BY
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Latest Developments in US GAAP

Wayne Bartlett discusses the latest developments in US GAAP and also looks at the FASB's Simplification Initiative.

With the effective suspension of efforts to bring US GAAP and IFRS into line, at least for the time being, the Financial Accounting Standards Board (FASB) continues to exercise its role as the standard-setter for all those using GAAP as their chosen or required method of financial reporting. Hot off the press is the release in March 2017 of guidance on Receivables – Non-Refundable Fees and Other Topics, Sub-Topic No. 310-20. This is not a new Standard, as the name might suggest, but it is rather an amendment to an existing Standard, more properly called a Codification, namely ASC 310 on Receivables.

The major impacts of the changes in the revised guidance are to change the amortisation period for some callable debt securities held at a premium. In the past users had generally amortised the premium applicable on such transactions as an adjustment to the yield over the contractual life of the instrument involved. However, critics of this approach had argued that the approach excluded the possibility of such instruments from being used as consideration for early repayment of a principal amount, even if it was certain that the call would be exercised in practice. The criticisms appear to have had an impact and ASC 310 is therefore being amended.

The way that the change has been made in ASC 310-20 is to shorten the amortization period for certain callable debt securities held at a premium. The premium involved will now be amortized to the earliest call date. This is in contrast to the current approach when the premiums are amortized to their maturity date. In the existing approach, if a call is exercised the entity must recognise a loss equivalent to the unamortized amount; the changes will mean that this will no longer be the case. The argument in favour of the change that is now made by this update is that it brings it into line with market practices, something that users will presumably be very happy about.

The timing of the changes varies depending on the nature of the entity involved. FASB recognises a category of businesses called 'public business entities'. Such a business defined by the FASB's Master Glossary as an entity with any one of the following characteristics:

- It is required by the Securities and Exchange Commission (SEC) to file or furnish financial statements to the SEC
- It is specifically required by the SEC Act of 1934 to file or furnish such financial statements
- It is required to file or furnish financial statements with a regulatory agency in preparation for the sale of securities
- It has unrestricted securities that can be sold in an over-the-counter market
- Its securities are unrestricted and it is required by US GAAP to make financial statements publicly available on a periodic basis

If an entity has one or more of these characteristics, then it will be defined as a public business entity. The changes predicated by ASC 310-20 require such entities to make the changes included for the first financial reporting period beginning after December 15, 2018. All other entities must do so for periods beginning a year later, namely after December 15, 2019. However, as is normally the case, earlier adoption is permitted.

Derecognition of non-financial assets

Another important update that has recently appeared is Sub-Topic 610-20 which deals with the Gains and Losses arising from the derecognition of non-financial assets. Some contractual situations may involve both non-financial and financial assets (e.g. cash or receivables in the latter category). The update makes clear that the latter are covered by the provisions of 610-20 if they are what is known as 'in substance non-financial assets'. This is an example of substance over form in practice. Under the terms discussed in 610-20 the financial assets are considered to be 'in substance non-financial assets' if the substantial part of the fair value promised to the other contracting party in any arrangement is to be found in non-financial assets.

The amendments included in 610-20 require that each non-financial asset or each 'in substance non-financial asset' be separately identified and derecognized when a counterparty gains control of it. Consideration shall be applied to each individual element so identified by applying the guidance in Topic 606 which allocates a price based on performance obligations.

610-20 identifies that the impact of the transactions thus clarified will mainly be felt in the real estate industry. However it notes that it might also have an impact in other areas, such as in power and utilities, alternative energies, life sciences and shipping. This is a good insight into the way that the FASB thinks when it considers changes in what may appear to be some quite technical areas. FASB seeks to look at the impact of such changes on specific industries and in the process reveals itself to be a deep-thinking organisation that is not just focussed on 'technical purity' when developing its Standards but also has an eye on practical issues. In this case, for public entities the changes become effective for a period starting after December 15, 2017 – which is not long when you think about it – and for other entities periods beginning after December 15 2018.

Non-Employee Share Based Options

On March 7, 2017 the FASB issued a press release saying that it was proposing, through the mechanism of an Accounting Standards Update (ASU), changes to the way that accounting for non-employee share based options take place. The aim is to reduce cost and complexity and to improve financial reporting in this specific area.

It would have the effect of extending the current provisions of Topic 718, on the subject of Stock Compensation, which is currently limited to employees only, to non-employees too. It is interesting to note that one of the reasons given for this proposed change was that it was identified as a target area by the FASB's Simplification Initiative. There will now be a consultation period before the Update is finalised and then released.

Infobesity

The Simplification Initiative referred to above has been launched by the FASB to look at some narrow-scope areas where simplification of existing Standards is possible. The specific target areas of the Initiative are to look at areas where;

- It is possible to improve or maintain the quality of information provided to stakeholders, whilst;
- Reducing cost and complexity in financial reporting

This is an interesting and welcome initiative. The accounting world as we all know is one that is becoming increasingly complex. There is a trade-off between the costs and benefits of providing financial information that does not always get taken into account when developing standards. Further, such information can be complex and difficult for users of financial information to understand. There is even an everyday phrase to take into account here: 'information overload'. An alternative name that is sometimes applied to this, and one I confess I find quite an interesting one, is 'infobesity'.

The American psychologist George Armitage Miller (1920-2012) hypothesised that people can only assimilate about seven items of information at one time. If they are overloaded then they become confused and become more likely to make poorer rather than better decisions as a result. There has been much research undertaken on this subject but as yet limited response in practice it would seem. But the Simplification Initiative is a good step in the right direction.

It is a timely reminder to all of us of the importance of clear communication. In an increasingly complex world, it is beholden on accountants to try and make things as clear as possible without dumbing down matters so much that the core information is insufficient. It is a difficult balance to strike in practice though it is one that is also encouraged by IFRS with its clear view that it is acceptable to take cost versus benefit considerations into account when preparing financial statements. The FASBs Simplification Initiative is an important step forward in this respect and it will be interesting to see what other clarifications might take place in the near future to add to the work that has already been undertaken.