

Client Alert

Latham & Watkins Corporate Department

The Codification of GAAP

Be Careful What You Wish For

On July 1, 2009, the Financial Accounting Standards Board (FASB) responded to the many requests over the years for a single source of all accounting standards, interpretations and other guidance by adopting the FASB Accounting Standards Codification™ (the Codification) as the single source for non-governmental US generally accepted accounting principles (GAAP). The Codification must be used for all financial statements for periods ending after September 15, 2009. This means that calendar year filers must apply the Codification to their third quarter 2009 reports and all subsequent reports. Furthermore, all Securities and Exchange Commission (SEC) comment letters will now refer to the Codification and not to the old accounting standards. Thus, familiar terms like SFAS 141, FIN 48 and SFAS 5 are no longer the source of accounting principles on business combinations, uncertainty in income tax and contingencies, respectively. The Codification is now the only authoritative source for such guidance.

What Exactly is the Codification?

The Codification places all previously issued accounting standards into code form, much like the Uniform

Commercial Code. The Codification organizes GAAP into 90 Topics and a plethora of Subtopics, Sections, Paragraphs and Subparagraphs. The chart provided at the end of this *Client Alert* lists the Codification's primary Topics.

The Codification is not intended to change GAAP (with limited exceptions noted later), but rather introduces a new, unified structure that supersedes all previously issued non-SEC accounting literature. It includes most previously issued accounting guidance from FASB, the American Institute of Certified Public Accountants (AICPA), the Emerging Issues Task Force (EITF), the Accounting Standards Executive Committee and the Accounting Principles Boards. All non-SEC accounting literature not included in the Codification is now considered non-authoritative. Additionally, the Codification eliminates the five-level GAAP hierarchy. Under the Codification, there are only two levels: authoritative and non-authoritative. All standards in the Codification are authoritative and have equal weight. Standards or guidance that are not included in the Codification are non-authoritative.

SEC accounting guidance remains authoritative and binding on companies reporting to the SEC. The Codification incorporates relevant SEC guidance, which is displayed below the related topic in the Codification. This includes portions of Regulation S-X, certain

" . . . the benefits of the Codification are capable of outweighing the inconveniences associated with the transition if practitioners take advantage of this opportunity to reevaluate and redraft current accounting disclosure in terms of content and style."

guidance from Staff Accounting Bulletins and other materials. However, the Codification contains only those matters where the SEC has issued guidance relating to financial statements. It does not incorporate guidance related to matters outside the financial statements, such as auditing and independence matters or Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A).

What's the Big Deal?

At the most basic level, the Codification should have little effect on the preparation of financial statements and the accompanying footnotes since the substance of GAAP remains unchanged. For most companies, the initial transition will involve little more than converting citations from the old "FASB Statement No. XXX" to the plain English version of the Codification's citation format that is discussed later in more detail.

However, practitioners can use this transition as an opportunity to update disclosure, correct errors, reevaluate policies and generally refine legacy disclosure that may not have been altered in years past. For most companies, disclosure in the financial statements has evolved organically. There was no reason or inclination to revise disclosure, even where it may have become cumbersome or difficult to read. Thus, companies can use the Codification and the requisite revisions to the accompanying footnotes to conduct a thorough review of their disclosure.

Preparing the First Post-Codification Report

As previously discussed, calendar year filers will apply the Codification to their third quarter 2009 reports filed on Form 10-Q and to all subsequent reports. The Staff of the SEC's Division of Corporation Finance (the Staff) has

issued interpretive guidance to clarify that references in SEC rules to pre-Codification GAAP standards should be understood to refer to the corresponding reference in the Codification.¹ The first step in preparing a Codification report is knowing where to find the newly codified GAAP that replaces the previous standards.

Where to Look For Guidance

The Codification is available at FASB's Accounting Standards Codification Web site, <http://asc.fasb.org>. Once logged in, the most useful tool will likely be the "FASB Cross-Reference" link. This tool allows a user to cross-reference the old standard type and number against a list showing the topic, subtopic and paragraph where the old standard's paragraphs and guidance can be found.

If you know the section of the Codification you are trying to reach, you can type it in the "GO TO" box. Alternatively, you can use the pop-up menus that appear if you hover over the nine topic categories on the left side of the screen. Hovering over a category will display the Topics and hovering over a Topic will reveal the Subtopics.

How to Cite the Codification

FASB has suggested the following method for citing the Codification: "FASB ASC AAA-BB-CC," where AAA is the Topic, BB is the Subtopic and CC is the Section. For example:

- "FASB ASC 310" refers to topic 310, *Receivables*.
- "FASB ASC 310-10" refers to the *Overall* subtopic in the *Receivables* topic.
- "FASB ASC 310-10-15" refers to the *Scope* section of the *Overall* subtopic in the *Receivables* topic.
- "FASB ASC 310-10-15-2" refers to paragraph 2 of the *Scope* section of the *Overall* subtopic in the *Receivables* topic.

To assist readers in the transition to the Codification, companies may present

both the Codification citation and former reference. If companies use this presentation, citations to the former reference must appear in parentheses following the Codification reference. For example, a reference to the former FASB Statement No. 141R, *Business Combinations* (SFAS 141(R)), could appear as, "FASB ASC 805-10, *Business Combinations* (SFAS 141(R))."

For clarity, companies may wish to include the title of the cited Codification section. "FASB ASC Topic 310" would appear as "FASB ASC Topic 310, *Receivables*," and "FASB ASC Section 310-10-15" would appear as "FASB ASC paragraph 310-10-15, *Receivables—Overall—Scope* (SFAS 131)."

Using Plain English

Companies may use this transition as an opportunity to switch to plain English disclosure by removing all technical references to FASB Statements, EITFs and FINs from quarterly and annual reports. FASB and the SEC have recommended that companies use plain English in their financial statement disclosures by avoiding specific GAAP references and more clearly explaining the accounting concepts.² For example, rather than refer to "SFAS 5, *Accounting for Contingencies*" or "FASB ASC 450, *Contingencies*," a company could write, "as required by the Contingencies topic of the FASB Accounting Standards Codification," or describe the principles as applied without reference to the Topics, Subtopics or Sections of the Codification: "as required by the general accepted accounting principles for contingency reporting." Time will tell whether companies will follow this guidance and whether the Staff will comment in the review process if a company does not do so.

Additions to the Periodic Reports

Adoption of the Codification should be noted in both the "Recent Accounting Pronouncements" footnote to a company's financial statements and

in the "Accounting Pronouncements" section of the MD&A. An explanatory note may also be included at the beginning of the report or the beginning of the footnotes and the MD&A. Such a note may read as follows:

On July 1, 2009, the FASB Accounting Standards Codification™ (the Codification) became the authoritative source of accounting principals to be applied to financial statements prepared in accordance with GAAP. In accordance with the Codification, citations to accounting literature in this report are to the relevant Topic of the Codification or are presented in plain English. For convenience, we have also included a corresponding reference to the pre-Codification literature.

If implementation of the Codification results in making an accounting change or recognizing an error from a prior period, the company should disclose the nature and reason for the change in accounting principle pursuant to FASB ASC 250-10-50, *Accounting Changes—Change in Accounting Principle* (SFAS 154). When disclosing a change, the company should disclose the standard that was used before and after the Codification and the reason that the Codification resulted in a change of accounting principle or correction of an error.

What is New in the Codification

Users of the Codification may notice subtle differences from the pre-Codification language to which they have become accustomed. The Codification does not require companies to adopt this new terminology in their non-GAAP disclosure. Companies may continue to use terms that have otherwise been changed in the Codification as appropriate for the company. Even though the Codification does not mandate the use of this new terminology, it will be interesting to see

whether companies adopt these new terms.

Some changes that FASB made in the Codification include:

Entities

The Codification will use the term "entity" to describe all business organizations. Previous uses of "company," "organization," "enterprise," "firm" and "preparer" have all been replaced by "entity." Because of this change, the term, "Intercompany" has also been eliminated from the Codification and replaced with "intra-entity."

Shall, Should and Must

The Codification uses the term "shall" throughout where there is a requirement to apply a standard. This change replaces the pre-Codification use of "should," "shall," "is required" and "must." In example scenarios included in the Implementation Guidance and Illustrations sections of the Codification, the terms "would" and "should" are used to indicate hypothetical scenarios.

Generally Speaking

Generic qualifying terms, such as "usually," "ordinarily" and "generally," have been eliminated from the Codification.

Changes From Pre-Codification GAAP

Certain inconsistencies which arose in pre-Codification accounting literature have been resolved with the publication of the Codification.

Grandfathered Accounting Standards

The Codification does not include certain grandfathered accounting standards that have continued applications. They include:

- pooling of interests in a business combination;
- pension transition assets or obligations;

- accounting for employee stock ownership plan shares;
- loans restructured in a troubled debt restructuring before the effective date of FASB Statement No. 114;
- stock compensation for nonpublic and other entities; and
- business combinations with an acquisition date before the first annual reporting period beginning on or after December 15, 2008 under SFAS 141.

These grandfathered accounting standards remain authoritative for companies eligible to use them. These standards are only available in their pre-Codification form.

Updates to the Codification

FASB will no longer issue EITF Abstracts, Staff Positions, Statements or Interpretations. New pronouncements on accounting principles will be issued in Accounting Standards Updates. Each Accounting Standards Update will be numbered in YYYY-XX format, where YYYY is the year of the update and XX is the sequential number of the update within that year. For example, the first update was Accounting Standards Update No. 2009-01, *Topic 105—Generally Accepted Accounting Principles*. Proposed updates will appear in the relevant place in the Codification in special boxes labeled "Proposed Text." Once it becomes effective, the proposed text will be integrated into the text and outdated text will be removed.

Other Considerations

Company accounting policy manuals or audit committee documents that refer to the pre-Codification accounting standard should be updated for the Codification. To enhance clarity and avoid ambiguity, companies may consider adopting a committee resolution stating that references to pre-Codification standards should be understood to refer to the corresponding

reference in the Codification. Companies should also consider updating manuals or other documents to insert proper Codification references. Additionally, current disclosure should be reviewed under the Codification so that accounting principles are being correctly applied. The reorganization of accounting literature may reveal other standards or considerations companies did not consider or utilize under the prior GAAP hierarchy.

Conclusion

The transition to the Codification may be challenging for practitioners accustomed to the pre-Codification standards. However, the benefits of the Codification are capable of outweighing the inconveniences associated with the transition if practitioners take advantage of this opportunity to reevaluate and redraft current accounting disclosure in terms of content and style. In terms of content, companies and practitioners will only need to reference one source for guidance on accounting principles. This single source for accounting principles will increase efficiencies and reduce complexities—and reduce the risk of missing or failing to locate important guidance amid the multiple sources. The Codification will also be updated with new guidance almost instantly, providing companies and practitioners with ready access to the most recent FASB decisions and deliberations. Further, the Codification's Master Glossary can be a useful tool in drafting disclosure. In terms of style, organizing and simplifying GAAP in the Codification has the potential to result in more plain English disclosure and better communication with the users of financial statements. For all of these reasons, the Codification can be a positive development as companies and practitioners become familiar and comfortable with its structure and content.

Endnotes

- ¹ SEC Interpretation (Release Nos. 33-9062; 34-60519; FR-80) (August 18, 2009) *available at* <http://www.sec.gov/rules/interp/2009/33-9062.pdf>.
- ² See AICPA, FASB Accounting Standards Codification, "Q & A," (July 1, 2009), *available at* <http://www.aicpa.org/download/fasb/Q&A-FASB-ASC-FINAL.pdf>.

If you have any questions about this *Client Alert*, please contact one of the authors listed below or the Latham attorney with whom you normally consult:

John J. Huber

+1.202.637.2242
john.huber@lw.com
Washington, D.C.

Catherine A. Bellah

+1.202.637.3335
catherine.bellah@lw.com
Washington, D.C.

Brian D. Miller

+1.202.637.2332
brian.miller@lw.com
Washington, D.C.

Client Alert is published by Latham & Watkins as a news reporting service to clients and other friends. The information contained in this publication should not be construed as legal advice. Should further analysis or explanation of the subject matter be required, please contact the attorney whom you normally consult. A complete list of our *Client Alerts* can be found on our Web site at www.lw.com.

If you wish to update your contact details or customize the information you receive from Latham & Watkins, please visit www.lw.com/LathamMail.aspx to subscribe to our global client mailings program.

Abu Dhabi

Barcelona

Brussels

Chicago

Doha

Dubai

Frankfurt

Hamburg

Hong Kong

London

Los Angeles

Madrid

Milan

Moscow

Munich

New Jersey

New York

Orange County

Paris

Rome

San Diego

San Francisco

Shanghai

Silicon Valley

Singapore

Tokyo

Washington, D.C.

Organization of the Codification

The primary Topics of the Codification are listed in the table on the below.

<table border="0"> <tr> <td style="background-color: #cccccc;">100</td> <td style="background-color: #cccccc;">General Principles</td> </tr> <tr> <td>105</td> <td>Generally Accepted Accounting Principles</td> </tr> </table>	100	General Principles	105	Generally Accepted Accounting Principles	<table border="0"> <tr> <td style="background-color: #cccccc;">600</td> <td style="background-color: #cccccc;">Revenue</td> </tr> <tr> <td>605</td> <td>Revenue Recognition</td> </tr> </table>	600	Revenue	605	Revenue Recognition																																												
100	General Principles																																																				
105	Generally Accepted Accounting Principles																																																				
600	Revenue																																																				
605	Revenue Recognition																																																				
<table border="0"> <tr> <td style="background-color: #cccccc;">200</td> <td style="background-color: #cccccc;">Presentation</td> </tr> <tr> <td>205</td> <td>Presentation of Financial Statements</td> </tr> <tr> <td>210</td> <td>Balance Sheet</td> </tr> <tr> <td>215</td> <td>Statement of Shareholder Equity</td> </tr> <tr> <td>220</td> <td>Comprehensive Income</td> </tr> <tr> <td>225</td> <td>Income Statement</td> </tr> <tr> <td>230</td> <td>Statement of Cash Flows</td> </tr> <tr> <td>235</td> <td>Notes to Financial Statements</td> </tr> <tr> <td>250</td> <td>Accounting Changes and Error Corrections</td> </tr> <tr> <td>255</td> <td>Changing Prices</td> </tr> <tr> <td>260</td> <td>Earnings per Share</td> </tr> <tr> <td>270</td> <td>Interim Reporting</td> </tr> <tr> <td>272</td> <td>Limited Liability Entities</td> </tr> <tr> <td>274</td> <td>Personal Financial Statements</td> </tr> <tr> <td>275</td> <td>Risks and Uncertainties</td> </tr> <tr> <td>280</td> <td>Segment Reporting</td> </tr> </table>	200	Presentation	205	Presentation of Financial Statements	210	Balance Sheet	215	Statement of Shareholder Equity	220	Comprehensive Income	225	Income Statement	230	Statement of Cash Flows	235	Notes to Financial Statements	250	Accounting Changes and Error Corrections	255	Changing Prices	260	Earnings per Share	270	Interim Reporting	272	Limited Liability Entities	274	Personal Financial Statements	275	Risks and Uncertainties	280	Segment Reporting	<table border="0"> <tr> <td style="background-color: #cccccc;">700</td> <td style="background-color: #cccccc;">Expenses</td> </tr> <tr> <td>705</td> <td>Cost of Sales and Services</td> </tr> <tr> <td>710</td> <td>Compensation - General</td> </tr> <tr> <td>712</td> <td>Compensation - Nonretirement Postemployment Benefits</td> </tr> <tr> <td>715</td> <td>Compensation - Retirement Benefits</td> </tr> <tr> <td>718</td> <td>Compensation - Stock Compensation</td> </tr> <tr> <td>720</td> <td>Other Expenses</td> </tr> <tr> <td>730</td> <td>Research and Development</td> </tr> <tr> <td>740</td> <td>Income Taxes</td> </tr> </table>	700	Expenses	705	Cost of Sales and Services	710	Compensation - General	712	Compensation - Nonretirement Postemployment Benefits	715	Compensation - Retirement Benefits	718	Compensation - Stock Compensation	720	Other Expenses	730	Research and Development	740	Income Taxes		
200	Presentation																																																				
205	Presentation of Financial Statements																																																				
210	Balance Sheet																																																				
215	Statement of Shareholder Equity																																																				
220	Comprehensive Income																																																				
225	Income Statement																																																				
230	Statement of Cash Flows																																																				
235	Notes to Financial Statements																																																				
250	Accounting Changes and Error Corrections																																																				
255	Changing Prices																																																				
260	Earnings per Share																																																				
270	Interim Reporting																																																				
272	Limited Liability Entities																																																				
274	Personal Financial Statements																																																				
275	Risks and Uncertainties																																																				
280	Segment Reporting																																																				
700	Expenses																																																				
705	Cost of Sales and Services																																																				
710	Compensation - General																																																				
712	Compensation - Nonretirement Postemployment Benefits																																																				
715	Compensation - Retirement Benefits																																																				
718	Compensation - Stock Compensation																																																				
720	Other Expenses																																																				
730	Research and Development																																																				
740	Income Taxes																																																				
<table border="0"> <tr> <td style="background-color: #cccccc;">300</td> <td style="background-color: #cccccc;">Assets</td> </tr> <tr> <td>305</td> <td>Cash and Cash Equivalents</td> </tr> <tr> <td>310</td> <td>Receivables</td> </tr> <tr> <td>320</td> <td>Investments - Debt and Equity Securities</td> </tr> <tr> <td>323</td> <td>Investments - Equity Method and Joint Ventures</td> </tr> <tr> <td>325</td> <td>Investments - Other</td> </tr> <tr> <td>330</td> <td>Inventory</td> </tr> <tr> <td>340</td> <td>Other Assets and Deferred Costs</td> </tr> <tr> <td>350</td> <td>Intangibles - Goodwill and Other</td> </tr> <tr> <td>360</td> <td>Property, Plant, and Equipment</td> </tr> </table>	300	Assets	305	Cash and Cash Equivalents	310	Receivables	320	Investments - Debt and Equity Securities	323	Investments - Equity Method and Joint Ventures	325	Investments - Other	330	Inventory	340	Other Assets and Deferred Costs	350	Intangibles - Goodwill and Other	360	Property, Plant, and Equipment	<table border="0"> <tr> <td style="background-color: #cccccc;">800</td> <td style="background-color: #cccccc;">Broad Transactions</td> </tr> <tr> <td>805</td> <td>Business Combinations</td> </tr> <tr> <td>808</td> <td>Collaborative Arrangements</td> </tr> <tr> <td>810</td> <td>Consolidation</td> </tr> <tr> <td>815</td> <td>Derivatives and Hedging</td> </tr> <tr> <td>820</td> <td>Fair Value Measurements and Disclosures</td> </tr> <tr> <td>825</td> <td>Financial Instruments</td> </tr> <tr> <td>830</td> <td>Foreign Currency Matters</td> </tr> <tr> <td>835</td> <td>Interest</td> </tr> <tr> <td>840</td> <td>Leases</td> </tr> <tr> <td>845</td> <td>Nonmonetary Transactions</td> </tr> <tr> <td>850</td> <td>Related Party Disclosures</td> </tr> <tr> <td>852</td> <td>Reorganizations</td> </tr> <tr> <td>855</td> <td>Subsequent Events</td> </tr> <tr> <td>860</td> <td>Transfers and Servicing</td> </tr> </table>	800	Broad Transactions	805	Business Combinations	808	Collaborative Arrangements	810	Consolidation	815	Derivatives and Hedging	820	Fair Value Measurements and Disclosures	825	Financial Instruments	830	Foreign Currency Matters	835	Interest	840	Leases	845	Nonmonetary Transactions	850	Related Party Disclosures	852	Reorganizations	855	Subsequent Events	860	Transfers and Servicing		
300	Assets																																																				
305	Cash and Cash Equivalents																																																				
310	Receivables																																																				
320	Investments - Debt and Equity Securities																																																				
323	Investments - Equity Method and Joint Ventures																																																				
325	Investments - Other																																																				
330	Inventory																																																				
340	Other Assets and Deferred Costs																																																				
350	Intangibles - Goodwill and Other																																																				
360	Property, Plant, and Equipment																																																				
800	Broad Transactions																																																				
805	Business Combinations																																																				
808	Collaborative Arrangements																																																				
810	Consolidation																																																				
815	Derivatives and Hedging																																																				
820	Fair Value Measurements and Disclosures																																																				
825	Financial Instruments																																																				
830	Foreign Currency Matters																																																				
835	Interest																																																				
840	Leases																																																				
845	Nonmonetary Transactions																																																				
850	Related Party Disclosures																																																				
852	Reorganizations																																																				
855	Subsequent Events																																																				
860	Transfers and Servicing																																																				
<table border="0"> <tr> <td style="background-color: #cccccc;">400</td> <td style="background-color: #cccccc;">Liabilities</td> </tr> <tr> <td>405</td> <td>Liabilities</td> </tr> <tr> <td>410</td> <td>Asset Retirement and Environmental Obligations</td> </tr> <tr> <td>420</td> <td>Exit or Disposal Cost Obligations</td> </tr> <tr> <td>430</td> <td>Deferred Revenue</td> </tr> <tr> <td>440</td> <td>Commitments</td> </tr> <tr> <td>450</td> <td>Contingencies</td> </tr> <tr> <td>460</td> <td>Guarantees</td> </tr> <tr> <td>470</td> <td>Debt</td> </tr> <tr> <td>480</td> <td>Distinguishing Liabilities from Equity</td> </tr> </table>	400	Liabilities	405	Liabilities	410	Asset Retirement and Environmental Obligations	420	Exit or Disposal Cost Obligations	430	Deferred Revenue	440	Commitments	450	Contingencies	460	Guarantees	470	Debt	480	Distinguishing Liabilities from Equity	<table border="0"> <tr> <td style="background-color: #cccccc;">900</td> <td style="background-color: #cccccc;">Industry</td> </tr> <tr> <td>905</td> <td>Agriculture</td> </tr> <tr> <td>908</td> <td>Airlines</td> </tr> <tr> <td>91X</td> <td>Contractors</td> </tr> <tr> <td>915</td> <td>Development Stage Entities</td> </tr> <tr> <td>92X</td> <td>Entertainment</td> </tr> <tr> <td>93X</td> <td>Extractive Activities</td> </tr> <tr> <td>94X</td> <td>Financial Services</td> </tr> <tr> <td>952</td> <td>Franchisors</td> </tr> <tr> <td>954</td> <td>Health Care Entities</td> </tr> <tr> <td>958</td> <td>Not-for-Profit Entities</td> </tr> <tr> <td>96X</td> <td>Plan Accounting</td> </tr> <tr> <td>97X</td> <td>Real Estate</td> </tr> <tr> <td>980</td> <td>Regulated Operations</td> </tr> <tr> <td>985</td> <td>Software</td> </tr> <tr> <td>995</td> <td>U.S. Steamship Entities</td> </tr> </table>	900	Industry	905	Agriculture	908	Airlines	91X	Contractors	915	Development Stage Entities	92X	Entertainment	93X	Extractive Activities	94X	Financial Services	952	Franchisors	954	Health Care Entities	958	Not-for-Profit Entities	96X	Plan Accounting	97X	Real Estate	980	Regulated Operations	985	Software	995	U.S. Steamship Entities
400	Liabilities																																																				
405	Liabilities																																																				
410	Asset Retirement and Environmental Obligations																																																				
420	Exit or Disposal Cost Obligations																																																				
430	Deferred Revenue																																																				
440	Commitments																																																				
450	Contingencies																																																				
460	Guarantees																																																				
470	Debt																																																				
480	Distinguishing Liabilities from Equity																																																				
900	Industry																																																				
905	Agriculture																																																				
908	Airlines																																																				
91X	Contractors																																																				
915	Development Stage Entities																																																				
92X	Entertainment																																																				
93X	Extractive Activities																																																				
94X	Financial Services																																																				
952	Franchisors																																																				
954	Health Care Entities																																																				
958	Not-for-Profit Entities																																																				
96X	Plan Accounting																																																				
97X	Real Estate																																																				
980	Regulated Operations																																																				
985	Software																																																				
995	U.S. Steamship Entities																																																				
<table border="0"> <tr> <td style="background-color: #cccccc;">500</td> <td style="background-color: #cccccc;">Equity</td> </tr> <tr> <td>505</td> <td>Equity</td> </tr> </table>	500	Equity	505	Equity																																																	
500	Equity																																																				
505	Equity																																																				