lease-accounting-rules

straight-line rent expense. An ROU asset is an asset that a lessee has the right to direct the use of as per contractual agreement and the lessor does not have the right to interfere with that direction.[14] Payments related to both types of leases will be featured in the operating section of the statement of cash flows.

Also for the lessee, there will now be an exception to the classification test. When an asset is in the last 25 percent of its useful life at the start of the lease, the lessee may disregard the requirement for the lease-term to be at least 75 percent of the estimated economic life. Similarly, when accounting for a lease with a term of 12 months or less, the lessee may elect to only account for the lease expense only and not recognize an asset and a liability.

Through the updates, the lessor accounting model is now better aligned with the updated revenue recognition guidance; specifically, when dealing with a sales-type lease, recognition is similar to that of a sale when the lessee gains control of the asset as a result of the lease. Correlating with the lessee accounting model, certain glossary terms will be revised so lessees that sublease to apply the same guidance as the primary lessor. The main term that relates to the updated standards is the definition of leases. A lease is now defined as a contract, or part thereof, that transfers the use, meaning right to all economic benefits and authority for direction, of an identified asset for a set period of time for consideration. In addition to the transaction related information, lessees and lessors must also provide qualitative disclosures so that users of financial statements may undust and weed through the nature of an entity's leasing activities.

One month after the revised Exposure Draft for the leasing standard, Topic 840, was published in May 2013, Deloitte (one of the Big Four international accounting firms) administered a survey of 138 executives at companies that engage in leasing activity. The

[14] FASB ASC 840-10-20 (2016, February). Leases: Amendments to the FASB Accounting Standards Codification. *Accounting Standards Update 2016-02* (par. 10). Norwalk, CT.

purpose of the survey was to better understand the potential financial and economic impact of the new guidelines, while also gaining feedback on potential implementation issues. A majority of the participants expected a significant impact on their company's financial reporting. The two ratios most often expected to be impacted were the debt to equity ratio and the return on assets percentage. As a result, 42 percent of participants expect more difficulty in obtaining financing due to the impact on financial ratios. More than 70 percent speculated that both lessees and lessors would be subject to a marked increase in reporting burden. Over half of the executives felt the implementation would take at least a full year, with many issues related to information technology (IT) systems and lease data compliance.[15]

Trends that could come from the new standard include a tendency to purchase rather than lease, shorter lease-terms, and implementation of new IT systems. It is likely businesses will take a new approach to entering into new credit agreements and that process will be aided by the more immediate availability of information. Multinational companies will face a bigger burden. One of the original objectives of this project was to create a converged system with the IASB; however, this goal was abandoned during the development process.[16]

In response to the new guidance Ralph Petta, CEO and president of the Equipment Leasing and Financing Association (ELFA), said, "…it will not impact the ability of companies to acquire productive equipment to grow their businesses. There are many reasons to lease equipment, and the primary reasons will remain intact under the new rules, from maintaining cash flow, to preserving capital, to obtaining flexible financial solutions, to avoiding

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[15] Deloitte. (2013, June). Lease Accounting Survey, Preparation for Implementation. Retrieved from http://www2.deloitte.com/content/dam/Deloitte/us/Documents/finance/us-fas-lease-accounting-report.pdf
[16] Tysiac, K. (2016, February 25). New FASB Leases Standard Brings Transparency to Lessee Balance Sheets. *Journal of Accountancy.* Retrieved from http://www.journalofaccountancy.com/news/2016/feb/fasb-issues-leases-standard-201613941.html?utm_source=mnl:cpald&utm_medium=email&utm_campaign=26Feb2016#sthash.YiaIyOjO.dpuf

obsolescence." After the Exposure Drafts of 2010 and 2013 were released to the public, members of ELFA had many concerns and submitted many suggestions that FASB then included in the final standard. This effort has made the new guidance more workable and economically feasible for American businesses.[17]

Though the new updates are quite extensive, how GAAP will be effected is relatively simple. The transparency and comparability of organizations that lease buildings, equipment, and other assets will be greatly increased. All off-balance sheet leasing activities will now be visible and identifiable on the balance sheet allowing users of financial statements a better understanding of the long-term obligations associated with these agreements. Many entities will now be required to recognize assets and liabilities associated with leases that previously were not recognized. The new leasing standard will be put into effect December 15, 2018 for public entities and December 15, 2019 or December 15, 2020 for all other entities depending upon the beginning date of the fiscal year of the business.[18]

Pensions:

In December 1985, FASB issued Statement No. 87 titled Employers' Accounting for Pensions. This statement announced that pensions should be accounted for on an accrual basis while also following three fundamental principles. The three principles are to *(1)* delay recognition of certain events, *(2)* report net costs, and *(3)* offset liabilities and assets. Delayed recognition means changes to the pension obligation and to the value of assets set aside to meet said obligation are not recognized as they occur but over future periods. The net cost feature recognizes the compensation, interest, and investing costs of a pension plan to be reported as a

[17] (2016, Feb 25). Equipment Leasing and Finance Association Issues Statement on New Lease Accounting Standard. *Targeted News Service* Retrieved from http://search.proquest.com/docview/1768314039?accountid=9609
[18] (2015, November 19). Project Update. *Financial Accounting Standards Board Project Roster and Status.* Retrieved from http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=900000011123

net cost on the financial statements. Offsetting requires assets and liabilities from past periods to be reported on the balance sheet. Net periodic pension cost is determined using a standard method and recognized over the employee's service period. A minimum liability is recognized immediately only when the obligation exceeds the fair value of the plan assets.[19]

Currently, there are two types of pension plans, defined contribution plans and defined benefit plans. For a defined contribution plan, each period the employer contributes a sum to the pension trust based on a formula that considers age, duration of employee service, business profits, and level of compensation. Each year, the employer accounts for the pension expense and incurs a liability when the full contribution cannot be made or reports an asset when more is paid. A plan description, the contribution formula, and significant impacting factors must also be disclosed. This plan outlines what the company has given, not what will be received by the employee at the end. On the contrary, a defined benefit plan recognizes what will be received upon retirement. Benefits relate to the number of years of service and usually consider the level of compensation in the years closely preceding retirement. The employer must contribute enough each year to satisfy the cost benefits outlined in the defined plan. This can be based on vested benefits at current salary levels, vested and nonvested benefits based on the current salary, or the present value of vested and nonvested benefits based on future salaries. The final method is preferred by FASB and, because future salaries are expected to be higher, often reports the greatest sum.

Under the proposed amendments, the accounting for the latter of the two, defined benefit plans, would be different. Suggested changes would require a business to separate service costs from net benefit cost in financial presentation. Only the service cost component of net benefit

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[19] FASB (1985, December). Employers' Accounting for Pensions. *Statement of Financial Accounting Standards No. 87*. Norwalk, CT.

costs would be eligible for capitalization. All other net benefit costs would be reported as one line item on the income statement with a detailed description included in the notes to financial statements. A service cost is the present value of new benefits earned by the employee during the year. Other net benefit costs include interest on the liability, actual return on plan assets, amortization of prior service cost, and gains or losses based on the fair value of plan assets and previous amortization.

Many current disclosure requirements for defined benefit plans would be removed because they are not consistent with the Concepts Statement for this topic and other new standards are being proposed for inclusion. Disclosures no longer required would include the amount of the accumulated benefit obligation, the aggregate amount of the fair value of plan assets with accumulated obligation benefits, amounts related to benefits covered by insurance and annuity contracts, and components of other comprehensive income to be recognized as part of the next period's net benefit. The proposed new requirements include a description of the benefits provided, the employee groups covered, the formula for the plan, the weighted-average interest credit rating used, quantitative and qualitative fair value measurements, and written explanation about gains and losses.

From a Financial Accounting Standards Advisory Council (FASAC) survey in 2013, a FASB advisory committee learned that stakeholders wanted simpler, better, and more useful information.[20] Thus, FASB began the disclosure framework project to, mainly, try to improve the usefulness of the notes to financial statements with pensions as one of areas of focus. Current disclosures aggregate amounts that are predicted using different methods which makes it more

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[20] Tysiac, K. (2013, September 16). Stakeholders Seek Simplification, Better Information from FASB Standards. *Journal of Accountancy.* Retrieved from http://www.journalofaccountancy.com/news/2013/sep/20138734.html#sthash.5eBJiaUl.SPdFlg6M.dpuf

costly for investors to decode the information. Proposed updates will come from two standards Subtopic 715-20: Changes to the Disclosure Requirements for Defined Benefit Plans and Topic 715: Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost.[21]

One issue that should be mentioned in relation to this topic is the state of the American Social Security system. With the current underfunded status of this resource, businesses and employees alike must take on a greater responsibility for the funding of individual employees' retirement. For business owners, the assumed discount rate of the plan is the aspect that causes the pension to be over or underfunded. John Keefe, an author for the Institutional Investor made the claim, "The dispute over discount rates is not just an academic amusement. Proper valuation is essential to the current efforts to get pension plans on an affordable long-term trajectory."[22] A discount rate that is too high pulls earnings away from the benefit of the business; however, a rate that is too low creates a future obligation to make up the difference. While FASB is trying to fix this problem at the level of individual businesses, the Government Accounting Standards Board (GASB) is also working to fix this problem on the national level. GASB has passed many standards in the past decade to aid this situation.[23]

For users of financial statements, these changes will allow separate analysis of service costs and net benefit costs. Service costs would be included with other compensation costs associated with the services provided by the individual employee and the net benefit costs would

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[21] FASB (2016, January 26). Proposed Accounting Standards Updates Compensation—Retirement Benefits—Defined Benefit Plans— General (Subtopic 715-20): Changes to the Disclosure Requirements for Defined Benefit Plans Compensation—Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost. *FASB in Focus.* Norwalk, CT.
[22] Keefe, J. (2011). Current Accounting Rules Understate Pension Problem. *Institutional Investor,* (pp. 40-41). Retrieved from http://search.proquest.com/docview/856969690?accountid=9609
[23] Thornton, N. (2015). New Accounting Rules Reveal Pension Shortfalls. *Benefits Selling.* Retrieved from http://search.proquest.com/docview/1664425014?accountid=9609

be presented as a line item separated from income from operations on the income statement. Included in net benefit costs are interest on the liability, actual return on plant assets (the increase in pension funds from interest, dividends, and realized and unrealized changes in fair value), amortization of prior service cost, and gains or losses. FASB is accepting feedback on these updates until April 25, 2016 so no effective date has been announced.

Fair Value Measurement

Use of the fair value method, historically, has been fragmented and scattered with much evolution occurring in during the 1990s. The original definition of fair value was "the amount at which the instrument could be exchanged in a current transaction between willing parties, other than in a forced or liquidation sale." In 1991 FASB Statement of Financial Accounting Standards (SFAS) No. 107 was passed requiring the fair value of a financial instrument to be reported, if able, at fair value.[24] Financial instruments include cash, ownership interest in an entity, or a contract that creates an obligation that one entity owes to another and the receiver views this obligation as a right. Two years later, FASB issued SFAS No. 115 which required "held to maturity" debt securities to be amortized; investments with readily determinable market values were considered "trading" securities and reported at fair value with unrecognized gains and losses included in income; all other securities were considered "available-for-sale" and reported at fair value with unrecognized gains and losses reported as separate line items in the stockholders' equity.[25] Then SFAS No. 121 brought about the use of fair value for the measurement of the impairment loss of a long-lived or intangible asset held for use.[26] A fair

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[24] FASB (1991). Disclosures about Fair Value of Financial Instruments. *Statement of Financial Accounting Standards No. 107.* Norwalk, CT.
[25] FASB (1993). Accounting for Certain Investments in Debt and Equity Securities. *Statement of Financial Accounting Standards No. 115.* Norwalk, CT.
[26] FASB (1995). Accounting for Certain Investments in Debt and Equity Securities. *Statement of Financial Accounting Standards No. 121.* Norwalk, CT.

value method of accounting for employee stock compensation plans was outlined in SFAS No. 123 shortly thereafter.[27]

SFAS No. 157 was issued in 2006; FASB declared, "…increased consistency and comparability in fair value measurements and for expanded disclosures about fair value measurements…" as the reason for making this announcement.[28] Before it was issued, there were different definitions and limited guidance for accounting at fair value. Each type of asset that was reported at fair value on financial statements had a different variation of similar procedures. In the definition, the value of the asset or liability should be measured from the perspective of a participant in the market, including any risks (such as a nonperforming liability) the investor would factor into the transaction, rather than from the entity's point of view. It also expands the use of fair value to assets and liabilities measured in interim and annual periods. The standards focus on the inputs and significant unobservable inputs used to measure and update the reported value.

Most importantly, SFAS No. 157 established a hierarchy for inputs used to measure fair value. Level 1 inputs are observable or quoted prices for identical assets and liabilities in active markets. Level 2 inputs are quoted prices for similar assets and liabilities in active markets, or identical assets and liabilities in inactive markets, or interest rates and yield curves. Level 3 inputs are unobservable and based on the best information available through reasonable means of attainment; meaning, an entity does not need to incur an excessive expense to obtain the information. Related to this standard, a Memorandum of Understanding was created between the FASB and IASB and published in that same year (2006). This then led to ASU No. 2011-04

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[27] FASB (1995). Accounting for Stock-Based Compensation. *Statement of Financial Accounting Standards No. 123.* Norwalk, CT.
[28] FASB (2006). Fair Value Measurements. *Statement of Financial Accounting Standards No. 157.* Norwalk, CT.

being issued in 2011. This update clarified the intent behind the existing measurement and disclosure requirements. ASU No. 2011-04 also created a fair value measurement and accounting requirements for United States and international accountants to follow.[29]

As of January 11, 2016, FASB announced this as another topic of the disclosure framework project that should "improve the effectiveness of disclosures in notes to financial statements by clearly communicating the information that is most important to users of each entity's financial statements." Currently, the guidance uses the phrases such as, "an entity shall disclose at a minimum." Businesses therefore, have difficulty justifying omitting material that is actually immaterial which makes needed information harder to find. Topic 235, Notes to Financial Statements, discusses the information that should be included in notes to financial statements and promotes excluding immaterial information.[30] The standard specifically for fair value measurement currently in process is Topic 820: Disclosure Framework-Changes to the Disclosure Requirements for Fair Value Measurement.

Requirements that would be modified are Level 3 assets and liabilities no longer need to be reconciled to previous balances, though transfers into and out of Level 3 of the hierarchy and purchases and issues of such assets and liabilities must be disclosed. An entity must disclose the timing of a liquidation of an investee's assets only if the investee has publicly announced said timing. The measurements of uncertainty should communicate standing on the reporting date rather than potential changes in the future. New disclosures that would be added include recognizing the change in unrealized gains and losses for the period and showing separate

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[29] FASB (2011). Fair Value Measurements (Topic 820). *Accounting Standards Update 2011-04.* Norwalk, CT.
[30] Tysiac, K. (2015, December 3). FASB Proposal Takes Aim at Immaterial Fair Value Disclosures. *Journal of Professional Accountancy.* Retrieved from http://www.journalofaccountancy.com/news/2015/dec/fasb-fair-value-disclosure-requirements-201513486.html#sthash.TSuebeZp.dpuf

amounts for each level of input. Also, for significant Level 3 assets and liabilities inputs, the range, weighted average, time period used to develop the inputs must be reported.

Regarding the use of fair value measurement for accounting David Rowe, an author for the United Kingdom journal Risk, noted a shift in accounting standards over the past 30 years from historical cost to mark-to-market pricing. He then claims, “While I am broadly supportive of this trend, it can be taken too far.”[31] Supporters of the fair value method list the virtues as increased objectivity and neutrality, better information about performance and the future of the company, and better guidance for managers.[32] The fact that the disclosures related to the fair value method are being stream-lined provides the opportunity for better understanding by all and to ensure that the values recognized are accurate.

At this point, there is no effective date for these proposed amendments and FASB is accepting feedback on the plan outline. The changes should, potentially, make it easier for users of financial statements to determine the materiality of items included in the notes to financial statements.

Conclusion

By nature, accountants focus on the details and thrive under a rules-based philosophy. Striving for perfection in such a society takes patience, determination, and teamwork. As such, when addressing issues within the financial accounting frameworks FASB works to include the opinions of all stakeholders. In virtually all stages of the updating and amending project, public

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[31] Rowe, D. (2014). Fair-value accounting's blind spot. *Risk,* (pp. 62). Retrieved from http://search.proquest.com/docview/1513540968?accountid=9609
[32] Zuca, M. (2015). The Faithful Image and Fair Value- Main Objectives in Insuring Transparency of the Financial and Accounting Information. *Journal of Information Systems & Operations Management,* (pp. 460-468). Retrieved from http://search.proquest.com/docview/1770932931?accountid=9609

opinion is sought and included if applicable and feasible. Thus, updates to the FASB Codification effectively change financial accounting standards and GAAP. Since 1986, FASB and the accounting community have considered leases, pensions, and changing prices as areas of recurring controversy. Updates to revenue recognition, leases, pensions, and fair value measurement will address problems with the current guidance. US GAAP will be more accurately represented and, in certain areas, methods will be more comparable with international standards.

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