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International Convergence Impacts FASB Policies and Procedures

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

In a previous article, we explored two aspects of the FASB's efforts to achieve international convergence of accounting standards. The first is the international convergence research project, through which we will identify and catalogue all of the substantive differences between U.S. generally accepted accounting principles (GAAP) and International Financial Reporting Standards (IFRS) and propose strategies for resolving them. The second aspect is the short-term convergence project, a joint project with the International Accounting Standards Board (IASB) that will address several specific differences in the near term.

In this article, we address two more aspects of the Board's convergence efforts—the role of convergence in making agenda decisions and the role of the IASB liaison Board member. Even before the IASB was established in 2001, the FASB decided that international convergence opportunities should be included among the criteria considered when evaluating potential agenda projects. This article describes those criteria and their effect on the Board's current agenda. We also will examine one of the most visible aspects of our convergence efforts—the on-site presence of an IASB member serving as liaison to the FASB. Finally, we will provide an update of the progress that both Boards have made to date on the short-term convergence project.

Convergence and Cooperative Opportunities in Agenda Decisions

In setting its agenda, the Board has historically evaluated potential topics based on the following four factors:

- *Pervasiveness of the problem*—the extent to which an issue is troublesome to users, preparers, auditors or others; the extent to which there is diversity of practice; and the likely duration of the problem (i.e., is it transitory or will it persist?)

- *Alternative solutions*—the extent to which one or more alternative solutions that will improve financial reporting in terms of relevance, reliability and comparability are likely to be developed

- *Technical feasibility*—the extent to which a technically sound solution can be developed, or whether the project under consideration should await completion of other projects

- *Practical consequences*—the extent to which an improved accounting solution is likely to be acceptable generally, and the extent to which addressing a particular subject (or not addressing it) might cause others to act—e.g., the SEC or Congress.

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. To be consistent with its stated objective of a single set of high quality standards used internationally, 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:

1. *Convergence possibilities*—the extent to which there is an opportunity to eliminate significant differences in standards or practices between the U.S. 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

2. *Cooperative opportunities*—the extent to which there is support by one or more other standard setters for undertaking the project jointly or through other cooperative means with the FASB

3. *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).

Those factors are combined with the four general factors to provide a context for assessing the relative merits of selecting a particular topic for the FASB's agenda. The factors are not considered in precisely the same way or to the same extent in every instance; however, consideration of those factors for every potential project generally helps to bring about consistent agenda decisions. Further, the explicit consideration of the convergence-related criteria are consistent with the pledges made by both Boards at their joint meeting on September 18, 2002, to use best efforts to (a) make their existing financial reporting standards fully compatible as soon as is practicable and (b) to coordinate future agendas to ensure that once achieved, compatibility is maintained.

Liaison IASB Member

The role of IASB liaison member (Liaison) was created to facilitate information exchange and increase cooperation between the FASB and the IASB. The Liaison is responsible for facilitating the exchange of views between the FASB and the IASB concerning projects on either or both of the Boards' agendas. The Liaison, however, is employed by the IASB and is independent from the FASB.

James J. Leisenring currently serves in the role of Liaison. Jim is a member of the IASB and fully participates in deliberations at the IASB's monthly meetings. He typically spends two weeks a month at the FASB offices and attends FASB meetings while in Norwalk. Jim has speaking privileges at FASB meetings, but he is not a member of the FASB and, thus, does not 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 Board members of the convergence implications of their decisions. Jim also communicates the views of FASB members to the IASB at IASB meetings in a similar manner. In addition to his other responsibilities, the Liaison updates the FASB members and staff on IASB projects following each IASB meeting.

Jim is uniquely qualified for the position of Liaison. He joined the FASB in 1982 as Director of Research and Technical Activities, served as the first Chairman of the Emerging Issues Task Force and served two terms as a member of the FASB. His international background includes serving as a member of the International Joint Working Group on Financial Instruments and as Chairman of the now-disbanded G4+1 group of national standard setters. His term with the IASB expires in June 2005, and he is eligible for reappointment.

Update on the FASB's Short-Term Convergence Project

The Board added the short-term convergence project to its agenda in October 2002. Since that time, the Board has addressed convergence issues related to (1) asset exchanges, (2) changes in accounting principles, (3) changes in depreciation methods and (4) inventory costing. The following summarizes the issues addressed and the Board's decisions to date:

1. Asset exchanges: As part of a project to improve existing International Accounting Standards (IAS), the IASB proposed a requirement that an exchange of similar productive assets should be accounted for based on the fair value of the assets exchanged. Current GAAP prohibits recognition of a gain on the exchange of similar productive assets.

In its deliberations, the Board has decided that nonmonetary exchanges of productive assets should be accounted for at fair value unless (1) neither the asset received nor the asset surrendered has a fair value that is determinable within reasonable limits or (2) the exchange transaction lacks commercial substance.

2. Voluntary change in accounting policies: The IAS improvements project would amend IAS to require retrospective application of voluntary changes in accounting policies, including adjustment of prior periods presented. Current GAAP generally requires a cumulative adjustment reported in the year of change.

The Board decided to adopt the IASB position that a voluntary change in accounting principle should be accounted for retrospectively and all prior periods should be restated as if the newly adopted accounting policy had always been used, except when retroactive application is impracticable.

In addition, the proposed Statement will require that any change in accounting principle made as a result of adopting a new pronouncement would be reported following the same guidance as that for voluntary changes in accounting principles, unless the new pronouncement's transition provisions require another method.

3. Accounting policies and changes in accounting estimates: GAAP and IFRS differ with regard to the classification of certain accounting changes as either changes in accounting policy or changes in estimate.

The Board decided to converge with the IASB position that a change in depreciation method should be accounted for as a change in estimate. As a result, a change in the method of depreciating an asset is accounted for in (a) the period of change if the change affects that period only or (b) the period of change and future periods if the change affects both.

4. Inventory costing: IAS requires idle capacity and abnormal spoilage costs to be excluded from the cost of inventory. Current GAAP requires those costs to be excluded only when they are so abnormal as to require treatment as current period charges.

The Board decided to converge with the IASB position that abnormal amounts of idle capacity and abnormal amounts of spoilage costs should be excluded from the cost of inventory and expensed when incurred.

Status of the IASB's Short-Term Convergence Project

Concurrently, in its short-term convergence project, the IASB has deliberated issues relating to (1) discontinued activities, (2) assets held for sale and (3) provisions for restructuring costs.

1. Discontinued activities: The IASB considered issues relating to the possible convergence of IAS 35, *Discontinuing Operations,* with the presentation requirements for discontinued operations in FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* The IASB decided that the presentation requirements of IAS 35 should be amended to follow Statement 144 as closely as possible.

2. Assets held for sale: The IASB discussed issues relating to the possible convergence of its existing Standards with the requirements for long-lived assets held for sale under Statement 144. The IASB tentatively agreed to introduce into IFRS several notions from Statement 144 that would significantly converge IAS and GAAP. Those provisions include the "held for sale" classification and the concept of a "disposal group." The IASB also decided to converge with the FASB on several aspects of the accounting treatment for assets classified as held for sale and assets that are part of a disposal group. For example, the IASB decided that assets or disposal groups that are classified as held for sale should be measured at the lower of (a) carrying amount and (b) fair value less cost to sell, and should not be depreciated.

3. Provisions for restructuring costs: The IASB considered issues relating to the possible convergence of (a) the recognition of provisions for restructuring costs under IAS 37, *Provisions, Contingent Liabilities and Contingent Assets,* and (b) the recognition of termination benefits under IAS 19, *Employee Benefits,* with FASB Statement No. 146, *Accounting for Costs Associated with Exit or Disposal Activities.*

The IASB agreed to amend the definition of a constructive obligation in IAS 37 to clarify that the actions of an entity must result in other parties being able to "reasonably rely" on the entity discharging its responsibilities. The IASB also decided to withdraw the existing guidance for provisions for restructuring costs in IAS 37 and to replace it with guidance that specifies that the existence and announcement of a restructuring plan do not by themselves create an obligation.

Further, the IASB decided to amend the requirements for termination benefits in IAS 19 to converge with GAAP. After amendment, IAS 19 would specify that the recognition of involuntary termination benefits requires the communication of those benefits to the employees. In addition, when employees are required to render service beyond any notification period to be entitled to one-time termination benefits, those benefits should be recognized over the future service period. Finally, voluntary termination benefits should be recognized when employees accept the offer of voluntary termination.

Future Plans

The Boards expect to issue Exposure Drafts on these issues and some others in the third quarter of 2003, and each Board expects to issue a final Statement in the first half of 2004. Subsequent to the issuance of the Exposure Drafts, the Boards will continue deliberations on other issues within the project's scope.

Future Convergence Article in FASB Report

A future 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 simultaneously conduct 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 staff based upon the FASB's level of interest in the topic being addressed.