Article from *The FASB Report,* November 27, 2002

## FASB Works with IASB toward Global Convergence

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*This is the first in a series of articles on the subject of convergence of global accounting standards.*

Convergence of global accounting standards has received a great deal of attention as of late. In October, the FASB and the International Accounting Standards Board (IASB) announced an agreement to work together toward convergence. This article will explore the strategies, policies and procedures in place at the FASB to facilitate convergence of U.S. standards with those of the IASB, including actions taken by the Board in October to accelerate the process of convergence. Specifically, the Board authorized its staff to conduct a research project to identify and catalog all of the substantive differences between U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS), which includes International Accounting Standards (IAS). At the same time, the Board formally added a project to its active agenda to address some specifically identified differences in the short term. Those two projects are discussed in detail below.

### Comprehensive Research Project

The FASB staff is currently working on a research project related to convergence. The project seeks to identify all of the substantive differences between U.S. GAAP and IFRS and to catalog those differences according to the Board's strategy for resolving them. The project scope includes differences in standards addressing recognition, measurement, presentation or disclosure. Any instance in which a specific accounting treatment would be permissible under one basis of accounting but would not be permissible under the other basis of accounting is included in the project scope.

The FASB staff, the IASB staff and many research and professional organizations have already identified many differences in conjunction with work on other projects. Several comprehensive comparisons have been published. Through the convergence research project, the Boards will validate and complete that work. Once completed, the database of differences will be continuously monitored and updated as new differences arise and existing differences are resolved.

Thus far, the staff has identified three possible strategies for resolving differences between U.S. GAAP and IFRS. Many differences are expected to be resolved as both Boards deliberate the major projects currently on their respective agendas. For example, there are many differences related to revenue recognition, business combinations and financial performance reporting that are within the scope of one of the projects currently being conducted jointly or simultaneously by the Boards. As the FASB and IASB comprehensively reconsider the existing guidance in each of those areas with the dual objectives of seeking a high-quality solution and furthering convergence, differences in those areas should be substantially reduced or eliminated.

Similarly, there are many differences that exist today simply because neither Board has comprehensively reconsidered the guidance relating to a particular area of accounting in quite some time. For example, there are differences related to lease accounting, pension accounting and other areas where the guidance in both bases of accounting is somewhat dated. Many of those differences would be eliminated if one or both Boards were to initiate a project to comprehensively reconsider that guidance. The criteria the Board considers when adding a project to its agenda include the potential for convergence, thus, identification of that class of differences between U.S. GAAP and IFRS will provide critical information for the Board to consider when it makes future agenda decisions. The process of monitoring these differences and working with the IASB to reduce or eliminate them will be ongoing for many years.

Finally, there are many differences between U.S. GAAP and IFRS that, while not necessarily important issues for either Board individually, present major challenges to those using, preparing, auditing or regulating cross-border financial reporting. Because these 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 are not expected to be addressed within the scope of any current or contemplated major project of either Board. Consequently, the FASB and the IASB agreed to add a joint project to each of their agendas with the objective of reducing or eliminating differences of this type.

### Short-Term Convergence Project

The scope of the short-term convergence project is limited to those differences in which convergence around a high-quality solution appears achievable in the short-term. Because of the nature of the differences, it is expected that a high-quality solution can usually be achieved by selecting between existing U.S. GAAP and IFRS. The short-term project is being conducted in three distinct parts.

## Part One

As one of its first priorities, the IASB has been conducting a project to improve the standards issued by its predecessor, the International Accounting Standards Committee (IASC) (the "improvements project"). One of the objectives of that project is convergence of IASC standards and U.S. GAAP. The recently issued Exposure Draft in the improvements project contains proposals that are convergent in many respects because the IASB would adopt accounting similar to U.S. GAAP. Nevertheless, differences would remain and some new differences would be created by the project. The first part of the short-term convergence project would seek to reduce or eliminate some of those differences, including:

- *Classification of liabilities on refinancing:* The IAS improvements project would amend IAS to require that liabilities be classified as current unless the refinancing is complete by the balance sheet date. Under U.S. GAAP, liabilities are classified as non-current if the refinancing is complete by the date of issue of the financial statements.

- *Classification of liabilities due on demand due to violation of debt covenant:* The IAS improvements project would amend IAS to require that such liabilities be classified as current even if the lender had agreed not to demand repayment prior to the issuance of the financial statements. Under U.S. GAAP, those liabilities would be classified as non-current if the lender had agreed before the issuance of the financial statements not to demand repayment for more than one year from the balance sheet date.

- *Asset exchanges:* The IAS improvements project would amend IAS to require a gain or loss to be recognized on the exchange of similar productive assets based on the fair value of the exchange. U.S. GAAP prohibits recognition of a gain on the exchange of similar productive assets.

- *Voluntary change in accounting policies:* The IAS improvements project would amend IAS to require retrospective application of voluntary changes. U.S. GAAP generally requires a cumulative adjustment in the year of change.

### Convergence Initiatives

**The following are the key initiatives that the FASB has undertaken to further the goal of international convergence.**

- ***Liaison IASB member on site at the FASB offices***
- ***Policies and procedures for FASB monitoring of IASB projects***
- ***The Short-Term Convergence Project***
- ***Other joint projects being conducted with the IASB***
- ***The Convergence Research Project***
- ***Explicit consideration of convergence potential in all board agenda decisions***

**As a result of these and other initiatives, the Board expects to make significant progress toward international convergence in the next few years. However, because of the volume of differences and the complex nature of some of the issues, many differences will persist well beyond 2005.**

- *Financial instruments:* Many of the changes to IAS financial instruments guidance proposed in the improvements project would reduce differences between U.S. GAAP and IFRS. However, some of the proposed changes will create new differences.

## Part Two

Certain differences between U.S. GAAP and IFRS arise from changes in U.S. GAAP made by recently issued FASB Statements. Part two of the project would seek to reduce or eliminate some of those differences, including:

- *Discontinued operations:* The FASB broadened the definition of discontinued operations in FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. IAS has a more restrictive definition of discontinued operations. In addition, differences in the timing of any remeasurement and in presentation will be considered within the project.

- *Accounting costs associated with exit or disposal activities:* U.S. GAAP requires accounting costs associated with exit or disposal activities to be recognized when the liability is incurred. IAS is generally consistent with U.S. GAAP, but there are differences relating to recognition of costs when future service is required from employees, recognition of income from sublease agreements and subsequent measurement of the liabilities.

## Part Three

Part three of the project will address some other differences on which convergence appears achievable in the short-term, including:

- *Inventories—idle capacity and spoilage:* IAS requires those costs to be excluded from the cost of inventory—U.S. GAAP does not.

- *Accounting policies and changes in accounting estimates:* U.S. GAAP and IAS differ in classification of certain accounting changes as either changes in accounting policy or changes in estimate.

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- *Income taxes:* Although both U.S. GAAP and IAS 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).

- *Financial reporting in hyperinflationary economies:* IAS requires restatement into current units while U.S. GAAP requires remeasurement into the parent's functional currency. In addition, there are differences regarding whether an entity that operates in a hyperinflationary economy should adjust its own financial statements and whether adjustments for inflation should be allowed for entities approaching hyperinflation as defined in the standards.

- *Joint ventures and proportionate consolidation:* U.S. GAAP and IAS differ in the definition of joint ventures. In addition, IAS permits the use of proportionate consolidation more extensively than it is permitted in the United States, where its use is confined to a few industries.

- *Interim financial reporting:* IAS requires interim financial statements to be prepared as if they covered a discrete period, with certain exceptions. U.S. GAAP treats the interim period as an integral part of the annual period. The distinction has implications for the recognition of revenues and costs.

- *Research and development:* U.S. GAAP requires research and development costs to be expensed when incurred. IAS requires a distinction to be made between research and development and requires development costs to be capitalized under certain circumstances.

### *Topics of Future Convergence Articles*

A future article will explore some important features of the FASB's daily operations that promote convergence. One of the most visible features is the presence of a full-time IASB member in residence at the FASB offices. James J. Leisenring, a former FASB member, is the IASB member currently filling the role of liaison Board member to the FASB. The role was created to facilitate information exchange and increase cooperation between the FASB and the IASB.

Another article will discuss the FASB's procedures for dealing with projects that are conducted jointly with the IASB, as well as the procedures for monitoring IASB projects that are of interest to the FASB but are not being conducted jointly. Joint projects are those that the FASB and the IASB have agreed to conduct simultaneously in a coordinated manner. Joint projects involve the sharing of staff resources, and every effort is made to keep joint projects on a similar time schedule at each Board. Other IASB projects are monitored by FASB members and/or staff based upon the FASB's level of interest in the topic being addressed.