Michigan Business & Entrepreneurial Law Review

Volume 6 | Issue 1

2016

Will We Ever Close the GAAP?: A Look into the International Convergence of Accounting Standards

Melanie Rosin
University of Michigan Law School

https://doi.org/10.36639/mbelr.6.1.will

WILL WE EVER CLOSE THE GAAP?: A LOOK INTO THE INTERNATIONAL CONVERGENCE OF ACCOUNTING STANDARDS

*Melanie Rosin**

Table of Contents

* J.D. Candidate, University of Michigan Law School, 2017. B.B.A., Southern Methodist University, 2014. Special thanks to Professor Michael Barr for his thoughtful feedback and the members of *Michigan Business & Entrepreneurial Law Review* for their helpful comments.

I. Introduction

This Note examines the trend toward the international convergence of accounting standards and then identifies the factors contributing to the process of this trend as well as the obstacles standard setters face in moving to one high quality, unified set of standards. The Note next identifies the possible outcomes for the future of convergence, including the mandatory adoption of International Financial Reporting Standards (IFRS) by the United States, the Securities & Exchange Commission's (SEC) encouragement of the voluntary of adoption of IFRS by the United States, requiring public companies to comply with both U.S. Generally Accepted Accounting Principles (U.S. GAAP) and IFRS, the Financial Accounting Standards Board (FASB) and International Accounting Standards Board's (the IASB) joint creation of a new set of combined standards, and the harmonization of existing standards. The Note then endorses the mandatory adoption of IFRS in the United States as the most efficient approach for the worldwide capital market as a whole but concludes that the most likely outcome will be a slow process of harmonization.

A. *Background on Accounting Standards*

Accounting standards are statements of authority designed to limit the areas of variance in accounting practices.[1] The international convergence of accounting standards is the development of a unified set of high-quality, international accounting standards that companies throughout the world can employ for both domestic and cross-border financial reporting. "High quality" signifies that these standards not only provide users of financial statements with information that is clear, beneficial, and relevant to their needs but also consider whether the expected benefits of that information justify the costs of providing and utilizing it.[2]

Approximately thirty years ago, only U.S. accounting standards promulgated by the FASB were broadly customary throughout the world. These standards are known as U.S. GAAP. The United States had the largest capital market, and several multinational companies were based in the United States as well. The subsidiaries of these international compa-

1. Appah Ebimobowei, *Convergence of Accounting Standards: The Continuing Debate*, 4 Asian J. Bus. Mgmt. 159, 159 (2012).

2. FASB, *Comparability in International Accounting Standards: A Brief History*, http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156304264 (last visited November 15, 2016) [hereinafter FASB, A History].

nies in other parts of the world consequently ended up applying U.S. GAAP, contributing to its increased use.[3]

The International Accounting Standards Committee (IASC) was the first international standards-setting body. Although the IASC was formed in 1973, it became better known throughout the world during the 1990s. Its use continued to increase after it was reorganized in 2001, when IASC became an independent international standard setter known as the IASB. The IASB subsequently became responsible for IFRS and is now in control of preparing and issuing IFRS and exposure drafts, approving and issuing interpretations of its standards, and progressing and following its own technical agenda.

U.S. GAAP and IFRS became the two sets of internationally accepted accounting standards, but the use of IFRS has significantly grown in the years since the IASB's creation. As of 2013, the European Union (EU) and over 100 other countries either necessitate or permit the use of IFRS (or a local variation of IFRS).[4] IFRS is increasingly replacing several sets of national accounting standards.[5] In fact, more publicly traded companies now use IFRS than any other accounting framework, including U.S. GAAP—over 12,000 and growing.[6] Aside from becoming more present throughout the world, IFRS's presence in the United States has dramatically increased as well, due in large part to business progressively becoming more global. In the past, only subsidiaries of foreign companies typically dealt with IFRS in the United States. Now almost every single company with foreign investors or investments uses IFRS in one way or another.[7]

B. *The Trend Toward the International Convergence of Accounting Standards*

It is difficult to ignore the trend toward the globalization of accounting standards. International convergence represents the direction for future development in the accounting world and also embodies the necessity of integrating international economies as business continues to extend beyond borders.[8] Countries and capital markets will continue to become

3. Robert H. Herz & Kimberly R. Petrone, *International Convergence of Accounting Standards-Perspectives from the FASB on Challenges and Opportunities*, 25 NW. J. INT'L L. & BUS. 631, 655 (2005).

4. FASB, A History, *supra* note 2.

5. FASB, *Comparability in International Accounting Standards: An Overview,* http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156245663 (last visited Nov. 16, 2016) [hereinafter FASB, An Overview].

6. PRICEWATERHOUSECOOPERS, *IFRS: The Right Step for US Business*, 3 (2007), http://www.sdn.sap.com/irj/scn/go/portal/prtroot/docs/library/uuid/70d7a259-b8f5-2b10-0aa7-96b908965b79?overridelayout=true.

7. GRANT THORNTON, *Now What? Considering IFRS for U.S. Issuers,* 3 (2012), http://www.betterregulation.com/external/IFRS_for_U%20S%20_Issuers_Whitepaper_Final.pdf.

8. Boka Moussa, *On the International Convergence of Accounting Standards*, 5 INT'L J. OF BUS. &AND MGMT. 89, 89 (2010).

more interdependent. Any organization that hopes to remain in the international market cannot afford to disregard this trend.[9] Of course, many organizations would favor using the accounting standards to which they have grown accustomed because of the cost and inconvenience of changing their accounting language, but most stakeholders at least recognize that the continuing trend of developing a uniform language for financial reporting is in everyone's best interest.

The idea of one set of high-quality, global accounting standards is not a novel idea. In the 1990s, the FASB outlined its support for the dual goals of converging global accounting standards while continuing to improve U.S. GAAP. Initial efforts focused on harmonization: reducing differences among the accounting principles used in major capital markets around the world.[10] However, stakeholders realized that working with dissimilar accounting standards leads to excessive complexities when comparing companies, and thus the notion of harmonization was gradually replaced with the concept of convergence, meaning the development of a cohesive set of excellent, international accounting standards that would be used in at least all major capital markets.[11]

The standard setters from the FASB and the IASB have described what convergence means to them and their tactics to achieve it in two different documents. First, the FASB and the IASB have been working together formally toward convergence since the 2002 execution of the Norwalk Agreement. Second, the FASB and the IASB also created a Memorandum of Understanding (MoU), which was issued in 2006 and updated in 2008 and 2010. The MoU identified the standard-setting projects that the Boards considered to be most in need of improvement in the near-term.[12] When updating the MoU, both the FASB and the IASB believed that improvements in convergence and financial reporting were on track at the time of their reviews.

II. Differing Accounting Standards and Movements Toward Unifying Them

A. *Differences Between U.S. GAAP and IFRS*

Accounting standards differ in numerous regards across countries, and these differences have normative implications for a country's financial statements. It is not solely a matter of choosing between set of rules X and set of rules Y: the choice reflects substantive differences between the standards. If the United States thought that IFRS painted a more accurate

9. *Id.*

10. FASB, An Overview, *supra* note 5.

11. *Id.*

12. *Id.*; *see also*, Office of the Chief Accountant, *Work Plan for the Consideration of Incorporating International Financial Reporting Standards into the Financial Reporting System for U.S. Issuers*, SEC, 2 (2011), http://www.sec.gov/spotlight/globalaccountingstandards/globalaccountingstandards.pdf,

picture of a company's financial situation, then U.S. GAAP would look more like IFRS. Likewise, if other countries believed U.S. GAAP was a superior set of standards, then those countries would have elected U.S. GAAP over IFRS when given the opportunity to do so.

1. Example One: Rules-Based Versus Principles-Based Frameworks

A chief distinction between U.S. GAAP and IFRS is the approach each set of standards takes to financial reporting. U.S. GAAP is a rules-based regime, while IFRS is principles-based. U.S. GAAP is viewed as more rules-based than IFRS because U.S. GAAP consists of a complex set of accounting guidelines that are meant to set forth rules and criteria for any and all contingencies. U.S. GAAP could be seen as favoring form over substance: the FASB supports following the letter of U.S. GAAP irrespective of the conceivable differences between how a company reports a transaction and the actual economic consequences of that transaction.[13] IFRS is viewed as more principles-based than U.S. GAAP because it begins with what the IASB considers to be more general objectives of good reporting and then offers direction regarding how each specific objective may relate to various situations. Unlike U.S. GAAP, IFRS could be seen as favoring substance over form because it attempts to capture the actual intent of a company's transaction.[14]

On one hand, supporters of a rules-based regime argue that a principles-based framework like IFRS can lead to similar transactions having very different explanations because fewer bright line rules exist and multiple accounting approaches are permitted to be used. This may lead to second-guessing when interpreting transactions. Such second-guessing can complicate accounting by creating uncertainty and thus requiring extensive disclosures in financial statements.[15] Further, under a principles-based framework, preparers have more ability to alter how transactions appear on financial statements than they would under U.S. GAAP.[16] A rules-based approach like U.S. GAAP has a number of advantages, including a reduction in risk when the applicable rule is followed, clarity in employing a particular rule, and increased comparability between companies in the same industry when applying the same rule.[17]

13. *See* Nicolas Pologeorgis, *The Impact Of Combining the U.S. GAAP and IFRS*, INVESTOPEDIA http://www.investopedia.com/articles/economics/12/impact-gaap-ifrs-convergence.asp , (last visited Nov. 28, 2016).

14. *See id.*

15. Remi Forgeas, *Is IFRS That Different From U.S. GAAP?*, THE AM. INST. OF CERTIFIED PUB. ACCOUNTANTS (June 16, 2008), http://www.ifrs.com/overview/General/differences.html.

16. IFRS USA, *Which Is Better – Principles or Rules?*, (Apr. 5, 2011), https://ifrsusa.wordpress.com/2011/04/05/which-is-better-–-principles-or-rules/.

17. *Id.*

On the other hand, supporters of a principles-based framework argue that a rules-based regime like U.S. GAAP is easier to circumvent.[18] At times, forcing companies to obey a given rule can lead to an overly restrictive result, such as when a company must adhere to that rule for a certain transaction even though applying the rule could lead to misleading results.[19] A rules-based system may encourage searching for loopholes rather than reporting what actually happened, which in turn can lower the quality of reporting.[20] A principles-based system allows preparers to contemplate the best way to report a transaction and gives the standards-setting board the opportunity to clarify areas of discussion and variant interpretations while also allowing for fewer exceptions than one would see in a rules-based system.[21]

2. Example Two: Derivatives

How standard setters measure derivatives is a significant dissimilarity between U.S. GAAP and IFRS. Standard setters can measure derivatives either on a net or gross basis. The FASB measures derivatives on a net basis, which is "the presentation of one or more financial assets together with one or more financial liabilities as a single net amount in the balance sheet, which is formally referred to as the statement of financial position."[22] This process of offsetting liabilities against assets is also called "netting." Under netting, a single payment obligation replaces reciprocal obligations that cancel each other out.[23] the IASB measures derivatives on a gross basis, which means financial assets and liabilities are presented separately, rather than offset.[24]

The divergent measuring requirements for derivatives cause considerable variance between the amounts presented in statements of financial position prepared in accordance with U.S. GAAP and those prepared in accordance with IFRS, especially for entities that have extensive deriva-

---

18. Nick Topazio, *Convergence of Accounting Standards*, Chartered Inst. of Mgmt. Accountants, 5 (Feb. 2008), http://www.cimaglobal.com/Documents/ImportedDocuments/cid_tg_accounting_standards_feb08.pdf.pdf.

19. IFRS USA, *supra* note 16.

20. A. D. Hillman et al, *International Convergence of Accounting Standards-Perspectives from the FASB on Challenges and Opportunities*, 1 Drake Mgmt. Review 1, 5 (2012).

21. Forgeas, *supra* note 15.

22. Patricia McConnell, *Gross or Net? That Is the Question*, Int'l Fin. Reporting Standards (June 1, 2011), http://www.ifrs.org/Investor-resources/2011-perspectives/June-2011-perspectives/Pages/gross-or-net.aspx.

23. *Id*.

24. FASB, *Exposure Draft: Offsetting of Financial Assets and Liabilites,* FASB in Focus, (Jan. 31, 2011) http://www.fasb.org/cs/ContentServer?site=FASBv&vc=vDocument_C&pagename=vFASB%2FDocument_C%2FDocuvmentPage&cid=1176158199991&_ga=1.160150586.629966569.1480436107 [hereinafter FASB, Offsetting].

tive activities.[25] In fact, variances between the FASB's and the IASB's derivatives' offsetting requirements are the cause of the single largest difference in the amounts presented in the balance sheets of financial institutions.[26]

Derivative measuring remains different between U.S. GAAP and IFRS for several reasons, most of which have to do with the fact that derivatives have inherent characteristics that are distinct from other financial instruments like securities or loans. A derivative's value is dynamic because it reacts to an underlying condition, such as a stock index, interest rate, mortgage, commodity, or credit rating.[27] Derivatives generally do not require an initial investment, and their value at inception is normally zero, while other securities like bonds, loans, and other forms of debt are typically fully funded.[28] As a result of these differences and added complexities, derivatives present a unique credit risk compared to other financial instruments that should be measured differently.[29]

In 2011, the FASB and the IASB issued a joint exposure draft that proposed new criteria for the offsetting of derivatives in order to address the differences between their derivatives' measurement and the consequences such differences have on financial reporting. In response to the feedback received on their proposal, the FASB and the IASB chose to continue to use the existing models and instead align their disclosure requirements to allow users to compare financial statements prepared in accordance with either U.S. GAAP or IFRS.[30]

Even though the FASB and the IASB agreed to disagree when it came to measuring derivatives, the International Swaps and Derivatives Association (ISDA) published a report called Netting and Offsetting: Reporting Derivatives Under U.S. GAAP and Under IFRS in 2012 in order to offer insight into the dissimilar offsetting requirements under the two sets of standards. The ISDA concluded that net presentation in accordance with U.S. GAAP marks the better approach to presenting derivatives in financial reporting.[31]

B. *Steps Taken Toward Convergence and Status of Joint Projects*

To date, the FASB and the IASB have taken multiple steps toward the international convergence of accounting standards. In 2002, the FASB and the IASB agreed in the Norwalk Agreement to work to improve the

25. Antonio Corbi, *Netting and Offsetting: Reporting Derivatives under U.S. GAAP and under IFRS*, INT'L SWAPS AND DERIVATIVES ASS'N., 13 (2012), http://www2.isda.org/attachment/NDQyMA==/Offsetting%20under%20US%20GAAP%20and%20IFRS%20-%20May%202012.pdf.

26. McConnell, *supra* note 22.

27. Corbi, *supra* note 25, at 14.

28. *Id.*

29. *Id.*

30. *Id.* at 6.

31. *Id.* at 4.

comparability and consistency of financial statements throughout the world. To this end, the FASB and the IASB decided to conduct short-term projects together designed to remove several important existing differences between U.S. GAAP and IFRS and to initiate joint projects in the future to eliminate any remaining differences between the two sets of standards.[32]

In creating this agreement, the main goal of the FASB and the IASB was improving the comparability and consistency of financial statements throughout the world.[33] The two main aspects of this goal of global improvement included promising to eliminate significant differences between U.S. GAAP and IFRS and working together on major projects.[34] The FASB and the IASB agreed to resolve some divergences by holding that, if either U.S. GAAP or IFRS clearly had a preferable standard on a given issue, both would adopt that standard.[35] The FASB and the IASB also agreed that they would work collectively on an improved joint standard in areas where both existing standards needed improvement.[36] Finally, the FASB and the IASB came to an understanding that, moving forward, removing any differences remaining between their standards would be given a high priority.

1. Major Initial Joint Projects

In the Norwalk Agreement, the FASB and the IASB agreed to focus first on four specific joint projects: (1) revenue recognition, (2) insurance, (3) financial instruments, and (4) leases. Out of these four original projects, revenue recognition has been the standard setters' greatest success to date.[37] The FASB and the IASB came to an agreement regarding recognizing revenue in contracts with customers and issued converged guidance on the matter on May 28, 2014.[38] This new converged guidance marked a significant achievement in their efforts to improve an important financial reporting area. The new guidance achieved their goal of simplifying and standardizing the revenue recognition process for customer contracts across different industries and geographic locations.[39]

Issuing this guidance marked a noteworthy achievement because investors view revenue recognition as one of the most significant measures used

32. BAKER TILLY VIRCHOW KRAUSE, LLP, *Progress Report: International Convergence of Accounting Standards*, (2014), http://www.bakertilly.com/insights/progress-report-international-convergence-of-accounting-standards/ [hereinafter BAKER TILLY].

33. *Id.*

34. Herz & Petrone, *supra* note 3, at 643.

35. Paul Pacter, *What Have the IASB and FASB Convergence Efforts Achieved?*, J. OF ACCOUNTANCY (Feb. 1, 2013), http://www.journalofaccountancy.com/issues/2013/feb/20126984.html.

36. *Id.*

37. BAKER TILLY, *supra* note 32.

38. FASB, An Overview, *supra* note 5.

39. *See* BAKER TILLY, *supra* note 32.

when it comes to evaluating an entity's performance and future opportunities.[40] The FASB and the IASB hope the new guidance on recognizing revenue in contracts with customers will provide many benefits, including: a stronger structure to handle revenue issues, better disclosure requirements to deliver more beneficial information to users of financial statements, a reduction in requirements to simplify the financial statement preparation process, the elimination of flaws and variations in the prior revenue recognition requirements, and enhanced comparability of revenue recognition customs throughout different capital markets, entities, and industries.[41]

Many companies have been unsure of how to apply the new revenue recognition rules. Prior to the converged guidance, U.S. GAAP had general revenue recognition rules with over 200 transaction- and industry-specific rules, while IFRS only provided limited guidance.[42] The new revenue recognition converged guidance will take effect for reporting periods of public companies beginning after December 15, 2016. Private companies can choose to implement the new revenue recognition rules at that time or take an extra year before they are required to comply.[43] To assist with the transition, in October 2014, the AICPA established sixteen industry-specific task forces to guide companies. Further, the FASB and the IASB have continued working together to improve the new revenue recognition guidance through a joint transition resource group in response to comments and concerns raised by stakeholders.[44]

With the exception of revenue recognition, however, completing the joint projects and implementing the overarching goals of the Norwalk Agreement has proven more difficult than anticipated. The FASB and the IASB have had more trouble than they originally foresaw agreeing on what is best for stakeholders. For example, they failed to produce joint guidance for insurance, the aim of which would have been to streamline and improve the financial reporting requirements for insurance contracts. Having an accurate and consistent presentation of insurance contracts is imperative because the information contained in insurance contracts reveals a company's long-term and uncertain obligations and is needed by stakeholders to understand an insurer's risk exposure, performance, and financial position.[45] The FASB and the IASB are currently developing a

40. *Why Did the FASB Issue a New Standard on Revenue Recognition?*, FASB, http://www.fasb.org/jsp/FASB/Page/BridgePage%26cid=1351027207987 (last visited Nov. 29, 2016).

41. *Id*.

42. Baker Tilly, *supra* note 32.

43. *Id.*

44. FASB, *the IASB and FASB Issue Converged Standard on Revenue Recognition*, (May 28, 2014) http://www.fasb.org/jsp/FASB/FASBContent_C/NewsPage&cid=1176164075286.

45. Int'l Financial Reporting Standards,, *Insurance Contracts*, http://www.ifrs.org/Current-Projects/theIASB-Projects/Insurance-Contracts/Pages/Insurance-Contracts.aspx (last visited Nov. 29, 2016).

model that would reflect current estimates of the dollar amount necessary to fulfill an insurance obligation, but they have not arrived at uniform conclusions for several elements of this model.[46]

Another subject on which the FASB and the IASB have failed to produce joint guidance is the area of financial instruments. Some of the projects within the area of financial instruments the FASB and the IASB attempted to address include classifications and measurements, hedge accounting, impairment, and balance sheet offsetting. The FASB and the IASB eventually chose to proceed separately with reforms in this area. The IASB completed its financial instruments project in July 2014 and not only confirmed that convergence for financial instruments would not occur when compared with the FASB's amendments but also demonstrated an even greater divergence than before the standard setters undertook the joint project.[47]

Financial instruments are among one of the most difficult areas on which to report accurately. Having clearer and consistent standards for financial instruments matters because financial instruments are already extremely complex in and of themselves, and having standards with a multitude of rules, exceptions, and alternatives leads to sizeable reporting inconsistencies. The intricate and dissimilar standards can result in a single entity, or more than one unrelated entities, measuring two identical financial instruments in different manners.[48]

The only outstanding convergence project out of the four main original projects the FASB and the IASB undertook in 2002 is the project on leases.[49] In May 2013, the FASB and the IASB issued a Revised Exposure Draft for leases for public comment in which they agreed that companies should record liabilities for lease contracts extending for over twelve months.[50] However, businesses that are disinclined to report higher debt to stakeholders are opposed to this suggestion.[51] The FASB and the IASB disagree on other prominent lease issues, one of which is the recognition of expenses on the income statement. While the FASB voted to keep using the current model for expense recognition regarding leases, the IASB

---

46. *Id.*

47. RSM US LLP, *FASB/the IASB Joint Project: Financial Instruments*, (2015), http://rsmus.com/what-we-do/services/assurance/financial-reporting-resource-center/fasb-iasb-joint-project-financial-instruments.html.

48. Int'l Accounting Standards Bd., *Discussion Paper: Reducing Complexity in Reporting Financial Instruments*, 17, (2008), http://www.ifrs.org/Current-Projects/theIASB-Projects/Financial-Instruments-A-Replacement-of-IAS-39-Financial-Instruments-Recognitio/Discussion-Paper-and-Comment-Letters/Documents/DPReducingComplexity_ReportingFinancialInstruments.pdf.

49. Baker Tilly, *supra* note 32.

50. FASB, Proposed Accounting Standards Update (Revised) on Leases (Topic 842), (May 16, 2013) http://www.fasb.org/jsp/FASB/Document_C/DocumentPage?cid=1176162613656&acceptedDisclaimer=true [hereinafter, FASB: Leases]; *see also* Baker Tilly, *supra* note 32.

51. Baker Tilly, *supra* note 32.

returned to an old approach where the lessees end up treating their leases primarily as financing transactions by front-loading expenses for lease contracts.[52]

Because the lease projects have taken longer than anticipated to complete, the FASB and the IASB have begun shifting their attention instead to more minor lease issues such as discount rates, lease modifications, variable lease payments, and whether to exempt small-ticket leased items from the new rules.[53]

However, addressing leases will continue to be an important project for the FASB and the IASB to keep in mind because leases will inevitably endure as a principal activity for organizations. Users of financial statements will continue to have a need for an accurate and comprehensive picture of an entity's leasing activities. Whether an entity is a private company, a public company, or a not-for-profit organization, there is a high prevalence of businesses utilizing leases as a means for attaining financing, acquiring assets, and minimizing the potential risks that come with owning and leasing assets.[54] Since models have required lessees and lessors to account for capital and operating leases differently, they may not show an accurate depiction of an entity's leasing transactions.[55] Completing this project will mean that the FASB and the IASB have found another way to increase comparability and transparency among entities by disclosing important information and consistently recognizing lease assets and liabilities on companies' balance sheets.[56]

The FASB and the IASB issued their latest update on this joint project in November 2015. They were able to come to an agreement on some points, such as that lessors should decide lease classification based on whether the lease in question is really a sale or a financing as opposed to an operating lease.[57] As of yet, however, the FASB and the IASB have not reached agreements on other key points, such as the lessee accounting model. The FASB has adopted a dual approach in which the principle in existing lease requirements determines lease classification, and the IASB has adopted a single approach in which all leases are considered to be finance leases.[58]

2. Other Efforts

Many other short-term projects commenced as joint projects between the FASB and the IASB as part of the Norwalk Agreement have been aban-

52. *Id.*

53. *Id.*

54. *Leases – Joint Project of the FASB and the IASB*, Fin. Accounting Standards Bd. (2015), http://www.fasb.org/jsp/FASB/FASBContent_C/ProjectUpdatePage&cid=900000011123.

55. *Id.*

56. *Id.*

57. *Id.*

58. *Id.*

doned after the groups were unable to come to an agreement.[59] Discontinued projects include those on government grants, impairment income taxes liabilities and equity, and post-employment benefits[60] Since these discontinuations, the FASB or the IASB has picked back up some of these halted projects.[61] Many more of the discontinued projects, however, remain untouched.

Nevertheless, some smaller projects have seen success. For example, the FASB and the IASB have achieved agreement in the area of fair value assessment.[62] The FASB and the IASB came to an agreement and issued converged guidance on this topic in 2011, which made fair value assessment almost identical across U.S. GAAP and IFRS.[63] This new issuance does not expand the use of fair value accounting, but it does provide direction on how fair value assessment should be applied where its use is already permitted or required by other standards within U.S. GAAP or IFRS.[64]

Some achievements have even pointed to the possibility of accepting IFRS in the United States. For example, in November 2007, the SEC eliminated the requirement that a foreign issuer using IFRS must present a reconciliation of IFRS measures of profit or loss as well as owner's equity to amounts that would have been reported under U.S. GAAP, thus achieving an important highpoint toward the use of IFRS in the United States.[65]

III. What is at Stake if Convergence Does Not Occur?

A. *Factors Driving the International Convergence of Accounting Standards*

Considering how difficult convergence has been for the FASB and the IASB to achieve as a practical matter, it is worth considering why there is still such a strong push for convergence. Several factors have historically driven—and continue to drive—the movement toward the international convergence of accounting standards, including: (1) the globalization of capital markets, (2) transparency as a priority, especially for investors, (3)

59. Pacter, *supra* note 35.

60. IASPlus, *the IASB-FASB Convergence*, Deloitte, http://www.iasplus.com/en/projects/completed/other/iasb-fasb-convergence (last visited Nov. 29, 2016).

61. *See e.g.* IASPlus, *Conceptual Framework – the IASB-FASB joint project*, Deloitte, http://www.iasplus.com/en/projects/completed/framework/framework-joint (last visited Nov. 29, 2016) (describing how the the IASB decided to reactivate the previously discontinued Conceptual Framework joint project as an the IASB-only project).

62. FASB, An Overview, *supra* note 5.

63. *Fair Value Measurement—Joint Project of the the IASB and FASB*, FASB, (May 16, 2011), http://www.fasb.org/cs/ContentServer?pagename=FASB/FASBContent_C/ProjectUpdatePage&cid=1176156576143.

64. Pacter, *supra* note 35.

65. *Id.*

the long-term cost savings associated with convergence, and (4) the efficiency gains of convergence.

1. Globalization of Capital Markets

One factor steering international convergence is the globalization of financial capital. The differences in accounting standards from one country to another can cause particular problems for multinational companies.[66] It is a well-known maxim that accounting is the language of business. Accounting has earned this reputation because it processes important financial information that anyone in the business world can use. Because everyone uses accounting information, the quality of the information can directly influence the level of market transactions and also affects both the quality and effective allocation of global resources.[67]

A number of positive capital market effects have developed under IFRS that have not developed under U.S. GAAP. Some examples include: increased transparency of non-U.S. companies, simplified mergers and acquisitions, less expensive compliance reporting, easier access to capital, and enhanced comparability across borders and within global industry.[68]

2. Transparency as a Priority

Another factor propelling international convergence is the importance of transparency for investors.[69] Investors need to understand potential risks, and the less access investors have to high-quality information, the less certainty investors will have when it comes to analyzing and understanding potential investments.[70] With convergence, financial statements will be more easily comparable, and the information they present will therefore be more transparent.[71] Convergence will allow investors to have access to more credible information, and this information will be much simpler to understand since investors will not have to change the information to adhere to the standards of their particular country.[72] If investors do not have the ability to understand or even evaluate the credibility of companies' financial statements, then companies' value will be irrelevant or at least misrepresented.[73]

---

66. Moussa, *supra* note 8, at 89.

67. *Id.* at 90.

68. *The New Globalization of Accounting Standards*, COLL. OF BUS. AT ILL. (2007), https://business.illinois.edu/news/college/2007/11/the-new-globalization-of-accounting-standards/.

69. Pologeorgis, *supra* note 13.

70. International Accounting Standards, SEC Concept Release Nos. 33-7801, 34-42430 (2000) [hereinafter SEC Concept Release].

71. *Id.*

72. Pologeorgis, *supra* note 13.

73. SEC Concept Release, *supra* note 70.

3. Long-Term Cost Savings

Another factor compelling the move toward a union of accounting standards is that convergence, while initially expensive, would ultimately reduce costs to both the users and preparers of financial statements in several ways. First, IFRS provides enhanced access to capital markets since investors are less likely to invest in a company whose financial statements they do not understand. This increased availability of capital will correspondingly drive down costs. Second, instead of having to invest resources in complying with and comprehending multiple sets of accounting standards, preparers and users would instead end up focusing on a single set of accounting standards.[74] Third, complying with one streamlined set of standards and practices that applies to all countries and is followed worldwide will be less expensive for companies than complying with two separate systems. Finally, convergence will give management the opportunity to raise capital at lower interest rates while, at the same time, lowering risk for investors and reducing the cost of doing business.[75]

4. Efficiency

The move to international convergence will ultimately make worldwide capital markets more efficient as a whole. Convergence will greatly improve the comparability between entities' financial statements for managers and investors, and capital markets will function more successfully when investors have high-quality financial information.[76] The access to accounting standards of superior quality affects the efficiency of capital markets since the credibility of financial information can influence decisions regarding the distribution of capital.[77] Even stock markets will experience reduced costs that accompany entering foreign exchanges, and all markets adhering to the same rules and standards will further allow markets to compete internationally for global investment opportunities.[78]

B. *Obstacles to Convergence*

It is clear from the efforts of the FASB and the IASB that moving forward in the direction of international convergence will prove difficult and that many obstacles to overcome still exist. Convergence will require agreement and cooperation among standard setters across the world, which will be difficult because of key differences from country to country. Some of these notable differences include different regulatory environments, business cultures, legal systems, and financial reporting objectives. Although a variety of perspectives could bring a beneficially diverse approach to improving standards, it is likely that the multitude of differences

---

74. Ebimobowei, *supra* note 1, at 160.
75. Pologeorgis, *supra* note 13.
76. Ebimobowei, *supra* note 1, at 164.
77. SEC Concept Release, *supra* note 70.
78. Pologeorgis, *supra* note 13.

will make it challenging for standard setters around the world to agree on the same accounting techniques. One country may view a given change as an improvement that another country views as a decline.[79] Converging standards means that stakeholders will have to collectively agree on what the central objective of financial reporting is despite their dissimilar interests and backgrounds.

Countries' pride and politics will also act as a barrier toward convergence. Many stakeholders in the United States fear the idea of giving away standard-setting power, which may occur if the SEC abandons or alters U.S. GAAP. PricewaterhouseCoopers sponsored a survey of U.S. stakeholders that showed that, although the vast majority of stakeholders favor having some sort of uniform global accounting standards, only about a third of stakeholders support allowing the IASB to develop a global set of financial reporting standards.[80] But this is not just a worry that stakeholders in the United States possess. Participants in other parts of the world also worry that the SEC may excessively interfere with IFRS, perhaps by construing IFRS in more restrictive ways that cause it to more closely resemble the narrower U.S. GAAP.[81]

Even though international convergence would ultimately lead to a reduction in costs when it comes to complying with accounting standards, the up-front costs associated with convergence will also make merging accounting standards problematic. The process of convergence for any country will produce one-time transitional costs of implementing the new standards, as well as ongoing costs of maintaining standard setting procedures for global accounting principles.[82] Successful convergence would involve extended negotiations among the standard setters as well as with various government officials, regulators, and other professionals with vested interests in participating in the convergence process, all of which would require significant expense to coordinate.[83]

Compliance costs would also arise as a consequence of the need to retrain users, preparers, regulators, and auditors to apply and interpret the new converged accounting standards.[84] Stakeholders' demands for standard setters' publications and services will also increase as new converged standards for which stakeholders need new guidance emerge, so the standard setters would incur additional direct costs to meet the rising demand for the new information.[85] Issuers of accounting standards would also incur costs from restricting the ability to choose to operate in jurisdictions where the accounting rules best reflect the nature of their business.[86]

79. FASB, An Overview, *supra* note 5.
80. PRICEWATERHOUSECOOPERS, *supra* note 6, at 11.
81. *Id.*
82. Ebimobowei, *supra* note 1, at 159.
83. *Id.* at 161.
84. *Id.*
85. *Id.*
86. *Id.*

IV. Procedural Paths Forward

A. *The Process of the International Convergence of Accounting Standards*

The path toward international convergence thus far has been the product of the concerted efforts of the FASB and the IASB to improve U.S. GAAP and IFRS and to eliminate (or at least minimize) the differences between these two frameworks. Going forward, in addition to completing the projects discussed above with the IASB, the FASB will continue to work on addressing global accounting issues with the IASB through its membership in the Accounting Standards Advisory Forum (ASAF).[87] The ASAF is an advisory body established in 2013 comprised of twelve standard-setting regions from across the globe, including Africa, North America, South America, Asia/Oceana, Europe (including non-EU countries), and representatives for the world at large to maintain an overall geographical balance.[88] The ASAF seeks to provide a forum where members can contribute toward the IASB's goal of globally accepted, high-quality accounting standards.[89] The FASB's participation in the ASAF provides a great opportunity for the United States to have its interests represented in the IASB's standard-setting process, as well as to work toward the convergence of accounting standards.[90]

However, in areas that are of unique interest to U.S. stakeholders, the FASB will most likely set its own agenda.[91] The FASB plans to contact various stakeholders—including stakeholders who may live or work outside the United States—to receive feedback on what these areas are.[92] Until the FASB completes the process of identifying and communicating with these stakeholders, they are committed to collaborating with other standard-setting bodies in order to arrive at accounting standards that are as converged as possible but without sacrificing the quality U.S. investors and other users of financial statements demand.[93]

---

87. IASPlus, *Accounting Standards Advisory Forum (ASAF)*, Deloitte, http://www.iasplus.com/en/resources/ifrsf/advisory/asaf (last visited Nov. 29, 2016).

88. *Id.*

89. *Id.*

90. *FASB to Join IFRS Foundation's Accounting Standards Advisory Forum*, Fin. Accounting Found. (Mar. 19, 2013), http://www.accountingfoundation.org/cs/ContentServer?c=FAFContent_C&pagename=Foundation%2FFAFContent_C%2FFAFNewsPage&cid=1176162294866.

91. Mark Sullivan, *The Rise and Stall the U.S. GAAP and IFRS Convergence Movement*, InsuranceNewsNet (Mar. 4, 2014), http://insurancenewsnet.com/oarticle/The-Rise-and-Stall-the-US-GAAP-and-IFRS-Convergence-Movement-a-468950.

92. *Id.*

93. *Id.*

B. *The Future of the International Convergence of Accounting Standards*

There are several possibilities for the future of the international convergence of accounting standards, including: (1) the mandatory adoption of IFRS by the United States, (2) the voluntary adoption of IFRS by the United States, (3) the mandatory use of both U.S. GAAP and IFRS in the United States, and (4) the creation and adoption of a new third standard to be used by all nations.

1. Option 1: Mandatory IFRS Adoption

One option is to have international convergence of standards through the mandatory adoption of IFRS in the United States. After all, over 120 countries around the globe currently use IFRS, and regulators throughout the world have urged the United States to adopt these common standards.[94] About 57% of investors believe the SEC, the agency that establishes and enforces accounting policies in the United States, will adopt IFRS one day, and even more investors agree that the long-term benefits of adopting IFRS would outweigh the costs.[95] The United States' adoption of IFRS would enable virtually the entire world to use the same accounting standards.[96] Even though adopting IFRS means the United States will switch to a set of standards that is very different from the guidance that U.S. GAAP currently provides, IFRS could present investors with what they need, including transparency, a framework that is less cumbersome to apply since it has fewer rules and exceptions than U.S. GAAP, and a platform to exercise better professional judgment.[97]

Entities subject to SEC oversight are investing throughout the world, and those investments often include purchasing companies that use IFRS. These entities are subsequently already obtaining IFRS expertise even if they do not use IFRS for their own financial reporting, Further, in many cases the acquirees' IFRS financial statements end up being switched to U.S. GAAP even though the subsidiary will continue using IFRS for SEC pro forma reporting purposes at acquisition—a switching process that will occur each reporting period.[98] Consequently, these U.S. entities already spend a significant amount of resources converting information every year that they could avoid if the United States switches to IFRS.

The Association of Chartered Certified Accounts (ACCA) published a report conducted by Forbes Insights called IFRS in the U.S.: An Investor's

---

94. Michael Rapoport, *SEC Ex-Chairman Cox Does a 180, Now Predicts U.S. Won't Switch to Global Accounting Rules*, The Wall St. J. (June 9, 2014), http://blogs.wsj.com/moneybeat/2014/06/09/sec-ex-chairman-cox-does-a-180-now-predicts-u-s-wont-switch-to-global-accounting-rules/.

95. Michael Cohn, *Investors Predict U.S. Will Adopt IFRS*, Accounting Today (Nov. 16, 2012), http://www.accountingtoday.com/news/Investors-Predict-US-Adopt-IFRS-64689-1.html.

96. Rapoport, *supra* note 94.

97. *Id.* at 8.

98. Grant Thornton, *supra* note 7 at 3.

Perspective that surveyed close to 500 U.S. investors. The report's findings demonstrated that, overall, the United States is equipped to adopt IFRS.[99] The ACCA report identified that the most significant challenges in the adoption of IFRS would mainly be one-off transition costs, and that longer-term concerns were not as significant.[100] Investors estimate that it would take about four and a half years for the United States to prepare for the adoption of IFRS.[101]

On the whole, ACCA believes that adopting IFRS, while—at least at first—expensive and time-consuming, would ultimately help global financial reporting and financial reporting in the United States in particular.[102] Some of the expected benefits from mandating IFRS adoption include: (1) overcoming the issue of diminishing global knowledge of U.S. accounting standards, (2) reducing the number of transactions structured to specifically meet the detailed U.S. guidance that must be accounted for, (3) increasing comparability of business results among entities, and (4) improving access to capital in global markets due to both a lower cost of capital and higher liquidity.[103] Many investors also believe that, in the long run, IFRS adoption will lead to reduced complexity and even cost savings.[104]

Although investors tend to be more comfortable with the idea of converting to IFRS as they become the more familiar with the standards, the FASB has not wanted to move forward with adopting IFRS because the United States would have to undertake great costs to do so, and U.S. companies would confront many burdens in trying to adhere to essentially completely new standards.[105] Former SEC Chairman Christopher Cox has commented that persuading the FASB to adopt IFRS would prove extremely difficult, because "the bar is set very high when it comes to convincing U.S. stakeholders to switch" as the United States already has its own developed set of rules.[106]

In the ACCA report, out of the investors who reported their skepticism of IFRS adoption, 28% reported that they would probably avoid companies using IFRS, 49% believe companies reporting under IFRS are actually riskier than they appear on paper, and 56% would continue to spend the time to reconcile the information of companies that report under IFRS's financial figures to U.S. GAAP.[107] The benefits of adopting

99. Cohn, *supra* note 95.

100. *Id.*

101. *Id.*

102. *Id*.

103. Ass'n of Chartered Certified Accountants, IRFS in the US: The Investor's Perspective, 18 (2012), http://www.accaglobal.com/content/dam/acca/global/PDF-technical/financial-reporting/pol-afb-iusip.pdf.

104. *Id.*

105. Rapoport, *supra* note 94.

106. *Id.*

107. Ass'n of Chartered Certified Accountants, *supra* note 103, at 14.

IFRS in the United States may not justify the burden of doing so if a sizeable number of investors would avoid companies utilizing IFRS or still invest the resources to reconcile these companies' financial statements with U.S. GAAP.

Perhaps even more troubling is that Cox, and others, feel that the IASB has failed to address many of the concerns of U.S. investors who would largely be affected by a switch to IFRS have.[108] The ACCA report identified five main concerns that influence U.S. investors' views on whether or not to support IFRS:

1) Will adopting IFRS cause U.S. corporations to be less complex?
2) Will adopting IFRS result in the United States having a significant loss of power in the process of setting standards?
3) Will adopting IFRS lead to cost savings and synergies?
4) Will adopting IFRS make comparing the performances of companies in the United States with ones overseas less cumbersome?
5) Will adopting IFRS cause U.S. auditors to second-guess management more frequently?[109]

Cox has also disparaged the IASB's failure to show "sensitivity to American criticisms of its proposals."[110] In the absence of the IASB's efforts to address these concerns, U.S. investors will continue to resist a switch to IFRS.[111]

Further, stakeholders will undoubtedly point to features of U.S. GAAP that the FASB has already included to speak to U.S.-specific transactions that IFRS does not include. Examples include certain aspects of contracts with the federal government and accounting for rate-regulated entities, where IFRS' general application does not offer specific guidance.[112] U.S. GAAP also requires certain disclosure requirements favored by stakeholders that are not mandated by IFRS, including: (1) interim disclosures after the adoption date explaining the effect of the change on net income, income from continuing operations, and related per share amounts, and (2) an explanation of the indirect effects not adjusted for under U.S. GAAP, including disclosures concerning cumulative amounts and current period as well as related per share effects.[113] For these reasons, the United States will likely remain hesitant to commit to adopting IFRS.

2. Option 2: Voluntary Adoption of IFRS

Rather than having the SEC implement the mandatory adoption of IFRS in the United States, another approach the SEC could take is to encourage the voluntary adoption of IFRS. Particularly for large international corpo-

108. *See* Rapoport, *supra* note 94.
109. Cohn, *supra* note 95.
110. Rapoport, *supra* note 94.
111. *Id.*
112. *See* SEC Concept Release, *supra* note 70, at 10.
113. *Id.* at 13.

rations that would benefit the most from a single set of standards, the SEC could take steps to make voluntary adoption more appealing for U.S. entities. For example, IFRS does not recognize a method of inventory used in the United States under U.S. GAAP called last-in, first-out (LIFO). If U.S. companies instead had to use the first-in, first-out (FIFO) method of inventory that IFRS permits, these companies would end up paying considerably higher taxes then they had been paying when using LIFO. To address this concern, the SEC could work with Congress to change the tax laws to eliminate or minimize unfavorable tax consequences of switching from LIFO to FIFO and, in doing so, make IFRS more appealing to U.S. companies.[114]

3. Option 3: Requiring Both U.S. GAAP and IFRS

Another possibility in the path toward convergence is a requirement for public companies throughout the world to prepare their financial statements using both U.S. GAAP and IFRS. As U.S. GAAP and IFRS are the two most commonly used standards in financial reporting, requiring the use of both sets of standards would solve the problems associated with convergence, including the need to reconcile companies' information from U.S. GAAP to IFRS and vice versa. Selecting this option would also mean that the United States would not alone bear the costs of adopting IFRS and would not have to surrender its own standards.

Even though mandating public companies use both sets of standards might be a fairer approach allowing everyone access to the information they want and requiring neither the FASB nor the IASB to change their standards, forcing everyone to invest the time and resources into learning and complying with two sets of standards would be prohibitively cumbersome, both in terms of the time it would take for everyone to learn two sets of standards and the costs associated with such a significant change.

4. Option 4: Creation of New Standards

When people think of international convergence, they often think of one set of unified accounting standards used in every country. The FASB and the IASB could choose this option and work together on each issue to create newly integrated standards. After all, the United States will be more likely to converge if the process of convergence is a two-way street rather than a circumstance in which the United States makes all of the sacrifices and bears all of the costs of convergence. Situations will almost certainly arise where the FASB or the IASB puts forth a better approach to a particular issue, and situations will arise where the FASB and the IASB can work together to create a new and improved joint standard, just as they have already done on certain joint projects already.[115]

114. Turner Inv. Partners, Will the U.S. Rather Fight than Switch to International Accounting Standards? (2009), http://www.turnerinvestments.com/will-the-us-rather-fight-than-switch-to-international-accounting-standards/.

115. SEC Concept Release, *supra* note 70, at 2.

The SEC has previously supported the creation of new joint standards that are "objectives-oriented" rather than rules-based or principles-based.[116] Objectives-oriented means that the FASB and the IASB would develop accounting standards that reflect objectives set by the FASB and the IASB that unify the accounting system as a whole.[117] Although "objectives" might sound like they have more in common with principles than rules, an objectives-oriented approach would have considerable differences from a principles-based framework. For example, an objectives-oriented approach would include bright-line tests and exceptions.[118] The SEC believes that an objectives-oriented approach would serve as an optimal alternative to the standards currently in place because an objectives-oriented approach would provide more flexibility than rules-based standards, but it would offer a substantially clearer system than a principles-based standard creates by reducing the amount of professional judgment necessary in interpretation.[119]

Another way to create a new, unified standard is to create a global registry of financial reporting standards, including a single set of standards for everyone based on a global conceptual framework. Standard-setters would have to approve the common framework in order to participate in the registry. In exchange for their endorsement, they would obtain a voice in shaping the registry going forward and would have their own standards added to the registry. The participants would then organize these suggestions and the standards in the registry into a shared codification scheme.[120] The standard setters would use the provisions held in common by U.S. GAAP, IFRS, and other sets of standards as the core provisions for the registry.[121] Such a global registry, like other methods of convergence, would improve the process of comparing financial information, but a global registry has the extra advantage of forcing companies into a–potentially ill-fitting–one-size-fits-all approach.[122] The global registry would ultimately provide uniformity and encourage collaboration without forcing standard setters to forgo their dominion over financial reporting matters.

---

116. George J. Benston et al, *Principles- Versus Rules-Based Accounting Standards: The FASB's Standard Setting Strategy*, 42 Abacus 2, 170 (2006).

117. *See* Sue Anderson, *Principles vs. Objectives-Based Accounting Systems*, Accounting Web (May 9, 2013), http://www.accountingweb.com/community-voice/blogs/sue-anderson/principles-vs-objectives-based-accounting-systems.

118. *Id.*

119. Benston, *supra* note 116.

120. *IFRS vs. U.S. GAAP vs. A Better Option,* Accounting Web (Nov. 9, 2009), http://www.accountingweb.com/community-voice/blogs/admin/ifrs-vs-us-gaap-vs-a-better-option.

121. *Id.*

122. *A Single Sandbox for Standard Setters*, Accounting Web (Feb. 2, 2010), http://www.accountingweb.com/community-voice/blogs/admin/a-single-sandbox-for-standard-setters-part-1.

5. Disagreements

The FASB and the IASB may have expected full convergence when agreeing to the Norwalk Agreement back in 2002, but it now seems that the Norwalk Agreement's goals may have been overambitious. Many stakeholders believe that a single set of standards to apply around the globe will never exist because numerous countries have already created various carve-outs and exceptions to existing rules.[123] Further, while a framework like the objectives-oriented approach sounds like an ideal alternative, it is still difficult to determine how standard setters would create these new standards or how much detail they would entail.

Disagreements even arise on the level of individual standards within the accounting frameworks. The FASB and the IASB are unlikely to budge on to appease the other side when addressing conflicting standards for which one because accepting certain changes could negatively impact their country. For example, the United States would have been negatively impacted if the FASB had chosen to adopt the IASB's approach to financial impairment: banks in the United States would most likely have experienced reduced loan loss reserves as a result because U.S. GAAP obliges companies to uphold higher reserves for a longer period of time than is required in the IASB's approach.[124] The FASB thought that the adoption of the IASB's approach would be unwise, particularly in the aftermath of the financial crisis in 2008 and the subsequent recession.

The FASB and the IASB continue to disagree on other significant issues, one of which, as mentioned above in Section II(B)(3), is the recognition of expenses on the income statement for leases. The FASB does not want to deviate from the standards they now have for expense recognition, and they have voted to maintain the model they currently have. However, the IASB has chosen to return to front-loading expenses by the lessee for all lease contracts. This method was a previously discarded approach, and by returning to it, the IASB is in effect treating all leases primarily as financing transactions.[125] Unless the FASB and the IASB can reach some kind of compromise on the areas of disagreement—such as expense recognition for leases on the income statement—acceptance of a joint proposal on long-term lease contracts, let alone a fully converged standard, is an implausible outcome.[126]

6. Harmonization: The New Option

Although full convergence may represent the ideal outcome (either through the adoption of IFRS or through the collaboration of standard

123. Floyd Norris, *Accounting That Comes in Flavors*, New York Times (July 7, 2011), http://www.nytimes.com/2011/07/08/business/accounting-standards-that-come-in-flavors-floyd-norris.html?_r=0.

124. Baker Tilly, *supra* note 31.

125. *Id.*

126. *Id.*

setters), the FASB and the IASB could instead focus on harmonization, meaning establishing guidelines for significant global standards without creating one set of fully converged standards. This harmonization view represents a new, collaborative approach that seems more achievable than full convergence.

This new collective approach acknowledges that a single global financial reporting model, while it may be a nice idea in theory, is nonetheless an idea that will most likely be infeasible in practice. In September 2014, the FASB publicized its plans for better financial reporting through the creation of a joint informal network of various accounting bodies in the major capital markets with the hopes of minimizing the differences in global accounting standards.[127] The FASB hopes this network will promote a shared understanding of financial accounting to different critical interests regarding reporting issues for standard setters around the world. This network also identifies cultural, legal, political, and other constraints on the development of more comparable accounting standards.[128] The FASB and the IASB have continued to meet regularly to promote collaboration.[129]

C. *The Most Efficient Outcome*

Market forces have, for many years, driven—and will continue to drive—the necessity for a single set of high-quality, global accounting standards. The most efficient course of action for the global accounting world as a whole would be for the United States to follow suit with other countries throughout the world and adopt IFRS. IFRS is already the most commonly used set of financial reporting standards in the world: a huge number of countries have either adopted IFRS, have considerably converged their local standards with IFRS, or have permitted the elective use of IFRS.[130]

IFRS is already relevant within U.S. borders regardless of whether the entity is a public or private company. As discussed above in Section I(A), several foreign subsidiaries of U.S. multinational companies already conform to IFRS. Capital raising, mergers and acquisitions, and cross-border transactions commonly entail the use of IFRS.[131] Even from a global investment standpoint, investors in the U.S. increasingly need to understand IFRS, as over $7 trillion of U.S. capital is invested in foreign securities.[132]

---

127. *Id.*

128. *Id.*

129. Denise Lugo, *FASB-the IASB Make Full Circle Return to the Norwalk Agreement*, Bloomberg BNA (June 15, 2015), http://www.bna.com/fasbiasb-full-circle-b17179927539/.

130. Grant Thornton, *supra* note 7, at 4.

131. *See* James G. Kaiser, *IFRS and US GAAP: Similarities and Differences*, PricewaterhouseCoopers, Oct. 2014, at 3, http://www.pwc.com/us/en/issues/ifrs-reporting/publications/assets/ifrs-and-us-gaap-similarities-and-differences-2013.pdf.

132. *Id.* at 4.

Although a principles-based framework would be remarkably different from the rules-based characteristics of U.S. GAAP, this set of standards could benefit the United States. Bright-line tests encourage taking advantage of loopholes, which consequently encourages financial reporting that is unfaithful to the economic substance of events and transactions. Even the SEC and the FASB have stated that they believe the costs of a rules-based approach outweigh the benefits, particularly in light of high-profile accounting scandals like Enron and WorldCom that occurred in the United States.[133] Moving to a framework that places faith in professional judgment more than complex rules could benefit the United States. Even though an increased use of professional judgment in the United States may result in more interpretations of transactions (which might decrease comparability in the short run), the IFRS disclosure framework can help reduce the effects of short-term problems, and market pressures will most likely encourage companies to adhere to industry norms in the long run.[134]

Studies, like the study performed by the ACCA discussed above in Section IV(B)(1), have demonstrated that U.S. investors' responses to adoption of IFRS greatly correlate with their level of knowledge and comprehension of the IASB's standards. Accordingly, one of the next critical steps to get more stakeholders on board with the mandatory adoption of IFRS is to inform stakeholders about the of changes a switch to IFRS would cause and how these changes would affect them.[135]

If the United States seriously considers undergoing mandatory IFRS adoption, the SEC will have to address several critical questions before deciding whether or not to make the switch. One of the most vital—and difficult to assess—factors will be determining a reasonable time frame in which to require companies to switch to IFRS after announcing the mandatory adoption.[136] Different types of stakeholders will likely disagree on this matter. Transition, for example, will be easier for companies that only use the United States as a corporate location and actually have multiple entities that report under other sets of standards.[137] Global accounting firms located in the United States would also transit more easily than other types of stakeholders because they already possess better IFRS resources than smaller accounting firms in the United States thanks to their international client base and firm structure. Some even have employees already familiar with IFRS working in their U.S. locations.

Although some types of stakeholders would not find the transition to IFRS to be as cumbersome as others, there are certainly entities on the other side of the spectrum that would find the change to be extremely difficult. The United States has many smaller domestic entities, investors,

133. Benston, *supra* note 116.

134. PricewaterhouseCoopers, *supra* note 6, at 19.

135. Ass'n of Chartered Certified Accountants, *supra* note 103, at 14.

136. *Id.* at 20.

137. *Id.* at 21.

and audit firms that do not have the expertise, capabilities, or resources of their larger international counterparts. These domestic entities would inevitably need more time and outside assistance.[138]

A second critical factor would be ensuring that the United States has an opportunity to continue influencing the standard-setting process, as it would be forgoing its existing standards.[139] The SEC in particular is concerned with automatically adopting standards without contemplating whether incorporating any given standard meets the interests of U.S. capital markets and investors.[140] One solution to this issue could be for the United States to maintain some national standard-setting body, which could have a role in the approval process of IFRS going forward, present input to the IASB for public companies, and continue setting standards for private companies until U.S. GAAP is completely phased out.[141] The IASB should have an open mind when it comes to providing the United States with a place in the standards setting process, not only to address these concerns, but also because the United States offers an outlook that highly prioritizes investor protection and independent standard-setting expertise that could benefit everyone using IFRS.

It is also imperative to recognize that many countries that already adopted IFRS have done so with exceptions, meaning that these countries actually have not adopted the exact IFRS model set forth by the IASB. If numerous countries have already made their own modifications, the commonality of the IFRS standards may already be compromised. In fact, there are some areas the United States regulates that would not apply to other countries, such as accounting for regulated utilities, meaning there is no applicable IFRS standard. In these situations, the United States would likely continue applying the applicable standards used in U.S. GAAP.

D. *The Likely Outcome*

Even though the most efficient outcome for global markets as a whole would most likely be for the United States to adopt IFRS, it is an outcome that the SEC will likely never mandate. SEC staff members have commented that they would never recommend that the United States adopt IFRS unless they were convinced that IFRS would be an improvement on existing U.S. GAAP, and most of the United States still regards U.S. GAAP as being a better-developed set of standards than IFRS.[142] Further, taking into account how most of the joint guidance projects undertaken following the Norwalk Agreement have progressed so far provides little hope for one set of standards: if the FASB and the IASB could not

138. Grant Thornton, *supra* note 7 at 4.

139. Ass'n of Chartered Certified Accountants, *supra* note 103 at 21.

140. Floyd Norris, *The Case for Global Accounting*, New York Times (May 10, 2012), http://www.nytimes.com/2012/05/11/business/the-case-for-global-accounting-rules.html?pagewanted=all [Hereineafter, *The Case for Global Accounting*].

141. PricewaterhouseCoopers, *supra* note 6, at 15.

142. Grant Thornton, *supra* note 7 at 2.

even agree on the original group of joint projects, it seems unlikely that the United States would agree on an entire set of dissimilar standards without having their input taken into account.

The FASB has made it clear that it believes U.S. GAAP is a better set of financial reporting standards, and it has demonstrated this belief in several ways. First, the FASB has specifically developed U.S. GAAP to meet and address the needs and desires of the United States and has not for the IASB. Second, the FASB would have had no problem agreeing on many of the joint guidance projects undertaken with the IASB if it believed IFRS was better than, or even comparable to, U.S. GAAP.

Many investors—likely those less familiar with IFRS—also remain unsupportive of U.S. implementation of IFRS.[143] Not everyone will be open to absorbing all the learning costs associated with embracing the new standards, even if the benefits they could derive would eventually outweigh the costs.[144]

A separate issue also arises with the sustainability of the IASB. Even if adopting IFRS in the United States makes sense today, the SEC cannot determine with certainty whether the United States can rely on the IASB for the foreseeable future.[145] In comparison to the FASB, the IASB in its current form is fairly new and has a less-developed infrastructure than the FASB. The IASB regularly outsources work to other national standard-setting bodies and even often shares resources with the FASB.[146] Sustainability could also create an issue in terms of funding for the IASB. The FASB has guaranteed funding because the Sarbanes-Oxley Act imposes fees on public companies in the United States, and those fees are committed to funding the FASB.[147] Conversely, the IASB does not have such secured funding and instead relies on money obtained through private donors. Adopting IFRS would require the creation of some sort of stable funding model for the IASB in order to ensure a steady flow of capital.[148]

The United States also has concerns with the IASB's responses to political pressures. In the past, the IASB reacted to political stress, worrying many investors. For example, in response to the financial crisis, the European Commission feared that plunging market values would result in losses for banks and threatened to take action against the IASB unless they allowed banks to retroactively reclassify assets to avoid taking such losses. The IASB ultimately gave in and undertook the actions the Commission wanted.[149]

143. ASS'N OF CHARTERED CERTIFIED ACCOUNTANTS, *supra* note 103, at 14.

144. *Id.*

145. PRICEWATERHOUSECOOPERS, *supra* note 6, at 14.

146. *Id.*

147. *Id.* at 16.

148. *Id.* at 15.

149. *The Case for Global Accounting*, *supra* note 143.

The link between convergence and comparability may not even be as strong as is hoped. As mentioned briefly above in Section IV(C), many countries that have adopted IFRS end up with a modified form of IFRS to account for their unique circumstances. If every country ends up employing a modified version of IFRS, accounting standards will ultimately not have the intended comparability. Adopting a principles-based framework presents shortcomings of its own for comparability. As discussed in Section II(A)(1), IFRS is a principles-based framework rather than a set of clearer cut rules, meaning it will produce a wider variety of results when it comes to financial reporting. The more possible outcomes similar transactions have, the less comparable financial statements presenting those transactions might ultimately be. Even financial statements within a single country may not even be that comparable under IFRS since analogous transactions can have divergent interpretations.

Rather than reaching full convergence of international accounting standards, it is more likely that the FASB and the IASB will instead continue working toward the harmonization of key differences between U.S. GAAP and IFRS. Conceivably, the FASB's proposal of an informal and collaborative model that aims to reduce differences in financial reporting in lieu of adopting the IASB's one-size-fits-all approach may be as close as global markets will ever arrive at convergence.[150] After all, the FASB and the IASB list comparability as one of the four "enhancing qualitative characteristics" of accounting information in their joint conceptual framework, so a collective effort to reduce differences would ultimately enhance standards within both of their frameworks.[151]

In fact, a single set of standards may not be best for the business world, even if it would be simpler. Variances in business practices and cultures from nation to nation may require a sort of flexibility that one set of accounting standards cannot provide, and harmonization would accommodate national differences more so than one set of standards. While full convergence will likely be too ambitious of a goal for standard setters to achieve, a more harmonized set of global accounting principles can at least continue taking us in the right direction.

If the FASB and the IASB move forward with harmonization in order to reduce the differences between U.S. GAAP and IFRS, they—and stakeholders—can take steps to optimize this process to increase comparability between countries. First, the FASB and the IASB should prioritize the most meaningful differences between the two sets of standards that exist at the conclusion of their joint guidance projects undertaken from the Norwalk Agreement. Embarking on the projects that currently contribute to the greatest and most significant variances in financial reporting, such as derivatives, should take precedence over other projects. Second, though

150. Baker Tilly, *supra* note 31.

151. Clare Wang, *Accounting Standards Harmonization and Financial Statement Comparability: Evidence from Transnational Information Transfer*, 52.4 J. of Accounting Research 52.4: 955, 955 (June 3, 2014).

perhaps even chronologically before prioritizing issues, the FASB and the IASB should create a set of universal accounting objectives on which to base harmonization so that changes and improvements commenced for standards throughout the world would have some shared base for global financial reporting. Third, companies should look for ways to centralize various accounting functions throughout business units to the extent they can.[152] Fourth, and finally, stakeholders should keep in mind that harmonization will require some give and take on both the FASB and the IASB's part and become prepared to make some concessions to accommodate harmonization.

V. Conclusion

The path toward the international convergence of accounting standards has been a complicated and arduous one thus far. While the standard setters have made progress in moving toward a unified set of high-quality global accounting standards, they are still far from achieving their goal.

Moving forward, the path toward conversion could go in many directions. First, whether mandatory or voluntary, convergence could occur through the United States' adoption of IFRS. Second, convergence could happen as a consequence of requiring companies to prepare their financial statements in accordance with both U.S. GAAP and IFRS. Third, convergence could occur through the creation of a new set of standards based on the collaborative efforts of the FASB and the IASB. Finally, harmonization could replace convergence, meaning standard setters would work together to resolve differences between their respective standards rather than unifying them.

Full convergence into unified standards would ultimately benefit the worldwide capital market as a whole. Factors driving the ongoing trend toward convergence include: (1) the globalization of financial capital, (2) the significance of transparency for investors, (3) an ultimate reduction in costs, and (4) an increase in the efficiency of worldwide capital markets. However, despite these factors, it is unlikely that the world will ever see a single set of accounting standards. More likely, the obstacles—including the costs associated with convergence, countries' pride and politics, and the difficulties in having stakeholders from various countries collaborate amongst each other in the face of their differences—will prove to be too burdensome to overcome.

A shift toward harmonizing accounting standards rather than converging them is the most probable outcome. Harmonization will ultimately allow the FASB and the IASB to share the costs and burdens of increasing comparability, continue reducing the differences between U.S. GAAP and IFRS, and maintaining their respective interests. While harmonization may not be the most efficient approach the FASB and the IASB can undertake, they can work together to optimize their approach.

152. PricewaterhouseCoopers, *supra* note 6, at 22.