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International Convergence of Accounting Standards—Perspectives from the FASB on Challenges and Opportunities

*Robert H. Herz and Kimberley R. Petrone**

I. INTRODUCTION

Convergence of international accounting standards is not a new initiative at the Financial Accounting Standards Board (FASB or Board); in fact, the FASB has pursued international "convergence" for almost half of its more than thirty year existence.[1] The FASB's international activities initially fell under the heading of *harmonization*, or *internationalization,* of accounting standards. Today those activities are referred to as *convergence.*

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[1] Financial Accounting Standards Board, Facts about FASB, *at* http://www.fasb.org/facts/index.shtml (last visited Mar. 6, 2005).

Whatever the term, the Board has long held the view that a single set of high-quality international accounting standards is desirable because its use will improve international comparability of financial information; reduce costs to financial statement users, preparers, auditors, and others; and, ultimately, help promote the efficiency of the world's capital markets. To that end, the FASB has and continues to invest considerable time and resources in convergence efforts.

Over time, the FASB's role in the international accounting arena has evolved from that of a participating observer involved with a few collaborative efforts to an active participant with the convergence goal integrated into all aspects of its processes and activities.[2] This paper describes that evolution in three parts. The first part provides a historical perspective—describing the various events that shaped the FASB's current view of international convergence. The second part describes the current view and the FASB's current convergence activities. The final part provides a view into the future—what may lie ahead for the FASB and the other standard setters around the world.

II. HISTORICAL PERSPECTIVE

Comparability of financial information has always been one of the driving forces behind U.S. accounting standards. Until the 1980s, the focus was on comparability among U.S. companies obtaining financing in U.S. capital markets. Globalization of commerce and trends in technology brought increases in the flows of cross-border financing and investing. Implications of events and transactions in international commerce and finance began to impact the domestic accounting environment. Where U.S. Generally Accepted Accounting Principles (GAAP) once centered on comparability between domestic companies, the focus began to shift to comparability between and among foreign and domestic companies seeking capital in U.S. markets.

A. FASB's 1991 Plan for International Activities

Globalization trends, and the issues they created, challenged the FASB to become more involved in the internationalization of accounting standards and prompted the development of the FASB's "Plan for International Activities," published in 1991 (1991 Plan).[3] The 1991 Plan was designed with the objective of achieving greater comparability between U.S. accounting standards and those promulgated by other major national standard-setting bodies and by the International Accounting Standards

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[2] *Id.*

[3] Financial Accounting Standards Board, FASB's Plan for International Activities (1995 revision), *at* http://www.rutgers.edu.accounting/raw/fasb/map/index.html (Aug. 1, 2004).

Committee (IASC). The mission of the FASB was revised at that time to incorporate the objective of promoting the international comparability of accounting standards concurrent with improving the quality of financial reporting.

As envisaged in the 1991 Plan, the ultimate goal of efforts to internationalize accounting standards would be the creation of a body of superior international accounting standards that could be accepted in all countries as GAAP for general-purpose financial statements.[4] The 1991 Plan acknowledged that because that goal was beyond reach for the foreseeable future, progress in the short and medium terms would be incremental.[5] Nonetheless, that goal served to guide the FASB's international activities.

One of the premises underlying the 1991 Plan was that the FASB's international activities would be conducted within the framework of the FASB's charter and mission statement. That meant that the Board would adhere to its full due process and to its conceptual framework. It also meant that the Board would strive for improvement in the quality of accounting standards—the essence of its mission—while simultaneously striving to improve international comparability. In other words, the Board would resist pressures to move to the lowest common denominator for the sake of international convergence. That underlying premise is still paramount as the year 2005 begins.

1. International Activities During the 1990s

With the 1991 Plan as its guide, the FASB engaged in many different activities during the 1990s to further its international goals. For example, an FASB Board member was a regular participant in meetings of the IASC and FASB Board and staff members participated in various steering committees on IASC projects. In addition, the FASB staff submitted comment letters on IASC and other standard setters' exposure documents, with the objective of improving the quality of those forthcoming standards.[6]

The FASB also undertook two projects in the 1990s that had international harmonization as a primary goal. First, the FASB joined with the Canadian Institute of Chartered Accountants to develop a common standard on segment reporting. Second, the FASB and the IASC worked together to develop very similar standards on earnings per share. In the early 1990s, the FASB began participating in a relatively loosely structured consortium of standard setters that shared similar conceptual frameworks—

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[4] *Id.*

[5] *Id.*

[6] International Accounting Standards Committee Foundation, IASC Projects 1999-2000, *at* http://www.iasb.org/current/comment_letters_iasc.asp (last visited Mar. 6, 2005).

initially standard setters from Australia, Canada, the United Kingdom, and the United States, with representatives from the IASC participating as observers. The group eventually became known as the G4+1 (a name that stuck despite the fact that New Zealand later joined the group). The G4+1 met about four times each year to analyze and discuss financial reporting issues. During its eight-year existence, the group published twelve discussion documents that were issued by each standard-setting body (issued by the FASB as Special Reports).[7]

The FASB also joined with standard setters from Canada and Mexico in the spirit of the North American Free Trade Agreement to analyze similarities and differences between accounting standards in the three countries.[8] Standard setters in Chile later joined the group, which became known as the American Free Trade Agreement Committee on Financial Reporting Matters.

During the mid-to-late 1990s, individual FASB staff members monitored the accounting developments in all the major countries, as well as in various international organizations. The Board also had a number of staff exchanges or staff secondments with other standard-setting organizations including the Australian Accounting Research Foundation, the Chinese Ministry of Finance, and the Accounting Standards Board (ASB) of the United Kingdom.[9] In addition, international visitors came to the FASB to observe its process and to discuss its technical agenda projects.

While these various activities were an effective approach to exploring common accounting issues, they were conducted in a somewhat ad hoc manner. The then-current pressures for higher-quality global accounting standards required a direct commitment from the FASB to the IASC's standard-setting process and a more focused approach to the FASB's international activities.

The 1991 Plan was revised in 1995 and in 1996 its key objectives and strategies were incorporated into the FASB's strategic plan. The fourth strategic direction of the FASB's 1996 strategic plan was to "promote the development and acceptance of superior international accounting standards." That strategic direction included an implementation strategy that was not part of the original plan for international activities—to respond to developments supporting the acceptance of IASC standards for cross-border filings.

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[7] Financial Accounting Standards Board, FASB Articles & Reports, *at* http://www.fasb.org/articles&reports/index.shtml (last visited Mar. 6, 2005).

[8] Deloitte, IFRS News Chronology, *at* http://www.iasplus.com/pastnews/2000dec.htm (last visited Mar. 6, 2005).

[9] *Id.*

2. *IASC-U.S. Comparison Project*

In November 1996 the FASB published *The IASC-U.S. Comparison Project: A Report on the Similarities and Differences between IASC Standards and U.S. GAAP* (Comparison Report).[10] The comparison project was undertaken in the spirit of harmonization and was guided by the belief that an enhanced understanding of the differences between IAS standards (IASs) and U.S. GAAP was necessary to guide efforts to improve the comparability of accounting standards and financial reporting worldwide. The objectives of the project were to provide

a. A basis for the FASB and IASC to raise the quality of their standards while narrowing the differences between them;
b. A tool for investors, financial analysts and other users of financial statements to use in comparing companies that use U.S. GAAP with companies that use IASC standards;
c. An information base that can be used in assessing the acceptability of IASC standards for securities listing in the United States; and
d. Insights into the relative strengths of the IASC and FASB structures and processes for serving the ongoing information needs of U.S. capital markets.[11]

The Comparison Report compares each IASC "core standard" (up to and including IAS 39) to its U.S. GAAP counterpart in areas such as scope, definitions, recognition and measurement requirements, and display and disclosure requirements.

Chapter 3 of the 1996 Comparison Report provided a detailed description and comparison of the institutional structures and standard-setting processes of the IASC and the FASB.[12] The IASC's structure and process were very different from those of the FASB, primarily in the areas of the size and composition of the respective Boards, the lack of independence of the IASC Board members from the accounting profession, the openness of the deliberative process to the public and the extent of due process. In addition, to reach the consensus needed to issue standards, the IASC was often faced with the issue of forgoing quality in favor of consensus. In the FASB's view, those factors raised the issue of whether the structure and processes of the IASC were sufficient to ensure development of consistently high-quality standards.

The FASB's involvement in international accounting issues and

[10] THE IASC-U.S. COMPARISON PROJECT: A REPORT ON THE SIMILARITIES AND DIFFERENCES BETWEEN IASC STANDARDS AND U.S. GAAP (Carrie Bloomer ed., 2d ed., 1999).
[11] *Id.*
[12] *Id.* at ch. 3.

international standard-setting was, and continues to be, guided by a commitment to quality. Although the FASB was committed to promoting the development and acceptance of superior international standards, the Board was not convinced that IASC standards were the appropriate solution, especially in the United States.

3. *FASB-FAF Vision (1999)*

Recognizing its leadership responsibilities in the ongoing development of a set of high-quality international accounting standards that meet global market demands, the FASB and its oversight body, the Financial Accounting Foundation (FAF), developed their vision of the future of international standard setting. That shared vision was articulated in a report, *International Accounting Standard Setting: A Vision for the Future* (Report or FASB-FAF Vision) that was published in January 1999.[13] The FASB-FAF Vision set forth the FASB's objective and goals for participating in the international accounting system of the future. It also conveyed the Board's intention to maintain a leadership role in standard setting and to ensure that the standards used in the U.S. capital markets, whether developed by the FASB or an international body, would be of the highest possible quality.[14]

The Report discussed how the FASB's role might continue to evolve and how its structure and processes might change over time in the context of the objectives and goals of international standard setters.[15] The Report identified the establishment of a high-quality global standard-setting structure as essential to the future success of a truly international financial reporting system in which a single set of accounting standards is used worldwide. The Report also identified eight essential functions of a high-quality global accounting standard setter: leadership, innovation, relevance, responsiveness, objectivity, acceptability and credibility, understandability, and accountability.[16] To carry out those functions, the Report stated that the following five characteristics must be present in a high-quality global standard-setting organization: (a) an independent decision-making body; (b) adequate due process; (c) adequate staff; (d) independent fundraising; and (e) independent oversight.[17]

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[13] FINANCIAL ACCOUNTING STANDARDS BOARD, INTERNATIONAL ACCOUNTING STANDARD SETTING: A VISION FOR THE FUTURE (1999).

[14] *Id.*

[15] *Id.*

[16] *Id.*

[17] *Id.*

B. Restructuring of the IASC

While the FASB and FAF were developing their vision of the future of international accounting standards, the IASC was in the process of reorganizing itself to create a new global standard-setting structure. It appointed a Strategy Working Party in 1997 to consider what the IASC's strategy and structure should be once its core standards project was complete.[18] In November 1999, the Strategy Working Party published a report, *Recommendations on Shaping IASC for the Future.*[19]

The FASB participated in the discussions of the Strategy Working Party, and various Board members played a pivotal role in the restructuring of the former IASC. The FASB's assistance in reshaping the IASC was based on, and consistent with, its vision of one global standard setter responsible for a single set of high-quality standards that could be used by companies around the world for raising capital in any country. In order for those standards to be of the highest quality, the global standard setter must be independent and objective and must operate with open due process. Because the Strategy Working Party's recommendations described a structure with many of the characteristics described in the FASB-FAF Vision, the FASB strongly supported the proposed restructuring of the IASC into a fourteen-member Board with independent trustees.

1. Role of National Standard Setters in the New IASC

A key element of the IASC's new strategy was to facilitate the international convergence of accounting standards by working with various national standard-setting bodies. The IASC Strategy Working Party envisioned that the new IASC (which became the IASB)[20] would aim to integrate its decision-making process more closely with the processes of the national standard setters.

In order to encourage cooperation among the IASB and national standard setters, the IASC Trustees appointed seven of the Board members as official liaisons to national standard-setting bodies in the following

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[18] In the late 1980s the IASC set about improving the quality of its standards to provide a stronger foundation for national financial reporting based on those standards. In the mid-1990s, at the request of the International Organization of Securities Commissions, the IASC agreed to make further improvements to its existing standards and to develop new ones as a way to fulfill an emerging need for a set of "core standards." Those core standards were intended to provide a reasonably complete set of accounting standards that would be of sufficient quality to be used in the preparation of financial reports for cross-border securities listings and offerings.

[19] INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE, RECOMMENDATIONS ON SHAPING IASC FOR THE FUTURE (1999).

[20] The reconstituted IASC changed its name to the IASB (International Accounting Standards Board) when it began operations in 2001.

countries: Australia and New Zealand together, Canada, France, Germany, Japan, the United States and the United Kingdom. The role of the liaison IASB member was to facilitate the exchange of information and increase cooperation between the national standard-setting body and the IASB.

The FASB recognized that, as the national standard setter for the world's largest capital market, its support for, and participation in, a high-quality global standard-setting structure and process were crucial to meeting the demands for international convergence of accounting standards and, thus, to serving the needs of its constituents. The FASB also recognized that to the extent national standard setters share the goal of developing a single set of high-quality international accounting standards, they must be willing to work with the IASB, even if that leads to a shift in the standard setter's national role, operational changes, or a need to devote substantial contributions of resources to the international standard-setting process. Thus, shortly after the proposed restructuring of the IASC was agreed to, the FASB formed a strategic planning group (consisting of Board and staff members) to consider the potential changes facing the FASB.

2. *FASB Strategic Planning Group*

In 2000, the strategic planning group undertook a review of the FASB's operating policies and procedures to identify how the Board and staff could best work with the new IASB. That review was needed even though there were still many uncertainties about the status of IASC standards and about the potential success of the IASB. The review did not include a discussion of developing a phase-out plan for U.S. GAAP or for the FASB. On the contrary, the Board recognized that domestic standard setting in some form may always exist—even when the IASB becomes the global standard setter. For example, as the U.S. markets experience highly specialized, complex, or unique transactions, they may be most effectively addressed by a national-level standard-setting organization. Further, the large body of existing U.S. GAAP will require maintenance and amendment from time to time, which may not be viewed as a priority by the IASB. Continued existence of the FASB as a national standard setter would also be critical to ensuring that the U.S. perspective is fully considered in IASB deliberations and that the IASB has an important vehicle through which it can maintain close contact with a key constituency. Thus, the Board concluded that, at least for the foreseeable future, the FASB's commitment to international standard setting would coexist with its continued commitment to domestic standard setting.

In developing plans for working with the newly constituted IASC, the FASB was striving for an appropriate and realistic balance between the FASB's international and national standard-setting commitments. The FASB's support for the new IASC structure was reflected in the changes made to the FASB's agenda-setting process. In setting its agenda, the Board historically evaluated potential topics based on the following factors: (a) pervasiveness of the problem, (b) alternative solutions, (c) technical feasibility, and (d) practical consequences. While those factors are clearly significant to agenda decisions, the Board recognized that they are not sufficient for meeting its standard-setting objectives in an international context.

Therefore, to be consistent with its stated objective of a single set of high-quality international accounting standards, in 2001 the FASB instituted a policy requiring that all potential agenda projects be assessed to consider the extent to which they provide opportunities for convergence and cooperation with the IASB and other national standard setters. The additional criteria used to evaluate potential agenda projects were thus expanded to include:

- *Convergence possibilities*—the extent to which there is an opportunity to eliminate significant differences in standards or practices between the United States and other countries with a resulting improvement in the quality of U.S. standards; the extent to which it is likely that a common solution can be reached; and the extent to which any significant impediments to convergence can be identified;
- *Cooperative opportunities*—the extent to which there is international support by one or more other standard setters for undertaking the project jointly or through other cooperative means with the FASB; and
- *Resources*—the extent to which there are adequate resources and expertise available from the FASB, the IASB, or another standard setter to complete the project and whether the FASB can leverage off the resources of another standard setter in addressing the issue (and perhaps thereby add the project at a relatively low incremental cost).[21]

The strategic planning group concluded that the FASB's plans for working with the IASB should be guided by the FASB-FAF Vision for participating in the development of international accounting standards.[22] The FASB-FAF Vision identified two related goals as part of the FASB's commitment to the development of international accounting standards. Those goals are: (a) to ensure that international accounting standards are of the highest quality and (b) to accelerate convergence of the accounting

[21] Financial Accounting Standards Bd., Facts about FASB at 4, *available at* http://www.fasb.org/facts/index.shtml (last visited Mar. 29, 2005).

[22] *Id.*

standards used in different nations. The FASB-FAF Vision notes that those goals should be pursued within the context of the FASB's ongoing commitment to establish and improve standards of financial accounting and reporting in the United States.

The strategic planning group decided that in its relationship with the IASB, the FASB's primary strategy should be to maximize its ability to simultaneously meet its international and domestic objectives by *jointly* undertaking common agenda projects with the IASB to the extent possible. The strategic planning group identified the joint-project strategy as the most efficient and effective way to use the FASB's resources to achieve that goal.

Under the joint-project strategy, the FASB would seek to undertake common agenda projects with the IASB to whatever extent possible. In those cases in which it was not possible to undertake a joint project, the FASB would decide on a case-by-case basis whether alternative forms of international cooperation were desirable. For a project to be considered "joint" the same project would be on the agendas of both Boards at the same time, the issues of the project would be fully deliberated by both Boards and the Boards would strive to achieve the same resolution by working together and sharing resources.

The Board supported the joint project approach not only because it was an important means by which the FASB could simultaneously meet its domestic and international goals, but also because undertaking joint projects provided maximum opportunities for success in: (a) converging national and international standards to high-quality solutions, (b) ensuring that international standards are of high quality, and (c) ensuring that domestic standards (when developed as part of an international effort) are also of high quality.

The Board agreed that for those projects that were not pursued jointly with the IASB, the FASB should interact with the IASB in ways that further the FASB's goals of convergence and high-quality international standards. Possible ways of interacting included: (a) cooperative efforts on common projects on both Boards' agendas that are not undertaken jointly, (b) cooperative efforts intended to facilitate convergence on topics that are on the agenda of one standard setter but not the other, and (c) cooperative efforts to ensure that standards that have been converged are similarly interpreted and applied.

3. Partnership Working Arrangements

When the IASB began its operations in April 2001 the FASB and the national standard setters, with an IASB liaison Board member, (the partner standards setters) worked together to make operational the "partnership" between the IASB and the national standard setters envisaged by the IASC

Strategy Working Party and the IASB Constitution. The IASB met with the chairs of the partner standards setters twice in both 2001 and 2002 to discuss various partnership working arrangements related to joint projects, non-joint projects and interpretive bodies.

Just as the FASB had done, the other partner standard setters supported the joint project approach and agreed that the overall objective of undertaking a joint project is for two standard setters to arrive at a common accounting standard. Through a series of discussions the partner standard setters agreed to the fundamental operating procedures for a joint project, including staff roles.

The partner standard setters next focused their discussions of cooperative efforts on projects that are not undertaken jointly. They agreed to a basic framework of objectives and expectations for "monitoring" non-joint projects. Monitoring IASB projects is an important means by which standard setters not participating directly in an IASB project can provide input to, and benefit from, IASB discussions as the IASB's deliberations take place. Thus, they do not need to wait until the IASB publishes its decisions in a formal document.

4. Monitoring IASB Projects

The IASB and its partner standard setters agreed to three different levels of monitoring. Under Level 1, the IASB liaison Board member would keep the national Board up to date. In general, Level 1 monitoring would be appropriate for IASB projects in which the national Board has limited interest and that have little or no significance from a convergence standpoint.

Under Level 2, the activities of the IASB liaison Board member would be supplemented by additional activities undertaken by staff of the national Board. That staff person would remain current on the progress and direction of the IASB project. Level 2 monitoring generally would be appropriate when issues in an IASB project are not on the national standard setter's agenda but are important to the national standard setter because they: (a) have potentially significant implications for existing or future convergence of IASB and national standards, (b) relate to a topic for which there are no national standards or the quality of those standards is less than optimal, or (c) cover issues that are fundamental and pervasive to the financial reporting model.

Under Level 3, the national Board would rely primarily on a national staff monitor to undertake monitoring activities, including cooperative activities with the IASB staff when appropriate. Level 3 monitoring assignments would be made when the national standard setter has the same topic on its agenda as the IASB. A Level 3 staff monitor generally would be a member of the national standard setter's project team working on a similar issue or project.

From the FASB's perspective, monitoring IASB projects would provide a number of benefits including: (a) greater integration and consideration of international perspectives in the FASB's approach to domestic projects, (b) earlier identification of convergence (and divergence) possibilities, (c) an increase in Board and staff expertise and knowledge about international standards and about similarities and differences between national and international standards, and (d) stronger relationships (at both the Board and staff levels) between the FASB and the IASB. When the initial monitoring assignments were made, an FASB staff member was assigned to monitor the IASB's projects on business combinations (phase one), share-based payment, insurance contracts, aspects of the IASB's improvements project and reporting performance.

5. *Interpretive Bodies*

Acknowledging that interpretations are an integral part of the standard-setting infrastructure, the partner standard setters also discussed how their respective interpretive bodies should work together. The partner standard setters agreed that interpretive guidance issued by either the IASB's or a liaison standard setter's interpretive body should maintain or improve convergence of similar or identical national and IASB standards. They agreed that the starting point would be for each interpretive body to monitor the activities of the IASB's International Financial Reporting Interpretations Committee (IFRIC) as a part of their deliberations and to communicate any differences and/or concerns before issuing an interpretation that would cause divergence in application. As the number of converged standards increases, the FASB's goal is to ensure that the interpretations issued by the FASB's EITF and the IASB's IFRIC do not result in divergent application of the converged standards.

III. FASB'S CURRENT CONVERGENCE ACTIVITIES (2002–2004)

A. The "Norwalk Agreement"

As part of a continuing effort to bring about convergence of global accounting standards, the FASB and the IASB held their first joint meeting in September 2002 at the FASB's headquarters in Norwalk, Connecticut.[23] At that meeting, the FASB and 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. Both

[23] Press Release, Financial Accounting Standards Bd., FASB and IASB Will Hold Joint Meeting in Support of Convergence of Global Accounting Standards (Sept. 17, 2002), *available at* http://www.fasb.org/news/ nr091702.shtml.

the FASB and IASB pledged to use their best efforts to make their existing financial reporting standards fully compatible as soon as practicable and to coordinate their future technical agendas to ensure that once achieved, compatibility is maintained. Following their first joint meeting, the FASB and the IASB issued in October 2002 a Memorandum of Understanding (referred to as the Norwalk Agreement)[24] marking a significant step toward formalizing their commitment to the convergence of U.S. and international accounting standards. That agreement focused on four key actions each Board committed to: (a) coordinating their future technical agendas, (b) taking on joint projects, (c) eliminating certain differences between U.S. GAAP and International Financial Reporting Standards (IFRSs, which include International Accounting Standards, IASs), and (d) coordinating the activities of their respective interpretive bodies (EITF and IFRIC).

B. Coordinated Long-Term Agenda

Two key aspects of the Norwalk Agreement are a commitment to remove significant differences between U.S. GAAP and IFRSs through coordination of the topics on their future agendas and the joint undertaking of major projects on substantive topics. At their October 2003 joint meeting, the IASB and the FASB set an objective of reaching agreement on a coordinated, longer-term technical agenda by April 2004. At their joint meeting in April 2004, the Boards agreed that in principle, any significant accounting standard would be developed cooperatively with the objective of issuing the same or similar standard concurrently in the United States and in those jurisdictions that apply IFRSs.

At that April 2004 meeting, the Boards discussed a list of potential major projects and an analysis of how those projects should be sequenced and prioritized. Based on that discussion, the Boards agreed on three projects that should be considered for admission to the joint agenda as resources become available: accounting for leasing, employee benefits and intangible assets. The Boards also expressed an interest in working together in the financial instruments area—possibly as a convergence project (to reduce or eliminate differences between U.S. GAAP and IFRSs) or as a major project (to improve existing financial reporting).

[24] *See* 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].

C. Joint FASB-IASB Projects

1. Business Combinations

A year before the Norwalk Agreement, the FASB and the IASB agreed to their first joint undertaking—a project to reconsider aspects of the purchase method of accounting for business combinations.[25] In deciding to undertake that project jointly, the Boards noted that differences in the accounting for business combinations were the most frequent cause of reconciling items between net income reported under U.S. GAAP and IFRSs. The Boards believe that undertaking a joint project to develop a high-quality accounting standard for business combinations will result in more transparent financial information to users of financial statements while making progress toward the Boards' shared convergence goal.

For all joint projects the Boards share staff resources, research and work to coordinate the eventual issuance of Exposure Drafts and final standards. Although the Boards coordinate the timing of deliberation on issues within the project, they individually deliberate and vote on the issues within the project. In the first quarter of 2005 the Boards expect to issue common Exposure Drafts on purchase method procedures and a related topic, the accounting for and reporting of non-controlling interests in consolidated financial statements.

2. Revenue Recognition

In May 2002, the FASB added to its technical agenda a project to develop a comprehensive accounting standard on revenue recognition and amend the related guidance on revenues and liabilities in some of the FASB Concepts Statements.[26] In June 2002 the IASB added a similar project to its technical agenda that it agreed to undertake jointly with the FASB. The Boards agreed that the primary objective of the joint project is to develop

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[25] This project is the second phase of each Board's overall business combinations project. The first phase of each project (undertaken separately and at different times) addressed the methods used to account for business combinations and the accounting for goodwill and other intangible assets. The FASB issued Statements No. 141 and No. 142, *Business Combinations*, and *Goodwill and Other Intangible Assets*, respectively, in June 2001. STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 141 ON BUSINESS COMBINATIONS (Financial Accounting Standards Bd., 2001); STATEMENT OF FINANCIAL ACCOUNTING STANDARDS NO. 142 ON GOODWILL AND OTHER INTANGIBLE ASSETS (Financial Accounting Standards Bd., 2001).

[26] The FASB's conceptual framework is a coherent system of interrelated objectives and fundamentals that is expected to lead to consistent accounting standards. The framework also prescribes the nature, function and limits of financial reporting. It consists of six Concepts Statements on the objectives of financial reporting, elements of financial statements, and recognition and measurement in financial statements. The Concepts Statements are expected to be the basis of future principles and standards.

and issue a common revenue recognition standard that includes a comprehensive set of principles for revenue recognition that is based on sound accounting concepts. By developing sound accounting concepts and a related comprehensive, principles-based standard, the Boards aim to (a) eliminate the inconsistencies in the existing authoritative literature and accepted practices, (b) fill the voids that have emerged in revenue recognition guidance in recent years, and (c) provide a conceptual basis for addressing issues that arise in the future.

The Boards are pursuing an approach to revenue recognition that focuses on changes in assets and liabilities (consistent with the definition of revenues in FASB Concepts Statement No. 6, *Elements of Financial Statements*)[27] and that is not overridden by tests based on the notions of realization and completion of an earnings process presented in FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*.[28] Currently, the Boards are working to further refine the definition of revenues and are discussing issues relating to initial and subsequent measurement of assets and liabilities that give rise to revenues. The Boards are hopeful that they will be in a position to issue a discussion paper outlining their preliminary views on those issues in either late 2005 or early 2006.

3. *Financial Performance Reporting by Business Enterprises*

Since 2002 the FASB has had a project on its agenda to address the presentation of information in financial statements with an objective of improving the usefulness of that information in assessing the financial performance of a business enterprise. As the IASB was working on a similar project with the U.K. Accounting Standards Board, the FASB and IASB staff kept in close contact about the progress of their respective projects. After over two years of working on parallel projects, in October 2004, the FASB and IASB agreed to conduct their similar projects on reporting financial performance as a joint project.

The joint project will focus on form and content, classification and aggregation, and display of specified items and summarized amounts on the face of the basic financial statements (in both interim and annual periods). That includes determining whether to require the display of certain items determined to be key measures or necessary for the calculation of key measures. In addition, the project will include a consideration of whether there should be common international standards regarding which financial statements should be presented and issues related to comparative periods.

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[27] ELEMENTS OF FINANCIAL STATEMENTS, Statement No. 6 (Financial Accounting Standards Bd. 1984).

[28] RECOGNITION AND MEASUREMENT IN FINANCIAL STATEMENTS OF BUSINESS ENTERPRISES, Statement No. 5 (Financial Accounting Standards Bd. 1984).

The project will not address management discussion and analysis or the reporting of "pro forma earnings" in press releases or other communications outside financial statements and does not include segment information or matters of recognition or measurement of items in financial statements.

In January 2005, the Boards met with a newly formed joint international advisory group on performance reporting to seek their views on the various issues the Boards plan to address in the project. The Boards plan to begin deliberating those issues with a goal of issuing a preliminary views document for public comment in late 2005.

D. "Short-Term" Convergence Project

Another key aspect of the Norwalk Agreement was a commitment by the Boards to jointly undertake a series of short-term projects aimed at removing a variety of narrow existing differences between U.S. GAAP and IFRSs.[29] Those narrow differences, while not necessarily major issues for either Board, can present major challenges to those using, preparing, auditing, or regulating cross-border financial reporting. Because those differences relate to areas of accounting that would not be areas of high priority to either Board were it not for the convergence objective, they would not be expected to otherwise be addressed by either Board.

Following their September 2002 joint meeting, both Boards added a short-term convergence project to their active agendas. The project scope was limited to those narrow differences in which convergence around a high-quality solution appears achievable in the short-term, usually by selecting between existing IFRSs and U.S. GAAP. For each difference, the Boards agreed to deliberate the accounting alternatives using shared research. If convergence around a high-quality solution could be achieved without comprehensive reconsideration of the issue, one or both Boards would propose changes to existing GAAP to bring about convergence. In the event that a more comprehensive reconsideration was determined to be desirable, the Boards agreed they would remove the difference from the scope of the short-term project.

In the fourth quarter of 2002, the FASB and the IASB began deliberating a number of the narrow differences in the short-term convergence project. Initially, the FASB was to focus on whether to change its literature in the following areas: balance sheet classification, exchanges of non-monetary assets, inventory costs, earnings per share and voluntary change in accounting policies. Concurrently, the IASB was to review IFRSs related to discontinued activities, restructuring costs and termination benefits, and post-employment benefits. Together, the IASB and the FASB were to address differences in their income tax standards.

[29] The Norwalk Agreement, *supra* note 24.

1. Differences Addressed by the FASB

In December 2003, the FASB issued Exposure Drafts on four of the five topics in its part of the joint short-term convergence project. In June 2004, the Board decided to defer issuance of an Exposure Draft on balance sheet classification and remove the issue from the scope of the short-term convergence project because the issues were broader than initially contemplated and would be more appropriately considered in the context of their joint project on financial performance reporting by business enterprises.

In the fourth quarter of 2004, the FASB issued two Statements resulting from the joint short-term convergence project: FASB Statements No. 151, *Inventory Costs*, and No. 153, *Exchanges of Non-Monetary Assets*.[30] The final Statements on earnings per share and accounting changes are expected to be issued in the first half of 2005.

2. Differences Addressed by the IASB

In March 2004, the IASB issued IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*, the first standard to arise from the joint short-term convergence project.[31] IFRS 5 results from the IASB's review of FASB Statement No.144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, which was issued in 2001.[32]

In December 2004, the IASB issued an amendment to IAS 19, *Employee Benefits*.[33] The objective was to build on the principles that are common to most existing national standards on this topic and to seek improvements to IAS 19 in specific areas. The amendments to IAS 19 allow the option of recognizing actuarial gains and losses in full in the period in which they occur in the income statement. This option is similar to the requirements of the U.K. ASB standard, FRS 17 *Retirement Benefits*.[34] In addition, the disclosures in IAS 19 were amended to be more like those required by FASB Statement No. 132 (revised 2003), *Employers' Disclosures about Pensions and Other Postretirement Benefits*.[35]

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[30] INVENTORY COSTS, Statement No. 151 (Financial Accounting Standards Bd. 2004); EXCHANGES OF NON-MONETARY ASSETS, Statement No. 153 (Financial Accounting Standards Bd. 2005).

[31] NON-CURRENT ASSETS HELD FOR SALE AND DISCONTINUED OPERATIONS, International Financial Reporting Standard No. 5 (Int'l Accounting Standards Bd. 2004).

[32] ACCOUNTING FOR THE IMPAIRMENT OR DISPOSAL OF LONG-LIVED ASSETS, Statement No. 144, (Financial Accounting Standards Bd. 2001).

[33] EMPLOYEE BENEFITS, International Accounting Standard No. 19 as amended (Int'l Accounting Standards Bd. 2004).

[34] RETIREMENT BENEFITS, Financial Reporting Standard No. 17 (UK Accounting Standards Bd. 2000).

[35] EMPLOYERS' DISCLOSURES ABOUT PENSIONS AND OTHER POSTRETIREMENT BENEFITS.,

As part of its improvement project, the IASB is amending IAS 37, *Provisions, Contingent Liabilities and Contingent Assets.*[36] The amendments to IAS 37 are also part of the short-term convergence project, as the goal is to eliminate most of the differences in the accounting for restructuring costs and termination benefits under IAS 37 and FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities.*[37] The IASB expects to issue an Exposure Draft proposing amendments to IAS 37 in 2005, concurrent with the Exposure Drafts in the joint business combinations project.

3. *Differences Addressed Jointly*

IAS 12, *Income Taxes,*[38] is the prevailing international guidance on income taxes and is based on principles similar to those of FASB Statement No. 109, *Accounting for Income Taxes.*[39] Although both IFRSs and U.S. GAAP use a temporary difference approach to accounting for income taxes there are a number of differences in the application of that method (for example, different exemptions from the basic principle). Those differences result in significant non-comparability between entities applying Statement 109 and those applying IAS 12. The objective of this aspect of the short-term convergence project is to reduce or eliminate that non-comparability by reconsidering the narrow set of differences that give rise to it. In 2003, the IASB began work on the income tax aspect of the project and has deliberated its share of the issues. The FASB began deliberating its share of the differences in 2004. Both Boards expect to issue an Exposure Draft in the first half of 2005. Each Board will propose making certain changes to its respective income tax accounting standard to bring that standard closer to that of the other Board.

4. *Next Set of Differences to Be Addressed*

Having made substantive progress on eliminating the initial set of differences included in the scope of their joint short-term convergence project, the Boards agreed to consider next whether they could eliminate differences in the areas of research and development, joint ventures and segment reporting.

Statement No. 132 (Financial Accounting Standards Bd., revised 2003).

[36] PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS, International Accounting Standard No. 37 (Int'l Accounting Standards Bd. 1998).

[37] ACCOUNTING FOR COSTS ASSOCIATED WITH EXIT OR DISPOSAL, Statement No. 146 (Financial Accounting Standards Bd. 2002).

[38] INCOME TAXES, International Accounting Standard No. 12 (Int'l Accounting Standards Bd. 1996).

[39] ACCOUNTING FOR INCOME TAXES, Statement No. 109 (Financial Accounting Standards Bd. 1992).

Research and development: FASB Statement No. 2, *Research and Development*,[40] requires research and development costs to be expensed when incurred. IAS 38, *Intangible Assets*,[41] requires a distinction to be made between research and development and requires development costs to be capitalized under certain circumstances. The objective of this aspect of the short-term convergence project is to consider whether differences in how research and development costs are accounted for can be eliminated. The FASB staff is in the process of identifying the issues that need to be addressed in order to better define the project's scope. The FASB expects to begin deliberations in the first part of 2005.

Joint ventures: The IASB staff is currently researching the issues that might be addressed in this project, including the following: (a) the substantive nature of interests in jointly controlled entities, (b) which of the two methods (equity method or proportional consolidation) more faithfully represents the economic substance of interests in jointly controlled entities, and (c) any differences between the notions of a jointly controlled entity under IFRSs and a corporate joint venture under U.S. GAAP. Staff members from the Australian Accounting Standards Board are also conducting research on joint ventures that may be used in this aspect of the short-term convergence project.

Segment reporting: In January 2005 the IASB will consider adding a project to its agenda that would seek to achieve convergence on the topic of segment reporting, as IAS 14, *Segment Reporting*,[42] and FASB Statement No. 131, *Disclosures about Segments of an Enterprise and Related Information*,[43] adopt different approaches.

Other topics the Boards might explore as part of their short-term convergence project include property, plant, and equipment, investments in real estate properties and interim reporting.

E. Convergence Research Project

In addition to their joint short-term convergence project, the FASB and IASB staffs are also conducting a research project on international convergence, with the following objectives:

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[40] ACCOUNTING FOR RESEARCH AND DEVELOPMENT COSTS, Statement No. 2 (Financial Accounting Standards Bd. 1974).

[41] INTANGIBLE ASSETS, International Accounting Standard No. 38 (International Accounting Standards Bd. 1999).

[42] SEGMENT REPORTING, International Accounting Standard No. 14 (International Accounting Standards Bd. 1998).

[43] DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION, Statement No. 131 (Financial Accounting Standards Bd. 1997).

a. *Identify all substantive differences between U.S. GAAP and IFRSs.* The FASB, IASB and other research organizations have already done much of this work. The staff will validate and complete that work. The listing of differences will be continuously monitored and updated as new differences arise and existing differences are resolved;
b. *Catalog those differences based on the most effective strategy for resolving them.* There are three possible strategies for resolving differences between U.S. GAAP and IFRSs: the difference (1) is expected to be resolved within the short-term convergence project, (2) is expected to be resolved within another major agenda project currently on the agenda of one or both Boards, or (3) is part of an issue that requires comprehensive reconsideration by one or both Boards; and
c. *Provide input to the FASB's agenda-setting process as needed to further the goal of convergence.* The research project will provide the FASB with the necessary information about the effect of current and future agenda projects on convergence to enable the FASB to make informed agenda decisions that ultimately will lead to greater compatibility between U.S. GAAP and IFRSs.

F. Conceptual Framework

Consistent with their decision that any significant accounting standard should be developed cooperatively, the Boards agreed with the objective of moving toward a single conceptual framework that would be used by both Boards in developing their standards. In October 2004 the Boards added a joint project to their respective agendas to refine, complete and converge the IASB's Framework and the FASB's Statements of Accounting Concepts. That common conceptual framework would be based on and built on the existing IASB and FASB frameworks and would be a framework that both Boards would use as a basis for their accounting standards.

The initial phase of the conceptual framework project will focus on achieving convergence of the frameworks and improving particular aspects of the frameworks dealing with objectives, qualitative characteristics, elements, recognition and measurement. As the frameworks converge and are improved, priority will be given to addressing issues that are likely to yield benefits to the Boards in the short term—cross-cutting issues that affect a number of their projects for new or revised standards.

The Boards plan to publish an initial communications document in the first half of 2005. That document will explain, among other things, the purpose and importance of the framework, why the Boards wish to converge their existing frameworks and why those frameworks need improvement.

G. Working Together

After almost two years of working cooperatively in a number of areas, the Boards agreed it was time to sit back and assess what was working well and what needed improvement. Part of the October 2004 joint meeting was spent discussing various administrative items, particularly the processes and procedures related to joint projects. Discussion topics included the role of Board members in relation to staff members on the project team, the structure and content of Board meeting materials and developing common language standards.

At the end of the discussion, the Boards agreed that more work needed to be done and asked the staff to develop papers on a number of issues for their consideration at a future meeting. In addition to various items related to joint projects, the staffs are developing ideas on how discussion papers or preliminary views documents should be structured. In addition, the IASB staff is working on a comparison of their due process procedures with those of the FASB to identify areas where alignment may be needed.

At the October 2004 joint meeting the Boards also discussed a possible approach to conducting projects on topics for which one Board is actively deliberating and the other Board may be interested in pursuing in the near future but does not currently have on its agenda. Under the modified joint project approach, the initial due process document would be a discussion paper developed primarily through the deliberations of the Board that is actively deliberating the topic. That discussion paper would be issued by both Boards for public comment. Following analysis of comments received, the Boards would plan to undertake a joint project with the objective of issuing identical or substantially similar Exposure Drafts and final standards.

The Boards expressed interest in using the modified joint approach on the FASB's active project on liabilities and equity and the IASB's active project on accounting for insurance contracts. The Boards should make a decision on those two projects in early 2005. Other active projects that might be conducted jointly in the not-too-distant future include the FASB's project on liability extinguishment and issues relating to consolidation policy (currently an active IASB project and an FASB research project).

H. Progress to Date

1. Recent Standards

In 2004 progress was made toward minimizing the differences between U.S. GAAP and IFRSs. Not only were a number of differences eliminated as the result of the short-term convergence project, but also differences were eliminated in the area of business combinations and accounting for share-based payment. IFRS 3, *Business Combinations*,[44] issued in March 2004, narrowed the differences in how a business combination is accounted for by: (a) eliminating the use of the pooling method, as did Statement 141, and (b) converging the accounting for acquired goodwill (no longer amortized but reviewed annually for impairment, as in Statement 142). The IASB issued IFRS 2, *Share-based Payment*, in February 2004, and the FASB issued a substantially similar standard (Statement No. 123 (revised 2004), *Share-Based Payment*)[45] in December 2004. Beginning in 2005, entities that apply either the U.S. GAAP or IFRSs will be required to recognize the cost of employee services received in share-based payment transactions in their financial statements. It should be noted that the Canadian accounting standards for business combinations and share-based payment were changed to be in line with those issued by the FASB and the IASB.

While the Board members and staff are consciously working on promoting convergence in joint and common projects, they also need to be sure that divergence of currently similar accounting standards is not happening as the result of other projects or activities of either Board or their interpretive bodies. This is an area where the IASB liaison Board member is critical.

2. *IASB Liaison Board Member*

As noted previously, the role of IASB liaison Board member was created to facilitate information exchange and increase cooperation between the national standard-setting body and the IASB. IASB member Jim Leisenring currently serves in the role of liaison to the FASB.[46] In that role, Leisenring is responsible for facilitating the exchange of views between the FASB and the IASB concerning projects on either or both of the Boards' agendas.

Leisenring typically spends two weeks a month at the FASB offices and attends FASB meetings while in Norwalk. He has speaking privileges at FASB meetings but is not a member of the FASB and, thus, does vote on matters under consideration. His primary role at FASB meetings is to convey the views of IASB members relative to the topic being discussed and to inform FASB members of the convergence implications of their

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

[45] SHARE-BASED PAYMENT, Statement No. 123 (Financial Accounting Standards Bd. 2004).

[46] Jeffrey J. Johnson, *International Convergence Impacts FASB Policies and Procedures*, THE FASB REPORT, May 22, 2003.

decisions. For example, if the FASB is heading in a direction that is different from that of the IASB, Leisenring is responsible for ensuring that FASB members are aware of the potential for divergence. He communicates the views of FASB members to the IASB in a similar manner.

Leisenring also updates the FASB members and staff on IASB projects following each IASB meeting. The primary purpose of those update meetings is to review IASB decisions on non-joint projects with a focus on areas of potential divergence. Those regular update meetings also provide a forum for the FASB members and staff to stay current on the IASB's various technical activities.

Another potential area for divergence is in the work of the Boards' interpretive bodies. Even if the Boards' standards in an area are identical, divergence can occur if the interpretation or application guidance provided by those bodies differ. The partner standard setters agreed that their respective interpretive bodies would need to monitor the activities of IFRIC and coordinate similar issues as appropriate. In the process of developing EITF agenda issues, consideration is given to whether: (a) IFRSs provide relevant guidance or potential alternative views, (b) similar issues have been addressed by the IFRIC and, if so, whether IFRIC's interpretation provides relevant guidance or potential alternative views, and (c) common or similar issues are being addressed currently by the IFRIC that provide an opportunity for convergence through sharing of views or potential solutions. Thus far, the FASB's effort to avoid unintended divergence has been successful.

I. U.S. Regulatory Environment

The Securities and Exchange Commission (SEC or Commission) has statutory authority to establish financial accounting and reporting standards for publicly held companies under the Securities Exchange Act of 1934. Throughout its history, however, the Commission's policy has been to rely on the private sector for this function to the extent that the private sector demonstrates the ability to fulfill the responsibility in the public interest. Since 1973, the FASB has been the private-sector organization designated by the SEC to establish standards of financial accounting and reporting. FASB standards are also officially recognized as authoritative for non-publicly-held companies by the American Institute of Certified Public Accountants (AICPA).

In conjunction with Section 108 of the Sarbanes-Oxley Act of 2002 (the Act)[47], the SEC issued a Policy Statement in April 2003 reaffirming the

[47] Public Company Accounting Reform and Investor Protection (Sarbanes-Oxley) Act, Pub. L. No. 107-204, 116 Stat. 745 (2002) (protecting investors by improving the accuracy

status of the FASB as a designated private-sector standard setter. Section 108 of the Act stated that the body that was recognized by the SEC for setting generally accepted accounting principles would have to consider international convergence in setting those principles.[48] Thus, the SEC Policy Statement stated that in order for U.S. accounting standards to remain relevant and to continue to improve, the Commission expects the FASB to:

> Consider, in adopting accounting principles, the extent to which international convergence on high quality accounting standards is necessary or appropriate in the public interest and for the protection of investors, including consideration of moving towards greater reliance on principles-based accounting standards whenever it is reasonable to do so.[49]

Another indication of the importance of international convergence to the U.S. capital markets came in July 2003 when the SEC staff submitted to Congress its *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* (the Study).[50] The Study included a number of recommendations for the FASB, including that the Board should continue its current convergence efforts (short-term convergence project, alignment of technical agendas and developing a common language and format for joint standards).

The SEC is actively involved in international financial reporting matters. The FASB and the SEC staff regularly discuss matters related to international convergence and there are periodic meetings between representatives of the FASB, IASB and the SEC staff to discuss progress towards the goals stated in the Norwalk Agreement.

As more countries adopt IFRSs, the SEC is constantly being asked whether it will lift the reconciliation to the U.S. GAAP requirement for foreign registrants. The SEC staff has said in various public forums that it is not a question of whether, but of when. In June 2004, the SEC Chief Accountant said that in his personal view "if things continue as they have been going . . . then 'in this decade', the SEC will be able to eliminate the reconciliation."[51]

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and reliability of corporate disclosures made pursuant to the securities laws, and for other purposes).

[48] *Id.*

[49] We expect that during its deliberations of an accounting issue the FASB will consider, among other things, international accounting standards addressing that issue.

[50] U.S. Securities and 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 (2003), *available at* http://www.sec.gov/news/studies/principlesbasedstand.htm.

[51] Donald T. Nicolaisen, Remarks before the Public Hearing on the IASC Constitution

IV. A LOOK INTO THE FUTURE (2005 AND BEYOND)

In reflecting on the past, it is interesting to note that twenty years ago only U.S. accounting standards were broadly accepted internationally. Not only did the United States have the largest capital market, but many multinational companies were based in the United States and their subsidiaries around the world had to apply U.S. GAAP. The larger foreign registrants in U.S. stock exchanges also chose to use U.S. GAAP because it was more widely accepted.

Through the 1990s, standards issued by the IASC came to be more widely accepted internationally. This has continued to increase in recent years under the IASB. Thus, at this point in time, there are effectively two sets of internationally accepted standards—U.S. GAAP and IFRSs. For international convergence to occur, it is important that those two sets of internationally accepted GAAPs converge. From the viewpoint of the international capital markets, it cannot be truly international if it does not include the United States; from the FASB's perspective, the United States cannot *not* be involved in the international convergence effort if it will benefit both U.S. investors and global commerce.

Now that 2005 is upon us and many more countries around the world are beginning to adopt IFRSs, what lies ahead? Significant strides have been made in the last few years toward international convergence due to the considerable efforts of many people. As with any goal worth achieving, there have been, and will continue to be, many challenges and opportunities along the way.

A. Challenges

First and foremost is the fact that the FASB and the IASB (as well as the rest of the standard setters around the globe) are starting from different places. While that is a "given" for any effort whose goal is achieving commonality in an area where commonality does not currently exist, it is not to be taken lightly. The existing FASB standards were developed over a period of thirty years by people dedicated to the FASB's mission of improving financial reporting. Convergence should not be achieved just for the sake of convergence. For individual Board members, balancing the desire for convergence with the goal of maintaining a high-quality set of accounting standards is a constant and difficult exercise.

Another significant challenge is the fact that little commonality exists in other aspects of the global reporting environment. There are cultural, institutional, and economic differences, as well as differences in regulatory and legal systems. While those differences may not be insurmountable and are faced by many operating in today's global business environment, those

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Review (June 3, 2004), *available at* http://www.sec.gov/news/speech/ spch060304dtn.htm.

differences do pose challenges not only to the accounting standards, but the standard-setting process as well.

Another challenge facing the FASB and the IASB as they work toward convergence is the fact that the topics on their technical agendas are not the same. With their stated goal of aligning their future agendas and undertaking more projects jointly, this should be an ever decreasing challenge but it is a challenge nonetheless—especially during the transition period. For example, the IASB is currently working on insurance accounting and the FASB is currently working on a liabilities and equity project. Both Boards have expressed an interest in pursuing those projects jointly, but that means the "lagging" Board must play catch up. While the modified joint approach described previously should help with the transition, logistical and process-related issues will continue to arise until the Boards' agendas are completely aligned.

The Boards also face the challenge of getting a majority of each Board to agree on a common answer to the issues underlying each of the joint projects. Getting a majority of the seven FASB members to agree in some cases is a challenge in and of itself, but then getting a majority of the IASB's fourteen Board members to also agree to the same answer further complicates the exercise.

B. Constituent Perspectives

Another set of challenges faces the FASB as it listens to its constituents. Many of the professional users, such as global equity analysts and institutional investors, many foreign-based multinationals, and some U.S.-based global companies are eager for international convergence to become a reality and do not understand why it is taking so long. However, many of those who are responsible for preparing the financial statements of U.S. companies appear to be less in favor of convergence.[52] That is because convergence essentially means change and U.S. companies have been through a great deal of change in terms of financial reporting over the past few years as a result of the Sarbanes-Oxley Act and related regulations. But hearing diametrically opposing views from its constituents is nothing new to the FASB. Thus, the Board is proceeding with its convergence efforts as it does with any of its challenging technical projects—systematically, thoroughly and carefully.

Moreover, constituents affected by proposed changes in accounting standards that they believe to be either unsound or detrimental to their interests sometimes will seek political and governmental intervention into

[52] *See, e.g.*, Letter from Saul Rosen and Robert Traficani, Citigroup Inc. to Robert Herz, Chairman, Financial Accounting Standards Board (Sept. 13 2004), *available at* http://www.fasb.org/ocl/1202-ITU/31200.pdf.

the accounting standard-setting process. Both the FASB and the IASB have experienced this recently in regards to particular projects that are consistent with the goal of international convergence but have faced opposition from certain constituents. In the FASB's case, this has been most evident in regards to the accounting for share-based payment. For the IASB, it has come in regards to the accounting for financial instruments. Thus, inevitably, because convergence involves change, the threat of political interference and intervention poses a serious challenge to achieving international convergence.

Another concern of U.S. constituents is the thought that having a single set of high-quality accounting standards used around the world will lead to two tiers of U.S. GAAP. The concern of some is that international standards will be required of public registrants (foreign and domestic), but a second set of accounting standards will be developed that would apply only to private companies (and possibly small business registrants). In its current project, accounting standards for small and medium-sized entities, the IASB is considering developing a set of standards that would apply to entities that do not have public accountability. While the title of the project implies that those standards might apply to an entity based on its size, the IASB has decided that their applicability would not be based on size. In addition to the IASB's efforts in this area, a number of national standard-setting bodies have developed, or are in the process of developing, "differential accounting standards" (a separate set of standards that would apply to smaller entities).

V. SOME CONCLUDING THOUGHTS ON THE OPPORTUNITIES THAT MUST BE PURSUED

Together the FASB and the IASB are coordinating their agendas, undertaking joint projects on major subjects, working together to improve the conceptual framework and proposing changes on both sides to reduce the number of specific areas of difference between U.S. GAAP and IFRSs. Those collaborative efforts will continue in the years ahead. In 2005, the Boards will consider adding one or more joint projects to their technical agendas. The potential joint projects described below each offer an opportunity to both improve financial reporting and eliminate differences between the U.S. GAAP and IFRSs.

a. *Consolidations*: This potential joint project could develop comprehensive accounting guidance on accounting for affiliations between entities, including reconsideration of Accounting Research Bulletin No. 51, *Consolidated Financial Statements*.[53] The project

[53] American Institute of Certified Public Accountants, Accounting Research Bulletin No. 51 on Consolidated Financial Statements (2004).

could focus initially on policy issues but also could "peek ahead" to related procedures issues (identify the procedural impact of any change to existing consolidation policy). Consolidation policy issues include (1) whether controlling financial interests can be established with less than a majority voting interest, and, if so, how to identify them, (2) the effect of minority shareholder rights on holders of majority voting interests, (3) controlling financial interests obtained through ownership of convertible debt, options, or other means of obtaining a voting interest, and (4) controlling financial interests established with the assistance of related parties and de facto agents.

b. *Leasing*: This potential joint project could fundamentally reconsider the accounting for leases (by the lessee) by developing an approach that is consistent with the conceptual framework definitions of assets and liabilities. The project could result in an amendment or replacement of existing leasing guidance.

c. *Employee benefits*: This potential joint project could fundamentally reconsider the accounting for *all* employee benefits with the goal of developing a single comprehensive standard that would replace FASB Statements No. 87, *Employers' Accounting for Pensions,*[54] No. 88, *Employers' Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits,*[55] No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions,*[56] No. 112, *Employers' Accounting for Postemployment Benefits,*[57] and possibly parts of ARB No. 43, *Restatement and Revision of Accounting Research Bulletins.*[58] The project could be conducted through a series of phases beginning first with the development of a fundamental model of accounting for employee service costs. That initial work could be followed by one or more projects that would apply that model to different types of benefit arrangements (e.g., reconsideration of pensions and other deferred compensation costs).

d. *Intangible assets*: This potential joint project could develop

[54] EMPLOYERS' ACCOUNTING FOR PENSIONS, Statement No. 87 (Financial Accounting Standards Bd. 1985).

[55] EMPLOYERS' ACCOUNTING FOR SETTLEMENTS AND CURTAILMENTS OF DEFINED BENEFIT PENSION PLANS AND FOR TERMINATION BENEFITS, Statement No. 88 (Financial Accounting Standards Bd. 1985).

[56] EMPLOYERS' ACCOUNTING FOR POSTRETIREMENT BENEFITS OTHER THAN PENSIONS, Statement No. 106 (Financial Accounting Standards Bd. 1990).

[57] EMPLOYERS' ACCOUNTING FOR POSTEMPLOYMENT BENEFITS, Statement No. 112 (Financial Accounting Standards Bd. 1992).

[58] American Institute of Certified Public Accountants, Accounting Research Bulletin No. 43 on Restatement and Revision of Accounting Research Bulletins (2004).

> standards of accounting and reporting that would result in balance sheet recognition of internally generated intangible assets that are consistent with the conceptual framework. As a first step toward achieving that objective, the Boards might consider a project to require disclosure of information about intangible assets that are not recognized in financial statements, including those assets that are developed internally (such as brand names and customer relationships) and those that are acquired and written off immediately (acquired in-process research and development).

Convergence clearly means change and the FASB must adhere to its thorough due process so as to ensure that convergence is not being pursued just for the sake of convergence—there also must be an improvement in the quality of the accounting standards and the resulting financial reporting. Convergence is both a process and a destination with many stations along the way. Despite the many challenges, the FASB is committed to the goal of one set of high-quality financial reporting standards that can be used domestically as well as internationally. Accordingly, the FASB has devoted significant time and resources in support of this effort. It is a difficult task—one full of challenges and opportunities—but one the FASB believes is very important to U.S. investors, the international capital markets and to the continued development of global commerce and finance.