

# The Prospects Of Replacing GAAP With IFRS In The United States

RamMohan R. Yallapragada, Fayetteville State University, USA

C. William Roe, Arkansas State University, USA

Alfred G. Toma, University of Louisiana, Lafayette, USA

## ABSTRACT

*Historically, each country developed its own Generally Accepted Accounting Principles (GAAP) for financial accounting and reporting and there was no uniformity among the GAAPs of different countries. Comparison of financial statements issued by business firms from different countries has become difficult leading toward suboptimal capital allocation across countries in the world. Gradually, there emerged a global demand for convergence of GAAP of different countries into a single set uniform accounting standards applicable to all countries. As a result, the International Accounting Standards Committee (IASC) was established in 1973. The IASC formed International Accounting Standards Board (IASB) in 2001 which began issuing International Financial Accounting Standards (IFRS). At this point about 100 countries have adopted IFRS for their financial reporting purposes. In 2010, the US Securities Exchange Commission (SEC) stated that it would be able to make a decision on the adoption of the IFRS in the United States within that year and would allow a five-year period for complete transition, if it is decided to incorporate the IFRS into the U S reporting standards. An intense debate ensued for and against incorporation of IFRS into the US GAAP. Four alternative processes are suggested for the transition - outright adoption, convergence, endorsement, and co-endorsement. This paper presents details of each of these suggested alternatives and future perspective of the adoption of IFRS into the U S accounting and reporting system.*

**Keywords:** GAAP; IFRS; International Accounting Standards Board; SEC; Convergence; Endorsement; Condorsement

## INTRODUCTION

Before the stock market collapse of 1929, many companies in the United States (US) were not issuing any financial reports. After the Crash, Congress enacted The Securities Act of 1933 and the Securities Exchange Act of 1934, establishing the Securities and Exchange Commission (SEC) to regulate the companies (Phillips, 2010). These laws required the companies to make to issue periodic financial reports according to a set of uniform accounting standards. The advent of these securities laws launched a movement for bringing some comparability among different companies, creating a need for a uniform system of financial reporting. The task of setting accounting standards was delegated by the SEC to various professional organizations over the period. These organizations began to issue authoritative rules and pronouncements of accounting procedures which together constituted the entire body known as the Generally Accepted Accounting Principles (GAAP) (Phillips, 2010). The Committee on Accounting Procedure (CAP, 1939-1959) created by the American Institute of Certified Public Accountants (AICPA) issued pronouncements known as ‘Accounting Research Bulletins’. The Accounting Principles Board (APB, 1959-1973) issued ‘Opinions,’ and the Financial Accounting Standards Board (FASB, 1973 – present) issued pronouncements known as “Statements of Financial Accounting Standards. The US GAAP are for a long time considered as the gold standard for accounting and reporting guidelines all over the world. Thus, in the US, there existed a comprehensive set of accounting standards in place long before the establishment of the International Accounting Standards Committee in 1973 (Tyson, 2011).

## **ORIGINS INTERNATIONAL ACCOUNTING STANDARDS**

Historically, each country developed its own unique accounting guidelines (GAAP) which are different from each other because of the differences in the cultures, financial climates, and the user-requirements of the quality of accounting information among different countries. Consequently, there were problems in movement of capital across the borders leading to inefficient global capital utilization (Wiecek and Young, 2010). With the gradual proliferation of multinational corporations operating across borders, a global movement emerged among accounting professionals in various countries towards achieving convergence of GAAPs of different countries into a single set of uniform accounting procedures equally applicable to business firms in all countries in the world.

The first step in the movement came in 1973 with the establishment of “International Accounting Standards Committee” (IASC). The International Accounting Standards Board (IASB) was formed in 2001 replacing IASC (Ruder et al., 2005). The IASB operates under the oversight of the IFRS Foundation, with a mandate to develop and approve pronouncements known as International Financial Reporting Standards (IFRS) (Poon, 2010). The IASB began to produce comprehensive and consistent accounting standards, mostly in conjunction with the FASB. In recent times, the IFRS are gradually gaining a higher respect in the international arena with about 120 countries now requiring or allowing the use of IFRS and that number is expected to reach 150 by 2011 (Conn, 2009). At the same time, there has been a relative decline in the international prestige of the US GAAP. Many people claim that the US GAAP’s rule-based standards create room for ‘financial engineering’ and that the more principles-based IFRS would lead to greater clarity. It is also claimed that the US GAAP-based financial statements were not able to prevent the huge accounting scandals in the late 1990s. The Enron and WorldCom fiascos that decimated the world capital markets gave further strength to calls for a single set of high-quality global accounting standards (Tyson, 2011)

### **ROAD TO ADOPTION OF IFRS IN THE US**

#### **October 2002: Norwalk Agreement**

The first step towards harmonization of US GAAP and IFRS was made in October 2002 when the FASB and the IASB together issued an agreement, known as the “Norwalk Agreement,” formally recognizing convergence as an avowed goal of these two standard-setters (Hopkins, et al., 2008). Since then, the process has been started for reducing differences between the US GAAP and IFRS, by means of several convergence projects undertaken by FASB and IASB. Consequently, differences in many areas have been reduced. However, there are still some significant differences, as for example, in the area of revenue recognition (Hopkins, et al., 2008).

#### **December 2007: Elimination Of Reconciliation Requirement**

Under previous SEC regulations, all foreign issuers registering with the SEC are required to complete Form 20-F under section 12 of the Securities Exchange Act of 1934. These companies are required to file their periodical financial reports in accordance with US GAAP, or in accordance with their local GAAP (IFRS), “accompanied by a reconciliation with the US GAAP.” This requirement of preparing and filing two sets of financial statements under two different sets of accounting standards resulted in considerable effort and cost to foreign companies registered with the SEC (Erchinger and Winfried, 2007). In December 2007, the SEC eliminated this very burdensome and costly requirement (James, 2008).

#### **August 2008: Sec Road Map**

On August 27, 2008, the SEC proposed a ‘Road Map’ in which deadlines were specified for US companies to adopt IFRS. The SEC also suggested that FASB and IASB would continue to work toward convergence through 2011. At that time, if the SEC finds that the IFRS meet the requirements (of the SEC), the U. S. companies could then be required to use IFRS, gradually by the year 2016 (Rahr et al. 2010). The gradual switch over to IFRS contained in the road map visualizes IFRS adoption by large filers on or before December 15, 2014, by medium-size companies on or before December 15, 2015, and by all other companies by December 15, 2016 (Morgan, 2008).

### **February 2010: Sec Work Plan**

On February 24, 2010, the SEC issued a statement reiterating its support for convergence and global accounting standards and indicated that a decision would be made by the SEC by June 2011 about incorporation of IFRS into the US financial reporting system. In its statement, the SEC outlined a “Work Plan” to enable the SEC evaluate the basic merits of IFRS and the key issues involved in transition to IFRS. The SEC did not make convergence as a pre-condition for adoption of IFRS. “Indeed, if standards are completely (identically) converged, the decision of adoption of IFRS would be moot” (Henry and Holzmann, 2011).

### **October 2010: Rome Was Not Built In A Day**

In October 2010, the chairs FASB and IASB announced a postponement of the deadlines set for completing the convergence projects from June 2011 to end of 2011. In April 2011, the two chairs again announced in a joint statement that they have decided to extend the time table for completing a few priority convergence projects for a few more additional months to enable them, “to check whether our conclusions would stand the test of time, and to ensure that the standards are of the highest quality,” (Conn, 2011). The SEC Work Plan did not specify any timelines for adoption of IFRS like the Roadmap did. It However indicated that adoption may not be likely before 2015 (Blaszczynski, et.al. 2012).

### **May 26, 2011: SEC Staff Paper**

On May 26, 2011, the SEC issued a Staff Paper in which the SEC proposed a new approach, referred to as ‘Condorsement’. The idea of condorsement is a combination of the already ongoing process of ‘convergence’ and another available option of outright ‘endorsement’ of the IFRS standards issued by the IASB. Convergence, a process that has been going on for some time, was undertaken jointly by the FASB and the IASB under which differences between the US GAAP and the issued IFRS are sought to be minimized. Several convergence projects have already been completed. Work on many others is proceeding slowly. The condorsement idea would infuse IFRS into the US GAAP by endorsing international standards one at a time while also simultaneously continuing to converge them to the GAAP (Whitehouse, 2011). However, according to the SEC Staff Paper, the condorsement proposal renders the process of incorporation of IFRS into the US GAAP to be much slower and is estimated to take, at the very least, five or seven years (Ohlgart and Ernst, 2011).

## **CONCLUSIONS**

The professional guidelines for accounting and reporting system in the US, reputedly known as ‘Generally Accepted Accounting Procedures’ (GAAP) were developed through a laborious due process over the past eighty or ninety years. Investors in US companies from all over the world viewed these GAAP as the Gold Standard for accounting measurement and reporting. Gradually, the markets have become more global in nature with increased opportunities for cross-border investments for investors all over the world. The SEC began to give its support for a single set of high quality, globally applicable financial reporting standards, for increased comparability among companies across national borders. The IASB was established in 2001 and began issuing the IFRS. Presently, over 12,000 companies from over 100 countries around the world have adopted IFRS. Starting in 2002, the SEC has set a timetable for achieving convergence of US GAAP and IFRS, by issuing a road map, a work plan and a staff paper with several options for incorporation of IFRS by US companies before the end of 2016.

There still exists an unending debate as to whether adoption of IFRS into the US financial reporting system is advisable at all. Many believe that such adoption would benefit both US and non-US companies and also capital markets all over the world. Many others claim that US GAAP are rule-based, with strict objective standards of measurement and reporting whereas, the IFRS which are principles-based provide opportunity for subjective and flexible judgment, thereby impeding comparability. Their fear is that switching over to the untested IFRS abandoning the time-tested US GAAP will not improve either the clarity or the comparability of the different companies across international borders. Some are claiming that the SEC does not have the legal powers to handover its authority to regulate the financial reporting procedures to a private international standard setting body, thus violating US sovereignty. Furthermore, the impact of switching over from US GAAP to IFRS, through this

laborious, confusing and long-drawn out process, on the US Business schools, students and the accounting professional and their certification is yet to be assessed. Many fear that the cost of this changeover will be humongous and is not worth the expected benefits, if any.

#### **AUTHOR INFORMATION**

**Dr. RamMohan R. Yallapragada** is a Professor of Accounting at Fayetteville State University. He obtained his PhD degree in Accounting from the University of Houston. He holds a CPA certificate from the State of Louisiana. He has published in several journals including *Journal of Business and Economic Research*, *International Business and Economic Research Journal*, *Journal of Accounting and Finance Research*, and *Clarion Business and Economic Review*. His research areas include Cost Accounting in Healthcare, Accounting irregularities in Fannie Mae, impact of Sarbanes-Oxley Act of 2002 on American corporations and issues involved in incorporation of IFRS. E-mail: [ryallapr@uncfsu.edu](mailto:ryallapr@uncfsu.edu) (Corresponding author)

**C. William Roe** received his doctorate from Mississippi State University in Management. He has authored/co-authored numerous journal articles and/or conference papers in management, marketing, healthcare administration and international business. He currently serves as Associate Dean and Director of Graduate Business Programs at Arkansas State University. He has consulted extensively with numerous public, private, for-profit, and not-for-profit organizations in the areas of strategic planning, leadership, organizational change and development and management development. E-mail: [broe@astate.edu](mailto:broe@astate.edu)

**Alfred G. Toma** is an Assistant Dean of Administration at the University of Louisiana, Lafayette. He holds the degrees of M.B.A. from the American University of Beirut, Lebanon and M.Sc in Marketing from Louisiana State University. He has published several journal articles and conference papers in the areas of International Business and Entrepreneurship. He currently teaches courses in International Business Management, Entrepreneurship, and Human Resources Management at the University of Louisiana at Lafayette. His extensive actual business and consultancy experiences are focused on the areas of entry and operations in Middle East markets and entrepreneurial ventures start-ups. E-mail: [agt5159@louisiana.edu](mailto:agt5159@louisiana.edu)

#### **REFERENCES**

1. Blaszczynski, Carol, Marianne L. James and Cheryl A. Cruz (2012). "Global Financial Reporting and the Future of US Generally Accepted Accounting Principles," *Journal of Global Business Education*, June 2012, Vol. 12, pp. 1-10).
2. Cohn, Michael (2011). "FASB and IASB Delay Convergence Timeline Again," *Accounting Today*, April 14, 2011.
3. \_\_\_\_\_ (2009). "Tweedie Warns of 2011 Deadline for IFRS Choice," *Accounting Today*, August 4, 2009.
4. Erchinger, Holger and Winfried Melcher (2007). "Convergence Between US GAAP and IFRS: Acceptance of IFRS by the US Securities and Exchange Commission (SEC)," *Accounting in Europe*, Vol. 4, Issue 2, 2007, pp. 123-139.
5. Henry E. and Holzmann, O. J. (2011). "FASB's Progress Toward Convergence: Expeditious but Thoughtful", *Journal Of Corporate Accounting and Finance*, Vol. 22, Issue 5, July/August 2011, pp. 97-100.
6. Hopkins, Patrick E. et al. (2008). "Response to the SEC Release, 'Acceptance from Foreign Private Issuers of Financial Statements Prepared in Accordance with International Financial Reporting Standards Without Reconciliation to U. S. GAAP File No. S7-13-07,'" *Accounting Horizons*, Vol. 22, No. 2, June 2008, pp. 223-240.
7. James, Marianne (2008). "Accounting Majors' Ability to Identify Financial Reporting Errors and Omission and the Convergence Between U. S. GAAP and International Financial Reporting Standards," *Proceedings of the Academy of Accounting & Financial Studies*, Vol. 13, Issue 2, October 2008, pp. 14-18.
8. Morgan John (2008), "SEC Launches International Accounting Road Map Proposal to be Monumental Undertaking for U. S. Companies," *Money Management Executive*, Vol. 16, No. 46, December 1, 2008.

9. Ohlgar, Christiane and Steve Ernst (2011). "IFRS Yes, No, Maybe: What US Companies Need to Know." *Financial Executive*, Vol.27, Issue 8, October 2011, pp. 39-43.
10. Phillips, Lance J. (2010), "The Implications of IFRS on the Functioning of the Securities Antifraud Regime in the United States," *Michigan Law Review*, Vol. 108, Issue 4, February 2010, pp. 603-631.
11. Poon, Wing W. (2010), "SEC Work Plan for the Consideration of Incorporating IFRS into the U. S. Financial Reporting System," Proceedings of the Northeast Business & Economics Association 2010, pp. 101-104.
12. Rahr, K., K. E. Karim, and R. W. Rutledge (2010), "Transitioning to IFRS," *CPA Journal*, Vol. 80, No. 3, March 2010, pp. 6-8.
13. Ruder, David S. et al., (2005), "Creation of Worldwide Accounting Standards: Convergence & Independence," *Northwestern Journal of International Law and Business, Symposium on the Convergence of Accounting Standards*, Spring 2005.
14. Tyson, Tom (2011). "The Convergence of IFMS and the US GAAP", *CPA Journal*, Vol. 81, Issue 6, June 2011, pp. 26-31.
15. Whitehouse, Tammy (2011). "SEC Staff Flesh Out 'Condorsement' to IFRS", *Compliance Week*, Vol. 8, Issue 90, July 2011, p. 8.
16. Wicek, Irene M. and Nicola M. Young (2010), *IFRS Primer: International GAAP Basics, U. S. Edition*, John Wiley & Sons, Hoboken, NJ 2010

**NOTES**