CHAPTER 2

Case 2-1

a. The FASB's conceptual framework study should provide benefits to the accounting community such as:

1. guiding the FASB in establishing accounting standards on a consistent basis.
2. determining bounds for judgment in preparing financial statements by prescribing the nature, functions, and limits of financial accounting and reporting.
3. increasing users understanding of and confidence in financial reporting.

b. Statement of Financial Accounting Concepts No. 2 identifies the most important quality for accounting information as usefulness for decision-making. Relevance and reliability are the primary qualities leading to this decision usefulness. Usefulness is the most important quality because, without usefulness, there would be no benefits from information to set against its costs.

Case 2-2.

a. i. The Conceptual Framework Project was an attempt by the FASB to develop concepts useful in guiding the board in establishing standards and in providing a frame of reference for resolving accounting issues. Over the years this project first attempted to develop principles or broad qualitative standards to permit the making of systematic rational choices among alternative methods of financial reporting. Subsequently the project focused on how well these overall objectives could be achieved. The FASB has stated that it intends the Conceptual Framework Project to be viewed not as a package of solutions to problems but rather as a common basis for identifying and discussing issues, for asking relevant questions, and for suggesting avenues for research. The Conceptual Framework Project has resulted in the issuance of five statements of Financial Accounting Concepts that impact upon financial accounting: No.1-Objectives of Financial Reporting by Business Enterprises; No.2-Qualitative Characteristics of Accounting Information; No.3-Elements of Financial Statements of Business Enterprises; No.5-Recognition and Measurement in Financial Statements of Business Enterprises; No.6-Elements of Financial Statements and No. 7-"Using Cash Flow Information and Present Value in Accounting Measurements."

ii. The FASB has been criticized for failing to provide timely guidance on emerging implementation and practice problems. During 1984 the FASB attempted to respond to this criticism by (1) establishing a task force to assist in identifying issues and problems that might require action, the Emerging Issues Task Force, and (2) expanding the scope of the FASB Technical Bulletins in an effort to offer quicker guidance on a wider variety of issues.

Emerging issues arise because of new types of transactions, variations in accounting for existing types of transactions, new types of securities, and new products and services. They frequently involve the company's desire to achieve "off balance sheet" financing or "off income statement" accounting.

The Emerging Issues Task Force was formed to assist the FASB in issuing timely guidance on these emerging issues. That is, the task force's responsibility is to identify emerging issues as they develop, investigate and review them, and finally to advise the board whether the issue merits its attention.

The members of the task force all occupy positions that make them aware of emerging issues. The current members include the directors of accounting and auditing from 11 public accounting firms (including all of the "Big Four"), two representatives from the Financial Executives Institute, one from the National Association of Accountants and the Business Roundtable, and the FASB's Director of Research who serves as Chairman.

b. In recent years the Financial Accounting Standards Board, the Securities and Exchange Commission, and the American Institute of Certified Public Accountants have been criticized for imposing too many accounting standards on the business community. The Standards overload problem has been particularly burdensome on small businesses that do not have the necessary economic resources to research and apply all of the pronouncements issued by these sources Those who contend that there is a standards overload problem base their arguments on two allegations.

1. Not all GAAP requirements arc relevant to small business financial reporting needs.

2. Even when they are relevant, they frequently violate the pervasive cost benefit constraint (discussed later in the chapter).

Critics of the standard-setting process for small business also assert that GAAP were developed primary to serve the needs of the securities market. Many small businesses do not raise capital in these markets therefore, it is contended that GAAP were not developed with small business needs in mind.

Some of the consequences of the standards overload problem to small business are as follows.

1. If a small business omits a GAAP requirement from audited financial statements, a qualified or adverse opinion may be rendered.

2. The cost of complying with GAAP requirements may cause a small business to forgo the development of other, more relevant information.

3. Small CPA firms that audit smaller companies must keep up to date on all of the same requirements as large international firms, but cannot afford the specialists that are available on a centralized basis in the large firms.

Many accountants have argued for differential disclosure standards as a solution to the standards overload problem. That is, standards might be divided into two groups. One group would apply to business regardless of size. The second group would be applied selectively only to large businesses, small businesses, or particular industries. For example, the disclosure of significant accounting policies would pertain to all businesses, whereas a differential disclosure such as earnings per share would be applicable only to large businesses.

Case 2-3

a. Quantitative data are helpful in making rational economic decisions. Stated differently, quantitative data aid the decision maker in making choices among alternatives, so that the actions are correctly related toconsequences

b. i. ASOBAT defined accounting as "the process of identifying, measuring, and communicating economic information to permit informed judgments and decision by users of the information." Both this definition and Sprouse and Moonitz believe that communicating information is helpful for users to make rational decisions and informed judgments'.

   ii. Similarly, *SFAC No. 1* states that accounting information should be useful for investment decision-making. The user should be able to use accounting information to make decisions about investing in a company.

Case 2-4

a. In describing continuity, Sprouse and Moonitz stated that in the absence of evidence to the contrary, the entity should be viewed as remaining in operation indefinitely. In the presence of evidence that the entity has a limited life, it should not be viewed as remaining in operation indefinitely.

b. No. Since a business is presumed to continue indefinitely, the value relevant to a purchaser is fair market value. This value measures the present value of future cash flows to the buyer. It is relevant for the buyer because the buyer presumes that the business will continue and thus will generate those future cash flows.

c. No. A bankruptcy provides evidence that the business is not expected to remain in operation indefinitely. In this case, the assets that are reported in the company's balance sheet should be measured at net realizable value.

Case 2-5

a. *SFAC No. 6* defines assets as "probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events." If your company is using a building to produce automobiles, the probable future economic benefit is the expected inflow of resources from the sales of automobiles. This benefit accrues to the company who may then use them, if it wishes, to make more automobiles. The prior transaction that caused the asset to exist is the acquisition of the building.

b. In this case, the probable future economic benefit is the net realizable value that the company will receive when it sells the building. Again, the acquisition of the building is the result of a prior transaction or event.

c. In this case, the probable future economic benefit is the inflow of resources that will eventually flow into the company when it produces the automobiles. The transaction that caused the asset to exist was the acquisition of the building.

Case 2-6

a. Employees meet the definition of an asset. An asset has three essential characteristics: (a) it embodies a probable future benefit that involves a capacity, singly or in combination with other assets, to contribute directly or indirectly to future net cash inflows, (b) a particular entity can obtain the benefit and control others' access to it, and (c) the transaction or other event giving rise to the entity's right to or control of the benefit has already occurred. Employees embody a probable future benefit that will contribute to future net cash flows. They will work so that the company can have revenues. The company will benefit because they control what the employees do on the job. Employment of the employees gave rise to the entity's right to control the benefit.

b. No. According to *SFAC No. 5*, to report an asset in the balance sheet, it not only must meet the definition of an asset, but it must be capable of being measured.

c. i. The value would be more relevant because it would measure the expected future cash flows that the employees would be expected to generate. It would be less reliable because there is no precise method to measure the value of human capital. It can only be estimated. Therefore two measurements made by two different measurers are unlikely to be the same.

   ii. Yes. Representational faithfulness means that the items in the balance reflect what they purport to be. If human capital is an asset then reporting its estimated value would reflect the value of that asset and would as a result provide representational faithfulness.

Case 2-7

Relevant accounting information can make a difference in a decision by helping users to form predictions about the outcomes of past, present, and future events, or to confirm or correct prior expectations. Relevant information has predictive value, feedback value, and timeliness.

The reliability of a measure rests on the faithfulness with which it represents what it purports to represent, coupled with an assurance for the user that it has that representational quality.

$42,000 represents the historical cost of the machine. It is reliable because it can be verified, because the value of the stock used to acquire it is readily determinable. However, the $50,000 appraisal value is more relevant because it measures what the asset is worth to the company, and thus to the investor. It measures what it would cost to replace the machine or to sell it.

Case 2-8

a. According to *SFAC No. 7* the bonds are distinguished by the uncertainty of their future cash flows. The bonds would sell at the present value of their future cash flows, discounted at the market rate of interest. The company with the better credit rating would yield a lower market rate, assuming that the stated rates for both companies is the same. So, if the stated rates are the same, Company A's bond might be more valuable it its credit rating were better than Company B's.

b. If both companies have the same credit rating, then the one reason that Company A's bond would have a higher market value than would Company B's bond would be that Company A's bond has a shorter term than Company B's bond. If they both have the same term, then Company A's bond would sell for more than Company B's bond if Company A were offering a higher stated interest rate.

FASB ASC

FASB ASC 2-1 Use of Present Value

The information on present value is contained in the FASB ASC at FASB ASC 820-10-55. It can be accessed through the glossary.

55-4 FASB Concepts Statement No. 7, Using Cash Flow Information and Present Value in Accounting Measurements, provides guidance for using present value techniques to measure fair value. That guidance focuses on a traditional or discount rate adjustment technique and an expected cash flow (expected present value) technique. This Section clarifies that guidance. (That guidance is included or otherwise referred to principally in paragraphs 39–46, 51, 62–71, 114, and 115 of Concepts Statement 7.) This Section neither prescribes the use of one specific present value technique nor limits the use of present value techniques to measure fair value to the techniques discussed herein. The present value technique used to measure fair value will depend on facts and circumstances specific to the asset or liability being measured (for example, whether comparable assets or liabilities can be observed in the market) and the availability of sufficient data.

> > > > The Components of a Present Value Measurement

55-5 A fair value measurement of an asset or liability, using present value should capture all of the following elements from the perspective of market participants as of the measurement date:

a. An estimate of future cash flows for the asset or liability being measured.

b. Expectations about possible variations in the amount and/or timing of the cash flows representing the uncertainty inherent in the cash flows.

c. The time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows (risk-free interest rate). For present value computations denominated in nominal U.S. dollars, the yield curve for U.S. Treasury securities determines the appropriate risk-free interest rate. U.S. Treasury securities are deemed (default) risk free because they pose neither uncertainty in timing nor risk of default to the holder.

d. The price for bearing the uncertainty inherent in the cash flows (risk premium).

e. Other case-specific factors that would be considered by market participants.

f. In the case of a liability, the nonperformance risk relating to that liability, including the reporting entity’s (obligor’s) own credit risk.

> > > > General Principles

55-6 Present value techniques differ in how they capture those elements. However, all of the following general principles govern the application of any present value technique:

a. Cash flows and discount rates should reflect assumptions that market participants would use in pricing the asset or liability.
b. Cash flows and discount rates should consider only factors attributed to the asset (or liability) being measured.
c. To avoid double counting or omitting the effects of risk factors, discount rates should reflect assumptions that are consistent with those inherent in the cash flows. For example, a discount rate that reflects expectations about future defaults is appropriate if using contractual cash flows of a loan (discount rate adjustment technique). That same rate would not be used if using expected (probability-weighted) cash flows (expected present value technique) because the expected cash flows already reflect assumptions about future defaults; instead, a discount rate that is commensurate with the risk inherent in the expected cash flows should be used. d. Assumptions about cash flows and discount rates should be internally consistent. For example, nominal cash flows (that include the effect of inflation) should be discounted at a rate that includes the effect of inflation. The nominal risk-free interest rate includes the effect of inflation. Real cash flows (that

exclude the effect of inflation) should be discounted at a rate that excludes the effect of inflation. Similarly, after-tax cash flows should be discounted using an after-tax discount rate. Pretax cash flows should be discounted at a rate consistent with those cash flows (for example, a U.S. Treasury rate is quoted on a pretax basis, as is a London Interbank Offered Rate [LIBOR] or a prevailing term loan rate). e. Discount rates should be consistent with the underlying economic factors of the currency in which the cash flows are denominated.

> > > > Risk and Uncertainty

55-7 A fair value measurement, using present value, is made under conditions of uncertainty because the cash flows used are estimates rather than known amounts. In many cases, both the amount and timing of the cash flows will be uncertain. Even contractually fixed amounts, like the payments on a loan, will be uncertain if there is risk of default.

55-8 A fair value measurement should include a risk premium reflecting the amount market participants would demand because of the risk (uncertainty) in the cash flows. Otherwise, the measurement would not faithfully represent fair value. In some cases, determining the appropriate risk premium might be difficult. However, the degree of difficulty alone is not a sufficient basis on which to exclude a risk adjustment.

55-9 Present value techniques differ in how they adjust for risk and in the type of cash flows they use. For example:

a. The discount rate adjustment technique uses a risk-adjusted discount rate and contractual, promised, or most likely cash flows.
b. Method 1 of the expected present value technique uses a risk-free rate and risk-adjusted expected cash flows.
c. Method 2 of the expected present value technique uses a risk-adjusted discount rate (which is different from the rate used in the discount rate adjustment technique) and expected cash flows.

FASB ASC 2-2

Search conceptual framework

605 Revenue Recognition
10 Overall
S99 SEC Materials

SEC Staff Guidance

> > Staff Accounting Bulletins

> > > SAB Topic 13, Revenue Recognition

S99-1 The following is the text of SAB Topic 13, Revenue Recognition.

SAB Topic 13.A, Selected Revenue Issues

SAB Topic 13.A.1, Revenue Recognition—General

The accounting literature on revenue recognition includes both broad conceptual discussions as well as certain industry-specific guidance. FN1 If a transaction is within the scope of specific authoritative literature that provides revenue recognition guidance, that literature should be applied. However, in the absence of authoritative literature addressing a specific arrangement or a specific industry, the staff will consider the existing authoritative accounting standards as well as the broad revenue recognition criteria specified in the FASB's conceptual framework that contain basic guidelines for revenue recognition.

> FN1 The February 1999 AICPA publication "Audit Issues in Revenue Recognition" provides an overview of the authoritative accounting literature and auditing procedures for revenue recognition and identifies indicators of improper revenue recognition.

Based on these guidelines, revenue should not be recognized until it is realized or realizable and earned. FN2 Concepts Statement 5, paragraph 83(b) states that "an entity's revenue-earning activities involve delivering or producing goods, rendering services, or other activities that constitute its ongoing major or central operations, and revenues are considered to have been earned when the entity has substantially accomplished what it must do to be entitled to the benefits represented by the revenues" [footnote reference omitted]. Paragraph 84(a) continues "the two conditions (being realized or realizable and being earned) are usually met by the time product or merchandise is delivered or services are rendered to customers, and revenues from manufacturing and selling activities and gains and losses from sales of other assets are commonly recognized at time of sale (usually meaning delivery)" [footnote reference omitted]. In addition, paragraph 84(d) states that "If services are rendered or rights to use assets extend continuously over time (for example, interest or rent), reliable measures based on contractual prices established in advance are commonly available, and revenues may be recognized as earned as time passes."

> FN2 Concepts Statement 5, paragraphs 83-84; ARB 43, Chapter 1A, paragraph 1 [paragraph 605-10-25-1]; and Opinion 10, paragraph 12 [paragraph 605-10-25-3]. The citations provided herein are not intended to present the complete population of citations where a particular criterion is relevant. Rather, the citations are intended to provide the reader with additional reference material.

The staff believes that revenue generally is realized or realizable and earned when all of the following criteria are met:

Persuasive evidence of an arrangement exists, FN3

> FN3 Concepts Statement 2, paragraph 63 states "Representational faithfulness is correspondence or agreement between a measure or description and the phenomenon it purports to represent." The staff believes that evidence of an exchange arrangement must exist to determine if the accounting treatment represents faithfully the transaction. See also SOP 97-2, paragraph 8 [paragraph 985-605-25-3]. The use of the term "arrangement" in this SAB Topic is meant to identify the final understanding between the parties as to the specific nature and terms of the agreed-upon transaction.

Delivery has occurred or services have been rendered, FN4.

> FN4 Concepts Statement 5, paragraph 84(a), (b), and (d). Revenue should not be recognized until the seller has substantially accomplished what it must do pursuant to the terms of the arrangement, which usually occurs upon delivery or performance of the services.

The seller's price to the buyer is fixed or determinable, FN5 and

FN5 Concepts Statement 5, paragraph 83(a); Statement 48, paragraph 6(a) [paragraph 605-15-25-1(a)]; SOP 97-2, paragraph 8 [paragraph 985-605-25-3]. SOP 97-2 [Subtopic 985-605] defines a "fixed fee" as a "fee required to be paid at a set amount that is not subject to refund or adjustment. A fixed fee includes amounts designated as minimum royalties." Paragraphs 26-33 of SOP 97-2 [paragraphs 985-605-25-30 through 25-40] discuss how to apply the fixed or determinable fee criterion in software transactions. The staff believes that the guidance in paragraphs 26 and 30-33 [paragraphs 985-605-25-30 through 25-31 and 985-605-25-36 through 25-40] is appropriate for other sales transactions where authoritative guidance does not otherwise exist. The staff notes that paragraphs 27 through 29 [paragraphs 985-605-25-33 through 25-35] specifically consider software transactions, however, the staff believes that guidance should be considered in other sales transactions in which the risk of technological obsolescence is high.

Collectibility is reasonably assured. FN6

FN6 ARB 43, Chapter 1A, paragraph 1 [paragraph 605-10-25-3] and Opinion 10, paragraph 12. See also Concepts Statement 5, paragraph 84(g) and SOP 97-2, paragraph 8 [paragraph 985-605-25-3].

Some revenue arrangements contain multiple revenue-generating activities. The staff believes that the determination of the units of accounting within an arrangement should be made prior to the application of the guidance in this SAB Topic by reference to the applicable accounting literature.

FASB ASC 2-3

Search decision maker

280 Segment Reporting > 10 Overall > 05 Overview and Background

05-1 The Segment Reporting Topic contains only the Overall Subtopic.
05-2 This Subtopic provides guidance to public business entities (referred to as public entities throughout this Subtopic) on how to report certain information about operating segments in complete sets of financial statements of the public entity and in condensed financial statements of interim periods issued to shareholders. It also requires that public entities report certain information about their products and services, the geographic areas in which they operate, and their major customers.
05-3 A public entity could provide complete sets of financial statements that are disaggregated in several different ways, for example, by products and services, by geography, by legal entity, or by type of customer. However, it is not feasible to provide all of that information in every set of financial statements. The guidance in this Subtopic requires that general-purpose financial statements include selected information reported on a single basis of segmentation. The method for determining what information to report is referred to as the management approach. The management approach is based on the way that management organizes the segments within the public entity for making operating decisions and assessing performance. Consequently, the segments are evident from the structure of the public entity's internal organization, and financial statement preparers should be able to provide the required information in a cost-effective and timely manner.
05-4 The management approach facilitates consistent descriptions of a public entity in its annual report and various other published information. It focuses on financial information that a public

entity's decision makers use to make decisions about the public entity's operating matters. The components that management establishes for that purpose are called operating segments.
05-5 To provide some comparability between public entities, this Subtopic requires that an entity report certain information about the revenues that it derives from each of its products and services (or groups of similar products and services) and about the countries in which it earns revenues and holds assets, regardless of how the entity is organized. As a consequence, some entities are likely to be required to provide limited information that may not be used for making operating decisions and assessing performance.

350 Intangibles—Goodwill and Other > 20 Goodwill > 55 Implementation Guidance and Illustrations

General

Implementation Guidance
55-1 Determining whether a component of an operating segment is a reporting unit is a matter of judgment based on an entity's individual facts and circumstances. Although paragraphs 350-20-35-33 through 35-35 includes a number of characteristics that must be present for a component of an operating segment to be a reporting unit, no single factor or characteristic is determinative. How an entity manages its operations and how an acquired entity is integrated with the acquiring entity are key to determining the reporting units of the entity.
55-2 The characteristics identified in paragraphs 350-20-35-33 through 35-35 that must be present for a component to be a reporting unit are discussed in the following implementation guidance.

> > The Component Constitutes a Business
55-3 The determination of whether a component constitutes a business requires judgment based on specific facts and circumstances. The guidance in Section 805-10-55 should be considered in determining whether a group of assets constitutes a business. The business must contain all of the inputs and processes necessary for it to continue to conduct normal operations after the transferred set is separated from the transferor. The fact that operating information (revenues and expenses) exists for a component of an operating segment does not mean that the component constitutes a business. For example, a component for which operating information is prepared might be a product line or a brand that is part of a business rather than a business itself.

Transition Date: *December 15, 2008* Transition Guidance: 805-10-65-1
The determination of whether a component constitutes a business requires judgment based on specific facts and circumstances. The guidance in Section 805-10-55 should be considered in determining whether a group of assets constitutes a business.

Transition Date: *December 15, 2009* Transition Guidance: 350-10-65-1

The determination of whether a component constitutes a business or a nonprofit activity requires judgment based on specific facts and circumstances. The guidance in Section 805-10-55 should be considered in determining whether a group of assets constitutes a business or a nonprofit activity.

> > Discrete Financial Information
55-4 The term *discrete financial information* should be applied in the same manner that it is applied in determining operating segments in accordance with paragraph 280-10-50-1. That guidance indicates that it is not necessary that assets be allocated for a component to be considered an operating segment (that is, no balance sheet is required). Thus, discrete financial information can constitute as little as operating information. Therefore, in order to test goodwill for impairment in accordance with this Subtopic, an

entity may be required to assign assets and liabilities to reporting units (consistent with the guidance in paragraphs 350-20-35-39 through 35-40).

> > Reviewed by Segment Management

55-5 Segment management, as defined in paragraphs 280-10-50-7 through 50-8, is either a level below or the same level as the chief operating decision maker. According to Topic 280, a segment manager is directly accountable to and maintains regular contact with the chief operating decision maker to discuss operating activities, financial results, forecasts, or plans for the segment. The approach used in this Subtopic to determine reporting units is similar to the one used to determine operating segments ; however, this Subtopic focuses on how operating segments are managed rather than how the entity as a whole is managed; that is, reporting units should reflect the way an entity manages its operations.

> > Similar Economic Characteristics

55-6 Evaluating whether two components have similar economic characteristics is a matter of judgment that depends on specific facts and circumstances. That assessment should be more qualitative than quantitative.

55-7 In determining whether the components of an operating segment have similar economic characteristics, all of the factors in paragraph 280-10-50-11 should be considered. However, every factor need not be met in order for two components to be considered economically similar. In addition, the determination of whether two components are economically similar need not be limited to consideration of the factors described in that paragraph. In determining whether components should be combined into one reporting unit based on their economic similarities, factors that should be considered in addition to those in that paragraph include but are not limited to, the following:

a. The manner in which an entity operates its business and the nature of those operations

b. Whether goodwill is recoverable from the separate operations of each component business or from two or more component businesses working in concert (which might be the case if the components are economically interdependent)

c. The extent to which the component businesses share assets and other resources, as might be evidenced by extensive transfer pricing mechanisms

d. Whether the components support and benefit from common research and development projects.

The fact that a component extensively shares assets and other resources with other components of the operating segment may be an indication that the component either is not a business or may be economically similar to those other components.

Transition Date: *December 15, 2009* Transition Guidance: 350-10-65-1

In determining whether the components of an operating segment have similar economic characteristics, all of the factors in paragraph 280-10-50-11 should be considered. However, every factor need not be met in order for two components to be considered economically similar. In addition, the determination of whether two components are economically similar need not be limited to consideration of the factors described in that paragraph. In determining whether components should be combined into one reporting unit based on their economic similarities, factors that should be considered in addition to those in that paragraph include but are not limited to, the following:

a. The manner in which an entity operates its business or nonprofit activity and the nature of those operations

b. Whether goodwill is recoverable from the separate operations of each component business (or nonprofit activity) or from two or more component businesses (or nonprofit activities) working in concert (which might be the case if the components are economically interdependent)

c. The extent to which the component businesses (or nonprofit activities) share assets and other resources, as might be evidenced by extensive transfer pricing mechanisms

d. Whether the components support and benefit from common research and development projects.

The fact that a component extensively shares assets and other resources with other components of the operating segment may be an indication that the component either is not a business or nonprofit activity or it may be economically similar to those other components.

55-8 Components that share similar economic characteristics but relate to different operating segments may not be combined into a single reporting unit. For example, an entity might have organized its operating segments on a geographic basis. If its three operating segments (Americas, Europe, and Asia) each have two components (A and B) that are dissimilar to each other but similar to the corresponding components in the other operating segments, the entity would not be permitted to combine component A from each of the operating segments to make reporting unit A.

> > Operating Segments that May Be Economically Dissimilar that Are Aggregated Into a Reportable Segment

55-9 If two operating segments have been aggregated into a reportable segment by applying the aggregation criteria in paragraph 280-10-50-11, it would be possible for one or more of those components to be economically dissimilar from the other components and thus be a reporting unit for purposes of testing goodwill for impairment. That situation might occur if an entity's operating segments are based on geographic areas. The following points need to be considered in addressing this circumstance:

a. The determination of reporting units under this Subtopic begins with the definition of an operating segment in paragraph 280-10-50-1 and considers disaggregating that operating segment into economically dissimilar components for the purpose of testing goodwill for impairment. The determination of reportable segments under Topic 280 also begins with an operating segment, but considers whether certain economically similar operating segments should be aggregated into a single operating segment or into a reportable segment.

b. The level at which operating performance is reviewed differs between this Subtopic and Topic 280 . It is the chief operating decision maker who reviews operating segments and the segment manager who reviews reporting units (components of operating segments). Therefore, a component of an operating segment would not be considered an operating segment for purposes of that Topic unless the chief operating decision maker regularly reviews its operating performance; however, that same component might be a reporting unit under this Subtopic if a segment manager regularly reviews its operating performance (and if other reporting unit criteria are met).

FASB ASC 2-4

Search understandability

715 compensation—Retirement Benefits > 10 Overall > 10 Objectives

The objectives of this Topic are as follows:

a. To enhance the relevance and representational faithfulness of the employer's reported results of operations by recognizing net periodic pension cost and net periodic other postretirement benefit cost as employees render the services necessary to earn their pension and other postretirement benefits

b. To enhance the relevance and representational faithfulness of the employer's statement of financial position by including a measure of the obligation to provide pension and other postretirement benefits based on a mutual understanding between the employer and its employees of the terms of the underlying plan

c. To enhance the ability of users of the employer's financial statements to understand the extent and effects of the employer's undertaking to provide pension and other postretirement benefits to its employees by disclosing relevant information about the obligation and cost of the pension and other postretirement benefit plans and how those amounts are measured

d. To improve the understandability and comparability of amounts reported by requiring employers with similar plans to use the same method to measure their pension and other postretirement benefit obligations and the related costs of the postretirement benefits.

FASB ASC 2-5

805 Business Combinations > 10 Overall > 10 Objectives

10-1
Transition Date: *December 15, 2008* Transition Guidance: 805-10-65-1
The objective of the Subtopics in this Topic that address business combinations is to improve the relevance, representational faithfulness, and comparability of the information that a reporting entity provides in its financial reports about a business combination and its effects.

715 compensation—Retirement Benefits > 10 Overall > 10 Objectives

The objectives of this Topic are as follows:

a. To enhance the relevance and representational faithfulness of the employer's reported results of operations by recognizing net periodic pension cost and net periodic other postretirement benefit cost as employees render the services necessary to earn their pension and other postretirement benefits

b. To enhance the relevance and representational faithfulness of the employer's statement of financial position by including a measure of the obligation to provide pension and other postretirement benefits based on a mutual understanding between the employer and its employees of the terms of the underlying plan

FASB ASC 2-6

Search recognition and measurement-over 70 hits

FASB ASC 2-7

Reporting Comprehensive Income is contained in sections FASB ASC 220-10-45. It is found by searching comprehensive income.

45-1 This Subtopic requires that all items that meet the definition of components of comprehensive income be reported in a financial statement for the period in which they are recognized.
45-2 This Subtopic requires that changes in the balances of items that are reported directly in a separate component of equity in a statement of financial position shall be reported in a financial statement that is displayed as prominently as other financial statements.
45-3 A full set of financial statements for a period should show: financial position at the end of the period, earnings (net income) for the period, comprehensive income (total nonowner changes in equity) for the period, cash flows during the period, and investments by and distributions to owners during the period.
45-4 This Subtopic does not require that an entity use the terms *comprehensive income* or other comprehensive income in its financial statements, even though those terms are used throughout this Subtopic.
45-5 All components of comprehensive income shall be reported in the financial statements in the period in which they are recognized. A total amount for comprehensive income shall be displayed in the financial statement where the components of other comprehensive income are reported.

Transition Date: *December 15, 2008* Transition Guidance: 810-10-65-1
All components of comprehensive income shall be reported in the financial statements in the period in which they are recognized. A total amount for comprehensive income shall be displayed in the financial statement where the components of other comprehensive income are reported. Paragraph 810-10-50-1A(a) states that, if an entity has an outstanding noncontrolling interest (minority interest), amounts for both comprehensive income attributable to the parent and comprehensive income attributable to the noncontrolling interest in a less-than-wholly-owned subsidiary are reported on the face of the financial statement in which comprehensive income is presented in addition to presenting consolidated comprehensive income.

FASB ASC 2-8

Search present value-over 100 hits

Room for Debate

Debate 2-1

Team 1: Arguments for capitalization of boxes.

1. Objectives of financial reporting

   Decision usefulness requires that companies report the status of enterprise resources. The boxes provide future service potential. As such, they meet the definition of an asset found in SFAC No. 6. Hence, they are a resource that should be reported.

2. Definition of assets

SFAC No. 6 defines assets as probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events.

The boxes are assets. They will provide future economic benefits for a particular entity (Roper Co). The company will use them for at least 10 years. They result from past transaction - a purchase.

3. Qualitative Characteristics

Relevance

Capitalization is relevant because it provides information about outcomes of past transactions or events. The user is informed that the boxes are assets. They were purchased by the company, and the company intends to use them over an extended period of time. Hence their cost is not a current period expense.

Reliability

Capitalization provides reliability. Because the boxes will be used over an extended period of time, they meet the definition of an asset found in SFAC No. 6. Hence, capitalization presents the economic facts and provides information that is representationally faithful. If they are assets, they should be reported as such, rather than expensed, a representation that would not report them as they purport to be. Also, capitalization of the cost would be neutral because it would provide an unbiased representation of the economic substance of the purchase transaction.

Team 2 Arguments against the capitalization of the boxes.

1. Materiality

Materiality is the threshold for recognition. When the dollar amount is small, the particular accounting treatment will not affect the decisions of an informed user. In this case, the cost of boxes is clearly immaterial, implying that they need not be capitalized as assets.

2. Cost/benefit Constraint

The benefits derived from capitalization should exceed the cost of capitalization. Since the cost of the boxes is not material, capitalization would not provide sufficient benefit, in terms of decision usefulness, to warrant this accounting treatment. Capitalization would require depreciation over the useful life of the boxes. This would require adjusting entries for a ten-year period. The amount of depreciation reported each period would be trivial and would have essentially no effect on earnings. Hence, the cost of the bookkeeping effort would be greater than the benefits, if any, derived.

1. Objectives of financial reporting

The primary objective of financial reporting is decision usefulness. Accounting information should provide information that is useful to investors, creditors and other users in making decisions regarding investing, lending, etc. This implies that accounting information is relevant to the decision-maker. Even though the boxes will last 10 years, the cost is immaterial and hence irrelevant.

2. Qualitative Characteristics of accounting information

Relevance

As stated above, relevance means that the information provided will make a difference in the decisions of investors, creditors and other users. The expenditure is immaterial and as such, the accounting treatment is irrelevant, and capitalization is irrelevant.

Debate 2-2 The need for a universally accepted theory of accounting

Team 1:

A universally accepted theory of accounting is needed for the development of internally consistent accounting principles. Accounting practices have developed in response to changing economic conditions and, in some cases, in response to what are perceived as crises. For example, SFAS No. 114, was prompted to inconsistent practices of reporting impaired loans, and SFAS No. 94 was prompted by off-balance sheet recognition of lease liabilities. This piece-meal, reactionary approach to accounting has resulted in standards that are not only internally inconsistent, but are also inconsistent with international standards.

A theory of accounting would provide a common basis for identifying and discussing issues. This is the goal of the FASB's conceptual framework project. Such a theory could be used to help narrow the number of accounting choices currently available to management, thereby reducing management's ability to manipulate financial statements to suit their personal, or company goals. As such, it could help guide the development of neutral standards, which aids in the allocation of scarce resources and the efficient functioning of capital markets

In addition to helping reduce managerial bias in reporting results of operations and financial position, a universally accepted theory of accounting could serve to reduce personal biases in the standard setting process itself. Reliance on such a theory could result in the development of those standards that are consistent with the theory itself.

A universal theory of accounting would be consistent with the concepts-based approach to accounting standards described by the American Accounting Association. A universally accepted accounting theory could provide a basis for standard setting that would satisfy the following.

1. Economic substance, not the form, of a given transaction should guide its *financial* reporting.
2. The mapping between economic substance of a transaction and its financial statement representation could be supported by a common theoretical basis, thereby providing understandability and a common basis of comparison across companies and over time.

Team 2:

To date, no standard setting body has developed a universally accepted theory of accounting. An argument against a universal theory of accounting can be based on the complexity of the phenomena that financial statements purport to represent. According to *SATTA*, while there has been general agreement that the purpose of financial accounting is to provide economic data about accounting entities, divergent theories have emerged because of the way different theorists specified users of accounting data and the environment. For example, *users* might be defined either as the owners of the accounting entity or more broadly to include creditors, employees, regulatory agencies, and the general public. Similarly, the environment might be specified as a single source of information or as one of several sources of financial information.

SATTA discussed why none of the approaches to theory had gained general acceptance, *SATTA* raised six issues.

1. *The problem with relating theory to practice*. The real world is much more complex than the world specified in most accounting theories. For example, most theory descriptions begin with unrealistic assumptions such as holding several variables constant.

2. *Allocation problem*. Allocation is an arbitrary process. For example, the definition of depreciation as a *rational* and *systematic* method of allocation has led to a variety of interpretations of these terms.

3. *The difficulty with normative standards.* Normative standards are desired states; however, different users of accounting information have different desired states. As a result, no set of standards can satisfy all users.

4. *The difficulties in interpreting security price behavior research*. Market studies (such as the efficient market studies discussed in Chapter 4) attempt to determine how users employ accounting numbers. These studies have attempted to control for all variables except the one of interest, but there have been disagreements over whether their research designs have actually accomplished this goal.

5. *The problem cost-benefit considerations accounting theories*. A basic assumption of accounting is that the benefits derived from adopting a particular accounting alternative exceed its costs. However, most existing theories do no indicate how to measure benefits and costs.

6. *Limitations of data expansion*. At the time *SATTA* was published, a view was emerging that more information is preferable than less. Subsequent research has indicated that users have a limited ability to process accounting information. (The issue of information processing is discussed in Chapter 4.)

The FASB's conceptual framework project (CPF) cannot be viewed as a universally accepted theory of accounting, nor does the FASB purport that it is. The FASB intends the CFP to be viewed not as a package of solutions to problems but rather as a common basis for identifying and discussing issues. For example, *SFAC Nos. 1* and *2* can be described as the goals to guide practice. It does not even directly affect practice. Rather, the *SFAC*s affect practice only by means of their influence on the development of new accounting standards.
So, rather than a universally accepted theory of accounting, we have settled for the CFP, which does not provide all the answers, but has been relied upon to aid the standard-setting process. And, it has provided a basis to narrow alternatives and to eliminate those that are inconsistent with it. It also is used to guide the development of neutral standards, which aids in the allocation of scarce resources and the efficient function of capital markets
In other words we can operate with concept-based accounting standards by relying upon the CFP rather than a universally accepted theory of accounting. The CFP has been criticized and will evolve to address criticism from the SEC that the objectives of the standards that are derived from it need to be more clearly defined, implementation guidance needs to be improved, scope exceptions need to be reduced and the asset-liability approach to standard setting should be retained

WWW

Case 2-9

The answer to this case requires a visit to the FASB's home page at the time it is assigned.

Case 2-10

The answer to this case requires a visit to the FASB's home page at the time it is assigned.

Case 2-11

The answer to this case requires a visit to the FASB's home page at the time it is assigned.

Case 2-12

During the early 2000s, the FASB noted that concerns were being expressed about the quality and transparency of accounting information. One of the main concerns was the increasing complexity of FASB standards. The Board concluded that much of the detail and complexity associated with accounting standards was the result of rule-driven implementation guidance, which allows "accounting engineering" to get around the rules thereby allowing companies to circumvent the intent and spirit of the standards.

Additionally, the FASB noted that its Conceptual Framework has not provided all of the necessary tools for resolving accounting problems. This deficiency was attributed to the fact the certain aspects of the Conceptual Framework are internally inconsistent and incomplete. As a result, the Board is considering the need to develop an overall reporting framework similar to *International Accounting Standard No. 1*. Such a framework would provide guidance on issues such as materiality assessments, going concern assessments, professional judgment, consistency and comparability. It would also allow few, if any, exceptions and fewer implementation guidelines.

To illustrate the difference between rules based and principles based standards, the standard setting process can be viewed as a continuum ranging from highly rigid standards on one end to general definitions of economics-based concepts on the other end. For example, consider accounting for the intangible asset goodwill. An example of the extremely rigid end of the continuum is the previously acceptable practice:

Goodwill is to be amortized over a 40 year life until it is fully amortized.

This requirement leaves no room for judgment or disagreement about the amount of amortization expense to be recognized. Comparability and consistency across firms and through time is virtually assured under such a rule. However, the requirement lacks relevance because it does not reflect the underlying economics of the reporting entity, which differ across firms and through time.

At the opposite end of the continuum is the FASB's new rule:

Goodwill is not amortized. Any recorded goodwill is to be tested for impairment and if impaired, written down to its current fair value on an annual basis.

This requirement necessitates the application of judgment and expertise by both managers and auditors. The goal is to record the economic deterioration of the asset, goodwill

Case 2-13

At a joint meeting in Norwalk, Connecticut on September 18, 2002, the FASB and the IASB both acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. The two Boards pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.

To achieve compatibility, the Boards agreed to: a) undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, discussed in Chapter 3), b) remove other differences between IFRSs and U.S. GAAP that remain at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently; c) continue progress on the joint projects that they are currently undertaking; and, d) encourage their respective interpretative bodies to coordinate their activities.

In a *Memorandum of Understanding* the Boards agreed:

1. To commit the necessary resources to complete such a major undertaking.
2. To quickly commence deliberating differences identified for resolution in the short-term project with the objective of achieving compatibility by identifying common, high-quality solutions.
3. To use their best efforts to issue an exposure draft of proposed changes to U.S. GAAP or IFRSs that reflect common solutions to some, and perhaps all, of the differences identified for inclusion in the short term project during 2003.

Later, at another joint meeting in October 2004, the boards decided to add to their agendas a joint project to develop an improved and common conceptual framework that is based on and builds on their existing frameworks; that is, the IASB's *framework For The Preparation And Presentation of Financial Stat*ements (discussed in chapter 3 and the FASB's conceptual framework :project
The project will:

1. Focus on changes in the environment since the original frameworks were issued, as well as omissions in the original frameworks, in order to efficiently and effectively improve, complete and converge the existing frameworks.
2. Give priority to addressing and deliberating those issues within each phase that are likely to yield benefits to the Boards in the short term; that is, cross-cutting issues that affect a number of their projects for new or revised standards. Thus, work on several phases of the project will be conducted simultaneously and the Boards expect to benefit from work being conducted on other projects
3. Initially consider concepts applicable to private sector business entities. Later, the Boards will jointly consider the applicability of those concepts to private sector not-for-profit organizations. Representatives of public sector (governmental) standard-setting Boards are monitoring the project and, in some cases, are considering what the consequences of private sector deliberations might be for public sector entities.

The Boards plan to conduct the joint project in eight phases. Each of the first seven phases (A through G) are expected to involve *planning, research*, and initial *Board deliberations* on major aspects of the Boards' frameworks and to result in an *initial document* that will seek comments on the Boards' tentative decisions for that phase. This will be followed by a period of redeliberations—the Boards' consideration of constituents' comments and redeliberations of the tentative decisions. While the Boards may seek comments on each phase separately they have not precluded seeking comments on several phases concurrently. An eighth phase will be used to address any remaining issues.

The Boards are conducting the project in eight phases as follows:

A. Objectives and qualitative characteristics
B. Elements and recognition
C. Measurement
D. Reporting entity
E. Presentation and disclosure
F. Framework purpose

G. Applicability to the not-for-profit sector
H. Remaining

In February, 2006, the two Boards reaffirmed their commitment to this process in a Memorandum of Understanding (MOU) and voiced the shared objective of developing high quality, common accounting standards for use in the world's capital markets. The MOU outlines a "roadmap" for the elimination of the reconciliation requirement for non-US companies that use IFRSs and are registered in the United States (discussed in Chapter 3). The MOU maintaines that trying to eliminate differences between standards is not the best use of resources; rather new common standards should be developed. Convergence will proceed as follows:

First, the Boards will reach a conclusion about whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and, if so, the goal is to complete or substantially complete work in those areas by 2008.

Second, the FASB and the IASB will seek to make continued progress in other areas identified by both Boards where accounting practices under U. S. GAAP and IFRSs are regarded as candidates for improvement.

In July, 2006, the first publication from the joint conceptual project was released. This document titled "Preliminary Views Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information," is quite similar to *SFAC No*'s 1 and 2.

The introduction to Preliminary Views notes that the Boards' existing frameworks differ in their authoritative status. For companies preparing financial statements under IFRSs, management is expressly required to consider the IASB's *Framework for the Preparation and Presentation of Financial Statements* if no standard or interpretation specifically applies or deals with a similar and related issue. In contrast, the FASB's *SFAC*s have a lower standing in the hierarchy of GAAP in the United States, and entities are not required to consider those concepts when preparing financial statements. However, the GAAP hierarchy in the United States is under reconsideration. The Boards have deferred consideration of how to accommodate any differences in the authoritative standing of the conceptual framework in their jurisdictions until that reconsideration is complete.

In Chapter 1 of Preliminary Views, the basic objective of external financial is defined as providing information that is useful to present and potential investors and creditors and others in making investment, credit, and similar resource allocation decisions. To help achieve its objective, financial reporting should provide information to help present and potential investors and creditors and others to assess the amounts, timing, and uncertainty of the entity's future cash inflows and outflows (the entity's future cash flows). That information is essential in assessing an entity's ability to generate net cash inflows and thus to provide returns to investors and creditors. Additionally, to help present and potential investors and creditors and others in assessing an entity's ability to generate net cash inflows, financial reporting should provide information about the economic resources of the entity (its assets) and the claims to those resources (its liabilities and equity).

Information about the effects of transactions and other events and circumstances that change resources and claims to them is also essential. Chapter 2 defines the qualities of decision-useful financial reporting information as relevance, faithful representation, comparability, and understandability. These qualities are subject to the two pervasive constraints of materiality and benefits that justify costs. The comment period for this document ended November 6, 2006 and the two Boards hope to have a final document published in 2007.

Case 2-14

The purpose of the financial statement presentation project is to establish a standard that will guide the organization and presentation of information in the financial statements. The boards' goal is to improve the usefulness of the information provided in an entity's financial statements to help users make decisions in their capacity as capital providers Accordingly, as a part of the Norwalk Agreement, the FASB and IASB committed to (1) undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, discussed in Chapter 3); (2) remove other differences between IFRSs and U.S. GAAP that remained at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects that both Boards would address concurrently; (3) continue progress on the joint projects that they are currently undertaking; and (4) encourage their respective interpretative bodies to coordinate their activities.

The goal is to present information in individual financial statements (and among financial statements) in ways that improve the ability of investors, creditors, and other financial statement users to:

1. Understand an entity's present and past financial position.
2. Understand the past operating, financing, and other activities that caused an entity's financial position to change and the components of those changes.
3. Use that financial statement information, along with information from other sources, to assess the amounts, timing, and uncertainty of an entity's future cash flows.

The project is being conducted in three phases

Phase A addresses what constitutes a complete set of financial statements and requirements to present comparative information.

Phase B addresses the more fundamental issues for presentation of information on the face of the financial statements, including:

1. Developing principles for aggregating and disaggregating information in each financial statement.
2. Defining the totals and subtotals to be reported in each financial statement (which might include categories such as business and financing).
3. Deciding whether components of other comprehensive income/other recognized income and expense should be recycled to profit or loss and, if so, the characteristics of the transactions and events that should be recycled and when recycling should occur.
4. Reconsidering *SFAS No. 95*, "Statement of Cash Flows," and IAS 7, *Cash Flow Statements*, including whether to require the use of the direct or indirect method.

Some preliminary decisions regarding the presentation of the financial statements have been published by the FASB. These decisions are discussed and illustrated in Chapter 6 and 7.

Phase C addresses the presentation and display of interim financial information in U.S. GAAP, including:

1. Which financial statements, if any, should be required to be presented in an interim financial report.
2. Whether financial statements required in an interim financial report should be allowed to be presented in a condensed format, and if so, whether guidance should be provided related on how the information may be condensed.

3. What comparative periods, if any, should be required to be allowed in interim financial reports and when, if ever, should 12 month-to-date financial statements be required or allowed to be presented in interim financial reports.
4. Whether guidance for nonpublic companies should differ from guidance for public companies.

The boards completed their deliberations on Phase A in December 2005. On March 16, 2006, the IASB published its Phase A exposure draft, "Proposed Amendments to IAS 1 Presentation of Financial Statements: A Revised Presentation." The FASB decided to consider phases A and B issues together and, therefore, did not publish an exposure draft on phase A. After considering the responses to its exposure draft, the IASB issued a revised version of *IAS No. 1* in September 2007 (See Chapter 3 for a discussion of *IAS No. 1*). The revisions to *IAS No. 1* affected the presentation of changes in equity and the presentation of comprehensive income, bringing *IAS No. 1* largely into line with *FASB Statement No. 130, Reporting Comprehensive Income* (FASB ASC 220).

Previously, in February 2006, the two Boards reaffirmed their commitment to the process of convergence in a Memorandum of Understanding (MOU) and voiced the shared objective of developing high-quality, common accounting standards for use in the world's capital markets. The MOU outlines a "roadmap" for the elimination of the reconciliation requirement for non-U.S. companies that use IFRSs and are registered in the United States (discussed in Chapter 3). The MOU maintains that trying to eliminate differences between standards is not the best use of resources; rather, new common standards should be developed. Convergence will proceed as follows: First, the Boards will reach a conclusion about whether major differences in focused areas should be eliminated through one or more short-term standard-setting projects, and, if so, the goal was to complete or substantially complete work in those areas by 2008. Second, the FASB and the IASB will seek to make continued progress in other areas identified by both Boards where accounting practices under U.S. GAAP and IFRSs are regarded as candidates for improvement.
In an effort to comply with the goals of the Norwalk Agreement the FASB issued four new statements to bring U. S. GAAP into consistency with IFRSs (*SFAS No.151(*Superseded), SFAS No. 153 (Superseded), *SFAS No. 154* (FASB ASC 250-10) and *SFAS No. 163* (FASB ASC 944). Additionally, it issued a revised *SFAS No. 141*(FASB ASC 805). The IASB published new standards on borrowing costs (*IAS No. 23* revised) and segment reporting (*IFRS No. 8*). Each of these new or revised statements are discussed under the relevant topics later in the text.

Phase B is being conducted with the following principles in mind:

Financial statements should present information in a manner that:

1. Portrays a cohesive financial picture of an entity.
2. Separates an entity's financing activities from its business and other activities.
3. Helps a user access the liquidity of an entity's assets and liabilities.
4. Disaggregates line items if that disaggregation enhances the usefulness of that information in predicting future cash flows.
5. Helps a user understand:
    - how assets and liabilities are measured
    - the uncertainty and subjectivity in measurements of individual assets and liabilities
    - what causes a change in reported amounts of individual assets and liabilities

The project has adopted cohesiveness as a standard for assessing its ability to attain these principles. That is, each financial statement should contain the same sections and categories, and the classification of assets and liabilities will drive the classification of the related changes in the statement of cash flows and comprehensive income statements. This is expected to obtain more clarity in the relationships between statements and to facilitate financial analysis.

The Statements of Comprehensive Income, Financial Position, and Cash Flows will each contain a Business Section, which will report operating activities and investing activities of the specific statement. For example, the Statement of Comprehensive Income's Business Section will contain operating income and expenses as well as investing income and expenses; the Statement of Financial Position's Business Section will report operating assets and liabilities and investing assets and liabilities. In addition to the Business Section, in three of the four statements (excluding the Changes in Equity Statement), a Financing Section is provided as well as a section on taxes and discontinued operations (net of taxes).Each financial statement will contain the following two primary sections: *(1) business*, and *(2) financing*. The following guidelines were adopted for displaying the items in each section:

1. The **business section** *should* have two defined categories: operating and investing. These categories require an entity to make a distinction between business activities that are part of an entity's day-to-day business activities (and the business activity generates revenue through a process that requires the interrelated use of the net resources of the entity) [operating category] and business activities that generate non-revenue income (and no significant synergies are created from combining assets) [investing category].
2. The **financing section** will include items that are part of an entity's activities to obtain (or repay) capital and consist of two categories: debt and equity (a change from their decisions in September).
    a. The debt category will include liabilities where the nature of those liabilities is a borrowing arrangement entered into for the purpose of raising (or repaying) capital.
    b. The equity category will include equity as defined in either IFRS or U.S. GAAP

Case 2-15

a. The goal of the CFP **i**s to create a sound foundation for future accounting standards that are principles-based, internally consistent and internationally converged**.**
b. The eight phases of the CFP are:

    A. Objectives and qualitative characteristics
    B. Definitions of elements, recognition and derecognition
    C. Measurement
    D. Reporting entity concept
    E. Boundaries of financial reporting, and Presentation and Disclosure
    F. Purpose and status of the framework
    G. Application of the framework to not-for-profit entities
    H. Remaining issues, if any.

    The objectives and summary of the decisions reached for each phase of the project at the time this text was published are outlined in the following paragraphs.

    Objectives and Qualitative Characteristics Phase

    The aim of the Objectives and Qualitative Characteristics phase of Financial Reporting is to consider:

    - The objective of financial reporting
    - The qualitative characteristics of financial reporting information

- The trade-offs among qualitative characteristics and how they relate to the concepts of materiality and cost-benefit relationships.

In July 2006, the first publication from the CFP was released. This document, that addressed Phase A of the CFP was titled "Preliminary Views Conceptual Framework for Financial Reporting: Objective of Financial Reporting and Qualitative Characteristics of Decision-Useful Financial Reporting Information," (PV) and is quite similar to *SFAC No. 1* and *2*.
Finally, in May 2008, the FASB and IASB jointly published an exposure draft (ED) of Chapters I and 2 of the CFP. This document updated PV to reflect the comments received on the initial document and stated:

> The Conceptual Framework for Financial Reporting establishes the concepts that underlie financial reporting. The framework is a coherent system of concepts that flow from an objective. The objective of financial reporting is the foundation of the framework. The other concepts provide guidance on identifying the boundaries of financial reporting; selecting the transactions, other events, and circumstances to be represented; how they should be recognized, measured, and disclosed; and how they should be summarized and communicated in financial reports.

The ED indicated that he objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful to present and potential equity investors, lenders, and other creditors in making decisions in their capacity as capital providers. Capital providers were defined the primary users of financial reporting. The ED also indicated that in order to accomplish the defined objective, financial reports should communicate information about an entity's economic resources, claims to those resources, and the transactions and other events and circumstances that change them.
The ED noted that the degree to which that financial information is useful will depend on its qualitative characteristics. Qualitative characteristics were defined as the attributes that make financial reporting information useful. Additionally, the qualitative characteristics were defined as complementary concepts that each contribute to the usefulness of financial reporting information.
The exposure draft maintains that two fundamental qualitative characteristics *relevance* and *faithful representation* distinguish useful financial reporting information from information that is not useful or is misleading. Relevant information was seen as capable of making a difference in decision making by virtue of its predictive or confirmatory value. Financial reporting information is viewed as faithfully representative if it depicts the substance of an economic phenomenon completely, neutrally, and without material error.
The ED suggests that financial reporting information may have varying degrees of usefulness to different capital providers and that certain enhancing qualitative characteristics (EQCs) distinguish more useful information from less useful information. These EQCs augment the decision usefulness of financial reporting information that is relevant and faithfully represented. The EQCs were defined as comparability, verifiability, timeliness, and understandability. The ED maintains that these enhancing qualitative characteristics should be maximized to the extent possible. Nevertheless, the Boards maintained that the EQCs, either individually or in concert with each other, cannot make information useful for decisions if that information is irrelevant or not faithfully represented. The enhancing qualitative characteristics were defined as follows:

1. *Comparable information* enables users to identify similarities in and differences between two sets of economic phenomena.
2. *Verifiable information* lends credibility to the assertion that financial reporting information represents the economic phenomena that it purports to represent.

3. *Timeliness* provides information to decision makers when it has the capacity to influence decisions.
4. *Understandability* is the quality of information that enables users to comprehend its meaning.

Finally, the ED maintains that providing useful financial reporting information is limited by two pervasive constraints, *materiality* and *cost*. Information was defined as material if its omission or misstatement could influence the decisions that users make on the basis of an entity's financial information. With respect to cost, the ED indicates that he benefits of providing financial reporting information should justify the costs of providing that information.

Definitions of Elements, Recognition and Derecognition Phase

The objectives of the Elements and Recognition phase are to refine and converge the Boards' frameworks in the following manner:

1. Revise and clarify the definitions of *asset* and *liability*. – The Boards have agreed that the FASB and IASB definitions of these elements have several shortcomings and have tentatively agreed on the following working definitions:
   a. An *asset* of an entity is a present economic resource to which the entity has a right or other access that others do not have.
   b. A *liability* of an entity is a present economic obligation for which the entity is the obligor.
2. Resolve differences regarding other elements and their definitions. **-** The FASB Concepts Statements presently identify more elements than does the IASB Framework, and the two frameworks define differently those elements that are common. The Boards' approach will focus initially on converging and defining only those key elements that are defined today in the FASB and IASB Frameworks. As well, the Boards will need to consider the extent to which, and if so how, to define elements that are not currently defined, such as comprehensive income.
3. Revise the recognition criteria concepts to eliminate differences and provide a basis for resolving issues such as derecognition and unit of account. **-** Each Board's current framework describes specific recognition criteria, some of which are similar and some of which are different. Neither Board's frameworks contain criteria to determine when an item should be derecognized. The Boards plan to revise their recognition criteria concepts to eliminate those differences and provide a framework for resolving derecognition issues. The Boards' current frameworks provide little or no guidance on how the unit of account should be determined. A Discussion Paper is expected to be issued late in 2010.

Measurement Phase

The objective of the Measurement phase is to provide guidance for selecting measurement bases that satisfy the objectives and qualitative characteristics of financial reporting. It consists of the following three "milestones:"

- **Milestone I** will inventory and defines a list of measurement basis candidates that might be used as a basis for measurement on financial statements;
- **Milestone II** will evaluate the basis candidates identified in Milestone I; and
- **Milestone III** will draw conceptual conclusions from Milestones I and II while addressing practical issues.

During its deliberations of Milestone I, the Boards addressed the following five issues:

1. **What are the measurement basis candidates?** The Boards agreed to a list of nine candidates: *past entry price*, *past exit price*, *modified past amount*, *current entry price*,

current exit price, *current equilibrium price*, *value in use*, *future entry price*, and *future exit price*.

2. **How are the measurement bases defined?** The Boards agreed to provide two definitions for each candidate—one from the perspective of an asset and one from the perspective of a liability. They further decided to focus on the concepts behind entry and exit prices, without respect to the way they are measured.
3. **What are the basic properties of the measurement bases?** The Boards concluded that most candidates are either prices or values, and that each candidate provides information primarily about a specific time frame.
4. **Are the measurement issues appropriate for both assets and liabilities?** The Boards concluded that all the candidates were appropriate for use with assets and liabilities
5. **Should any measurement basis candidates be eliminated from consideration for evaluation in Milestone II?** The Boards agreed not to eliminate any of the nine candidates identified at the end of Milestone I. However, they did eliminate some other candidates in the earlier stages of Milestone I deliberations.

A discussion paper is expected to be released in 2010.

Reporting Entity Concept Phase

The objective of the Reporting Entity phase is to determine what constitutes a reporting entity for the purposes of financial reporting. The FASB has authorized its staff to prepare an exposure draft. The IASB had not formally addressed this issue at the time this text was published but a final draft is expected by the end of 2010.

Boundaries of Financial Reporting, and Presentation and Disclosure Phase

An objective of the Presentation and Disclosure, including Financial Reporting Boundaries phase is to determine the concepts underlying the display and disclosure of financial information, including the boundaries of such information that will achieve the objective of general purpose financial reporting. This phase is currently inactive. The Boards have not yet deliberated or made decisions regarding concepts for financial presentation and disclosure of financial information.

Purpose and Status of the Framework Phase

The objective of the Purpose and Status of the Framework phase, is to consider the framework's authoritative status in GAAP Hierarchy. The goal is to develop a framework that is of comparable authority for the use of both Boards in the standard-setting process.

At present, there are differences in the status of the Boards' existing frameworks. For an entity preparing financial statements under International Financial Reporting Standards, the IASB's *Framework* provides guidance when there is no standard or interpretation that specifically applies to a transaction or other event or condition, or that deals with a similar and related issue. In those situations, the entity's management is required to consider the definitions, recognition criteria, and measurement concepts for assets, liabilities, income, and expenses in the *Framework.* Under US GAAP, the FASB's Concepts Statements have a much lower status—they are ranked no higher than accounting textbooks, handbooks, and articles, and below widely recognized and prevalent general or industry practices.

The FASB has decided that the authoritative status of the framework within the US GAAP hierarchy should be considered once the framework is more substantially complete. However, for the purposes of providing comments on documents issued by the Boards, respondents will be asked to assume that the framework's authoritative status will be elevated in the US GAAP hierarchy to have a status comparable to the IASB's current *Framework.*

The FASB and the IASB agreed that each Board, within the context of its current GAAP hierarchy, will finalize the common framework as parts are completed and that later parts may include consequential amendments to earlier parts. The Boards noted that the decision of how to finalize the joint framework may need to be readdressed when the Boards discuss the placement of the framework within the IASB and FASB hierarchies. This phase of the Conceptual Framework Project is currently inactive.

Application of the Framework to Not-For-Profit Entities Phase

The objective of this phase of the Conceptual Framework Project is to consider the applicability of the concepts developed in earlier phases to not-for-profit entities in the private sector. This phase is currently inactive. The Boards have not yet deliberated or made decisions regarding the applicability of particular concepts to not-for-profit entities.

Remaining Issues, If Any Phase

The objective of the Remaining Issues phase is to consider remaining issues that have not been addressed by the previous seven phases. This phase is currently inactive. The Boards will not deliberate or make decisions regarding final issues until the first seven phases are complete.

Financial Analysis Case

The solutions to the financial analysis depend upon the company and year selected.