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Coming in 2023: 5 New Accounting Rules

Accounting rules are complicated, to say the very least, and they are subject to rather frequent changes. The Financial Accounting Standards Board (FASB) is in charge of maintaining Generally Accepted Accounting Principles (GAAP) for many government agencies and private organizations in the United States. Since the FASB is not a government agency, its rules do not automatically have the force of law. The Securities and Exchange Commission (SEC), however, has adopted the FASB's standards and rules, meaning that all publicly-traded companies that are subject to the SEC's jurisdiction must abide by them. Even if an organization is not specifically bound by FASB's rules, following them is often highly advisable. At least five Accounting Standards Updates (ASUs) have gone into effect for various entities in 2023. The following provides an overview of the updated rules.

1. Accounting for Contract Assets and Contract Liabilities from Contracts with Customers

ASU No. 2021-08, Business Combinations (Topic 805): Accounting for Contract Assets and Contract Liabilities from Contracts with Customers, became effective for publicly-traded companies on January 1, 2023. It will take effect for private companies on January 1, 2024. It builds on ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606), which the FASB describes as a "single comprehensive accounting model on revenue recognition for contracts with customers."

The new ASU addresses questions about how a business that has adopted Topic 606 should account for contracts with customers acquired in a business combination. Under the previous rules, companies would measure contracts with customers at fair value. ASU No. 2021-08 directs companies to measure the assets and liabilities in contracts with customers as if they had originated the contracts themselves.

2. Disclosure of Supplier Finance Program Obligations

The FASB issued ASU No. 2022-04, Liabilities — Supplier Finance Programs (Subtopic 405-50): Disclosure of Supplier Finance Program Obligations, in the fall of 2022. It is effective for public companies in 2023 and for private companies in 2024.

The new ASU provides investors and others with greater transparency about companies' use of supplier finance programs. A supplier finance program allows companies to maintain cash reserves by having a third-party finance company pay invoices ahead of their due date at a discounted rate. Companies then have a set period of time to pay off the third-party providers. Companies must disclose key details about these programs in their financial statements.

3. Fair Value Hedging-Portfolio Layer Method

Issued in March 2022, ASU No. 2022-01, Derivatives and Hedging (Topic 815): Fair Value Hedging — Portfolio Layer Method, took effect for publicly-traded companies on January 1,

2023. Private companies must adopt it starting on January 1, 2024. It clarifies and expands on earlier rules regarding transactions intended to reduce the risk of loss, commonly known as hedging transactions. The goal is to promote accurate accounting of a company's risk management activities and reduce conflicts between hedge accounting methods and the Current Expected Credit Losses (CECL) method.

The new rule specifically addresses the last-of-layer method, which it renames the portfolio layer method. Previously, this method only allowed one hedged layer in a closed portfolio. It now allows multiple hedged layers.

4. Measurement of Credit Losses on Financial Instruments

ASU No. 2016-13, Financial Instruments — Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments, applies to organizations that "hold[] financial assets and net investment in leases that are not accounted for at fair value through net income." It has already taken effect for many publicly-traded companies. In 2023, it takes effect for small public companies, private companies and nonprofit organizations.

This rule affects how banks and other entities that extend credit account for losses associated with those loans. It states that covered entities must, upon making a loan, predict credit losses into the foreseeable future. They must then book those losses immediately.

5. Targeted Improvements to the Accounting for Long-Duration Contracts

The FASB issued ASU No. 2018-12, Financial Services — Insurance (Topic 944): Targeted Improvements to the Accounting for Long-Duration Contracts, more than four years ago. It deferred the rule's effective date twice, in part because it may require extensive — and expensive — software investments. It took effect for large publicly-traded insurance companies on January 1, 2023. It will not apply to private insurance companies until 2025, giving them more time to prepare.

The new rule requires insurers to make widespread changes to their accounting systems. Insurers covered by the rule must do the following on an annual basis:

- Review the assumptions they use to measure their cash flows;
- Modify those assumptions based on new circumstances; and
- Adjust their balance sheets, particularly with regard to their liabilities, to reflect the new assumptions.

The new Accounting Standards Updates outlined in this article provide an overview of the updated rules that organizations need to adopt in 2023 or 2024. It is crucial for companies to understand and implement these updates in their financial reporting to ensure transparency and accuracy. Failure to comply with the standards could result in penalties, legal liabilities, and reputational damage. By staying up-to-date with the latest accounting standards, companies can improve their financial reporting and make informed decisions to drive their business forward.

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