FASB In Focus

Proposed Accounting Standards Update—*Development Stage Entities*

What is a development stage entity, and what prompted the FASB to add this project to its agenda?

A development stage entity is a company or organization that devotes substantially all of its efforts to establishing a new business. In a development stage entity, planned principal operations have not started or, if they have started, have produced no significant revenue.

At its meeting on July 16, 2013, the Private Company Council (PCC) recommended that the FASB add a project to its technical agenda to address financial reporting complexity for all organizations in the development stage—not just private companies.

Why is the FASB proposing improvements to financial reporting about development stage entities?

The Board's objective in issuing this proposed Update is to improve financial reporting by reducing the cost and complexity associated with the incremental reporting requirements for a development stage entity.

Currently, U.S. Generally Accepted Accounting Principles (GAAP) requires development stage entities to present the same basic financial statements that are required of established operating organizations and to apply the same recognition and measurement requirements for revenues, start-up costs, and other similar costs incurred. In addition to these requirements, development stage entities also must present inception-to-date information about income statement line items, cash flows, and equity transactions.

Some users of financial statements of companies in the development stage have told the Board that distinguishing development stage entities from established companies serves little purpose and does not produce decision-useful information. They also have said that additional inception-to-date information and certain other disclosures currently required in the financial statements of development stage entities provide information of limited relevance. This is because many development stage entities with multiple products under development do not intend to ever manufacture a single product, but rather, may periodically sell the research and development to another business. Pharmaceutical, biotechnology, and technology industries are most likely to have long-term development stage entities affected by these requirements and it is now common for many of these entities to remain in the development stage for several years or even in perpetuity.

What are the changes being proposed, and why does the Board think they would be an improvement?

The Board believes the proposed changes would reduce data maintenance and audit costs by eliminating the requirement for development stage entities to report inception-to-date information in the statements of income, cash flows, and shareholder equity. They also believe the proposed changes would simplify the consolidation accounting guidance by removing the differential accounting requirements for development stage organizations. As a result of these changes, there would be no accounting or reporting differences between development stage entities and other operating entities.

Based on the input received from investors and other financial statement users, the Board is proposing to: 1) eliminate the inception-to-date information and the incremental disclosure requirements to label the financial statements as those of a development stage entity,
2) to disclose a description of the development stage activities in which the company is engaged, and 3) to disclose—in the first year in which the entity is no longer a development stage entity— that, in prior years, it had been in the development stage. Therefore, the proposed amendments would provide cost savings for preparers without reducing information relevance to users of financial statements.

Additionally, the proposed amendments would remove the guidance contained in paragraph 810-10-15-16 of the FASB *Accounting Standards Codification*®. This paragraph states that a development stage entity is not considered a variable interest entity subject to consolidation if (1) the entity can demonstrate that it has enough equity to finance the activities it is currently engaged in and (2) the entity's governing documents and contractual arrangements allow additional equity investments. Removing this guidance would mean that all entities would be evaluated for consolidation using the same guidance and may affect whether some development stage entities are evaluated as variable interest entities and consolidated in the financial statements of another enterprise or organization. Companies and enterprises that are within the scope of the Variable Interest Entities Subsections in the Codification (Topic 810-10, Consolidation), would be required to evaluate whether the total equity investment at risk is sufficient using the guidance provided in paragraphs 810-10-25-45 through 25-47, which requires both qualitative and quantitative evaluations. The Board believes that a single set of consolidation criteria applied by all reporting enterprises would benefit users of financial statements by providing more relevant and consistent consolidation decisions across all entities.

Who would be affected by the amendments in this proposed Update?

The proposed Update would affect entities that are development stage entities. In addition, it could affect the consolidation conclusions for a reporting entity that has an interest in an entity that is a development stage entity.

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When would the amendments be effective?

The amendments in this proposed Update would be effective in interim and annual periods as of the effective date. Early adoption would be permitted. The effective date will be determined after the Board considers feedback on the proposed amendments.

How do the proposed provisions compare with International Financial Reporting Standards (IFRS)?

IFRS currently does not include the concept of a development stage entity and, therefore, does not provide different guidance on presentation or disclosure for entities in the development stage. As such, the amendments in this proposed Update would narrow any existing difference between U.S. GAAP and IFRS.

What kind of input from stakeholders is the Board seeking on this proposed Update?

The Board encourages stakeholders to read and provide comment on its proposed Update. Specifically, the Board wants stakeholders to let them know:

- If they agree or disagree with the proposed amendments, and why
- If they think that the proposed amendments would

result in substantive changes in the consideration of a development stage entity for consolidation and if so, in what way and how significant would they would be

- If they think there's information—either previously required and proposed to be eliminated, or not previously required—that would be useful to investors and potential investors of development stage entities
- If they think that the proposed amendments would result in substantive changes to the application of other existing guidance that would require transition provisions or that the Board should consider in determining the appropriate effective date for the final amendments, and
- If they think any of the proposed amendments require special consideration for nonpublic entities.

Stakeholders are encouraged to review and provide comments on the proposal by December 23, 2013. The proposed Accounting Standards Update—including instructions on how to submit comments—is available at www.fasb.org. ■

For more information about the project, please visit the FASB's website at www.fasb.org.

FASB In Focus has been prepared as a summary of the proposed Accounting Standards Update. The views expressed in this document do not necessarily reflect the views of the FASB. Official positions of the FASB are arrived at only after extensive due process and deliberation.

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