



## FASB Codification to Be Sole Reference Source for Authoritative GAAP

The FASB's Accounting Standards Codification will become the exclusive authoritative reference for nongovernmental U.S. GAAP for use in financial statements issued for interim and annual periods ending after September 15, 2009, except for SEC rules and interpretive releases, which are also authoritative GAAP for SEC registrants.<sup>1</sup> The change was established by new FASB Statement 168, which divides nongovernmental U.S. GAAP into the authoritative Codification and guidance that is nonauthoritative, doing away with the previous four-level hierarchy.<sup>2</sup>

### The Codification's Content

The Codification brings together in one place all authoritative GAAP previously in levels A through D of the GAAP hierarchy that has been issued by a standard setter, for example, FASB Statements, FASB Interpretations, EITF Abstracts, FASB Staff Positions, and AICPA Accounting and Auditing Guides. Nonauthoritative GAAP includes certain items currently in the GAAP hierarchy's Level D (for example, prevalent industry practice) and other accounting guidance, such as textbooks and articles.

The FASB believes that the Codification retains existing GAAP without changing it except in one instance. The exception is guidance on software revenue recognition from AICPA Technical Practice Aids that the Board decided to include in the Codification with transition provisions for nonpublic companies that did not previously apply the guidance.<sup>3</sup> Nonpublic companies will be required to apply the accounting guidance in the Technical Practice Aids for revenue arrangements entered into or materially modified in fiscal years beginning on or after December 15, 2009, and interim periods within those years. No transition provisions were included for public companies because the SEC previously required them to apply the guidance.

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<sup>1</sup> *FASB Accounting Standards Codification™*, available at [www.fasb.org](http://www.fasb.org).

<sup>2</sup> FASB Statement No. 168, *The FASB Accounting Standards Codification™ and the Hierarchy of Generally Accepted Accounting Principles*, available at [www.fasb.org](http://www.fasb.org).

<sup>3</sup> Paragraphs 38-76 of Section 5100, *Revenue Recognition*, of the AICPA's Technical Inquiry Service.

Statement 168 carries forward Statement 162's grandfathering provisions.<sup>4</sup> They permitted an entity that followed specified industry practices that were recognized as authoritative in category D of the GAAP hierarchy as of March 15, 1992, to continue to follow those practices. In some cases, a new pronouncement allows some or all entities to continue to follow previous guidance for a specific class of transactions, such as Opinion 25's guidance on accounting for share-based awards issued to employees prior to the effective date of Statement 123R for nonpublic entities that elected to apply that guidance prospectively.<sup>5</sup> Users of the Codification will have access to grandfathered requirements within an archived section of the FASB's Codification Web site. The archive will also contain all previously issued FASB pronouncements.

The Codification excludes "nonessential content." It omits historical text and other material considered not essential to conveying GAAP requirements, including much of the basis for conclusions contained in previously issued accounting pronouncements, which are referred to below as "legacy" pronouncements.

The FASB intends to form a Codification Issues Group to identify inadvertent changes in GAAP requirements that occurred during the codification process. Constituents are encouraged to communicate to the FASB what they believe may be a change in GAAP requirements caused by the codification process.

### **Subsequent New GAAP**

Future FASB accounting pronouncements will be designed to update the Codification. They will be referred to as Accounting Standards Updates and will be subject to the same due-process procedures currently in place for new accounting pronouncements, including public Board meetings and published exposure documents subject to public comment periods. Update pronouncements will be identified by the year of issuance followed by a number locating the pronouncement within the sequence of updates issued during that year. For example, the designation for the first new accounting pronouncement issued during 2010 would take the form "Accounting Standards Update No. 2010-001." Each pronouncement will consist of a standard, a basis for conclusions, and codification update instructions. All authoritative GAAP issued by the FASB after July 1, 2009, will be published in this format, with no additional FASB Statements, FASB Interpretations, FASB Staff Positions, and EITF Abstracts.

### **Errors Occasioned by Transitioning**

Preparers of financial statements may identify errors in their previous accounting as a result of identifying Codification requirements of which they were not aware. Statement 168 says that such changes should be accounted for as a change in accounting principle or a correction of an error, as applicable, under Statement 154's requirements.<sup>6</sup> When applying Statement 154, the preparer would disclose the accounting principles that were used before and after the entity applied Statement 168 and the reasons that applying Statement 168 caused a change in accounting principle or a correction of an error.

<sup>4</sup> FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, available at [www.fasb.org](http://www.fasb.org).

<sup>5</sup> APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and FASB Statement No. 123 (revised 2006), *Share-Based Payment*, available at [www.fasb.org](http://www.fasb.org).

<sup>6</sup> FASB Statement No. 154, *Accounting Changes and Error Corrections*, available at [www.fasb.org](http://www.fasb.org).

### The Codification's Structure

The Codification is organized by descriptors referring to increasingly more specific GAAP requirements and implementation guidance, all arranged under higher-level organizing categories. From most broad to most specific, the descriptors are topics, subtopics, sections, and subsections. The numbering sequence parallels the increasing levels of specificity.

Topics are grouped under a General Principles and Objective category and the four other organizing categories described below:

- **Presentation** topics provide guidance specific only to presentation. They include, for example, the income statement, balance sheet, segment reporting, and earnings per share.
- **Financial Statement Accounts** topics are organized by account designations within financial statements. Examples include equity, revenue recognition, receivables, and inventory.
- **Broad Transactions** topics relate to multiple financial-statement accounts and are generally transaction-oriented. They include business combinations, derivatives and hedging, and nonmonetary transactions.
- **Industries** topics cover accounting that is unique to an industry or type of activity (for example, airlines, software, and real estate).

Subtopics refer to subjects within the scope of a topic. For example, operating leases and capital leases are two subtopics of the leases topic. Each topic contains an “overall” subtopic that contains guidance that is either self-contained because there are no other subtopics or applies to all other subtopics within the topic. The guidance within each other subtopic is specific to that subtopic.

Sections are devoted to portions of the subject matter covered in a subtopic, including recognition, measurement, and disclosure. The section titles and organization are the same for all subtopics. Sections are further broken down into subsections, paragraphs, and subparagraphs, as needed to cover the content.

### SEC Content in the Codification

Some SEC and SEC staff guidance is included in the Codification to increase its usefulness to public companies. The guidance is presented in separate sections and is limited to material on the basic financial statements. With that focus, it includes portions of Regulation S-X; Financial Reporting, Accounting Series, and Interpretative Releases; and SEC staff guidance originally contained in Staff Accounting Bulletins, EITF Topic D, and SEC Staff Observer comments at EITF meetings.

The Codification does not replace or affect requirements issued by the SEC or its staff for public companies in their filings with the SEC, nor does it change the process whereby the SEC will issue requirements in the future.

### The Codification's Research Advantage

A key goal in the Codification project is to streamline research on accounting requirements. Bringing all authoritative GAAP together in one place will facilitate research, and that advantage will be leveraged by computerized access and tools. A basic view of the Codification topics will be available without charge at [asc.fasb.org](http://asc.fasb.org). Powerful search and retrieval functions

and cross-reference features are available for a subscription fee. The cross-reference tool allows users to learn the legacy source or sources of Codification text and to learn where in the Codification specific legacy standards are incorporated.

The FASB plans to issue a hard copy of the initial Codification.

### **Citing the Codification in Financial Statements**

The FASB suggests an approach to referencing Codification content that could establish consistent references in financial statements, accounting policy manuals, working papers, articles, textbooks, and other documents and communications. The approach depends on the intended citation's level of specificity. Here are examples of the FASB's suggested reference format for a topic, subtopic, section, and paragraph.

Topic reference: FASB ASC 305 (for the Cash and Cash Equivalents topic)

Subtopic reference: FASB ASC 305-10 (for the Overall subtopic of topic 305)

Section reference: FASB ASC 305-10-15 (for the Scope section of subtopic 305-10)

Paragraph reference: FASB ASC 305-10-15-2 (for paragraph 2 of section 305-10-15)

The Codification will become effective for financial statements issued for interim and annual periods ending after September 15, 2009. The financial statements for those periods should contain Codification citations in place of any corresponding references to legacy accounting pronouncements.

However, the transition to the Codification may provide an opportunity for entities to review their disclosures and to revise them to use plain English descriptions of their policies or to enhance their descriptions for accounting for specific financial-statement items. References to GAAP are not a substitute for clear descriptions, and unnecessary references hinder them. We believe that in many cases it may be more helpful to financial-statement users to describe the specifics of the accounting policy applied in the financial statements than to refer readers to the relevant text within GAAP—for example, to describe the policies for share-based-payment accounting, rather than to say instead that the entity follows Statement 123R or FASB ASC 718.

Entities that refer to specific accounting pronouncements in financial statements for reporting periods that end before the Codification is effective may continue to refer to the relevant legacy GAAP. In financial statements for reporting periods ending before the Codification is effective that are not issued until after the effective date, we believe that it also would be acceptable to provide the applicable Codification reference alone or to cite both legacy GAAP and the Codification.

We understand that the SEC staff will expect registrants to cite the relevant parts of the Codification rather than legacy GAAP in financial statements for interim and annual periods ending after September 15. Although the SEC staff may not require registrants to amend filings merely to change GAAP references to the Codification, the staff may consider providing a reminder in comment letters to refer to the Codification rather than legacy GAAP in future filings.

We also understand that registrants should not use Codification references in financial statements for the SEC content that is in the Codification. Registrants should instead continue to refer to the applicable SEC rule or regulation, for example, Regulation S-X or a Staff Accounting Bulletin.



We believe that references to legacy GAAP would be appropriate, even in financial statements for periods ending after the effective date of the Codification, for grandfathered guidance that was never included in the Codification. For example, an entity may have appropriately applied Statement 141 on business combinations to account for an acquisition that occurred before Statement 141R on the same subject became effective.<sup>7</sup> In that instance, it would be appropriate to refer to Statement 141 if the entity concludes that references to specific authoritative literature are appropriate, because the superseded pronouncement was never included in the Codification but was grandfathered under Statement 168.

Entities should also consider replacing legacy GAAP references in internal documents with Codification references, including internal documents that support accounting treatments, accounting policy manuals, and group reporting packages. There is no requirement to update GAAP references in internal documents, but users of those documents would benefit from the most relevant, up-to-date GAAP references.

The descriptive and summary statements in this newsletter are not intended to be a substitute for the text of any of the cited documents or any other potential or applicable accounting literature or SEC regulations. Companies applying GAAP or filing with the SEC should apply the texts of the relevant laws, regulations, and accounting requirements, consider their particular circumstances, and consult their accounting and legal advisors.

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<sup>7</sup> FASB Statements No. 141, Business Combinations, and No. 141 (revised 2007), Business Combinations, both available at [www.fasb.org](http://www.fasb.org).