On Extraordinary Items

I read with interest the article "Extraordinary Items: Time to Eliminate the Classification" (February 2007). The authors noted some interesting trends in the changes of the accounting rules with respect to extraordinary items. I find, however, that the analysis and conclusion are somewhat impractical.

We all agree that U.S. GAAP's treatment of extraordinary items (EI) has morphed over the decades. However, at any given time the treatment for that period would have been consistent for the time of preparation of the financial statements, with little to doubt about period-to-period comparability. The current requirements of SFAS 154 further enforce the retrospective restatement for changes in accounting treatment.

The impracticality test that the authors are referring to with respect to Hurricane Katrina and the September 11, 2001, events are not outside the bounds of GAAP's approach to EI. On the contrary: When EIs can be measured and recognized, GAAP requires that a separate EI recognition occur. When separating costs from interruption and rebuilding is impractical, EI application is also excluded. I believe that in practice, the results are rather consistent as demonstrated by the EITF decision with respect to these two events.

Finally, in a circuitous argument the authors contend that the "extraordinary items category is used so infrequently in practice" that it should be removed as an option. I find that because events are infrequent in occurrence, the EI events are infrequent. The causality shows that any misuse of EI has subsided, not surged.

In practice I find that EI are a helpful line item to transparently express the state of operations and to capture the true nature of the state of the reporting entity. Events that are infrequent in occurrence and unusual in nature do occur in the small to midsized environment from time to time. Including EI recognition in reporting them as results of operations or even as a change to equity balances would be counterproductive to expressing a fair and true representation of the "facts on the ground."

Yigal Rechtman, CPA, CFE, CISM, CITP
Buchbinder Tunick & Company, LLP
New York, N.Y.

The authors respond:

We stand by our conclusion that EI should no longer be a separate section on the income statement. The primary reason is that elimination of the category is consistent with the convergence of FASB and IASB standards. Similar to the rationale underlying the issuance of SFAS 154 relative to accounting changes, exclusion of the EI category would improve financial reporting by eliminating another, in this case, very narrow difference between the two sets of existing accounting standards.

We also agree with the concept that U.S. GAAP should "morph" as new or different circumstances develop. There does not, however, seem to be any basis for the mere passage of time to create different treatment for the same item. With regard specifically to gains and losses on the retirement of debt, the circumstances did not change, merely the treatment. Such a lack of consistency in the classification of the same item over time seems to be in conflict with the beliefs that accounting information should be transparent and simultaneously facilitate the analysis, understanding, and usefulness of the accounting data to readers. One outcome of convergence is supposed to be similar treatment for similar items—a concept that has not always been applied in the past.

As to the classifications of the financial implications of September 11 and Hurricane Katrina as non-extraordinary, we agree that the difficulty of separation between the direct and indirect costs created a substantive problem. On the other hand, the enormity of these two particular losses for many companies pushed the far limits of materiality. A separate line item was essential for full disclosure; the only question was whether that separate line item would be shown net of, or not net of, the tax effects. There is no bottom-line income differential between showing the items as EI or Other Losses; it is simply a placement issue.

We agree that items that are material, unusual in nature, and infrequent in occurrence in the environment in which the business operates should be separately disclosed to "capture the true nature of the state of the reporting entity." But such separate disclosure can be shown "above the line" in continuing operations and footnoted to provide "a fair and true representation of the facts" that would allow readers to make the most informed assessment of the situation and any potential future implications.

Marcos Massoud, PhD, CPA
Peter F. Drucker Graduate School of Management
Claremont McKenna College, Claremont, Calif.
Cecily Raiborn, PhD, CPA, CMA
Texas State University, San Marcos, Texas
Joseph Humphrey, PhD, CPA
Texas State University, San Marcos, Texas

JUNE 2007 / THE CPA JOURNAL