Looking Back, Looking Ahead

There have been many significant developments in corporate financial reporting in the past year. Accounting and finance professionals can look forward to even more in the year ahead.

Each July 1, the Institute of Management Accountants (IMA®) begins a new fiscal year as well as a new term for the organization’s volunteer leaders. As a longtime member of IMA, I’m very familiar with this annual cycle—I typically find myself each June looking back over the preceding 12 months and looking ahead to the next 12. Accordingly, in this month’s column I’ll summarize the major developments in corporate financial reporting that have occurred over the past year as well as the major developments that are likely to occur in the coming year.

Convergence Continues

When I began writing this column last July, I knew that one phenomenon in particular was destined to drive most of the changes in financial reporting that I would be writing about in the months to follow. As regular readers of this column know, that phenomenon is the convergence of U.S. Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS), or simply “Convergence.”

The efforts of the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) to converge U.S. GAAP and IFRS at the standard level have already started to reshape financial reporting in the United States and around the world in profound ways. This past year, three particular Convergence projects have stood out.

A Common Conceptual Framework. The first of the three projects is an attempt by the FASB and the IASB to define a common conceptual framework that will form the foundation of future converged standards. Although it is currently being conducted in parallel with numerous standard-level projects, successful completion of the conceptual framework project will be essential to the ultimate success of all of the Boards’ Convergence efforts. As I say in the Convergence Guidebook for Corporate Financial Reporting (Wiley), “If different standard setters disagree on the basic concepts of financial reporting, then it is unlikely that those standard setters will ever agree on specific standards.”

The first phase of the conceptual framework project, which states the objectives of financial reporting and identifies both necessary and desirable qualitative characteristics of financial information, is nearing completion. Significant progress on other phases dealing with the fundamental elements of financial statements, recognition, measurement, and the definition of a reporting entity is expected in the year ahead.

Financial Statement Presentation. The second of my “top three” Convergence projects, financial statement presentation, has generated a lot of attention because the FASB and the IASB have proposed dramatic changes to the contents and formats of the principal financial statements. The
high level of attention—much of it oppositional—isn’t surprising. After all, the project aims to overhaul the key tangible deliverable of the financial reporting process. As such, the project is likely to remain highly visible as the Boards redeliberate the issues that were raised in comment letters submitted in response to their October 2008 discussion paper. An exposure draft of a new standard on financial statement presentation is expected in the first half of 2010.

Revenue Recognition. The third Convergence project, which deals with revenue recognition, has the potential to greatly simplify a chronically problematic application area under both U.S. GAAP and IFRS. But the new model that the FASB and the IASB tentatively proposed in their December 2008 discussion paper wasn’t well understood by practitioners—including me. In my March 2009 column, I explained what I thought the Boards were proposing. Upon reading my explanation, Kenny Bement, who manages the revenue recognition project for the FASB, kindly pointed out that I hadn’t gotten it quite right. I subsequently met with Kenny to discuss the finer points of the Boards’ proposed model for revenue recognition and came away with a better understanding of it.

To set the record straight, the FASB and the IASB have proposed that a seller’s contract with a customer, consisting of a combination of rights and obligations, should be considered the seller’s unit of account rather than considering the seller’s rights and obligations as separate units of account. The key implication is that, during the life of the contract, the seller’s contract-related rights and obligations would be netted against each other and only the net result (if not zero) presented as an asset or a liability. Thus, when the seller’s rights exceed its obligations (such as when the seller has delivered goods but hasn’t yet received payment), the seller would recognize a contract asset in the amount of the difference. When the seller’s obligations exceed its rights (such as when the seller receives payment in advance of delivering goods), the seller would recognize a contract liability, again in the amount of the difference. Then, as explained in my original column, revenue is recognized when the seller’s net contract position increases.

This simple, principles-based approach is intended to replace the many diverse, complex, and often arbitrary approaches to recognizing revenue under U.S. GAAP and IFRS today. Consequently, this project is likely to produce the greatest direct benefits for preparers of any of the three Convergence projects that I have discussed here.

What about the Roadmap?
In November 2008, the U.S. Securities & Exchange Commission (SEC) formally proposed a “Roadmap” for eventually considering whether or not to require U.S. companies under the SEC’s jurisdiction to prepare their financial statements in accordance with IFRS instead of U.S. GAAP. Since the proposed Roadmap was issued, Mary Schapiro has become the new SEC chair. Unlike her predecessor, Schapiro clearly lacks enthusiasm for the proposed Roadmap, leading many observers to wonder about its fate.

In looking ahead, it’s important to recognize that the SEC’s proposal was ambiguous, noncommittal, and poorly justified, so it always bore a strong likelihood of eventual rejection. Meanwhile, the FASB and the IASB are continuing to converge U.S. GAAP and IFRS at the standard level. And as this continues, the issue of U.S. public companies converting to a dissimilar set of standards increasingly becomes a nonissue. In other words, as U.S. GAAP and IFRS become more similar to each other, it won’t matter much which of those two sets of standards companies use, nor will it matter much if companies are allowed to switch from one set to the other. The biggest remaining issue will be whether the U.S. will accept the same standards setter as other countries; if so, we will then have no need for two separate sets of standards that differ in name only, and full Convergence will truly be within reach.

Coping with the Crisis
Although I had foreseen the signifi-

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On June 30, 2009, Bruce Pounder will present educational sessions on recent developments in financial reporting at the Ohio Society of CPAs’ Annual Summit in Columbus, Ohio. For more information, visit www.ohioscpa.com/content/education.aspx.
significant impact of Convergence on financial reporting, there’s another phenomenon whose impact I hadn’t foreseen a year ago: the global financial crisis. As a result of turmoil in credit markets and in the economy as a whole, the FASB and the IASB have been pressured by financial institutions, politicians, and other parties who want the Boards to “do something” about standards that many observers believe are at least partly to blame for our current economic circumstances. Though much of the pressure for immediate action has subsided, the crisis led the Boards to launch a long-term, comprehensive project on financial instruments. This ensures that we’ll continue to see the present crisis influence their work for years to come.

Codification Coming
For U.S. accounting professionals in particular, there’s no development of the recent past or near future that’s more significant than the FASB’s Accounting Standards Codification™. The FASB’s adoption of the Codification as the sole source of authoritative U.S. GAAP on July 1, 2009, will profoundly change the way that U.S. GAAP is documented, updated, referenced, and accessed. The good news is that the Codification will make it much easier for practitioners to identify and apply relevant accounting standards in all situations. The bad news is that the Codification will impose technical and managerial challenges on the unprepared. The worst news is that most U.S. accounting professionals are woefully unprepared for the Codification. A recent survey by Grant Thornton found that most U.S. financial executives aren’t even aware of it.

If you practice, teach, or research accounting in accordance with U.S. GAAP, my advice is to learn the Codification and learn it fast. As a starting point, IMA members have free access to the recorded version of the Inside Talk webinar I presented on the Codification in February 2009 (see www.imanet.org/development_webinar_library.asp).

Relief for SMEs
In the August 2008 issue of this magazine, I wrote about the “IFRS for Private Entities,” which, after two more name changes in the past year, is back to being known by its original name, “IFRS for Small and Medium-sized Entities” (SMEs). This is the most exciting financial-reporting development I have ever seen for accounting professionals who work for and with SMEs. The final version of the IFRS for SMEs is scheduled for release this month. It will provide smaller, privately held companies with the opportunity to use a freely available set of financial reporting standards tailored to their needs and capabilities, in sharp contrast to the large-public-company orientation of U.S. GAAP and full IFRS. The IFRS for SMEs will also enable private U.S. companies to immediately enjoy the benefits of country-neutral standards, with assurance services available from U.S. Certified Public Accountants (CPAs) thanks to recent rule changes by the American Institute of CPAs (AICPA).

Collectively, all of these developments indicate that we as financial professionals certainly live in a time of great change. And in the coming year, as in the past, my goal for this column is to help you stay on top of all major changes in financial reporting. SF

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