Current Issues in Accounting and Auditing: An Annual Update

AAU4/26/V1-A1

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Overall Learning Objectives

- After completing this course, you should be familiar with:
  - Recently issued Accounting Standards Updates (ASUs) and updates on convergence;
  - A review of the FASB's Stage 3 PIR Report Findings covering ASC 842, *Leases*; and
  - Other AICPA activities, including newly issued standards and ethics interpretations

Course Overview

- Supplement: ASU Nos. 2026-01 to 02
- Chapter 1 – FASB Accounting Standards Updates, Including the Activities of the PCC
- Chapter 2 – FASB Stage 3 PIR Report Findings – ASC 842, *Leases*
- Chapter 3 – Recent AICPA, PCAOB, and SEC Activity

A Quick Word on Policy vs. Politics

- Many times when discussing accounting, tax and finance policy issues, it can be difficult to divorce the politics from the policy
- Today, when discussing the various issues we will encounter over the next several hours, let’s agree to keep our own view of politics out of the application of the policy and focus on doing the very best we can for all our clients
- This goes for religious/faith views as well

Supplement:
ASU Nos. 2026-01 to 02

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Recently Issued Accounting Standards Updates

- ASU No. 2026-01, *Equity (Topic 505): Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock*
  - Provided authoritative guidance for the initial measurement of paid-in-kind (PIK) dividends on equity-classified preferred stock
- ASU No. 2026-02, *Environmental Credits and Environmental Credit Obligations (Topic 818)*
  - Established a comprehensive recognition, measurement, presentation, and disclosure framework for environmental credits and environmental credit obligation liabilities

ASU No. 2026-02, *Environmental Credits and Environmental Credit Obligations (Topic 818)*

- Creates an entirely new Topic (Topic 818) to address the accounting for environmental credits and environmental credit obligations, including carbon offsets
- Establishes a comprehensive recognition, measurement, presentation, and disclosure framework for environmental credits such as emissions allowances, renewable identification numbers (RINs), renewable energy certificates (RECs), and carbon offsets
- It also creates a dedicated model for obligations arising from regulatory compliance programs

ASU No. 2026-02 – Reason for Issuance

- Environmental markets have expanded dramatically over the last two decades. Entities increasingly participate in cap-and-trade systems, renewable fuel standards, renewable portfolio standards, and voluntary carbon reduction programs
  - Despite this growth, GAAP contained no dedicated accounting framework for these arrangements
- As a result, companies often analogized the accounting to inventory accounting, intangible asset accounting, or contingency guidance, producing inconsistent recognition and measurement outcomes

ASU No. 2026-02 – Main Provisions (ECs)

- **Environmental credit:** "enforceable rights represented to prevent, control, reduce, or remove emissions or other pollution that are separately transferable in an exchange transaction." Examples include emissions allowances, renewable energy certificates, renewable identification numbers, and carbon offsets
- Environmental credits are recognized as assets only when it is probable that they will be:
  a. Used to settle an environmental credit obligation;
  b. Transferred in an exchange transaction; or
  c. Used in a nonreciprocal transfer
- Credits acquired solely for voluntary sustainability initiatives, such as voluntary net-zero commitments, generally are expensed as incurred rather than recognized as assets

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ASU No. 2026-02 – Main Provisions (ECs)

- The Update creates two categories:
  - **Compliance environmental credits** – Credits expected to be used to satisfy regulatory obligations. These remain recorded at cost and are not subsequently remeasured
  - **Noncompliance environmental credits** – All other credits held for other purposes, such as trading. These are measured at cost less impairment and must be tested for impairment each reporting period. The credit is impaired if carrying value exceeds fair value. Impairment reversals are prohibited
- Entities may elect a fair value option for certain eligible classes of noncompliance credits, with changes recognized in earnings. Entities are required to present compliance environmental credit assets separately from environmental credit obligation liabilities on the balance sheet (e.g., no offsetting)

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ASU No. 2026-02 – Main Provisions (ECOs)

- An environmental credit obligation (ECO) is defined as "enforceable obligations resulting from regulatory compliance programs represented to prevent, control, reduce, or remove emissions or other pollution that may be settled with environmental credits"
- An obligation is recognized when emissions or other qualifying events occur that create a compliance requirement
  - Voluntary environmental commitments do not create environmental credit obligations under Topic 818

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ASU No. 2026-02 – Main Provisions (ECOs)

- The entity must measure the ECO "using the carrying amount of the compliance environmental credits that the entity holds and expects to use to settle that obligation at the reporting date"
  - This is referred to as the funded portion of the ECO
- If the entity lacks sufficient credits to satisfy the liability, the unfunded portion must be "measured at the fair value of the environmental credits necessary to settle the unfunded portion at the reporting date, with certain exceptions"
- The ECO should be derecognized when an entity remits the necessary environmental credits to a regulator

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ASU No. 2026-02 – Presentation and Disclosure

- Disclosure requirements for ECs:
  - The entity must disclose qualitative information about how it obtains and intends to use such credits. The entity must also disclose the current and noncurrent portions of the credits, total impairment expense, and total expenses for voluntary environmental credits
  - For annual reporting periods, if the use or intended use of environmental credits changes, the company must disclose:
    a. The nature of the change as of the date it occurs; and
    b. The impact on earnings

ASU No. 2026-02 – Presentation and Disclosure

- For ECOs, for annual periods, the entity must disclose the following:
  - The activities or events that result in environmental credit obligation liabilities under those programs, including the nature and timing of settlement provisions;
  - The accounting policies used to account for the environmental credit obligations;
  - How the unfunded portion of an environmental credit obligation liability is measured;
  - Significant estimates and judgments used in applying the guidance;
  - The current and noncurrent amounts of the funded and unfunded portions of environmental credit obligation liabilities (if not separately presented on a classified balance sheet);
  - Total expense related to environmental credit obligation liabilities; and
  - Total costs associated with environmental credit obligation liabilities that are capitalized in the carrying amount of another asset during the reporting period in accordance with another Topic

ASU No. 2026-02 – Effective Date and Transition

- The ASU applies to all entities
- For public business entities, the Update is effective for annual periods beginning after December 15, 2027, including interim periods. For all other entities, the effective date is December 15, 2028
  - Early adoption is permitted as of the beginning of an annual reporting period
- The standard is adopted using a **retrospective approach** through a cumulative-effect adjustment to opening retained earnings
  - Prior periods are not restated
- At adoption, entities must reassess existing environmental credits and obligations under the new framework, including derecognizing certain voluntary environmental credits that no longer qualify for asset recognition and recognizing EC assets if it's probable the entity will use ECs to settle an ECO, transfer the credit in an exchange transaction, or use the credit in a nonreciprocal transfer

ASU No. 2026-01, *Equity (Topic 505): Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock*

- Establishes authoritative guidance for the initial measurement of paid-in-kind (PIK) dividends on equity-classified preferred stock. Prior to this Update, U.S. GAAP addressed when PIK dividends should be recognized but did not provide explicit guidance regarding how they should be measured
  - As a result, issuers used varying approaches, including fair value measurement and measurement based on contractual dividend rates, creating diversity in practice and reducing comparability across financial statements
- The Update resolves this issue by requiring issuers to measure PIK dividends based on the dividend rate specified in the preferred stock agreement

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ASU No. 2026-01 – Main Provisions

- The core provision requires that PIK dividends on equity-classified preferred stock be initially measured using the PIK dividend rate specified in the preferred stock agreement
  - For example, if the agreement specifies that dividends equal a stated percentage multiplied by the liquidation value of the preferred stock, the dividend is measured using that formula
    - Consider a preferred stock instrument with a liquidation value of $10 million and a contractual PIK dividend rate of 8 percent. Under the new guidance, the issuer would recognize a PIK dividend of $800,000 ($10M x 8 percent) based on the contractual formula
- The Update defines PIK dividends as dividends satisfied either by issuing additional preferred shares with terms identical to the original instrument or by increasing the value of the existing preferred stock, such as increasing the original's liquidation value
- Unlike fair value approaches, it does not require recurring valuation exercises or subjective judgments regarding market pricing

ASU No. 2026-01 – Effective Date and Transition

- The amendments are effective for all entities that issue PIK dividends on equity-classified preferred stock for annual reporting periods beginning after December 15, 2026, including interim periods within those years
  - Early adoption is permitted
- Entities may choose either:
  - **Prospective application**, applying the new guidance to PIK dividends recognized after adoption; or
  - **Modified retrospective application**, applying the guidance to equity-classified preferred stock instruments that are outstanding as of the initial application date

Chapter 1

FASB Accounting Standards Updates, Including the Activities of the PCC

Learning Objectives

- After completing this chapter, you should be familiar with:
  - Recently issued ASUs of greatest significance to smaller and medium-sized entities;
  - Recently issued ASUs impacting SEC registrants and other public entities; and
  - Items on the FASB's technical agenda

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Recently Issued Accounting Standards Updates

- ASU No. 2025-01, *Income Statement – Reporting Comprehensive Income – Expense Disaggregation Disclosures (Subtopic 220-40): Clarifying the Effective Date*
  - Clarified the effective date for ASU No. 2024-03
- ASU No. 2025-02, *Liabilities (Topic 405): Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 122*
  - Removed guidance from SAB 121 that was repealed by SAB 122
- ASU No. 2025-03, *Business Combinations (Topic 805) and Consolidation (Topic 810): Determining the Accounting Acquirer in the Acquisition of a Variable Interest Entity*
  - Clarified how to identify the accounting acquirer when a VIE is involved in an acquisition

Recently Issued Accounting Standards Updates

- ASU No. 2025-04, *Compensation – Stock Compensation (Topic 718) and Revenue from Contracts with Customers (Topic 606): Clarifications to Share-Based Consideration Payable to a Customer*
  - Clarified the accounting for share-based consideration payable to a customer in a revenue contract
- ASU No. 2025-05, *Financial Instruments – Credit Losses (Topic 326): Measurement of Credit Losses for Accounts Receivable and Contract Assets*
  - Simplified the application of CECL for trade receivables and contract assets
- ASU No. 2025-06, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*
  - Modernized guidance for capitalizing internal-use software costs, including agile development environments

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Recently Issued Accounting Standards Updates

- ASU No. 2025-07, *Derivatives and Hedging (Topic 815) and Revenue from Contracts with Customers (Topic 606): Derivatives Scope Refinements and Scope Clarification for Share-Based Noncash Consideration from a Customer in a Revenue Contract*
  - Refined derivative scope exceptions and clarified revenue guidance related to noncash consideration
- ASU No. 2025-08, *Financial Instruments – Credit Losses (Topic 326): Purchased Loans*
  - Clarified the accounting for purchased loans under the CECL model
- ASU No. 2025-09, *Derivatives and Hedging (Topic 815): Hedge Accounting Improvements*
  - Improved hedge accounting to better reflect an entity's risk management activities
- ASU No. 2025-10, *Government Grants (Topic 832): Accounting for Government Grants Received by Business Entities*
  - Established accounting guidance for government grants received by business entities

Recently Issued Accounting Standards Updates

- ASU No. 2025-11, *Interim Reporting (Topic 270): Narrow-Scope Improvements*
  - Clarified and improved interim reporting disclosure requirements
- ASU No. 2025-12, *Codification Improvements*
  - Minor in scope – Made technical corrections and clarifications across multiple areas of the Codification
    - Not covered in this course – minor scope and impact

ASU No. 2025-11, *Interim Reporting (Topic 270)*

- ASU 2025-11 reorganizes Topic 270 to present a clearer, more coherent framework for interim disclosures. The Update clarifies what must be disclosed in condensed interim financial statements, consolidates scattered legacy guidance, and updates cross-references throughout the Codification
  - It does **not** add to or reduce existing disclosure requirements
- The central theme of the ASU is an **explicit** requirement to disclose events that occur after the end of the last annual reporting period that have a material impact on the entity
  - Topic 270 now directs preparers to consider applicable annual disclosure requirements as the baseline for explaining material interim events, rather than relying on minimal or generic quarterly descriptions

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ASU 2025-11: Main Provisions

- Reorganized interim reporting framework
  - Topic 270 is restructured to articulate a clearer disclosure principle: interim financial statements must include the information necessary to avoid being misleading, taking into account users' access to the latest annual financial statements
  - The guidance now delineates (a) general interim disclosure principles, (b) minimum required disclosures, and (c) how interim requirements in other Topics interact with Topic 270
- Explicit requirement to disclose material post–year-end events
  - New paragraphs 270-10-50-68 through 50-70 require disclosure of material events occurring after the last annual reporting period that significantly affect the entity, such as major estimate changes, impairments, restructurings, financing changes, and business combinations
  - Preparers must look to annual disclosure requirements for the relevant Topic to determine the scope of interim disclosure for these events

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ASU 2025-11: Main Provisions

- Clarification of when annual disclosures are needed in interim periods
  - Preparers must provide annual-type disclosures when necessary to explain a material interim event but need not repeat annual disclosures that have not changed
  - Continuing contingencies and uncertainties must be disclosed and repeated at each interim date until resolved or immaterial
- Conforming amendments across the Codification
  - More than 100 conforming amendments revise interim disclosure references in Topics including fair value, credit losses, financial instruments, segments, revenue, leases, and insurance
    - These amendments do not add new disclosures; they align terminology and cross-references with the reorganized Topic 270

ASU 2025-11: Effective Date and Transition

- This ASU is effective for interim reporting periods within annual reporting periods beginning after December 15, 2027, for public business entities and for interim reporting periods within annual reporting periods beginning after December 15, 2028, for entities other than public business entities
    - Early adoption is permitted

ASU No. 2025-10, *Government Grants (Topic 832): Accounting for Government Grants Received by Business Entities*

- Establishes, for the first time, authoritative U.S. GAAP on the accounting for government grants received by business entities
- Historically, business entities relied on IAS 20, Topic 450, or portions of Subtopic 958-605 by analogy, resulting in persistent diversity in practice
- Despite the introduction of disclosure-only requirements in Update 2021-10, stakeholders, including preparers, auditors, and investors, noted that recognition and measurement remained unaddressed areas of inconsistency

ASU 2025-10: Reason for Issuance

- Prior to this Update, U.S. GAAP lacked explicit guidance on government grants issued to business entities
- Stakeholder feedback emphasized that increased federal and state grant activity, including programs tied to pandemic relief and climate-related legislation, magnified the need for authoritative GAAP
- Preparers and auditors stressed the need for clarity regarding when grants should be recognized, especially when conditions span multiple periods, and how repayable or forgivable arrangements should be handled
- Replaced the current reliance on nonauthoritative analogies

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ASU 2025-10: Main Provisions

- ASU 2025-10 provides a unified GAAP model for recognition, measurement, and presentation of government grants. The amendments apply to business entities and exclude not-for-profit organizations and employee benefit plans
  - A government grant is defined as a transfer of a monetary or tangible nonmonetary asset from a governmental entity, outside of an exchange transaction
- **Recognition threshold** – A government grant received by the entity cannot be recognized until two criteria are met:
  a. It is probable that the entity will (1) comply with any attached grant conditions, and (2) the entity will receive the grant; and
  b. A business entity meets the recognition guidance for a grant related to an asset or a grant related to income

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ASU 2025-10: Main Provisions – Grants Related to Assets

- For a government grant conditioned on the purchase, construction, or acquisition of an asset, an entity must choose one of two recognition approaches:
  a. **Deferred income approach** – The grant is recorded as deferred income on the balance sheet and amortized to earnings in a systematic and rational manner as the related asset costs are recognized (for example, through depreciation, impairment, or sale)
  b. **Cost accumulation approach** – The grant reduces the cost basis of the related asset. Under this approach, no separate subsequent recognition of grant income occurs; instead, the reduced cost basis yields lower depreciation or gains/losses over the asset's life
- The ASU retains optionality because stakeholders and Board members could not agree on a single model (over the dissent of the three Board members), and many preparers already use both by analogy

ASU 2025-10: Main Provisions

- **Grants related to income** – Grants not directly tied to the acquisition of an asset are treated as income grants. These are recognized in earnings on a systematic and rational basis over the periods in which the entity incurs the expenditures the grant is intended to reimburse. Grants intended to compensate for prior expenditures or provide immediate financial support are recognized when the recognition threshold is met (Summary, p. 7)
- Measurement of tangible nonmonetary grants
  - Entities receiving nonmonetary assets (such as land or equipment) may:
    - Measure the asset at fair value under the deferred income approach if the grant is related to an asset; or
    - Measure it at cost to the entity under the cost accumulation approach (Codification 832-10-30-1)

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ASU 2025-10: Main Provisions

- If a grant becomes repayable (e.g., when conditions are not met), the repayment is accounted for based on the nature of the underlying grant (832-10-35-1):
  - **Income grants** – Repayments first reduce any unamortized deferred income; excess repayments are recognized immediately in earnings
  - **Asset grants** – Repayments either increase the asset's carrying amount (cost accumulation approach) or reduce the deferred income balance (deferred income approach), with any excess also recognized in earnings

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ASU 2025-10: Presentation and Disclosure

- Grant proceeds may be presented in earnings either:
  - As other income; or
  - As a deduction from related expenses (Summary, p. 7)
- Entities must disclose (832-10-50-3 and 50-3A–C):
  - The nature and form of the grant;
  - Accounting policies applied (including which approach is used for asset grants) – "for example, for a grant related to an asset, whether the deferred income approach or the cost accumulation approach is applied, or for a grant related to income, whether the grant is presented separately under a general heading such as other income or deducted from the related expense";
  - Significant terms and conditions of the grant;
  - Affected financial statement line items and amounts;
  - For tangible nonmonetary grants, the fair value in the period recognized

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ASU 2025-10: Effective Date and Transition

- The amendments become effective as follows (Summary, pp. 8–9):
  - **Public business entities** – Annual periods beginning after December 15, 2028, and interim reporting periods within those annual periods
  - **All other entities** – Annual periods beginning after December 15, 2029, and interim reporting periods within those annual periods
  - **Early adoption** is permitted in both interim and annual reporting periods
- Entities may choose among **three** transition methods:
  a. **Modified prospective** – Apply to grants entered into on or after the effective date and to incomplete grants – no restatement and no cumulative-effect adjustment
  b. **Modified retrospective** – Restate only incomplete grants as of the earliest period presented, with a cumulative-effect adjustment to the opening balance of retained earnings
  c. **Full retrospective** – Restate all periods presented with a cumulative-effect adjustment to the opening balance of retained earnings

ASU No. 2025-09, *Derivatives and Hedging (Topic 815): Hedge Accounting Improvements*

- ASU 2025-09 introduces targeted improvements to hedge accounting to enhance operability, address areas of diversity in practice, and respond to market developments following global reference rate reform
- The Update is consistent with the original objective of ASU 2017-12 and focuses on five issues:
    1. Similar risk assessment for cash flow hedges
    2. Hedging forecasted interest payments on choose-your-rate instruments
    3. Hedge accounting for nonfinancial forecasted transactions
    4. Net written options in hedge relationships
    5. Foreign-currency-denominated debt instruments as hedging instrument and hedged item (dual hedge)

ASU 2025-09: Reason for Issuance

- Following Update 2017-12, stakeholders continued to request clarification on several hedge accounting topics, including application of similar risk assessments, designation of hedged risks, and treatment of basis adjustments in dual hedges
- In addition, the cessation of LIBOR created new complexities for hedging strategies involving interest rate swaps and optionality embedded in debt instruments
- The Board responded with a targeted yet comprehensive refinement designed to align accounting more closely with contemporary risk management strategies

ASU 2025-09: Main Provisions

Issue 1: Similar risk assessment for cash flow hedges

- The Update fundamentally reshapes how entities determine whether a group of individual forecasted transactions may be designated together in a single cash flow hedge. Under prior guidance, forecasted transactions needed to have a shared risk exposure, a requirement interpreted narrowly in practice and one that often prevented entities from grouping transactions that were economically similar but not perfectly aligned in timing, volume, or rate sensitivity. ASU 2025-09 replaces the "*shared risk exposure*" standard with a more flexible "**similar risk exposure**" requirement
- Under the new standard, a group of forecasted transactions qualifies for hedge designation if the derivative hedging instrument is highly effective in offsetting the designated risk for each hedged risk in the group

ASU 2025-09: Main Provisions

Issue 2: Hedging forecasted interest payments on choose-your-rate debt instruments

- The Update introduces a new model designed specifically for choose-your-rate debt, which contains contractual provisions permitting the borrower to change both the interest rate index and the interest-rate tenor (for example, switching from SOFR one-month to SOFR three-month)
- Under the previous guidance, such contractual optionality risked triggering dedesignation because a change in index or tenor constituted a change in the hedged risk, even if the borrower’s intent and exposure were economically continuous
- ASU 2025-09 establishes a structured framework permitting entities to apply hedge accounting to forecasted or existing interest payments on choose-your-rate debt without dedesignating the hedging relationship when contractual terms change
- The Update allows entities to use simplified probability assessments and streamlined hedge-effectiveness evaluations when the debt terms meet the criteria for choose-your-rate treatment. An entity may apply this model to existing, forecasted issuances of, and subsequent replacements of choose-your-rate debt
  - Entities are prohibited from applying this guidance by analogy to other circumstances

ASU 2025-09: Main Provisions

Issue 3: Cash flow hedges of nonfinancial forecasted transactions

- This issue expands hedge accounting eligibility for forecasted purchases and sales of nonfinancial assets, particularly in industries such as energy, manufacturing, chemicals, and agriculture, where entities routinely face exposure to variable underlying inputs or referenced pricing components
- ASU 2025-09 moves away from the contractual-specification requirement and instead permits designation of variable price components that are **clearly and closely related** to the nonfinancial asset being acquired or sold
    - This includes components embedded in spot-market transactions and forward-market transactions, as well as subcomponents of explicitly referenced pricing components in an agreement's pricing formula
    - To qualify for hedge designation, the variable price component of the forecasted purchase or sale of a nonfinancial asset is required to be clearly and closely related to the NFA being purchased or sold in the current normal purchases and normal sales exception
- The amendment further clarifies that entities may designate a variable price component in a contract that is accounted for as a derivative as the hedged risk if all other hedge criteria are satisfied
- The shift is significant. It acknowledges that contracts often reference only broad pricing mechanisms or indices, while economic exposure may stem from underlying elements within those mechanisms

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ASU 2025-09: Main Provisions

Issue 4: Net written options as hedging instruments

- In response to the elimination of LIBOR, ASU 2025-09 eliminates the requirement to apply the net written option test to certain compound derivatives that include both a swap component and a written option designated as the hedging instrument in a cash flow hedge or fair value hedge of interest rate risk

Issue 5: Foreign-currency-denominated debt instrument as hedging instrument and hedged item (dual hedge)

- A dual hedge strategy is a hedge for which a foreign-currency-denominated debt instrument is both designated as the hedging instrument in a net investment hedge and designated as the hedged item in a fair value hedge of interest rate risk
- ASU 2025-09 resolves this issue by requiring entities to exclude the debt instrument's fair value hedge basis adjustment from the net investment hedge effectiveness assessment. As a result, gains and losses from remeasuring the debt instrument's fair value hedge basis adjustment at spot exchange rates are recognized immediately in earnings

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ASU 2025-09: Effective Date and Transition

- For public business entities, ASU 2025-09 is effective for annual reporting periods beginning after December 15, 2026, and interim periods within those annual reporting periods
  - Early adoption is permitted
- For entities other than public business entities, the amendments are effective for annual reporting periods beginning after December 15, 2027, and interim periods within those annual reporting periods
  - Early adoption is permitted
- The Update is applied prospectively for all hedging relationships, and entities may modify hedge documentation for existing hedges without dedesignating the hedge, allowing for smooth transition and operational continuity
  - The entity may elect to adopt the ASU for hedging relationships that exist as of the date of adoption even if they originated prior to adoption

ASU No. 2025-08, *Financial Instruments – Credit Losses (Topic 326): Purchased Loans*

- ASU 2025-08 revises the accounting for acquired loans under Topic 326 by expanding the population of assets subject to the gross-up approach and reducing those subject to credit loss expense on day one
- Historically, the distinction between purchased credit-deteriorated (PCD) and non-PCD loans created inconsistent and sometimes uneconomic results, particularly where non-PCD loans produced day-one credit loss expense despite expected credit losses already reflected in fair value
- This Update introduces the concept of purchased seasoned loans (a new term) and significantly reduces reliance on subjective credit-quality assessments
  - It aligns acquisition accounting with the economic substance of purchased loan portfolios

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ASU 2025-08: Reason for Issuance

- Following the issuance of ASU 2016-13, the Board monitored implementation through its post-implementation review (PIR) process
- Stakeholders identified two key challenges:
  a. The operational difficulty of consistently distinguishing PCD from non-PCD loans; and
  b. The uneconomic day-one loss recognition required for non-PCD assets
- Investors described this treatment as “double counting” because expected credit losses were reflected both in the acquisition date fair value and in the newly recorded expense and related allowance

ASU 2025-08: Main Provisions

- Introduces purchased *seasoned* loans by deeming all non-PCD loans acquired in a business combination as seasoned and by requiring other acquired loans to be evaluated using bright-line seasoning criteria
- All non-PCD loans (excluding credit cards) that are acquired in a business combination are deemed **seasoned**
- A loan is also seasoned if:
  a. It is purchased more than 90 days after origination; and
  b. The acquirer was not involved in the origination of the loan
- Purchased seasoned loans are accounted for under the gross-up approach, which adds the initial allowance for credit losses to the purchase price to determine the loan's amortized cost basis

ASU 2025-08: Effective Date and Transition

- Effective for annual periods beginning after December 15, 2026, including interim periods within those annual reporting periods
  - Early adoption is permitted
- The Update must be applied prospectively to loans acquired on or after the application date. Entities adopting in an interim period must apply the amendments either at the start of the interim period of adoption or the beginning of the annual period that includes that interim period

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ASU No. 2025-07, *Derivatives and Hedging (Topic 815) and Revenue From Contracts With Customers (Topic 606)*

- This dual-issue Update modernizes and clarifies the accounting treatment for two areas of concern, derivatives (Topic 815) and revenue (Topic 606):
  1) The scope of derivative accounting for contracts linked to an entity's own operations or performance; and
  2) The accounting for share-based noncash consideration received from customers in revenue contracts
- The amendments are designed to reduce unnecessary complexity, enhance consistency across entities, and better align financial reporting with economic substance

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ASU 2025-07: Reason for Issuance

- Stakeholders raised concerns that the definition of a derivative under Topic 815 had become too broad, leading to unintuitive results for contracts based on operational or entity-specific variables
  - For example, funding or licensing arrangements tied to regulatory milestones or internal financial performance measures were sometimes treated as derivatives subject to fair value accounting, even though such treatment did not reflect their underlying economics
- The Board also observed diversity in accounting for share-based noncash consideration received from customers under Topic 606
- This ASU addresses both issues to simplify application and enhance comparability across industries

ASU 2025-07: Main Provisions (Derivatives)

- Refines the scope of derivative accounting under Topic 815 by expanding the existing scope exception to exclude certain non-exchange-traded contracts with underlyings based on operations or activities specific to one of the parties to the contract
- Under the revised derivative guidance, contracts are excluded from Topic 815 if their settlement depends on operational or activity-based variables such as an entity’s own earnings, sales volumes, or the occurrence of events like regulatory approval or a greenhouse gas reduction target
  - However, the exception does not apply to variables tied to market rates, prices, or indexes; the price or performance of a financial asset or liability; contracts involving the issuer’s own equity (Subtopic 815-40); or call and put options on debt instruments. This principles-based refinement aims to improve alignment between financial reporting and the economic substance of such agreements

ASU 2025-07: Main Provisions (Topic 606)

- Clarifies that share-based noncash consideration from a customer in a revenue contract should be accounted for under Topic 606 until the entity's right to receive or retain the share-based instrument is unconditional
- For share-based noncash consideration, the ASU clarifies that an entity should apply Topic 606's noncash consideration guidance (paragraphs 606-10-32-21 through 32-24) when it receives shares, warrants, or other equity instruments from a customer as payment for goods or services
- The entity should recognize revenue as it satisfies performance obligations, and the share-based instruments should not be recognized as derivative assets or equity securities until the right to receive them becomes unconditional

ASU 2025-07: Impacted Entities and Effective Date

- Effective for all entities for annual reporting periods beginning after December 15, 2026, including interim periods within those years
  - Early adoption is permitted
- Entities may apply the guidance either prospectively to new contracts entered into on or after the adoption date or on a modified retrospective basis through a cumulative-effect adjustment to opening retained earnings
- The Board also allows, on an instrument-by-instrument basis, an election to continue or revoke the fair value option for contracts affected by the new scope exception
- Must describe the nature and reason for the accounting change and its cumulative impact on equity

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ASU No. 2025-06, *Intangibles – Goodwill and Other – Internal-Use Software (Subtopic 350-40): Targeted Improvements to the Accounting for Internal-Use Software*

- The FASB issued this Update in response to extensive stakeholder feedback that the existing guidance for accounting for internal-use software had become outdated
- Previous requirements relied on a stage-based model (preliminary, application development, and post-implementation) that aligned with the traditional "waterfall" method of software development
- Most entities now use incremental and iterative approaches such as agile methodologies. As a result, the prior framework was difficult to apply and did not reflect the way software is currently developed

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ASU 2025-06: Main Provisions

- ASU 2025-06 eliminates the prescriptive references to project stages and introduces a recognition threshold based on management authorization and the probability of completion. Under the new model, capitalization of software costs begins only when (1) management has authorized and committed to funding the computer software project, and (2) it is probable that the project will be completed and the software used as intended. This threshold is referred to as the "probable-to-complete" recognition threshold
- The Update requires entities to evaluate whether "significant development uncertainty" exists before capitalization can begin. Two factors indicate that such uncertainty exists:
    a. "The software being developed has technological innovations or novel, unique, or unproven functions or features, and the uncertainty related to those technological innovations, functions, or features, if identified, has not been resolved through coding and testing"
    b. "The significant performance requirements of the software have not been identified, or the identified significant performance requirements continue to be substantially revised"
- If either factor is present, capitalization must be delayed until the uncertainty is resolved

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ASU 2025-06: Main Provisions

- The amendments also revise disclosure requirements. All capitalized internal-use software costs must follow the Property, Plant, and Equipment disclosure model under Subtopic 360-10, rather than the intangible asset disclosure requirements under Subtopic 350-30. Furthermore, the Update supersedes Subtopic 350-50 on website development costs and incorporates relevant website-specific guidance into Subtopic 350-40
- For most entities, the amendments are not expected to result in significant changes to the amount of capitalized costs. However, for software developed for delivery through cloud computing arrangements, the new guidance may result in reduced capitalization and more frequent immediate expense recognition

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ASU 2025-06: Impacted Entities and Effective Date

- ASU 2025-06 is effective for **all entities** for annual reporting periods beginning after December 15, 2027, including interim periods within those years
  - Early adoption is permitted in an interim or annual reporting period in which financial statements have not yet been issued or made available for issuance. If an entity adopts the ASU in an interim reporting period, it shall adopt the ASU as of the beginning of the annual reporting period that includes that interim reporting period
- Entities may apply the amendments using one of three transition methods:
  1) A prospective approach applying the guidance only to new costs incurred after adoption;
  2) A modified approach in which in-process projects that no longer meet the capitalization criteria are derecognized through a cumulative-effect adjustment; or
  3) A full retrospective approach with cumulative-effect adjustment to retained earnings

ASU No. 2025-05, *Financial Instruments – Credit Losses (Topic 326)*

- Issued to simplify the application of ASC 326 to **current accounts receivable** and **current contract assets** arising from transactions accounted for under ASC 606 (revenue)
- The PCC indicated that private entities were struggling with implementation costs and estimating credit losses under the standard despite the application of the standard not having a material impact on the entities
- The PCC further indicated that many private entities were recognizing credit losses as of the balance sheet date for amounts that were ultimately collected before the financial statements were made available

ASU 2025-05: Main Provisions

- The ASU provides **all** entities with a practical expedient and **entities other than public business entities** with an accounting policy election when estimating expected credit losses for current accounts receivable and current contract assets arising from transactions accounted for under Topic 606
  - **Practical expedient (available to all entities, public and private)** – In developing reasonable and supportable forecasts as part of estimating expected credit losses, all entities may elect a practical expedient that assumes that current conditions as of the balance sheet date do not change for the remaining life of the asset
  - **Accounting policy election (available to nonpublic entities only)** – An entity that elects the practical expedient is permitted to make an accounting policy election to consider collection activity after the balance sheet date when estimating expected credit losses (ASU 2025-05)

ASU 2025-05: Main Provisions

- If applicable, nonpublic entities may adopt both provisions:
  - Practical expedient; and
  - Policy election
- If adopting ASU 2025-05, an entity must apply expedient and/or election consistently across applicable balances
- Customer-specific risks must still be considered
- Disclosures must contain the election being made (policy election and/or practical expedient) and the date of the assessment being performed if such elections are made

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ASU 2025-05: Impacted Entities and Effective Date

- The practical expedient applies to all entities, public and private, while the policy election applies to entities other than public entities
- The ASU is effective for annual periods beginning after December 15, 2025, including interim periods within
  - Early adoption was permitted
- The practical expedient and/or policy election should be applied **prospectively**
- A preferability assessment is not required for nonpublic entities adopting the practical expedient or policy election after the effective date

Discussion Question:

Given the focus the PCC places on making standards less burdensome for preparers, what are some reasons your clients may be giving for not implementing the accounting policy election or practical expedient allowed under ASU 2025-05?

ASU No. 2025-04, *Share-Based Consideration Payable to a Customer*

- Issued to resolve diversity in practice and improve the clarity and operability of existing guidance related to share-based consideration (e.g., warrants, options, other equity instruments) granted to customers to incentivize them to purchase goods or services
- Designed to address uncertainty in distinguishing between service conditions and performance conditions
- This ASU aims to ensure that revenue recognition reflects the economic substance of customer awards, especially when vesting is tied to purchase volume or value, and better aligns guidance for these awards with the principles of ASC 606 and ASC 718

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ASU 2025-04: Main Provisions

- The ASU redefines the term *performance condition* in the Master Glossary to include vesting targets based on the volume or monetary amount of purchases as follows:
- "For share-based consideration payable to a customer that can result in a reduction of the transaction price in accordance with Topic 606, a condition affecting the vesting, exercisability, exercise price, or other pertinent factors used in determining the fair value of an award that relates to any of the following:
  - Achieving a specified performance target that is defined solely by reference to the grantor's own operations (or activities) or by reference to the grantee's (the customer's) performance related to the grantor's own operations (or activities)
  - The grantee's purchase (or potential purchase) of the grantor's goods or services from either the grantor or the grantor's customers
  - A purchase (or potential purchase) of the grantor's goods or services from either the grantee or the grantee's customers"

ASU 2025-04: Main Provisions

- For awards with service conditions, the ASU eliminates the forfeitures-as-they-occur election and instead requires entities to estimate forfeitures
- The amendment further clarifies that the ASC 606 constraint on variable consideration does not apply to share-based customer awards
  - The grantor is required to only apply Topic 718 to such scenarios
- Revenue recognition will no longer be delayed when an entity grants awards that are not expected to vest, allowing a better initial estimate of the transaction price under ASC 606

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ASU 2025-04: Impacted Entities and Effective Date

- Applies to all entities, public and private, issuing share-based consideration to customers in the scope of Topic 606
- ASU is effective for all entities for annual reporting periods (including interim reporting periods within annual reporting periods) beginning after December 15, 2026
  - Early adoption is permitted
- Modified retrospective (default) or full retrospective adoption is permitted

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ASU 2025-04: Transition – Modified Retrospective

- The grantor should recognize a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) as of the beginning of the period of adoption
  - The grantor should not recast any financial statement information before the period of adoption
- The grantor should apply the amendments as of the date of initial application to all share-based consideration payable to a customer

ASU 2025-04: Transition – Retrospective

- The grantor should recast comparative periods and recognize a cumulative-effect adjustment to the opening balance of retained earnings (or other appropriate components of equity or net assets in the statement of financial position) as of the beginning of the earliest period presented
- An entity that elects to apply the guidance retrospectively should use the actual outcome, if known, of a performance condition or service condition as of the beginning of the annual reporting period of adoption for all prior-period estimates
    - If actual outcomes are unknown as of the beginning of the annual reporting period of adoption, an entity should use its estimate of the probability of achieving a service condition or performance condition as of the beginning of the annual reporting period of adoption for all prior-period estimates

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ASU No. 2025-03, *Business Combinations (Topic 805) and Consolidation (Topic 810): Determining the Accounting Acquirer in the Acquisition of a Variable Interest Entity*

- The FASB issued ASU 2025-03 to address inconsistencies in the determination of the accounting acquirer in transactions where a variable interest entity (VIE) is acquired
- Under prior guidance, the primary beneficiary of a VIE was **always** considered the accounting acquirer, even when the transaction was effected by exchanging equity interests. Stakeholders raised concerns about lack of comparability between VIE and non-VIE transactions, especially regarding reverse acquisitions and whether a business combination had occurred
- The amendments aim to enhance consistency and comparability by allowing the same accounting acquirer assessment factors that are currently required for determining which entity is the accounting acquirer in other acquisition transactions

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ASU 2025-03: Main Provisions

- The ASU modifies Topic 805 and Topic 810 to require entities to apply the same set of factors (outlined in ASC 805-10-55-12 through 55-15) to determine the accounting acquirer when:
  - The legal acquiree is a VIE;
  - The legal acquiree meets the definition of a business; and
  - The transaction is effected primarily by exchanging equity interests
- Previously, the primary beneficiary was **always** the acquirer for VIEs
  - **The ASU removes that automatic designation** in the specific case of equity exchange transactions
- The factors to consider include relative voting rights, governing body composition, senior management continuity, and size of the entities involved. The ASU does not change the accounting for reverse acquisitions or acquisitions where the legal acquiree is not a business

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ASU 2025-03: Impacted Entities, Transition, and Effective Date

- This Update affects all entities involved in acquisition transactions effected primarily by exchanging equity interests when the legal acquiree is a VIE that meets the definition of a business
- ASU 2025-03 is effective for all entities for annual reporting periods beginning after December 15, 2026, including interim periods within those annual periods
  - Early adoption is permitted at the beginning of any interim or annual reporting period where financial statements have not yet been issued or made available for issuance
- The amendments must be applied prospectively to any qualifying acquisition transactions occurring after the initial application date

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Significant ASUs Issued Prior to 2025 That Are Effective in 2025 and Beyond

ASU No. 2024-04, *Debt – Debt with Conversion and Other Options (Topic 470-20)*

- Provides guidance on whether a transaction should be accounted for as an induced conversion or an extinguishment of convertible debt when the conversion does not occur in accordance with the instruments' preexisting terms
- Specifically focuses on the settlement of a convertible debt instrument that does not require new equity securities to be issued upon conversion
- Current guidance was lacking clarity after the issuance of ASU 2020-06

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ASU 2024-04: Reason for Issuance and Entities Affected

- The Update seeks to clarify the guidance for determining whether a transaction involving the modification of a convertible debt instrument's terms (particularly a cash convertible instrument) at terms that are different from the original conversion terms should be accounted for as an induced conversion or a debt extinguishment
  - This Update affects entities, public and private, that settle convertible debt instruments where the conversion privileges have been modified to induce conversion

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ASU 2024-04: Main Provisions

- Clarification of inducement offers
  - To account for a settlement of a convertible debt instrument as an induced conversion, the inducement offer must provide the holder with the consideration (in form and amount) that was issuable under the conversion privileges provided in the original terms of the instrument
  - Addresses ambiguities about whether modifications to terms or the addition of new conversion incentives constitute an induced conversion or a debt extinguishment
    - The entity must assess this as of the date the conversion offer is accepted by the holder
  - If, when applying this criterion, the convertible debt instrument had been exchanged or modified (without being deemed substantially different) within the one-year period leading up to the offer acceptance date, an entity should compare the terms provided in the inducement offer with the terms that existed one year before the offer acceptance date

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ASU 2024-04: Main Provisions

- Treatment of volume-weighted average price (VWAP) modifications
  - Incorporation, elimination, or changes to a VWAP formula or similar provision do not automatically lead to a debt extinguishment classification
  - Instead, an entity should assess whether the modified terms preserve the form and amount of the conversion consideration stipulated in the original terms as of the offer acceptance date
- Applicability to nonconvertible instruments
  - The guidance extends to scenarios where a convertible debt instrument is not currently convertible but has a substantive conversion feature at issuance and at the time the inducement offer is accepted

ASU 2024-04: Effective Date and Transition

- Effective for all entities for annual reporting periods beginning after December 15, 2025, and interim periods within those annual periods. Early adoption is permitted for all entities that have adopted ASU 2020-06. Entities may apply the new guidance on a prospective or retrospective basis:
  - Prospective application
    - Entities apply the amendments to settlements of convertible debt instruments occurring after the effective date of the guidance
  - Retrospective application
    - Entities can recast prior periods and recognize a cumulative-effect adjustment to equity at the later of the beginning of the earliest period presented or the date the entity adopted the amendments in ASU 2020-06

ASU No. 2024-03, *Income Statement – Reporting Comprehensive Income – Expense Disaggregation Disclosures (Subtopic 220-40): Disaggregation of Income Statement Expenses (DISE)*

- ASU 2024-03 was issued in response to feedback from investors and other financial statement users who expressed the need for more detailed information about expenses to better understand an entity's performance, forecast future cash flows, and compare performance across entities. Specific feedback highlighted the importance of disaggregating costs of sales and selling, general, and administrative expenses (SG&A) to better understand an entity's cost structure

ASU 2024-03: Main Provisions

The main provisions require public business entities to disclose more detailed information about their expenses in the notes to their financial statements. Specifically, entities must:

a. Disclose the amounts of:
   1) Purchases of inventory;
   2) Employee compensation;
   3) Depreciation;
   4) Intangible asset amortization; and
   5) Depreciation, depletion, and amortization recognized as part of oil-and gas-producing activities (DD&A) (or other amounts of depletion expense) included in each relevant expense caption. A relevant expense caption is an expense caption presented on the face of the income statement within continuing operations that contains any of the expense categories listed in (1)–(5)

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ASU 2024-03: Main Provisions (Cont.) and Entities Affected

b. Include certain amounts that are already required to be disclosed under current generally accepted accounting principles (GAAP) in the same disclosure as the other disaggregation requirements;

c. Disclose a qualitative description of the amounts remaining in relevant expense captions that are not separately disaggregated quantitatively; and

d. Disclose the total amount of selling expenses and, in annual reporting periods, the entity's definition of selling expenses
   - These disclosures (a–d) are required for both interim and annual reporting periods and aim to enable investors to better understand the components of an entity's expenses, assess performance, and forecast future expenses

- Affected entities
  - The ASU applies to all public business entities
  - Private companies are <u>not</u> in scope

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ASU 2024-03: Illustrative Example – Standard F/S

220-40-55-14 For the year ended December 31, 20X4, Entity X, which is a services provider, presents the following comparative income statement.

Entity X
Consolidated Income Statement
For the Years Ended December 31, 20X4, 20X3, and 20X2

	20X4	20X3	20X2
Revenues	$ 737,132	$ 710,146	$ 694,180
Cost of sales (exclusive of depreciation and amortization shown separately below)	140,055	170,435	145,778
Depreciation and amortization related to cost of sales	31,578	26,178	23,628
Selling, general, and administrative expenses	497,962	458,215	471,626
Research and development expenses	57,235	52,174	48,898
Operating income	10,302	3,144	4,250
Interest expense	3,145	2,665	2,297
Income before income taxes	7,157	479	1,953
Income tax expense	1,503	101	410
Net income	$ 5,654	$ 378	$ 1,543

ASU 2024-03: Illustrative Example – Applying DISE

Disaggregation of Relevant Expense Captions

	20X4	20X3	20X2
Cost of sales			
Cost of sales			
Employee compensation (exclusive of one-time employee termination benefits)	$ 86,336	$ 83,903	$ 100,009
One-time employee termination benefits	7,434	39,298	-
Other cost of sales [(a)]	46,285	47,234	45,769
Total cost of sales	$ 140,055	$ 170,435	$ 145,778

(a) Other cost of sales consist primarily of subcontractor costs and travel expenses for the years ended December 31, 20X4, 20X3, and 20X2.

	20X4	20X3	20X2
Depreciation and amortization related to cost of sales			
Depreciation and amortization related to cost of sales			
Depreciation	$ 19,126	$ 17,984	$ 17,893
Intangible asset amortization	12,452	8,194	5,735
Total depreciation and amortization related to cost of sales	$ 31,578	$ 26,178	$ 23,628

ASU 2024-03: Illustrative Example – Applying DISE

Selling, general, and administrative expenses

Selling, general, and administrative expenses (SG&A)			
Employee compensation (exclusive of one-time employee termination benefits)	$ 278,859	$ 238,272	$ 301,841
One-time employee termination benefits	19,243	60,635	-
Other SG&A [(b)]	199,860	159,308	169,785
Total SG&A	$ 497,962	$ 458,215	$ 471,626

(b) Other SG&A consists primarily of professional services fees and the costs paid to third parties for printing, publications, and advertising for the years ended December 31, 20X4, 20X3, and 20X2.

Research and development expenses

Research and development expenses (R&D)			
Employee compensation (exclusive of one-time employee termination benefits)	$ 46,242	$ 41,379	$ 40,764
One-time employee termination benefits	1,454	1,855	-
Other R&D [(c)]	17,836	16,845	15,890
Cost reimbursements [(d)]	(8,297)	(7,905)	(7,756)
Total R&D	$ 57,235	$ 52,174	$ 48,898

(c) Other R&D consists primarily of payments to third parties for professional services and licenses of intellectual property for the years ended December 31, 20X4, 20X3, and 20X2.

(d) Cost reimbursements consist of payments from a strategic partner for employee compensation and materials costs related to R&D incurred as part of a funded research and development arrangement for the years ended December 31, 20X4, 20X3, and 20X2.

ASU 2024-03: Implementation and Effective Date

- The FASB removed the initial effective date that was announced in ASU 2024-03. **The effective date of ASU 2024-03 was amended shortly after issuance by ASU 2025-01** to correct for a situation where the guidance made it possible for a public business entity to apply the guidance to an interim reporting period prior to applying the guidance to an annual reporting period. Under ASU 2025-01, ASU 2024-03 is effective for public business entities for annual reporting periods beginning after December 15, 2026, and interim reporting periods within annual reporting periods beginning after December 15, 2027
  - The only reason for the issuance of ASU 2025-01 was to amend the effective dates of this Update
- Early adoption is permitted. Entities have the option to apply the amendments either retrospectively to all prior periods presented or prospectively to new or modified transactions after the effective date

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ASU No. 2024-01, *Compensation – Stock Compensation (Topic 718): Scope Application of Profits Interest and Similar Awards*

Aims to improve clarity and lead to consistent application

Provides illustrative examples to help practitioners apply scope guidance in determining whether profits interest and similar awards should be accounted for under Topic 718, *Compensation – Stock Compensation*

Issued in response to complexities and diversity in practice (even for similar fact patterns) identified by the PCC regarding the accounting of profits interest awards, which are used by entities to align compensation with performance and provide participants with future profits and/or equity appreciation

ASU 2024-01: Implementation and Effective Date

- For public business entities (PBEs), the amendments are effective for annual periods beginning after December 15, 2024, including interim periods within those annual periods
  - For all other entities, they are effective for annual periods beginning after December 15, 2025, and interim periods within those annual periods
- Early adoption is permitted for both interim and annual financial statements not yet issued or available for issuance
- Entities can apply the amendments retrospectively to all prior periods presented or prospectively to awards granted or modified after the first application date

Discussion Question:

Now that some of the largest changes to the FASB Codification are behind us, which of the standards issued in 2025 do you think will have the largest impact on you or your clients? Which provisions do you anticipate being the most difficult to apply?

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ASU 2023-09: *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*

- Enhances and expands disclosure requirements to help investors:
  - "Better understand an entity's exposure to potential changes in jurisdictional tax legislation and the ensuing risks and opportunities"
  - "Assess income tax information that affects cash flow forecasts and capital allocation decisions"
  - "Identify potential opportunities to increase future cash flows"
- Disclosures expand for (1) rate reconciliations, (2) income taxes paid, (3) amounts surrounding the disaggregation of foreign and domestic income before taxes, and (4) income tax expense or benefit from CO disaggregated by foreign, federal, and state

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ASU 2023-09: Implementation and Effective Date

- Effective for public entities for fiscal years beginning after December 15, 2024; for private entities, the effective date is after December 15, 2025
  - Early adoption was permitted
- Prospective application should be applied
  - Retrospective application also permitted

ASU 2023-09: Major Provisions

- Public entities must disclose specific categories in the rate reconciliation and expand disclosures for all reconciling items that meet a quantitative threshold for items that are greater than or equal to 5 percent of pretax income (loss) by the applicable statutory income rate
  - Private entities require qualitative, not quantitative, disclosure about categories of reconciling items and tax jurisdictions that result in a “significant difference” between the statutory tax rate and the effective tax rate
- Disclose “the amount of income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign taxes”
- Disclose “the amount of income taxes paid (net of refunds received) disaggregated by individual jurisdictions in which income taxes paid (net of refunds received) is equal to or greater than 5 percent of total income taxes paid (net of refunds received)”

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Illustrated Example – Uncertain Tax Positions

	20X7	20X6 (in thousands)	20X5
Balance at January 1	$ 370,000	$ 380,000	$ 415,000
Additions based on tax positions related to the current year	10,000	5,000	10,000
Additions for tax positions of prior years	30,000	10,000	5,000
Reductions for tax positions of prior years	(60,000)	(20,000)	(30,000)
Settlements	(40,000)	(5,000)	(20,000)
Balance at December 31	$ 310,000	$ 370,000	$ 380,000

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ASU 2023-09: Major Provisions

- Additional disclosure requirements:
  - Income (or loss) from continuing operations before income tax expense (or benefit) disaggregated between domestic and foreign
  - Income tax expense (or benefit) from continuing operations disaggregated by federal (national), state, and foreign
- Eliminates the requirement for all entities to (1) disclose the nature and estimate of the range of the reasonably possible change in the unrecognized tax benefits balance in the next 12 months or (2) make a statement that an estimate of the range cannot be made

ASU No. 2023-05, *Business Combinations – Joint Venture Formations (Subtopic 805-60)*

- This ASU was issued as an amendment to provide clear guidance on accounting for contributions made to a joint venture, upon formation, in a joint venture's separate financial statements
- Prior to the ASU, joint ventures took a diverse approach to measuring contributions at the formation date, with some electing to account for net asset contributions at fair value and others electing to account for net asset contributions at the venturer's carrying amount. The Update now provides consistent and decision-useful guidance to investors and reduces diversity in joint venture formation accounting
- Applies only to entities that meet the FASB ASC Master Glossary definition of a joint venture or corporate joint venture

Provisions of ASU No. 2023-05

- Key provisions of ASU No. 2023-05
  - Newly formed joint ventures should initially measure assets and liabilities at fair value as of the formation date (with fair value measurement exceptions that are consistent with business combination guidance)
  - This approach is consistent with the accounting result that would occur if the joint venture was treated as the acquirer of a business and subject to the guidance in FASB ASC Subtopic 850, *Business Combinations*
  - **Disclosures for joint venture formation should occur in the period in which the formation date occurs**
    - Note that joint venture formation disclosure requirements are different from the requirements for disclosures in a business combination

Effective Date of ASU No. 2023-05

- Effective date for ASU No. 2023-05
  - Prospectively for all joint venture formations with a formation date beginning on or after January 1, 2025
    - Joint ventures formed prior to this date may elect to apply the ASU retrospectively if sufficient information exists
  - Early adoption is permitted for annual and interim periods for which financial statements have not been issued or made available for issuance, either prospectively or retrospectively

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FASB's Technical Agenda

FASB Technical Agenda

- 24 active projects as of April 2026:
  - Recognition and measurement projects (13)
  - Research projects (7)
  - EITF (3)
  - PIR (1)
- Details available at FASB.org

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How To Read the Agenda: Milestones, Timing Labels, and Interpretation

- **Understanding milestones**
  - Milestones like Initial Deliberations, Board Deliberations, Exposure Draft, and Final ASU mark key decision stages in the agenda
- **Timing labels explained**
  - Timing labels such as quarters and ongoing indicate expected project phases, with quarters as planning estimates
- **Long-term pipeline review**
  - Review research and PIR sections to understand feedback loops and future agenda items

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Active Standard-Setting Projects: What's Nearest to Issuance

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Projects With Final ASU Expected: Near-Term GAAP Changes To Watch

Project	Next Milestone	Expected Date	Why It Matters (Student Lens)
Accounting for Debt Exchanges	Final ASU	1Q 2026	Modification vs. extinguishment analysis; impacts gain/loss and interest calculations
Accounting for Environmental Credit Programs	Final ASU	1Q 2026	Emerging markets with diversity in practice; affects recognition/measurement choices
Initial Measurement of Paid-in-Kind Dividends on Equity-Classified Preferred Stock	Final ASU	2Q 2026	Equity-related measurement and EPS/retained earnings implications

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Exposure Draft Stage: Proposed Guidance in Comment Period

Project	Next Milestone	Expected Date
Application of Topic 715 to Market-Return Cash Balance Plans	Exposure Draft	2Q 2026
Targeted Improvements to Hedge Accounting for Interest Rate Risk and Net Foreign Investments	Exposure Draft	3Q 2026

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Deliberations (Part 1): Ongoing Board Work on Measurement and Digital Assets

Project	Next Milestone	Expected Date	Conceptual Questions ADDRESSED
Accounting for Commodities	Board deliberations	Ongoing	Which measurement attribute best reflects different commodity business models?
Accounting for Transfers of Crypto Assets	Board deliberations	Ongoing	When does a transfer meet derecognition based on control and rights?
Classification of Certain Digital Assets as Cash Equivalents	Board deliberations	Ongoing	Do liquidity and convertibility overcome volatility and risk criteria?

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Deliberations (Part 2): Simplification and Comparability Initiatives

Project	Next Milestone	Expected Date	Typical Improvement Goal
Codification Improvements (Evergreen)	Initial deliberations	Ongoing	Incremental clarity and consistency fixes across Codification
Definition of Common Control	Board deliberations	Ongoing	Reduce diversity by clarifying a key scope/definition threshold
Equity Method of Accounting: Targeted Improvements	Board deliberations	Ongoing	Simplify application issues and improve comparability for investors
Statement of Cash Flows – Targeted Improvements	Board deliberations	Ongoing	Clarify cash flow classification and presentation judgments

Pipeline Beyond Active Standard-Setting: Research, EITF, and Review

Research Agenda: Topics Under Evaluation and Problem Definition

Research Topic	What It Signals	Main FOCUS
Accounting for and Disclosure of Intangibles	Information gaps and recognition challenges	Purchased vs. internally developed intangibles – what should users see?
Accounting for Derivatives/ Hedge Accounting	Complexity and cost of application	How to improve risk-reporting alignment without losing comparability
Consolidation for Business Entities	Judgment in control assessments	How rights/economics drive consolidation outcomes
Financial KPIs for Business Entities	Demand for consistent performance metrics	Pros/cons of standardizing non-GAAP-like measures
Agenda Consultation	Stakeholder-driven prioritization	How should a standard setter pick "what's next"?

EITF and Post-Implementation Review: Rapid Issue Resolution and Feedback Loops

Mechanism	Items Listed in the Overview	Why It Exists
EITF	1. Topic 815: normal purchase and normal sales scope exception for electricity contracts 2. Mortgage Servicing Rights – Recapture 3. Consideration Payable to a Customer	Resolve narrow issues quickly to reduce diversity in practice
Post-Implementation Review	Credit Losses	Assess whether major standards work as intended and identify areas for refinement

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Stages of PIR Process

- Stage 1 – Post-issuance date implementation monitoring
  - Actively monitor practice as stakeholders prepare for initial implementation
  - Develop and disseminate implementation guidance and educational material
  - Communicate and perform outreach with stakeholder organizations
- Stage 2 – Post-effective date evaluation of costs and benefits
  - Understand the costs that an entity incurred in applying the standard as well as the costs that investors and other users incurred in analyzing and interpreting the information that the standard provides
  - Understand the benefits of the standard to investors and other users as well as to entities
  - Monitor the ongoing application of the standard
- Stage 3 – Summary of research and reporting

FASB Post-Implementation Reviews

- FASB has begun Post-Implementation Reviews (PIRs) for the following standards (and the process remains ongoing), both of which are in Stage 1:
  - ASC 326 – *Credit Losses*
- FASB completed the PIR from ASC 842 – *Leases*
  - Covered in Chapter 2
- Purpose of PIR process
  - An evaluation of whether a standard is achieving its objective by providing financial statement users with relevant information in ways that justify the cost of providing it
  - During the PIR process, the FASB solicits and considers diverse stakeholder input and other research to evaluate the standards that are issued and determine whether there are areas of improvements that the FASB should address

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Update on FASB's Private Company Council

Purpose and Composition of PCC

- Two primary responsibilities:
  - To determine whether exceptions or modifications to existing nongovernmental U.S. GAAP are required to address the needs of users of private company financial statements; and
  - To serve as the primary advisory body to the FASB on the appropriate treatment for private companies for items under active consideration on the FASB's technical agenda
- The PCC has completed this first responsibility and is now generally serving in a consulting and advisory role to the FASB as the FASB progresses on its technical agenda
- Influence of PCC seen in recently issued FASBs on consolidation, etc.

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Composition of the PCC

- Between 9–12 members, including a Chairperson
  - New chair, Jere G. Sawver, began their term on January 1, 2024
  - Replaced Candace Wright, who had been chair since January 1, 2016
- Appointed by FAF Board of Trustees
- Represent broad constituencies:
  - Financial statement users
  - Financial statement preparers
  - Accounting practitioners

PCC Strategic Priorities

- The PCC's work is guided by three strategic priorities:

1. **Stakeholder Engagement** – Maximizing outreach to preparers, practitioners, and users to understand challenges in private company financial reporting
2. **Simplification of Standards** – Evaluating existing GAAP for practical and efficient alternatives tailored to private companies
3. **Advisory Role to FASB** – Providing consistent, influential feedback to the FASB on private company implications of standard-setting activities
    1. Remember, the PCC itself is not a standard setter

Summary of PCC 2025 Progress

Completed Projects (2025)

2

Key deliverables for private companies: a **credit losses simplification** (ASU 2025-05) and guidance on **retainage disclosures**.

Active Research Projects

3

Ongoing initiatives on **lease accounting simplifications**, **debt classification (SAC)**, and **debt modification/TDR** simplifications.

Research Areas Dropped

5

Topics studied but not pursued further (e.g., single-model leases, low-value lease exception, certain disclosures) due to limited benefit or stakeholder opposition.

Stakeholders Engaged

1,030+

Private company participants reached via Town Halls, liaison meetings (940+) and targeted outreach (~90) – feedback directly shaped the PCC's 2025 agenda.

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PCC Results Summary

- In 2025, the Private Company Council (PCC) advanced its mission of simplifying U.S. GAAP for private entities through targeted projects and stakeholder-driven priorities. The PCC completed two major initiatives by introducing a new credit losses practical expedient and policy election and by issuing guidance on construction contract retainage
- PCC is currently progressing three key research projects on leases and debt and concluding five other research areas based on stakeholder input

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2025 Accomplishments (From PCC Annual Report)

- **Credit Losses Simplification (ASU 2025-05)** – Introduced a practical expedient for measuring expected credit losses on trade receivables and contract assets, reducing implementation complexity while maintaining decision-useful information
- **Retainage Disclosures in Construction Contracts** – Issued an FASB Staff Educational Paper clarifying GAAP presentation and disclosure of retainage under Topic 606, including voluntary disclosure examples to enhance transparency

Active Research Projects

- **Lease Accounting Simplifications** – Exploring relief in areas such as embedded leases, related-party lease disclosures, and lease modifications. A dedicated working group is evaluating options to reduce complexity while preserving transparency
- **Subjective Acceleration Clauses (SAC)** – Developing a trigger-based model for debt classification, replacing complex probability assessments with a more practical approach based on actual lender actions
- **Debt Modifications and Troubled Debt Restructurings (TDR)** – Investigating simplifications to reduce the cost and complexity of applying current guidance, with a working group formed to explore alternatives
  - New topics, such as ESOP repurchase obligation disclosures, have been added to the research agenda for 2026

Research Areas Concluded (No Further Action)

- **Optional Single Lease Classification Model** – Determined to be disruptive and not aligned with user needs
- **Weighted-Average Disclosures** – Found to be useful and not overly burdensome
- **Short-Cycle Manufacturing Revenue** – Not considered pervasive enough to warrant further action
- **Low-Value Lease Scope Exception** – Existing materiality guidance deemed sufficient
- **Interest Method Simplification** – Deprioritized in favor of more pressing debt-related issues

Chapter 2

FASB Stage 3 PIR Report Findings – ASC 842, *Leases*

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Learning Objectives

- After completing this chapter, you should be familiar with:
  - The results and findings of the FASB's Final (Stage 3) Post-Implementation Review (PIR) Report Topic 842

Stage 3 – The Final PIR Process for ASC Topic 842, *Leases*

Objectives of the PIR Process

1. Determine whether ASC 841 is accomplishing its stated purpose
2. Evaluate the implementation and continuing compliance costs, as well as the benefits realized by various stakeholders, including preparers, investors, and regulators
3. Provide feedback to the standard-setting process

Timeline of the PIR Process for ASC 606

- Stage 1
  - 2016: ASC 842 formally issued, beginning Stage 1 (despite deferral of effective dates)
- Stage 2
  - 2016–2025: Evaluated the actual costs and benefits of the standard post-implementation. During stage 2, which begins after the effective date of the final standard and continues for approximately three to five years, the FASB undertakes activities to:
    - Understand the costs that an entity incurred in applying the standard and understand the costs that investors and other users incurred in analyzing and interpreting the information in the standard
    - Understand the benefits of the standard to investors, entities, and other stakeholders
    - Monitor the ongoing application of the standard
- Stage 3
  - Final report issued after public meeting in November 2025

Stakeholders Engaged

- The FASB used a multi-faceted approach to gather feedback. They conducted individual interviews and hosted group discussions. They organized advisory group meetings, public roundtables, and stakeholder surveys. They delivered webcasts and participated in conferences, and they solicited and reviewed comment letters in response to exposure drafts
  - **Investors** – Including buy-side and sell-side analysts, accounting analysts, credit rating agency professionals, lenders, and private equity firms
  - **Preparers** – Public and private companies, as well as not-for-profit entities, across a wide spectrum of industries and sizes
  - **Practitioners** – Representatives from audit and consulting firms at the international, national, and regional levels
  - **Other stakeholders** – Academics, state CPA societies, trade organizations, regulators, and other standard setters

Summary of Leases (Topic 842) PIR Results

- FASB determined that Topic 842 successfully met its primary goal of recognizing lease assets and liabilities on lessees' balance sheets, enhancing visibility of lease obligations
- Stakeholder feedback was mixed
  - Investors and other users generally agree they now receive more decision-useful information about companies' leasing activities
  - For lessees, the cost and complexity of implementation were significantly higher than initially expected by the FASB due to unanticipated system and process overhauls
  - Lessors' experience was smoother, with minimal implementation effort needed because lessor accounting changed only modestly from prior GAAP

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Significance of Implementation Costs – Lessees

- Implementing the new lessee accounting requirements entailed substantial one-time and ongoing costs
- Preparers report that initial adoption costs were significantly higher than the FASB anticipated, and continuing compliance remains costly
- Key cost drivers:
  - **System upgrades and software** – Most companies discovered their existing IT systems couldn't handle the new standard's demands, especially the need to track operating leases on the balance sheet. This led to purchasing new lease accounting software or heavily modifying systems. Many entities also needed to develop processes for amortizing right-of-use assets for operating leases, a concept that didn't exist under prior GAAP
  - **Comprehensive contract reviews** – Implementing Topic 842 required identifying all arrangements that contain a lease, including embedded leases, which were often difficult and costly to identify. Many lessees undertook painstaking reviews of contracts (real estate, equipment, service agreements, etc.) to find embedded leases and gather data on lease terms

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Significance of Implementation Costs – Lessees

- Key cost drivers (continued):
  - **Data capture and entry** – Companies had to extract lease terms (payments, duration, renewal/termination options, etc.) from contracts and input them into new systems
    - Ensuring completeness and accuracy of lease data demanded significant time and effort from accounting teams and consultants
  - **Increased staffing and training** – Preparers often needed to hire additional staff or consultants specialized in lease accounting. Existing employees required training on Topic 842. Firms also incurred higher audit fees, as auditors spent more time reviewing lease implementations
  - **Ongoing compliance** – Even after adoption, lessees face higher ongoing costs for maintaining lease inventories, updating for modifications, and generating enhanced disclosures each period
    - These recurring costs (e.g., software maintenance and internal controls) have generally been higher than the Board's original expectations for post-implementation compliance

Significance of Implementation Costs – Lessors

- Costs for lessors to implement and comply with Topic 842 have been low because Topic 842 largely retained the prior lease accounting model for lessors
  - **Little systems overhaul needed** – Lessor systems and processes for lease accounting (e.g., recognize lease receivables, perform lease classification) remained largely unchanged, avoiding significant new costs
  - **Targeted improvements only** – The FASB issued a few narrow updates for lessors (for example, eliminating leveraged lease accounting and aligning revenue recognition timing). These tweaks were not cost-intensive, and the Board provided transition relief where needed

Biggest 7 Challenges (in Order) for Lessees in Applying Topic 842

1. **Determining the discount rate** – Lessees must record lease liabilities at the present value of lease payments, which requires selecting an appropriate discount rate (incremental borrowing rate or the rate implicit in the lease). Private companies got relief by being allowed to use a risk-free rate, but for many lessees, especially public companies, estimating the correct discount rate for each lease was a complex and judgmental task that gained new scrutiny once lease liabilities were on the balance sheet
2. **Recognition and measurement** – Lessees struggled with the appropriate recognition of shipping costs, installation costs, ROU impairments, accounting for lease incentives, and the interaction of the requirements with business combination accounting under other standards. The FASB noted that these challenges were higher in the initial adoption period and have decreased over time
3. **Related parties** – Under ASC 842, **related party leases are treated the same as all other lease arrangements**. There is no separate guidance except for leases under common control arrangements (ASU 2023-01). The common control arrangements presented the biggest challenge for related party leases, which led to the issuance of the ASU

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Biggest 7 Challenges (in Order) for Lessees in Applying Topic 842

4. **Lease modifications and remeasurements** – The accounting for lease modifications (changes in lease scope or consideration) under Topic 842 can be complex. Depending on the nature of the change, a modification might be treated as a separate new lease or a remeasurement of the existing lease. Stakeholders reported difficulty applying the modification guidance, which often requires significant judgment and can affect multiple balances. This area was a notable change from legacy GAAP and required careful analysis
5. **Identifying *all* lease arrangements, with a focus on embedded leases** – Because Topic 842 requires bringing operating leases onto the balance sheet, companies had to scrutinize contracts enterprise-wide. Determining whether an arrangement "contains a lease" became a routine process. Lessees had to evaluate service agreements, supply contracts, and other agreements to find embedded leases (identified assets with control by the customer). This was more challenging than under prior rules, as previously many operating leases were just disclosed and not systematically tracked

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Biggest 7 Challenges (in Order) for Lessees in Applying Topic 842

6. **Sale-and-leaseback transactions, including built-to-suit arrangements** – Topic 842 implemented new rules for sale-leaseback (where an asset is sold and then leased back by the seller). These rules focus on establishing that a *true sale* has occurred under revenue recognition guidance. Preparers found the sale-leaseback guidance challenging, as it changed prior practice and required analyzing whether control of the asset transfers to the buyer/lessor. Determining if a sale took place (and when to recognize gain/loss) introduced complexity in these transactions. Under previous GAAP, "build-to-suit" leases had unique guidance. Topic 842 removed some of that and aligned more with the new control model, but accounting for unique or complex arrangements (like build-to-suit) still requires significant judgment. Lessees mentioned these areas as tough to navigate, although they are relatively niche

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Biggest 7 Challenges (in Order) for Lessees in Applying Topic 842

7. **Allocating between lease and nonlease components** – Contracts often bundle lease components (right to use an asset) with nonlease components (services or maintenance). Under Topic 842, lessees must separate lease components from service components to account for each appropriately (unless a practical expedient to combine is elected). Determining that split for each contract (and whether a contract even *contains* a lease) proved difficult and time-consuming for many companies

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What Is Next for the Lessee Challenges?

- Despite these challenges, it's important to note that many difficulties were mitigated over time through FASB staff guidance, new ASUs, and companies' growing experience
- The FASB's PIR found that no fundamental changes to the lessee model are deemed necessary now
  - *Stakeholders prefer not to overhaul the standard again*
- However, private company constituents continue to seek practical expedients or simplifications to ease ongoing compliance burdens (e.g., simpler discount rate options), indicating some challenges persist for smaller entities

Three Minor Lessor Challenges

1. **Recognition and measurement** – Despite minimal changes to lessor accounting, lessors still reported the most difficulties with recognition and measurement, particularly as it relates to sales taxes and other similar taxes collected as part of the lease transaction. The FASB responded by allowing lessors to make an election to skip the evaluation of such taxes altogether and not account for those taxes as lessor costs
2. **Allocating between lease and nonlease components** – Aligning lessor accounting with the revenue recognition model (Topic 606) led to some initial confusion, for example, how to handle certain variable payments or classification criteria differences
3. **Interaction with Topic 606 and Topic 610** – Minor issues

Key Benefits Observed From Implementing Topic 842

- **Increased balance sheet transparency for investors** – The *primary benefit* of Topic 842 is that it (largely) ended the widespread off-balance sheet accounting for leases
  - Virtually all leases (other than short-term leases) now result in a right-of-use asset and lease liability on the balance sheet, whereas under legacy GAAP operating leases were invisible on the balance sheet
  - This gives investors and lenders a more faithful representation of a company's financial position regarding leased assets and obligations. Investors have better data to analyze leverage and obligations. For instance, they no longer must estimate lease liabilities from footnote disclosures, improving comparability across companies and industries

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Key Benefits Observed From Implementing Topic 842

- **Enhanced disclosures and visibility of lease commitments** – Stakeholders broadly agree that qualitative and quantitative disclosures about leasing improved under Topic 842. The standard introduced new disclosure requirements (e.g., weighted-average lease term, discount rate, maturity analysis of lease obligations, and information about lease variable payments and options)
- Investors commented that these disclosures are a notable improvement over the boilerplate or minimal disclosures under old rules, giving deeper insight into companies' leasing arrangements
  - For example, the PIR cites that "*almost all investors agree that the disclosures provided under Topic 842 are an improvement to those provided under legacy GAAP*"

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Key Benefits Observed From Implementing Topic 842

- **Improved internal controls and lease management** – Many preparers (lessees) reported an unintended but positive consequence of implementing Topic 842 – it forced a thorough inventory of lease contracts and better cross-functional processes. By having to identify and quantify all leases, companies often discovered contract management weaknesses and subsequently strengthened internal controls around leasing and procurement
- Organizations established new procedures to ensure completeness of lease recording and to monitor lease changes, which in many cases improved governance over contracts
  - Lessees gained better visibility into their lease portfolios and exposures, which is beneficial for management and auditors beyond just financial reporting compliance

Key Benefits Observed From Implementing Topic 842

- **Greater comparability of financial statements** – Bringing leases on the balance sheet enhances comparability between companies that lease assets and those that borrow to buy assets. Under legacy GAAP, a company heavily using operating leases appeared less leveraged than a company owning assets with debt, even if the economic position was similar
    - Now, the playing field is more level, as lease liabilities are visible and can be compared or combined with debt obligations to assess true leverage
- **This benefit was a key objective stated by FASB (improving understanding of commitments regardless of financing method), and PIR feedback indicates this goal was achieved**

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Key Benefits Observed From Implementing Topic 842

- **Alignment for lessors with revenue recognition** – Although lessor accounting didn't drastically change, one benefit of Topic 842 was better alignment of lessor guidance with the new revenue recognition standard (ASC 606)
- The PIR notes that Topic 842's lessor provisions were brought closer in line with the concepts of control and revenue recognition
  - For example, the definition of a lease and certain classification criteria were adjusted to mirror revenue principles
- Stakeholders see this as a benefit because it reduces conceptual inconsistencies and is especially helpful when companies are both sellers and lessors (like manufacturers leasing their equipment)

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Key Benefits Observed From Implementing Topic 842

- **Preservation of relevant information for lessors** – Investors generally remain satisfied with the information provided by lessors under Topic 842. Key metrics (lease income, residual values, etc.) are still reported in ways similar to before, meaning useful trend information was preserved, while incremental improvements (like additional disclosures on lessors' exposure to risks) were added
- In essence, lessors kept the familiar reporting (no loss of decision-useful info) and gained some alignment benefits, which was in line with what the Board intended.

Expected vs. Actual Outcomes: Lessees vs. Lessors

	Lessees – Expected (FASB's assumptions)	**Lessees – Actual Outcome (PIR findings)**	**Lessors – Expected (FASB's assumptions)**	**Lessors – Actual Outcome (PIR findings)**
Implementation Costs	*Moderate* incremental costs. Many companies anticipated using existing systems and processes from legacy GAAP; once initial setup was done, ongoing compliance costs would be only slightly higher than under old lease rules.	Significantly higher than expected. Widespread system limitations forced most lessees to purchase new software or overhaul processes. Substantial effort to identify all leases and inputs led to much greater one-time and ongoing costs than the Board envisioned. Many firms needed extra staff/consultants and continue to incur higher compliance costs annually.	*Minimal* changes needed. Because Topic 842 left most lessor accounting unchanged, the Board expected little cost impact for lessors. Preparers and the FASB assumed legacy systems and methods could handle the new standard with negligible effort or expense.	Minimal costs realized, as expected. Most lessors did not incur significant costs to implement or comply. Systems and processes were indeed adequate. The only investments were minor updates (for targeted amendments aligning with revenue recognition), which were not costly.

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Expected vs. Actual Outcomes: Lessees vs. Lessors

	Lessees – Expected (FASB's assumptions)	Lessees – Actual Outcome (PIR findings)	Lessors – Expected (FASB's assumptions)	Lessors – Actual Outcome (PIR findings)
Key Challenges	*(Anticipated as low)* – FASB did not fully expect major operational challenges since lessee concepts (e.g., lease classification, lease term, etc.) were similar to old GAAP, and stakeholders downplayed implementation difficulty during development.	Numerous challenges emerged. Lessees faced unforeseen complexity in gathering complete lease data, applying new judgments (discount rates, options), and updating controls. The PIR found a "significant gap" between what preparers thought would be needed and the real-world complexity, especially in contract reviews, component separation, and lease modifications.	*(Anticipated as low)* – With no fundamental changes to the lessor model, the Board foresaw few challenges for lessors. Any issues would likely be minor clarifications, given alignment efforts with Topic 606 and removal of outdated concepts like leveraged leases.	Few challenges in practice. Lessor feedback confirmed no significant ongoing issues in applying 842. A few lessors requested fixes (e.g., for sales-type lease definitions, handling certain variable payments), which FASB addressed through small improvements, but overall, the lessor model was operational as intended.

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Expected vs. Actual Outcomes: Lessees vs. Lessors

	Lessees – Expected (FASB's assumptions)	Lessees – Actual Outcome (PIR findings)	Lessors – Expected (FASB's assumptions)	Lessors – Actual Outcome (PIR findings)
Benefits of New Standard	Greater transparency and comparability from on-balance-sheet leases; improved lease disclosures; better insight into lease obligations for investors and creditors; closer alignment between lease accounting and the economics of transactions (fewer structuring opportunities). Also expected: stronger internal controls as companies formalize lease processes (acknowledged qualitatively in basis for conclusions).	Key benefits achieved. Investors report more useful information on lessee finances (lease liabilities now visible) and generally affirm that Topic 842's disclosures and balance sheet recognition met their needs. Preparers and auditors note improved internal lease controls and awareness. Some investors had mixed views on the *magnitude* of benefits, but *almost all agree disclosures are better than before*. Overall, benefits realized match those intended, with no major benefits gap identified in PIR.	Preserve useful info from legacy GAAP while aligning with new revenue standard; give users additional details on lessors' leasing risks; minimal disruption to lessor financial reporting.	Outcome met expectations. Investors are satisfied with lessor information under 842, indicating that the standard maintained decision-useful data for lessors. The intended alignment with revenue guidance was accomplished, and users received some incremental disclosures about lessors' exposure to risk, without unexpected consequences. Benefits for the lessor side were essentially "as expected" in the PIR findings.

PIR Conclusions and Next Steps

- The post-implementation review of Topic 842 validates that the lease standard successfully addressed the core problem of off-balance sheet financing through lease accounting, providing more faithful representation of lease obligations and useful information to investors
- Experienced CPAs should recognize that, despite initial hurdles, the standard has led to better financial reporting outcomes and improved internal practices around leases
- The FASB has noted that no immediate standard-setting changes to Topic 842 are warranted as a result of the PIR
  - Partially because the FASB has issued clarifying ASUs since initial implementation

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PIR Conclusions and Next Steps

- Board will continue to monitor feedback, particularly on reducing ongoing compliance costs for lessees (for instance, through the Private Company Council for smaller entities)
- Future standard-setting projects will also incorporate lessons learned from this PIR, such as the importance of thoroughly assessing system readiness and transition complexity during the development of major standards

Chapter 3

Recent AICPA, PCAOB, and SEC Activity

Learning Objectives

- After completing this chapter, you should be able to:
  - Understand recently issued AICPA and PCAOB standards and SEC rulemaking;
  - Identify the AICPA's and PCAOB's priorities for 2025;
  - Gain familiarity with the standards on the horizon; and
  - Gain an understanding of recent PCAOB inspection results and areas of emphasis

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Evolution of AICPA Professional Standards

- Align standards with IAASB
- Environmental drivers form the focus for the future:
  - Emerging technology and the extent of its use;
  - Increasing complexity in business transactions and globalization;
  - Complexity in financial reporting standards where more estimates and management judgments come into play;
  - External reporting with users of financial statements asking for additional information about internal control, sustainability, cybersecurity, and governance; and
  - Changing expectations of stakeholders

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Audit Standards Effective for 2025, 2026, and Beyond

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SAS No. 149, *Special Considerations – Audits of Group Financial Statements (Including the Work of Component Auditors and Audits of Referred-to Auditors)*

- Supersedes AU-C section 600 of SAS No. 122 and amends other existing SASs
- Issued alongside Statement on Quality Management Standards (SQMS) No. 3 that amends QM Section 10 and QM Section 20
- Provides a risk-based approach to planning and performing group audits
  - Replaces the determinants of “significant component” language of AU-C section 600 with the auditor’s professional judgment in determining significant components based on the auditor’s assessed risks

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SAS 149 – Main Provisions and Timing

- Establishes the term "referred-to auditor"
  - "An auditor who performs an audit of the financial statements of a component to which the group engagement partner determines to make reference in the auditor's report on the group financial statements"
  - Makes clear that a referred-to auditor is ***not*** a part of the engagement team for a group audit and is ***not*** considered a component auditor
    - A component auditor is part of the engagement team
    - Updates AU-C 600 to align it with definitions in SAS No. 146
- Investments accounted for under the equity method of accounting are components and subject to SAS No. 149 guidance
- Effective for audits of group financial statements for periods ending on or after December 15, 2026
  - SQMS No. 3 is effective concurrently with effective dates in QM 10 and QM 20

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Prior SASs Effective for 2025 Audits

148	*Amendments to AU-C Section 935, Compliance Audits*	• Updates AU-C section 935, *Compliance Audits*, to align with the issuance of SASs 142–145 • Updates requirements of compliance audits related to the auditor's responsibility in applying requirements related to control activities • Updates guidance and requirements related to identifying and assessing the risk of material noncompliance and its related documentation • Effective dates are aligned with SAS 142 and SAS 145
146	*SAS 146 (SSARS 26) – Quality Management for an Engagement Conducted in Accordance With GAAS (SSARS)*	• Clarifies that the engagement partner is ultimately responsible for the engagement even though that person may assign certain tasks to others within the engagement team • Effective for engagements conducted in accordance with GAAS for periods beginning on or after December 15, 2025

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Recently Issued SSARS

- SSARS No. 27, *Applicability of AR-C Section 70 to Financial Statements Prepared as Part of a Consulting Services Engagement*
  - Amends scope paragraphs of AR-C section 70 to clarify that the accountant is not required to apply (but not precluded from applying) AR-C section 70 "when an accountant prepares financial statements or prospective financial information as part of a consulting services engagement performed in accordance with CS section 100 in which the preparation of financial statements is not the primary objective of the engagement"
  - Effective for the preparation of financial statements for periods ending on or after December 15, 2026
    - Early implementation is permitted

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Recently Effective Updates to the Code

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Recently Enacted PEEC Interpretations

- Revisions to Engagements Subject to the Statements on Standards for Attestation Engagements
- ET section 1.275.005
  - Simultaneous Employment or Association With an Attest Client
    - Effective as of September 15, 2026, with early adoption permitted
- ET section 1.295.135
  - Executive or Employee Recruiting
- ET sections 1.230.030 and 1.230.040
  - Determining Fees for an Attest Engagement
  - Fee Dependency
- ET section 1.240.070
  - Section 529 Plans

New Definition and Technical Wording Changes for ET Section 1.220.030

- **Period covered by the attest report**. The point in time or period of time to which the subject matter of the *attest engagement* relates. The period covered by the attest report can vary depending on the scope of the *attest engagement*
- Also replaces much of the language focused on audit standards with "professional standards applicable to the attest engagement, such as AU-C…"
- Replaces "audit" with "attest" throughout the Code section
- Effective as of June 15, 2026

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Period Covered by the Attest Report – Examples

Examples of engagements performed in accordance with Statements on Auditing Standards or Statements on Standards for Accounting and Review Services	Examples of engagements performed in accordance with Statements on Standards for Attestation Engagements
a. The fiscal- or calendar-year period covered by an audit or review report on a complete set of financial statements, such as "as of and for the year ended December 31, 20X0" b. The single day covered by an audit or review report on a balance sheet, such as "as of December 31, 20X0"	a. The six-month period covered by an examination report on the controls at a service organization, such as "for the six-month period ending September 30, 20X0" b. The fiscal- or calendar-year period covered by an examination or review report on greenhouse gas emissions information, such as "for the year ended December 31, 20X0"

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ET Section 1.275.005 – Simultaneous Employment or Association With an Attest Client

- New definition added to the Code – **Simultaneously employed or associated**
- *“When a partner or professional employee of the member’s firm serves as a member of those charged with governance or as an employee of an attest client during the period of the professional engagement. This includes contractual or volunteer positions at the attest client”*

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ET Section 1.275.005 – Threats to Independence

- "The familiarity, management participation, advocacy, self-interest, or self-review *threats* to compliance with the 'Independence Rule' would **not** be at an *acceptable level* and could **not** be reduced to an *acceptable level* by the application of *safeguards*, and *independence* would be *impaired* when:
  - A *covered member* is *simultaneously employed or associated* with the *attest client*; or
  - A *partner* or professional employee who is not a *covered member* is *simultaneously employed or associated in a key position* with the *attest client*"
    - *"Key position"* term replaces former "officer or director" language

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ET Section 1.275.005 – Threats to Independence

- "When a partner or professional employee intends to accept an offer to become simultaneously employed or associated with an attest client:
  - The person should promptly report the offer to an appropriate person in the firm; and
  - The appropriate person should apply the "Conceptual Framework for Independence" interpretation [1.210.010] to evaluate whether the familiarity, management participation, advocacy, self-interest, and self-review threats are at an acceptable level"
- An inadvertent and isolated failure to apply the above will not impair independence if the impacted parties perform the required procedures upon discovery of the failure and continue to meet the rest of the standard in 1.275

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ET Section 1.275.005 – Threats to Independence

- Factors to consider if the threat is at an acceptable level
  - The person's position and role at the attest client – The more responsibility and visibility, the higher the threat
  - The person's position and role at the firm – The more significant, the higher the threat
  - The level of assurance of the attest engagement – Audit clients likely present a higher threat than other assurance engagements
  - The nature and scope of the activity to be performed
  - The size and structure of the attest client – The smaller the client, the larger the threat
  - The length and status of the simultaneous employment/arrangement – The longer/full-time association is riskier than a short-term/temporary position
  - The value of compensation paid to the member – If material to the member's net worth, the threat is higher

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ET Section 1.275.005 – Safeguards to Threats

- Examples of actions that may be safeguards:
  - Designating an appropriate reviewer who has **not** provided services to the attest client to review the attest work performed
  - Modifying the individual's position or role at the attest client sufficiently so that threats to independence are reduced to an acceptable level
- Note that communication with those charged with governance regarding threats is a safeguard but is not a sufficient safeguard independently. It must be applied with other safeguards like those listed above

ET Section 1.275.005 – Independent Contractors

- When an employee of an attest client is engaged as an independent contractor (IC) by the firm to perform professional services for the attest client, independence **would be impaired** if the same employee is **any** one of the following:
  - A member of the attest engagement team for the same attest client
  - An individual in a position to influence the attest engagement for the same attest client
  - In a key position at the same attest client
  - Serving in a role held by those charged with governance at the same attest client

ET Section 1.275.005 – Exceptions to the Rule

Threats will be at an acceptable level, and independence will not be impaired when:

a. A partner or professional employee of the member's firm serves as an adjunct faculty member of an educational institution that is an attest client of the firm, and the partner or professional employee meets all the following safeguards:
   i. They are not in a key position or in a role held by those charged with governance at the educational institution
   ii. They are not a member of the attest engagement team
   iii. They are not an individual in a position to influence the attest engagement

b. A member in a government audit organization performs an attest engagement with respect to the government entity, and the head of the government audit organization meets at least one of the following criteria:
   i. They are directly elected by voters of the government entity with respect to which attest engagements are performed
   ii. They are appointed by a legislative body and are subject to removal by a legislative body
   iii. They are appointed by someone other than the legislative body, as long as the appointment is confirmed by the legislative body, and removal is subject to oversight or approval by the legislative body

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ET Section 1.240.070 – Section 529 Plans

- A 529 plan is a tax-advantaged savings plan designed to help families save for education expenses
  - Represents an investment vehicle for future qualified education expenses
  - Plans may be:
    - Prepaid tuition plans
    - Savings plans
  - The plan designation impacts the independence interpretation
  - Account owner can designate themselves or another individual as the beneficiary and may change this designation over time
- The updated interpretation is effective as of May 31, 2025

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ET Section 1.240.070 – Section 529 Plans – Prepaid Tuition Plans

- The account owner of a Section 529 prepaid tuition plan is considered to have a direct financial interest in the plan. Accordingly, if the plan is an attest client, **independence would be impaired if a covered member is an account owner**
- With respect to the plan's underlying investments, the account owner does **not have any financial interests**

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ET Section 1.240.070 – Section 529 Plans – Savings Plans

- The interpretation finds that the account owner's interest in the **savings** plan's underlying investments constitutes an **indirect** financial interest rather than a direct one
  - Prior guidance classified the underlying investment a **direct** investment
- When the underlying investments in an account owner's Section 529 savings plan do not include an attest client, there are no threats to independence
- When an underlying investment in an account owner's Section 529 savings plan is an attest client, threats to independence may exist if the account owner is a covered member with respect to the underlying investment

ET Section 1.240.070 – Section 529 Plans – Savings Plans

- If the underlying investment in the attest client is material to the covered member, the self-interest threat would not be at an acceptable level, and independence would be impaired unless the covered member deployed one of the following safeguards:
  1. Reallocating plan holdings such that there is no material indirect financial interest in an attest client for which the member is a covered member
  2. Transferring the account to another sponsor's Section 529 savings plan that does not include a material indirect financial interest in an attest client for which the member is a covered member
  3. Transferring the account to another account owner who is not subject to the "Independence Rule" [1.200.001]
- The safeguard should be applied as soon as practicable but no later than 30 days after the covered member has knowledge of the material indirect financial interest

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ET Section 1.295.135 – Executive or Employee Recruiting (Attest Clients)

- The recruiting guidance introduced new prohibitions for members performing recruiting services for **attest** clients
- The updated guidance is effective as of January 1, 2026
  - Early implementation was allowed

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ET Section 1.295.135 – Threats to Independence in Recruitment Services

- Specifically, the following actions by a member **would represent a threat** to independence:
  - Hiring or terminating the attest client's employees (item prohibited under previous guidance)
  - Advising on the specific terms of employment, remuneration, or related benefits of a particular candidate for a key position
  - Searching for or seeking out candidates for key positions
  - Undertaking reference checks of prospective candidates for a key position
  - Recommending to the attest client only one candidate for consideration for a key position
  - Ranking candidates for a key position whether or not using the attest client's criteria
  - Negotiating with the candidate on behalf of the attest client
  - Committing the attest client to employee compensation or benefit arrangements

ET Section 1.295.135 – Threats to Independence in Recruitment Services

- While there are new prohibitions, the new guidance also identifies activities where threats would likely be at an acceptable level, **and independence would not be impaired**:
  - Recommending or advising on a position description or candidate specifications
  - Advising on the general terms of employment, remuneration, or related benefits of a particular position
  - Searching for or seeking out candidates for non-key positions using the attest client’s criteria, such as required education, skills, or experience
  - Reviewing candidate resumes provided by the attest client to identify those who meet the attest client’s criteria
  - Interviewing candidates and advising on a candidate’s competence based on the attest client’s criteria for any position
  - Recommending to the attest client more than one candidate for any position for consideration based on the attest client’s criteria, including providing analysis of how each candidate meets the attest client’s criteria. If only one candidate for a non-key position meets the attest client’s criteria, the member should apply the “Conceptual Framework for Independence” interpretation [1.210.010] to evaluate whether the threats are at an acceptable level

ET Section 1.230.040 – *Fee Dependency*

- The “Fee Dependency” interpretation (ET sec. 1.230.040) addresses the self-interest and undue influence risks that occur when a significant portion of a firm’s revenue is derived from a single attest client
- This interpretation aids firms and covered members in assessing and mitigating independence risks associated with substantial fee dependency on an attest client, which could lead to concerns over losing the client and undue influence threat
- If fee dependency remains for five years or more, the firm must put enhanced safeguards in place for the dependent engagement

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Fee-Related Independence Threats

- To help members identify fee-related independence threats, the PEEC enhanced the "Conceptual Framework for Independence" (ET section 1.210.010) with updated examples of threats
- The "Client Affiliates" interpretation (ET section 1.224.010) has also been revised to clarify the affiliates subject to the fee-dependency requirements
- Changes are effective as of January 1, 2025
  - Early adoption was permitted

Select SEC and PCAOB Updates

PCAOB: AS 2310, *The Auditor's Use of Confirmation*

- Effective for audits of financial statements for fiscal years ending on or after June 15, 2025
- Updates the confirmation standard that was adopted on an interim basis by the PCAOB at its formation and that had not been updated since 1992
- The updated standard moves to a principles-based approach to confirmations to allow for technological advancements and flexibility and removes references to fax machines and traditional mail

PCAOB: AS 2310, *The Auditor's Use of Confirmation*

- The standard clarifies that negative confirmations alone are **not** sufficient audit evidence for accounts receivable
  - The auditors must perform other substantive audit procedures if negative confirmations are used
- The new standard also reaffirms that the auditor is responsible for maintaining control over the confirmation process and must be the one to select the items to be confirmed, send the confirmation requests, and receive confirmation responses
- In modernizing the standard, "the auditor or the confirming party can engage another party as an intermediary to facilitate direct electronic transmission of confirmation requests and responses between the auditor and the confirming party. When using an intermediary for this purpose, the auditor should evaluate the implications on the reliability of confirmation requests and responses"

PCAOB: AS 2310, *The Auditor's Use of Confirmation*

- AS 2310 also establishes that the auditor **should perform audit procedures for cash and cash equivalents held by third parties** in addition to accounts receivable. When the auditor determines it is not feasible to obtain audit evidence, the auditor should obtain external audit evidence indirectly by performing other audit procedures
  - This requirement had not been part of the previous standard

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PCAOB Release No. 2024-007

- In June 2024, in issuing PCAOB Release No. 2024-007, the PCAOB adopted significant amendments to Auditing Standards (AS) 1105 and AS 2301, which focused on modernizing audit requirements in light of technology-assisted analysis used by auditors. The changes clarify auditor responsibilities when using data analytics and other technology-based tools to obtain and evaluate audit evidence, ensuring auditors continue to obtain sufficient appropriate evidence in an era of increasing electronic data, AI, and analytic procedures. These amendments are principles-based (not prescribing specific tools) and adaptable to evolving technology, and they apply to all PCAOB audits for fiscal years beginning on or after December 15, 2025, following approval by the SEC in August of 2024. The key standards changed were:
  - **AS 2301 – The Auditor's Responses to the Risks of Material Misstatement**
  - **AS 1105 – Audit Evidence**

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PCAOB: AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*

Clarified definition of a "test of details"

- Now defined in the standards as procedures on ***individual items*** in an account or disclosure, distinguishing them from analytical procedures
- This can include dates, amounts, or terms. Auditors must apply appropriate procedures to each item selected for testing. This clarification (now located in AS 2301.48) addresses confusion over whether data-analytic procedures can constitute tests of details
- It makes clear that analytics can be designed as tests of details if applied at **the item level and aimed at a substantive objective**

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PCAOB: AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*

Investigation of identified items (outliers)

- When using technology-assisted analysis to perform a test of details on a full population or specific items, auditors often identify outliers or unusual items
- New AS 2301.49 requires auditors to investigate items identified through such procedures as part of their response to risk. The auditor must determine whether the identified items indicate a misstatement or a control deficiency, individually or in aggregate
- This ensures apparent anomalies flagged by data analytics are appropriately followed up with additional audit work rather than ignored

PCAOB: AS 2301, *The Auditor's Responses to the Risks of Material Misstatement*

Selecting specific items vs. full population

- If an auditor tests specific items (nonstatistical selection) rather than an entire population or a statistically verified representative sample, new AS 2301.50 addresses the risk in the remaining, untested items
- Auditors must evaluate whether untested items could contain a material misstatement and, if there's a reasonable possibility, perform additional substantive procedures to cover that risk
- This closes a gap in prior standards by explicitly requiring auditors to consider what hasn't been tested when using targeted selection (often done with data analytic tools)

PCAOB: AS 1105, *Audit Evidence*

Using one procedure for multiple purposes

- Amendments to AS 1105.14 make it explicit that if an audit procedure is designed to achieve more than one objective (for example, a single data analytics procedure used both to identify risks and to obtain substantive evidence), the auditor must achieve each relevant objective of that procedure
- In practice, this means auditors can't double-count one analytical procedure for two purposes without meeting the full requirements of both. For instance, an automated transaction analysis might serve to pinpoint risk areas and test transactions. In doing so, the auditor should ensure it meets the standards for risk assessment and for substantive testing, or supplement it as needed

PCAOB: AS 1105, *Audit Evidence*

Evaluating reliability of external information (electronic)

- A major update is the addition of AS 1105.10A, which codifies auditors' responsibilities when using external information obtained by the company and provided to auditors in electronic form. Examples include bank statements, invoices, or confirmations that the company downloads or receives and then gives to the auditor. The auditor's requirements involve:
  - "Obtaining an understanding of (1) the source from which the company received the information; and (2) the company's process by which such information was received, maintained, and, where applicable, processed, which includes understanding the nature of any modifications made to the information before it was provided to the auditor; and
  - Testing the information to determine whether it has been modified by the company and evaluating the effect of those modifications; or testing controls over receiving, maintaining, and processing the information (including, where applicable, information technology general controls and automated application controls)."

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PCAOB: AS 1105, *Audit Evidence*

Emphasis on information technology (IT) controls

- The amendments reinforce the notion that effective IT controls at the company directly affect the reliability of information used as audit evidence. AS 1105.08 (which discusses reliability of evidence) and related provisions were amended to highlight that information from electronic sources is more reliable if the company's relevant IT general controls and application controls are effective
  - For example, if a company's report is generated from an IT system, the trustworthiness of that report improves if the underlying system access controls, change management, and data processing controls are sound. Auditors are reminded (and now explicitly required) to factor in IT control effectiveness when evaluating evidence quality and when deciding whether further procedures are needed to validate information
- Additionally, AS 1105.10 was updated to explicitly mention testing IT controls as one way to verify the accuracy and completeness of information produced by the company (see clause (1) of .10), and AS 2501.12 (estimates standard) was conformed to reference IT controls in this context

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PCAOB: AS 1105, *Audit Evidence*

Relevance and disaggregation of information

- AS 1105.07 was revised to stress that the relevance of audit evidence depends on its relationship to the assertion *and* on the level of detail (disaggregation) of the information relative to the audit objective. In practice, this means auditors should ensure that when using aggregated data or broad analytical procedures, the data is broken down sufficiently to actually address the risk in question
  - For instance, analyzing an entire revenue balance might not be relevant to a specific fraud risk if not disaggregated by region or product line. The standard now emphasizes using an appropriate level of detail so that evidence gathered is relevant to the specific audit assertion
- This concept ties into technology-assisted procedures because such tools enable analysis of large data sets
  - The auditor must choose the proper granularity for that analysis to be meaningful

Summary and Effective Dates

Effective date

- These amendments will become effective for audits of financial statements for fiscal years beginning on or after December 15, 2025
- Updates to AS 1105 and AS 2301 reinforce fundamental audit principles in the context of modern tools and practices by focusing on a principles-based approach to auditing instead of specific applications and tools. The common theme is ensuring audit quality in the age of data analytics
- The standards' language is now closer to the reality of today's audit environment, providing clearer guidance on points that have caused diversity in practice. These amendments, as the PCAOB noted, are "*principles-based and adaptable to evolving technology*," meaning they set expectations without being tied to any one tool, which is a necessary approach given the rapid change in audit technology

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Thank you!

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