The Codification of GAAP

by John J. Huber, Catherine A. Bellah, and Brian D. Miller

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™ (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 such as 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 as the Uniform Commercial Code. The Codification organizes GAAP into 90 Topics and a plethora of Subtopics, Sections, Paragraphs, and Subparagraphs. Exhibit 1 lists the Codification’s primary Topics.

The Codification is not intended to change GAAP (with limited exceptions noted below), 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: (1) authoritative, and (2) non-authoritative. All standards in the Codification are authoritative and have equal weight. Standards or guidance 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 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
### Exhibit 1—Organization of the Codification

<table>
<thead>
<tr>
<th>100 General Principles</th>
<th>600 Revenue</th>
<th>700 Expenses</th>
</tr>
</thead>
<tbody>
<tr>
<td>105 Generally Accepted Accounting Principles</td>
<td>605 Revenue Recognition</td>
<td>705 Cost of Sales and Services</td>
</tr>
<tr>
<td>200 Presentation</td>
<td>710 Compensation—General</td>
<td>712 Compensation—Nonretirement Postemployment Benefits</td>
</tr>
<tr>
<td>205 Presentation of Financial Statements</td>
<td>715 Compensation—Retirement Benefits</td>
<td>718 Compensation—Stock Compensation</td>
</tr>
<tr>
<td>210 Balance Sheet</td>
<td>720 Other Expenses</td>
<td>730 Research and Development</td>
</tr>
<tr>
<td>215 Statement of Shareholder Equity</td>
<td>740 Income Taxes</td>
<td>800 Broad Transactions</td>
</tr>
<tr>
<td>220 Comprehensive Income</td>
<td>805 Business Combinations</td>
<td>808 Collaborative Arrangements</td>
</tr>
<tr>
<td>225 Income Statement</td>
<td>810 Consolidation</td>
<td>815 Derivatives and Hedging</td>
</tr>
<tr>
<td>230 Statement of Cash Flows</td>
<td>820 Fair Value Measurements and Disclosures</td>
<td>825 Financial Instruments</td>
</tr>
<tr>
<td>235 Notes to Financial Statements</td>
<td>830 Foreign Currency Matters</td>
<td>835 Interest</td>
</tr>
<tr>
<td>250 Accounting Changes and Error Corrections</td>
<td>840 Leases</td>
<td>845 Nonmonetary Transactions</td>
</tr>
<tr>
<td>255 Changing Prices</td>
<td>850 Related Party Disclosures</td>
<td>852 Reorganizations</td>
</tr>
<tr>
<td>260 Earnings per Share</td>
<td>855 Subsequent Events</td>
<td>860 Transfers and Servicing</td>
</tr>
<tr>
<td>270 Interim Reporting</td>
<td>890 Industry</td>
<td>905 Agriculture</td>
</tr>
<tr>
<td>272 Limited Liability Entities</td>
<td>908 Airlines</td>
<td>91X Contractors</td>
</tr>
<tr>
<td>274 Personal Financial Statements</td>
<td>915 Development Stage Entities</td>
<td>92X Entertainment</td>
</tr>
<tr>
<td>275 Risks and Uncertainties</td>
<td>92X Entertainment</td>
<td>93X Extractive Activities</td>
</tr>
<tr>
<td>280 Segment Reporting</td>
<td>93X Extractive Activities</td>
<td>94X Financial Services</td>
</tr>
<tr>
<td>300 Assets</td>
<td>942 Franchisors</td>
<td>954 Health Care Entities</td>
</tr>
<tr>
<td>305 Cash and Cash Equivalents</td>
<td>958 Not-for-Profit Entities</td>
<td>96X Plan Accounting</td>
</tr>
<tr>
<td>310 Receivables</td>
<td>958 Not-for-Profit Entities</td>
<td>97X Real Estate</td>
</tr>
<tr>
<td>320 Investments—Debt and Equity Securities</td>
<td>98X Regulated Operations</td>
<td>985 Software</td>
</tr>
<tr>
<td>323 Investments—Equity Method and Joint Ventures</td>
<td>995 U.S. Steamship Entities</td>
<td></td>
</tr>
</tbody>
</table>
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 the former GAAP citations, such as “FASB Statement No. XXX,” to the plain English version as discussed in more detail below.

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 (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 finding 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 likely will 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.

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 As recently stated by Wayne Carnall, Chief Accountant in the SEC’s Division of Corporation Finance: “This is a great time to eliminate references to your accounting standards. Now that you have a nine-digit number, people don’t know whether you’re referring to an accounting standard or a nuclear launch code.”3

A survey of reports filed on Form 10-Q for the third quarter of 2009 reveals that many companies have transitioned to the Codification by eliminating all references to accounting standards and using plain English disclosure. For example, instead of, “Pursuant to SFAS No. 141(R), business acquisitions are accounted for using the acquisition method of accounting . . . .” companies omit the reference to the accounting standard and state, “Business acquisitions are accounted for using the acquisition method of accounting . . . .” Omitting reference to the specific accounting standards helps to make the report more readable and takes little of substance away from the disclosure.

Where the use of both plain English and a reference to the accounting standards is desired, a company could write, “as required by the Business Combinations topic of the FASB Accounting...
Standards Codification.” Alternatively, a company could 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 business combinations.” However, the prevailing method in periodic reports is a complete elimination of specific references to the citations of the accounting standards.

How to Cite the Codification

Where specific citation is necessary, 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.

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.” 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 should follow the Codification reference in parentheses. For example, “FASB ASC paragraph 310-10-15, Receivables—Overall—Scope (SFAS 131).”

Additions to 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™ (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 GAA**—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.

NOTES