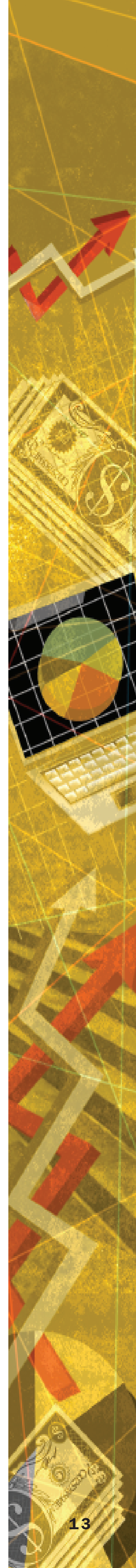
Bruce Pounder, CMA, CFM, Editor



When Diversity Isn't a Good Thing

Here are several recent examples of how the FASB's Emerging Issues Task Force reduces diversity in the interpretation and application of U.S. GAAP.

Some financial accounting and reporting standards can be interpreted reasonably in different ways by preparers and auditors of financial statements. But most of the time, diversity in the interpretation and application of standards isn't consistent with the intent of standards setters. Diversity in practice can be especially problematic if it significantly reduces the comparability of financial statements among reporting entities. When it's known that U.S. Generally Accepted Accounting Principles (GAAP) are interpreted and applied differently by different entities, the Emerging Issues Task Force (EITF) often becomes involved in resolving the differences.

The EITF was formed by the Financial Accounting Standards Board (FASB) in 1984 to "promulgate implementation guidance within the framework of existing authoritative literature to reduce diversity in practice on a timely basis." As the FASB's primary interpretative body, the EITF follows a due process in identifying, discussing, and resolving issues that arise from the interpretation and application of existing U.S. GAAP.

Many of the FASB's Accounting Standards Updates (ASUs) are the result of recommendations made by the EITF. In this month's column, I'll summarize the three most recent ASUs, each of which is an example of the FASB implementing an EITF recommendation for changing the wording of GAAP in order to reduce diversity in practice.

Casino Jackpot Liabilities

FASB *Accounting Standards Codification*™ (ASC) Topic 924, *Entertainment—Casinos*, addresses the accrual of jackpot liabilities by casinos. But not all jackpots are alike. Depending on the regulations of the gaming jurisdiction in which a casino operates, the casino may or may not be required to eventually award the jackpots that it advertises. Diversity in practice has developed regarding whether a casino should accrue a jackpot liability if the casino can avoid paying the jackpot.

On April 26, 2010, the FASB issued ASU No. 2010-16, "Accruals for Casino Jackpot Liabilities." ASU No. 2010-16 reflects the EITF's consensus that a casino shouldn't accrue a jackpot liability if the casino can avoid paying the jackpot. This ASU amends ASC 924 accordingly, with the amendments effective for fiscal years (and interim periods within those fiscal years) beginning on or after December 15, 2010. If the amendments require a change in an entity's accounting, the entity must record a cumulative-effect adjustment to the opening balance of retained earnings.

Milestone Method of Revenue Recognition

A reporting entity may enter into an arrangement with another entity to perform research and/or development (R&D) work for the other entity. Such R&D arrangements frequently include provisions whereby payments are made only when one or more specified "milestone" events occur—for example, upon successful completion of phases in a drug study or achieving a specific result from the R&D efforts.

Entities that perform R&D under such arrangements often recognize the contingent consideration as revenue when they achieve the related milestone. This is commonly referred to as the *milestone method* of revenue recognition. But U.S. GAAP has lacked specific guidance on the use of the milestone method, so diversity in practice has arisen with regard to when and how to apply it.

On April 28, 2010, the FASB issued ASU No. 2010-17, "Milestone Method of Revenue Recognition," which reflects the EITF's consensus on

- The definition of a milestone;
- When it may be appropriate to apply the milestone method to R&D transactions;
- A framework for consistently applying the milestone method, when appropriate;
- Proposed additions and a modification to related eXtensible Business Reporting Language (XBRL) elements; and
- Disclosures that vendors must make about their R&D arrangements.

The amendments in ASU No. 2010-17 are effective on a prospective basis for milestones achieved in fiscal years (and interim periods within those years) beginning on or after June 15, 2010. Retrospective application is permitted for all prior periods. Early adoption is permitted, but additional disclosures are required.

Modified Pooled Loans

In recent years there has been an increase in the number of acquired loans that fall under the scope of ASC Subtopic 310-30, *Receivables > Loans and Debt Securities Acquired with Deteriorated Credit Quality*, as well as an increase in the number of modifications to the contractual terms of such acquired loans. In general, ASC Subtopic 310-30 provides guidance on accounting for acquired loans that have evidence of credit deterioration upon acquisition. In particular, ASC paragraph 310-30-15-6 allows acquired assets with "common risk characteristics" to be pooled together and accounted for as a single asset.

Separately, ASC Subtopic 310-40, *Receivables > Troubled Debt Restructurings by Creditors*, addresses measurement, derecognition, disclosure, and implementation guidance issues concerning troubled debt restructurings (TDRs) from the creditor's perspective. ASC paragraphs 310-40-15-4 through 12 establish the criteria for evaluating whether a particular loan modification should be classified as a TDR. For example, ASC 310-40-15-5 states: "A restructuring of a debt constitutes a troubled debt restructuring for purposes of this Subtopic if the creditor for economic or legal reasons related to the debtor's financial difficulties grants a concession to the debtor that it would not otherwise consider."

Diversity in practice has developed regarding whether a loan that's part of a pool of loans accounted for as a single asset should be removed from that pool when a modification occurs that would constitute a TDR. Some of the FASB's constituents believe that ASC 310-40 doesn't apply to the individual loans within a pool, so modified loans should remain within the pool. Other constituents believe that each modified loan should be evaluated against the TDR criteria and that, if the loan modification is a TDR, the modified loan should be removed from the pool and accounted for as a separate asset.

On April 29, 2010, the FASB issued ASU No. 2010-18, "Effect of a Loan Modification When the Loan Is Part of a Pool That Is Accounted for as a Single Asset." In accordance with the EITF's consensus on this issue, ASU No. 2010-18 amends ASC 310 so as to clarify that an entity should not apply TDR accounting guidance to loans accounted for as a pool under ASC 310-30 and not remove modified loans from their pools. The amendments in this ASU are effective for modifications of loans accounted for within pools under ASC 310-30 occurring in the first interim or annual period ending on or after July 15, 2010. The amendments are to be applied prospectively. Early application is permitted.

As these three recent ASUs illustrate, the EITF deals with a very broad range of accounting issues for which diversity in practice has arisen. Over time, the quality and consistency of U.S. GAAP have improved significantly as a result of the EITF's efforts. **SF**

Bruce Pounder, CMA, CFM, DipIFR (ACCA), is president of Leveraged Logic, a provider of educational products and services for accounting professionals. He is chair of IMA's Small Business Financial and Regulatory Affairs Committee and the liaison from that Committee to IMA's Financial Reporting Committee. You can reach Bruce at BPounder@LeveragedLogic.com.