



FASB Update, with a Twist...

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The views expressed in this presentation are our own and do not represent positions of the Financial Accounting Standards Board. Positions of the FASB Board are arrived at only after extensive due process and deliberations.



Presentation Overview

Each of us provide update on a major issue

- Tom - International Convergence
- Jeff - Revenue Recognition Project
- Bob - Financial Statement Presentation Project

Twist – mention importance of academic perspectives

- How FASB uses research in setting standards
- Roles for academics at the FASB
- Some FASB initiatives to advance research and education

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International Financial Reporting Ideal Financial Reporting System

- Efforts aimed at a common, high-quality global financial reporting system that can be used for decision-making purposes across borders
- Ideal system requires
 - A single set of high-quality accounting standards, developed and promulgated by an independent, well-funded, global standard-setting organization
 - Cooperative international regulatory, enforcement, and corporate governance regimes
 - Common, high-quality auditing standards
 - Systems for training and educating capital market participants

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International Financial Reporting Why Now?



Countries adopting IFRS or a variant

Countries converging toward IFRS

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International Financial Reporting The Evolution of IFRS

- Pre 2001 – Old IASC, “Harmonization Efforts”
- 2001 Establish IASB with support of FASB/SEC
- 2002 Norwalk Agreement between FASB/IASB
 - Make existing standards fully compatible as soon as practicable
 - Align future work programs/agendas
- 2006 Memorandum of Understanding (MOU) between FASB and IASB
 - Short term: remove major differences in focused areas
 - Medium term: develop new joint standards where significant improvement required

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International Financial Reporting Major MOU Priorities

• Business Combinations	• Post Employment Benefits
• Fair Value Measurement	• Financial Statement Presentation
• Revenue Recognition	• Liabilities and Equity
• Consolidations	• Leases
• Derecognition and Financial Instruments	• Intangibles

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FASB International Financial Reporting SEC Releases

Issuing release (2007): Allows foreign companies listing shares in the U.S. to avoid reconciling their financial statements filed with SEC to U.S. GAAP, but only if they use IFRS as adopted by the IASB

- Recent reconciliations indicate significant differences still exist

Concept release: Collects views regarding whether U.S. public companies should be allowed to use IFRS in financial statements filed with SEC

- Next step: SEC will consider issuing proposing release sometime this spring

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FASB International Financial Reporting Analysis of SEC Releases

```

graph TD
    A[SEC Releases] --> B[Preparer Choice  
U.S. GAAP or IFRS]
    C[Why allow CHOICE?] --> D[Market forces -> 1 set  
high-quality  
accounting stds]
    C --> E[Reduce preparer costs]
  
```

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FASB International Financial Reporting Regulation by Market Forces

Will market forces → 1 set high-quality standards?

- Some say yes
 - Preparers choose methods
 - Investors and other users punish poor choices
 - End up with single set of high-quality standards
- Others see problems
 - Accounting standards are “public goods”
 - Market forces seldom result in a single product
 - Can result in a “race to the bottom”

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FASB International Financial Reporting Reduce Preparer Costs

- Foreign filers HATE reconciliation requirement
- Domestic filers might save \$\$ using IFRS
- BUT preparer choice pushes costs to others
 - Users must deal with two GAAPs for similar transactions
 - Auditors must be ready to audit either system or lose clients to those who can
 - College curricula and CPA exam must cover two sets of accepted standards

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FASB International Financial Reporting Analysis of SEC Releases

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FASB International Financial Reporting FASB Recommendations

Prepare a blueprint for moving U.S. to IFRS

- Get relevant parties together
 - FASB, IASB, SEC, PCAOB, audit firms, preparers, users, academics, regulators, AICPA, IRS etc.
- Identify financial reporting infrastructure that needs to change
- Set a date for completion, with milestones
- FASB shift to “improve and adopt” approach
 - Work with IASB on a few areas that need improvements
 - FASB adopts IFRS in other areas “as is”

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International Financial Reporting FASB Recommendations

Need international cooperation to:

- **Improve IASB governance, funding and staffing mechanisms**
 - Current voluntary funding system is inadequate
 - Current staff size too small
 - Allow U.S. representation on IASB and IASCF
- **Reduce after-the-fact “endorsement” processes**
 - Define: legislative body required to review and approve each IASB standard after it is issued
 - Some of endorsements change the standard (e.g. EU)
 - Existence of multiple “endorsed” variants of IFRS is inconsistent with having a global set of standards
- **Avoid national “flavors” via local interpretations**

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International Financial Reporting Recent Events

- **SEC hosted two roundtables in December on allowing U.S. companies the choice to use IFRS**
- **FASB and others host webcasts on convergence**
- **My interpretation:**
 - Amazing consistency in views – U.S. needs a blueprint with date certain when public companies must use IFRS
 - Most oppose allowing free choice for U.S. companies before the blueprint is developed (though many support a short period of choice as date draws near)
 - Most recognize need for well-funded, independent IASB
 - But many issues need to be discussed (length of the transition period, accounting by U.S. private companies, regulatory implications, future of FASB, etc.)

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International Financial Reporting Research Perspectives/Opportunities

- **Impact of AAA/FARS comment letter on SEC Proposing Release**
 - Conclusions based on research evidence
 - Significantly affected FASB views on steps forward
 - Lead author- Teri Yohn, Indiana- testified before Congress about research findings
 - Indicates nature of research that is relevant to this issue
- **Short-term research opportunity**
 - If SEC allows some U.S. registrants to adopt IFRS this year
 - Researchers can assess the motivations for switching
 - Lower preparation costs, more comparable reporting vs. earnings management

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- **Role of 2-year Academic Fellow**
- **Lease Research Syntheses**
- **Revenue Recognition**

Jeff Wilks

FASB Academic Fellow &
Associate Professor,
Brigham Young University



2-Year FASB Academic Fellow

- **Focused on standard setting, not research**
 - Assigned to projects with duties akin to permanent staff
 - Work on EITF issues and other technical application and implementation issues
 - Meet with constituent resource groups (CFO's, industry association leaders, auditors, SEC, PCAOB)
- **Academic perspective/experience valuable**
- **But not focused on infusing research into the process**

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Example Assignment Lease Research Syntheses

- **Lease Accounting one of MOU projects**
- **Analyzed the history of lease accounting**
 - The rationales used in prior standards
 - The interaction between standard setters and the SEC
 - Noted early research by John Myers (Northwestern) on property rights approach

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Example Assignment Lease Research Syntheses

- Also analyzed the academic research on lease accounting
 - Synthesized that literature along topical lines of interest to the Boards
 - Debt-like characteristics of lease obligations
 - Impact of lease accounting on financial statements
 - Managerial reaction to standards
 - Highlighted unanswered questions
 - A dearth of research on lessor accounting

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Example Assignment Revenue Recognition Project

- Revenue Recognition also MOU project
- Joint project with IASB
- My role
 - FASB Project Manager
 - Project team composition

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Example Assignment Revenue Recognition Project

- Project Need
 - IFRS and US GAAP based on earned and realized approach (complexity, volume, standard shopping)
 - Leads to pressure to defer costs that are not assets and defer revenues that are not liabilities
 - Project should add some conceptual and practical discipline to the notion of an earnings process

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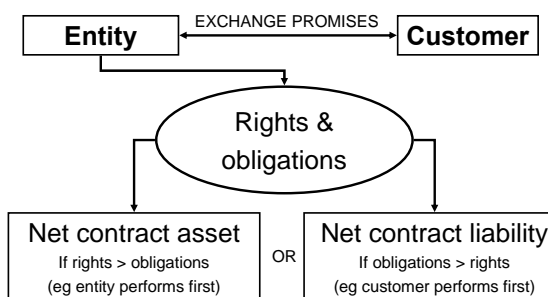
Revenue Recognition Project Status Update

- Six years old with no discussion paper
- In 2007, worked with two advisor teams
 - Measurement model
 - Customer consideration model
- Ready to draft discussion paper (almost?)
 - One contract-based revenue recognition model
 - Two measurement approaches
 - Other key issues:
 - Defining a performance obligation
 - Determining when performance obligations are satisfied

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Revenue Recognition Project Contract Based Model



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Revenue Recognition Project Contract Based Model

- Revenue is recognized when the contract asset increases or the contract liability decreases (or some combination of the two) as a result of
 - The obtaining of a contract in which the measure of the rights exceeds the measure of the obligations
 - The satisfaction of performance obligations in the contract

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Revenue Recognition Project Measurement Approaches

- “Current measurement” approach
 - Direct, explicit measurement of rights and obligations
 - Can result in revenue at contract inception
 - Remeasurement of rights and obligations at each reporting date
 - Revenue recognized equals value of goods or services when transferred
 - Revenue recognized ≠ consideration received

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Revenue Recognition Project Measurement Approaches

- “Customer consideration” approach
 - Direct, explicit measurement of rights
 - Allocation of that measure to performance obligations
 - No revenue can result at contract inception
 - No remeasurement of performance obligations
 - Contracts subject to onerous tests

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Revenue Recognition Project Performance Obligations

- Performance obligations are the entity’s promises within a contract with a customer to transfer an economic resource to that customer.
 - Contracts include any arrangement between entity and customer that would be upheld by a court or other equivalent means
 - Economic resources are scarce and capable of producing cash flows or reducing cash outflows

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Revenue Recognition Project Performance Obligations

- Troubling examples
 - Promise to allow customer to return item for refund (return rights)
 - Service vs. good (audit work: Is the client paying for audit work or for an audit report?)

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Revenue Recognition Project Satisfaction of Performance Obligations

- Performance obligations are satisfied when the promised economic resource transfers to the customer
 - In the case of a good, when the enforceable right (or other access) transfers to the customer
 - In the case of a service, when the economic resource created by the service
 - Enhances an economic resource to which the customer already has an enforceable right (e.g., lawn maintenance)
 - Provides an immediate benefit to the customer (e.g., a rock concert)

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Revenue Recognition Project Satisfaction of Performance Obligations

- Troubling Example
 - Paint delivered before painting services
 - Use of equipment or space (stadium naming rights and other leases)

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Revenue Recognition Project Academic Research

- **Recent**
 - Peterson (Univ. of Michigan): Revenue recognition complexity (e.g., words, methods, subjective revenue standards) positively associated with restatements
 - Srivastava (Texas A&M): Deferred revenues created when software firms adopt SOP 97-2 are priced by the market as if revenue, not liabilities. Earnings appears less informative.

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Revenue Recognition Project Academic Research

- **Still needed**
 - What revenue recognition model will be the most decision useful to users?
 - One that predicts the next cash inflow better
 - One that reflects inflows from existing contracts
 - In what industries would a current measurement approach make sense? Customer consideration approach?
 - To what extent do IFRS filers implicitly follow US revenue standards?
 - How can disclosure be improved?

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Revenue Recognition Project Timeline to Discussion Paper

- **Hope to complete by 2nd Quarter 2008**
 - But, what is a performance obligation?
 - And, how are they satisfied?

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- **Role of 1-year Research Fellow**
- **FASB Research Initiatives**
- **Financial Statement Presentation Project**

Bob Lipe
FASB Research Fellow &
Professor University of Oklahoma



1-Year FASB Research Fellow

- **New position – I am first one**
- **Supply the FASB and its staff with research expertise when and where needed**
 - Identify existing research pertinent to Board projects/mission performed by academics and others
 - Evaluate research methods and conclusions, then translate relevant findings for standard setting
 - Invite researchers with cutting edge ideas to present their work to Board and staff
 - Interact with other FASB Research Initiatives
- **Supply researchers with information about current FASB projects and research needs**

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Current Roles for Academics with FASB

- **Some academics are already in the building**
 - Tom Linsmeier, Board Member
 - Todd Johnson and Kevin McBeth, permanent staff
 - Jeff Wilks, Academic Fellow
 - Bob Lipe, Research Fellow
- **Financial Accounting Standards Research Initiative**
 - Partner with researchers to foster new research findings related to ongoing deliberations (ex ante research)
- **FASB Syntheses – encourage reviews early in process**
- **Joint FSA/AAA Subcommittee to Develop Financial Valuation Teaching Materials – Mary Stone, Alabama**

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Example Assignment Financial Statement Presentation

Joint Project of the IASB and FASB



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Financial Statement Presentation Objectives

- Establish a common, high-quality standard for presentation of information in the financial statements.
- Information presentation format should help investors, creditors, and others to:
 - Understand current and past financial position
 - Understand current and past operating, financing, and other activities that caused financial position to change
 - Use information to assess the amounts, timing, and uncertainty of future income or cash flows.

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Financial Statement Presentation Project Phases

- Phase A (IASB: Finished; FASB: deliberations complete)
 - A complete set of financial statements includes:
 - Statement of financial position
 - Statement of comprehensive income
 - Statement of cash flows
 - Statement of changes in equity
 - A minimum of two annual periods of comparative information
- Phase B (deliberating):
 - Categories in each financial statement
 - Totals, subtotals
 - Other comprehensive income (and recycling)
 - Statement of cash flows (direct vs. indirect method)
- Phase C (not started):
 - Interim financial information

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Financial Statement Presentation Phase B – Working Principles

- Financial statements should :
 - Portray a cohesive financial picture
 - Separate business activities from financing activities
 - Disaggregate line items if enhances usefulness
 - Help users assess ability to meet financial commitments and invest in business opportunities
 - Help users understand:
 - Measurement bases
 - Uncertainty in measurement of assets and liabilities
 - Causes of changes in recognized assets and liabilities
 - Difference between cash-based and accrual accounting
 - Effects of noncash activities on financial position

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Financial Statement Presentation Tentative Views (TV): Working Format

Statement of Financial Position	Statement of Comprehensive Income	Statement of Cash Flows
Business •Operating assets and liabilities •Investing assets and liabilities	Business •Operating income •Investing income	Business •Operating cash flows •Investing cash flows
Discontinued operations	Discontinued operations	Discontinued operations
Financing •Financing assets •Financing liabilities	Financing •Financing income •Financing expenses	Financing •Financing asset cash flows •Financing liability cash flows
Translation adjustments	Translation adjustments	
Income taxes	Income taxes	Income taxes
Equity	Statement of Changes in Equity	Equity

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Financial Statement Presentation TV: Categories

- Display categories and sections in the same order in each statement (cohesion).
No prescribed order
- Categorization based on management's view:
 - *Operating Category*—related to producing & delivering goods and providing services
 - *Investing Category*—investing activities not integral to business activities
 - *Financing Category*—liabilities and assets used to finance operating and investing activities

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Financial Statement Presentation TV: Income Tax Section

- Tax related assets, liabilities, income effects, and cash flows in a single section of each statement
- No more intraperiod tax allocation
- Operating income, financing income and expense, discontinued operations, and OCI items all shown on a pretax basis
- ➔ line “net income continuing ops” disappears; only comprehensive income is after tax
- Additional income tax disclosures

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Financial Statement Presentation TV: Other Comprehensive Income

Long-term goal:

- All current period non-owner changes in A&L appear in Stmt of Comprehensive Income in functional section/category
 - No separate OCI category and no recycling
- BUT project is about presentation, so OCI section necessary in the interim
- Removal of OCI items to be addressed individually and separately outside this project

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Financial Statement Presentation TV: Reconciliation Schedule

- Reconcile the statement of cash flows to the statement of comprehensive income
 - Disaggregate reconciling items into at least 4 components:
 - Cash flows not affecting income
 - Accruals and systematic allocations
 - Recurring valuation changes
 - Remeasurements other than recurring valuation changes
- FASB adds unusual and infrequent events/transactions

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Financial Statement Presentation TV: Reconciliation Schedule

Statement of Cash Flows	Several Reconciling Columns			Statement of Comprehensive Income
Business *Operating cash flows *Investing cash flows				Business *Operating income *Investing income
Discontinued operations				Discontinued operations
Financing *Financing asset cash flows *Financing liability cash flows				Financing *Financing income *Financing expenses
				Translation adjustments
Income taxes				Income taxes

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Financial Statement Presentation Next Steps

- Deliberations continue 1st and 2nd quarter 2008
- Initial discussion document released for public comment mid-2008

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Financial Statement Presentation Using Research in the Process

- FASRI team of experimental researchers
 - Identifying key user decisions expected to be affected by new presentation approach
 - Working with FASB project team to develop realistic sample financial statements
 - Planning research project regarding how new approach will change (improve?) decisions
 - Results should be available as FASB and IASB redeliberate following comment period on Preliminary Views

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Financial Statement Presentation Using Research in the Process

- FSP Project identifies persistence/recurrence as a rationale for disaggregating income
 - Staff asked me to help them understand persistence and explain it to constituents
 - Persistence key in picking columns in reconciliation
 - Very interesting potential conflict
 - Financial Stmt Presentation focus on persistence
 - Conceptual Framework quest for the best measurement basis may favor current values
 - What info helps users to forecast the entity's potential to create value in the future?

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Financial Statement Presentation Future Research Topics

- Does cohesion across financial statements make a difference for users, auditors, or students?
- If income tax items appear in a single section, what additional disclosures do users need?
- Will the reconciliation between cash flow and income help users interpret the persistence and/or subjectivity in earnings better than under current reporting conventions?
- How will the new approach affect analyst following and forecast accuracy?

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CONCLUSIONS

- FASB's task is primarily normative
 - What accounting methods should be mandated?
 - Researchers' focus is primarily positive
 - How does the world work and why does it work that way? How will people respond to a new standard?
- As a result:
- Very low probability that a research paper directly solves a standard setting issue.
 - But...

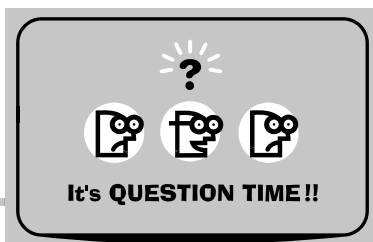
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CONCLUSIONS

- But indirectly, positive research can help a lot
 - Milton Friedman, *Essays in Positive Economics*
 - I venture the judgment ...[that]...differences about economic policy among disinterested [U.S.] citizens derive predominantly from different predictions about the economic consequences of taking action – differences that in principle can be eliminated by positive economics – rather than from fundamental differences in basic values...
- Positive research that predicts consequences for users (and others) can aid FASB decisions

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For Tom, Jeff, or Bob