

Update on the Convergence of GAAP and IFRS

Introduction

In order to eliminate differences and achieve a common framework that would improve financial reporting practices in the United States, the International Accounting Standards Board (“IASB”) and the Financial Accounting Standards Board (“FASB”) began an effort in 2002 to converge United States Generally Accepted Accounting Principles (“U.S. GAAP”) with International Financial Reporting Standards (“IFRS”). While the IASB and the FASB have been collaborating on this project for many years, there is still some contention over the scope of the project and the best way to approach it.

Debate

The IASB seeks to incorporate IFRS into U.S. GAAP so that investors can easily compare the financial statements of U.S. companies to companies abroad. Past differences between the two financial reporting standards have caused problems.

Hans Hoofervorst, Chair of the IASB, cites the recent issue regarding the process of offsetting in the financial reporting for U.S. banks where the IASB and FASB were unable to reach an agreement about the process. In the U.S., banks were allowed to show net derivatives, while the rest of the world was required to show gross derivatives. This issue caused the balance sheets of U.S. banks to look much smaller than banks in Asia and Europe, resulting in confusion for investors.¹

While the FASB believes that minimizing differences between the two sets of standards is important, FASB Chair Leslie Seidman points out practical issues for creating one converged set of standards, stating, “As any observer can see, this process is challenging technically and administratively”.²

¹ “FASB, IASB Chiefs Agree New Convergence Model Is Needed”, *Journal of Accountancy*, December 6, 2011, www.journalofaccountancy.com.

² Ibid.

Those in opposition to convergence have also pointed out that the IASB gives priority to the needs of the countries that are already members of the IFRS. Some fear that the convergence would give too much authority to an international governing body that may not always have the best interests of the U.S. capital markets and investors in mind.

Instead of a complete convergence, the FASB and the Financial Accounting Foundation (“FAF”) have proposed to retain the U.S. GAAP name, continue to work on the current convergence projects that are already underway, and work with the IASB to set new standards and develop plans to address remaining differences between GAAP and IFRS. This would allow the FASB to maintain authority, protect investors, and address issues of importance for the U.S. that are not on the agenda of the IASB.¹

Timeline

Despite the ultimate outcome, both Boards believe in the importance of improving financial reporting standards, eliminating differences, and completing the projects they have started. Since 2002, the FASB and the IASB have released a number of public documents and correspondences related to the status of the convergence process.

The first document, the [Norwalk Agreement](#), was issued in September of 2002 after the FASB and the IASB met and agreed to work toward the common goal of eliminating differences between the two sets of standards and collaborating to improve financial reporting.

Other major documents include the Memorandum of Understanding (“MoU”), which was originally issued in 2006 and then updated in 2008. The [2006 MoU](#) describes the goals that the two Boards hoped to achieve by 2008. It also outlines their combined intention to create new standards where significant divergence existed between U.S. GAAP and IFRS, instead of attempting to simply eliminate differences. In 2008, [the updated MoU](#) describes the progress made since 2006 and sets goals that the Boards expected to achieve by 2011.

Most recently, in the [joint progress](#) report issued in April of 2012, the IASB and the FASB identify mid-2013 as their new target completion date. The report also summarizes their progress to date and explains the plan of action to complete the remaining projects.

¹ Ibid.

Remaining Projects

The progress report describes the four highest-priority convergence projects that are still underway. These projects address financial instruments, insurance contracts, revenue recognition, and leases.

Financial Instruments

For the financial instruments project, the IASB originally developed three phases for completion. First, they intended to set standards for the classification and measurement of financial assets and financial liabilities. An exposure draft will be issued by the end of 2012, and they intend to finalize these new standards in the first half of 2013. New standards will be effective in January of 2015.

The second phase of the financial instruments project involves determining impairment methodology. The greatest amount of discussion for the impairment project centered on the deterioration of financial asset credit quality. The FASB and the IASB proposed an impairment model that divides financial assets into three different categories to determine the impairment loss. The Boards expect to release the next exposure draft on this issue by the end of 2012, and finalize these standards in the first half of 2013.

Hedge accounting is the third phase of the financial instruments project. The IASB split this phase into two parts: general hedging and macro hedging. The IASB has almost completed their work on the general hedging model, which will be an overhaul of the current model and will tie into risk management. The IASB posted a review draft on their website in December 2010 and intend to finalize it later this year. The Boards are working separately on this portion of the project and the FASB is asking its constituents to comment on both the IASB's review draft and their own proposals. The IASB will release a draft on macro hedge accounting by the end of 2012.

Insurance Contracts

While the insurance contracts project is not formally part of the work program, the Boards are collaborating with one another to try to reduce a breadth of differences between the two sets of standards related to the topic. They do not necessarily intend to create a fully converged set of standards for this issue.

Significant issues include whether to use other comprehensive income to measure insurance contracts and financial assets, and how to report volatility

in profit or loss under the proposed models. The IASB is currently reviewing comments from their 2010 exposure draft on the topic, and the FASB and IASB expect to release another publication by the end of 2012. Final standards could be issued in 2013.

Revenue Recognition

The Boards expect discussions regarding the revenue recognition project to be complete by the end of 2012 and hope to finalize standards by 2013. For more information on revenue recognition, please see our previous white paper, [*Revenue from Contracts with Customers*](#).

Leases

Likewise, the Boards expect to publish revised proposals for the leases project by the end of 2012, with final standards scheduled for mid-2013. The leases project will likely receive a great deal of attention since it puts assets and liabilities arising from leases on the balance sheets of both lessor and lessee.¹ For more information on this topic, please see our previous white paper, [*Leases \(Topic 840\)*](#).

Other Projects

Other lower-priority projects that are currently underway or have already been completed include: Fair value measurement (see [*Fair Value Measurement and Disclosure*](#)), derecognition, consolidations, post-employment benefits, income tax, investment property entities, and financial instruments with the characteristics of equity.

A summary of active joint FASB/IASB convergence projects and their current timelines can be found below. For a full list of projects, please see pages 3 and 4 of the [joint progress report](#).

¹ “Lack of SEC Decision on IFRS turns CPAs’ Focus to Convergence Projects,” Tysiac, Ken, Journal of Accountancy, July 16, 2012.

ACTIVE JOINT FASB/IASB PROJECTS:			
Current Technical Plan	2012		2013
	3rd Qtr	4th Qtr	1st Half
<u>Investment Companies</u> (Updated September 6, 2012)		Final Report	
<u>Accounting for Financial Instruments</u> (Updated August 21, 2012)			
<u>Impairment</u> (Updated September 13, 2012)		<u>Exposure Draft</u>	
<u>Classification and Measurement</u> (Updated August 21, 2012)		<u>Exposure Draft</u>	
<u>Hedging¹</u> (Updated August 21, 2012)			
<u>Insurance Contracts</u> (Updated October 5, 2012)		Exposure Draft	
<u>Leases</u> (Updated October 3, 2012)			Exposure Draft
<u>Revenue Recognition</u> (Updated October 4, 2012)			Final Report
<u>Consolidation: Policy and Procedures</u> (Updated May 7, 2012)			Final Report

While there are many open areas of discussion between FASB and IASB, several areas of past disagreement have already been resolved. Joint requirements have been issued for business combinations, and guidance has been aligned for fair value measurement. Likewise, amendments have been issued to presentation standards for other comprehensive income, and

¹ FASB and IASB are each working on Hedging separately. FASB has requested their constituency to comment on both once they are released, presumably in late 2012.

reforms to disclosure requirements for derecognition of financial assets and liabilities.¹

Achievability

As directed in February 2010, the SEC staff developed a work plan to "consider specific areas and factors relevant to a Commission determination as to whether, when, and how the current financial reporting system for U.S. issuers should be transitioned to a system incorporating International Financial Reporting Standards."

The SEC's Office of Chief Accountant published its final staff report, titled the *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers*, on July 13, 2012. The report, which included observations and analyses of key areas currently under consideration for convergence between FASB and IASB, was met with disappointment by the IASB, which noted it did not include an action plan.²

The SEC did not clearly state that transitioning to IFRS is in the best interest of U.S. security markets and investors. The report states, "It became apparent to the staff that pursuing the designation of the standards of the IASB as authoritative was, among other things, not supported by the vast majority of participants in the U.S. capital markets."³

While the ultimate goal of convergence is to achieve a single set of accounting standards used by companies worldwide, as noted in a comment letter to the SEC from the Accounting Foundation, "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."⁴

For more information or questions regarding the convergence of U.S. GAAP and IFRS, please feel free to contact any of the principals of Bond & Pecaro, Inc.

¹ "The State of Major FASB and IASB Convergence Projects" Sidney K Garmong, Financial Executives International, September 2012.

² Ibid.

³ "SEC Staff Pulls Back on Accounting Convergence" Kathleen Hoffelder, CFO.com, July 16, 2012.

⁴ Ibid.

Works Referenced

IASB/FASB Update Status of Convergence Projects, KPMG, May 2012, www.kpmg.com/ifrs.

US GAAP & IFRS Convergence, PricewaterhouseCoopers, www.pwc.com.

IASB-FASB Update Report to the Financial Stability Board Plenary on Accounting Convergence, Financial Accounting Standards Board, April 5, 2012, www.fasb.org.

Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers, Final Staff Report, July 13, 2012, www.sec.gov.