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Setting a Global Standard: The Case for Accounting Convergence

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I. THE LOGIC OF INTERNATIONAL ACCOUNTING STANDARDS

Over the past decade the rapid integration of capital markets has underscored the desirability of developing a single set of high quality international accounting standards. The growing acceptance of international standards has provided momentum for the work of the International Accounting Standards Board (IASB) and has raised the possibility that international standards could serve as one of the foundations of modern capital markets.

The Asian financial crisis and, more recently, the financial scandals in the United States and elsewhere during recent years have underscored the fact that good financial reporting is essential to the effective functioning of capital markets and the productive allocation of economic resources. The failures at Enron, WorldCom, and Parmalat demonstrate the potential costs of reporting failures, not only to particular companies but also to the economy as a whole. Markets punish uncertainty, and any sustained investor concern regarding the quality of financial reporting and corporate governance will be an impediment to economic growth, job creation, and personal wealth. The prospect of rigorous, improved and uniform reporting practices raises hope that the risk of future scandals could be reduced.

The growing consensus around the benefits of International Financial Reporting Standards (IFRSs) reflects trends in an increasingly integrating global economy. [1] At the end of 1990 the market capitalization of equity

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[1] International standards, as developed by the IASB and its predecessor IASC, are known as IFRSs or International Accounting Standards (IASs). IAS is the nomenclature used to denote standards set by IASC prior to 2001. The IASB has adopted the new terminology of International Financial Reporting Standards, or IFRSs, to describe standards wholly developed by the IASB. IFRSs is also used to describe the cumulative set of IASs and

shares of domestic companies on the world's stock exchanges totaled $8.8 trillion.[2] At the end of 2003, the world's market capitalization of equity shares of domestic companies on the world's exchanges had grown to $31.8 trillion.[3] The development of and innovation in capital markets have offered companies access to cheaper capital, and investors have gained new opportunities for diversification.

As capital markets play an increasingly central role in today's modern economies, policy-makers are confronted with the question of how to assure the continued effective functioning of these markets and, in particular, how to develop a sound financial reporting infrastructure. Recent experience suggests that such a reporting infrastructure must be built on four pillars:

1. <u>Accounting standards</u> that are consistent, comprehensive, and based on clear principles to enable financial reports to reflect underlying economic reality;
2. <u>Effective corporate governance practices and strong internal controls</u>;
3. <u>Auditing practices</u> that give confidence to the outside world that an entity is faithfully reflecting its financial position and economic performance; and
4. An <u>enforcement or oversight mechanism</u> that ensures that the principles as laid out by the accounting and auditing standards are followed.

This article focuses on the first of these four "pillars."

The accounting profession and accounting standard-setters are facing a changing marketplace and are emerging from a tumultuous period. The advent of financial engineering and other new transactions has raised questions regarding the relevance of traditional accounting practices. At the same time, disparate national solutions to accounting's problems are not sufficient for an increasingly globalized market.

The simple fact is that markets are integrating without regard to borders. To seek new investors and to reduce their cost of capital, companies are listing on major international exchanges outside their home jurisdiction. According to statistics from the World Federation of Stock Exchanges, the value of trading in foreign companies accounted for 9.75% of all trading on the major stock exchanges in 2002, an increase from 4.69%

IFRSs. IASs, modified by the IASB, retain the prefix IAS.

[2] World Federation of Exchanges, 2003 Statistics on Worldwide Capitalization of Domestic Equity Markets, *available at* http://www.world-exchanges.org/publications/EQUITY104.pdf (last visited Feb. 27, 2005) [hereinafter 2003 Statistics].

[3] *Id.*

in 1995.[4] A robust financial reporting system must cope with this new reality.

Regardless of the quality and resources put into the development of existing national accounting standards, the logic of international standards is plain to see and a broad range of interests will share the benefits. On the broadest level, the removal of barriers for capital flows and the provision of better information for cross-border investment should make the allocation of capital more efficient. This should enhance economic performance, reduce market risk and provide welfare gains.

More specifically, a common financial language, applied consistently, will enable investors to compare the financial results of companies operating in different jurisdictions more easily. The removal of a major investment risk—the concern that the nuances of different national accounting regimes have not been fully understood—should open new opportunities for diversification and improved investment returns. For multinational companies, the acceptance of international standards should cut this cost of complying with various national regimes. Subsidiary companies of multinationals must now comply with different national standards in each jurisdiction and then the parent company must consolidate these different national accounts into a single statement according to its home country's requirements. This process is extremely costly and inherently wasteful of scarce resources. For auditors, a single set of accounting standards should enable international audit firms to standardize training and better assure the quality of their work on a global basis. An international approach for accounting should also permit international capital to flow more freely, enabling audit firms and their clients to develop consistent global practices for accounting problems and thus further enhancing consistency. Finally, for regulators, the confusion associated with needing to understand various reporting regimes would be reduced.

II. MAKING THE OBJECTIVE A REALITY

The effort to develop international accounting standards is not a new one, but the establishment of the reconstituted IASB in 2001 did mark a turning point. In 1973, the International Accounting Standards Committee (IASC) was formed to begin work on the establishment of an international set of standards.[5] As a representative part-time body, the IASC made significant progress toward the objective of creating a comprehensive set of standards that could be accepted by national securities regulators. In 1998,

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[4] *Id.*

[5] For a timeline and brief history of the IASC, the IASB's predecessor, see the International Accounting Standards Bd., History at http://www.iasb.org/about/history.asp (last visited Mar. 30, 2005).

the IASC completed a core set of standards in an effort to get such an endorsement from securities regulators.[6]

In 2000, the International Organization of Securities Regulators (IOSCO), on behalf of the securities regulatory community, welcomed the progress made by the IASC but could not provide an unconditional endorsement of the standards for the purposes of cross-border offerings and listings. IOSCO identified a number of areas that needed improvement and where existing options in the standards reduced comparability. The weaknesses identified reflected regulatory concerns, particularly in some of the major marketplaces, regarding both the quality of the standards and the standard-setting process.[7]

The effort to create a single set of widely accepted international accounting standards received a major boost with the reconstitution of the IASC and the subsequent creation of the IASB. The new IASB has become an organization with both the resources to address the concerns of regulators and other market participants in a timely manner and the framework to facilitate the participation of national standard-setters throughout the world.[8]

At the heart of the IASB's efforts is the concept of convergence. In the context of the IASB, convergence carries a specific meaning. The IASB's goal is to identify the best in standards around the world and build a body of accounting standards that constitute the "highest common denominator" of financial reporting.[9] For the IASB, convergence must improve both existing financial reporting and consistency across borders. This is not convergence for convergence's sake.

Since the IASB's establishment in 2001, the effort to establish IFRSs as the international basis of accounting has accelerated. Many countries have agreed to adopt IFRSs for publicly traded companies by either January 1, 2005 or January 1, 2007.[10] The European Union has adopted a regulation that requires publicly traded companies to apply IFRSs, which have been

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[6] International Accounting Standards Committee, *Board Meeting Highlights*, IASC UPDATE, Dec. 1998, at 1.

[7] For the view of the IOSCO, *see* International Organization of Securities Regulators, Resolution of the President's Committee on IASC Standards, *available at* http://www.iosco.org/resolutions/pdf/ IOSCORES19.pdf (May 2000).

[8] For more on the restructuring of the IASC and the establishment of the IASB, see Ruder et. al., *Creation of World Wide Accounting Standards: Convergence and Independence*, 25 NW. J. INT'L L. & BUS. 513 (2005).

[9] The objectives of the IASC Foundation and IASB are laid out in the IASC Foundation Constitution. INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE, IASC FOUNDATION CONSTITUTION 5 (2002).

[10] Deloitte, the IASPlus home page, News About International Financial Reporting, *at* http://www.iasplus.com (last visited Feb. 27, 2005). For a full listing of the countries, refer to Appendix 1, *infra*.

approved in an E.U. endorsement process, for their consolidated accounts beginning in January of this year.[11] It is expected that in addition to the more than seven thousand publicly traded companies in Europe, tens of thousands of unlisted companies will choose to adopt IFRSs, depending upon various national rules.

The momentum towards adopting international standards has not been limited to the European Union, and acceptance of the IASB has extended to six continents and is growing. For example, Australia, Hong Kong, and South Africa have followed the European Union's lead in requiring the use of IFRSs in 2005.[12] A Deloitte & Touche study indicates that more than ninety countries either require or permit the use of IFRSs for publicly traded companies beginning in 2005.[13]

Many African and Asian countries, such as China and many countries of South-East Asia, have a policy of pursuing convergence of national standards with IFRSs. Similarly, among Latin American countries, Costa Rica, the Dominican Republic, Panama, and Venezuela have adopted IFRSs, and Peru has a formal policy of convergence.[14] Mexico has established a new body with the specific mandate of convergence, and intensive discussions about the acceptance of IFRSs in Brazil are taking place.[15]

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[11] The European Union formalized the regulation for adoption of IFRSs on July 19, 2002. Counsel Regulation 1606/2002 of 19 July 2002 on the Application of International Accounting Standards, 2002 O.J. (L 243) 1, 1-4. The European Union has now endorsed all forty extant IFRSs with the exception of seventeen paragraphs of IAS 39. For further information on the E.U. endorsement process, refer to the Website of the Internal Market Directorate of the European Commission at http://europa.eu.int/comm/internal_market/accounting/ias_en.htm (last visited Mar. 5, 2005).

[12] For Australia, see the decisions of the Australian Financial Reporting Council, Bulletin of the Financial Reporting Council, *at* http://www.frc.gov.au/content/bulletins.asp (July 3, 2002 and Apr. 2004). In South Africa, the South African Institute of Chartered Accountants, the body responsible for the setting of accounting standards, incorporated all extant IFRSs for use in South Africa after January 1, 2005. South African Institute of Chartered Accountants, Contents—Volume 1 Periods Commencing After 1 January 2005, *at* http://www.saica.co.za/documents/ContentVolume1_After_to_1January2005.pdf (Jan. 1, 2005). For Hong Kong, see Press Release, Hong Kong Institute of Certified Public Accountants (Dec. 9, 2004), *available at* http://www.hkicpa.org.hk/corporate_relations/media/pressrelease/041209e.pdf.

[13] IASPlus Home Page, *supra* note 10.

[14] *Id.*

[15] *See* Consejo Mexicano para la Investigación y Desarrollo de Normas de Información Financiera [Mexican Council on the Investigation and Development of Rules on Financial Information], Mision y Objetivos [Mission and Objectives], *available at* http://www.cinif.org.mx (last visited Feb. 27, 2005).

III. AN EVOLVING U.S. ATTITUDE TO INTERNATIONAL STANDARDS

In and of itself, the adoption of IFRSs in more than ninety countries is a significant step forward. However, any effort to develop a set of international accounting standards without U.S. participation and acceptance would be incomplete and fail to achieve the full benefits that a common global reporting language could offer. U.S. capital markets are the deepest and most liquid, accounting for 46% of the world's market capitalization in 2003.[16] In comparison, the combined market capitalization of exchanges in the European Union, including the recent accession countries, comprised only 25.3% of the world's total at the end of 2003.[17]

While the Financial Accounting Standards Board (FASB) and the United States Securities and Exchange Commission (SEC) had participated in and supported the former IASC's work, their participation has not translated into the acceptance of international standards for cross-border listings on the U.S. markets. Because of concerns regarding comparability, the SEC has required the reconciliation of foreign accounts to U.S. GAAP in the United States.[18] This remains a lingering source of frustration for non-U.S. companies seeking access to U.S. markets and a barrier for U.S. investors hoping to diversify portfolios with non-U.S. securities.

While the FASB and the SEC have a long history of direct involvement in international activities, broader U.S. interest in international accounting standards is a relatively recent occurrence. In the FASB, the United States had a full-time professional and highly skilled standard-setter that had developed special expertise, backed by significant resources for the task of standard-setting.[19] At the same time, U.S. market regulators and participants could point to the fact that U.S. GAAP represented the most comprehensive and highest quality set of standards in the world. Some pointed to the depth and the liquidity of U.S. capital markets as testaments to the strength of the U.S. financial reporting model.[20] Despite the cost of

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[16] 2003 Statistics, *supra* note 2.

[17] *Id.*

[18] *See* Form 20-F, Items 17(c) and 18(b), 17 C.F.R. § 249.220f (2005).

[19] For more information see Financial Accounting Standards Board, Facts About FASB at http://www.fasb.org/facts (last visited Feb. 21, 2005).

[20] SEC staff and officials have emphasized this point on several occasions. *See Global Markets, National Regulation, and Cooperation: Hearing on U.S.-EU Financial Regulations Before the House Comm. on Financial Services*, 108th Cong. (2004) (statement of Ethiopis Tafara, Director, Office of International Affairs, U.S. Sec. Exch. Comm.), *available at* http://www.sec.gov/news/testimony/ts051304et.htm; *see also Are Current Financial Accounting Standards Protecting Investors?: Hearing Before the House Subcomm. on Commerce, Trade and Consumer Protection*, 107th Cong. (2002) (statement of Robert K. Herdman, Chief Accountant, U.S. Sec. Exch. Comm.), *available at* http://www.sec.gov/news/testimony/021402tsrkh.htm.

reconciliation and compliance with U.S. listing rules, 462 companies from 53 countries were listed on the New York Stock Exchange at the end of 2001, the year that the IASB was established.[21] On January 20, 2005, the number had fallen slightly to 460 companies from 47 countries.[22] Because of the significant international presence in U.S. markets, it would hardly be surprising if a widespread belief existed, particularly in the United States itself, that U.S. GAAP was becoming the *de facto* international set of standards.

However, a combination of factors has led to what is now a focused effort aimed at convergence of U.S. GAAP and IFRSs. As mentioned above, there had always been pressure on the SEC to relax or remove the reconciliation requirement for non-U.S. companies, but market forces and events provided additional incentive for the United States to participate in the international process.[23]

The IASB is an international body insulated from national political pressures, committed to a rigorous due process, and established with a similar structure as the FASB. Its creation gave encouragement to the SEC and the FASB to see the IASB as a viable and credible partner, consistent with the one that the FASB had advocated in its vision statement for international standard-setting.[24] Upon formation of the IASB, then SEC Chairman Arthur Levitt commented:

> Strong and resilient capital markets cannot function without high quality information. Efficient capital allocation depends on accurate, timely and comparable financial reporting. The [IASB] Board members who have been appointed today carry an enormous burden. It is up to them, working in cooperation with our Financial Accounting Standards Board and other accounting standards setters, to create global accounting standards that will support effectively the imperatives of a global

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[21] N.Y. STOCK EXCHANGE, 2001 Statistics, *available at* http://www.nyse.com/pdfs/01forlist030113.pdf (Jan. 13, 2003).

[22] N.Y. STOCK EXCHANGE, 2004 Statistics, *available at* http://www.nyse.com/pdfs/updatedforlist_041228.pdf (Dec. 29, 2004).

[23] The Senate Committee on Banking, Housing, and Urban Development held a series of hearings after the collapse of Enron, which among other things explored international accounting and the possibilities for convergence. As part of these hearings, Paul Volcker, Chairman of the IASC Foundation, David Ruder and John Biggs, Trustees of the IASC Foundation, and David Tweedie, Chairman of the IASB, were called to testify. *See Accounting Reform and Investor Protection Issues Raise by Enron and Other Public Companies: Hearings Before the Senate Comm. on Banking, Housing, and Urban Development*, 107th Cong. (2002) (testimony of Paul Volcker, Chairman of the International Accounting Standards Committee Foundation, David Ruder and John Biggs, Trustees of the International Accounting Standards Committee Foundation, and Sir David Tweedie, Chairman of the International Accounting Standards Board).

[24] IASPlus Home Page, *supra* note 10.

marketplace.[25]

The initial work program of the IASB also laid the groundwork for a serious initiative to eliminate the differences in international accounting standards that caused reconciliations with U.S. GAAP to be necessary. The platform of revised international standards resulting from the initial work program raised confidence in the United States about the quality of IFRSs, while reducing the scope of differences between U.S. GAAP and IFRSs. The IASB's initial work program addressed many of the concerns raised by members of IOSCO, including the SEC. The Improvements Program, the bulk of the IASB's initial work, amended and eliminated options in fourteen International Accounting Standards (IASs) inherited from the IASB's predecessor.[26] At the same time, five of the "improved" standards, IASs 16, 17, 24, 28, and 40 eliminated differences between IFRSs and U.S. GAAP.[27] Further differences were removed when the IASB completed a new business combinations standard that banned the pooling method of accounting and eliminated the amortization of goodwill, bringing international practice and U.S. GAAP into line.[28] The IASB also introduced a requirement to expense share-based payments, broadly consistent with one of the options permitted under U.S. GAAP.[29] The FASB has since removed one of its options, aligning its requirement with the international approach.[30]

Furthermore, in the aftermath of Enron, the United States became more receptive to non-U.S. approaches to accounting. While the accounting standards are rarely the cause of the reporting failures, and while U.S. GAAP provide a high degree of transparency for investors, Enron and subsequent failures demonstrated the need for improvement. Indeed, concerns were expressed that dependence on overly detailed rules for accounting (rather than principles and auditor judgment) may have hampered the quality of financial reporting.[31]

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[25] Press Release, Securities Exchange Commission, SEC Chairman Arthur Levitt Congratulates IASC on Selection of New Board Members (Jan. 15, 2001), *available at* http://www.sec.gov/news/press/2001-17.txt.

[26] These standards are IAS 16, 17, 24, 28 and 40. INTERNATIONAL ACCOUNTING STANDARDS BOARD, IMPROVEMENTS TO INTERNATIONAL ACCOUNTING STANDARDS (2003).

[27] *Id.*

[28] BUSINESS COMBINATIONS, International Financial Reporting Standard No. 3 (International Accounting Standards Bd. 2004).

[29] SHARE-BASED PAYMENT, International Financial Reporting Standard No. 2 (International Accounting Standards Bd. 2004).

[30] Press Release, Financial Accounting Standards Board, FASB Issues Final Statement on Accounting for Share-based Payment (Dec. 16, 2004), *available at* http://www.fasb.org/ news/ nr121604_ebc.shtml.

[31] *See* Herdman, *supra* note 20; *see also* Office of the Chief Accountant and The Office

In this context, the idea of drawing upon the "best of breed" of existing national and international standards offered potential to improve deficiencies identified in the U.S. reporting environment as a result of the financial reporting scandals. At times, national standard-setters, including the FASB, have found it difficult to act alone. The case of accounting for stock options (or share-based payments for employee services) is such a case. Constituents often complain that a "tough" standard would put local companies at a competitive disadvantage relative to companies outside of their jurisdiction.[32] Local political pressures and policies may work against individual national standard setters. An international standard setting process, independent of political pressures, can establish financial reporting standards that would apply to all companies in all jurisdictions, thus eliminating perceived disadvantages.

IV. THE NORWALK AGREEMENT

The coalescence of these conditions provided the environment in which both the FASB and the IASB could commence work on eliminating differences between U.S. GAAP and IFRSs, and both Boards were willing to act. The appointment of Bob Herz, one of the IASB's original members, as the Chairman of the FASB in 2002, sent a message about the importance and relevance of international standards. This set the stage for the FASB and IASB's first joint meeting in September 2002.[33]

As a result of this meeting, the FASB and the IASB published a joint memorandum of understanding, now known as the Norwalk Agreement. The two Boards agreed to:

a. Undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International

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of Economic Analysis, U.S. Securities & Exchange Comm'n, Study Pursuant to Section 108(d) of the Sarbanes-Oxley Act of 2002 on the Adoption by the United States Financial Reporting System of a Principles-Based Accounting System, *available at* http://www.sec.gov/news/ studies/principlesbasedstand.htm (July 25, 2003).

[32] Opponents of mandatory stock option expensing have often used this argument as a case against reform of existing practice. *See FASB Stock Options Proposal: Before the House Comm. on Financial Services, Subcommittee on Capital Markets, Insurance and Government Sponsored Enterprises,* 108th Cong. (2004) (statement of George Scalise, President, Semiconductor Industry Association); Comment Letter from the International Employee Stock Options Coalition to the Financial Accounting Standards Board (Jan. 30, 2003), *at* http://www.siia.net/govt/docs/pub/tax_letter_013003.pdf.

[33] For information regarding convergence and joint IASB-FASB initiatives, see Financial Accounting Standards Board, Short-term International Convergence at http://www.fasb.org/ project/short-term_intl_convergence.shtml (last visited Feb. 27, 2005) and International Accounting Standards Board, IASB Activities at http://www.iasb.org/current/ iasb.asp?showPageContent=no&xml=16_13_67_23092003.htm (last visited Feb. 27, 2005).

Accounting Standards, IASs);

b. Remove other differences between IFRSs and U.S. GAAP that will remain on January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
c. Continue progress on the joint projects that they are currently undertaking; and
d. Encourage their respective interpretative bodies to coordinate their activities.[34]

This agreement marked the first time a strategy was put in place to eliminate differences between U.S. GAAP and IFRSs. The philosophy of the agreement is simple. The Boards agreed to identify differences pinpointed by examining the reconciliation statements filed by non-U.S. companies using IFRSs and registered in the United States. The Boards decided to focus on making the principle of the standards similar with an understanding that differences in the detailed application guidance may require additional time to address. The SEC greeted the prospect with strong support and offered significant assistance in identifying the areas to reconcile that were candidates for convergence.[35] The European Commission also greeted the convergence project with enthusiasm.[36]

At the same time, the Boards recognised the need to limit future divergences of U.S. GAAP and IFRSs; once existing differences were eliminated and the Boards approved new interpretations and new standards. For that reason, the FASB and the IASB agreed to coordinate their work programs. This is now occurring, and the Boards are conducting a range of joint projects on some of the most challenging issues before standard-setters today.

The depth of cooperation underlines the priority that the project is receiving. The process is aided by the fact that the IASB has a full-time board member, Jim Leisenring, who maintains an office at the FASB and participates in their deliberations. The Boards are now meeting jointly twice a year. The Boards have established a video link between each other's meetings, so Board and staff members can observe and participate in the other's discussions. To accomplish the objectives described above, the

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[34] Financial Accounting Standards Board and International Accounting Standards Board, Memorandum of Understanding, "The Norwalk Agreement," *available at* http://www.fasb.org/intl/convergence_iasb.shtml (Sept. 18, 2002) [hereinafter The Norwalk Agreement]. For the text of the Norwalk Agreement, see Appendix 2, *infra*.

[35] Press Release, Securities and Exchange Commission, Actions by FASB, IASB Praised (Oct. 29, 2002), *at* http://www.sec.gov/news/press/2002-154.htm.

[36] Press Release, European Commission, Financial Reporting: SEC's Pitt, European Commission Praise Actions by FASB, IASB (Oct. 29, 2002), *at* http://www.useu.be/Categories/Tax%20and%20Finances/Oct2902SECPittAccountingStandards.html.

Boards have established joint staffing teams to work on several major projects. Furthermore, the two Boards are drawing upon the expertise of other experienced standard-setters by including their staff in joint project teams.

More importantly, progress on eliminating differences is significant and promising. Though there are doubters on both sides of the Atlantic, convergence really has been a two-way process in an effort to build a set of standards that are truly "best of breed." Both Boards have shown their commitment to change towards the better answer and to accept the input of other national standard-setters when neither U.S. GAAP nor existing IFRSs have a high quality solution. As discussed above, the IASB has brought many international standards into line with U.S. GAAP through the IASB's Improvements Programme and its standards on business combinations. As a direct response to the Norwalk Agreement, the IASB has also:

- Replaced IAS 35, instead issuing IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations,* which achieves convergence with aspects of SFAS 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*;[37]
- Drafted agreed amendments to IAS 37 to converge with aspects of SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* (Exposure Draft expected this year);[38]
- Tentatively agreed to propose the replacement of IAS 14, *Segment Reporting*, with SFAS 131 *Disclosures about Segments of an Enterprise and Related information*;[39] and
- Begun to actively work with the FASB on convergence between IAS 12, *Income Taxes*, and SFAS 109, *Accounting for Income Taxes*, with a view to developing an Exposure Draft this year.[40]

The FASB has issued amendments to standards that achieve substantial convergence with IFRS in the following areas:

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[37] NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS, International Financial Reporting Standard No. 35 (International Accounting Standards Bd. 2004).

[38] PROVISION, CONTINGENT LIABILITIES AND CONTINGENT ASSETS, International Financial Reporting Standard No. 37 (revised) (International Accounting Standards Bd. 2004).

[39] International Accounting Standards Board, IASB Update, *at* http://www.iasb.org/news/index.asp (Jan. 25, 2005).

[40] The latest information on the project to produce convergence of income tax standards can be found on the IASB website. International Accounting Standards Committee Foundation, Amendments to IAS 12 Income Taxes, *at* http://www.iasb.org/docs/projects/conv-ias12-ps.pdf (last visited Feb. 27, 2005).

- Share-based payments;
- The treatment of idle capacity and spoilage costs in the cost of inventory; and
- Asset exchanges.[41]

In addition, the FASB has also issued Exposure Drafts that propose requirements in the following areas that would achieve convergence with IFRSs:

- Earnings per share; and
- Voluntary changes in accounting policies.[42]

These FASB proposals are expected to be finalised early in 2005.

Now that the initial drive to prepare the standards for adoption in 2005 is over, the IASB has ranked its convergence project as its highest priority. In the next phase of the short-term project aimed at eliminating existing differences, the Boards plan to work together on the following areas: research and development, interim reporting, joint ventures, property, plant and equipment and investment properties.

During the first half of 2005 the FASB and the IASB will be determining the programme's additional priorities and developing a timeline for its work. This topic will be on the top of the meeting agenda for the next joint meeting in April 2005. Without putting a specific date on convergence, both the IASB and the FASB hope that the major differences between U.S. GAAP and IFRSs will be eliminated in the next few years. Among other benefits, this will enable those E.U. companies presently allowed to use U.S. GAAP in their domestic accounting until the end of 2007 to have a relatively painless transition to IFRSs the following year.

It will also be useful to examine reconciliation issues arising from the adoption of IFRSs for U.S. filers from Australia and Europe. This should give both Boards a better view of the differences remaining. To facilitate that examination, the IASB is planning to convene conferences in mid-2005 and early 2006 to discuss practicalities of convergence with companies, auditors and analysts. Of course, the elimination of these differences will provide further reason for the SEC to consider removing the reconciliation

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[41] SHARE-BASED PAYMENT, Statement No. 123 (Financial Accounting Standards Bd. 2004); INVENTORY COSTS—AN AMENDMENT OF ARB NO. 43, Statement No. 151 (Financial Accounting Standards Bd. 2004); EXCHANGES OF NONMONETARY ASSETS—AN AMENDMENT OF APB OPINION NO. 29, Statement No. 153 (Financial Accounting Standards Bd. 2004).

[42] EARNINGS PER SHARE—AN AMENDMENT OF FASB STATEMENT NO. 128, Exposure Draft (Financial Accounting Standards Bd. 2003); ACCOUNTING CHANGES AND ERROR CORRECTIONS—A REPLACEMENT OF APB OPINION NO. 20 AND FASB STATEMENT NO. 3, Exposure Draft (Financial Accounting Standards Bd. 2003).

requirement for non-U.S. listed companies. That is a matter for the SEC and not standard-setters, and also entails judgments regarding, *inter alia*, the quality of audits and enforcement. The point is that if the two Boards remain focused on their shared task and eliminate the differences, a major reason for demanding reconciliation will no longer exist. There is a commitment from both Boards to eliminate these differences rapidly.

V. IMPEDIMENTS TO SUCCESS

The changed attitude toward IFRSs in the United States and the results already achieved improve the prospect that IFRSs and their U.S. equivalents will become the basis for financial reporting worldwide. However, both the IASB and the FASB face serious challenges before success is assured. Some of these challenges are intellectual. The standard-setting bodies are tackling difficult conceptual issues, on which there is little or no consensus. Some of the more challenging topics are already on the joint agenda. Reaching a common international standard on such topics will not be easy because those applying U.S. GAAP, IFRSs, and other national standards are all starting from different points with different national practices and cultural backgrounds. What is incumbent upon the IASB, the FASB, and other bodies concerned with standard-setting is to set up a process that engages the interests involved and evaluates the many issues in an even-handed manner.

The two Boards also must overcome resistance to change in general. Both the FASB and the IASB recognize that in the aftermath of Enron and the adoption of new accounting standards, corporate preparers and auditors have come through a turbulent period. It is the standard-setters' responsibility to help manage the timing of new requirements. The IASB has agreed to delay the implementation of any new standard until 2006 or 2007.

At the same time, market participants should recognise the general public good at stake. The potential long-term economic benefits that will flow from promoting common financial reporting rules for the world's capital markets justify the short-term costs imposed by system changes. Nevertheless, the challenge here is significant.

Convergence with an international approach will inevitably raise the question of rules versus principles. Despite the realization that a reliance on overly detailed rules might impede the quality of financial reporting, acceptance of a more principles-based approach will be difficult. The FASB has always developed standards based on principle, but the business and legal environment in the United States has demanded detailed guidance or exceptions to the underlying principle, which causes additional complexity. Recent analyses by the SEC staff and the FASB indicate a desire to re-emphasize principles. The fear of litigation and the desire for a safe harbor in detailed rules could be a deterrent for change.

The IASB is determined not to develop such a detailed approach to standard-setting. In the view of the IASB, the desire for more rules is often counter-productive and helps those who are intent on finding ways around standards more than it helps those seeking to apply standards in a way that gives useful information. Detailed guidance may obscure, rather than highlight, the underlying principle. The emphasis tends to be on compliance with the letter of the rule rather than on the spirit of the accounting standard. Internationally, there is a clear desire to maintain a more principles-based approach to accounting.

Acceptance of a more principles-based approach will not be easy and may take time to evolve. Of course, the issue is not black and white, and there will always be a need for some explanatory guidance for the principles. But in promoting international convergence, the IASB is determined to focus on crafting principles that are sufficiently clear to make detailed rules unnecessary. In the interim, one could possibly foresee a halfway solution. The FASB and the IASB could agree to the same set of principles, while the FASB provides more application guidance for U.S. listed companies.

Lastly, if convergence is to succeed, those affected by the standard-setting process must resist attempts to reject standards through political processes rather than the standard-setting process when local or regional interests perceive adverse consequences in particular standards. Quite understandably, national authorities and legislatures should be able to examine the standards and to demand effective oversight of standard-setting Boards. On the other hand, if political pressures in a national or regional context are able to overrule standards that have been developed in a deliberate and open manner, then it may lead to a system of "beggar thy neighbor" which will not produce the consistency and quality of accounting standards that the world's markets demand.

The accounting scandals of the past few years have focused attention on the importance of accounting to the functioning of the modern economy. Any loss of confidence in the quality of financial information could have significant effects on the economy.

Due to a variety of circumstances, accounting standard-setters and regulatory authorities now have a once-in-a-lifetime opportunity to transform the basis of financial reporting worldwide. With the support of regulators, the FASB and the IASB have embarked on an ambitious convergence program. The effort to eliminate accounting differences between the world's largest capital market and the rest of the world has yielded results, and both Boards have made significant changes in their standards.

The chief challenge in the coming weeks and months will be sustaining momentum for convergence and accelerating the timetable for the elimination of remaining differences. Now the FASB and the IASB must build on the initial successes. The potential benefits of the project are clear—the elimination of barriers for investment and improved transparency could serve as the basis of a truly modern financial reporting infrastructure and will translate into enhanced economic growth and opportunities. This payoff is worth the fight.

APPENDIX 1: COUNTRY USE OF IFRSs [43]

COUNTRY	IFRSs REQUIRED FOR ALL DOMESTICALLY LISTED COMPANIES	IFRSs REQUIRED FOR SOME DOMESTICALLY LISTED COMPANIES	IFRSs PERMITTED FOR DOMESTICALLY LISTED COMPANIES
Armenia	X		
Aruba			X
Austria	X		
Australia	X		
Bahamas	X		
Bahrain		X	
Barbados	X		
Bangladesh	X		
Belgium	X		
Bermuda			X
Bolivia			X
Bosnia and Herzegovina		X	
Botswana			X
Brunei Darussalam			X
Bulgaria	X		
Cayman Islands			X
China		X	
Costa Rica	X		
Croatia	X		
Cyprus	X		
Czech Republic	X		
Denmark	X		
Dominica			X
Dominican Republic	X		
Ecuador	X		
Egypt	X		
El Salvador			X
Estonia	X		
Finland	X		
France	X		
Germany	X		
Georgia	X		
Gibraltar			X

[43] *See* IASPlus Home Page, *supra* note 10.

Greece	X		
Guatemala	X		
Guyana	X		
Haiti	X		
Honduras	X		
Hong Kong			X
Hungary	X		
Iceland	X		
Ireland	X		
Israel			
Italy	X		
Jamaica	X		
Japan			
Jordan	X		
Kazakhstan		X	
Kenya	X		
Korea (Republic of)			
Kuwait	X		
Kyrgyzstan	X		
Laos			X
Latvia	X		
Lebanon	X		
Liechtenstein	X		
Lesotho			X
Lithuania	X		
Luxembourg	X		
Macedonia	X		
Malawi	X		
Malta	X		
Mauritius	X		
Myanmar			X
Namibia			X
Netherlands	X		
Netherlands Antilles			X
Nepal	X		
New Zealand	X (beginning in 2007)		
Nicaragua	X		
Norway	X		
Oman	X		
Panama	X		
Papua New Guinea	X		
Peru	X		

Poland	X		
Portugal	X		
Romania		X	
Russia		X (phased in from 2004-2007)	
Slovenia	X		
Slovak Republic	X		
South Africa	X		
Spain	X		
Sri Lanka			X
Sweden	X		
Swaziland			X
Switzerland			X Multi-national main board companies must choose either IFRS or U.S. GAAP starting in 2005
Tajikistan	X		
Tanzania	X		
Trinidad and Tobago	X		
Turkey			X
Uganda			X
Ukraine		X	
United Arab Emirates		X	
United Kingdom	X		
United States			
Uruguay			X
Venezuela	X (by 2006)		
Virgin Islands			X
Yugoslavia	X		
Zambia			X
Zimbabwe			X

APPENDIX 2: THE NORWALK AGREEMENT[44]

Memorandum of Understanding
"The Norwalk Agreement"

At their joint meeting in Norwalk, Connecticut, USA on September 18, 2002, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board (IASB) each acknowledged their commitment to the development of high-quality, compatible accounting standards that could be used for both domestic and cross-border financial reporting. At that meeting, both the FASB and IASB pledged to use their best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate their future work programs to ensure that once achieved, compatibility is maintained.

To achieve compatibility, the FASB and IASB (together, the "Boards") agree, as a matter of high priority, to:

e. undertake a short-term project aimed at removing a variety of individual differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs);
f. remove other differences between IFRSs and U.S. GAAP that will remain at January 1, 2005, through coordination of their future work programs; that is, through the mutual undertaking of discrete, substantial projects which both Boards would address concurrently;
g. continue progress on the joint projects that they are currently undertaking; and,
h. encourage their respective interpretative bodies to coordinate their activities.

The Boards agree to commit the necessary resources to complete such a major undertaking.

The Boards agree to quickly commence deliberating differences identified for resolution in the short-term project with the objective of achieving compatibility by identifying common, high-quality solutions. Both Boards also agree to use their best efforts to issue an exposure draft of proposed changes to U.S. GAAP or IFRSs that reflect common solutions to some, and perhaps all, of the differences identified for inclusion in the short-term project during 2003.

As part of the process, the IASB will actively consult with and seek

[44] The Norwalk Agreement, *supra* note 34.

the support of other national standard setters and will present proposals to standard setters with an official liaison relationship with the IASB, as soon as is practical.

The Boards note that the intended implementation of IASB's IFRSs in several jurisdictions on or before January 1, 2005 require that attention be paid to the timing of the effective dates of new or amended reporting requirements. The Boards' proposed strategies will be implemented with that timing in mind.