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MP&S ACCOUNTING AND AUDITING ALERT: CONVERGENCE OF US GAAP AND IFRS: WHERE DO THINGS STAND?

Since 2002, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) have been working toward "convergence" of US Generally Accepted Accounting Principles (GAAP) and International Financial Reporting Standards (IFRS). Although the two boards have made significant progress, efforts to converge critical standards — such as those dealing with revenue recognition, financial instruments and leases — have been challenging and time consuming.

FASB and IASB had planned to complete their major convergence projects by mid-2011, but several are still in progress. Recognizing that convergence will take more time, on April 13 the European Commission (the European Union's executive body) extended rules that permit European Union–listed US companies to continue to use US GAAP. The rules had expired at the end of 2011, but the European Commission granted a three-year extension, retroactive to Jan. 1, 2012.

The State of Convergence

FASB and IASB have completed several short-term convergence projects, substantially converging their standards for share-based payments, segment reporting, the fair value option for financial assets and liabilities, borrowing costs, and more. In some cases, such as share-based payments, both boards issued revised standards. In others, convergence required one board to revise its standards to align with those of the other board.

The boards also completed several major convergence projects, including:

- Issuing joint requirements for business combination accounting and noncontrolling interests,
- Substantially aligning their disclosure requirements for derecognition of financial assets and liabilities and reducing the differences between their accounting requirements (although the boards are reassessing the scope of this project),
- Aligning their guidance on fair value measurement,
- Bringing their standards on postemployment benefits closer together, and
- Converging or substantially converging their standards on joint arrangements, other comprehensive income and consolidated financial statements. (The boards are continuing to discuss consolidation of investment companies.)

The boards currently are working on four high-priority convergence projects:

1. Revenue recognition,
2. Leasing,
3. Financial instruments, and
4. Insurance contracts.

As of this writing, the boards are close to reaching an agreement on revenue recognition but continue to deliberate over the other three projects. In an April 20 update submitted to the Group of 20 industrial nations, FASB and IASB said they expect to begin redeliberations of their joint

project on revenue recognition shortly and to re-expose aspects of their financial instrument project, as well as their projects on leases and insurance, in the second half of 2012. The boards expect to issue final standards on these projects by mid-2013 (about two years behind their original schedule).

Several projects have been reassessed as lower priority and won't be addressed in the near future. They include financial instruments with characteristics of equity, financial statement presentation, reporting discontinued operations, earnings per share and income taxes.

The State of the SEC Roadmap

While FASB and IASB have been striving to converge their standards, the US Securities and Exchange Commission (SEC) has been exploring the possibility of adopting IFRS for use in the United States. In 2007, it eliminated the requirement that foreign registrants that use IFRS reconcile their financial statements to US GAAP. Then, in 2008, the SEC issued its proposed "roadmap" to adoption of IFRS by US companies.

The SEC had planned to vote in 2011 on whether to make IFRS mandatory for US public companies beginning as early as 2015, but the decision was pushed back into 2012. In February 2012, an SEC staff member said that a decision on IFRS was "a few months away."

What's on the Horizon?

During the last year or so, support has been building for a "condorsement" approach. In May 2011, the SEC published a paper suggesting condorsement — a combination of convergence and endorsement — as a possible alternative to requiring US companies to adopt IFRS outright.

Under this approach, FASB and IASB would continue their efforts to converge US GAAP and IFRS. At the same time, FASB would endorse and incorporate other IFRS standards into US GAAP individually over time.

At a recent American Institute of Certified Public Accountants (AICPA) conference, the leaders of FASB and IASB agreed that, given the political and administrative challenges, convergence isn't a practical long-term solution and that a new model is needed. Absent formal adoption of IFRS, that model may be condorsement or something like it.

In a comment letter to the SEC, the Financial Accounting Foundation (FAF) — FASB's parent organization — supported condorsement, but suggested certain refinements to the SEC's suggested approach that would give FASB a more prominent role in the international standard-setting process.

The FAF proposed that FASB and IASB complete the four high-priority convergence projects discussed above. Then, rather than adopt IFRS, the United States would retain US GAAP but defer to IASB to set new accounting standards (although FASB would actively participate in the process). FASB would retain the authority to develop its own standards in critical areas in the event IASB fails to provide satisfactory guidance or fails to address an issue in a timely fashion.

FASB and IASB heads emphasized that, for this approach to work, the threshold for deviating from IFRS must be high. If there are too many "nonendorsements" or FASB creates too many "carve-outs" that depart from IASB standards, the benefits of uniform global accounting standards will be lost.

The SEC staff has hinted that its upcoming report on IFRS will recommend an endorsement framework that combines a strong US commitment to international accounting standards while preserving FASB's role in the standard-setting process.

Stay Tuned

Just about everyone agrees that a single set of high-quality global accounting standards is a worthy goal. Uniform standards would improve comparability for both domestic and cross-border financial reporting, enhance transparency, facilitate capital raising and reduce accounting complexity and expense. The challenge is finding a way to achieve that goal with minimal disruption to US markets and without diluting the authority of the SEC and FASB over US accounting matters.

As the FAF observed in its comment letter, “a more practical goal for the foreseeable future is to achieve highly comparable (but not necessarily identical) financial reporting standards among the most developed capital markets that are *based on* a common set of international standards.” The future of US GAAP should become clearer in the coming months.