THE ACCOUNTING EDUCATORS' JOURNAL
Volume XXI
2011
pp. 153 - 171

Introducing Students to the FASB Codification System

Vincent C. Brenner
Stetson University

Ann L. Watkins
Lamar University

Abstract

The FASB completed its Codification System project in July of 2009. It is the single source of US GAAP for non-governmental entities and will be continually revised and up-dated. The Codification also provides a search engine to research various accounting and reporting issues. This paper discusses the purpose of the Codification and the various approaches to GAAP research using the Codification. The paper also sets forth the need for accounting educators to adequately educate their students on the Codification and develop their research skills using the Codification search processes. A practice case approach is employed for developing student research skills. An in-depth analysis of one case is presented which investigates the results of different search approaches. The Appendix also provides three additional cases with searches and solutions.

Introduction

July 1, 2009 the Financial Accounting Standards Board (FASB) introduced the Accounting Standards Codification (Codification or ASC) and it became the sole authoritative source of US accounting standards for nongovernmental entities. All non-SEC accounting literature not included in the Codification is now considered non-authoritative. The Codification must be used for all financial statements for periods ending after September 15, 2009. The Codification collapses the previous five levels of authoritative support representing thousands of standards by numerous standard-setters in various forms into two levels: authoritative and non- authoritative.

The Codification project was developed to address the following issues: 1) to clarify the authoritative status of accounting literature by providing a single source of GAAP, 2) to ensure that the codified content accurately represented authoritative US GAAP, 3) to create a timely codified research system that is up to date and reflects the results of standard-setting activity, 4) to aid FASB in research and convergence efforts, and; 5) to create a single authoritative source of literature for the completed XBRL taxonomy. Constituents were concerned that US GAAP had become overly confusing and difficult to research. Under the old "House of GAAP," there were multiple types of standards, standard setters, indexing schemes and different levels of authority. It was often difficult to ensure completeness of all relevant guidance and accuracy in its application. All relevant material to a particular topic is now located in one place. Users often found it necessary to read an entire standard when only a portion of it might be relevant to the issue they were researching. The new system eliminates redundancy by creating as-amended versions of the accounting standards. The FASB hopes the Codification will expedite the research process in solving accounting research issues, and reduce the risk of noncompliance due to oversight by providing standards in a centralized location in "real-time."

FASB will no longer issue EITF Abstracts, Staff Positions, Statements or Interpretations. New standards will no longer be considered authoritative in their own right. New standards will serve only to update the ASC and provide the historical basis for conclusions of a new standard. The ASC does not change GAAP, but changes the way GAAP is referenced by placing all previously issued accounting standards into code form. The idea was to create an easily accessible, user-friendly online research system.

Importance of Understanding FASB Codification

There are many reasons for incorporating exposure to the FASB's Codification system into upper level Accounting coursework. FASB requires statement preparers, auditors, analysts and academics to use the Codification when referencing GAAP. Audit, attest, compilation and review work papers associated with financial statements reflect the Codification since the underlying financial statements, the subjects of those engagements, reference the Codification. CPA exam candidates are required to utilize authoritative sources to complete exam simulations. In 2011 this included the FASB Codification system.

The Codification uses a topic-based model consisting of 90 individual Topics. Each Topic contains at least one Subtopic. Subtopics contain Sections, which include the actual accounting guidance. Sections are based on the nature of the content (e.g. scope, recognition, measurement, etc.) and are standardized throughout the Codification. Each Section includes numbered Paragraphs. Paragraph numbers start with the Section number followed by the unique Paragraph number. It is at the paragraph level where the actual topical content is located. All other elements in the Codification structure facilitate selection to the Paragraph level. Figure 1 provides an example of the structure using Leases.

Students are likely to find that the Codification system is not as easy to use as many of the search engines with which they are familiar. Instructors should get students to actively engage in utilizing the Codification so that they become comfortable navigating through the system.

[Place Figure 1 about here]
`

Using Case Materials to Introduce Students to the FASB Codification

This section demonstrates how case materials might be used in the classroom to introduce students to the Codification system. We use four cases to illustrate the use of the Codification in research. These cases, the research process and the solution are presented in the Appendix.
We suggest that students complete the FASB ASC tutorial guide offered by the FASB through the Codification Research System website. Schools must register and pay a small fee for access (see http://aaahq.org/FASB/Access.cfm for details). The tutorials can be found on the home page of the FASB ASC. The tutorials include the following:
Codification overview
Navigation and content
Other features
Feedback

Next, a case can be used by the instructor to demonstrate the various approaches to conducting a search in ASC in the classroom. We will use Case 1 from the Appendix as our illustration. This approach works best in a classroom equipped with internet access that is available on an overhead projector. It is suggested that students be required to read the case and attempt the solution on their own prior to the class demonstration.

The FASB suggests three navigation techniques: Browsing, Searching and Go To. The Codification is arranged within Topics, Subtopics, and Sections through a Table of Contents that facilitates the browsing of the content. It works like a large drop down menu. Students should first identify the issues in the case selected. This might take some class discussion, but eventually students should agree that the case involves issues related to a business combination, defined benefit plan, and recognition of assets. Students might try accessing relevant Paragraphs by starting with Assets or Liabilities. Neither of these will produce Topics of relevance. If they decide to approach this starting with business transactions as the Topic they will select the category "Broad Transactions." By clicking on Business Combinations six Subtopics are revealed. Identifiable Assets and Liabilities, and Any Noncontrolling Interest would be the most relevant Subtopic. Clicking on this Subtopic reveals the Section Recognition. Once Recognition is chosen students will need to scroll down through the Paragraphs. Paragraph 23 provides guidance on Pension and Postretirement Benefits Other than Pensions. GAAP indicates that the overfunded pension plan must be reported as an asset.

A second approach to finding this information would be to use the Search feature. If students simply type in Pensions in the Search window they will receive 194 results. These results can be narrowed either by Related Term or By Area using the choices on the right below the Search window. If the student then selects Assets under By Area, the results are narrowed to six, but none are relevant. If they narrow the search using Broad Transactions the results are reduced to 17. The challenge for students is that even though the following result appears, it may be difficult for students to recognize this is the right answer. By clicking on this link they will be brought to the appropriate Paragraph 23.

> 805 Business Combinations > 20 Identifiable Assets and Liabilities, and Any Noncontrolling Interest > 25 Recognition
> General
>
> > ... 805-20-25-23 through 25-26 would be recognized in accordance with that guidance and as specified in those paragraphs. Pension and Postretirement Benefits Other than Pensions 25-23 December 15, 2008 805-10-65-1 Guidance on defined benefit pension plans is presented in Subtopic 715-30. If an acquiree sponsors a single-employer defined benefit pension plan, the acquirer shall ...

A proper combination of terms such as "business combinations-pensions" will provide 19 results including the following:

> 805 Business Combinations > 20 Identifiable Assets and Liabilities, and Any Noncontrolling Interest > 25 Recognition
> General
>
> > ... assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree . Recognition of identifiable assets acquired ..., the identifiable assets acquired and liabilities assumed must meet the definitions of assets and liabilities in FASB Concepts ... guidance and as specified in those paragraphs. Pension and Postretirement Benefits Other than Pensions 25-23 December 15, 2008 805-10-65-1 Guidance on defined benefit pension plans is presented in Subtopic ...

When students click on this link they will be brought to the appropriate paragraph section, but will still need to scroll down to Paragraph 23 for the correct guidance. As you can see, students will need to spend some time with the Codification system to gain adequate skill in navigating through it.

A third method of researching the Codification, the Go To method, is primarily designed for experienced constituents and would be difficult for students to master. If you know the Topic, Subtopic, Section, or Paragraph number you can use this feature and simply jump directly to the location without the need to Browse or Search. Cross-Referencing is another advanced technique that allows you to determine where prior standards are now located in the Codification system.

Regardless of which method students employ, they will have to have some knowledge of GAAP to ensure that they are on the right track.

Referencing FASB ASC

The FASB ASC Notice to Constituents describes how to reference FASB ASC in financial statements and other documents. Detailed referencing is recommended for working papers, articles, textbooks and other similar items. An example of referencing would be: FASB ASC AAA-BB-CC-D(E), where:

AAA is the Topic
BB is the Subtopic
CC it the Section
D is the Paragraph
E is the subparagraph
In the case of SEC content, an "S' precedes the Section number.

When referencing FASB ASC in financial statements, such as in footnote disclosures, FASB encourages the use of plain English. Additionally, the AICPA states,

> …entities may find it more useful for users to describe the specifics of the accounting policy applied rather than simply give the FASB reference. For example, a clear description of an entity's accounting policies for the share-based payment arrangements would often be more relevant to financial statement users than a general statement that the entity follows FASB ASC 718, Compensation-Stock Compensation. (http://www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AcctgFinRptg/AcctgFinRptgGuidance/Pages/FASBAccountingStandardsCodification.aspx)

Cases and suggested solutions provided in the Appendix were developed by the authors and have been tested in both intermediate and advanced financial accounting courses. For each of the cases we provide the search process and also a memorandum to the client setting forth the solution. These cases are not copyrighted, so they are available for anyone to use in their class.

Depending on the instructor's objective, students can be asked to provide responses in a variety of forms. Some instructors may want to provide more opportunity for students to develop their writing skills, including their ability to consider the accounting sophistication of the recipient and craft their response to effectively communicate results. This could be accomplished by requiring a formal business letter instead of a memo. If the emphasis is primarily honing students' research skills, in the interest of time, a briefer memo such as the examples provided in the solutions may be more appropriate.

Conclusion

In the future, accountants will be required to use the Codification in the practice of accounting and auditing. Its use is important for accountants in both public practice and in business enterprises. CPA candidates will be required in the CPA exam to demonstrate their ability to use and apply the Codification. As a result, it is essential that our students understand the nature and purpose of the Codification. It is also necessary that they become proficient in the use of the Codification in researching issues in accounting and financial reporting. The accounting curriculum must provide the students with ample opportunities to fully develop their skills in the use of the Codification.

We believe the most effective approach to the development of these skills is through the use of practice related research cases. It is suggested that instructors begin with simple cases that are easy to research and develop basic search skills. As the student's skills increase, the complexity of the cases should be increased so that students more fully develop their Codification research skills.

References

AICPA, "FASB Accounting Standards Codification," (2010) http://www.aicpa.org/InterestAreas/AccountingAndAuditing/Resources/AcctgFinRptg/AcctgFinRptgGuidance/Pages/FASBAccountingStandardsCodification.aspx.

AICPA, "The FASB Codification: What You Need to Know," (2010) http://www.slideshare.net/dickson/aicpa-presentation-on-gaap-codification.

AICPA, "The FASB Accounting Standards Codification: Q & A," (2009) http://www.picpa.org/Content/Files/Documents/Q&A-FASB-ASC-FINAL.pdf.

DeFelice, A., "CPA Exam to Undergo an Evolution," *Journal of Accountancy* (May, 2010), pp.54-56.

Financial Accounting Foundation. "FASB Accounting Standards Codification," (April 30, 2010) (v4.1).

Ford, C. O. and Thomas, C.W., "Test-Driving the Codification," *Journal of Accountancy* (December, 2008) http://www.journalofaccountancy.com/Issues/2008/Dec/TestDrivingTheCodification.htm

Huber, J. J, C. A. Bellah and Miller, B. D., "The Codification of GAAP," *Insights; the Corporate & Securities Law Advisor* (December, 2009) 23(12) pp: 20-24.

Journal of Accountancy, "CPA Exam to Undergo Transformation," (September 30, 2009) http://www.journalofaccountancy.com/Web/20092194.htm

Financial Accounting Standards Board, "FASB Codification Expected to Become Single Source of Authoritative U.S. GAAP on July 1, 2009," http://www.fasb.org/cs/ContentServer?c=Document_C&pagename=FASB%2FDocument_C%2FDocumentPage&cid=1176156244073

Appendix A

Case 1

Business Acquisition – Over funded Pension Plan

You are a partner with Peat Waterhose CPAs and one of your clients is Vette Automotive, a public company. You have been their audit partner for two years and the company has been a client for the past seven years. Vette's CFO is Will Pushgaap, a CPA who joined the company after eight years in public accounting. In the past Will has attempted to interprete GAAP in ways that made the company's financials look better. Since Sarbanes Oxley he has become more conservative and is very concerned that the company's financials are not misleading. Because of his involvement in strategic planning, acquisitions, etc. he has not had time to keep up with all GAAP developments in the past couple of years.

You just received a phone call from Will in which he said: "We are in the process of recording our recent acquisition of Cor Transmissions and I have a question about how to record one of the items. Cor has had a defined benefit plan for several years and the company's plan is currently overfunded by about $5 million. In their financials they have been amortizing the overfunded amount as a reduction in pension expense over the average service life of employees. My question is whether we should continue to account for the overfunding in the same way or should we recognize it as an asset acquired in the purchase. I know that in the past the FASB has not allowed company's to recognize overfunded pensions as an asset. Naturally we would like to show the asset if it is acceptable. Would you please check out GAAP for me and let me know which alternative we can or should use. Please send me a letter and provide specific references to related GAAP so that I can have it in my files. Must go, we have a due diligence meeting related to another potential acquisition."

Required: Write a memo to Will Pushgaap and answer his question.

Search: Business combinations – pensions

Results:

805 Business Combinations > 20 Identified assets and liabilities > 25 Recognition

Clicking on this result with bring students to the paragraph section. By scrolling down the paragraph section students will find Paragraph 23

805 Business Combinations > 20 Identified assets and liabilities > 25 Recognition

>23 Pension and postretirement benefits other than pensions

Guidance on defined benefit pension plans is presented in Subtopic 715-30. If an acquiree sponsors a single-employer defined benefit pension plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (see paragraph 715-30-25-1). Paragraph 805-20-30-15 provides guidance on determining that funded status. If an acquiree participates in a multiemployer plan, and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of the business combination a withdrawal liability in accordance with Subtopic 450-20.

Solution:

Peat Waterhose CPAs

Memorandum

To: Will Pushgaap, CFO, Vette Automotive

CC:

From: Student Name

Date: XX/XX/XXXX

Re: Recent Acquisition of Cor Transmissions and Treatment of Overfunded Pension

---

Our research of GAAP indicates the following under FASB ASC 805-20-25-23:

> Guidance on defined benefit pension plans is presented in Subtopic 715-30. If an acquiree sponsors a single-employer defined benefit pension plan, the acquirer shall recognize as part of the business combination an asset or a liability representing the funded status of the plan (see paragraph 715-30-25-1). Paragraph 805-20-30-15 provides guidance on determining that funded status. If an acquiree participates in a multiemployer plan, and it is probable as of the acquisition date that the acquirer will withdraw from that plan, the acquirer shall recognize as part of the business combination a withdrawal liability in accordance with Subtopic 450-20.

GAAP requires the overfunded plan to be reported as an asset.

CONFIDENTIAL

Case 2

Balance Sheet Setoffs

You are a partner with Wee Checkem CPAs and you have just signed a new client, Keaton Enterprises Inc. Debby Keaton, the president of the company, has been very successful in growing the company and she took it public about five years ago. The company is diversified and has sustained a minimum of a 25% growth per year since it went public. Much of the growth was through acquisitions and the company has a significant debt load on its balance sheet. While Debby Keaton is an astute businesswoman, she does not have a background in accounting and sometimes expresses displeasure at the "dumb accounting rules".

This morning you saw her at the post office and she indicated that she was concerned about their year-end financial statements. With all of the debt the company has outstanding, there are loan covenants that require the company to maintain a 2:1 current ratio. She has expressed concern because the company may have difficulty meeting the ratio. She indicated that the company has a sizable account payable with Hay Co. and that her company also has a slightly larger long-term receivable from Hay. Debby Keaton indicated that she has talked to the president of Hay and discussed the possibility of offsetting the receivable and payable. This would lower Keaton's current liabilities and allow it to more than meet the creditor's current ratio requirement. She indicated that the president of Hay said he is willing to do the offset but not until after year-end because he wants to show Keaton's receivable as a current asset in his year-end financial statements. While there is an informal agreement to do the offset, no legal agreement has been signed. Debby Keaton indicated that she wants Keaton Enterprises to be permitted to offset its account payable against the long-term receivable with Hay in its year-end financial statements. She was in a hurry so she asked that you write a letter and include specific references to GAAP so that she can discuss the issue with her controller.

REQUIRED: Prepare a memo to Ms. Keaton giving the information requested.

Search: offsets

Results: 210 Balance sheet > 20 off setting > 05 Overviews and backgrounds

05-1 This Subtopic provides criteria for offsetting amounts related to certain contracts and provides guidance on presentation. It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except if a right of setoff exists.

Click on "right of setoff" goes to glossary and provides

A right of setoff is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor.

This does not give the criteria necessary for the right of setoff.

Search: right of setoff

Result: 210 Balance Sheet > 20 Offsetting > 45 other presentation matters
Section 45 regarding right of setoff criteria indicates:

45-1 A right of setoff exists when all of the following conditions are met:

a. Each of two parties owes the other determinable amounts.
b. The reporting party has the right to set off the amount owed with the amount owed by the other party.

c. The reporting party intends to set off.
d. The right of setoff is enforceable at law.

Alternately, students may research this issue by Browsing. By clicking on presentation there are brought to a set of Topics including Balance Sheet. Clicking on Balance Sheet will bring them to a set of Subtopics including Offsetting. Clicking on Offsetting brings them to Sections including Overview and Background. Clicking on Overview and Background brings them to Paragraph 05-1.

Solution:

Wee Checkum CPAs

Memorandum

To: Debby Keaton, President, Keaton Enterprises, Inc.

CC:

From: Student Name

Date: XX/XX/XXXX

Re: Offsetting Receivable and Payable

Our research of GAAP indicates the following under FASB ASC 210-20-05-1:

> This Subtopic provides criteria for offsetting amounts related to certain contracts and provides guidance on presentation. It is a general principle of accounting that the offsetting of assets and liabilities in the balance sheet is improper except if a right of setoff exists.
>
> A right exists when all of the following conditions are met:
>
> a) Each of two parties owes the other determinable amounts.
> b) The reporting party has the right to set off the amount owed with the amount owed by the other party.
> c) The reporting party intends to set off.
> d) The right of setoff is enforceable at law.

With respect to Keaton Enterprises agreement with Hay Co., criteria b and d have not been met because there is no formal agreement to do the setoff. Keaton Enterprises would have to enter into a formal, non-cancellable, agreement with their Hay Co. to legally establish a right of setoff and to be able to perform the desired setoff in the financial statement. If this is not accomplished, the setoff cannot be made.

Case 3

Sublease

You are an audit partner in Slick & Co. CPAs. Mann Co. has been an audit client for ten years. Mann Company is owned by Lisa Mann who is a very astute businesswoman but she is not at all knowledgeable about GAAP. In fact over the years she has complained about the “stupid GAAP rules”. Lisa has built Mann into a $100 million in sales company that went public several years ago.

You ran into her waiting in line at a restaurant and she indicated that she had a problem you need to address for her. She said: “ I know you remember all of the equipment we leased about three years ago. Remember, we had disagreements on how the lease should be handled. You made us treat it as a purchase and record a related liability of about $5 million, as I recall. The lease was an eight-year lease and we have been depreciating the asset over the lease term. As you know, our business has been expanding rapidly and the leased equipment is no longer adequate for our needs. We have decided to buy or lease new high output equipment. The lease on the original equipment allows us to sub-lease the equipment, which is our plan since the lease has another four to five years to go. My question to you is, if we sublease the equipment can we take it and the related liability off our books? We really need to get that debt off our books. Perhaps you could tell me how we should structure the deal so that we can get the liability off the books.”

At this point Lisa was told that her table was ready so she needed to rejoin her party. She said “Would you please write a letter giving your advice and please give me specific references to GAAP so that my controller can review the materials with me. Thanks so much for your help on this. I really need to join my friends….. Try the Veal Marsala…it is great here!”

Write a memo to Lisa Mann providing the information she requested.

Search: A search on “Leases” generates 250 results. If students choose to search on “Subleases” 21 results will be generated. Among them is the following:

840 Leases >30 capital leases > 40 derecognition

Clicking on this result will bring students to the paragraph level. Paragraph 5 indicates the following:

Subleases

40-5 Subleases in which the original lessee is not relieved of the primary obligation under the original capital lease are addressed in paragraph 840-30-35-12. If, under the guidance in paragraph 840-10-40-2, a sublease is a termination of the original lease, it shall be accounted for by the lessee as follows:

- a. If the original lease was a capital lease of property other than real estate (including integral equipment), the asset and obligation representing the original lease shall be removed from the accounts, a gain or loss shall be recognized for the difference, and, if the original lessee is secondarily liable, the guarantee obligation shall be recognized in accordance with the guidance in paragraph 405-20-40-2. Any consideration paid or received upon termination shall be included in the determination of gain or loss to be recognized.

If students click on 840-30=35-12 they will be brought to the following paragraph:

35-12 A sublease in which the original lessee is relieved of the primary obligation under the original capital lease is addressed in paragraph 840-30-40-5. If the nature of a sublease is such that the original lessee is not relieved of the primary obligation under the original capital lease, the original lessee (as sublessor) shall account for the sublease as follows:

- a. The obligation related to the original capital lease shall continue to be accounted for as before.

Again, students may choose to Browse through Topics, Subtopics etc. They could start with Broad Transactions and progress through the tables as follows: > Leases > Capital Leases > Subsequent Measurement > Lessee. This brings them to the paragraph level where they can scroll down to paragraph 12- Subleases. They may also explore > Derecognition under the Capital Leases menu. Here they will find paragraph 5 discussing Subleases.

Solution:

Slick & Co. CPAs

MEMORANDUM

To: Lisa Mann, Mann Co.
From: Student Name
Date: XX/XX/XXXX
Re: Subleases

Our research of GAAP indicates the following under FASB ASC 840-30-40-5:

> Subleases in which the original lessee is not relieved of the primary obligation under the original capital lease are addressed in paragraph 840-30-35-12. If, under the guidance in paragraph 840-10-40-2, a sublease is a termination of the original lease, it shall be accounted for by the lessee as follows:
>
> - If the original lease was a capital lease of property other than real estate (including integral equipment), the asset and obligation representing the original lease shall be removed from the accounts, a gain or loss shall be recognized for the difference, and, if the original lessee is secondarily liable, the guarantee obligation shall be recognized in accordance with the guidance in paragraph 405-20-40-2. Any consideration paid or received upon termination shall be included in the determination of gain or loss to be recognized.

Further, FASB ASC 840-30-35-12 indicates:

> A sublease in which the original lessee is relieved of the primary obligation under the original capital lease is addressed in paragraph 840-30-40-5. If the nature of a sublease is such that the original lessee is not relieved of the primary obligation under the original capital lease, the original lessee (as sublessor) shall account for the sublease as follows:
>
> - a. The obligation related to the original capital lease shall continue to be accounted for as before.

A new lease was not signed between the lessor and the sub-lessee, therefore the original lessee is still liable under the original lease. According to FASB ASC 840-30-35-12 the lease obligation would have to remain on the books of Mann Co. For Mann Co. to remove the lease obligation, Mann would have to get the lessor and the sub-lessee to enter into a new lease arrangement where Mann was not a party to the lease. If this was done, the leased asset and liability would be removed from Mann's books and a gain or loss recognized for the difference.

Case 4

Issuable stock as part of EPS

You are a partner with Arthur Ambers Sum CPAs. Your secretary has just called to tell you that Bea Bad, the president of Rap-sa-dee Music is on the phone for you. This company has been an audit client of yours for about three years. It is a publicly traded company. The president is a musician and is not at all familiar with GAAP but he knows his music and how to sell it. The company has been very successful and has acquired other record and entertainment companies. The following conversation takes place:

You: Bea, good to hear from you! What can I do for you?

Bea: I am on my way to a meeting regarding the acquisition of another company and I don't have much time. Bop (Bop Perr is the controller) is already at the meeting or he would have called you. We are preparing our year-end financials and we have a couple of questions. This year we purchased Willie Co., a country music company, in a cash and stock deal.

You: Yes, I remember we helped you structure the contract.

Bea: Well, you remember that the contract had a clause in it stating that if Willie Company made over $2 million this year, we would issue them an additional 50,000 shares of our stock within six months of year-end. Preliminary figures indicate the Willie will do almost $3 million this year, which is great news.

You: You always seemed to have the Midas touch!

Bea: Thanks. Our question is whether we have to include these shares in our basic and diluted EPS for this year even though we will not actually issue them until next year. We also have another potential problem. Earlier this year, we purchased a large amount of production equipment and got a very favorable deal because we allowed the seller to have the option of taking shares of our stock in settlement of our note on the due date. The note has an interest rate of 8% and matures next September. Since our stock price has increased significantly, we are confident that they will opt for the stock. Will this affect our EPS calculations this year? If so, how?

You: You have some interesting questions.

Bea: I gotta go, I'm late for the meeting. Bop and I are heading out of town immediately after the meeting so could you send a letter indicating what we need to do. Bop asked that you include any specific references to GAAP so that he can review them.

Write a memo providing the information requested.

Search: If students search on EPS "contingently issuable shares" three results will be generated.

Results: Clicking on the following result

260 EPS > 10 Overall > 45 other presentation matters >

will take students to the paragraph level where under > Basic EPS they will find:

> > Treatment of Contingently Issuable Shares in Weighted-Average Shares Outstanding

45-12A Contractual agreements (usually associated with purchase business combinations) sometimes provide for the issuance of additional common shares contingent upon certain conditions being met. Consistent with the objective that basic EPS should represent a measure of the performance of an entity over a specific reporting period, contingently issuable shares should be included in basic EPS only when there is no circumstance under which those shares would not be issued and basic EPS should not be restated for changed circumstances.

45 -13 Shares issuable for little or no cash consideration upon the satisfaction of certain conditions (contingently issuable shares) shall be considered outstanding common shares and included in the computation of basic EPS as of the date that all necessary conditions have been satisfied (in essence, when issuance of the shares is no longer contingent)

Continuing in Section 45 under > Diluted EPS and Related Topics students will find:

> > Computation of Diluted EPS

45-16 The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, in computing the dilutive effect of convertible securities, the numerator is adjusted to add back any convertible preferred dividends and the after-tax amount of interest recognized in the period associated with any convertible debt. The numerator also is adjusted for any other changes in income or loss that would result from the assumed conversion of those potential common shares, such as profit-sharing expenses. Similar adjustments also may be necessary for certain contracts that provide the issuer or holder with a choice between settlement methods. See Example 1 (paragraph 260-10-55-38) for an illustration of this guidance.

> > Contracts that May Be Settled in Stock or Cash

45-45 If an entity issues a contract that may be settled in common stock or in cash at the election of either the entity or the holder, the determination of whether that contract shall be reflected in the computation of diluted EPS shall be made based on the facts available each period. It shall be presumed that the contract will be settled in common stock and the resulting potential common shares included in diluted EPS (in accordance with the relevant provisions of this Topic) if the effect is more dilutive. Stock-based compensation arrangements that are payable in common stock or in cash at the election of either the entity or the employee shall be accounted for pursuant to this paragraph and the following paragraph. An example of such a contract is a written put option that gives the holder a choice of settling in common stock or in cash.

> > Contingently Issuable Shares

45-48 Shares whose issuance is contingent upon the satisfaction of certain conditions shall be considered outstanding and included in the computation of diluted EPS as follows:

- a. If all necessary conditions have been satisfied by the end of the period (the events have occurred), those shares shall be included as of the beginning of the period in which the conditions were satisfied (or as of the date of the contingent stock agreement, if later).

Browsing through tables may not be as intuitive for students with respect to this particular issue. Students must have some idea that EPS is located under Presentation in the initial Table. After clicking on >10 Overall they would have to know to go to > 45 Other presentation matters next. Incorporating adequate case solving that requires researching the Codification is one way to build skills necessary to navigate through the FASB ASC.

Arthur Ambers Sum CPAs

Memorandum

To: Bea Bad, President, Rap-sa-dee Music

From: Student Name

Date: XX/XX/XXXX

Re: Issuable stock as part of EPS

Our research of GAAP indicates the following under FASB ASC 260-10-45-12A:

> Contractual agreements (usually associated with purchase business combinations) sometimes provide for the issuance of additional common shares contingent upon certain conditions being met. Consistent with the objective that basic EPS should represent a measure of the performance of an entity over a specific reporting period, contingently issuable shares in basic EPS only when there is no circumstance under which those shares would not be issued and basic EPS should not be restated for changed circumstances.

FASB ASC 260-10-45-13:

> Shares issuable for little or no cash consideration upon the satisfaction of certain conditions (contingently issuable shares) shall be considered outstanding common shares and included in the computation of basic EPS as of the date that all necessary conditions have been satisfied (in essence, when issuance of the shares is no longer contingent).

FASB ASC 260-10-45-16:

> The computation of diluted EPS is similar to the computation of basic EPS except that the denominator is increased to include the number of additional common shares that would have been outstanding if the dilutive potential common shares had been issued. In addition, in computing the dilutive effect of convertible securities, the numerator is adjusted to add back any convertible preferred dividends and the after-tax amount of interest recognized in the period associated with any convertible debt. The numerator

also is adjusted for any other changes in income or loss that would result from the assumed conversion of those potential common shares, such as profit-sharing expenses. Similar adjustments also may be necessary for certain contracts that provide the issuer or holder with a choice between settlement methods. See Example 1 (paragraph 260-10-55-38) for an illustration of this guidance.

FASB ASC 260-10-45-45

> If an entity issues a contract that may be settled in common stock or in cash at the election of either the entity or the holder, the determination of whether that contract shall be reflected in the computation of diluted EPs shall be made based on the facts available each period. It shall be presumed that the contract will be settled in common stock and the resulting potential common shares included in diluted EPS (in accordance with the relevant provisions of this Topic) if the effect is more dilutive. Stock-based compensation arrangements that are payable in common stock or in cash at the election of either the entity or the employee shall be accounted for pursuant to this paragraph and the following paragraph. An example of such a contract is a written put option that gives the holder a choice of settling in common stock or in cash.

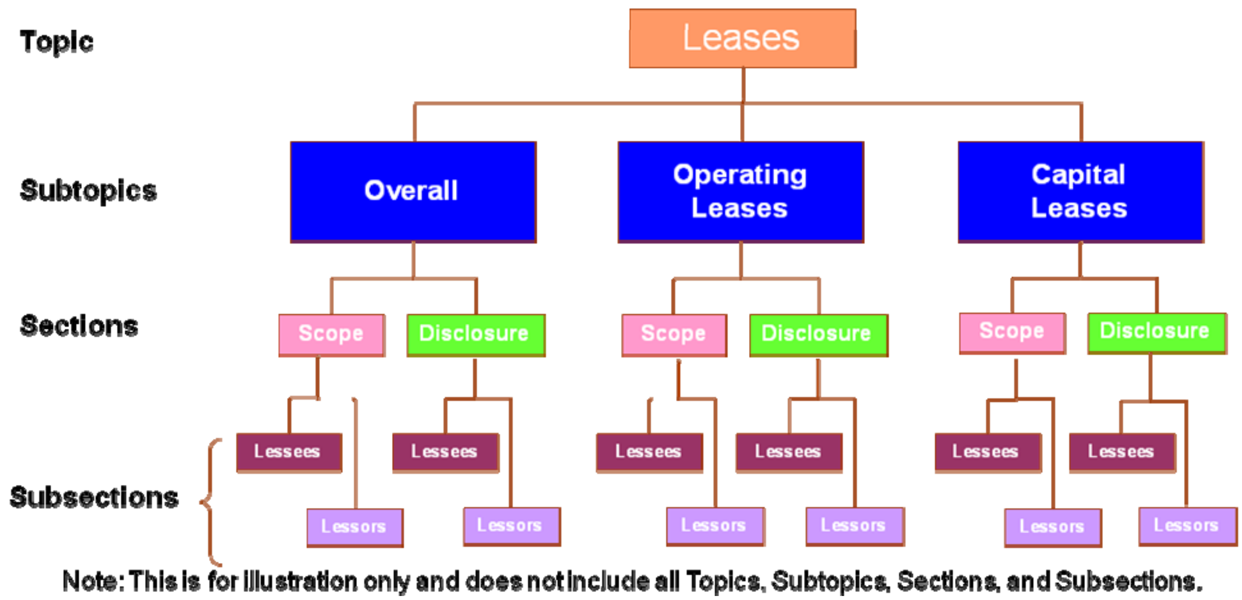
FASB ASC 260-10-45-48

> Shares whose issuance is contingent upon the satisfaction of certain conditions shall be considered outstanding and included in the computation of diluted EPS as follows:
>
> - a. If all necessary conditions have been satisfied by the end of the period (the events have occurred), those shares shall be included as of the beginning of the period in which the conditions were satisfied (or as of the date of the contingent stock agreement, if later).

With respect to Issue # 1 – Willie Co. additional stock issuance. Since it is certain that the additional 50,000 shares will have to be issued, the shares should be included in **both** basic and diluted EPS.

With respect to Issue # 2 – Debt to be settled in stock. These shares would be included in diluted EPS if dilutive. The dilutive effect will include in the numerator the after-tax interest on the debt that could have been avoided.

Figure 1



(Taken from: AICPAs FASB ASC Presentation, 2010, The FASB Codification: What You Need to Know)