



GAAP: The Effect of the Codification on Accountant and Auditor Liability Cases

By Tim Lucas, Elaine Harwood, and Ryan Miller

A wide variety of accounting issues, from off-balance sheet financing to options backdating, have been prominent in litigation and regulatory matters for many years. At the heart of these matters is the question of whether a company's accounting was in accordance with accounting standards, referred to as generally accepted accounting principles, or GAAP. Addressing that question involves accessing the body of pronouncements and standards that define what is deemed to be appropriate accounting in various circumstances (the GAAP literature). In the past, this task was complicated by the fact that the GAAP literature consisted of a collection of thousands of individual standards, issued by various standard setters over more than 50 years, with different levels of authority and different formats.

In June 2009, the Financial Accounting Standards Board (FASB) introduced the FASB *Accounting Standards Codification* (Codification) to address these issues. The Codification is the result of over five years of work by over 200 people. It combines and organizes the standards issued by accounting standard setters into a single source arranged by topic areas. It is intended to reduce the time it takes to research accounting issues and to provide a consistent organizational structure for accounting guidance. The Codification became effective for quarterly or annual financial statements for periods ending on or after September 15, 2009.

The Codification is beginning to change the way we research and refer to GAAP in accountant and auditor liability cases. Over the short term, it requires learning a new system. When cases include both pre-Codification standards and the Codification, it may be more challenging to evaluate GAAP. Although the Codification will provide greater ease of access to the GAAP literature, it will not eliminate the need to identify changes in GAAP during the time period at issue in an accountant and/or auditor liability case. This article provides an overview of the Codification and its use.

Pre-Codification Standards

If you have found it challenging to research pre-Codification accounting standards, you are not alone. In fact, 80 percent of the 1,400 people the FASB surveyed in the initial phases of the Codification project believed that GAAP was confusing; 85 percent believed that the level of research required was excessive (FASB *Accounting Standards Codification, Notice to Constituents* (v. 4.1), April 30, 2010, p. 35).

The pre-Codification standards were a mixture of accounting pronouncements issued by various standard setters and industry practices. The level of authority attributed to a given pre-Codification standard was set forth in what was commonly known as the GAAP hierarchy. As illustrated in the table below, the GAAP hierarchy was separated into four categories, a through d, from the most to least authoritative. It established that, for example, a Statement of Financial Accounting Standards (SFAS) issued by the FASB (category a) had a higher level of authority than a “widely recognized and prevalent” industry practice (category d).

Pre-Codification Standards: The GAAP Hierarchy	
Level	Accounting Standards/Literature
a	Statements of Financial Accounting Standards, Interpretations, and Staff Positions issued by the FASB Authoritative guidance issued by prior standard setters (Accounting Principles Board Opinions and American Institute of Certified Public Accountants (“AICPA”) Accounting Research Bulletins) to the extent not superseded
b	FASB Technical Bulletins AICPA Industry Audit and Accounting Guides and Statements of Positions to the extent the FASB has not objected to a pronouncement
c	Consensus positions of the FASB’s Emerging Issues Task Force (“EITF”) AICPA Accounting Standards Executive Committee Practice Bulletins to the extent the FASB has not objected to a pronouncement
d	Implementation guides published by the FASB staff Accounting Interpretations issued by the AICPA Practices that are widely recognized and prevalent either generally or in the industry

Source: Statement of Financial Accounting Standards No. 162, *The Hierarchy of Generally Accepted Accounting Principles*

Researching an accounting issue required not only identifying relevant GAAP at the highest level of authority in the GAAP hierarchy, but also identifying any changes in GAAP during the time period at issue. For example, during the class period in a securities case, a new accounting standard might have become effective or changes may have been made to a previously issued standard. As a result, to identify the relevant standards in effect during the class period, collections of previously issued standards were important resources in accountant or auditor liability cases.

The Accounting Standards Codification

Because the pre-Codification standards varied extensively in structure and authority, the goal of the Codification was to organize them to be more user-friendly. To that end, the GAAP hierarchy was eliminated; the standards in the Codification now carry an equal level of authority.

With its release, the Codification became the authoritative source of accounting guidance for public and private nongovernmental entities. Although the Codification also includes certain guidance for public entities issued by the Securities and Exchange Commission (SEC), the Codification is not the authoritative source of such content and does not contain the entire population of SEC rules, regulations, interpretive releases, and staff guidance. The Codification does not affect or replace standards issued by the SEC.

All other sources of accounting guidance outside of the Codification are now considered to be “non-authoritative.” Some might view that as a significant demotion, especially for “widely recognized and prevalent” industry practices, which have been moved from level d GAAP to non-authoritative. In fact, the change is more semantics than substance. The reason that industry practice was included in level d was to make clear that while a pronouncement in levels a through c could require a change in established industry practice, other documents in level d and other guidance (such as textbooks and articles) could not require such a change. Post-codification, industry practices that have never been captured in written GAAP literature will continue to be “generally accepted” and will continue to be an appropriate part of GAAP. Companies are still required to consider all authoritative literature and analogous guidance and, in the case where the issue is not addressed, turn to “widely recognized and prevalent” industry practices or other non-authoritative guidance.

The content of the pre-codification standards was not amended; rather, the structure was overhauled from a standards-based to a topically based model. The FASB effectively pulled apart thousands of accounting standards and reorganized the pieces into a collection of related guidance. The following screenshot from the Accounting Standards Codification illustrates its structure.

The screenshot displays the Accounting Standards Codification Professional View interface. On the left, the 'CODIFICATION' sidebar lists nine 'AREAS' (General Principles, Presentation, Assets, Liabilities, Equity, Revenue, Expenses, Broad Transactions, Industry) and 'OTHER SOURCES'. The main content area shows a breadcrumb trail: Home > Broad Transactions > 840 Leases > 20 Operating Leases. The '840 Leases' is identified as the 'TOPIC', and '20 Operating Leases' is the 'SUBTOPIC'. Below the subtopic, a list of 'SECTIONS' is shown, including 00 Status, 05 Overview and Background, 15 Scope and Scope Exceptions, 20 Glossary, 25 Recognition, 30 Initial Measurement, 35 Subsequent Measurement, 40 Derecognition, 45 Other Presentation Matters, 50 Disclosure, 55 Implementation Guidance and Illustrations, and 75 XBRL Elements. A 'GO TO ?' button is visible in the sidebar, and a 'JOIN ALL SECTIONS ?' button is located below the subtopic.

Source: Accounting Standards Codification, reproduced with permission.

Areas: There are nine areas included in the Codification, as shown on the left side of the image above. Areas are not part of the numerical referencing system that is used to cite the GAAP literature (described below).

Topics: Each area includes general and industry-specific topics, as shown on the right side of the image above. For example, the Area “Broad Transactions” includes Topic 840 on “Leases.”

Subtopics: Subtopics represent subsets of a topic and are generally distinguished by type or scope. For example, “Operating Leases” is a subtopic of the “Leases” topic.

Sections: Sections represent partitions of content in each subtopic. Although subtopics vary, the FASB introduced a standardized reference system for sections. The list of sections that can be included for a subtopic is illustrated below.

XXX-YYY-ZZ, where XXX = Topic; YY = Subtopic; ZZ = Section	
XXX-YYY-00	Status
XXX-YYY-05	Overview and Background
XXX-YYY-10	Objectives
XXX-YYY-15	Scope and Scope Exceptions
XXX-YYY-20	Glossary
XXX-YYY-25	Recognition
XXX-YYY-30	Initial Measurement
XXX-YYY-35	Subsequent Measurement
XXX-YYY-40	Derecognition
XXX-YYY-45	Other Presentation Matters
XXX-YYY-50	Disclosure
XXX-YYY-55	Implementation Guidance and Illustrations
XXX-YYY-60	Relationships
XXX-YYY-65	Transition and Open Effective Date Information
XXX-YYY-70	Grandfathered Guidance
XXX-YYY-75	XBLR Definitions

Source: FASB *Accounting Standards Codification, Notice to Constituents (v. 4.1)*, April 30, 2010, p. 14, reproduced with permission.

If there is no content for a section, it will not display in the Codification. For example, section 10 for “Objectives” is not included in the subtopic “Operating Leases” in the image above.

Subsections: Subsections occur in a limited number of cases. Unlike a section, a subsection is not numbered. There are no subsections for “Operating Leases” in the image above.

Glossary: The glossary contains definitions of certain terms identified throughout the Codification. Note that there is a master glossary that is shown on the left side of the screenshot as well as a section for “glossary” that contains definitions specific to a subtopic (i.e., section 20 in the screenshot).

By way of example, to find disclosure requirements for operating leases, one would start with the topic “Leases” (ASC 840); then go to the subtopic “Operating Leases” (ASC 840-20); then go to the section “Disclosures” (ASC 840-20-50); and then review the paragraphs in that section (e.g., ASC 840-20-50-1). This system is used to cite the GAAP literature as shown in the table below.

Codification Organizational Structure		
Level	Citation Example	Category/Content Example
Topic	ASC 840	Leases
Subtopic	ASC 840-20	Operating Leases
Section	ASC 840-20-50	Disclosure for Operating Leases
Subsection1	N/A	N/A
Paragraph	ASC 840-20-50-1	“...the lessee shall disclose rental expense for each period for which an income statement is presented....”
Note 1: Subsections are not numbered and only occur in a limited numbers of cases.		

Source: Accounting Standards Codification

Note that as a result of the Codification structure, there are parallel citations. For example ASC 840-30-50-1 is a parallel citation to “Disclosures for Operating Leases,” which provides the relevant guidance on “Disclosures for Capital Leases.”

For many, this system requires learning a new referencing scheme. All of the old favorite numbers that were part of the language of accountants (e.g., FAS 133, FAS 140, APB 25) have been eliminated and replaced by a system that to some sounds like references to tax code sections. To ease the transition, the Codification includes a cross-reference tool, which allows users to identify where legacy accounting guidance resides in the Codification, as illustrated below.

Accounting Standards Codification® Professional View

SEARCH: GO ?

Navigation: Codification | Other Sources | Advanced Search

Home > Cross Reference

Page / Print Functions

Cross Reference

Use this feature to cross reference between the original standards and the Codification. Insert information about a standard to identify the Codification Sections that contain the content. Alternatively, insert information about the Codification to identify the standards that populated that portion of the Codification. Click here for help with or to view a tutorial on the Cross Reference feature. NOTE: The report only includes content contained in published Topics. Click here to view the details of the standard type acronyms.

By Standard ?

Standard Type: FAS Standard Number: 013

By Codification ?

Topic: Subtopic: Section: Paragraph:

GENERATE REPORT START OVER

Sort your results by Standard Type or by Topic.

PAGES: 1 | 2

Standard Type	Standard Number	Paragraph / Label	Sequence	Topic	Subtopic	Section	Paragraph
FAS	013	1	70.1.1.1	840	10	05	05-2
FAS	013	1	70.1.1.2.1.1	Lease			term
FAS	013	1	70.1.1.2.1.2	840	10	15	15-9
FAS	013	1	70.1.1.2.2	840	10	15	15-10
FAS	013	1	70.1.2.1	840	10	15	15-8
FAS	013	1	70.1.2.2	840	10	15	15-15
FAS	013	1	70.1.2.2	410	20	55	55-44
FAS	013	1	70.2	840	10	15	15-15
FAS	013	1	71.1	Heat Supply (or Burn-Up) Contracts			term

Source: Accounting Standards Codification, reproduced with permission.

There are two types of online access to the Codification: the basic view and the professional view. While the professional view requires an annual subscription, the basic view is free to all users but lacks certain functions, such as the ability to print source references for a particular standard. Printed versions of the Codification can also be purchased from the FASB.

Ongoing Standard-Setting Process

Prior to making a change to the Codification, the FASB will release an Accounting Standards Update (ASU). The FASB does not consider new ASUs as authoritative per se; instead, the ASUs provide background information about issues and the bases for conclusions on amendments to the Codification. Forty-seven ASUs have been issued since the Codification took effect in 2009 through February 2011.

Changes to the Codification may occur during the time period at issue in an accountant or auditor liability case. Thus, although the Codification may make it easier to access accounting standards, it does not eliminate the need to identify changes to GAAP. The online version of the Codification has status sections and archives pages to assist with this task.

Conclusion

Although public companies have been using the Codification to prepare their interim and annual financial statements since September 2009, the Codification is just beginning to change the way we research and refer to GAAP in accountant and auditor liability cases. Over the short term, the Codification will require learning a new system. But that system is expected to decrease the time it takes to identify relevant accounting guidance and to reduce the risk that relevant guidance will be missed in accountant and auditor liability cases.

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