ACCOUNTING STANDARD SETTING IN THE INTERNATIONAL ARENA: UPDATE ON THE CONVERGENCE PROJECT

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Our paper contributes to the literature on international accounting by focusing on the standard setting process. As documented by research literature, accounting regulation can enhance corporate governance (Melis and Carta, 2010), corporate reporting being expected to reduce information asymmetry. Based on accounting research and trade literature we first synthesize recent evolutions in the international accounting arena. We therefore position our study within current realities significantly marked by uncertainty in relation to the world wide globalization process. The objective of our paper is to perform an analysis that would help assess further developments of the convergence project. This is done by looking at the current status of the projects being developed under the IASB –FASB collaboration, as well as by developing a comparison between IFRS and US GAAP. The employed research methodology relies on analyzing data provided through the IASB and the FASB's websites, as well as other official documents being issued by the two Boards. The assessment of the projects was done by reviewing exposure documents and monitoring the Boards' deliberations, while the developed comparison requires accounting regulations content analysis. Concluding upon the Boards' ongoing projects, we might identify areas in which convergence seems to be quite close (such as revenue recognition and leasing), but also areas in which convergence becomes even more challenging (such as financial instruments or the particular case of offsetting). Similar to other studies being developed within accounting research and trade literature (SEC 2011: 8) we may conclude that, generally, US GAAP present more detailed, specific requirements than IFRS.
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1. Historical evolutions and landmarks in the international accounting arena

It is a well known fact that national differences impact upon national accounting systems, accounting research literature identifying a series of reasons for differences in the financial reporting process, including the character of the national legal system, the way in which industry is financed, the relationship of the tax and reporting systems, the influence and status of the accounting profession, the extent to which accounting theory is developed, language, etc. On the other hand, economic realities closely linked to the globalization process encourage us to aim the diminishing of such differences. In this regard literature offers the option of the standardization approach (referring to rules to account for similar items in all countries) and the harmonization approach (aiming to provide a common framework while allowing for some different national approaches). The therefore generated benefits would mainly relate to permitting greater comparability and reducing training costs for the accounting profession on the long run.

A significant role under the given circumstances belongs to accounting standard setting bodies based on their accountability for the accounting standards' (financial reporting standards') due process. When positioning our analysis in the international arena we implicitly relate to the

International Accounting Standards Board (IASB), former International Accounting Standards Council (IASC). Furthermore, we must also relate to the Financial Accounting Standards Board (FASB) as being the regulatory body for the world's largest economy, the United States (US) representing an attractive source of capital for foreign companies. This also takes us to the Securities and Exchange Commission closly monitoring the accounting standard setting process in the US. Looking back on the relation between the IASB and the FASB, we consider it safe to assess that there was always an apparent competition for international supremacy between the two accounting standard setters and the corresponding regulations which they issue (namely the International Financial Reporting Standards – IFRS (including the International Accounting Standards -IAS) and US Generally Accepted Accounting Principles – US GAAP). Despite such potential competition, the above mentioned process of globalization also impacted their relation due to the manifestation of a need for accounting harmonization. Perhaps a more suitable term when discussing the IASB and FASB would be accounting convergence. Following such a purpose, the IASB and FASB signed in 2002 what we all know as the Memorandum of Understanding (MoU - The Norwalk Agreement, September 2002), both Boards acknowledging their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting.

While US GAAP were perceived as high quality accounting standards until the 21st century, it was the large US bankruptcies that became known world wide (Enron, Parmalat, WorldCom) that also brought doubts with regard to the accounting regulations that would allow for such manifestation without signaling stakeholders. It was also at the beginning of the 21st century that the European Union (EU) started negotiations in order to adopt a set of accounting regulations. Considering the negative impact of the previously mentioned bankruptcies taking place under the watch of the FASB, but without forgetting the IASB's flexibility in the negotiation process, it therefore becomes easy to follow the EU's decision. It was Regulation (EC) No 1606/2002 of the European Parliament and of the Council of 19 July 2002 on the application of international accounting standards and Regulation (EC) No 1725/2003 of the European Parliament and of the Council of 29 September 2003 on adoption of certain international accounting standards in accordance to Regulation (EC) No 1606/2002 that became landmarks in the evolution of the accounting standard setting process in the international arena. In accordance to these regulations, consolidated financial statements of companies listed on EU capital markets had to be filed in based on IFRS starting with year 2005.

This can of course also be easily seen as one of IASB's victories over the FASB. The following was to come in 2007 when the SEC and the FASB were recognizing IFRS for the purposes of foreign companies listed in the US (mentioning that this applied only to IFRS as issued by the IASB since the SEC was not at all pleased with the IAS 39 carve out that the IASB accepted under European lobby). Things were looking quite promising for the IASB, considering the fact that by the end of 2007 IFRS were used in more than 100 countries round the world. It was through a subsequent MoU (September 2008) that the FASB and the IASB agreed that a common set of high-quality, global standards remained their long-term strategic priority and established a plan to align the financial reporting of US issuers under US GAAP with that of companies using IFRS (AICPA, 2011). Very soon (November 2008) the SEC issued a proposed roadmap that included seven milestones for continuing US progress toward acceptance of IFRS.

Evolutions in the international arena started storming and it was only turbulent times that were able to slow things down. The 2007-2009 financial crisis determined shareholders to also question the high quality of IFRS considering that this time it happened under the watch of both the IASB and the FASB. Furthermore, SEC's new chair, Mary Schapiro, stated she did not feel bound by the existing roadmap, arguing that another assessment should be made regarding the decision (Millman, 2009 quoted by Erickson et al., 2009), and early in 2009 expressing reservations about the progress and proposing a timetable of IFRS convergence, criticizing the

IASB and indicating reluctance to adopt IFRS (WebCPA, 2009 quoted by Rezaee, 2010). It was in 2011 that the SEC should have decided whether to incorporate IFRS into the US financial reporting system for US issuers, and in case of deciding so, when and how. In early January 2012 Schapiro was promising a decision in the next few months, adding that there are some challenges that have to be addressed before the SEC will be comfortable making the ultimate decision (IFRS USA, 2012).

Positioning our study under the above discussed setting, the purpose of our paper is to develop an analysis that would help assess further developments of the convergence project. This is done by looking at the current status of the projects being developed under the IASB –FASB collaboration as well as by developing a comparison between IFRS and US GAAP.

2. Research methodology

The employed research methodology relies on analyzing data provided through the IASB and the FASB's websites, as well as other official documents being issued by the two Boards. The developed analysis comprises two parts. The first focuses on the actual stage of the IASB-FASB collaboration in terms of undertaken projects. The assessment of the projects was done by reviewing exposure documents and monitoring the Boards' deliberations. The second part of the analysis develops content analysis of IFRS and US GAAP in order to establish differences without considering their impact in practice, which would be more difficult to assess. Developing the comparison between IFRS and US GAAP is done based on accounting regulations content analysis.

3. IASB - FASB collaboration: actual stage of projects

When looking at projects which the IASB and the FASB undertook in their collaboration when considering the accounting standard setting process we have to consider both the MoU and their other joint projects. The two accounting standard setting bodies issued the MoU in 2006 and further updated it in 2008 with the purpose of identifying the accounting standard setting projects that they considered to mostly require improvement in the near-term. The MoU included both short-term projects and longer-term projects. Establishing the two Boards' priorities was mainly done by considering the purpose of increased convergence between IFRS and US GAAP as well as higher quality for the two sets of accounting standards. The manner in which the Boards considered it suitable to do so primarily related to the development of new standards. We will further synthesize the longer-term projects based on their status:

Table 1: MoU longer term projects

Completed
Business combinations
Fair value measurement
Post-employment benefits
Project scope reassessed
Derecognition
Re-exposure of proposals
Insurance
Leases
Revenue recognition
Redeliberation of exposure draft
Insurance
Leases
Reassessed as a lower priority project
Financial statement presentation
Financial instruments with characteristics of equity
Intangible assets

Differentiated on project elements	
Financial instruments: classification and measurement, impairment, hedge accounting, and balance sheet offsetting.	
Ongoing	
Consolidations	

Source: (authors' projection based on information available on IASB's and FASB's website)

If we are to select the projects that are considered to have greater priority, we have to make reference to financial instruments, revenue recognition and leasing, all requiring the Boards final decision regarding technical aspects. We will further synthesize the two Boards' collaboration on these topics, all representing active on-going MoU projects.

With regard to the financial instruments project (which includes the elements mentioned within the above presented table), the two Boards aim the issuance of converged standards, but actual timing and phasing in their development was differentiated. The IASB chose to consider each of the above mentioned elements of the project as a separate phase which is approached under the development of IFRS 9 Financial Instruments. Meanwhile, the FASB initially approached the project by considering the following two phases: classification and measurement, impairment, and hedging; and balance sheet offsetting. Offsetting represents a significant aspect due to the fact that the different requirements result in a significant difference between amounts presented in statements of financial position prepared in accordance with IFRS and amounts presented in statements of financial position prepared in accordance with US GAAP, particularly for entities that have large amounts of derivative activities. Despite the fact that the Boards jointly issued the exposure draft on offsetting in January 2011 (proposing changes to address the differences between IFRS and US GAAP), it seems like the received feedback encouraged them to continue further with different offsetting models. Still, considering the fact that users consistently asked that information be provided to help reconcile differences in the offsetting requirements between IFRS and US GAAP, the Boards decided to work on converging disclosure requirements to assist users in this regard (SEC 2011: 4).

As seen from the above presented table, in June 2011 the revenue recognition project was considered to require re-exposure (despite their due process requirements stating that re-exposure was not required) of the proposals due to the special nature of revenue. The two Boards had previously published a joint discussion paper (in December 2008) and a joint exposure draft (in June 2010) related to revenue from contracts with customers. The leasing related project was also included in the re-exposure of proposal category. After jointly publishing a discussion paper (in March 2009) and a joint exposure draft (in August 2010) related to leases, it was in July 2011 that the two Boards decided to re-expose the revised proposals due to the fact that up to date decisions were significantly different when compared to the exposure draft, and therefore required re-exposure. A more detailed content analysis of IFRS and US GAAP will further be developed within the following section with the purpose of providing the synthesis of such a comparison.

4. Where are we today? Synthesis of IFRS and US GAAP comparison

We will further synthesize the results of the developed comparison between IFRS and US GAAP by considering specific areas and factors that are relevant (SEC 2011) for the convergence process nowadays still under debate.

Intangibles (IAS 38 and ASC (Accounting Standards Codification) Topic 350): require initial capitalization of acquired intangibles and preclude the recognition of most internally-generated intangibles. While IFRS allow entities to elect between the cost model and the revaluation model, US GAAP requires the cost model for all intangible assets within the scope of ASC Topic 350, the revaluation model therefore not being permitted. Still, practical implementation of the revaluation model is perceived to be limited even under IFRS due to the existence of several restrictions (fair value needs to be determined by reference to an active market, and the revaluation must be kept sufficiently up-to-date so that the carrying amount of the asset does not differ materially from its fair value). *Research and development* (IAS 38 and ASC Topic 730): IFRS require capitalization of development costs under given criteria, with costs incurred before the criteria being met having to be expensed as incurred; meanwhile US GAAP require research and development costs to be expensed as incurred, with the exemption of computer software development that requires capitalization under criteria that is similar to those in IFRS. *Property, Plant, and Equipment* (IAS 16 and ASC Topic 360): require initial capitalization at an amount based on cost and subsequent depreciation of the capitalized asset, with impairment tests being required in case there is an indicator of impairment. While we notice general consistency between the principles of IFRS and US GAAP, there are some differences with regard to definitions and mostly in detailed guidance. SEC (2011: 26) exemplifies what it considers some of the potentially more significant differences including: asset depreciation, remeasurement of residual value, option for revaluation, impairment and impairment reversals. *Investment Property* represents another area that might generate differences due to the fact that IAS 40 Investment Property allows the use of the fair value model and the cost model (based on the entity's election) while US GAAP only allows for the cost model (unless the entity meets the criteria of an investment company measuring its assets at fair value).

Inventory (IAS 2 and ASC Topic 330): require initial recording at cost and subsequent testing for impairment by reference to a market-based value. Among the significant differences we would mention: IFRS require inventory to be carried at the lower of cost or net realizable value while US GAAP requiring the lower of cost or market; IFRS require reversal of inventory impairments in the period in which an impairment condition reverses while US GAAP precludes a reversal of previous inventory write-downs; US GAAP permit the use of LIFO (last-in, first-out) method which is not permitted under IFRS. *Cash and Cash Equivalents* (IAS 7and ASC Topic 305): similar principles (such as cash equivalent instruments requirements: short-duration, highly liquid, and readily convertible to cash), IFRS articulating certain requirements in a less prescriptive manner than US GAAP. *Liabilities* (IAS 39 and ASC Topic 405): mainly consistent accounting guidance for the extinguishment of liabilities. US GAAP offer application guidance for circumstances which are less (or not at all) covered under IFRS (such as transactions, transfers of noncash financial assets in settlement of a creditor's receivable). *Contingencies* (IAS 37 and ASC Topic 450): require that loss contingencies are recorded when a future economic outflow is probable, with the term probable itself being defined differently (IFRS: more likely than not to occur, US GAAP: the future event or events are likely to occur), but allowing similar interpretations (more than 50%).

Share-based Payment (IFRS 2 and ASC Topic 718): include similar share-based payment models requiring fair value measurement. Significant differences can be noted in relation to the classification of share-based payment awards. *Foreign Currency Related Aspects and Inflation* (IAS 21 and ASC Topic 830): require translation of financial statements of foreign operations into the reporting currency, with recognition of the effects of changes in exchange rates in other comprehensive income and remeasurement of foreign currency transactions into the entity's functional currency with impact upon income; operating in hyperinflationary economies imposes special accounting. SEC (2011) emphasizes some significant differences including exchange rates for translation, cumulative translation adjustment and impairment, translation of entities with multi-level organizational structures, monetary items forming part of net investment in foreign operation, application of highly inflationary accounting, and cessation of highly inflationary accounting. *Risks and Uncertainties* (IAS 1 and ASC Topic 275): include similar principles, but US GAAP present more particular disclosure requirements that are not required under IFRS. Main differences that might generate differential disclosure are linked to vulnerabilities due to certain concentrations and estimates and uncertainties.

5. Concluding remarks, research limitations and research perspectives

The above presented synthesis represents a selection of topics that were approached and could further be developed by enlarging the list of analyzed topics. We consider this to represent both a limitation of our paper and an opportunity for its future development. Another limitation of aiming to develop a similar comprehensive comparison between IFRS and US GAAP comes from the fact that differences affect stakeholders in different manners and to different extant, therefore making their assessment difficult. Concluding upon the Boards' ongoing projects, we might identify areas in which convergence seems to be quite close (such as revenue recognition and leasing), but also areas in which convergence becomes even more challenging (such as financial instruments or the particular case of offsetting). Furthermore, it is also difficult to position the Boards' decisions related to the priority of the approached projects in relation to the so-called roadmap for convergence previously being undertaken and which again is currently under significant uncertainty. More precisely we must not forget that the US representatives keep delaying the decision related to the incorporation of IFRS into the financial reporting system for US issuers.

Similar to other studies being developed within accounting research and trade literature (SEC 2011: 8) we may conclude that, generally, US GAAP present more detailed, specific requirements than IFRS. Nevertheless, there are cases in which IFRS offer higher-level or general guidance, as there are also cases in which they do not contain any corresponding guidance when compared to US GAAP. We therefore relate to SEC (2011: 11) emphasizing the fact that any developed comparison between IFRS and US GAAP should consider the existent fundamental differences linked to:

- IFRS containing broad principles to account for transactions across industries, with limited specific guidance and stated exceptions to the general guidance; and
- fundamental differences existing between the FASB and IASB conceptual frameworks. Ohlson et al. (2010) discuss how standard setters and most academics maintain that accounting standards should be guided by a set of precepts and principles spelled out in a conceptual framework document. As Whittington (2008) and Ronen (2008) note, both the FASB and the IASB already had conceptual frameworks in place, the FASB's, dating mainly from the 1970s, comprising seven substantial concepts statements, each published separately, and the IASB's 1989 briefer framework in one document containing 110 paragraphs. The IASB and FASB are currently jointly facing the challenge of developing a comprehensive project (added on their agendas in 2004) having the purpose to replace existing documents with an improved, common conceptual framework that builds on their existing frameworks.

The developed historical retrospective documents how things started to move quickly in relation to the IASB – FASB collaboration after the 2002 Norwalk Agreement, providing a roadmap for convergence that was recently stormed by turbulent times such as the financial crisis. Discussing the IASB - FASB collaboration on recent projects as well as developing a comparison content analysis of IFRS and US GAAP might prove helpful in assessing the developments as well as perspectives of the convergence process.

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